FINANCIAL MANAGEMENT TOOLKIT

FOR RECIPIENTS OF EU FUNDS FOR EXTERNAL ACTIONS

European
Commission

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CONTENTS

The Tools and Templates referred to in this toolkit are available at:
http://ec.europa.eu/europeaid/financial_management_toolkit/

INTRODUCTION AND OVERVIEW

PURPOSE OF THE TOOLKIT

This toolkit aims to help Recipients of EU funds for external actions to comply with the conditions for financial management set out in Contracts for EU-financed external actions.

Its specific objectives are to:

- provide basic, practical guidance in an easy-to-use format;
- raise awareness of existing EC Contractual Conditions;
- identify important risk areas, indicate what can go wrong and explain how these risks can be avoided;
- provide best practices, tools and templates.

WHAT THE TOOLKIT IS NOT

The toolkit:

- is <u>not</u> a set of rules in addition to the existing legal, contractual and regulatory framework and guides;
- is <u>not</u> a comprehensive manual of financial management instructions. It does not guarantee complete and accurate coverage of all existing Contractual Conditions for financial management;
- is <u>not</u> an interpretation of the existing EC Contractual Conditions;
- is <u>not</u> a substitute for reading the EC Contractual Conditions and existing guides and instructions.

DISCLAIMERS

- The EC is not legally bound by the information contained in or omitted from this toolkit and does not accept any liability in this respect.
- Only the Contractual Conditions and the relevant legal and regulatory framework which apply to the implementation of a specific EU funded external action are binding. Recipients should obtain a sufficient understanding of these.
- The names and descriptions in the real life stories have been changed to avoid disclosing the identities of the entity or persons concerned. Any similarity with existing entities or persons is coincidental.
- All information in this toolkit is based on the 2009 release of the Commission's contract models and guides. Caution should be exercised in applying it to projects based on earlier contract models.

USE OF THE TOOLKIT AND BASIC TERMS

This toolkit is for use by Recipients of EU funds for external actions.

Recipients of EU funds for external actions refers to organisations that have signed a contract to receive EU funding.

The Recipient of EU funds is responsible for implementing the contract, managing and using the EU funds and reporting on the use of the funds.

Recipients of EU funds for external actions can be:

- Organisations (often NGOs) that have been awarded an EU funded grant contract;
- Contractors for EU funded service contracts (often consultancy and technical assistance firms);
- Contractors for EU funded works and supplies contracts;
- Governments of beneficiary states that have signed a financing agreement with the EU on funding external actions (where the financing agreement may include programme estimates) and that may become **Contracting Authorities** themselves.

- **Contracting Authority** refers to the authority that has signed a contract for EU funding with a Recipient.

  Depending on the 'management mode', (e.g. aid may be centralised, decentralised or jointly managed with international organisations) the Contracting Authority may be the European Commission ("EC"), a partner country, or an organisation to which the EC has delegated implementation.

  Where the EC is the Contracting Authority, it is usually represented by EuropeAid or an EU Delegation.

USE OF THE TOOLKIT AND BASIC TERMS (continued)

- ‘Contract’ can refer to any conventional or contractual document signed by the Contracting Authority and a Recipient which forms the specific legal basis for an EU funded external action. The Annexes to the Contract also form part of the Contract.
- Grants and service contracts are the commonest types of contracts for EU funding of external actions.
- Programme estimates are another common way of implementing external aid but they are not contracts in the strict legal sense.
- These three way of implementing external actions will often be mentioned in this toolkit. Other contract types are not explicitly covered (i.e. works and supplies contracts, contribution agreements with international organisations and delegation agreements with national agencies).
- Contractual Conditions refer here to the conditions, rules, and criteria which are set out in an EU-funded Contract for external actions.

The terms “Recipient of EU funds for external actions” (or “Recipient”), “Contract”, “Contractual Conditions” and “Contracting Authority” are basic terms used throughout this toolkit.

The rationale for this is that the toolkit aims to provide basic guidance on financial management which can in principle be used by any type of Recipient and for any type of Contract, no matter who the Contracting Authority is.

ACCOUNTABILITY

By signing a Contract, Recipients accept responsibility and accountability for:

- carrying out the action and managing and using EU funds in compliance with the Contractual Conditions,
- sound financial management, and
- reporting on the action and on the use of EU funds to the Contracting Authority.

The EC reserves the right to check that recipients meet their obligations, by having audits and checks carried out by its own staff or by professional audit firms. The European Court of Auditors and the European Anti-Fraud Office (OLAF) may also carry out audits or investigations.

Recipients are also accountable for any Contract for an EU funded external action that they sign with a Contracting Authority other than the EC. In such situations, the accountability chain involves both the Recipient <u>and</u> the Contracting Authority, which must report to the EC.

POSSIBLE CONSEQUENCES OF NOT MEETING CONTRACTUAL OBLIGATIONS

If a Recipient fails to meet the Contractual Conditions it may face serious consequences, such as:

- recovery by the Contracting Authority of funds relating to unjustified or ineligible expenditure;
- additional audits or checks on other EU funded actions for which it is responsible, or extrapolation of errors to those actions, if its errors are systemic;
- sanctions, which may take the form of financial penalties and/or termination of the contract.

If false declarations, substantial errors, irregularities or fraud are found, the Recipient can be banned from all EU funded contracts for up to 5 years. This may be extended to 10 years for a repeat offence.

CONTENT OF THE TOOLKIT

This toolkit covers eight financial management areas:

- ► *Module 1 - Internal Controls*
- ► *Module 2 - Documentation, Filing and Record Keeping*
- ► *Module 3 - Procurement*
- ► *Module 4 - Asset Management*
- ► *Module 5 - Payroll and Time Management*
- ► *Module 6 - Cash and Bank Management*
- ► *Module 7 - Accounting*
- ► *Module 8 - Financial Reporting.*

HOW TO OBTAIN A COPY OF THE TOOLKIT

The toolkit is available in printed (A5 "pocketbook") and MS PowerPoint form.

- Printed copies of the toolkit can be obtained from EuropeAid Development and Cooperation in Brussels, Belgium and from EU Delegations.
  - To contact EuropeAid Development and Cooperation, see: http://ec.europa.eu/europeaid/contact/contact_en.htm
  - To contact an EU Delegation, see: http://eeas.europa.eu/delegations/web_en.htm
- The toolkit can also be downloaded from EuropeAid's website, at http://ec.europa.eu/europeaid/financial_management_toolkit/

TOOLS AND TEMPLATES

The tools (mainly checklists) and templates (e.g. the asset register, etc.) to be used with this toolkit are provided at:

http://ec.europa.eu/europeaid/financial_management_toolkit/

MODULE 1 - INTERNAL CONTROLS

Real life story

As Director of the Forestry Development Project of Syldavia, I was heading a team of agronomists responsible for EU funded activities.

The accounting records for our project were kept by the Project's bookkeeper with the help of a junior administrative assistant. My Deputy Director and myself fully trusted our bookkeeper. He was a very efficient, highly motivated individual. His deliverables were always submitted well in time, and he required very little supervision from my Deputy Director or myself.

His tasks consisted of keeping the accounting records of the project and preparing the payment orders. He also kept the petty cash and controlled the cheques and payments. In view of his high competence and trustworthyness, we had also granted him a proxy signature on the bank account. He was a very conscientious accountant, who performed all cash and bank reconciliations on a weekly basis.

After some 18 months of good service, he asked for a few days' vacation, from which he never returned. We hired a replacement bookkeeper, who discovered on his arrival that a very significant sum of money was missing from our bank account. We reported it to the local police, who have not yet managed to locate our missing bookkeeper.

Lesson learnt: Had we segregated basic financial duties, the theft would most likely not have occurred…

WHY IS INTERNAL CONTROL A KEY FINANCIAL MANAGEMENT AREA?

Key Message:

Better safe than sorry: set up internal controls.

Internal Control is designed to provide reasonable assurance that operations are effective and efficient, that financial information is reliable and that the Contractual Conditions have been met.

If proper internal controls are not in place, there is a high risk that EU funds will not be spent efficiently and as agreed in the Contract. Project assets may be lost and the use of funds may not be properly accounted for.

Lack of adequate internal controls: a key risk

It is essential to have an internal control system that provides reasonable assurance of achieving the objectives.

Content of this module

► Minimum contractual conditions.

► Basic tips.

► Specific issue - Importance of the internal control environment.

► Specific issue - Multilocation/multipartner projects.

► Tools and templates.

MINIMUM CONTRACTUAL CONDITIONS

Contracts for EU funded external actions do not include exhaustive internal control requirements. They do, however, contain certain specific requirements which are internal control-related.

The main ones are:

- Segregation of duties between the authorising and the accounting officer

For programme estimates, the Practical Guide for Programme Estimates:

- ► requires the duties of the imprest administrator and the duties of the imprest accounting officer to be kept separate (see "Roles and responsibilities" - Section 2.5);
- ► defines the roles and responsibilities of these two officers (see "The imprest administrator" and "The imprest accounting officer"- Sections 2.5.1 and 2.5.2).

These requirements aim to segregate the duties of authorising expenditure and handling payment (this is known as the 'four eyes' principle).

The Practical Guide for Programme Estimates can be found at: http://ec.europa.eu/europeaid/work/procedures/financing/work_programmes/index_en.htm

Most Financing Agreements and Technical and Administrative Provisions require authorisation and payment duties to be segregated.

- Prohibition of conflicts of interest and confidential payments

All Contracts for EU funded external actions prohibit conflicts of interest, confidential payments (e.g. secret commissions, bribes) and other unethical practices.

MINIMUM CONTRACTUAL CONDITIONS (continued)

- Regular checks → In actions implemented through 'delegated cooperation' (for example contributions to international organisations or delegation agreements with public sector bodies), the Contract will generally require the delegatee to conduct regular checks to ensure that the action has been implemented correctly.

- Measures to prevent irregularities, fraud and corruption → In actions implemented through 'delegated cooperation', the Contract will generally require the delegatee to set up measures to prevent irregularities, fraud and corruption.

BASIC TIPS

Internal Control is an ongoing process which requires the continuous attention of management. This section covers important, basic measures concerning control activities.

Key Message:

Ensure sufficient segregation of duties.

A key measure is to ensure that no single transaction or chain of transactions is in the hands of a single person.

A transaction or chain of transactions may often involve many different tasks. By assigning these tasks to different people, Recipients will reduce the risk of individuals being in a position to commit fraud or conceal errors in the normal course of their duties.

Examples of activities that can usefully be segregated include:

- physical control of assets versus verification tasks (for example, cash custody versus cash reconciliation tasks);
- management tasks versus authorisation tasks (for example, following procurement procedures versus authorising the contract with the supplier);
- management tasks versus accounting tasks (for example, approving the purchase invoice versus accounting for it);
- accounting tasks versus payment tasks (for example, preparing payment versus signing the bank transfer order).

BASIC TIPS (continued)

Key Message:

Consider the most effective way of segregating duties.

There may be several ways of segregating tasks, and some may be more effective than others.

It may be possible to organise the tasks so that the individuals performing them will control each other. This would enhance controls and mitigate risks.

Recipients should take the time to think about the most effective way of segregating tasks, depending on the nature of the project.

Key Message:

Foresee effective approval points.

Approving also means checking.

Appropriate authorisation procedures enhance controls. Identify approval points that are relevant to the project and assign responsibility for carrying out such tasks to the most appropriate individuals.

These individuals must understand that they are responsible for checking anything they approve.

For example, for a service contract the team leader may be asked to approve the timesheets for the project staff.

Approval will usually be shown by the team leader's signature on the timesheets. However, to provide effective control, the team leader must effectively check the timesheets before signing them.

BASIC TIPS (continued)

Key Message:

Staff must understand their responsibilities.

For the segregation of duties to work as intended, every person concerned must understand what his/her responsibilities are.

To avoid misunderstandings, it is important to describe all responsibilites and tasks in writing, for example by means of:

- written job descriptions;
- a clear organisation chart, showing responsibilities and tasks;
- descriptions (or flow-charts) of the intended flow of transactions, indicating control points and the frequency of controls.

An effective way to cover these topics is to put them into a specially designed project or programme manual.

Key Message:

Small organisations must also segregate duties and controls.

Organisations with few staff may find it difficult to segregate duties. However, a minimum level of segregation (for example, separation between the most important functions such as authorisation and accounting) is needed.

Sometimes only limited segregation of duties is possible and economically feasible. Recipients should compensate this by introducing a close control and review system, run by management.

SPECIFIC ISSUE - IMPORTANCE OF THE INTERNAL CONTROL ENVIRONMENT

The primary foundation of a good internal control system is the Recipient's own internal environment, as set up by the Recipient's management.

This control environment includes:

- integrity, ethical values and the behaviour of key executives;
- management's operating style;
- management's commitment and competence;
- the organisational structure and assignment of responsibility and authority;
- human resources policies and practices.

By setting up the control environment, management "sets the tone" of the entire organisation, influencing the control consciousness of its staff. By promoting key values such as integrity, ethics, transparency, competence and dedication to good management practices, management provides a framework for discipline and structure.

The internal control framework devised by the "Committee on Sponsoring Organizations" of the Treadway Commission (COSO) is currently the most widely accepted internal control framework.

This framework identifies several layers and dimensions of internal control:

- the internal control environment
- objective setting
- risk assessment and management
- control activities
- communications
- monitoring.

Information on the COSO internal control framework can be obtained from: www.coso.org

SPECIFIC ISSUE - MULTILOCATION / MULTIPARTNER PROJECTS

In multilocation projects, the project is often carried out by several independent partners, each with its own internal control structure.

