



## EUROPEAN COMMISSION

ENTERPRISE AND INDUSTRY DIRECTORATE-GENERAL  
INFORMATION SOCIETY AND MEDIA DIRECTORATE-GENERAL  
RESEARCH AND INNOVATION DIRECTORATE-GENERAL  
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RESEARCH EXECUTIVE AGENCY  
EUROPEAN RESEARCH COUNCIL EXECUTIVE AGENCY

# **FP7 Ex-post Audit Strategy 2009-2016**

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## 1. BACKGROUND

### 1.1. Context

The 7<sup>th</sup> Framework Programme (FP7) is characterised by a substantial increase in the budget allocated to EU-funded research activities. While boosting research in Europe, the European Commission must equally demonstrate its effectiveness in the management of this budget.

New entities have been created in order to enhance the ability to respond to the key challenges created by this new context, such as the European Research Council Executive Agency (ERCEA) and the Research Executive Agency (REA). On top of the four Research Directorate Generals (RDGs), a fifth Directorate General is being created through the separation of the energy and transport activities of the present DG TREN. Therefore, there will be 7 main entities concerned by the FP7 Ex-post Audit Strategy (5 RDGs plus 2 Executive Agencies, collectively referred to, in this document, as the 'Commission services' of the Ex-post Audit Strategy).

In addition, a number of Joint Undertakings (JU) have been established, including IMI (Innovative Medicines Initiative), Artemis (Embedded Computing Systems Initiative), Clean Sky (Air transport), ENIAC (in the field of nanotechnologies), FCH (Fuel Cells and Hydrogen Joint Technology Initiative), Fusion for Energy, and the SESAR Consortium (Single European Sky ATM Research). Furthermore, the European GNSS Agency (GSA, in the field of navigation satellite systems) also manages grants covered by FP7 funds. These bodies should have their own Ex-post Audit Strategy, which has to be harmonised, under their own responsibility, with the Commission's.

Finally, the Commission participates in two 'Article 169' initiatives (Eurostars and EMRP, respectively in the fields of research-performing SMEs and of metrology) managed through a delegation of executive tasks to a dedicated implementation structure. These initiatives fall outside the "normal" audit population covered by this Strategy. The respective Delegation Agreements clearly define the extent to which the External Audit functions can intervene in these entities' proceedings.

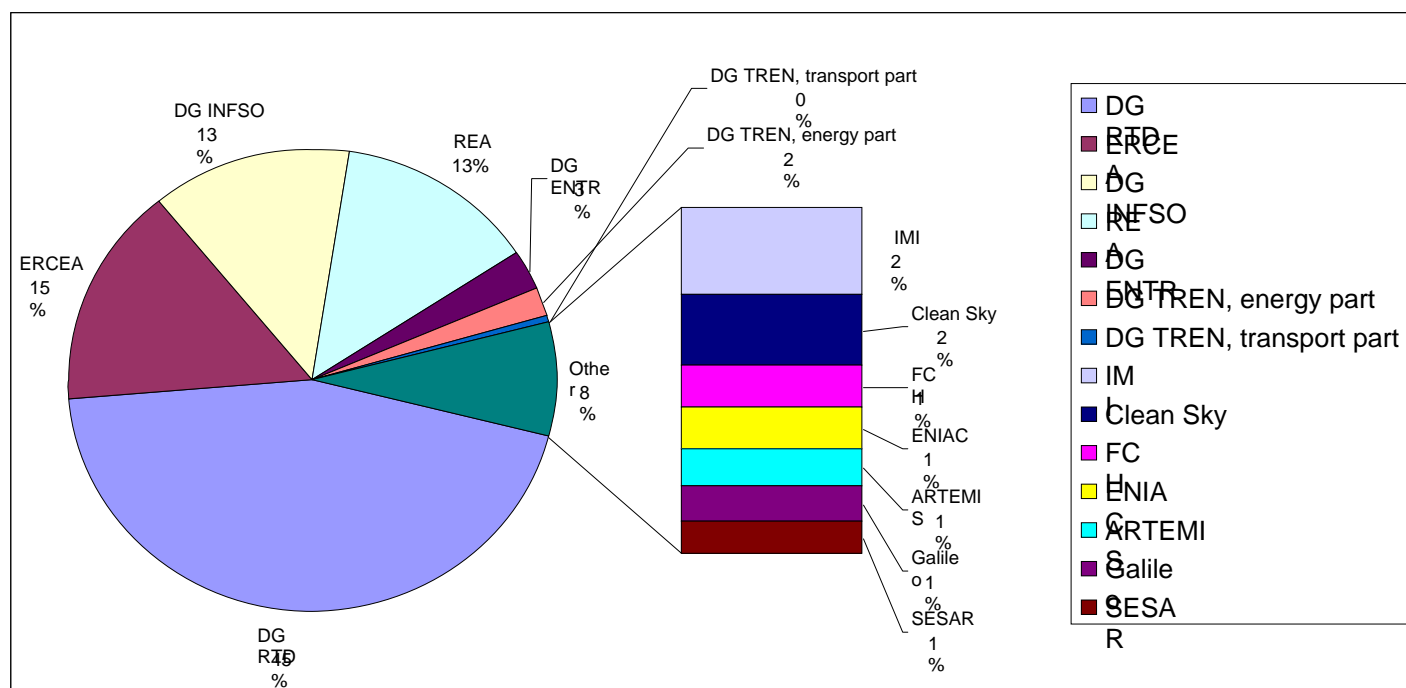
All the above-mentioned bodies<sup>1</sup>, which address emerging challenges in specific research fields, run their own budget and are responsible for its correct implementation. Whilst this decentralised approach certainly favours a targeted budget execution, it obviously requires alignment of the RDGs' and Executive Agencies' external audit functions and strategies to guarantee a corporate Commission approach on planning, interpretations of rules, relations with beneficiaries or the management information to be provided, to name but a few examples.

