Financial Guidance

Guidance on financial management under the EEA and Norwegian Financial Mechanisms 2021-2028

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LIST OF ABBREVIATIONS

AA	Audit Authority
AAR	Annual Audit Report
AO	Audit opinion
BF	Bilateral fund
BFA	Bilateral Fund Agreement
BS	Beneficiary State(s)
CA	Certifying Authority
CN	Concept Note
DPP	Donor Programme Partner
DS	Donor State(s)
EEA	European Economic Area
EC	European Commission
EU	European Union
FAR	Final Audit Report
FMC	Financial Mechanism Committee
FMs	Financial Mechanisms
FMO	Financial Mechanism Office
FO	Fund Operator
FPR	Final Programme Report
GrACE	Grant Administration and Collaboration Environment
IFAC	International Federation of Accountants
IFR	Interim Financial Report
INTOSAI	International Organisation of Supreme Audit Institutions
IPO	International Partner Organisation
ISA	International Standard on Auditing
ISSAI	International Standard of Supreme Audit Institutions
ISRS	International Standard on Related Services
MCS	Management and Control System
MoU	Memorandum of Understanding
NFP	National Focal Point

NGO	Non-governmental Organisation
NMFA	Norwegian Ministry of Foreign Affairs
PA	Programme Agreement
PDP	Pre-defined project
PIA	Programme Implementation Agreement
PO	Programme Operator
SCO(s)	Simplified cost option(s)
ТА	Technical assistance
TER	Total Error Rate
VAT	Value Added Tax

I. Introduction

1.1 Purpose of the document

The purpose of this guidance is to support the work of National Focal Points (NFP), Audit Authorities (AA), Certifying Authorities (CA), Programme Operators (PO), Fund Operators (FO)¹, Project Promoters and project partners.

The document does not constitute part of the legal framework of the Financial Mechanisms 2021-2028 (hereinafter referred to as "the Grants"), nor is it intended to replace consultation of the legal framework where appropriate. The document provides practical guidance on the financial provisions outlined in the legal framework. Neither the Financial Mechanism Committee (FMC), Norwegian Ministry of Foreign Affairs (NMFA), the Financial Mechanism Office (FMO) nor any person acting on their behalf can be held responsible for the use made of this guidance document.

For legal purposes, references are made to the Regulations on the implementation of the European Economic Area (EEA) Financial Mechanism and of the Norwegian Financial Mechanism 2021-2028 (hereinafter referred to as "the Regulations")².

1.2 Grants Management System (GrACE)

The Grant Management System used for the implementation of the Grants is called GrACE (Grant Administration and Collaboration Environment).

Most of the grant management processes described in this guidance are administered in and processed through GrACE. The users can access the system through the <u>dedicated website</u>. Prior registration is required to access the system. Registration can be obtained by contacting <u>grace-support@efta.int</u>.

GrACE user manuals are available on the <u>Grants website and in the Knowledge base within GrACE</u>. The user should make sure to check these sources regularly for updated versions of manuals.

1.3 The legal framework

The legal framework for the Financial Mechanisms 2021-2028 is regulated by the following:

- the Agreement between the Kingdom of Norway and European Union on a Norwegian Financial Mechanism and Protocol 38d to the EEA Agreement on the EEA Financial Mechanism 2021-2028;
- the Regulations issued by the Donor States;
- the Memorandum of Understanding on the Implementation of the EEA and Norway Financial Mechanisms 2021-2028 (MoU), entered into between the Donor States and the Beneficiary States;
- the Programme Agreement signed between the FMC/ NMFA³ and the Beneficiary State; guidelines adopted by the Donors (Bilateral Guideline, Research Guideline).

¹ Fund Operators implementing programmes under the Civil Society Fund should refer to a dedicated "Fund Operator Manual".

² This document will be updated to reflect modifications to the legal framework of the Grants, should they occur. It might also be complemented by ad-hoc recommendations or interpretations issued by the Donors or the FMO by means of formal or informal communications. In case of any inconsistency, the provisions of the Regulations prevail.

³ Hereinafter referred to as "the Donors".

Financial Guidance document serves as a supplementary resource and does not form part of the legal framework governing the Grants. In the event of inconsistencies or contradictions between the information presented in this Financial Guidance and the provisions in the Regulations or other documents within the EEA and Norway legal framework, the latter takes precedence. The Regulations and official legal framework documents remain authoritative sources for all matters related to the preparation, implementation and closure of the Grants.

II. Financial Mechanisms set-up

2.1 The Grants set-up

The Grants are Iceland, Liechtenstein and Norway's ("the Donor States" or "the Donors") contribution to 15 Beneficiary States⁴ in Central and Southern Europe and the Baltics. The FMO acts as a secretariat to the Donors.

The Grants are based on a programme model where the Beneficiary States (hereinafter referred to as "the BS") are responsible for programmes and projects implemented under the programmes. Some programmes are directly contracted and managed by the FMO, for instance, programmes in the areas of civil society and social dialogue and decent work. The total amount that the Donors contribute to the reduction of economic and social disparities and to the strengthening of their relations with the Beneficiary States (the two objectives of the Grants) is €3.268 billion.

The programme approach of the Grants means that considerable responsibility is delegated to the BS. The NFPs have the overall responsibility of the grant schemes. The POs⁵ are responsible for making the funding available to applicants through calls for proposals, appraising applications, selecting and monitoring projects. The Project Promoters initiate, prepare and implement the projects, typically in partnership with project partners.

To strengthen bilateral relations, the Grants might be implemented in partnerships between entities from the Donors and the BS at programme level (Donor partnership programmes), project level (donor partnership projects) and through activities specifically aiming at strengthening bilateral relations, both within and outside the scope of programmes (bilateral initiatives).





⁴ Bulgaria, Croatia, Cyprus, Czechia, Estonia, Greece, Hungary, Latvia, Lithuania, Malta, Poland, Portugal, Romania, Slovakia, Slovenia.

⁵ In programmes where the FMO acts as the PO and the implementation is performed by the FO, the term "Programme Operator" should be understood to apply to the Fund Operator (FO).

- Donors level represented by the Donors (FMC/ NMFA); FMO (secretariat to the Donors), programmes and funds directly contracted by the FMO; Donor Programme Partners (DPPs) and International Partner Organisations (IPOs);
- BS level the management and control system of the Grants within each BS is represented by the NFP (main responsible for the implementation of the Grants), the AA (responsible for verifying the effective functioning of the Grants), the CA (responsible for certifying financial information and, unless otherwise agreed in the MoU, for reporting on irregularities), the PO (responsible for preparing, implementing and closing the programme(s));
- Project level programmes are implemented via projects on the ground. Project Promoter initiates, prepares and implements projects alone or in cooperation with one or several (donor) project partners.