In such cases, a single entity will usually lead and coordinate the entire project.

In Contracts for EU funded external actions, the lead entity will usually be the main Recipient, which is considered responsible for the entire project.

The lead (coordinating) entity in such a project will generally be considered liable for poor execution of activities by the project partners.

In order to mitigate this risk, the lead (coordinating) Recipient should consider the following basic measures:

- ► at project design stage, evaluate whether the entities taking part in the project have adequate internal controls in place, in line with the general principles outlined in this Module;
- ► during project execution, closely monitor the performance of the project partners to ensure that their internal controls remain adequate and that execution remains under control;
- ► at regular intervals during the project, obtain copies and / or review the accounting records and supporting documents of those activities managed by participating entities to ensure they meet the contractual conditions.

TOOLS AND TEMPLATES

The following tool can be downloaded from the EuropeAid website at:

http://ec.europa.eu/europeaid/financial_management_toolkit/

FMT - MODULE 1 - INTERNAL CONTROL CHECKLIST

Recipients are encouraged to use the Internal Control Checklist compiled with this toolkit.

Since internal control is an ongoing process, it is highly recommended that Recipients update their answers to the Internal Control Checklist at regular intervals.

MODULE 2 - DOCUMENTATION, FILING AND RECORD KEEPING

<u>Real life story</u>

The purpose of the project "Agricultural Development in San Theodoro Province" was to build grain storage silos in approximately 250 villages in the province.

During an audit launched by the Contracting Authority, the auditors found that the project's accounting records, kept in the Recipient's offices in the provincial capital, were based on expense lists sent by the villages which summarised the quantities and cost of the materials used. The supporting documents, however, were kept in each of the 250 villages.

The auditors also found that the supporting documents were archived in bags (several bags for each village). The documents in each bag were not cross-referenced with the expense lists sent by the villages, nor were they filed in any way. Many supporting documents for purchase of materials had been obtained from local suppliers, most of whom were very small, rural suppliers who did not draft valid invoices or receipts.

<u>What happened</u>: The auditors submitted a disclaimer report to the Contracting Authority, indicating that the financial report for the project was unverifiable, failing a proper audit trail and proper supporting documentation. As a result, the Contracting Authority decided to terminate the contract.

WHY IS DOCUMENTATION A KEY FINANCIAL MANAGEMENT AREA?

Key Message:

Not documented, Not eligible!

For a Recipient, keeping clear and relevant documentation is vital. Without proper documentation, it is impossible to show that the costs claimed from the Contracting Authority meet the conditions of the Contract.

Approximately 4 out of 10 issues affecting project funding found during audits under the EuropeAid Audit Plan relate to inadequate record-keeping.

Lack of proper documentation; a key risk

If a Recipient cannot provide documentation showing that the funds have been used in accordance with the Contractual Conditions, the Contracting Authority may decide to recover the unsubstantiated expenditure.

Content of this module

- Minimum contractual conditions.
- What could go wrong? Key control measures.
- Basic tips.
- Specific issue - Multipartner/multilocation projects
- Specific issue - Difficult local environments
- Specific issue - Electronic documentation
- Tools and templates.

MINIMUM CONTRACTUAL CONDITIONS

Key Message:

Understand the Contractual Conditions.

The following summarises the minimum contractual requirements for documentation and record keeping in EU-funded external actions managed through grants, service contracts and programme estimates.

- Grant Contracts

The general conditions of grant contracts specify that:

- To be eligible, the costs must be identifiable and verifiable (Article 14).

  This means that there must be adequate documentation proving that any expenditure is related to the project.

- The Recipient must allow the Contracting Authority to carry out checks and audits and to examine supporting documents, accounting documents and any other documents relevant to the financing of the project (Article 16(2)).

- The supporting documents and records must be kept available for inspection by the Contracting Authority for up to seven years after the final balance of the grant is paid (Article 16(2)).

- The supporting documents and records must be easily accessible and filed in a way that facilitates examination (Article 16(2)).

- Certain documents must be kept (Article 16(3)): a list is given.

MINIMUM CONTRACTUAL CONDITIONS (continued)

• Service Contracts

The general conditions of service contracts state that:

- Full, accurate and systematic records and accounts must be kept to show the actual days worked and the incidental expenditure incurred to provide the services (Article 24(1)).
- For fee-based service contracts, timesheets recording the days or hours worked must be kept (Article 24(2)).
- The records and documents must be kept available for inspection by the Contracting Authority for seven years after final payment of the contract (Articles 24(3) and 25(1)).
- The documentation to be kept must include any documents needed to check expenditure, such as timesheets, transportation tickets, boarding passes, pay slips and invoices or receipts for incidental expenditure (Article 24(3)).
- Documents must be easily accessible and filed in a way that facilitates examination (Article 25(2)).

MINIMUM CONTRACTUAL CONDITIONS (continued)

• Programme Estimates ⇨

The Practical Guide for Programme Estimates gives:

- ► a list of the supporting documents required for the record of expenditure (see "Documents making up a record of expenditure", Section 4.1.3);
- ► an indicative list of the documents needed for payment files (see Annex 11, "Examples of supporting documents by type of expenditure to be included in payment files").

The Practical Guide for Programme Estimates can be found at:

http://ec.europa.eu/europeaid/work/procedures/financing/work_programmes/index_en.htm

The Financing Agreement usually requires all supporting documents to be kept available for inspection by the Contracting Authority for seven years after final payment.

Recipients should consult the relevant Financing Agreement and Technical and Administrative Provisions to check whether they contain any specific, additional requirements.

• Other contract types ⇨

If the action is financed by means of some other type of contract, the Recipient should refer to its provisions.

Most contracts include a general requirement that supporting documents and records be kept available for inspection by the Contracting Authority for seven years after final payment.

WHAT COULD GO WRONG? KEY CONTROL MEASURES.

What could go wrong?	Key control measures
• Certain documents may not be drafted or kept. For example, the Recipient's internal procedures may not provide for certain documents required in the Contract.	• Ensure that project staff know and understand the Contractual Conditions (these include the special conditions, the general conditions, and any other conditions referred to in the Contract).
• The documents kept do not provide sufficient evidence that the Contractual Conditions have been met.	• Ensure that the project documentation provides strong, relevant proof (for example, the documents are official documents from an outside source).
• Project documents may have been kept, but may not be retrievable later.	• Arrange for a numbering, filing and archiving system that can be followed easily and allows easy retrieval of the documents.
• Project documents may be prematurely discarded. This may occur if the Recipient's rules do not require a document to be kept for the full period required in the project contract.	• State clearly the date until which the documents must be kept in the archiving system. • Also write this date on the boxes containing the project documents.
• Project documents may deteriorate over time. This may occur if documents are not protected from heat or damp.	• Arrange for the documents to be archived in safe, secure conditions.

BASIC TIPS

Key Message:

Prudence does no harm. Better safe than sorry!

The project staff may no longer be available when the Contracting Authority decides to carry out an audit. This is often the case if staff have been specially hired for the project.

In that case, the project documentation will often be the only reliable supporting evidence.

With this in mind, be aware that most contracts for EU funded external actions allow the Contracting Authority to perform audits and checks up to seven years after final payment.

For these reasons, Recipients should keep extensive records so they can later show how the project was managed.

Recipients are advised to keep more than just the minimum documents listed in the Contract.

The tips below may provide useful guidance.

BASIC TIPS (continued)

Key Message:

Does the project documentation provide strong enough evidence?

Review all documentation with a critical eye to ensure that it provides sufficient evidence of eligibility. Here are some basic principles:

- An *original* document is more reliable than a copy, as it is difficult to alter and offers better protection against recording the same expense item twice.

  For this reason, during checks or audits, the auditors will generally ask to see original documents.

- An *official* document is more reliable than an unofficial one.

  For example, an official bank statement provides more reliable evidence of payment than a cash payment voucher drawn up by the Recipient's cashier.

- A document issued by an *outside source* is better evidence than a document drawn up in-house.

  For example, for procurement under a grant contract, a tender or letter sent by the tenderer is better evidence of a competitive consultation than a note from the Recipient stating that the tenderer was contacted.

  For a service contract, a timesheet filled in and signed by the person who did the work is better evidence than a summary drafted by the Recipient's administrative department.

BASIC TIPS (continued)

Key Message:

Does the project documentation show that expenses are eligible?

Several documents may be needed to prove that expenses are eligible. For example, a supplier's invoice may prove that an item was bought for a certain price, but not that the expense was eligible in other ways, such as:

- *Relation to the project*: The supplier's invoice shows that goods were bought, but not necessarily that they were used for the project. The link to the project may need to be documented, for example by means of receipts signed by the ultimate recipients.

  For vehicles, a logbook can be kept to prove that the vehicle was used for the project and not for other purposes.

- *Reality*: Project documentation should prove that the costs were incurred. For example, the supplier's invoice may prove that the supplier was owed money by the project. But it does not necessarily prove that the project completed the transaction by accepting the goods and paying for them. So it may be necessary to keep the supplier's invoice AND the supplier's delivery note AND the bank statement (or receipt) showing that payment was made.

- *Within the project period*: Contracts for EU funded external actions generally specify a period during which the action may be implemented. The purchase invoice may not show that the costs were incurred during the term of the contract. A delivery note or a transport document showing when the goods were received may be helpful.

- *Specific contractual conditions*: The Contract may include specific conditions, for example requiring competitive procurement procedures or some form of EU visibility. In these cases, the project documentation will need to include not only the supplier's invoice but evidence that these Contractual Conditions were also met.

BASIC TIPS (continued)

Key Message:

Avoid unclear or ambiguous arrangements!

Review the documentation arrangements with a critical eye to ensure they are fully transparent and free of any ambiguity.

At first glance some project arrangements may seem practical, but if they are not completely clear they may cause problems later.

Example 1

A project has several decentralised offices with staff based in remote villages. For want of a proper banking system in the region, the project has to pay their salaries in cash.

For practical reasons, the staff based in certain villages decide to send one of the villagers to the central project office to collect their salaries.

This villager offers, in good faith, to sign the cash receipt voucher on behalf of the payees – the staff. At the time, the staff may find this a quick and easy way to document the payment.

However, this arrangement may mean that the Recipient is later unable to prove that the staff were actually paid. An auditor inspecting the documents several years after the facts might believe that the payment voucher was fraudulent.

Example 2

A Recipient manages several health development projects, some funded by EU grants and others funded by grants from other international donors (e.g. USAid).

In order to obtain better prices, the Recipient might decide to procure certain supplies for the different projects in one transaction.

But if all the goods are on only one invoice, this invoice will have to be allocated between the different projects. The same invoice will also have to be used as a supporting document in different projects.

This may create a risk of allocation errors. It may also cause the documentation to be more difficult to follow.

The Recipient should instead ask the supplier to issue project-specific invoices.

BASIC TIPS (continued)

Key Message:

Can the supporting documents be retrieved easily?

If the Recipient cannot retrieve the project documentation during an audit, the consequences could be the same as if no documentation had been kept at all, especially if the project has already ended and the staff are no longer on hand. How can this be prevented?

- *Simple, easy-to-use referencing*: Use a simple referencing and numbering system that anybody can follow, even people unfamiliar with the project.

  Make sure the system allows the documents to be found easily and quickly.

  Project references may follow a chronological, numerical, thematic, geographical or other system. The Recipient should decide on the most appropriate system depending on the circumstances.

  A clear filing index can save a lot of trouble.

- *Orderly filing*: Use orderly physical arrangements to file the documents.

  For example, file the documents in folders for easy retrieval, rather than tying them with string or keeping them in bags or in piles. If they are archived in boxes, one simple, effective measure is to label the box with its contents.

- *Physically secure archiving conditions*: Make sure the documents are physically protected and cannot deteriorate while in storage or in transit.

  Documents should not be stored in damp conditions or next to flammable or chemical products. They should be stored in closed premises safe from rodents and other animals.

SPECIFIC ISSUE - MULTIPARTNER/MULTILOCATION PROJECTS

The lead partner of a multipartner and/or multilocation project has to reconcile multiple requirements.

► As lead partner, it has to acknowledge that local partners may be obliged to keep documentation locally to comply with local accounting and tax regulations.

► As a Recipient of EU funds, the lead partner is accountable to the Contracting Authority for the local partners' execution of the contract. It must:

- present supporting documents when the contracting authority conducts audits and checks;
- take into account that the auditors will generally require original supporting documents as proof;
- facilitate audits and checks, bearing in mind that if the documentation is spread over many locations this may create obstacles.

The lead partner will need to find practical ways to reconcile these conflicting objectives. Here are some possible approaches.

► For grants, at the project proposal stage, question whether project execution/documentation really needs to be spread between so many local actors. If it is possible to organise the project so that it is not overly dispersed, this will make audits and checks easier.

► See whether the documentation can be grouped in fewer locations (for example all the documentation for one particular country might be grouped in only one location in that country).

► See whether the documentation can be moved temporarily to a central location when an audit is carried out.

► Find out whether the local partners can be asked to send a copy of their documentation together with their financial reports. This would help the lead partner to check the work of the local partners.

This approach would also facilitate audits, as the auditors might then be able to inspect the copies centrally.
But the auditors may still wish to check that the copies match the originals.