The current document presents the Ex-post control Audit Strategy related to the Commission's services, and needs to be seen in the wider context of the internal control systems which are already in place within each of them, where the focus remains intentionally very much on ex-post controls in order to simplify the beneficiaries' burden in providing evidence before payments are made.

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<sup>1</sup> With the exception of the Article 169 initiatives for which the Director General maintains its role of Authorising Officer by Delegation.

Here is an FP7 budget breakdown which provides an overview per entity:



**FP7 Budget break-down in M€**

	in M€	% of total budget
<b>DG RTD</b>	21,632	44.7%
<b>ERCEA</b>	7,510	15.5%
<b>DG INFSO</b>	6,508	13.5%
<b>REA</b>	6,496	13.4%
<b>DG ENTR</b>	1,192	2.5%
<b>DG TREN, energy part</b>	989	2.0%
<b>DG TREN, transport part</b>	212	0.4%
<b>Subtotal: RDGs + Executive Agencies</b>	<b>44,539</b>	<b>92.1%</b>
<b>IMI</b>	974	2.0%
<b>Clean Sky</b>	782	1.6%
<b>FCH</b>	470	1.0%
<b>ENIAC</b>	442	0.9%
<b>ARTEMIS</b>	412	0.9%
<b>Galileo</b>	400	0.8%
<b>SESAR</b>	350	0.7%
<b>Subtotal: JUs</b>	<b>3,830</b>	<b>7.9%</b>
<b>TOTAL</b>	<b>48,369</b>	<b>100%</b>

## 1.2. Main changes from FP6

The most important change in FP7 from FP6 which has a direct impact on the ex-post control auditing activities is that the average length for financial reporting periods has

increased from 12 to 18 months. Consequently, projects will become auditable later than in FP6, and this has already had a delaying effect on the launching of the FP7 audit campaign. This also affects the number of auditable cost statements at any given point in time, although it is in turn counter-balanced by the increase in the overall number of projects and in the expected size of the auditable population(s).

In terms of the audit certificates, FP7 has introduced three further notions as follows:

- Beneficiaries who have applied for and received the Certificate of Methodology for direct and indirect costs (CoM) will not have to present certificates on financial statements on the periodic financial statements. In case of an approved CoM, a certificate on financial statement will only be necessary with the final financial statement for the project (if the cumulative reimbursement claimed is over € 375.000).
- Beneficiaries who received a Certificate on Methodology for average personnel costs (CoMav) may apply average rates when preparing their cost claims. This is because these average rates are deemed not to significantly differ from actual costs. On the other hand, those beneficiaries who are not certified may nevertheless declare average personnel costs provided their average personnel cost methodology complies with the cumulative criteria laid down in the Commission's Decision of 24 January 2011 laying down simplification measures related to the seventh Framework Programme.
- In addition, non-CoM beneficiaries (CoMav and others) are only required to submit certificates on financial statements when the EC contribution is greater than or equal to € 375.000 as a cumulative figure for all previous payments to a beneficiary (within a given project) for which a certificate on financial statement has not been submitted.

