

Guidelines

for

**Sound Financial Management and
Control according to Art. 4 of Commission
Regulation (EC) No. 438/2001 (“First Level Control”)**

**of service type Structural Funds projects (studies, consultancy
services, networks, Technical Secretariats),
characterized by a high share of personal costs**

**especially within the Community Initiative Programmes
INTERREG IIIB and C, INTERACT and ESPON**

Version 09/2004

This guideline was originally elaborated in German to assist Austrian project partners participating in the Community Initiative Programmes INTERREG IIIB and C and ESPON by trying to answer frequently asked questions concerning accounting and control specific for these programmes and, thus, to facilitate a proper financial management of these programmes in Austria.

The English version (in which specific reference to Austrian legislation was omitted) was produced with the assistance of the INTERACT Secretariat and serves as an official guideline for projects within the INTERREG III network programme INTERACT.

This guideline, however, is not necessarily limited to Austria or the INTERACT programme. It is an attempt to contribute to the development of a common understanding of the state-of-the-art of sound and efficient financial management of cooperation programmes in the EU. If project partners or control authorities in other EU member countries involved in such programmes find it helpful, they are invited to use it for their own orientation.

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1. WHO IS RESPONSIBLE FOR THE PROPER FINANCIAL MANAGEMENT? WHAT HAS TO BE TAKEN INTO ACCOUNT IN THE CASE OF CONTRACTS IN WHICH RESPONSIBILITIES ARE TO BE SHARED OR ASSIGNED TO SUBCONTRACTORS?

Basically, it is the Commission who is responsible for the proper use of funds from the EU budget vis-à-vis the European Parliament. In the case of Structural Funds, however, the Commission shares this responsibility with the Member States. This requires joint rules of the games which are provided by the regulations of the Council and the Commission as well as by the respective programming documents.

The primary legal reference for the EU Structural Funds is Council Regulation (EC) No. 1260/1999 (hereinafter: General Regulation) laying down the general provisions for the Structural Funds. This regulation defines the following responsibilities:

- Institutions (public and private) responsible for the “operation” (= within the scope of co-financed projects and activities) are called “final beneficiaries” (Art. 9 lit. k and l of the General Regulation). However, according to EU, in the case of aid schemes, the bodies granting aid are also called final beneficiaries
- According to Art. 34, the Managing Authority as defined in Art. 9 lit. n of the General Regulation is responsible for the proper execution of the Programme
- The Paying Authority (Art. 9 lit. o as well as Art. 32 of the General Regulation) receives the EU funds paid out by the Commission, transfers them to the final beneficiaries according to the institutional rules of the Member State and programme and submits, based on certifications of expenditure, applications for further payments of funds to the Commission
- Pursuant to Art. 38 of the General Regulation, Member States are responsible for the proper management and financial control of the Structural Funds programmes

Further details on the administration and control systems for the management of EU Structural Funds are set out in Council Regulation No. 438/2001:

- Art. 2 (2) acknowledges the existence of “intermediate bodies” – as practiced in many Member States – that serve as a link between the Managing Authority and/or the Paying Authority and the final beneficiaries and which assume some of the tasks of the Managing Authority and/or Paying Authority
- Art. 4 defines that the management and control systems established by the Member States must guarantee that procedures are carried out to verify –
 - the actual delivery of the products and services co-financed,
 - the correctness of the expenditure claimed,
 - compliance with the provisions of the relevant legislation (in particular, the rules on the eligibility of expenditure for support from ERDF). This level of control has come to be referred to as “First Level Control” (to differentiate it from the system of checks pursuant to Art. 10 of Council Regulation 438/2001 – see below)
- Pursuant to Art. 7, the management and control systems must include a sufficiently transparent “audit trail”, which guarantees the full traceability of the payments for which a certification of expenditure is presented by the Paying Authority to the European Commission and the individual receipts relating to said co-financed expenditure
- The Paying Authority must satisfy itself that the Managing Authority and, if applicable, the intermediate bodies, comply with the regulations and therefore only correct expenditures are reported (Art. 9)
- The reliability of the management and control system shall be examined on the basis of sample checks (so-called “Second Level Control”). The bodies that carry out these checks of the management and control systems in place shall be independent of the operations of the programme (Art. 10). After the winding-up of a programme, an independent body shall draw up an audit declaration (Art. 15)

The INTERREG-III Guidelines of the Commission (C(2000)1101) state that only one Managing Authority and one Paying Authority is to be established per INTERREG programme and that for operations with partners from several Member States, one “Lead Partner” is to be defined who is responsible vis-à-vis the Managing Authority for the proper financial management. However, the requirements defined for common structures contradict the final responsibility of the Member States pursuant to Art. 38 of the General Regulation in the case of INTERREG programmes with the participation of several Member States (i.e., in the INTERACT Programme). This has

resulted in unclear scopes of responsibility, inconsistent procedures and – in order to clarify these contradictions – to considerable additional efforts spent on coordination.