SPECIFIC ISSUE - DIFFICULT LOCAL ENVIRONMENTS

Certain projects may present specific difficulties linked with the regional environment, for example:

- Some local actors may be illiterate, e.g. suppliers may not be able to read, write or sign documents.
- There may be no reliable alternative suppliers on the market, which may complicate competitive procurement procedures.
- There may be no effective banking system, so that local actors ask to be paid only in cash, not via a bank.
- The remoteness of field operations, combined with other difficulties, may make it difficult to collect supporting documents.

In such circumstances, it is important to find practical ways of accommodating local circumstances while providing acceptable supporting evidence. For example:

- If fingerprints must be collected instead of signatures, consider taking a copy of the signer's identity card as well as noting their name next to the fingerprints.
- Avoid unclear practices. For example, if a person signs for the receipt of funds instead of another person, it may later be impossible to prove that the transaction was regular.
- If it is impossible to avoid making payments in cash, be extremely strict about the way the payments are documented.
- If the circumstances of the project are so difficult that it is impossible to obtain sufficient documentation, Recipients are advised to inform the Contracting Authority in writing as early as possible, suggesting measures to reduce the risks, and ask for its prior written approval.

SPECIFIC ISSUE - ELECTRONIC DOCUMENTATION

The use of electronic documentation is becoming increasingly widespread.

The contractual conditions for documentation, filing and record keeping also apply to electronic documentation.

To avoid the risk of e-documents being considered unreliable, Recipients are advised to follow the principles set out below:

- Electronic documentation should be used only if it is allowed under the Recipient country's laws on accounting and bookkeeping.
- If a Recipient uses electronic documentation, it should do so for all its operations and not only for the EU-funded project.
- The Recipient's internal control system should be designed to guarantee that e-documents are genuine, valid, and appropriate, and are subject to appropriate approval procedures.
- If the original documents were received or drafted in paper form, the Recipient should keep them available for inspection by the Contracting Authority.

Recipients using e-archiving or image processing systems (meaning that the original documents are scanned and stored in electronic form) are advised to organise their internal control system so that it guarantees that:

- Each e-document scanned is identical to the paper original.
- It is impossible to scan the same paper document to produce several different e-documents.
- Each e-document remains unique and cannot be re-used for any other than its initial purpose.
- The approval, accounting and payment process for each e-document should be unique. It should not be possible to approve, account for or pay the same e-document twice.
- Once scanned, e-documents should be impossible to amend or to created altered copies of.

TOOLS AND TEMPLATES

The following tool can be downloaded from the EuropeAid website at:

http://ec.europa.eu/europeaid/financial_management_toolkit/

FMT - MODULE 2 - DOCUMENTATION CHECKLIST

Recipients are encouraged to use the Documentation Checklist presented with this toolkit. Since each project is specific, each Recipient needs to determine which questions on the checklist are applicable to its project.

MODULE 3 - PROCUREMENT

Real life story

The NGO "ALTERNOVI" managed a number of projects in Africa, Asia and Latin America, financed by EU funded grants. Most of these projects involved substantial spending on supplies and equipment.

The auditors engaged by the Contracting Authority noted that, for a number of the projects, many of the procurement contracts for supplies and equipment had been awarded to the same company. When they reviewed a sample of procurement contracts awarded to this particular supplier, the auditors found a number of issues, such as contracts being signed before the date set for evaluating the bids, documents missing in tender procedures, etc. These issues were reported to the Contracting Authority.

The Contracting Authority decided to investigate further, and found that a close relative of the NGO's Director had an interest in the supplier in question.

What happened: The Contracting Authority decided to recover the funds granted for all the procurement contracts in question from the NGO. As the amount to be repaid exceeded the NGO's financial capacity, it had to cease activity.

WHY IS PROCUREMENT A KEY FINANCIAL MANAGEMENT AREA?

Key Message:

Procurement is crucial: if it does not comply with the rules, the Contracting Authority may recover the funds.

Sound financial management is a key principle of EU financial regulations and requires EU funds to be used in line with the principles of economy, efficiency and effectiveness.

Good procurement is vital to achieving these objectives.

The European Commission pays great attention to procurement.

If you fail to comply fully with contractual obligations on procurement, the project expenditure could be ineligible and this may result in the Contracting Authority recovering the funds.

Content of this module

- Minimum contractual conditions.
- What could go wrong? Key control measures.
- Basic tips.
- Tools and templates.

MINIMUM CONTRACTUAL CONDITIONS

Key Message:

Understand the Contractual Conditions.

The rules on procurement are set out in the contract models for EU-funded external actions.

They are summarised below.

- Grant Contracts → The procurement rules for grant contracts are laid down in a standard annex to the contract (Annex IV).

  Useful interpretations of the rules have been published by the "European NGO Confederation for Relief and Development" (CONCORD). These interpretations can be found on the CONCORD website at: http://www.concordeurope.org

- Service Contracts → Service contracts do not usually involve procurement.

  If they do, this will be specified in the Terms of Reference for the action and the relevant costs will be financed under the incidental expenditure heading in the budget.

  In such cases, if the Contracting Authority requires the Contractor to follow specific procurement procedures they will be referred to in the Terms of Reference for the action.

MINIMUM CONTRACTUAL CONDITIONS (continued)

- Programme Estimates

The procurement rules for projects managed by means of Programme Estimates are set out in the "Practical Guide to Contract Procedures for EU External Actions" ("PRAG") drafted by the European Commission.

The PRAG, together with model template documents, can be found at:

http://ec.europa.eu/europeaid/work/procedures/implementation/practical_guide/index_en.htm

Contracts involving Programme Estimates generally require Recipients to comply with the PRAG.

- Other contract types

If the action is financed by means of some other type of contract, Recipients should refer to its provisions.

International organisations and public sector bodies will need to check the Special Conditions of the Contract to see whether they must follow the procurement procedures of the organisation/country or other procedures specified by the Contracting Authority.

WHAT COULD GO WRONG? KEY CONTROL MEASURES.

What could go wrong?	Key control measures
• The procurement process may not be transparent. This issue may occur if the selection and award criteria used are not made clear, or if the grounds for the selection decision are not documented properly.	• Ensure that the tender/invitation documents are clear. • Establish clear selection criteria beforehand and ensure that they are known to all stakeholders. • Ensure the entire procurement process is clearly documented. Keep minutes of evaluation sessions, explaining selection decisions.
• The procurement process may not obey the principles of non-discrimination and equal treatment. For example, tender announcements / tender invitations may not be properly drafted or may be dispatched without enough notice. Or the tender specifications may be so restrictive that they limit access to certain potential suppliers.	• Ensure that the bidding process is as open as possible and is accessible to all potential suppliers. • Dispatch invitations / publish notices early enough to give interested suppliers time to respond. Ensure that invitations cover the market as widely as possible. • Ensure the same information is given to all participants at the same time. • Ensure that all offers are opened at the same time in a controlled environment.
• The evaluation process may not be objective or impartial. For example, the evaluation of offers may not be made in accordance with suitable pre-determined selection and award criteria or the evaluators may not be impartial.	• Make sure that none of the evaluators has a conflict of interest. • Ensure that the selection and award criteria are correctly applied. • Ensure that the offers are evaluated only after the date set for their submission.

WHAT COULD GO WRONG? KEY CONTROL MEASURES (continued).

What could go wrong?	Key control measures
• The wrong procurement procedure may be applied. For example, the procurement procedures of the Recipient or of the beneficiary country might be applied instead of the procedure laid down in the Contract.	• Ensure that the procedure applied provides at least the same level of competition as that provided for in the Contract signed with the Contracting Authority. • Check that the procedure applied is the right one according to the monetary thresholds specified in the Contract.
• There may be irregularities in applying the required competitive procedures. For example, procurement needs may be split into smaller amounts, resulting in the use of a negotiated procedure instead of an open tender procedure.	• Plan procurement well in advance so as to limit the risk of irregularities. • Make sure that all goods/services of a similar nature required in the same time frame are considered together when calculating whether they exceed the monetary threshold that determines the type of procurement procedure to be used.
• Conflicts of interest may arise.	• Ask evaluators to sign a declaration that they have no conflict of interest. • Ensure that the tenderers are unrelated.
• The contract may not be awarded in line with appropriate criteria.	• Giving reasons, set out award criteria that take into consideration the type of contract and the type of item to be procured.

BASIC TIPS

Key Message:

Plan procurement well in advance!

You should allow enough time to execute the procurement process properly and in accordance with the rules.

If you do not plan procurement long enough in advance, you may be tempted to “cut corners” to make up time.

This increases the risk of irregularities.

Key Message:

The entire process should be documented.

In order to clearly document the procurement process, it is not enough to keep copies of three offers on file. Recipients should be able to show how they managed the entire process.

It is good practice to draft a document describing the steps followed, from the initial identification of suppliers through to the final contracting decision. The document does not need to be long and could take the form of a brief ‘note for the file’.

It will help to demonstrate the management of the entire process at a later date.

BASIC TIPS (continued)

Key Message:

Do not forget the rules of origin! Failure to comply with them is a frequent cause of ineligibility.

Basic principle:

Under EU rules, supplies must originate from eligible States and Territories. These are set out in the basic acts governing the financing instrument under which the action is financed.

A list of the eligible countries for each financing instrument can be found in Annex 2 to the PRAG.

What does "origin" mean?

Under the rules, goods 'originate' not in the country of the supplier but in the country where the goods were last produced or assembled. That is what is meant by their 'country of origin'.

What are the rules?

For actions managed under grant contracts, the rules are explained in Annex IV to the Contract.

For actions managed by means of Programme Estimates, the rules are explained in the PRAG, under "The rule on nationality and origin" and "Exceptions to the rule on nationality and origin" (Sections 2.3.1 and 2.3.2).

Certificate of origin:

The origin of the goods must be attested to by a "certificate of origin", i.e. an official document delivered by the relevant authorities of the country of origin of the supplies (for example, a Chamber of Commerce).

- For programme estimates, a certificate of origin is always required.
- For grant contracts, a certificate of origin is required only for equipment or vehicles with a unit cost in excess of EUR 5 000 (but please note that the rules of origin must be obeyed even for expenditure below this amount).

Without a certificate of origin, the Contracting Authority may consider the expenditure ineligible.

Before entering into a contract with a supplier, it is advisable to make it clear to him or her that an official certificate of origin will be required.

It is advisable to accept delivery from the supplier only if he or she has duly submitted an official certificate of origin.

BASIC TIPS (continued)

Key Message:

Make sure that the contract is in line with the procurement process.

All the information given in the contract with the supplier/consultant/contractor should match that given during the procurement process.

Any deviation from the procurement documents when drafting the contract (for example, stating higher quantities or higher prices) may raise doubts about the whether procedure was correctly followed.

This also means that contracts must not be signed before the procurement process is complete.

For the same reason, if you start to work with the supplier/consultant/contractor before procurement is complete the expenditure will be ineligible.

Key Message:

Make sure that the contract is signed during the correct period.

Recipients may prepare the procurement procedure as early as they wish (even before the official period for implementing the action starts). However, the contract <u>may not</u> be awarded outside of the official implementation period.

- For grants, the Recipient must award (sign) the procurement contracts during the implementation period stated in the special conditions of the Grant Contract.
- For actions managed under programme estimates, the procurement contracts must be awarded (signed) before the end of the operational implementation phase of the corresponding financing agreements (see the Practical Guide for Programme Estimates, under “End of the time-limit for performing contracts”).

BASIC TIPS (continued)

Key Message:

Do not let the formalities overshadow the basic substance!

Procurement rules should not be viewed as merely a set of administrative formalities. The rules are there to ensure a transparent, equal-opportunity, competitive process which offers the best value for money.

In the following examples, project staff neglected these basic objectives and concentrated only on the formalities:

Example 1

In certain regions, local suppliers might be illiterate and unable to draft written offers. Project staff might have no alternative but to conduct the local procurement process verbally.

However, an issue would arise if the project staff drafted written offers themselves, "as if" they were drafted by local suppliers, just to have formal-looking documentation for its project files.

In an audit, the "made-up" offers might be considered fraudulent because the way they were drafted actually disguises the true nature of the process.

In such a situation, the project staff should document the local suppliers' inability to provide written offers and any negotiations held, and do so in a way that properly reflects the reality.

Example 2

If there is not much time, project staff may be tempted to split a large procurement into several requests of a low individual value so they can use a simplified procedure instead of a lengthier competitive tender procedure.

In doing so, the project staff may believe that they have complied with the formalities, because they have documentation on file showing that a simplified negotiated procedure was applied.

But by splitting the procurement, they have not complied with the fundamental principles of good, transparent procurement in reality.

BASIC TIPS (continued)

Key Message:

In case of doubt, contact the Contracting Authority.

From time to time during a procurement procedure, Recipients might encounter a specific situation not covered in the Contract.

When in doubt, Recipients should not hesitate to contact the Contracting Authority, in writing, to obtain clarification about the required procedure.

Recipients are also allowed to use more elaborate procedures, even when these are not mandatory for the Contract. Refer to the “Practical Guide to Contract Procedures for EU External Actions” (PRAG), which can be found at:

http://ec.europa.eu/europeaid/work/procedures/implementation/practical_guide/index_en.htm

Model templates such as those used for declarations of impartiality, the minutes of evaluation committees, and dispatch letters can also be found in the annexes to the PRAG.

TOOLS AND TEMPLATES

The following tool can be downloaded from the EuropeAid website at:

http://ec.europa.eu/europeaid/financial_management_toolkit/

FMT - MODULE 3 - PROCUREMENT CHECKLIST

Recipients are urged to use the Procurement Checklist presented with this toolkit. The checklist has been drafted to help Recipients ensure that their procurement is transparent, impartial and non-discriminatory and offers the best value for money.