This simplification implies that a large portion of auditable transactions may not be subject to any kind of certification. A simulation run on a population of FP6 contracts shows that 82% of the participations receive EC contributions below €375.000.

Furthermore, the current rules in indirect actions to ensure consistent verification of the existence and legal status of participants, and their operational and financial capacities, foresee that, as protection measure against participants considered as "weak", the Commission reserves the right to systematically initiate a financial audit during the implementation of the relating FP7 indirect action, which may be accompanied if necessary by a technical audit, carried out by the Commission services (including OLAF), or its duly authorised representatives, or by the Court of Auditors under a series of conditions.<sup>2</sup>

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<sup>2</sup> Commission Decision C2007/2466 of June 13<sup>th</sup> 2007, Rules to ensure consistent verification of the existence and legal status of participants, as well as their operational and financial capacities, in indirect actions supported through the form of a grant under the Seventh Framework Programme of the European Community for research, technological development and demonstration activities (2007-2013) and under the Seventh Framework Programme of the European Atomic Energy Community (Euratom) for nuclear research and training activities (2007-2011), point 4.2.2, p.20.

The FP7 Ex-post control Audit Strategy takes note of this Decision and acknowledges that audits of this type will be carried out on the basis of specific and properly justified requests from the AOSDs<sup>3</sup>, which take the specific risks for the contractor into account, on an ad hoc basis, and following when applicable the standard "audit on request" procedure.

The lifetime of the Seventh Framework Programme is 2007 to 2013, but auditing activities will most likely extend to at least three years after the conclusion of the programme. The scope of this document is therefore the period 2009-2016. However, revisions will take place as appropriate if the environment changes significantly.

## **2. OBJECTIVES**

The main overall objectives of this Strategy are:

- (1) Assess the regularity and legality of financial transactions under FP7 and provide input to the Annual Declaration of Assurance of the respective Authorising Officers by Delegation, and in this context:
  - Ensure the cost-effectiveness and coherence of auditing efforts through efficient co-ordination between all Commission services, and
  - Achieve a number of quantitative targets, to be set by each Commission service (see Annex I)
- (2) Provide the basis for corrective and recovery mechanisms in place as part of the respective internal control systems of each Commission service, and in this context:
  - Provide feedback on potential corrective actions to the relevant internal procedures of both the Commission and of beneficiaries, based on the analysis of audit findings, and
  - Improve awareness within the population of research funding beneficiaries of the regulatory framework within which they operate, with an emphasis on sound project cost accounting.

It is important to note that ex-post controls alone cannot by themselves deliver the objectives of the wider internal control systems in place. In particular, they cannot reduce error rates or ensure that they achieve certain values. They have to be seen as a complement to ex-ante controls and other measures, such as raising awareness and producing guidelines, which have a 'pedagogical' impact on beneficiaries. In addition, the effect of audit adjustments and the correction of systematic errors by extrapolation depend on other segments of the internal control system and cannot be ensured by the ex-post audit function alone.

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<sup>3</sup> Authorising Officer by Subdelegation.

In the sequence of controls, the Ex-post Audit Strategy comes at the end of the research funding cycle. This being said, the Ex-post Audit Strategy is a key control of the overall FP7 internal control system, besides other (ex-ante) controls (for example: certificate of financial statements, certification of methodology, etc. of the other phases of the research funding process (e.g. calls for proposals, proposal selection, grant agreement management, recovery mechanisms after audit)). Furthermore, the implementation of the audit adjustments and the correction of systematic errors through extrapolation involve other actors of the research funding process (i.e. project officers, authorising officers ...) and cannot be credited to the ex-post auditing activity.

Moreover, the FP7 Audit Strategy cannot be looked at in isolation. It also builds on the immense experience obtained from the audits carried out as part of the FP6 audit campaign and their results and findings. In that sense, an important 'pedagogical' effect has already been achieved, and this lays the basis of the Commission's future collaboration with many contractors.

