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Community research

PRAGUE, 10 November 2009

FULL COSTING IN FP7

FP7 Certification

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FP7 Indirect Costs Methods

- **Based on actual Indirect Costs:** as registered in the accounts of the beneficiary according to its usual accounting and management practices adjusted, when necessary, in order to eliminate all ineligible costs
 - ‘Normal’ (analytical accounting system)
 - Simplified (at entity level)

- **Flat-rates on direct costs:** to be calculated on the direct eligible costs excluding subcontracting and costs of resources made available by third parties which are not used in the premises of the beneficiary
 - Flat rate 20% (general)
 - Flat rate 60% (for certain types of entities: non-profit public bodies, research organisations, universities, SMEs)



Which method in FP7?

About 84 % of Universities are currently using flat-rates²

		Real Indirect Costs		Flat Rate	
		Normal	Simplified	20%	60% ¹
Do I have an analytical accounting system allowing to determine with certitude the indirect cost related to research activities ?	YES	✓		✓	
IF THE ANSWER IS NO , THEN:					
Do I have an accounting system allowing to identify all my indirect costs and a reliable cost driver to allocate them?	YES		✓	✓	✓
	NO			✓	✓

1 Only applicable to Non-profit public bodies, Secondary and higher education establishments, Research organisations and SMEs