MODULE 4 - ASSET MANAGEMENT

Real life story

I worked for the NGO "DALITMUNDIA" as a team leader for several projects located in a small country in Africa. Over a number of years, the NGO had managed several successive EU-funded projects in the country, requiring a large number of vehicles.

To reduce costs, most of the project vehicles were acquired locally, some of them bought second-hand.

During a check on one of our projects, auditors hired by the Contracting Authority found that some of the second-hand vehicles had been financed under earlier EU-funded projects managed by the NGO. These were vehicles which had been donated to local beneficiaries, who subsequently resold them to us without it being noticed.

The audit also found that some of the local drivers whom we employed for the projects were in fact using the project vehicles as cabs outside their hours of duty. This problem went unnoticed because the logbooks used were not precise.

The auditors reported these findings, which caused significant embarrassment at NGO management level.

Lesson learnt: Our project team had not detected these issues because of poor asset management procedures. Had our procedures been better, these problems would not have arisen.

WHY IS ASSET MANAGEMENT A KEY FINANCIAL MANAGEMENT AREA?

Key Message:

Project assets should be kept safe and used for their intended purposes.

In projects involving grants and programme estimates, valuable assets may be acquired.

It is important to the ultimate beneficiaries of the project that these assets are used for their intended purposes and are kept safe so that they can continue to produce benefits over a long period.

It is essential to manage project assets properly, both to ensure sound financial management and to prevent improprieties or fraud.

This module explains the specific measures used to manage assets. Procedures for acquiring these assets (procurement) are discussed in Module 3.

Content of this module

- Minimum contractual conditions.
- What could go wrong? Key control measures.
- Basic tips.
- Tools and templates.

MINIMUM CONTRACTUAL CONDITIONS

Key Message:

Understand the Contractual Conditions.

The following summarises the main contractual requirements for asset management in EU-funded external actions managed through grants, service contracts and programme estimates.

- Grant Contracts

The general conditions of grant contracts specify that:

- If the Recipient does not have its headquarters in the country where the project is implemented, the equipment, vehicles and supplies financed by the project budget must be transferred to local partners and/or to the beneficiaries at the end of the project. The proof of this transfer must be kept (Article 7).
- To be eligible, the costs must comply with the requirements of sound financial management, in particular regarding economy and efficiency (Article 14(1)(e)).

  If a Recipient does not check that its project assets are kept safe and properly used, the above conditions may not be met.
- Purchases of land or buildings are ineligible, unless necessary to implement the project. In that case, ownership must be transferred to the final beneficiaries or to local partners at the end of the action (Article 14(6)).
- A fixed asset register must be kept. For vehicles, records of mileage and fuel/oil consumption must be kept (Article 16(3)).

- Service Contracts

Service contracts do not usually involve assets. However, should this be the case, the Contractor will need to consult the Contract for the rules to follow.

MINIMUM CONTRACTUAL CONDITIONS (continued)

- Programme Estimates ⇒ The Practical Guide for Programme Estimates requires recipients to:
  - ► keep a permanent inventory of investment and capital goods (see "Financial monitoring documents", section 4.1.4);
  - ► keep records proving the running costs of vehicles and monitor the cost for each vehicle, e.g. by means of log books (see Annex 11, under "Cost of vehicles");
  - ► transfer materials and equipment to the relevant administration in the beneficiary country when the programme is closed – this transfer must be documented (see "Transfers of materials and equipment", section 4.1.10);
  - ► use the materials and equipment only to carry out the activities of the programme (same section).

- Other contract types ⇒ If the action is financed by means of some other type of contract, the Recipient should refer to its provisions.

WHAT COULD GO WRONG? KEY CONTROL MEASURES.

What could go wrong?	Key control measures
• The asset register may be inadequate or nonexistent. Without a proper asset register, it may be impossible to find out where the project assets are located, whether they still exist, and what they are used for.	• Keep an up-to-date, clear asset register which tallies with the accounting records and which allows easy identification of the physical assets concerned.
• Physical checks of the assets may not be performed regularly. As a result, it may become impossible to find out whether the assets still exist and are still in working condition. In addition, thefts or losses may go unnoticed.	• Inspect the assets regularly. It is widely accepted practice to perform a complete physical inventory of all assets at least once a year.
• The assets may not be clearly identified as project assets. As a consequence, the project assets may get mixed up with other assets and it may become impossible to retrieve them.	• Ensure that all project assets are duly and physically identified (e.g. by stickers, tag numbers, etc.).
• The use of the assets may not be properly supervised. For example, vehicle log books may not be maintained, or the use of consumables may not be monitored, which means the assets could be misused or stolen.	• Ensure that proper tools are in place to monitor the use of project assets, including consumables (see Tools and Templates for suggested ready-to-use tools).

BASIC TIPS

Key Message:

Different asset types require different control measures.

The risks to project assets may be high or low, depending on what the assets are. So Recipients need to identify the main risks affecting their assets to determine the best way of protecting them.

Examples of different risks by asset class include the following:

- Movable equipment, for example computers, office equipment and vehicles, have a higher risk of improper use.

  To protect against this type of risk, set up an accurate, up-to-date investment register. For vehicles, provide mileage logbooks.

- Consumables, for example gasoline, oil, seeds, small tools and repair parts, have a high risk of theft.

  To protect them, set up a solid inventory system.

- Infrastructure (normally only included in Programme Estimates), for example buildings, roads and irrigation infrastructure, are at less risk of theft. However they risk being damaged if not maintained. They are also at risk of being poorly used or not being used by the final beneficiaries.

  To protect this type of asset, set up a good maintenance system together with a physical inspection system.

BASIC TIPS (continued)

Key Message:

A register of investment assets is a vital control tool.

To be effective, a register of investment assets should contain enough information to enable each asset listed to be traced back to the accounting records and to the physical asset in question.

This information includes:

- the identification number and description of the asset (e.g. type, model, serial number)
- the cost of the asset, which must tally with the project's accounts
- the date of acquisition, and the reference to the relevant entry in the bookkeeping records (e.g. the reference number of the vendor's invoice)
- the identification number of the asset in the project records (this number should also be stated on a tag fixed to the asset so it can be identified)
- the location of the asset (and for movable equipment, the place where it is based)
- the person and/or department responsible for the asset.

A ready-to-use asset register template is provided in the Tools and Templates for use with this toolkit.

To ensure that the register remains reliable, Recipients should regularly check that it tallies both with the accounting records and with the physical assets concerned.

BASIC TIPS (continued)

Key Message:

Investment assets need to be physically identifiable for checking.

For retrieval, each asset item should be assigned an identification number (internal to the project).

This identification number should be noted on a tag physically affixed to the item. It should also be stated in the asset register.

This will help reconcile the register with the physical asset and vice versa.

It will also facilitate physical checks later.

Key Message:

Control of assets means regular inspection.

Inspect all project assets regularly to ensure that they still exist, are in suitable working condition and are still used for the project.

It is generally accepted financial practice to perform a 100% inventory check of all project assets at least once a year.

Consumables, which are more prone to error, may need to be inspected more frequently.

BASIC TIPS (continued)

Key Message:

Permanent inventory records are necessary to control consumable goods.

Certain projects may possess large quantities of consumables, for example gasoline, repair parts, and small tools.

As these are fungible items, an investment register is less appropriate. The best way to control consumables is to keep a permanent inventory.

To allow proper controls, permanent inventory records need to give a description of the item, and record the quantity held and any movements in (purchases) or out (usage or distribution).

A ready-to-use template for permanent inventory records is provided in the Tools and Templates.

To ensure that permanent inventory records remain reliable, regular inspections should be held.

Key Message:

Differences need to be investigated and resolved immediately!

Inspections of the investment assets and/or consumables inventory may reveal discrepancies.

Recipients are strongly encouraged to investigate any discrepancies immediately.

This will increase the chance of identifying the cause and retrieving the assets in question.

If the investigation is not successful, the Recipient will need to adjust the project records to reflect the loss of the asset(s).

Recipients are encouraged to record asset losses/thefts in an account dedicated for that purpose and to disclose them in the financial report.

Such write-off entries should be approved by the relevant project's management.

BASIC TIPS (continued)

Key Message:

Control of the use of assets is vital.

Good management requires that Recipients take measures to ensure that assets are used effectively and only for the project.

Failure to check that assets are used effectively may expose the project to the risk of fraudulent use of its assets.

If assets are used for a purpose unrelated to the project, the costs incurred may be declared ineligible.

Possible checks on the use of assets include:

- For vehicles, a log book can be kept for each vehicle to record mileage and reviewed regularly.

  A ready-to-use log book template is provided in the Tools and Templates.
- For goods intended for distribution, receipts can be obtained from the ultimate recipients to ensure that the goods are used only for their intended purpose.
- For infrastructure assets in Programme Estimates, regular inspection visits can be made to ensure that they are in effective use.

Key Message:

Leased assets also need to be controlled!

Certain projects lease assets instead of buying them. For example, they may lease vehicles, equipment or premises.

If the project is responsible for the use of these assets, it is good practice to supervise their use in the same way as the project supervises the use of its own assets.

Checks on the use of leased assets include:

- For rented vehicles, a log can be kept of the trips the leased vehicles are used for.
- For a large project renting several buildings to house short-term staff, a register of the rented buildings can be kept and the location and use of the buildings recorded, together with the rental dates.

BASIC TIPS (continued)

Key Message:

Unclear or unsound arrangements should be avoided.

A Recipient that enters into a suspect transaction may be exposed to fraud. Therefore, prudence commands to avoid entering transactions unless they are fully sound.

Examples of points for attention include:

Second-hand assets: If second-hand equipment is purchased for the project, its ownership history should be checked to avoid acquiring equipment originally financed under a previous EU funded external action project.

This precaution is of special importance for local purchases of second-hand vehicles.

It is also best to check the history of second-hand rented vehicles.

Recipient assets rented to the project: Because of the inherent conflict of interest, equipment belonging to a Recipient should not be leased to the project. The Contracting Authority will generally consider the cost of using this equipment to be covered by the flat rate agreed for indirect costs for grants or by the fee rate for services.

For grants, in exceptional cases, the depreciation costs of using the Recipient's own equipment may be accepted as an eligible cost. This exception needs to be duly reflected in the contract.

In that case, the Recipient should be able to demonstrate that the rent does not involve any profit.

BASIC TIPS (continued)

Key Message:

Asset transfers must be duly proven.

In certain cases, the Contract will require the Recipient to transfer equipment, vehicles and supplies financed by the project budget to local partners or to other recipients in the beneficiary country.

Such transfers must be made, at the latest, by the end of the implementation period of the project.

In these cases, the transfers should be documented and the evidence retained with the project documentation.

For grants, copies of the proof of transfer of assets, equipment and vehicles that cost more than EUR 5000 per item must also be attached to the final report.

An example template for asset transfers is provided in the Tools and Templates.

TOOLS AND TEMPLATES

The following tool can be downloaded from the EuropeAid website at:

http://ec.europa.eu/europeaid/financial_management_toolkit/

FMT - MODULE 4 - TEMPLATE FOR ASSET TRANSFER

FMT - MODULE 4 - TEMPLATE FOR ASSET REGISTER

FMT - MODULE 4 - TEMPLATE FOR PERMANENT INVENTORY RECORDS

FMT - MODULE 4 - TEMPLATE FOR VEHICLE LOG BOOK

These templates are indicative, non-compulsory examples which Recipients may adapt as they see fit.

MODULE 5 - PAYROLL AND TIME MANAGEMENT

Real life story

The company "AIDCONSULT" managed a technical assistance (service) contract for an EU-funded project. The service contract was implemented in Borduras, Latin America, by a team of expatriate experts and a team of local staff.

The auditors appointed by the Contracting Authority to audit the contract noted that a large number of timesheets for the international staff had in fact been completed before the work actually took place.

The auditors also noted that the timesheets of some of the local staff contained obvious errors (such as the same day being entered twice, or 33 days worked in the same month). As the local staff in question were paid per day worked, this meant they had been overpaid.

It was also found that some staff charged for time every day, including Saturdays and Sundays, throughout the project period (and even for an uninterrupted period of up to four months).

What happened: These issues had not been detected by the company, which had not checked the timesheets effectively. As a result, the Contracting Authority asked the company to rectify its invoices. The company was unable to recover the amounts overpaid to the former local project staff, so it had to cover the difference itself.

WHY IS PAYROLL A KEY FINANCIAL MANAGEMENT AREA?

Key Message:

The payroll is a significant cost that must be properly controlled.

Human resources are a major cost component for many projects, particularly service contracts.

In such projects it is essential to control and account properly for these costs.

Critical aspects of payroll costs include:

- proper calculation of pay and compliance with national social security and related rules;
- adequate staff contracting;
- adequate systems to allocate staff costs to projects;
- adequate control of attendance;
- sound remuneration practices.

Content of this module

- Minimum contractual conditions.
- What could go wrong? Key control measures.
- Basic tips.
- Specific issue – Compensation for leave entitlement.
- Tools and templates.

MINIMUM CONTRACTUAL CONDITIONS

Key Message:

Understand the Contractual Conditions.

The following summarises the main contractual requirements for payroll and time management in EU-funded external actions managed through grants, service contracts and programme estimates.

- Grant Contracts

The general conditions of grant contracts:

- Define eligible payroll costs as the "actual gross salaries of the staff assigned to the action, including social security charges and other remuneration-related costs". These payroll costs may not exceed those normally borne by the Recipient or its partners (Article 14(2)).
- Specify that the supporting documents to be provided are payroll records such as contracts, timesheets and salary statements (broken down into gross salary, social security charges, insurance and net salary (Article 16(3)).