The Ex-post Audit Strategy requires a series of specific actions and associated tools which will be used in order to attain the overall objectives set out above. A synthesis is provided in the following table:

<b>What the AS has to respond to:</b>	<b>Audit (and/or system) tool</b>
Provide a representative error rate.	Representative audit sample (section 3.1).
Provide appropriate ex-post audit coverage and initiate the 'cleaning' of a significant part of the budget from systematic material errors.	Target beneficiaries representing at least 50% of the budget, and implement the extrapolation of systematic errors after audit when appropriate. The figure of 50% comprises both amounts audited (direct audit coverage) and non-audited amounts of audited beneficiaries clean from systematic errors (indirect coverage).
Provide assurance for specific portions of research budgets, such as the Fusion programme, or the Research Fund on Coal and Steel (which is not part of FP7).	Specific samples on the appropriate populations.
<b>Where the AS can contribute:</b>	<b>Audit (and/or system) tool</b>
Contribute to financial/technical audits.	Pilot-projects of financial/technical audits are ongoing. The value-added of this approach is yet to be established. As a consequence, a more specific approach will need to be developed as a complement to this Ex-post Audit Strategy.

Contribute to the prevention and detection of the risk of fraud and irregularities (e.g. plagiarism, double funding...).	Define risk profiles. Risk based audits, Audits on request.
Contribute to the assurance on CoM and CoMav beneficiaries.	Specific audit programme for certified beneficiaries.
Contribute to reasonable assurance in the case of beneficiaries with a cumulative EU support of less than €375.000, given their specific risk profile <sup>4</sup> .	Identify risk factors. Perform regular risk analyses on the population of beneficiaries. Perform risk based audits and audits on request.

### 3. AUDIT TOOLS

The objectives mentioned above will be achieved in practice through conducting ex-post audits to the highest professional standards, and collecting, analysing and disseminating their results. Depending on their nature and purpose, audits will be grouped essentially into two categories: representative audits, which contribute towards an error rate representative for the whole population, and corrective audits. Both will obviously lead to recoveries or similar.

#### 3.1. REPRESENTATIVE audits

Building on the experience of auditing FP6, and on an ongoing endeavour to enhance the representativity of samples, FP7 representative audits will be conducted on the basis of representative samples with the following characteristics:

- One common representative sample for the whole research family every two years, with a single representative error rate.
- Sampling will be done on a population consisting of all cost statements (not beneficiaries, as was the case in FP6) received by all the Research Commission services since the date when the previous common sample was taken and up to the date when a new sample is prepared.
- The monetary unit sampling (MUS) technique will be used for selecting the cost statements (on the basis of the EC-share of the amount claimed) to be audited<sup>5</sup>.
- Contrary to FP6, there will be no stratification of the population, i.e. the samples will be taken on the whole population.

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<sup>4</sup> This objective has been underlined in the IAS Report on DG RTD's and DG INFSO's Internal Control Systems for managing the 7<sup>th</sup> Framework Programme (Design – Final report – Recommendation 7 on "Reinforcing the control strategy").

<sup>5</sup> Details on the MUS – parameters can be found in the relevant Annex.



The ongoing results of audits on those cost statements in the sample at a given point in time will provide interim common representative error rates<sup>6</sup>. Representative error rates will, in turn, be the starting point for the calculation of separate residual error rates by each Commission service (see Annex II for formula and calculation method).

All these characteristics, together with the sampling methodology to be used, are discussed in more detail in Annex III. It is important to note the crucial role that effective and efficient co-ordination across all Commission services will play in the implementation of this common sampling approach and, consequently, in the ability to provide statistically representative error rates.

The working group with the Court of Auditors will continue to compare error rate calculation methods in use at both institutions.

### **3.2. CORRECTIVE audits<sup>7</sup>**

All audited cost statements which are not part of the representative sample will be part of this corrective strand. The scope is deliberately very wide to provide Commission services with enough flexibility to target the portions of their budgets where corrections to the errors detected can be most effective (highest contribution beneficiaries, highest contribution participations, high-risk beneficiaries...).

This part lists all categories of beneficiaries not covered by the representative audits:

#### **APPROACH FOR TOP BENEFICIARIES**

For the top beneficiaries, the main purpose is 'cleaning' at least 50% of the budget from systematic material errors through audit and extrapolation. Yet, if for non-top-beneficiaries systematic material errors would equally be identified, extrapolation would also apply. This being said, with the focus on top beneficiaries, the audit coverage will be important and the effect on the residual error rate high. Within the context of this Ex-post Audit Strategy, it is agreed that at least 9 cost reporting periods in three different FP7 participations will be audited before concluding that for a given beneficiary no systematic material errors are present in the whole portion of the budget that they receive. It is to be noted that cost statements of top beneficiaries may also be selected as part of the representative sample, as a consequence of the MUS sampling method.