► The bodies implementing the Grants within the BS should be functionally independent from each other and separation of functions should be ensured. However, the NFP can exceptionally (following the approval of the Donors) assume the role of the PO. The NFP can also act as the CA provided the payment function is carried out by a separate department within the NFP structure. If the NFP takes the role of the PO, it should not take over the role of the CA. The AA should always be functionally independent from the NFP, CA, PO and other auditees identified in the MoU.

2.2 Beneficiary States and Memoranda of Understanding (MoU)

The Donors conclude the MoU with each BS to ensure concentration and efficient implementation, setting out the programmes, the distribution of funds between programme areas, the structures for management and control and applicable conditions.

The MoU is a framework for cooperation between the Donors and the BS. It covers:

- designated national authorities involved in the implementation of the Grants (these would normally be the NFP, CA, AA, PO), their roles and responsibilities;
- list of programmes to be implemented within the BS, financial contributions from the Grants (grants allocation) and the BS (programme/ national co-financing) for each programme, bilateral ambitions, conditions and/ or specific concerns for the programme implementation, DPPs, and relevant IPOs and pre-defined projects.

The template for the MoU is provided in the Regulations as <u>Annex 2</u>.

Table 1. Financial	parameters of th	e implementation	framework – M	loU template
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	[Beneficiary State]	EEA/ Norway Grants contribution	National contribution
	Programmes	contribution	contribution
1	[Name of programme]	€ [amount]	€ [amount]
2	[Name of programme]	€ [amount]	€ [amount]
	Other allocations		
	Technical assistance to the Beneficiary State (Art. 1.10)	€ [amount]	€ [amount]
	Reserve for completion of projects under FM 2014-2021 (Art. 1.11)	€ [amount]	€ [amount]
	Funds for bilateral relations at national level (Art. 4.7)	€ [amount]	€ [amount]
	Funds for bilateral relations at programme level (Art. 4.10)	€ [amount]	€ [amount]

		Net allocation to [Beneficiary State]	€ [total]	€ [total]
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Financial contributions from the Grants and the BS in MoUs are established as whole numbers (integers) following the general rounding rules. These amounts will be used as a reference throughout the implementation of the Grants.

If the BS receives financial contributions from both the EEA and Norwegian Financial Mechanisms, two separate MoUs are signed between the Donors and the BS.

The total financial contribution from the DS to the BS from the Grants is defined in Article 6 of the Protocol 38d and the Agreement on the Norway grants. It consists of the "country specific allocations" (i.e., gross allocations per BS) and the share of the fund for civil society for each BS. When the country specific allocations are reduced by the costs of the Donors, the "net country allocations" are established. This latter net envelope is channeled to the BS via programmes agreed upon in the MoU.

In addition, there are also three funds implemented outside of the country specific allocations – the fund for civil society ("the CSF fund", 10% of the total allocations from the Grants), the fund for capacity building and cooperation with international organisations and institutions ("the IPO Fund", 2% of the total allocation), and the fund for social dialogue and decent work (financed only by the Norway Grants, 1% of the Norway contribution).

The Protocol 38d and Norway grants agreement have earmarked the amount of 183 million euro to be allocated to the projects related to challenges experienced as a result of the invasion of Ukraine. Within that allocation, 160.2 million euro should be implemented via projects within the programmes agreed between the BS and the Donors in the MoUs.

2.3 Programmes and Programme Agreement

Programmes implemented in the BS shall be in line with the "Policy Framework" of the Grants, known as "<u>the Blue Book</u>". They should contribute to the objectives of the programme areas as agreed upon in the individual MoUs.

A Programme Agreement (PA) sets out the terms and conditions of the operation of the programme, as well as the roles and responsibility of the parties. It is concluded between the Donors and the NFP for each programme.

The POs are responsible for the preparation and implementation of the programme.

Where the Donors and the BS in the MoU entrust the operations of a programme to the FMO, the implementation of the programme is normally performed by FO, contracted by the FMO. The FMO and FO sign a Programme Implementation Agreement (PIA) where the roles and responsibilities, as well as reporting requirements of the FO to the FMO are established. When a programme is operated by FMO, the BS bears no responsibility for the implementation of such programme, financially or otherwise (however, the funds for the implementation of such programmes shall be covered by the financial allocation to the respective BS).

The template of the PA is provided in <u>Annex 4 to the Regulations</u>.

The programme budget is defined in Annex I to PA and shall contain the maximum amount of the programme grant, the programme grants rate and the estimated eligible costs of the programme, including a breakdown between the programme budget headings (management costs and outcomes).

The table below shows the structure of the budget tables in the PA.

Table 2. Financial tables from the PA

Eligibility of costs - period	First date	End date
Eligibility of costs	dd/mm/yyyy	dd/mm/yyyy
Grant rate and co-financing		
Programme eligible expenditure	€ [an	nount]
Programme grant rate	% [perc	entage]
Maximum amount of Programme grant - EEA Financial Mechanism	€ [an	nount]
Maximum amount of Programme grant - Norwegian Financial Mechanism	€ [an	nount]
Maximum amount of Programme grant - Total (€)	€ [an	nount]

	Maximum eligible costs and Advance payment amount (€)								
		No Grants	Total grant	Programme grant rate	Programme co-financing	Programme eligible expenditure	Advance payment		
PM	Programme management	€	€	€	%	€	€	€	
PAxx	Outcome 1 (EEA Grants)	€	€	€	%	€	€	€	
PAxx	Outcome 2 (NO Grants)	€	€	€	%	€	€	€	
PAxx	Outcome 3 (EEA Grants)	€	€	€	%	€	€	€	
PAxx	Outcome 3 (NO Grants)	€	€	€	%	€	€	€	
	Bilateral funds	€	€	€	N/A	N/A	€	€	
	Total	€	€	€	%	€	€	€	

Retention of management costs	
Retention of management costs – percentage of the management costs	10%
Retention of management costs – planned euro value	€ [amount]

Financial contributions from the Grants and the BS in PA are established as whole numbers (integers) following the general rounding rules. These amounts will be used as a reference throughout the implementation of the Grants.

2.4 Projects and project contract and partnership agreement

For each approved project, the PO signs the project contract with the Project Promoter. The project contract regulates the implementation of the project. The Project Promoter is the key actor to initiate, prepare and implement the project.