As an outcome of the coordination efforts to date, it has been defined that First Level Control (FLC) is to be carried out by controlling bodies from the Member States of the individual project partners in the case of INTERACT. In line with the terminology of Regulation 438/2001, legally these are “intermediate bodies”. The controlling bodies have to be authorized by the official national representatives of the INTERACT programme.

As regards “Second Level Control”, negotiations on an EU-wide agreement are still under way in the framework of the INTERACT Financial Control Group.

In order to ensure sufficient legal certainty for all involved parties and as a basis for control, it is absolutely necessary to assign the responsibilities (rights and duties) to the participating parties as clearly and unambiguously as possible with an uninterrupted chain of responsibility (also as a basis for the prescribed uninterrupted audit trail for controlling purposes). EU regulations and programmes, however, are directly binding only for EU bodies and Member States. To hand over the responsibilities to third parties and to share responsibilities among Member States requires separate contractual agreements:

- Agreement between the Member States participating in the INTERACT Programme and the Managing/Paying Authority (Austrian Federal Chancellery)
- ERDF subsidy contract between the Managing Authority and the final beneficiary, i.e., in the case of INTERACT the Lead Partner of a project
- Partnership agreement between the Lead Partner and the other project partners
- If applicable, work contracts between the project partners (as principal) and third parties (as subcontractor)

RECOMMENDATIONS

It is important to regulate the following issues in the agreements regarding ERDF co-financing (especially the subsidy contract and the partnership agreement):

- *Unambiguous legal definition of the contractual partners (name of institutions, correct designation of government institutions)*
- *Definition of the content and object of the project (co-financed services, with optional subdivision into modules)*
- *Definition of timeframe (beginning and end of the eligibility of costs and payments, dates for final settlement of accounts)*
- *A more detailed definition of eligible costs by type of cost (if necessary, also including a negative list of costs that are not eligible for aid) and amount (cost plan)*
- *Amount of assistance (ERDF funds) as well as other financial assistance (finance plan)*
- *Time and form of statements of account and reports*
- *Payment and repayment conditions*
- *Assignment of relevant Community and national legislation (that would not apply automatically to everyone without a formal contractual agreement!)*

It is necessary to reach agreements that are as clear as possible. At the same time though, it must be taken into account that from a pragmatic standpoint a project changes over the course of time and it may happen that not all relevant issues were known to a sufficient degree or it was not possible to plan for them at the time the contract was entered into. The contracts therefore should – to a reasonable extent – include flexibility clauses for project changes, the re-allocation of costs and changes to financial plans as well as delays in the schedule.

2. WHICH COSTS ARE ELIGIBLE FOR CO-FINANCING FROM ERDF FUNDS?

Generally, the principle of sound financial management (Art. 27, Council Regulation No. 1605/2002 EU applicable to the general budget) applies to the expenditure of funds from the EU budget – similar to comparable budgetary principles under national law.

The specific issue of the eligibility of INTERACT projects for assistance from ERDF funds is governed primarily by the following legal provisions:

- Art. 28 to 30 and 32 of the General Regulation
- ERDF Regulation (Regulation No. 1783/1999 of the European Parliament and of the Council)
- Regulation No. 1685/2000, as amended by Regulation No. 448/2004 of the Commission (rules for eligibility for funding from the Structural Funds)
- INTERREG Guideline of the European Commission;
- INTERACT Programme Document and INTERACT Programme Complement :

Therefore, costs may – generally – be financed from the ERDF funds if they meet the following criteria:

- 1. They have actually been incurred (receipts);**
- 2. They can be allocated to an eligible project; to be eligible a project has –**
 - (a) to meet the selection criteria of a measure of the INTERREG programme as regards persons (project organiser, “final beneficiary”), object (content), start and end of eligible timeframe and place (assisted area)**
 - (b) to be formally approved (resolution of the Monitoring and Steering Committee, ERDF subsidy contract)**
 - (c) actually to be carried out (verification of physical implementation) and settled (proper documentation);**
- 3. The amount is commensurate with the purpose of the project, and**
- 4. They do not contradict any specific eligibility criteria.**