#### **APPROACH FOR BENEFICIARIES WITH SPECIFIC RISKS**

For this type of beneficiaries, without being exhaustive, a number of objectives can be listed:

- Reduce the risk of frauds and irregularities (through a specific programme and methodology for conducting risk-based audits, taking into account professional

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<sup>6</sup> The representative error rate will also be calculated for its two components: a systematic error rate and a non-systematic error rate.

<sup>7</sup> It must be noted that errors detected in the participations audited as part of the representative sample will also lead to corrections.

standards, as ISA 240<sup>8</sup>, and best practices). In this context, the RDGs are also committed to intensifying their fraud prevention and detection strategies. This will imply communication among RDGs on preventing, detecting and combating fraud and irregularities (through the FAIR committee), the use of advanced data-mining tools among RDGs and, when relevant, joint audit teams to globally assess a beneficiary.

- Audit specific populations not sufficiently covered by representative audits and/or TOP which might present specific risks (e.g. 'small' beneficiaries with a cumulative EU contribution less than €375.000; entities with a high dependency on EU-funds; beneficiaries with an important error rate in previous FPs; specific programmes with a specific design and modalities for EU funding such as the Marie Curie actions; etc.). For a number of these specific populations, there will be a corporate approach; for the remainder the RDGs will apply their own risk analyses.
- Follow-up audits to monitor the extrapolation of audit results (see section 4.3). These beneficiaries represent a specific risk, for instance when the revised cost statements submitted after an audit are not in line with the results of the audited cost statements.
- To allow for certain specific commitments and population peculiarities to integrate easily within the overall strategy (such as the FUSION programme or the Research Fund for Coal and Steel<sup>9</sup>).

The implementation of audit results (i.e. their detection and initiation to recovery) will result in a reduction of the amount of error present in the budget(s), as reflected by the 'residual error rate'<sup>10</sup>. Under this corrective strand, and based on FP6 experience, it must be clear that moving from the detected error rate to the residual error rate on the audited participations only has a marginal effect. This underlines the importance of extrapolation, which can have a substantial effect on the decrease of the detected error rate in view of the large number of non-audited participations covered.

It is important to note that non-systematic errors in the non-audited population cannot be corrected. Given their very nature, there can be no systematic approach to removing them. The error rate calculation will however track the incidence of non-systematic errors. If the incidence of non-systematic errors is found to be important, the 'cleaning' of systematic errors from a larger part of the population will have to be intensified in order to have a better chance of lowering the residual error rate.

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<sup>8</sup> International Standard of Auditing n° 240: "The auditors' responsibility to consider fraud in an audit of financial statements."

<sup>9</sup> It must be noted, however, that the Research Fund for Coal and Steel is not part of FP7.

<sup>10</sup> The residual error rate formula does not reflect the effectiveness of the corrective and recovery mechanisms since the formula does not distinguish between the amounts already recovered and not yet recovered.

### **3.3. Joint audits (technical and financial)**

The FP7 audit campaign may include joint audits in which not only financial but also scientific aspects are considered. There may also be cases where only the scientific aspects are looked at. These audits will be done in collaboration with operational services and/or external experts<sup>11</sup>.

The RDGs are currently gathering their first experiences on this type of audits, which are often generated on specific request of the operational service if doubts occur with regard to the scientific/technical deliverables or as a follow-up to previous financial audit findings. Pending the outcome of these pilot-audits, they may gain importance in the course of implementing the FP7 Ex-post Audit Strategy.

### **3.4. Resources (in-house and externalised)**

As indicated in the objectives, all Commission services should achieve a number of quantitative targets while ensuring the cost-effectiveness of auditing through strong coordination efforts. The FP7 audit campaign will continue the trend started in FP6 of increasing the proportion of audits carried out directly by Commission auditors, whilst maintaining the proper balance between in-house and external expertise according to available resources and cost-effectiveness considerations. Experience has shown that an objective of 20% of audits done by in-house auditors should be feasible. Given the total number of audits undertaken for the implementation of this Ex-post Audit Strategy, the Commission services believe that this percentage is acceptable.

Overall, the RDGs consider that current human and financial resource levels are adequate for achieving the objectives of this Strategy.

### **3.5. IT tools**

A number of collaborative IT tools are currently in place which reinforce co-ordination efforts across the Commission services and with JUs, in particular in the areas of extrapolation (SAR-EAR) and planning co-ordination (SAR-PAA). The SAR-Wiki, introduced in 2008, is now widely used for sharing audit results, and it will continue to be useful during the FP7 audit campaign. A number of local IT tools already in place will remain and support the practical implementation of this Strategy.