The **project contract** shall set out the terms and conditions of the grant assistance, as well as the roles and responsibilities of the parties. It should contain provisions on the following elements (the list of minimum requirements for project contracts is set out in Article 7.9.3):

- the project's objectives and the results to be achieved;
- the maximum amount of the project grant and the maximum project grant rate;

- the eligibility of expenditures and requirements regarding the submission of proof of expenditure and/ or proof of conditions fulfilled for simplified cost options;
- the first and final dates of eligibility of expenditures (final date of eligibility for projects expenditure is 30 April 2031 or as specified in PA);
- forms of grants for all costs in the project and their calculation method(s);
- obligations regarding reporting to PO.

A project may be implemented in partnership between the Project Promoter and one/ several project partners (from the BS, from a country outside the EEA with common border with the BS in question, international organisations). It is also possible that the project will be implemented in partnership with donor project partners (Article 4.4). Such projects are referred to as donor partnership projects.

The Project Promoter signs a partnership agreement with all project partners (incl. donor project partners). The document regulates the tasks and responsibilities of the parties, establishes the budget and other key parameters (outlined below).

▶ When donor project partners are involved, the partnership agreement must be in English. It must be based on the template provided by the FMO (Article 7.10.4). The template is part of the Bilateral Guideline. The use of this template is mandatory. While the template serves as the foundation for the agreement, its provisions may be amended and/ or supplemented according to the agreements between the Project Promoter and the donor project partner.

The partnership agreement should cover the following elements (the full list is provided in Article 7.10):

- the list of activities carried out by the project partner (in the form of a work plan with indicative timings and budgets associated with different activities);
- main roles and responsibilities of the parties (incl. obligations of the Project Promoter and the project partner);
- the maximum amount of project partner grant (in euro or national currency for BS that do not use euro);
- project partner's co-financing, if they provide their own contributions to the project;
- forms of grants for all costs in the project and their calculation method(s);
- financial management and payment arrangements between the Project Promoter and (donor) project partner(s);
- currency in which transfers are done to the partners and reporting and currency exchange rules;
- a detailed (itemized) budget;
- proof of expenditure for incurred costs and conditions fulfilled for simplified cost options where relevant.

Budgets in project contracts and partnership agreements will be set in the BS local currency or in euro, while the donor project partner keeps accounts in another currency. This creates a risk of exchange rate losses (described in <u>section 6.4</u>). The partnership agreement should specify which entity will bear the exchange rate risk and how these will be managed.

Up to 5% of the project's total eligible expenditure (grant and co-financing) can be ringfenced for contingency purposes (point (k) of Article 7.9.3). The project contract and partnership agreement should also cover the flexibility rules for shifts between the budget headings (cost categories).

1. Contingency measures

It is a good practice to set aside up to 5% of the project budget for contingencies – to meet unforeseen costs that may emerge in the implementation of the project (e.g., to cover price increases, additional activities if/ where justified).

2. Flexibility rules

For example, the project contract and partnership agreement could foresee a reallocation of up to X% of the total budget between cost categories (defined in the project contract) without prior approval. Or a project could use a fast-track approval for small adjustments (e.g., reallocation up to a certain amount/ percentage). Another example could be to allow for reallocation of unspent funds from one cost category to other(s) during a mid-term project review. All in all, a project contract and partnership agreement shall foresee flexibility rules for shifts between budget headings.

A draft partnership agreement should be submitted to the PO before the signing of the project contract.

A template for the partnership agreement⁶ will be available at the Grants website.

2.5 External partners: DPPs and IPOs

The DPPs are public entities from the Donor States with national mandates in their respective fields that have been designated as Programme Partner contributing to the preparation and implementation for the programme. DPPs can also be donor project partners in pre-defined projects (i.e., projects identified in the MoU, in the Concept Note, or proposed by the POs).

The IPOs can provide expertise and strategic advice in their fields to the Donors and the FMO overall, and to the NFP, PO and/ or FO in selected programme areas. The IPOs may also implement their own projects and initiatives or be Project Promoters/ project partners in some projects under nationally managed programmes (if agreed in the Programme Agreement). The IPOs are designated by the Donors. They are funded by an independent IPO Fund. If an IPO acts as a Project Promoter or project partner under nationally managed programmes, its costs will be borne by the project.

2.6 Grant rates and co-financing

The grant rate refers to the percentage of total eligible costs covered by grant funding. Information on the grant rate should be provided in the PA for all programmes. Payments to programmes are calculated by applying the co-financing rate laid down in the PA. The principle of the pro-rata financing should be applied, meaning that payments of the programme grant by the FMO should be matched within one month by payment from the entity(ies) responsible for providing the co-financing (Article 9.1.5).

2.6.1 Grant rate at programme level

At programme level, the contribution from the Grants should not exceed 85% of the total eligible expenditure of the programme (Article 6.4.1), except for programmes directly managed by the FMO and programmes of special interest where the Donors may set a higher programme grant rate. Bilateral funds

⁶ A template for the partnership agreement between the Project Promoter and project partners is provided for information purposes only and its contents are not intended to replace consultation of any applicable legal sources or the necessary advice of a legal expert, where appropriate.

at programme level are not co-financed (i.e., the grant is 100%) and, therefore, they should not be included when the grant rate at the programme level is calculated.

The programme grant rate is established based on the grant rate at the level of outcomes and management costs (also, "programme management costs"). The BS should provide at least 15% co-financing to match the 85% of the contribution from the Grants. This means that the grant rate can be lower than 85%, while the national co-financing should be at least 15%.

Budget heading	Grant amount	Grant rate	Co-financing	Co-financing rate	Total eligible expenditure
Programme management	€850,000	85%	€150,000	15%	€1,000,000
Outcome 1	€4,250,000	85%	€750,000	15%	€5,000,000
Outcome 2	€1,500,000	60%	€1,000,000	40%	€2,500,000
Outcome 3	€4,800,000	80%	€1,200,000	20%	€6,000,000
Bilateral funds	€1,000,000	N/A ⁷	N/A	N/A	€1,000,000
Total	€12,400,000	78.6% ⁸	€3,100,000	21.4%	€15,500,000

Table 3. An example of programme budget

Payments to programmes will be calculated by applying the grant rates set at budget heading level (in accordance with the PA) based on the Interim (Final) Financial Reports.

The FMO will disburse the grant part of the declared expenditure in the Interim Financial Reports (IFRs), unless expenditure proposed by the PO is considered not justified.

2.6.2 Grant rate at project level

At project level, the grant rate is calculated as a percentage of the total eligible expenditure of the project, as determined in the PA. It is recommended that pre-financing and payments from the PO to the Project Promoter are made according to the same rate.

