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.
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

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](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.

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

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

Key Message: The accounting records must include all transactions.

> 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 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.
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](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 through 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.

**Key Message:** Pay attention to currency rules.
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.

Key Message:
Use a proper chart of accounts and coding system.

► 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.
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.
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)

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.

**Key Message:**
Obey the rules on budget changes.

**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.
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.