

MODULE 8 - FINANCIAL REPORTING

Real life story:

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

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

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

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

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



WHY IS FINANCIAL REPORTING A KEY FINANCIAL MANAGEMENT AREA?

Key Message:

Financial reporting is a fundamental Contractual Condition.

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

Such reports have several purposes:

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

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

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

Content of this module

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



MINIMUM CONTRACTUAL CONDITIONS

Key Message:

Understand the Contractual Conditions.

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

• Grant Contracts



The general conditions of grant contracts specify that:

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

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



MINIMUM CONTRACTUAL CONDITIONS (continued)

- Service Contracts




The general conditions of service contracts state that:

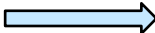
- ▶ All invoices for fee-based contracts must be accompanied by an up-to-date financial report. The structure of the interim or final financial reports must match that of the budget, which is shown in Annex V to the Contract. The financial report must show at least the expenditure for the reporting period,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



MINIMUM CONTRACTUAL CONDITIONS (continued)

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

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

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



WHAT COULD GO WRONG? KEY CONTROL MEASURES.

What could go wrong?

- Financial reports may not be drafted in accordance with the Contractual Conditions, or at all.

This could cause the Contracting Authority to cancel the Contract and recover any payments already made.

- There may be no trail from the financial report to the accounting records and/or to the underlying supporting documents.

This could lead the Contracting Authority to recover any expenses that have not been substantiated.

- The financial report may not mirror the classification used in the budget.

This could cause the Contracting Authority to reject the financial report.

- The financial report may not be drafted using the correct currency.

This could lead the Contracting Authority to reject the financial report.

- The financial report may not cover all sources of funding for the project.

This could lead the Contracting Authority to reject the financial report.

Key control measures

- Ensure that the accounting records are kept up-to-date and that the financial reports are drafted by the deadline set in the Contract.

- Ensure that the financial reports agree with the underlying accounting records.
- Ensure there is a proper trail from the accounting records to the supporting documents.

- Ensure the financial report mirrors the classification used in the budget and allows actual-to-budget comparison.

- Check which currency is stipulated in the Contract.
- Ensure currency conversions follow the rules laid down in the Contract. Further details are provided in Module 7 (Accounting) under Basic Tips.

- Ensure the financial report covers all funding sources.



BASIC TIPS

Key Message:

Drafting financial reports is a must!

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

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

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

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

Key Message:

The financial report must tie in with the accounting records.

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

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

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

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



BASIC TIPS (continued)

Key Message:

Financial reports must mirror the classification used in the budget.

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

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

For more guidance please refer to Module 7.

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

Key Message:

Financial reports must be drafted in the correct currency.

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

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

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

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

For more guidance please refer to Module 7.



BASIC TIPS (continued)

Key Message:

Financial reports must cover all sources of project funding.

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

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

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

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

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

Key Message:

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

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

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

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

For more guidance please refer to Module 7.



BASIC TIPS (continued)

Key Message:

Financial reports must follow an appropriate format.

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

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

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



TOOLS AND TEMPLATES

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

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

FMT - MODULE 8 - FINANCIAL REPORTING CHECKLIST

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

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