## **4. PRINCIPLES**

### **4.1. Efficient co-ordination and harmonised approach towards beneficiaries**

Considering the number and variety of Commission services responsible for the implementation of FP7 and the fact that part of the population of research beneficiaries is common, an efficient use of resources will be paramount in achieving the objectives of this Strategy through taking advantage of the many opportunities for synergies. An

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<sup>11</sup> In DG RTD, a specific methodology has been developed and is currently subject to pilot audits.

essential element of efficient co-ordination efforts will be to avoid unnecessary duplication of audit efforts. In the context of corrective audits, Commission services agree to the principle of not auditing common beneficiaries multiple times if relevant and appropriate audit results exist beforehand while bearing in mind that, for the representative sample, no possibilities for partial implementation of the sample or for substitution exist. Results will need to be shared and common positions will need to be taken vis-à-vis beneficiaries. It is for all these reasons that strong, ongoing and pro-active co-ordination efforts will be very much needed in order to make the implementation of this Ex-post Audit Strategy a success.

A number of co-ordination groups were already set up as part of the implementation of the FP6 Strategy, and they will continue operating for FP7, although some changes will be needed to accommodate the increase in the number of Commission services. Indeed, given the increase of services, the different groups will obtain defined mandates.

- (1) The CAR (Coordination group for external Audit in the Research family)
- (2) The ESC (Extrapolation Steering Committee)
- (3) The SAR (Sharing Audit Results)
- (4) Monitoring of External Audit Firms (MASR meetings)
- (5) FAIR Fraud and irregularities committee (not specific to a programme)
- (6) Joint Assessment Committee (JAC) for the analysis of the certificates on methodologies (both CoM and CoMav)
- (7) The Research Clearing Committee, involving senior officials from all the Commission services responsible for the implementation of indirect actions under the Seventh Framework Programme, will remove inconsistencies in the application of the rules on research funding.

Efficient and effective co-ordination and a harmonised approach towards common beneficiaries being a cornerstone of this Ex-post Audit Strategy, there needs to be an escalation mechanism for issues resulting from conflicting interests which cannot be resolved at the level of the above-mentioned groups. The arbitrating system is such that if any of the groups has an issue which it is unable to resolve, it should refer it to the CAR.

Unilateral initiatives outside the scope of the Ex-post Audit Strategy should be avoided.

## **4.2. Cost methodology certification**

FP7 has introduced the Certificate on the Methodology for personnel and indirect costs (CoM) and the Certificate for average personnel costs (CoMaV).

### **a) The CoM**

Aiming at simplifying and reducing the administrative burden for beneficiaries, those who receive approval from the Commission on their CoM

will not have to submit audit Certificates on the Financial Statements for interim payments. In addition, the final Certificate on the Financial Statements will be prepared by auditors by verifying the compliance with the declared methodology as described in Part I of the Guidance Notes for Beneficiaries and Auditors (for the other costs (such as travel, equipment, etc), the actual costs rule applies). This adds simplification to the procedures foreseen in Form D and performed by the auditor.

In the case of beneficiaries who have an approved CoM for both personnel and indirect costs, audit procedures should be limited to the assessment of the correct application of the certified methodology. The 'system' part of this audit would involve confirming whether the certified methodology was correctly applied. Any audit adjustments would then be limited to discrepancies in cost categories other than direct labour and overheads. The resulting audit report will be referred to the JAC, so that it can evaluate any findings and decide on further steps to be taken towards the beneficiary. Up to that point, pending the JAC decision, any findings relating to the certified methodology will not have any effect on the error rate.

The CoM, once approved, is intended to be valid throughout FP7.

#### **b) The CoMav**

With reference to the Certificate for average personnel costs, i.e. the CoMav, the legislator has foreseen the possibility to declare average personnel costs if a series of acceptability criteria are fulfilled<sup>12</sup>. For completeness, it is worthwhile recalling the acceptability criteria according to Article 1 of this Commission Decision:

*"The Commission adopts the following acceptability criteria, for the assessment of the certified average personnel costs methodologies submitted in accordance to article II.14.1 and to Annex VII of the Grant Agreements:*

- *Methodologies in which, for each personnel category, the difference between the average rate and the extreme values (upper and lower rates) is equal or below 5%: the methodology is acceptable.*
- *Methodologies in which, for any personnel category, the difference between the average rate and the extreme values (upper and lower rates) is above 25%: the methodology is not acceptable.*
- *Methodologies not fulfilling the first criterion and in which, for each personnel category, the difference between the average rate and the extreme values (upper and lower rates) is equal or below 25%: only methodologies applied by beneficiaries having*