2 September 2009 data

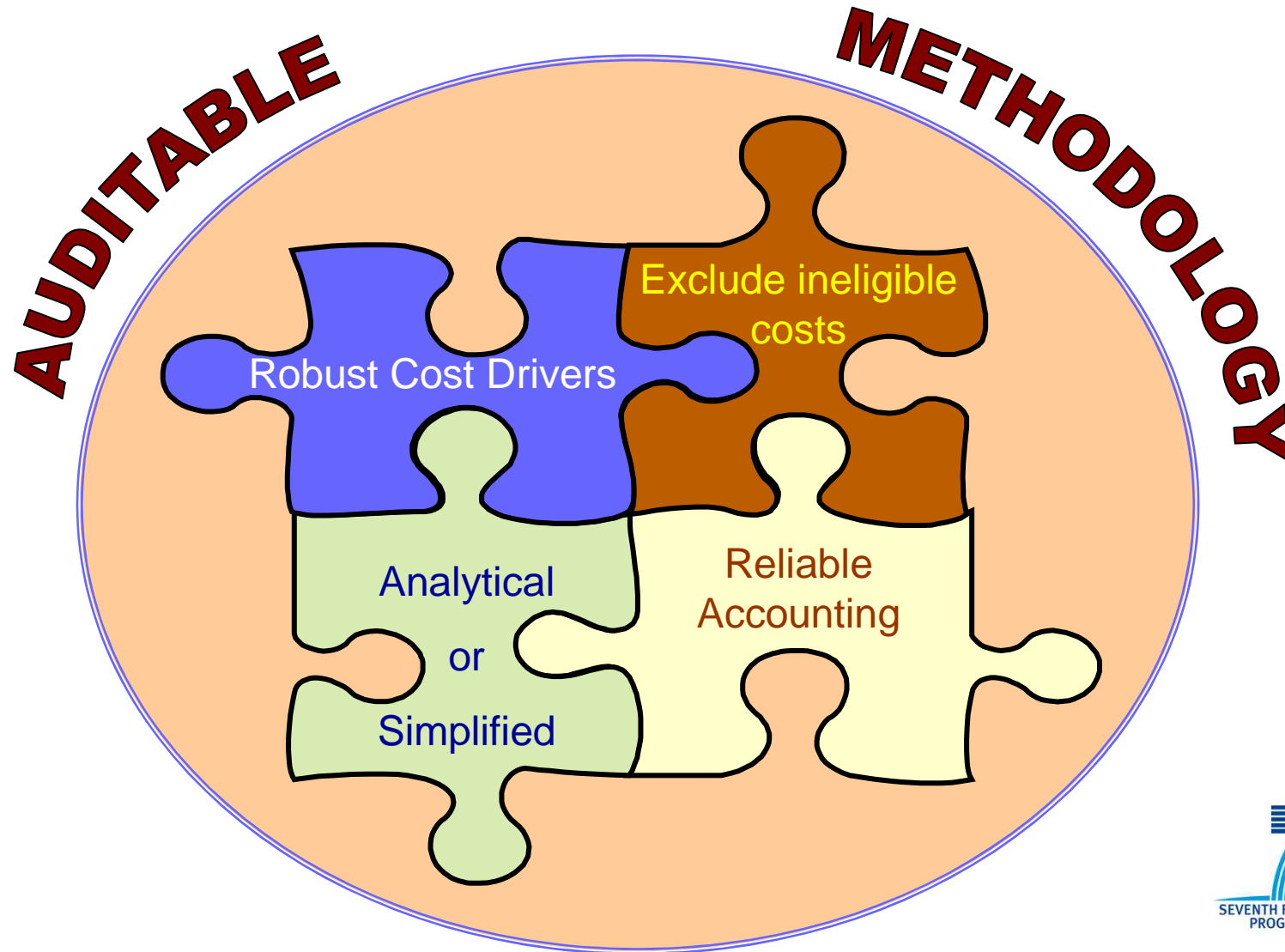




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Actual Indirect Costs Methodologies Minimum requirements for FP7





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Reliable accounting

Definition and requirements (I)



Article II.14.1 of the FP7 Grant Agreement: “*Eligible costs of the project*”

Costs incurred for the implementation of the project shall meet (**ALL**) the following conditions in order to be considered eligible:

- a) They must be **actual** (no estimated or budgeted)
- b) Incurred by the beneficiary (be careful about third party contributions!)
- c) Incurred during the duration of the project
- d) In accordance with the accounting principles of the beneficiary (**when compatible with the other eligibility principles**)
- e) Incurred « for or in relation to the project » and in accordance to the principles of economy, efficiency and effectiveness
- f) **Recorded in the accounts of the beneficiary**
- g) Indicated in the estimated budget (Annex I of the Grant Agreement)



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Reliable accounting

Definition and requirements (II)



In addition, the accounting system must permit to differentiate direct costs (charged directly to projects) from indirect costs (allocated via cost drivers) in order to avoid double charging.

Example:

The university considers chemicals for the laboratory as part of the indirect costs as they are commonly and indistinctly used for several projects. However, a specific research project needs an unusually large amount of an expensive chemical and this is ordered specifically for the project and charged to it as a direct cost.

The accounting system must permit to identify and deduct these costs from the pool of indirect costs in order to avoid double charging



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Reliable accounting

Auditor's verifications (Forms D & E)



Certificate on the Financial Statements (Form D)

Procedure 10: Indirect costs

"The Auditor obtained a detailed breakdown from the accounting system of the indirect costs which have been charged to the contract, and reconciled the individual amounts to the general ledger of the Beneficiary."

Certificate on the Methodology (Form E)

Procedure 4: Indirect costs

"The breakdown of indirect costs used to calculate overhead rates was reconciled to the accounting records"

"This breakdown did not contain costs relating to direct project activity"



Exclude ineligible costs Definition and requirements



Article II.14.3 of the FP7 Grant Agreement: “Eligible costs of the project”

The following costs shall be considered as non-eligible and may not be charged to the project:

- a) identifiable indirect taxes including value added tax,
- b) duties,
- c) interest owed,
- d) provisions for possible future losses or charges,
- e) exchange losses, cost related to return on capital,
- f) costs declared or incurred, or reimbursed in respect of another Community project,
- g) debt and debt service charges, excessive or reckless expenditure.

Not everything registered as a cost is eligible, the accounting system must be able to identify and deduct ineligible costs from the pool of indirect costs.

Example: irrecoverable VAT



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Exclude ineligible costs

Auditor's verifications (Forms D & E)



Certificate on the Financial Statements (Form D)

Procedure 10: Indirect costs

” For each element of the breakdown, the Auditor obtained the Beneficiary's confirmation that it contained none of the ineligible costs specified (typical examples are leasing costs, loan charges, provisions for doubtful debt (but not normal accruals), local business and property taxes, customs duties, exchange losses from billing in a foreign currency).”

Certificate on the Methodology (Form E)

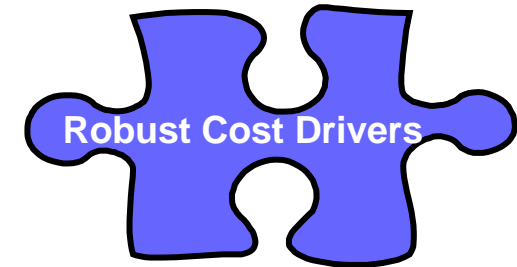
Procedure 5: Indirect costs

” The Auditor reviewed the breakdown provided by the Beneficiary in order to check that the ineligible items specified were eliminated ”



Robust cost drivers

Definition and requirements



A cost driver is a variable with a cause-effect relationship to a cost / a group of costs used as allocation key to distribute these costs among activities / projects / cost objects.