Project Grant Rate = Project Grant/ Project Total Eligible Expenditure

For example,

Project grant rate

Under the call for proposals under Outcomes 1 to 3 (regular grant scheme/ call for proposals) grants from the programme will not exceed (as a proportion of the total eligible project expenditures):

- 100% in the case of PPs that are central government bodies or NGOs;

- 60% in the case of commercial/ private entities.

⁷ Bilateral funds are excluded from the calculation of the programme grant rate, although the whole amount is covered by the Grants.

⁸ Bilateral funds are excluded from the grant rate calculation.

The project grant rate should comply with the relevant state aid rules. It should also account for any other forms of public support granted to projects.

The project grant includes the programme-level co-financing (amount provided by the PO), while the project eligible expenditure includes the project level co-financing (amount provided by the Project Promoter, if any).

When deciding on the grant rate of the project, the PO should also consider the economic benefits that are expected to be generated during or after the implementation of the project as a result of receiving the financial contribution from the Grants (revenue generating projects) (Article 6.4.2). The Regulations do not set up any specific rules on estimation of revenues, hence, this is up to the NFP/ PO to organise respective procedures in line with the national law.

When it is foreseen that significant increased revenues will be generated as a result of the project, the grant rate should be set at a level that does not provide undue benefit to the beneficiaries.

In the event of unforeseen or incidental revenues generated during project implementation, the economic benefits should be used in a manner which supports the objectives of the project. The Regulations do not establish specific rules for monitoring that the revenues are used in a manner that supports the project's objectives, thus, it is up to the PO to organise this and to set the relevant conditions in the project contract.

Revenues generated in projects after the end of project implementation may be used to sustain the project's results during the period of the minimum post-completion operation of the project. The relevant rules should be set in the project contract.

The grant rate at project level does not automatically apply to all partners within the project. It depends on the nature of PP, and not of the project partners. The relationship between the Project Promoter and the partners should be agreed between them in the partnership agreement (Article 7.10). The Regulations, however, do not state any specific obligations for co-financing provided by project partners.

For example,

Project partnership

In a project, there might be 4-5 entities involved as partners. One entity will submit the application and ultimately become PP, acting on behalf of the partnership and signing the project contract with the PO. The Project Promoter may provide the co-financing for the entire project, while the other partners receive 100% of their eligible expenditures from the Grants.

If the Project Promoter provides the co-financing, other partners, including NGOs or donor project partners, do not need to provide financial resources. This arrangement should always be agreed upon upfront and clearly stipulated in the partnership agreement. Alternatively, all or some project partners may contribute a share of private resources to the grant amount.

The grant rate should always be communicated in the calls for proposals organised by the PO.

As a rule, the project co-financing should be in the form of cash, including electronic transfers. This means contributing actual money (instead of in-kind support) toward the funding of a project or initiative along the Grants' share. For instance, if a project with a project grant rate of 85% spends €100 on some activity, the PO will reimburse €85 to the project (Grants share), while the remaining €15 come out of the Project's own funds in the form of cash. However, there are two exceptions to the project co-financing in the form of cash (where there is no requirement for the project co-financing to be provided in cash):

- 1. For projects where PPs and project partners are non-governmental organisations (NGOs) or social partners, in-kind contribution in the form of voluntary work may constitute up to 100% of the project co-financing.
- For projects under Donor partnership programmes falling under the programme area "Research", in-kind contribution in the form of labour may constitute up to 100% of the co-financing required for the project.

To illustrate these two cases, if a project with a project grant rate of 85% spends €100, the PO will reimburse €85 to the project, and project can contribute with voluntary work (in case of NGO)/ labour (in case of Donor partnership programmes under Research) with a value of €15 (100% of project co-financing).

In both cases, the PO should specify the appropriate unit prices for the voluntary work/ labour which should be in accordance with salary normally paid for such work in the BS, including the required social security contributions (Articles 6.4.6 and 6.4.7). The unit prices may be adjusted during the implementation of the programme to account for changes in salaries. They can also differ depending on the region in which the work is performed or the type of the voluntary work.

The range of the project sizes for different calls must be defined in the programme development phase and outlined in the PA, while the size of each project should be set in the project contract.

2.7 Technical assistance to the Beneficiary State and the TA Agreement

Technical assistance (TA) covers the costs of the national authorities (normally, the NFP, CA and AA) needed for the implementation of the Grants. The NFP coordinates the use of the TA and ensures that authorities covered by the TA receive sufficient funding to perform their activities and tasks as defined in the Regulations (Article 8.11).

The Donors and the BS conclude the TA Agreement based on the template provided by the FMO (<u>Annex</u> <u>5 to the Regulations</u>).

The maximum amount of the TA is fixed in the MoU and in the TA Agreement (contributions from EEA and Norwegian Financial Mechanisms). The TA is financed 100% by the Grants (national co-financing is not required).

Contributions from the Grants towards the TA should not exceed 1.5% of the total contribution to the respective BS (EEA and Norwegian cumulatively). There is one exception (Article 8.11.3):

• where the BS's allocation is 5% or less of the Financial Mechanisms (EEA and Norwegian, cumulatively), a higher percentage for the TA can be set in the MoU⁹.

TA disbursements

The disbursement of the contribution from the Grant towards TA is done in the form of **a fixed amount**. This means that TA disbursements are not linked to actual incurred expenditure, but to the delivery of pre-defined outputs (listed below). The payments of TA take form of first, subsequent and final disbursements.

⁹ If the BS requests an amount for the TA that exceeds 1.5% of the total contribution to the BS, the BS will be required to provide justifications to support their calculations for the higher rate.

► The notions of "eligibility of expenditure" and "eligibility period" do not apply to the TA as the payments of the TA are linked to the delivery of pre-defined outputs and not actual expenditure.

The signature of the TA agreement triggers the first disbursement to the NFP which has to be requested in the first available Interim Report (in GrACE). The subsequent disbursements are done in equal tranches twice per year (via the regular Interim Reports workflow in GrACE) until the end of the Grants. These disbursements are conditional upon the timely and satisfactory delivery to the FMO of the following four outputs:

- the Country Report (Article 2.6);
- the Interim Financial Reports (Article 9.3);
- the Annual Audit Report (Article 5.5.1); and
- the Irregularities report (Article12.5).

For the final payment of the TA, the following outputs should be delivered to the FMO:

- the Final Country Report (Article 2.6.4);
- the closure declaration and final audit report (Article 5.5.1); and
- all Final Programme Reports (FPR) (Article 6.8).