MINIMUM CONTRACTUAL CONDITIONS (continued)

• Service Contracts

The general conditions of service contracts include many rules on staff management. The main ones are summarised below:

- For fee-based contracts, timesheets recording the days or hours worked by the Consultant's staff must be maintained. These timesheets must be approved on a monthly basis by the project manager or by any person authorised by the Contracting Authority (Article 24(2)).
- The Consultant must inform the Contracting Authority of all staff whom it intends to use to carry out tasks, in addition to the key experts named in the contract (Article 16.1).
- The Consultant may not make changes to the agreed staff without the prior approval of the Contracting Authority (Article 17).
- The days and hours of work of the Consultant's staff are to be consistent with the laws, regulations and customs of the beneficiary country and the requirements of the work (Article 21).
- For fee-based contracts, the fee rates are deemed to take account of annual leave. Days taken as annual leave are not considered to be working days (Article 22).
- The Consultant must respect internationally agreed core labour standards, e.g. ILO (International Labour Organisation) core labour standards, conventions on freedom of association and collective bargaining, the elimination of forced and compulsory labour, the elimination of discrimination in employment and occupation, and the abolition of child labour (Article 8(2)).
- Civil servants or public agents of the beneficiary country may not be recruited as experts for contracts in the beneficiary country unless the Contracting Authority has given its approval (Article 9(5)).

MINIMUM CONTRACTUAL CONDITIONS (continued)

- Programme Estimates ⇒ The Practical Guide for Programme Estimates, under "Staff Management", Section 4.1.9, states that:
  - ► The rules for managing the various categories of staff must be set out in the administrative implementing arrangements of the programme estimate. These must include the procedures for recruiting staff, the national legislation applicable, the type of contract used and the relevant social entitlements.
  - ► The recruitment procedures and remuneration package for management staff must be approved by the Head of the EU Delegation.
  - ► Terms of reference and contracts must be drafted for the recruitment of contract staff. These contracts should usually be for a fixed term coinciding with that of the programme estimate. The list of staff, their pay scales and rates for additional allowances must be annexed to the programme estimate.
  - ► The imprest administrator and the imprest accounting officer must keep an up-to-date staff register and payroll with monthly tables showing the details of expenditure on staff. Each year they must also draw up a list of staff by function and by name, stating the cost of their pay and the relevant contributions.
- Other contract types ⇒ If the action is financed by means of some other type of contract, refer to its provisions.

WHAT COULD GO WRONG? KEY CONTROL MEASURES.

What could go wrong?	Key control measures
• It may be impossible to show how much time staff spent on the project.	• Set up a timesheet system to record and control the time spent by the staff. Have the timesheets of all staff checked by a responsible individual. • In addition to the above, keep travel documentation and boarding passes for expatriate staff working in beneficiary countries showing arrival and departure dates relating to the project.
• The time reported by staff on timesheets may not be reliable.	• Ensure timesheets are reviewed by a responsible individual within the project (e.g. the team leader or the head of project support unit).
• For service contracts, the Consultant may assign staff to the project without informing the Contracting Authority.	• Inform the Contracting Authority of any new staff before they start work on the project.
• The actual salary costs may not be determined correctly or the amount may not be supported.	• Keep payroll records in accordance with the relevant national legislation. Draft payroll sheets by person and in total. • Ensure that salary scales are in line with market levels.
• The relevant social security rules and/or the relevant national employment legislation may not be obeyed.	• Consider using a specialised payroll office.
• Undue allowances (per diem and other) may be paid to staff and charged to the project.	• Ensure that any allowances paid to staff are justified.

BASIC TIPS

Key Message:

Consider using timesheets even if the contract does not require them.

An effective timesheet system can help to meet several important objectives:

- Allocating staff costs to the project according to their actual time inputs.
- Allocating the work to the correct activity in the project.
- Checking that staff are actually present.
- Documenting the staff's work on the project.

Recipients are encouraged to set up a timesheet system to manage staff time, even if this is not required in the Contractual Conditions.

Timesheet requirements may be more or less strict depending on the objectives.

For example, if staff work on several different projects during the same period, a stricter timesheet system may be needed than if they are hired to work exclusively on one project.

The next page presents basic measures which can be taken to make the timesheet system stricter.

BASIC TIPS (continued)

Key Message:

Consider what makes a good time recording system.

Appropriate measures to make a timesheet system more effective include:

- Preparation by staff themselves: Arrange for the timesheets to be filled in by the people who performed the work. Have them sign their timesheets to acknowledge their responsibility for their input.
- Timely preparation: Require project staff to submit their timesheets no later than one or two days after the end of the designated period. To encourage reliability, monitor this deadline.
- Periodicity: Make the timesheet period sufficiently short (weekly, fortnightly, or, at most, monthly).
- Data integrity: Once the timesheet has been filled in and approved, the staff member should no longer be able to amend it.
- Standardised format: Set up a standardised timesheet format which must be followed by all staff. This will improve staff discipline.
- Review and approval: Have staff timesheets reviewed and approved by their direct superior (for example the team leader, for a service contract).

  If the objective of requesting timesheets is to prevent absenteeism, consider asking staff to submit their timesheets to their superior on a daily basis (otherwise, the supervisor's review may be less effective).
- Reconciliation with total time worked: If staff work on several projects during the same period, maintain an overview of the time spent by each individual on the different projects, which should tally with his/her total time worked. This practice should ensure that no time can be charged twice.
- Use of time recording software: (relevant mainly to service contracts). If a Recipient already has its own internal time recording system, it should ensure that the timesheets submitted to the Contracting Authority for the project tally with its internal time recording system.

BASIC TIPS (continued)

Key Message:

Make sure that agreed staff are used for the project.

If staff are named in the project budget or in the project proposal, always obtain prior approval in writing from the Contracting Authority before making any changes.

The project budget and the project proposal are part of the contractual agreement between the Recipient and the Contracting Authority. Changes in items of the Contract require a rider or amendment to be drawn up.

Recipients should never change a staff member who has been agreed upon with the Contracting Authority without obtaining its prior approval in writing.

For service contracts, the Contracting Authority should be notified in writing of the inclusion of any non-key experts who are not named in the Contract.

Key Message:

Make sure that project staff work in the contract period.

Contracts for EU funded external actions generally specify a period during which the action may be implemented.

Staff costs for work performed outside this period are ineligible.

Recipients should inform staff of the start and end of the project implementation period, which is the only time they may work on the project.

BASIC TIPS (continued)

Key Message:

Make sure that social and tax laws are strictly obeyed.

Recipients should never "by-pass" the required social security contributions and income taxes in an attempt to reduce project costs. Nor should project staff be allowed to evade these contributions to increase their net salary income.

The Recipient or its staff might face penalties imposed by the national authorities as a result.

There would also be an unacceptable risk of damaging the reputation of EU-funded projects in the country.

Keep sufficient documentation showing compliance with national social and tax legislations.
For example:

- correctly drafted employment contracts;
- payroll sheets showing that gross and net pay tally for individual staff and for the entity as a whole;
- copies of tax returns where required by national legislation;
- returns submitted to national authorities concerning social security and income taxes, reconciled with the payroll, and proof of payment to the authorities;
- possibly, proof of payment by staff member themselves, where they are responsible under national rules for paying social contributions and income tax (consider asking staff to provide such proof).
- As some countries' social legislation can be complex, unless the project's accountant is familiar with the rules it might be advisable to obtain the help of a specialised payroll office.

BASIC TIPS (continued)

Key Message:

Always use sound practices for allowances.

Remember that the basic objective of paying allowances to project staff or others is to save paying their expenses.

Paying allowances that are not commensurate with reasonable reimbursement may cause various problems. For example:

- ► Excessive training attendance allowances may attract unmotivated participants who may attend just for the allowance and not for the training itself.
- ► Excessive mission allowances may encourage project staff to arrange unnecessary missions which are not in the best interests of the project.

Recipients might consider the following:

- ► For training attendance allowances, fix the allowance at a level compatible with reasonable reimbursement of expenses. Document the basis for fixing the allowance. Avoid paying “fees” or “remuneration” for attending training courses.
- ► Keep attendance lists. Request participants to provide feed-back on training courses.
- ► For mission allowances (per diems), remember that the amounts published by the EC are the maximum. Recipients can always pay lower amounts, for example if the mission takes place in cheaper parts of the country or if the actual costs are lower.
- ► For mission allowances, keep appropriate documentation showing that the mission actually took place (mission orders, mission reports, boarding passes for international missions, copies of hotel bills showing the dates of arrival and departure, etc.)

BASIC TIPS (continued)

Key Message:

Always avoid unclear or ambiguous arrangements!

Unclear arrangements are a potential source of risk. Recipients are advised to challenge remuneration arrangements to ensure they are fully transparent.

The following are examples of potentially risky arrangements:

Staff donations: In projects with humanitarian or social content, some project staff may wish to donate part of their salary to the project. Whilst the donation may be made with good intentions, it might raise the following issues from a financial management standpoint:

- For cost-reimbursement contracts, the donation may effectively reduce the payroll costs of the project, thereby reducing eligible costs by the amount of the donation.
- If the donation is made by means of a deduction from salary, it might be very difficult to demonstrate later that the arrangement was not designed to inflate the cost basis of the project.

For these reasons, Recipients should be very prudent with this type of transaction. Recipients who intend to arrange staff donations are advised to inform the Contracting Authority in advance.

Additional salaries : In certain projects, additional salaries (top-ups) may need to be paid, for example to staff seconded by national authorities, to motivate them to work for the EU-funded project.

These could, however, attract criticism from other national actors, with a resulting risk of bad publicity. If the top-ups are funded by deductions from the salaries of other staff, it might also involve a risk of improprieties and social disputes.

If the project pays salary top-ups, Recipients should make sure that the amount, allocation criteria and means of funding are fully transparent. It is recommended that they obtain the endorsement of the relevant EU Delegation before making this type of arrangement.

SPECIFIC ISSUE – COMPENSATION FOR LEAVE ENTITLEMENT

For grants and programme estimates, the conditions of most contracts follow these principles:

- actual basis: the Contracting Authority reimburses the real salary cost of the employee, i.e. their gross pay plus social security and social insurance.
- generally accepted accounting principles: the project's accounting records must be kept in accordance with generally accepted accounting principles in the country of the Recipient.

  As most countries follow the accrual accounting principle, that is the method Recipients will most often need to follow.

Examples of accrual accounting for paying compensation for leave entitlement are given in the box on the right.

EXAMPLES

- A project employee is entitled, under national legislation, to 30 days paid holiday leave per year worked. The project period is 10 months and the employee takes her/his 30 vacation days during the period of the project.

  Under the accrual accounting principle, the share of the salary cost of leave accruing to the project is 30 days x 10/12, i.e. 25 days of remuneration (and not the 30 days taken during the project period).
- If the same project employee does not take leave during the project period but prefers to take it after the project ends, the share of the salary cost of leave accruing to the project is still 25 days of remuneration (and not zero).

TOOLS AND TEMPLATES

The following tool can be downloaded from the EuropeAid website at:

http://ec.europa.eu/europeaid/financial_management_toolkit/

FMT - MODULE 5 - TIME SHEET TEMPLATES

(2 templates included)

FMT - MODULE 5 - PRESENCE SHEET TEMPLATES

(2 templates included)

These templates are indicative, non-compulsory examples which Recipients may adapt as they see fit.

MODULE 6 - CASH AND BANK MANAGEMENT

Real life story

Our NGO, “Green Cross”, was based in the UK and managed several projects funded by EU grants. One of our projects ran in several Latin American countries with the help of local partners. In addition to the EU funding, the project was co-financed by us and by the “American Blue Cross”, a US-based charitable organisation (a regular partner of our UK NGO) as well as by our local partners.

According to the usual practice of our organisation, the euro funds received from the Contracting Authority were converted immediately to GBP. Depending on the requirements of the local partners, we then forwarded the necessary funds to our US partner, which converted them to USD and re-forwarded them in USD to our Latin American partners, together with its own contribution.

Each local partner prepared a financial report in its own national currency, which was submitted to us. Our accounting department in London then consolidated these into an overall project financial report in GBP, presented along with the euro equivalents.

What happened: In an audit of our project launched by the Contracting Authority, our finance department was unable to provide an exact amount for the interest generated by the EU advances. It was also unable to reconcile the advances paid by the Contracting Authority, the contributions of our US partner, our local partners, and our NGO with the project expenses stated in our final financial report. It was also impossible to reconcile the intervening currency exchange differences.

Consequently, the auditors raised exceptions in their audit report to the Contracting Authority.

Lesson learnt: These problems would have been avoided if we had used more disciplined banking techniques, as described in this module.

WHY IS CASH AND BANK MANAGEMENT A KEY FINANCIAL MANAGEMENT AREA?

Key Message:

Cash must be kept safe and banks used properly.

Otherwise, the entire project may be at risk.

This module is particularly relevant to projects managed by means of programme estimates and grants.

Such projects depend on the funds contributed by the Contracting Authority and might have to close without them.

Good management of financial resources is critical for these projects.

The Contracting Authority will generally want to know how its funds have been employed.

Content of this module

- Minimum contractual conditions.
- What could go wrong? Key control measures.
- Basic tips.
- Tools and templates.

MINIMUM CONTRACTUAL CONDITIONS

The following summarises the main contractual requirements for cash and bank management in EU-funded external actions managed through grants, service contracts and programme estimates.