In order to be robust and fair, a cost driver should have certain characteristics:

RELEVANT: It must have a reasonable cause-effect relationship to the cost being allocated

Example: the IT maintenance costs being distributed among departments based on the number of PCs of each department

OBJECTIVE: Based on FACTS not on thoughts

Measurable and measured

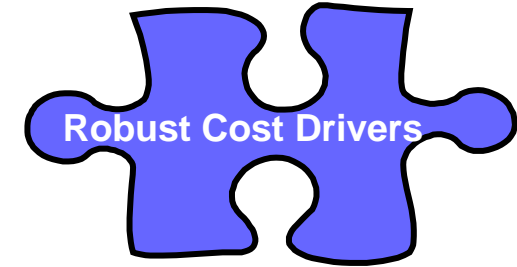
VERIFIABLE: Audit evidence supporting the cost driver

Example: using the number of employees working in each department to distribute the costs of Human Resources department (the number of employees in each department can be verified)



Robust cost drivers

Objective cost drivers



OBJECTIVE: Based on FACTS not on thoughts
Measurable and measured

Estimated costs resulting from subjective cost-drivers can not be considered actual costs

- ~~▪ I think that...~~
- ~~▪ It should be around...~~
- ~~▪ My experience tells me that...~~

Subjective ⇒ Non-Actual ⇒ **Not eligible**

To be objective, the cost-driver must be based on measurable (and measured) facts

Example: working hours of academics is a measurable fact, however, without a reliable time-recording system (not measured) the cost driver will not be objective as it will be based on estimations

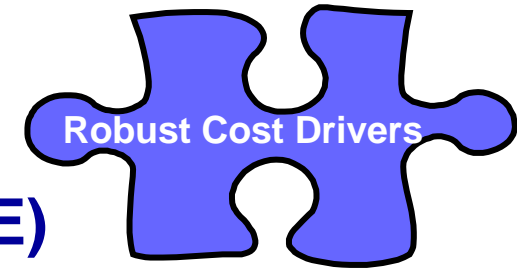


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Robust cost drivers

Auditor's verifications (Forms D & E)



Certificate on the Financial Statements (Form D)

Procedure 10: Indirect costs

” The Auditor found that costs for the non-research activities of the Beneficiary, such as manufacturing, education, marketing of products or services, etc., had not been included in the calculation.”

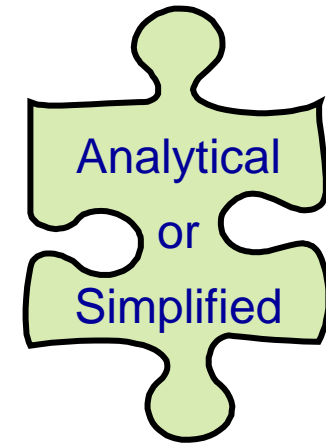
Certificate on the Methodology (Form E)

Procedure 5: Indirect costs

” For each allocation method used by the Beneficiary, the Auditor reconciled the amount to be allocated to the accounting records, and reconciled the allocation basis to the relevant management accounting information (usage records, floor space, activity-based-costing, headcount, etc.) ”



Analytical or Simplified Definition and requirements (I)