Supporting documents to receive the payments of the TA are the outputs (reports) described above and not the expenditure incurred! The underlying incurred expenditure should not be checked by the audit authorities in their audit work either.

The Interim Reports for Technical Assistance should be prepared by the NFP, certified and submitted to the FMO by the CA, in accordance with the following schedule (same as for the "regular" IFRs):

- for the reporting period 1 January 30 June (year N), the report should be submitted by 15 September (with the respective disbursement of funds to be done by 15 October);
- for the reporting period 1 July 31 December (year N-1), the report should be submitted by 15 March (with the respective disbursement of funds to be done by 15 April).

In the Interim Report for TA, the NFP should include the amount of the disbursement, as specified in the TA agreement, and provide information on the relevant reports (outputs) submitted to the FMO. The FMO will check whether the outputs were delivered in a timely and satisfactory manner and provided the conditions are met, the disbursements of the TA funds will be made to the NFP.

In general, the TA funds are intended to cover the following activities (the list is non-exhaustive):

- activities related to preparation, financial flow, monitoring and evaluation of the assistance, programmes and the fund for bilateral relations;
- preparation of and participation in annual meetings with the Donors, and other meetings with the Donors related to the implementation of the assistance;
- meetings and conferences organised by the NFP, the AA, or the CA to share experience related to the implementation, monitoring, evaluation, reporting and auditing of projects funded by the Grants. The Donors should be invited to participate in such meetings and conferences;
- communication activities;
- audits referred to in Article 5.5, and Article 5.7.2;
- on-the-spot verifications of programmes and projects.

Final reporting on the use of TA is part of the Country Report. The final Country Report should be submitted to the FMO no later than 31 August 2032 (Article 2.6.4).

2.8 Bilateral funds and Bilateral Fund Agreement

Each BS shall set aside between 2 and 5% of its total allocation for bilateral initiatives (Article 4.6). The exact amount shall be agreed in the MoU and allocated to the bilateral funds at national and programme level. The part for use at programme level shall be further divided between the programmes in each BS during the MoU negotiations and identified in the PA. The allocation for the bilateral funds at the programme level is part of the programme budget and shall be linked to a separate bilateral outcome.

The allocation for funds for bilateral relations cannot be less than 2% or more than 5%!

Activities funded by the funds for bilateral relations are referred to as "bilateral initiatives".

The first date of eligibility for support under the funds for bilateral relations is the date of entry into force of the MoU with the respective BS. The final date of eligibility for the bilateral funds depends on the level at which the bilateral fund is established:

- at national level, the final date of eligibility of expenditure is 30 April 2032;
- at programme level, the final date of eligibility of expenditure is 31 December 2031.

There are no co-financing requirements for the funds for bilateral relations; i.e., bilateral initiatives are fully financed by the Grants (100%).

The rules on eligibility of expenditures set out in Chapter 8 of the Regulations apply to the funds for bilateral relations and should be interpreted by analogy. In general, provisions on "projects" apply to bilateral initiatives and "project contracts" apply to contracts for bilateral initiatives.

Two provisions in Chapter 8 of the Regulations specifically do not apply to the funds for bilateral relations:

- Where new or second-hand equipment is purchased, the main rule is that only the portion of the depreciation corresponding to the duration of the project and the rate of actual use for the purposes of the project may be considered eligible expenditure. Article 8.4.1 (c) allows for an exception from this rule in case of projects. This exception is not applicable to the funds for bilateral relations.
- 2. Purchase of land and real estate is not eligible under the funds for bilateral relations as per Article 8.4.1 (d). Provisions of Article 8.8 concerning the purchase of land and real estate do not apply to the funds for bilateral relations either. However, Article 8.8.3 does apply, regarding restrictions for buildings that are constructed, reconstructed or renovated. This means that (minor) constructions, reconstructions or renovations can be eligible under the BF provided that the general eligibility conditions are respected. In case of construction, reconstruction or renovation, it is the actual cost that is eligible. Depreciation cannot be considered eligible in this case.

The funds for bilateral relations at national level are regulated by a separate agreement between the Donors and the NFP, which is called the Bilateral Fund Agreement.

Further details on the set-up, design and implementation of the bilateral funds are provided in the dedicated Bilateral Guideline, which forms part of the legal framework of the Grants.

2.9 Management and control systems

The BS should set up management and control systems (MCS) at the national level. The MCS should follow the principles of accountability, economy, efficiency and effectiveness. The MCS is a comprehensive framework designed to oversee, administer, and monitor the Grants lifecycle in the BS.

2.9.1 Key requirements of the national MCS

The MCS should be described in the dedicated document. The description should cover 14 key requirements as defined in the Regulations (Reg. Art. 5.1.2). The table in Annex I presents these key requirements and provides additional information on the content for each of them.

2.9.2 MCS at national level

The national authorities have to set-up the systems to fulfil their responsibilities in line with the Regulations.

The NFP is responsible for submitting an MCS description at the national level to AA covering the principles and <u>key requirements</u> identified in Article 5.1 of the Regulations. The MCS description should, among other things, describe the organisational structure and the procedures of the NFP, CA, AA and other national entities that are involved in the implementation of the Grants.

The MCS at national level should describe how the NFP will carry out regular monitoring of the programmes with regards to their progress towards the programme outputs, outcome(s) and objective(s) according to the agreed results framework and the financial requirements specified for the programme (Article 5.3.4). Further information on results-based management, risk-based monitoring and evaluation can be found in "Results-Based Management Guidance".

AA should review the description of the MCS at the national level in respect of the 14 key requirements laid out in Article 5.1 and, in particular, the organisation and procedures of the NFP, CA, AA and any other national entities involved in the implementation of the Grants. The review should lead to an audit report and audit opinion confirming that the systems of the BS comply with the Regulations and generally accepted accounting principles. The report should also assess the proportionality of the management and control system's requirements in relation to the effectiveness of achieving the objective(s) of the programmes.

AA may, to the extent possible, base its review on the equivalent description submitted under the previous Financial Mechanisms (2014-2021) (Article 5.7.2). If AA bases its opinion on the MCS from the previous funding period, AA needs to ensure that information in the MCS covers key requirements as defined in Article 5.1.2.

2.9.3 Audit report and opinion on the MCS at national level

AA should submit its **opinion** on the functioning of the MCS to the Donors within 12 months of the entry into force of the MoU, using the template provided by the FMO (Articles 5.7.2 and 5.7.5). If it is not submitted, the Donors may suspend payments to the programmes. The FMC may also request the detailed description of the MCS along with the AA's report with the assessment of the functioning of the MCS.