- **Designation of a bank account** ⇒ All Contracts generally require the Recipient, at the beginning of the contract, to designate the bank account into which payments by the Contracting Authority will be made.

- **Dedicated project bank accounts** ⇒ For projects managed through programme estimates, the technical and administrative provisions annexed to the financing agreement generally require one or more bank accounts to be opened for the sole purpose of managing the project's funds. Further details are given in the Practical Guide for Programme Estimates, under "Bank accounts" - Section 3.3.7.

  The technical and administrative provisions lay down rules for these bank accounts (for example, the currency they must use, how to make transfers between them, and the bank account to which project expenditure must be debited).

- **Petty Cash** ⇒ For projects managed through programme estimates, the Practical Guide for Programme Estimates states that the petty cash balance should be kept to a strict minimum and kept secure (Practical Guide for Programme Estimates, under "Petty Cash" - Section 3.3.8).

- **Cash flow reconciliation and bank reconciliation** ⇒ For projects managed by means of programme estimates, Annexes 9 and 10 of the Practical Guide for Programme Estimates provide sample formats for cash flow reconciliation and the cash reconciliation to be presented in replenishment requests and in records of expenditure.

WHAT COULD GO WRONG? KEY CONTROL MEASURES.

What could go wrong?	Key control measures
• The funds paid by the Contracting Authority may not reach the project's implementing unit in time for implementation.	• Ensure that the funds are channelled as directly as possible, without intermediary steps. • Draft replenishment requests in good time (in the case of programme estimates).
• The funds paid by the Contracting Authority may be used to finance activities other than the project. This can occur, for example, if the implementing entity experiences cash shortages and uses funds intended for the project to cover other pressing cash needs.	• Use project-dedicated, specific bank accounts even if it is not required. • Reconcile cash flow.
• Unauthorised payment vouchers may be drafted.	• Segregate the duties of payment preparation, payment authorisation and payment signature. • Segregate accounting and cash custody duties. • Check payment documents against the supporting documents. • Use double signatures on bank accounts.
• Cash may be misappropriated. • The funds may not be received by the designated payee.	• Perform frequent bank reconciliations and petty cash counts. • Make payments by bank transfer, preferably. • Ensure that the bank/cash reconciliations are performed by people who do not have custody of the bank/cash funds.
• Funds in other currencies may not be converted at the correct exchange rates.	• Make sure the currency rules in the Contractual Conditions are obeyed. Further details are provided in Module 7 (Accounting) under Basic Tips.

BASIC TIPS

Key Message:

Always make sure the funds follow the most direct route.

If the arrangements for channeling the funds to the project are ineffective, many problems can occur:

- the funds may take too long to reach the project's implementing unites), hampering implementation;
- part of the funds may be diverted by intermediaries;
- in multi-country/multi-currency projects, unexplained currency losses may occur;
- it may become impossible to say how much interest the EU funds generated.

Arrange for the funds to be forwarded to the project implementing unit by the most direct route.

For example:

- Avoid sending funds through intermediary entities or currencies (e.g. from Europe to Latin America via the US or the USD).
- Consider using the imprest technique, whereby a fixed amount is forwarded to the implementing unit and is replenished for the exact amount of the actual expenditure proven by that implementing unit.
- Consider opening dedicated project bank accounts even if it is not required. Dedicated accounts are mandatory only for projects managed by means of programme estimates. However they can also be useful for grants as they allow project funds to be segregated from other funds.

BASIC TIPS (continued)

Key Message:

Open dedicated bank accounts for the project if possible.

Dedicated bank accounts bring all funding for the project together in one or more bank accounts used exclusively for the project.

This is a very effective way of managing the project's cash. It has many advantages:

- ► it allows the funds to be traced clearly from their source to their use;
- ► it makes checks and reconciliation easier;
- ► it minimises the risk that funds intended to finance the project may be used to finance other activities;
- ► it helps minimise the risk of double financing;
- ► if the Contractual Conditions stipulates contributions from several parties (co-financing), it helps to show that all the parties have made the financial contribution stipulated and that these contributions have been used for the project.

For programme estimates, dedicated bank accounts are usually required by the relevant technical and administrative provisions.

For grants, the use of dedicated bank accounts is not mandatory.

However, because of their advantages, Recipients are urged to consider using them.

BASIC TIPS (continued)

Key Message:

Frequently reconcile and verify.

Cash is easy to misappropriate, so strict control measures are required. Here are some examples:

- Reconcile/check balances: Count petty cash regularly. Check that the cash count matches the accounting records and the cash book.

  Frequently check that the balances given in bank statements tally with the accounting records.

- Reconcile cash-flow: Perform frequent cash-flow reconciliations to ensure that cash/bank transactions tally with the bank balances.

- Ensure proper segregation of duties: Arrange as much as possible to segregate:
  - people with access to cash (e.g. those preparing the bank transfers / those signing the bank transfers / those with custody of petty cash) from people responsible for bookkeeping;
  - people with access to cash and bank resources from people who performing checks and reconciliations.

- Require two signatures: Ensure that two signatures are required for bank payments.

BASIC TIPS (continued)

Key Message:

Minimise petty cash floats and transactions.

Cash can be easily stolen, for example by falsifying receipts.

Keep payment in cash to a minimum, and limit the petty cash float.

Key Message:

Pay by bank transfer wherever possible.

Bank transfers have several advantages over other methods of payment:

- they allow duplicate signature control;
- they limit the risk of theft;
- they ensure that the payment reaches the intended payee if the bank account number has been properly checked;
- they ensure that the funds can be traced using bank statements.

These advantages explain why bank transfer is much safer than payment in cash.

Bank transfer is also safer than payment by cheque. Cheques can be lost or may remain uncashed for some time.

They may also make it difficult to prove payment, as the payee's name does not usually appear on the bank statement.

BASIC TIPS (continued)

Key Message:

Do not make inter-project loans.

EU funds may only be used for the action covered by the relevant agreement.

Recipients should not provide temporary advances or loans from the project's funds to other projects, including other EU funded projects.

If, for programme estimates, a Recipient intends to make temporary advances from the project's funds to another EU-funded project, he should obtain the prior approval of the relevant EU Delegation.

Key Message:

Use only safe solutions to shelter project funds.

It would be imprudent to take risks to maximise the project's financial income.

Recipients should use only safe financial arrangements that will not put project funds at risk.

Recipients are advised to:

- open bank accounts for the project only with reputable financial institutions that offer a sufficient guarantee of financial solidity;
- abstain from keeping project funds in currencies other than that of the contract or that in which the funds are spent;
- abstain from investing project funds in aggressive financial products or financial instruments that pose a counterparty risk.

TOOLS AND TEMPLATES

The following tool can be downloaded from the EuropeAid website at:

http://ec.europa.eu/europeaid/financial_management_toolkit/

FMT - MODULE 6 - BANK RECONCILIATION TEMPLATE

FMT - MODULE 6 - CASH FLOWS RECONCILIATION TEMPLATE

FMT - MODULE 6 - PETTY CASH TEMPLATES

(2 templates included)

These templates are indicative, non-compulsory examples which Recipients may adapt as they see fit.

MODULE 7 - ACCOUNTING

Real life story

The project "Human Relief and Rights" was run by a public sector organisation which had its own pre-existing accounting system. However the Recipient organisation did not open a specific code in its accounting records for project activities, as its accounting system only allowed classification of expenses by type and not by project.

The Recipient therefore decided to keep project accounting records by re-typing every expense voucher related to the project into a large set of spreadsheets.

In an interim audit of the project, the auditors found many errors in these spreadsheets, for example manual input errors (such as inverted digits), expense vouchers entered twice under different budget headings and incorrect formulae entered in the spreadsheets (leading to clerical errors).

A number of the entries in the project records related to cost allocations, but these were estimates, which the organisation was not able to support with precise, verifiable data.

The auditors reported these issues.

What happened: On receipt of the draft audit report, the EU Delegation decided to ask the Recipient to submit a corrected financial report, and suspended its payments to the project. The Recipient re-constructed the records, which resulted in a material correction to the interim financial report and to the EU payment.

WHY IS ACCOUNTING A KEY FINANCIAL MANAGEMENT AREA?

Key Message:

Reliable accounting is vital to financial management and reporting purposes.

Accounting has two basic purposes:

- to show the revenue, expenses, assets and liabilities of the project for financial management purposes;
- to provide the data needed to draw up accurate financial reports.

To meet these basic objectives, accounting records must be:

- up to date
- accurate and reliable
- drawn up according to proper accounting standards, methods, policies and rules.

The project accountant should be a competent, disciplined person trained and experienced in accounting techniques.

It is essential to keep good accounting records. Without reliable, up-to-date accounting records, it is impossible to know where the project stands in terms of its use of financial resources.

Content of this module

- ► Minimum contractual conditions.
- ► What could go wrong? Key control measures.
- ► Basic tips.
- ► Specific issue – Contributions in kind.

MINIMUM CONTRACTUAL CONDITIONS

Key Message:

Understand the Contractual Conditions.

The following summarises the main accounting requirements for EU-funded external actions managed through grants, service contracts and programme estimates.

- Grant Contracts

The general conditions of grant contracts specify that:

- Accurate and regular accounts of the implementation of the action must be kept, using an appropriate accounting and double-entry bookkeeping system (Article 16(1)).
- The accounts and expenditure must be made easily identifiable and verifiable, either by using separate accounts for the project, or by ensuring that project expenditure and revenue is easily identifiable and traceable in the Recipient's accounting system. The accounts must specifically provide details of interest on funds advanced by the Contracting Authority (Article 16(1)).
- To be eligible, costs must be recorded in the Recipient's accounting records and determined in line with the accounting standards of the country in which the Recipient is established and the Recipient's usual accounting practices (Article 14(1)(d)).
- The general conditions of grant contracts include the conditions under which costs are eligible, and give a list of costs considered ineligible (Article 14). This information should enable Recipients to distinguish between eligible and ineligible expenses in their accounting records.
- Recipients may keep their accounting records in their local currency, but in their financial reports they must use the currency specified in the special conditions (Article 3(1) of the Contract), usually the euro. Article 15(8) requires expenditure in other currencies to be converted at the average, for the reporting period, of the monthly rates published on the Inforeuro website at: http://ec.europa.eu/budget/inforeuro

MINIMUM CONTRACTUAL CONDITIONS (continued)

• Service Contracts → The general conditions of service contracts specify that:

- The Contractor must keep full, accurate and systematic records and accounts in a form and in detail sufficient to establish that the number of days and the reimbursable expenditure stated on the invoice have been duly spent on providing the services (Article 24(1)).

- The Contracting Authority has the right to conduct a full audit if necessary, drawing on the supporting documents for the accounts, accounting documents and any other documents relevant to the financing of the action (Article 15(1)).

MINIMUM CONTRACTUAL CONDITIONS (continued)

• Programme Estimates ⇒ The Practical Guide for Programme Estimates, under “Records and accounts” (Section 4.1.6) states that:

- The Recipient must keep accounting records covering the activities of the programme.
- The accounting records must consist of double-entry accounts. They must comply with generally accepted accounting principles and be kept according to the accounting rules of the beneficiary country.
- The accounts must cover all sources of finance for the programme, including resources generated by the programme itself. The accounting system must be designed to link expenditure to the source of the funds that financed it.
- The accounting system must use a software package that guarantees reliability and security.
- The Recipient must follow Annex 7 of the Practical Guide for Programme Estimates, which sets out rules on currency for each type of project and on opening bank accounts for programme estimates.

Recipients should also consult the Financing Agreement and the Technical and Administrative Provisions to check whether they contain any other specific requirements.

• Other contract types ⇒ If the action is financed by means of some other type of contract, refer to its provisions.

WHAT COULD GO WRONG? KEY CONTROL MEASURES.

What could go wrong?	Key control measures
• The accounting system may be inadequate. For example, it may not be a double-entry system.	• Practice double-entry bookkeeping. • Consider using specialised accounting software.
• The accounting records may not comply with generally accepted accounting standards. For example, asset items (e.g. recoverable advances) may be recorded directly as expenses.	• Ensure the project's bookkeeping staff are qualified and experienced in accounting.
• For grants, the Recipient may not keep the project's accounting records according to its usual accounting practices. For example, the Recipient may use accrual accounting for its normal operations but cash accounting for the EU funded project.	• For grants, be sure to use the same accounting policies and practices for the EU funded project as for all other operations.
• The accounting system may not handle foreign currencies correctly.	• If the entity or project operates in several currencies, consider using multi-currency accounting software.
• The currency conversion method or the exchange rates used may be incorrect.	• Make sure any currency conversions comply with the Contractual Conditions. Further details are given in this Module under Basic Tips. • Use InforEuro rates if required.

WHAT COULD GO WRONG? KEY CONTROL MEASURES (continued).

What could go wrong?	Key control measures
• Incorrect accounting entries may be made. Examples of incorrect accounting entries include misclassifications or ineligible expenditure being recorded in eligible expense accounts.	• Ensure journal vouchers are properly checked and reviewed by authorised persons.
• The accounts may not be kept up-do-date or long outstanding balances may not be reconciled in good time.	• Reconcile the accounts regularly. Ensure all transactions are recorded without delay.
• Actual expenditure may not be checked regularly against the budget, leading to cost underruns or overruns.	• Regularly check actual expenditure againt the budget.
• The budget may be inadequate because the activities and resources required have not been analysed thoroughly.	• Draft budgets very carefully (further information is provided in this module under Basic Tips).
• Budgets may be unrealistic or may not be based on plausible assumptions.	• Draft budgets very carefully (further information is provided in this module under Basic Tips).