Therefore, the following expenses shall generally not be eligible for aid:

- Expenditure that is not sufficiently documented
- Current expenditure not specific to a project, private expenditure
- Costs incurred before the initial date of operation (invoice date and payment date) for the recognition of eligible costs (pursuant to the Commission’s resolution on the approval of the programme and pursuant to project-specific co-financing agreement)

Some EU rules regarding eligibility (if not stated otherwise: according to Council Regulation No. 448/2004) that are especially important for INTERACT projects are recalled below in brief:

- The basis for co-financing from the Structural Funds are (apart from a few defined exceptions: depreciation, overheads, contribution in kind) expenses actually incurred and for which evidence has been furnished in the form of invoices and payment slips or equivalent booking receipts
- Overhead costs shall be recognised as eligible costs if they refer to the execution of the project, to actual costs (payments) and can be allocated to the project on a pro rata basis according to a method properly explained
- Revenues directly relating to the co-financed project (e.g. sale of brochures, event entrance fees) are to be deducted from the project costs. Thus, eligible costs are project costs minus revenues
- Rule no 3 of Annex “Eligibility rules” to Commission Regulation 448/2004 applies to Financial charges, bank charges on account, legal fees on advice, notary fees, the cost of technical or financial expertise, accountancy or audit costs, costs of guarantees provided by a bank or other financial institutions, fines, financial penalties and expenses of litigation
- Expenditure for value added tax is not eligible, if the Lead Partner and the project partners are entitled to recover it, even if they do not actually make use of this possibility (e.g. because of difficult procedures to recover foreign VAT)
- Projects that are financed under other EU funding programmes (i.e. those promoting cooperation in the areas of research, education and culture) are not eligible under INTERACT

Apart from these criteria, there are a number of questions regarding eligibility, for which the regulations do not provide unambiguous answers. We recommend that project partners should take note of the following orientations:

RECOMMENDATIONS

a) Staff costs

Personnel costs, such as gross salaries, social security fees and other remuneration for the work of staff of the project partners required for a particular project, are eligible provided they have a formal legal basis (law or contract). Payments to employees without such a legal basis (e.g. ad hoc allowances) are not eligible.

The total amount of personnel costs (not only level of salary, but also fringe benefits, if applicable) has to be commensurate with the qualification of the personnel and the amount of work employed for the project which, in turn, have to be commensurate with the requirements of the project. Costs, which (in terms of level of salary, size of employed work force or qualification) evidently exceed reasonable values (as compared with similar public activities) should not be regarded eligible.

Self-employed private project partners (which may be rare in INTERACT projects) who do not have contractually regulated salary costs may apply for funding for acceptable staff costs providing they furnish well-documented evidence of the "opportunity costs" ("What would it cost if the service were rendered by a dependent employee?"). On account of considerable problems arising in connection with the evidence to be furnished, this type of project partners should be avoided as far as possible.

Given the legal basis and reasonable amount, the eligibility of a project partner's own staff costs is usually undisputed if staff is employed entirely and exclusively for a single project co-financed under only one programme. In those cases (frequent in INTERREG projects) in which staff is employed only in part for a specific project and, at the same time, also for other projects with EU co-financing or in other work that does not receive co-financing, evidence of the project-specific services and eligible staff costs must be furnished as follows:

- *Transparent records of the working hours for the entire work period (total volume must be credible, well-founded explanations must be provided for extra work!) with plausible allocations to the individual projects and the areas of work.*
- *Calculation of an average daily or hourly rate by dividing the total staff costs (salaries, social insurance, fringe benefits, if applicable) by the total number of working hours including overtime. Increased costs for overtime work have to be allocated to single projects proportionally.*

Costs for staff working for a project outside the scope of their employment contract (e.g. university teachers) shall only be recognised as eligible if double invoicing can be ruled out. This risk will be avoided, if

- *either the scope and required attendance for the work on the project are obviously outside of regular working hours (e.g. on weekend, holidays)*
- *or the costs of project work within regular working hours are refunded to the employer from the project budget*

In both cases the level of costs has to be commensurate with the requirements of the project (see above).

b) Overhead costs

Overhead costs (e.g. for rents, electricity, cleaning, etc.) are eligible, if the following conditions are met:

- *Whatever method is applied (there is not the only right method, but many possible acceptable methods!) it has to be transparent and plausible. Overhead costs must be calculated on the basis of proven costs and allocated proportionally (e.g. to working hours, salaries, office space) to all cost units for the whole company or public institution and not only to single co-financed projects*
- *Overhead costs allocated to a co-financed project must not contain costs which, according to the regulations, are not eligible for co-financing (e.g. calculatory costs, financing costs)*
- *Overhead costs must not contain costs which are also calculated as direct project costs*

c) Travel expenses

As regards the eligibility of travel expenses, there are different national regulations which make a fully standardised procedure impossible. The following aspects may serve as guidance:

- Per diem payments are subject to different regulations in each country. Costs will usually be eligible if they are recognised as operating expenses according to national tax regulations or correspond to the relevant provisions of civil servants' employment contracts. The eligibility of any further reimbursements shall be questionable. The travel time claimed for the per diem payment must be grounded in the facts (e.g. duration of an event) and must match the travel documentation (e.g. flight times). The prolongation of a trip in order to benefit from cheaper flight prices may be accepted if the costs are not higher
- Hotel accommodations can be accepted without reservations if in the middle-class price range (***, possibly also ****), but higher price categories (as of *****) will be accepted only with a plausible reason
- Invoice amounts for private consumption are not eligible as travel costs
- In order to keep distances short and costs low, mass transport (plane, train, bus, taxi, etc.) should be used. Costs that are not in line with these principles (e.g. taxi instead of bus/train, departure and arrival not from/to work location, business class ticket for flights, etc.) must be explained in writing on the corresponding receipts (e.g. taxi for time reasons, for transporting large volumes of documents for meetings, or to lower costs by sharing a taxi with several persons). If there is a reason for using one's own car or a company car, project-related travel must be documented in a logbook and the mileage allowance charged must be in accordance with recognised tax regulations. If the reasons given are insufficient or not plausible, recognition of the costs should be rejected

d) Contracting supplies and services:

It must be ascertained that such costs reflect the usual market rates (for typical INTERREG projects e.g. printing of brochures, rental fees and catering for events, translation costs, fees for experts; for project staff employed on a fee basis see staff costs), for example, by requesting comparable offers from other providers. Further offers do not have to be obtained if the same services are commissioned several times in a row at the same conditions and comparability with usual market rates has already been confirmed once. Should this not be possible or reasonable, only the actually incurred and documented costs should be claimed in cases of doubt.

Public project partners have to respect the public procurement legislation.

Investment costs (e.g. office equipment) are eligible only in proportion of remaining project time after date of purchase to total depreciation period.

The following costs are not eligible:

- Unpaid sub-amounts of invoices (e.g. claims for damages, guarantees, discounts, etc. – as regards the latter, it should be noted that the financial controlling body will classify discounts offered but not used as non-eligible costs, as in their opinion this constitutes a supplier credit and thus – non-eligible – financing costs)
- Expenditure invoiced to third parties and thus not borne by the project organiser
- Project costs which cannot be clearly allocated to one of the project organisers (or partners (e.g. invoices addressed to another person or institution or invoices not paid by the project organiser)
- Project costs that are not in line with the project's content
- Double invoicing of costs

The following costs typical for INTERREG projects are difficult to assess and should generally be excluded from eligibility or accepted only in exceptional cases based on a detailed and plausible explanation of the project-specific necessity:

- Internal transactions between formally independent legal entities but related in terms of staff and functions (e.g. identity of the owners or association bodies, parent companies and subsidiaries, etc.); such transactions are acceptable only if the documented cost price is invoiced excluding any surcharges and the cost is lower than that of commissioning to external service providers
- Entertainment costs and working meals (except catering for events provided by third parties to a reasonable extent)
- Purchase of movable goods that are not clearly project-related (e.g. coffee sets/cutlery; mobile phones)
- Representation costs (flowers, presents)

The eligibility of phone costs, photocopies, etc, is frequently disputed especially when there are founded suspicions that non-eligible cost components (e.g. phone calls and copies for routine business or for private purposes) are allocated to the co-financed project. On the one hand, such expenses are often generally indispensable for a project and thus justified on these grounds, and on the other hand, it is practically impossible to conduct regular controls at reasonable costs to avoid abuse. In case of doubt or if the project share in the overall costs is relatively low, these costs should not be included in the eligible project costs, as the additional work for certifying and auditing would be too high compared to the benefit of co-financing. In cases in which ERDF co-financing can not or should not be foregone, commensurateness with usual market rates may be checked on the basis of traceable, roughly plausibility assumptions or experience in similar institutions, and documented for control purposes. A more detailed examination (e.g. itemised phone call lists attached to phone bills) could be restricted to those cases in which a reasonable level is significantly exceeded without any apparent reason. We recommend specifying the availability of the records necessary for this purpose in the contract.