All information concerning the MCS should be submitted electronically (via GrACE) in accordance with Article 5.1.3.

To review the key requirements of the MCS at national level, the AA may use the guidance on the content of the key requirements as provided in <u>Annex I</u>¹⁰. When reviewing the MCS, AA could use the risk-based approach; i.e., placing more focus on requirements that are more relevant to the kick-off of the implementation of the Grants.

The Regulations no longer require a description of the MCS at programme level. However, the NFP and the PO may still choose to draft a document outlining the PO procedures. Alternatively, they can use existing documents or include the procedures in the MCS description at the national level. The organization of this process is entirely at the discretion of the national authorities, as the Regulations do not impose any additional rules.

The MCS should reflect the key requirements as specified in the Regulations. The description should be short but detailed enough to cover all the relevant aspects. It is important that the description is self-explanatory. This means that all references to other documents, rules or regulations must be explained properly in the MCS.

Good practice

The information on the MCS at national level should include details on the system structure. This should encompass general information and a flowchart illustrating the organizational relationships between the authorities and entities involved in the MCS.

The MCS should identify the main bodies, including their names, addresses, and contact points.

Additionally, it should explain how the separation of functions is maintained between and within the programme authorities.

Further details on the organisational structure of the Grants for the description of the MCS are provided in <u>Annex II</u> to this document.

¹⁰ The information on the key requirements in Annex I adopts elements from the guidance from the European Commission (EC) on the assessment of the key requirements for the management and control system (as defined in the Common Provision Regulation, Regulation (EU) 2021/1060). The AA may use the EC's guidance documents, methodological notes or other relevant resources when assessing the MCS of the BS.

III. Eligibility of expenditure

3.1 Forms of grants

The Regulations provide for two forms of grants (Article 8.3).

Figure 2. Forms of grants



Costs actually incurred are tangible and can be directly measured and documented through receipts, invoices, and other financial records. Incurred expenditures are costs that a beneficiary has actually paid or is obligated to pay as a result of carrying out a specific activity in a project.

Simplified cost options (SCOs) are amounts or percentages, defined ex-ante (in advance), that represent the *best possible approximation* of actual (real) eligible costs incurred in practice when implementing an action. SCOs are an alternative method for reimbursing the eligible costs of a project as opposed to the traditional methods where costs actually incurred and paid by the partner are reimbursed. This means that when SCOs are used, the amount paid to the partner to cover an activity or cost category may be higher or lower than the amount the partner actually used on that activity or cost category. When using SCOs, both the entity providing the grant and the partner accept this risk because of the expected benefits for both parties from simplified processes (e.g., reporting, verification, audit, payment flows). SCOs are explained in detail in <u>Chapter IV</u>.

Both options are forms of eligible expenditure under the Grants (Article 8.3.1).

Simplified cost options can take the form of unit costs, lump sums, and flat rates (flat-rate financing):

- Unit costs are amounts calculated based on the quantified activities, input, outputs or results multiplied by standard scale of unit costs established in advance. They can cover all or part of the costs of the project.
- Lump sums are amounts established in advance which are paid if the pre-defined activities and/ or outputs are delivered. The lump sums can cover all or part of the eligible costs of the project.
- Flat rates are specific categories of eligible costs, calculated as percentages, established in advance and applied to one or several other categories of eligible costs.

Table 4. Types of SCOs and their characteristics

Types of SCOs	Unit costs	Flat rates	Lump sums
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Definition	An amount fixed in advance (unit cost) for delivery of quantifiable outputs	A percentage fixed in advance to calculate one or several cost categories in the project	An amount fixed in advance for a delivery of pre-defined output/ result
Design	Can cover all or part of the cost category	 When applying a flat rate, two different types of cost category should be defined: the cost category calculated as a flat rate; and the "basis cost category," to which the flat rate is applied. Cost categories can only be covered by a single flat rate, but several flat rates can be applied to the same basis cost category to calculate flat rates for different cost categories. 	Binary approach – the whole output should be delivered in order for the payment to happen (unless the lump sum is composed of several parts linked to payments).
Practical examples	Hourly rate to calculate staff costs Staff costs = Hourly rate * Number of hours actually worked on the project	A flat rate to cover indirect costs of the project as a percentage of personnel costs Indirect costs = Eligible personnel costs * X%	Organisation of a final conference based on the delivered signature list and photos. Lump sum = €10,000 for a final conference
	Unit cost per participant to organise an event Costs of an event = Unit cost per participant * Number of participants in the event	A flat rate to cover the project management equipment (needed for the delivery of the project) as a percentage of personnel costs <i>Project management equipment =</i> <i>Eligible personnel costs * Y%</i>	Delivery of a market strategy composed of 2 outcomes: market research (50% of the payment); market strategy (50% of the payment).

Since SCOs are calculated based on amounts and percentages defined in advance, tracing of every euro of co-financed expenditure to individual supporting documents is not required. This represents the fundamental difference between the actually incurred expenditure (real costs) and costs covered by SCOs. Verification and audit work of the two forms of eligible expenditures differ greatly and is explained in <u>Chapter V</u>.

Real costs and SCOs can be combined in the same project provided that each form covers different categories of costs or successive phases of a project (e.g., project preparation, implementation and closure). For this reason, it is of utmost importance to have a clear definition of direct and indirect costs in the project and of categories of costs and types of costs that fall under different categories.

As a general guidance, the following definitions should be used for direct and indirect costs.

The eligible **direct expenditures** for a project are those expenditures which are identified by the Project Promoter and/ or project partners, in accordance with their accounting principles and usual internal rules, as specific expenditures directly linked to the implementation of the project, and which can be directly booked to it. The following categories of costs are considered direct eligible expenditure in projects (Article 8.4.1):

- staff costs assigned to the project (actual salaries and costs of social security charges and other statutory costs included in the remuneration);
- travel and subsistence allowances for participants in the project provided that this corresponds to the usual policy of the Project Promoter and project partner on travel allowances (this covers travel costs of both staff assigned to the project and any participants in a project);
- costs of new (where the PO determines that it is an integral and necessary component for achieving project's outcomes) or second-hand equipment (not eligible under the funds for bilateral relations, programme management and TA);
- purchase of land and real estate (not eligible under the funds for bilateral relations, programme management and TA);
- costs of consumables and supplies provided that they are identifiable and assigned to the project;
- costs entailed by other contracts awarded by the Project Promoter for the purposes of carrying out the project;
- costs arising directly from the requirements imposed by the project contract for each project.

Different categories of eligible direct costs can be reimbursed based on the real costs or SCOs.