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<sup>12</sup>Commission Decision C/2009 4705 final of 23/06/2009 on the adoption of interim implementing rules for the provisions of article 31.3 of the Regulation (EC) No 1906/2006 and 30.3 of the Council Regulation (Euratom) No 1908/2006 concerning average personnel costs, and article II.14.1 of the model Grant Agreement adopted on 10 April 2007 and article II.14.1 of the model Grant Agreement for 'frontier' research actions adopted on 16 April 2007 in the context of the implementation of the Seventh Framework Programmes of the European Community (2007-2013) and the European Atomic Energy Community (2007-2011) concerning ex-ante certification of the methodology of calculation of the average personnel costs.

*participated in at least four Sixth Framework Programme projects with an EC contribution<sup>13</sup> in each of them equal or above EUR 375.000 or four Seventh Framework Programme projects with an EC contribution<sup>14</sup> in each of them equal or above EUR 375.000 are acceptable."*

According to the FP7 grant agreement provisions, if a beneficiary's average personnel cost methodology has been certified and approved by the Commission, "the average personnel costs charged are deemed not to differ significantly from actual personnel costs"<sup>15</sup>. Accordingly, personnel costs charged on the basis of methodologies approved by the Commission will not be subject to financial adjustments and the subsequent application of liquidated damages unless an inappropriate use of the methodology is identified by the Commission.

Obviously, from an ex-post audit point of view, the implications of the existence of the certificates on average personnel costs are wide and need to be taken into consideration. In particular, it is necessary to determine the audit approach towards those beneficiaries. This audit approach has been determined in an audit programme consisting of three parts and which requires the auditor to deliver an opinion on each of the following issues:

1. Whether the methodology applied by the beneficiary to charge average personnel costs is the one certified.
2. Whether the certified methodology operates effectively.
3. Whether the certified methodology is applied in an appropriate manner<sup>16</sup>.

On the last point, the system audits referred to under section 3.3(a) will provide the elements to calculate an overall deviation between the average personnel costs charged and the actual personnel costs. The resulting audit report will be referred to the JAC so that it can evaluate any findings and decide on further steps to be taken towards the beneficiary. Up to that point, pending the JAC decision, these findings will not have any effect on the error rate, since "the average personnel costs remain deemed not to differ significantly from actual personnel costs". Audit adjustments on categories of costs other than direct labour will be implemented in the normal manner, i.e. directly with the beneficiary.

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<sup>13</sup> In this context, EC contribution is defined as the Community financial contribution allocated to the beneficiary in the estimated breakdown of the budget and Community financial contribution as approved by the Commission in Annex I of each individual FP7 research contract.

<sup>14</sup> In this context, EC contribution is defined as the Community financial contribution allocated to the beneficiary in the table of the estimated breakdown of the budget and Community financial contribution as approved by the Commission in Annex I of each individual FP7 research grant agreement.

<sup>15</sup> Article II.14.1 of the model Grant Agreement adopted by Commission Decision of 10 April 2007 (C(2007)1509) and Article II.14.1 of the model Grant Agreement for "frontier" research actions adopted on 16 April 2007 (C(2007)1625).

<sup>16</sup> Article 4 of the Commission Decision C/2009 4705 final.

Within the context of the simplification of the Seventh Framework Programme, the Commission Decision of 24 January 2011 laid down simplified cumulative criteria for the acceptance of average personnel cost methodologies without the need for the aforementioned certification. These criteria read as follows:

- (1) The average personnel costs methodology shall be the one declared by the beneficiary as its usual cost accounting practice; as such it shall be consistently applied to all indirect actions of the beneficiary under the Framework Programmes;
- (2) The methodology shall be based on the actual personnel costs of the beneficiary as registered in its statutory accounts, without estimated or budgeted elements;
- (3) The methodology shall exclude from the average personnel rates any ineligible cost item as defined in Regulations (EC) No 1906/2006 and the model Grant Agreements established by Decisions C(2007) 1509 and C(2007) 1625 (hereinafter "the model Grant Agreements") and any costs claimed under other costs categories in order to avoid double funding of the same costs;
- (4) The number of productive hours used to calculate the average hourly rates shall correspond to the usual management practice of the beneficiary provided that it reflects the actual working standards of the beneficiary, in compliance with applicable national legislation, collective labour agreements and contracts and that it is based on auditable data.