Simplified Method

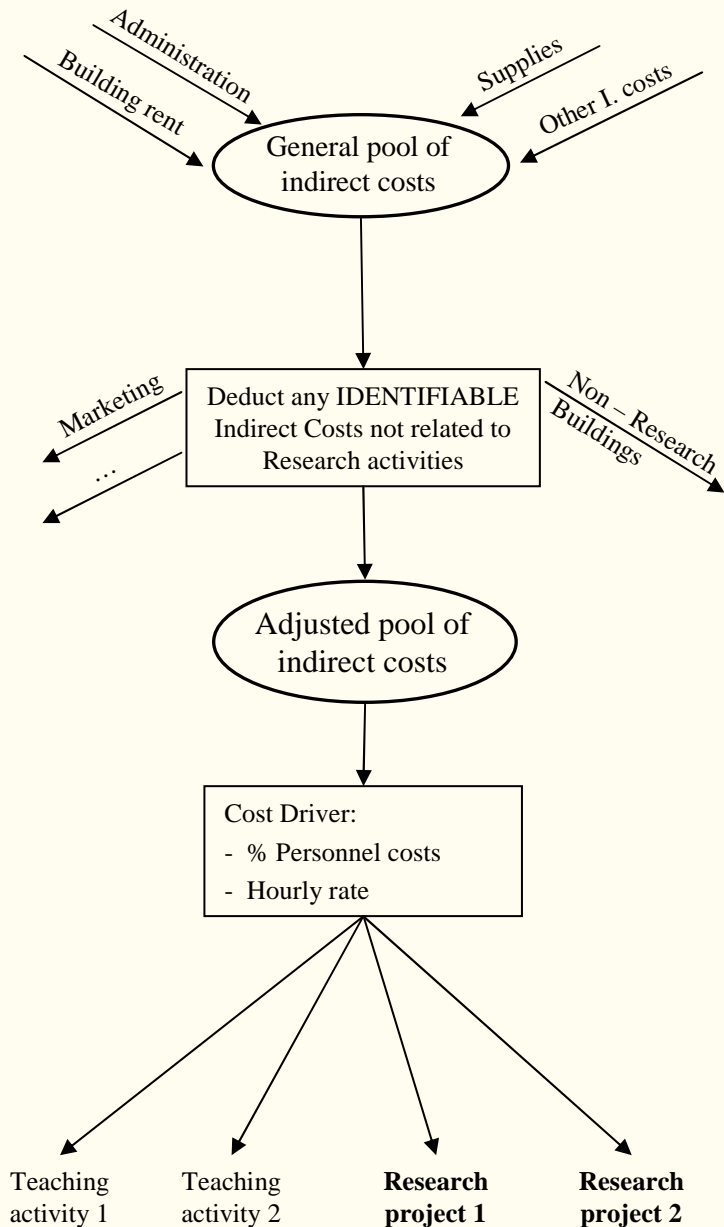
The use of this method is optional, however "Simplified" does not mean "Simple"

- > accounting system which enables to identify all eligible indirect costs
- > a reliable cost driver to allocate the indirect costs

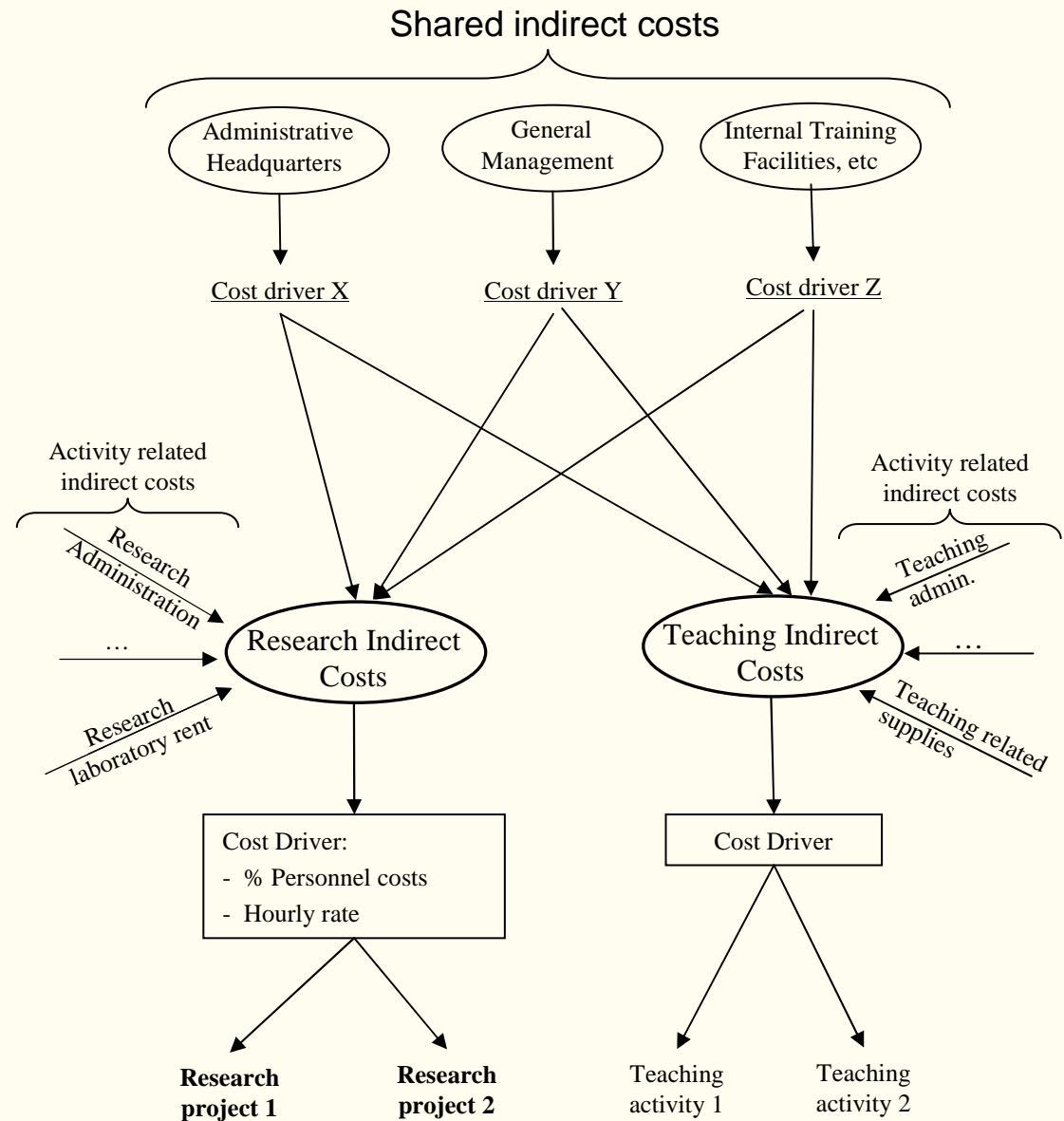
It is called 'Simplified' because the calculation can be done at 'entity' level (i.e. not by departments, activities, etc) when a more refined alternative is not possible.