Indirect costs are all eligible costs that cannot be directly attributed to the project. Such costs could include, for example, administrative expenses, for which it is difficult to precisely determine the amounts attributable to a specific project (e.g., office rent; utilities such as electricity, water, heating; office supplies; accounting; archives; communication, such as telephone, postal services, etc.).

The indirect costs can also be calculated based on the real costs or SCOs.

3.2 General principles on the eligibility of expenditure

The general principles stipulated in Article 8.2 of the Regulations and described below apply "mutatis mutandis" (with the necessary changes being made) to all eligible expenditure under the Grants, except for TA. This means that they also apply to programme management costs as well as to expenditure under the Bilateral Funds unless otherwise explicitly stated.

Supporting documents regarding incurred expenditures must be kept either in the form of originals or in versions certified to be in conformity with the originals for a period of at least three years following the approval of the FPR (Article 9.7), without prejudice to more stringent national rules.

To be eligible under the Grants, expenditures need to be in accordance with the following rules.

1. Eligibility period

For costs incurred, they need to be actually incurred between the first and final dates of eligibility of a project as specified in the project contract. Furthermore:

- expenditure can be eligible from the date the PO approves the project, unless a later date is specified in PA (PIA), or project contract (however, limited preparation costs of projects selected for funding may be eligible as of the date of publication of the respective call for proposals in line with clear and transparent rules established by the PO); however, the first date of eligibility of a pre-defined project cannot be earlier than the entry into force of the PA;
- if the project approval is contingent on the availability of funds, only expenditure incurred from the date of this conditional approval are eligible;

• the start and end dates for eligible project expenses should be clearly stated in the project contract.

All project expenditure must be incurred by the PP/ project partner(s) by 30 April 2031 to be considered eligible under the Grants.

Where SCOs are used, the actions constituting the basis for payment should be carried out between the first and final dates of eligibility as specified in the project contract. This is relevant for unit costs and lump sums. Where flat rates are concerned, the basis costs on top of which flat rates are calculated, are either actually incurred costs, or SCOs. The respective rules apply then to the basis costs.

2. Connected with the subject of the project contract and indicated in the budget

An estimation of eligible expenditures should be shown in detail in the project budget, whether the expenditures are real costs or simplified cost options. The same expenditure item included in one project budget heading cannot be reported and reimbursed in any other budget heading (no double financing).

All project applications submitted under calls for proposals should include a detailed (itemised) estimated budget. At the stage of the project selection, the eligibility of expenditures included in the project budget will be assessed. In line with point (k) of Article 7.9.3, the detailed project budget will be part of the project contract. The final grant amount is established based on the accepted eligible costs of the project. If the actual project cost turns out to be higher than the cost budgeted, the maximum grant amount (set in the project contract) will not be increased. This means that the maximum amount of the project grant set in the project contract serves as a ceiling for the eligible costs in the project. Everything that exceeds the total budget will have to be covered by the project's own funds. This does not concern exceeding the amounts per budget headings (cost categories). These flexibility rules shall be specified in the project contract and partnership agreement.

3. Proportionate and necessary for the implementation of the project

All project costs must be reasonable and justified.

"Proportionate" means that the costs do not exceed what is needed to achieve the objective(s) sought. This can, for example, be assessed through price comparison or the consideration of other measures that can achieve the same result (value for money). Where simplified cost options are used, off-the-shelf SCOs are considered proportionate and justified as these methods derive from the Regulations.

Where the PO develops their own SCOs using the fair, equitable and verifiable method or the draft budget method (explained in sections 4.2.4 and 4.2.5), costs included in the calculation of the amounts/ rates/ percentages should be proportionate, realistic, and justified.

"Necessary" implies that the expenditure item is necessary (indispensable) for the achievement of the project results.

4. Used for the sole purpose of achieving the objective(s) of the project and its expected outcome(s) in a manner consistent with principles of economy, efficiency and effectiveness

Expenditure is only eligible if it has been used for the purpose of achieving the objective(s) of the relevant project and its expected outcomes.

Economy can be understood as minimising the costs of resources used for an activity (input) whilst maintaining quality. Efficiency refers to production or delivery of something without wasting resources,

time, or energy. Cost effectiveness refers to the degree to which a cost contributes to attaining a specific outcome or goal.

For amounts/ rates/ percentages established using the simplified cost options to be considered in line with the principles of economy, efficiency, and effectiveness, they should be:

- correctly applied (e.g., conditions for reimbursement are met);
- correctly developed when it comes to programme-specific SCOs and fair, equitable, verifiable method/ draft budget method;
- correctly transferred from Union policies/ national schemes to projects of a similar nature.

5. Identifiable and verifiable, and properly accounted for

This principle is only applicable to actually incurred costs (i.e., real costs).

Incurred costs must be identifiable, verifiable and properly documented (e.g., contract, invoice, purchase order), through being recorded in the accounting records of the Project Promoter and/or project partners according to the applicable accounting standards of the country where PP/ partner is located, and according to generally accepted accounting principles.

Costs which are not identifiable, verifiable and properly accounted for are not eligible.

🔎 For example,

A project has hosted a final conference, which includes costs related to the venue rental, fees for speakers and catering. Each of these costs must be based on supporting documents such as evidence of public procurement, contracts signed, invoices, etc. In addition, these costs must have been recorded in the accounting records of the Project Promoter or project partner.

6. Comply with the requirements of applicable tax and social security legislation

All relevant legislation on taxes and social legislation should be complied with, e.g., taxes due under relevant legislation must be paid, and social obligations towards employees, such as severance pay, retirement benefits, minimum wage levels, as stated in the relevant legislation should be complied with.

When establishing amounts/ rates for SCOs, these costs should be included in the calculations. For example, any other costs directly linked to the salary payments, incurred and paid by the employer (e.g., employment taxes and social security, including pensions, benefits, holidays, sick leaves), in accordance with the legislation and standard policies in the BS and/ or PP/ partner organisation can be included in the annual gross employment cost which serves as a nominator when establishing the hourly rate (unit cost) using the 1,720 hours method (point (a) of Article 8.6.2).

3.3 Eligible expenditure of a programme

The eligible expenditures of a programme consist of three elements (Article 8.1).

Figure 3. Eligible expenditure of a programme



The eligibility of costs is conditional on the programme's approval by the Donors and is subject to limits set in the PA. The starting date of eligibility of expenditures is when the PO is designated in the MoU (or when the PIA is signed by the FO).