BASIC TIPS

Key Message:

Use proper bookkeeping techniques!

To be able to keep proper accounting records, Recipients should pay attention to the following:

- Fundamental bookkeeping principles: If the principles listed below are not followed, there can be no proper bookkeeping:
  - the accounting records must be double-entry (debit/credit);
  - the accounting records must be based on a properly defined chart of accounts;
  - the methods used must ensure that once an accounting entry is recorded, it can no longer be altered.
- Knowledge of accounting techniques: The person appointed to keep the project's accounts must have the skills needed for the job.

  This is vital. Bookkeeping requires the use of specific tools and techniques. A person who is not familiar with these techniques will not be able to keep suitable records.
- Manual versus computerised methods: If the bookkeeper is competent and obeys the fundamental principles of bookkeeping, it is not always necessary to use computerised methods.

  However, specialised accounting software will generally allow more powerful control features than a manual system, so it is preferable to use accounting software.
- Separate versus integrated records: Recipients may opt to keep a separate set of accounts specifically for the project, or to include the project's accounts in their own accounting system.

  In the latter case, they should have a method of ensuring that the project's records are still easily identifiable.

  For example, if the Recipient has an ERP ("Enterprise Resource Planning ") system, it may identify the project operations through analytical accounting codes.

BASIC TIPS (continued)

Key Message:

Use proper accounting policies and principles.

For grants, the Contract requires the project's accounting records to be kept in accordance with the accounting principles and rules of the country of the Recipient.

For projects managed through programme estimates, the Practical Guide for Programme Estimates states that the accounting records of the project must be kept according to the accounting rules in the beneficiary country.

These accounting principles and rules generally prescribe accrual accounting.

Under accrual accounting, not every transaction is recorded in expenses. Some transactions must be recorded in the assets or liabilities accounts in the balance sheet. For example:

Examples of assets:

- Recoverable guarantees: For example, a rental guarantee paid to the landlord of the project office is recorded as an asset and not an expense because the landlord must ultimately return this amount to the project.
- Advances paid to suppliers: These are project assets because they are the property of the project until such time as the supplier has earned the right to payment by carrying out the contract.
- Advances paid to grantees or sub-grantees: These are project assets because the payments remain the property of the project until the grantee has earned the right to the grant by carrying out the contract.

Examples of liabilities:

- Retention guarantees for construction works: These are liabilities as they will have to be paid to the works contractor when the guarantee period expires.
- Amounts owed to suppliers for contracts carried out but still to be paid for.

BASIC TIPS (continued)

Key Message:

Use spreadsheets only for what they can do!

Spreadsheets are useful for a number of purposes, for example:

- preparing account reconciliations;
- preparing account analyses;
- preparing fixed asset registers, inventory registers, budgetary follow-up and other follow-up tools;
- preparing financial reports.

Spreadsheet applications are not designed for keeping double-entry accounting records. Spreadsheets can easily be changed and so do not meet the requirement that accounting entries be unalterable.

For these reasons, Recipients should not use spreadsheets for keeping the accounting records, except if used in conjunction with additional control tools which ensure the respect of the principles of double-entry bookkeeping and inalterability of the accounting entries.

Key Message:

The accounts must record any interest on advances.

For grants and programme estimates, any interest produced by advances paid by the Contracting Authority must be recorded in the accounting records and disclosed in the financial reports.

This obligation entails opening a specific account in the project's books to record the interest.

- For projects managed by means of programme estimates, accounting for interest does not pose any special problems because the projects use dedicated bank accounts.
- For grants, the use of dedicated bank accounts is not mandatory and the Contracting Authority may make payments into the Recipient's general bank account.

  Recipients should therefore draft a detailed analysis of the interest on the general bank account and calculate the share accruing to the project. They should keep this analysis in case checks are made later.

BASIC TIPS (continued)

Key Message:

The accounting records must include all transactions.

The accounting records must cover all the costs of the project, irrespective of whether they have been financed by EU funds or by funds provided by other parties.

All costs must be stated in the financial report.

- For grant contracts, the accounting records and the financial report for the project must cover not only project activities financed by EU funds, but any activities financed with funds from other donors or from the Recipient's own financial resources (e.g. under co-financing).

  The reason for this rule is that, for grants, the EU contribution is calculated as a share of the total eligible expenditure of the project.

  This means that the Contracting Authority has the right to audit the all project expenditure and not only that financed by its funds.

- For projects managed by means of programme estimates, the accounting records and the financial report must cover not only the project activities financed by EU funds, but also those financed by national contributions or by local beneficiaries.

  The accounting records must also classify expenditure according to the source of funds that financed them.

BASIC TIPS (continued)

Key Message:

Pay attention to currency rules.

At the beginning of the project, Recipients should check the Contractual Conditions to ascertain:

(i) the currency to be used in drafting the project's financial report(s);

(ii) the rules to be followed for currency conversion.

- For grant contracts, Recipients will generally record project expenses in the local functional currency. But the financial report will have to be drafted using the currency stipulated in the special conditions of the Contract, usually the euro.

  In the financial report, local currency expenses will need to be converted into euros using the average of the rates published on Inforeuro for the months covered by the relevant financial report. These can be found at: http://ec.europa.eu/budget/inforeuro (Article 15(8) of the general conditions).

  Foreign exchange losses are not eligible costs for grant contracts (Article 14(6) of the general conditions).

- For projects managed though programme estimates, the rules are set out in Annex 7 to the Practical Guide for Programme Estimates.

  Annex 7 to the Practical Guide for Programme Estimates states that payments in currencies other than that of the programme estimate must be converted at the rate applied by the bank at the time of the transaction.

- For service contracts, if the contract is in the Recipient's national currency, reimbursable expenditure denominated in other currencies must be converted at the Inforeuro rate for the month of the expenditure.

  If the contract is in euros and this is not the Recipient's national currency, reimbursable expenditure denominated in other currencies must be converted at the rate published on Inforeuro on the first working day of the month in which the invoice is dated.

BASIC TIPS (continued)

Key Message:

Use a proper chart of accounts and coding system.

Properly coding the bookkeeping entries in the accounting records makes it easier to draft financial reports. Recipients are advised to pay attention to the following points.

- Accounting classifications:

  The Contractual Conditions will always require financial reports for the project to use the same classifications as the project's budget.

  Recipients should design the chart of accounts for the project to meet this requirement.

- Segregation of eligible from ineligible costs:

  Not every type of cost is eligible. To be eligible, project costs need (i) to meet all the eligibility criteria set in the contract and (ii) not to be specifically excluded under the contractual conditions (e.g. VAT and import duties).

  Recipients should design the chart of accounts for the project to allow eligible and ineligible costs to be segregated.

- Analytical classification by funding source (for programme estimates only)

  The Guide to Procedures for Programme Estimates requires expenditure to be linked to each source of financing and each activity.

  Recipients should design the chart of accounts for the project to allow each item of expenditure to be coded according to the funding source which financed it.

- Checking account codes:

  So that the accounts are meaningfully classified, set up a method of ensuring that each bookkeeping entry is posted to the correct account.

  For example, arrange for the project's accounting entries to be approved by the project's finance manager or director.

BASIC TIPS (continued)

Key Message:

The budget is an essential control tool.

Purposes of the budget

The budget for an EU funded external action is a forecast of the costs of the objectives and activities set out in the Contract. The budget is therefore an essential part of the Contract. It is a tool for checking on implementation, and an essential part of the financial report.

Possible issues

A Recipient that does not draft its budgets well may experience the following problems:

- budget overruns, which will be considered ineligible by the Contracting Authority;
- budget underruns, which suggest that the budget was incorrect and that funds have been committed to the project that might have been better used elsewhere;
- interpretation issues, which may cause the Contracting Authority to disallow some expenditure at the financial closure stage;
- the need to request amendments to the budget during the course of the project (see below).

Key budget principles

When drafting the budget, Recipients should keep in mind some key principles:

- The budget is a tool for financial compliance. In EU funded actions, the contractually agreed budget is a compliance tool. This means that the amounts for budget categories and lines are spending limits.
- The budget is a planning and control tool. A budget helps to control expenditure by setting cost guidelines, benchmarks, estimates and criteria. It is essential that the budget properly reflects all projected expenditure in line with the activities financed by the Contract.
- The budget will be mirrored in the financial report. Actual expenditure on implementing planned and agreed objectives and activities will be presented in the financial report, and will be compared with projected expenditure in the budget.

Basic tips for a good budget

To prepare good budgets, follow the tips on the next page.

BASIC TIPS (continued)

Key Message:

Budgets need to be carefully drafted.

Tips for drafting a good budget:

- carefully examine the causal links between planned activities and projected costs. Begin by identifying activities, then list all the necessary resources in order to identify relevant qualitative and financial data.
- In a narrative document annexed to the budget, document how the projected amount for costs has been arrived at.
- Make sure that the budget is clear, transparent and comprehensive.
- Make sure the budget is realistic. If it includes too many rough estimates, it will not provide a proper tool for planning and control and there is a higher risk of over- or underestimates.
- Make sure that cost estimates are properly valued and that assumptions are plausible.
- Make sure budgeted expenditure is properly classified according to the activities in the Contract. Otherwise, overruns may occur on certain headings, which will result in ineligible expenditure.

- Ensure that all cost items are clearly defined and cannot give rise to confusion or misinterpretation about which heading and line they relate to. Ensure there is no possible overlap between different headings and lines.
- Quantify where appropriate; for example state the type and number of items to be purchased (e.g. vehicles, equipment, tools, etc), staff numbers, time required (hours, weeks, months) and measures (e.g. weight, distance, content, etc.) of resources to be consumed.
- Use appropriate cost and price data (item unit prices and costs).
- Ensure that the quantitative data budgeted are clearly defined. They should use the same measures to be used during implementation.
- Ensure that the budget uses principles coherent with the accounting policies used in the accounting records (for example, cash-based versus accrual accounting).
- Allocate costs correctly (for example, avoid including overhead-type items in direct expense lines).

BASIC TIPS (continued)

Key Message:

Obey the rules on budget changes.

There are rules on making changes to project budgets:

- ► The Recipient must submit a proposal to amend the budget in writing to the Contracting Authority. The Contracting Authority will then decide whether or not to draft an amendment to the contract (budget changes usually require a contract amendment).
- ► Some budget transfers do not require a contract amendment (see the box on the right for details).
- ► Contracts may not be amended retroactively, and there are time limits.
- ► The contingency reserve may not be used without the prior written approval of the Contracting Authority.

Cases in which a contract amendment is not required

- ► For grants, subject to exceptions the Recipient may make transfers (i) between items within the same main budget heading or (ii) between main budget headings, up to a limit of 15% of the initial amount for that main heading.

  The Recipient may make these changes directly, but must inform the Contracting Authority in writing without delay.

  The exceptions are changes to overheads and contingencies, which do require a contract amendment.
- ► For service contracts, the Contracting Authority may authorise transfers under the Fees heading and between Fees and Incidental Expenditure involving a variation of no more than 15% by means of a simple administrative decision.
- ► For projects managed by means of programme estimates, transfers between budget headings may be decided by the relevant representative of the beneficiary country (on a proposal from the imprest administrator and the imprest accounting officer). The EU Delegation must be informed of the changes, in writing, without delay.

SPECIFIC ISSUE – CONTRIBUTIONS IN KIND

The following points are important if the budget provides for non-cash contributions (“contributions in kind”):

► Contributions in kind may not be considered project expenditure and may not be financed by EU funds (except, for grant contracts, for the cost of the Recipient’s staff assigned to the project - see Article 14(5) of the general conditions for grant contracts.

► Any contributions in kind included in the budget must also be included in the financial report.

If the project relies on contributions in kind, the Recipient needs to:

► Quantify the actual value of the contributions in kind so that this value can be reported. This valuation should be properly documented. The Recipient should detail the items and quantities contributed and their actual value so that the contributions in kind can be checked.

► Record the actual value of the contributions in kind in the project’s bookkeeping records separately from project expenditure.

► Report the actual value of the contributions in kind separately from project expenditure in the financial report.

MODULE 8 - FINANCIAL REPORTING

Real life story:

The project "Farm the Desert" was implemented by a public sector body in a Middle East country.

During a check on the project's first interim financial report, the EU Delegation found that it had been drawn up using USD, instead of euros as specified in the Contractual Conditions. The financial report also used the accounting classifications used internally by the Recipient, instead of following the headings and items used in the budget for the project.

It was therefore impossible to compare the financial report and the budget.

In addition, the Contract stipulated that the project would be 40% financed by the government of the country. However, the interim financial report only covered expenditure financed by EU funds, omitting all information about the use of the government funding.

What happened: The EU Delegation asked the Recipient to re-draft its financial report and suspended payments to the project in the mean time. It took over six months to resubmit the interim financial report and have it checked by external auditors. During that time, because EU funding was suspended, the project had to be put 'on hold'.

WHY IS FINANCIAL REPORTING A KEY FINANCIAL MANAGEMENT AREA?

Key Message:

Financial reporting is a fundamental Contractual Condition.

All contracts for EU funded external actions require the Recipient to submit financial reports on the project to the Contracting Authority.

Such reports have several purposes:

- to allow the Contracting Authority to check that the funds have been used in accordance with the objectives, activities and budget agreed in the Contract;
- for interim financial reports, to inform the Contracting Authority of the progress of the activities;
- to provide the Contracting Authority with the information it needs to determine the final amount of the EU's contribution to the project.