3. WHAT DOES FIRST LEVEL CONTROL (FLC) INCLUDE AND WHAT ARE THE PROCEDURES?

Here is a short checklist to help the reader become familiar with the issues:

What does the controlling cover? (Art. 4 of Commission Regulation No. 438/2001)	Appropriate documentation of controlling procedures
Verifying the <u>actual delivery</u> of the co-financed supplies and services	E.g., project reports, participant lists of events, copies of brochures, if applicable, on-the-spot verifications (machines and buildings)
The <u>correctness</u> of the co-financed project costs (usually only expenditure actually paid)	Invoices including payment receipts (original invoices as far as possible) for details see below
The eligibility of costs with regard to persons (project organiser), content (assisted objective), time (duration of programme and project) and territory (assisted area) according to the provisions of the respective EU programme; Furthermore, <u>compliance with other relevant national and EU legislation</u> , e.g., regarding public procurement, state aid, environmental protection and equality of opportunity; this also includes the sound financial management of the services granted assistance.	Object, addressee and date of the invoices and payment receipts must match the relevant terms of the programme and any other legal provisions (specified in the ERDF co-financing contract as a requirement for receiving ERDF funds); (Comparison) offers or any other information to be documented regarding commensurateness with usual market rates; If applicable, written statement of reasons.

Generally, FLC shall take the following requirements on the organisation, procedures and documentation into consideration:

- The dual control principle must be observed, i.e., as far as possible a separation of project implementation and project control should be maintained in the organisation, but at the least regarding the persons involved
- The appropriate memorandums regarding the controlling procedures must be drawn up that clearly indicate the costs controlled and the outcome of the audit as well as their eligibility as expenditure; the relevant steps of the controlling procedure must be documented.
- Should costs be rejected, the reasons must be stated in a transparent and understandable manner; an itemised list of the individual costs rejected must be provided.

The following measures facilitate the controlling task and are strongly recommended:

- It is advisable to prepare a list containing all project expenses and their source of financing.
- If there is a large number of confirmation slips, it is advisable to list these (broken down by type of cost according to the cost plan in the co-financing contract in a list of confirmation slips.
- It must ensure the unambiguous allocation of each invoice to the project (based on the subject) and to one of the project organisers
- In order to prevent cases of assistance being paid twice to the same recipient, the documents confirming eligible amounts must be marked on the face as audited and thus rendered worthless
- The controlling should cover 100% of all documents as far as possible
- In the case of several invoices for partial amounts: The invoices must be listed consecutively
- Internally provided services: Evidence of contractual employment relations with persons participating in a project (employment contracts, confirmations of health insurance), time sheets of hours worked, payment of salaries.)
- Requests for other offers as a measure of comparison to ensure commensurateness with the usual market rates (the sound financial management of funds must be examined critically!)

In any case, the following shall be considered insufficient and must be evaluated critically:

- Lacking documentation of project costs with respect to timeframe and content
- Frequent changes of invoices as regards their allocation to accounting items

Short checklist for auditing invoices (original invoices as far as possible)

Invoice / statement of fees

- Invoicing party
- Date of invoice
- Addressee
- Object of service or goods supplied
- Scope of service (quantity, number of hours)
- Price per unit and total price

Payment confirmation for cash payment

- Confirmation of receipt on the invoice, e.g., "paid in cash", "received in cash"
- Stamp and/or signature of the invoicing party (recipient)

Telebanking payment confirmation

- Account statement
- Booking confirmation slip
- Record of the transfer of funds

Bank transfer payment confirmation

- Bank teller stamp confirming receipt (slip with stamp indicating the date and stating "accepted for payment" is deemed not sufficient!)
- Account statement
- If denominated in a foreign currency, confirmation of exchange rate (Internet)

Payment confirmation for the collective transfer of funds

- Order for the collective transfer of funds (broken down by entry)
- Confirmation for each transfer of funds (executed by the bank)
- Account statement

Cash payout confirmation slip

- Issuer of confirmation slip
- Amount
- Name, address, signature of recipient
- Service (if applicable, broken down by item in an attachment to the cash payout confirmation)