The FP7 model Grant Agreements and the standard audit programme have been modified accordingly.

FP7 beneficiaries found to have charged average personnel costs without the average personnel cost methodology being approved by the Commission and without the average personnel cost methodology complying with the aforementioned criteria will be subject to a standard audit comparing costs charged with actual costs. Deviations from actual costs will be reported for relevant corrections including the application of extrapolation.

### **4.3. Extrapolation**

Extrapolation was a key element of the FP6 Ex-post Audit Strategy because it contributed significantly to the removal of systematic errors from non-audited contracts of a given beneficiary and, in turn, to a significant decrease from the representative error rate to the residual error rate. This will continue to be the case in FP7. Its implementation

relies on beneficiaries preparing and submitting revised cost statements from which the effect of any systematic error(s) detected in audits has been eradicated<sup>17</sup>.

Extrapolation is operational since the end of 2007 and has been formally integrated across RDGs as from February 2008. This Ex-post Audit Strategy foresees no changes on how it will be applied in FP7, namely:

- Across Commission services and for all FP7 projects a beneficiary participates in, both open and closed.
- Only after discussion and agreement in the ESC, taking due account of materiality and cost-effectiveness considerations.
- Follow-up audits may be undertaken in order to check if extrapolation has been correctly applied by beneficiaries. In case of refusal by the beneficiary to co-operate, a reminder letter will be sent. Subsequently the possibility to suspend the payments will be considered by the AOD.

It must be noted that the responsibility for the implementation of extrapolation results is ultimately held by the Authorising Officers.

Besides the establishment of the debts resulting from the submission of revised cost statements from which the effect of any systematic error(s) detected in audits has been eradicated, the Commission's Communication SEC(2009)1720 introduced the alternative possibility to establish the debts following an extrapolation of systematic errors in non-audited projects on a flat rate basis.

#### **4.4. Cost-effectiveness**

Ex-post auditing activities will be conducted at all times with due regard to cost-effectiveness.

However, it is not always easy or straightforward to ascertain the cost-benefit achieved by each ex-post audit. Some of the benefits of auditing are not easily quantifiable as they are strictly qualitative, such as the 'ripple effect' that an audit can have on other participants of an audited project or on non-audited projects of an audited beneficiary, even in non-extrapolation cases. Awareness amongst beneficiaries that there is a real possibility that they could be audited at some point can also act as a deterrent. Measuring such benefits is practically impossible.

In addition, in many cases the apparent cost inefficiency of an individual audit has to be considered in the context of achieving the overall objectives of the Ex-post Audit Strategy as a whole. For example, an audit in a representative sample might not appear

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<sup>17</sup> Although there is no explicit legal basis for extrapolation, the legal basis for extrapolation under FP7 is identical to the one in FP6. It can be found in recitals 18 and 20 of the rules of participation Regulation 1906/2006 of the EP and the Council which refers to the protection of the financial interests of the Community. Furthermore, the legal basis is provided by the Model GA, II.5.3 d, (suspension of payments) and Art.II.22.8 (protection of the Communities' financial interests), II.24 (liquidated damages) and II.21 (reimbursement to the Commission and recovery orders).



very cost-effective by itself, but it is to be carried out in order not to compromise the sample and collect statistically-representative error rates (see Annex III).

All Commission services will exercise their best professional judgement in considering all variables in each case.

#### **4.5. Indicators**

An effective Ex-post Audit Strategy needs to be complemented with the specification of a number of performance indicators that will help to assess over time whether specific targets and objectives are being achieved. Furthermore, the quantitative results of ex-post auditing will need to be reported on a regular basis for a variety of audiences, both internal and external.

The reporting format for indicators to be used throughout the FP7 audit campaign can be found in Annex I, together with a number of quantitative targets which can be set from the outset.

#### **4.6. Co-operation with the European Court of Auditors (ECA)**

Commission services will co-ordinate and co-operate as much as possible in their auditing efforts with the ECA. This collaboration will cover in particular:

- Exchange of planning information.
- Joint audits (when appropriate).
- Follow-up of ECA results and sector letters.
- The RDGs will continue their efforts to reconcile the methodologies of the Court of Auditors and their own to the extent allowed by their different institutional mandates.

#### **ENCLOSURES**

**ANNEX I: INDICATORS PER COMMISSION SERVICE**

**ANNEX II: CALCULATION OF THE RESIDUAL ERROR RATE**

**ANNEX III: SAMPLING METHODOLOGY**