Foreseen for beneficiaries who do not aggregate their indirect costs at a detailed level but at entity level (e.g. beneficiaries without analytical accounting system or with cash-based accounting) and beneficiaries migrating from flat-rate methods in previous framework programmes.

Simplified Method



Analytical system

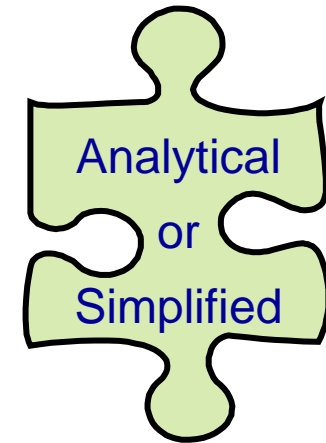




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Analytical or Simplified Auditor's verifications (Forms D & E)



Certificate on the Financial Statements (Form D)

Procedure 11: Indirect costs – Simplified method

” The Beneficiary may use a simplified method of calculation (either due to the lack of analytical accounting or legal requirement to use a form of cash-based accounting). This does not permit the use of a generalised estimate, or the use of a 'standard' rate that is not derived from the accounting records of the period in question.”

Certificate on the Methodology (Form E)

Procedure 6: Indirect costs – Simplified method

” If the organisation is using a simplified indirect cost calculation (either due to the lack of analytical accounting or use of a form of cash-based accounting) all estimates are clearly described and are based on factual criteria which can be objectively confirmed.”



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SOME ADVICES

- ⇒ Design your full-costing methodology according to your management, control and decisional needs and, where necessary, implement separately adjustments to fulfil the EC cost reporting requirements.
- ⇒ Choose the most adequate costs-drivers for your organisation. Analyse your structure, needs and information availability to make the choice.



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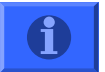
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ADDITIONAL INFO



Guidance note on FP7 audit certification

http://cordis.europa.eu/fp7/find-doc_en.html#guidance



FP6 / FP7 Audit certification policy website

http://cordis.europa.eu/audit-certification/home_en.html



FP7 Certification FAQs

ftp://ftp.cordis.europa.eu/pub/fp7/docs/faq-certification_en.pdf



And in case of doubts, don't forget: **RESEARCH HELPDESK**

ec.europa.eu/research/enquiries



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Thank you very much for your attention!