A final financial report, covering the entire project period, is always required. Interim financial reports are also required in some cases.

Failure to submit the requisite reports may result in the Contracting Authority's terminating the contract and recovering the amounts already paid but unreported.

Content of this module

► Minimum contractual conditions.

► What could go wrong? Key control measures.

► Basic tips.

► Tools and templates.

MINIMUM CONTRACTUAL CONDITIONS

Key Message:

Understand the Contractual Conditions.

The following summarises the main contractual requirements for financial reporting in EU-funded external actions managed through grants, service contracts and programme estimates.

- Grant Contracts

The general conditions of grant contracts specify that:

- The Recipient must submit a financial report. The financial report must cover the action as a whole, regardless of which parts of it are financed by the Contracting Authority (Article 2(1)).
- The final financial report must be submitted within three months of the end of the implementation period, which is laid down in Article 2 of the special conditions of the contract (Article 2(3)).

  This deadline is extended to six months if the Recipient's headquarters are outside the country where the project is implemented.
- For grants with an implementation period of more than 12 months and where the EU financing exceeds EUR 100 000, an interim financial report must be submitted for each 12-month period and with every request for interim payment (Article 2(3)).
- The financial reports (interim and final) must be drafted using the template provided in Annex VI to the contract (Article 2(1)).
- If an expenditure verification report produced by an external auditor is not required (i.e. for grants under EUR 100 000), the financial report must be accompanied by a list detailing each item of expenditure (Article 2(1)).
- The financial reports must be reconciled with the underlying accounting records. The Recipient must draft and keep these reconciliations (Article 16(1)).

MINIMUM CONTRACTUAL CONDITIONS (continued)

• Service Contracts → The general conditions of service contracts state that:

- All invoices for fee-based contracts must be accompanied by an up-to-date financial report. The structure of the interim or final financial reports must match that of the budget, which is shown in Annex V to the Contract. The financial report must show at least the expenditure for the reporting period, the cumulative expenditure and the balance of the budget, i.e. the amount remaining (Article 26(2)).
- There is no standard template for financial reports. However, the format of the interim and final financial reports must comply with the Contracting Authority's instructions (Article 26(1)).

MINIMUM CONTRACTUAL CONDITIONS (continued)

• Programme Estimates

The Practical Guide for Programme Estimates says the following about financial reporting:

- The imprest administrator and the imprest accounting officer must submit financial reports regularly. The financial reports must show at least the financial situation, including a summary of expenditure incurred in the period in question and the balance for each budget item (see "Implementation reports" - Section 4.3).
- The final financial report must be submitted within 30 days after the end of the period covered by the programme estimate ("Implementation reports" - Section 4.3).
- In case of replenishment requests, the request must be accompanied by a "record of expenditure", which is a statement of expenditure incurred in the period concerned (for a list of the information to be included with the request see "Replenishment of the programme estimate" – Section 4.1.2 – and "Documents making up a record of expenditure" – Section 4.1.3).
- There is no compulsory template for final financial reports, but Annexes 9 and 10 provide sample templates for replenishment requests and records of expenditure.

In addition to the Practical Guide for Programme Estimates, Recipients need to consult the Financing Agreement and Technical and Administrative Provisions to check whether they contain any other specific requirements.

• Other contract types

If the action is financed by means of some other type of contract, Recipients should refer to its provisions.

WHAT COULD GO WRONG? KEY CONTROL MEASURES.

What could go wrong?	Key control measures
• Financial reports may not be drafted in accordance with the Contractual Conditions, or at all. This could cause the Contracting Authority to cancel the Contract and recover any payments already made.	• Ensure that the accounting records are kept up-to-date and that the financial reports are drafted by the deadline set in the Contract.
• There may be no trail from the financial report to the accounting records and/or to the underlying supporting documents. This could lead the Contracting Authority to recover any expenses that have not been substantiated.	• Ensure that the financial reports agree with the underlying accounting records. • Ensure there is a proper trail from the accounting records to the supporting documents.
• The financial report may not mirror the classification used in the budget. This could cause the Contracting Authority to reject the financial report.	• Ensure the financial report mirrors the classification used in the budget and allows actual-to-budget comparison.
• The financial report may not be drafted using the correct currency. This could lead the Contracting Authority to reject the financial report.	• Check which currency is stipulated in the Contract. • Ensure currency conversions follow the rules laid down in the Contract. Further details are provided in Module 7 (Accounting) under Basic Tips.
• The financial report may not cover all sources of funding for the project. This could lead the Contracting Authority to reject the financial report.	• Ensure the financial report covers all funding sources.

BASIC TIPS

Key Message:

Drafting financial reports is a must!

All contracts for EU funded external actions (except supply and works contracts) require the Recipient to submit financial reports to the Contracting Authority.

Failure to submit these reports may cause the Contracting Authority to terminate the contract and to recover any amounts already paid and not substantiated.

If the project is audited, the lack of a financial report may cause the auditors to issue a disclaimer report (declaring that it is impossible to formulate an opinion on the project's financial report).

This could result in the Contracting Authority deciding to recover any funds paid.

Key Message:

The financial report must tie in with the accounting records.

Recipients should arrange for a clear audit trail from the financial report to the accounting records and the underlying supporting documents.

If there is no proper audit trail, any auditors might declare the financial report to be unauditable. The consequences for the Recipient might be the same as if no financial report was submitted at all.

Ideally, the financial report should directly tally with the accounting records, account by account, line by line, without any addition, grouping, adjustment or omission.

If this is not possible, the Recipient should at least draft a clear reconciliation between the two. This reconciliation should be kept in the project documentation.

BASIC TIPS (continued)

Key Message:

Financial reports must mirror the classification used in the budget.

It is essential to draft the financial report using the same classifications as in the agreed budget.

This budget, annexed to the Contract, is the only budget version that matters.

For more guidance please refer to Module 7.

This requirement is vital to allow budgeted and actual expenditure to be compared.

Key Message:

Financial reports must be drafted in the correct currency.

It is essential to draft the financial report in the same currency as that used in the agreed budget, usually the euro.

The currency is specified in the special conditions of the Contract. It is the currency in which the EU contribution is denominated.

This requirement is vital to allow budgeted and actual expenditure to be compared.

Recipients must follow the rules laid down in the Contract when converting expenditure in local currency into the reporting currency.

For more guidance please refer to Module 7.

BASIC TIPS (continued)

Key Message:

Financial reports must cover all sources of project funding.

The financial report must cover the entire project and not just that part of it financed by the EU.

For grant contracts, the general conditions require that "the financial report shall cover the action as a whole, regardless of which part of it is financed by the Contracting Authority" (Article 2(1)).

It is essential to comply with this rule, as the EU grant is calculated as a share of the total eligible costs of the project.

For Programme Estimates, the Practical Guide for Programme Estimates states that the accounts must cover all activities financed by all sources of financing. It also states that the expenditure must be linked to the source of funds that financed it (see the "Records and accounts" section).

This implies that financial reports should include a statement of income and expenditure both by source of financing and as a whole.

Key Message:

Actual contributions In kind must be reported separately from project expenditure.

Contributions in kind may not be EU funded (except for the cost of the Recipient's staff assigned to projects awarded an EU grant). However, if they are included in the project budget, they must be included in the financial report.

If the project includes contributions in kind, the Recipient must:

- quantify their value;
- record their value in the financial report separately from project expenditure.

For more guidance please refer to Module 7.

BASIC TIPS (continued)

Key Message:

Financial reports must follow an appropriate format.

The format requirements for financial reports are summarised below by type of contract.

- For grant contracts, draw up financial reports in the format set out in Annex VI to the Contract. The electronic template is available at: http://ec.europa.eu/europeaid/work/procedures/implementation/grants/index_en.htm
- For projects managed by means of programme estimates, there is no compulsory format, but refer to the example in Annex 10 of the Practical Guide for Programme Estimates ("Non-exhaustive example of documents making up a record of expenditure").
- For service contracts, the Contact does not prescribe a template, but the Contracting Authority may issue case-specific instructions regarding the format.

- If no specific financial reporting format is prescribed, Recipients should at least follow the basic guidelines set out in this module. In particular:
  - The financial report should mirror the classification used in the agreed budget and should allow actual and budgeted expenditure to be compared.
  - The financial report should use the same currency as the agreed budget.
  - The financial report should cover all funding sources for the project.

TOOLS AND TEMPLATES

The following tool can be downloaded from the EuropeAid website at:

http://ec.europa.eu/europeaid/financial_management_toolkit/

FMT - MODULE 8 - FINANCIAL REPORTING CHECKLIST

Recipients are encouraged to use the Financial Reporting Checklist presented with this toolkit.

Since each project is specific, each Recipient needs to determine which questions on the checklist are applicable to its project.

Beneficiary country	A country or state outside the European Union with which the European Union has an agreed programme of cooperation.
Competitive negotiated procedure	Procedure without prior publication of a procurement notice, in which only candidates invited by the Contracting Authority may submit tenders.
Contract	The term “Contract” can refer to any conventional or contractual document (legal commitment) signed between the Contracting Authority and a Recipient which constitutes the specific legal basis for an EU funded external action. The Annexes to the Contract also form part of the Contract. There are various types of contracts for EU funded external actions: Grant, Service, Supply and Works Contracts, Financing Agreements with governments of beneficiary countries, Contribution Agreements with International Organisations and Delegation Agreements with national agencies.
Conflict of interests	Any situation influencing the capacity of a candidate, tenderer, contractor or beneficiary to give an objective and impartial professional opinion, or preventing it, at any moment, from giving priority to the interests of the Contracting Authority. Any consideration relating to possible contracts in the future or conflicts with other commitments, past or present, of a candidate, tenderer, contractor or beneficiary. These restrictions also apply to any sub-contractors and employees of the candidate, tenderer, contractor or beneficiary.
Contracting Authority	The authority concluding the contract for EU funding with a Recipient. Depending on the management mode of the external aid (e.g. centralised, decentralised, joint management with international organisations), the Contracting Authority is either the European Commission (“EC”), a partner country or an organisation to which the EC has delegated the implementation of external actions. Where the EC is the Contracting Authority, it is usually represented by EuropeAid or a Delegation of the European Union (“EU Delegation”).

Contractual Conditions	The conditions, rules, and criteria which are set out in an EU funded Contract for external actions. This also extends to the set of documents governing the action, programme or project which are referred to in the Contract. These may include, for example, the legal bases governing the financing instrument under which the action is financed (the Cotonou Agreement, the European Neighbourhood and Partnership Instrument, etc.), the Financing Agreement and Technical and Administrative Provisions signed between the EU and a beneficiary country, and guides published by the EC such as the PRAG and the Practical Guide for Programme Estimates.
EC	European Commission
EU	European Union
EuropeAid	EuropeAid Development and Cooperation, the Directorate-General of the European Commission responsible for implementing the Commission's external assistance programmes worldwide.
Financing Agreement	An agreement between the EU and the beneficiary country which sets out the objectives and scale of a future programme of cooperation.

Generally Accepted Accounting Principles ("GAAP")	Term used in the accounting profession to designate a set of accounting pronouncements, rules and practices. Examples of Generally Accepted Accounting Principles include: - IFRS ("International Financial Reporting Standards") - a set of accounting pronouncements published by the International Federation of Accountants (IFAC) for use by private companies. IFRS is often used by quoted companies. - IPSAS ("International Public Sector Accounting Standards)" - a set of accounting pronouncements published by the International Federation of Accountants (IFAC) for use more specifically by the public sector. - *"Country name"* GAAP - a set of national accounting pronouncements applicable to companies and other entities domiciled in the country named (for example, UK GAAP, US GAAP, French GAAP, etc).
InforEuro	The webpages of the European Commission where monthly exchange rates are published http://ec.europa.eu/budget/inforeuro
Key expert	In service contracts, an expert who is defined as instrumental in the Terms of Reference and who is subject to evaluation as part of the tender. A change of key expert requires a contract change.
NGO	Non-governmental organisation.
Non-key expert	In service contracts, an expert who is not defined as instrumental in the Terms of Reference and who may be approved by the Contracting Authority by administrative order.
Per diem	Fixed daily allowance to cover accomodation, meals, local travel and sundry expenses at the place of mission. The official list of per diems can be found at: http://ec.europa.eu/europeaid/work/procedures/implementation/per_diems/index_en.htm

PRAG	"*Practical Guide to Contract Procedures for EU external actions*". This guide, issued by the European Commission, sets out and explains the procurement and contracting procedures applying to EU funded external aid contracts financed from the general budget (budget) and the European Development Fund (EDF). The Guide can be found at : http://ec.europa.eu/europeaid/work/procedures/implementation/practical_guide/index_en.htm The introduction to the PRAG states its scope, i.e. what is covered and what is not covered.
Practical Guide for Programme Estimates	"*Practical Guide to Procedures for Programme Estimates financed by the European Development Fund (EDF) and the General Budget (Budget) of the European Communities (Project approach)*". This Guide, issued by the European Commission, sets out and explains the procedures applying to projects and programmes managed by means of programme estimates. The Guide can be found at: http://ec.europa.eu/europeaid/work/procedures/financing/work_programmes/index_en.htm The introduction to the Guide states its scope, i.e. what is covered and what is not covered.
Recipient	Recipient of EU funds for external actions. Recipients are organisations and entities which have signed a contract for EU funding. The Recipient of EU funds is responsible implementing the contractually agreed activities, managing and using EU funds and reporting on the use of the funds.