The final date of eligibility differs for different types of costs:

- for programme management costs (costs of PO) 30 April 2032 unless an earlier date is specified in the PA (Article 8.10.1);
- for project expenditures 30 April 2031 (unless earlier date is specified in the project's contract) (Article 8.14.4);
- for expenditures under the funds for bilateral relations at programme level 31 December 2031 (Article 4.10.2).

If the PO delegates certain tasks to other entities or, on the basis of the MoU, the tasks are split between different entities, costs of the other entities can be covered if they fall within the eligible categories.

The eligible programme expenditures should be reported to FMO through IFRs and Final financial report at the end of the programme implementation.

During the implementation, cumulative transfers of up to 10% of the total eligible expenditure of the programme may be made between programmes without the modification of the MoU (however, relevant PAs will have to be modified). Reallocations to and from calls and pre-defined projects (both within the same Outcome and between Outcomes) within the programme without the modification of the Programme Agreement are permitted for an amount of up to 10% of the total allocation for each planned call or pre-defined project. This is specified in the Programme Agreement (Annex 4 to the Regulations). In addition, cost savings and amounts not committed to projects could be transferred to the funds for bilateral relations at the programme and/ or national level provided that the transfer has been consulted and agreed upon with the Cooperation Committee of the programme concerned.

3.3.1 Management costs of PO

The (programme) management costs of the PO are costs needed for the preparation and effective implementation of the programme. The eligibility of the management costs starts on the date of the entry into force of the MoU and ends on 30 April 2032 (one year after the final date of eligibility of project

expenditure, and the deadline for the submission of the FPR to FMO) unless an earlier date is indicated in the PA.

The management costs should follow the categories provided in the Article 8.10.5 (table below). They should be proportionate and necessary for the implementation of the PO tasks.

Category of expenditure Article 8.10.5	Additional information
Preparation of the programme, including the development of the programme design, the results framework and stakeholder consultations – until approval	Expenditure needed for the development of the programme design, the results framework and stakeholder consultations.
Preparation of the implementation of the programme, including the development of procedures for project selection and financial flows	Expenditure needed for the development of procedures for project selection and financial flows. New / updates to the e-system, hiring new staff, buying equipment and furniture for new staff, costs of meetings. Expenditure to assist possible applicants and PPs in complying with the requirements set by PO for project applications and/ or implementation of projects; costs of experts and selection committee meetings and appeals.
Verification of declared expenditure, monitoring, and audits	Expenditure related to verification of declared expenditure, approval of payments, transfer of payments to PPs; monitoring of projects and reviews; audits and on-the-spot verification of projects.
Promotional and information activities, including calls for proposals and information work during the application period as well as information events to share experiences and evaluate the impact of the programme	Expenditure needed for calls for proposals and information work during the application period; information events to share experiences and evaluate the impact of the programme. Information events, website and social media costs, promotional materials.
Reporting to the Donors and national authorities	Expenditure related to reporting obligations to the Donors, the NFP, the CA. Meeting with authorities, travels to meetings and workshops organised by the NFP/ FMO.
Establishment and operation of bank accounts	Costs for the establishment and operation of the bank accounts required by the Regulations, including costs of incoming and outgoing transfers.
Overheads	Indirect costs of the PO. Can be identified in accordance with the relevant rules established by the PO organisations if in line with the PA.
Operation of the Cooperation Committee and the Regional Programme Committee, when required within programmes falling under the programme area "Research and Innovation"	Including costs of the Regional Programme Committee under Research programmes. Meetings, travels, external experts if needed.
Expenditures related to the strengthening of bilateral relations, including management of the bilateral funda at programme level	All bilateral activities costs at the programme level.
Cooperation activities, exchange of best practices between POs and similar entities within the BS and/or Donors, and/ or international organisations	Meetings and travels to other Beneficiary/ Donor States, workshops for all POs, international conferences.

Table 5. Eligible types of activities and costs covered by the management costs of the PO

Article 8.10.2 sets out the **maximum amount** for the management costs, where the limit is a percentage of the total eligible expenditure of the programme¹¹:

¹¹ The programme budget can be easily calculated using <u>this tool</u> in GrACE. The programme management costs can be calculated using <u>this tool</u> in GrACE.

- a. 10% of the first €10 million;
- b. 7% of the next €40 million;
- c. 5% of the next €50 million;
- d. 4% of the remaining total eligible expenditures of the programme.

For example,

If the total eligible budget of the programme is €120 million, the maximum amount for the management costs is:

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€10 million * 10% + €40 million * 7% + €50 million * 5% + €20 million * 4% = €7,100,000.
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For programmes with the total eligible budget up to €10 million, the Donors may approve a higher ceiling in exceptional and duly justified cases.

The eligibility of management costs is conditional on the approval of the programme by the Donors.

Reimbursement of management costs

Programme management costs can take form of:

- 1. incurred costs ("real costs");
- 2. simplified cost options (SCOs);
- 3. combination of real costs and/ or SCOs.

The method of reimbursement of management costs must be defined in the PA.

Table below shows examples of eligible types of expenditure under the programme management costs provided they are proportionate and necessary.

Table 6. Programme	management cos	sts per type of expenditure

Type of expenditure	Further information
Staff costs	Employees of the PO organisation (full-time, part-time, flexible engagement)
Depreciation of equipment	The full purchase price of the equipment is not eligible under programme management costs. Should be proportionate to the actual use for the intended purpose.
Meetings and travel costs	Travel costs of employees of the PO.
External experts (project selection, monitoring, audits, reviews, etc.)	Including travel costs of the external experts.
Costs of monitoring of projects and verification of eligibility of costs, reporting	
Costs of promotional and information activities	
Charges related to the bank accounts	Establishment and operation costs of the required bank accounts.
Overheads	Indirect costs of the PO.

Both actually incurred costs and simplified cost options can be used to reimburse eligible types of expenditure under the programme management costs.

The Regulations do not specifically identify trainings and improvement of professional skills in general as being eligible under the Grants. There is a general assumption that POs should already possess the necessary skills and competences required to fulfil their role (including, e.g., language skills).

In justifiable cases, however, costs of the participation of the staff in trainings aimed at improving skills in terms of performing their tasks, such as monitoring, public procurement, financial management and/ or programme content-related may be considered eligible. Before certifying the related costs, CA should check whether there has been a proper justification concerning the participation of the staff in such training.

The management costs of the PO are claimed together with the projects' expenditure via the regular IFRs (and in the Final financial report of the FPR).

It is not possible to claim more than 90% of the programme management costs via the IFRs (Article 9.1.4). The remaining 10% are retained by the Donors in case of irregularities/ deficiencies in the management and control system and are paid at the end of the programme implementation with the FPR (they are included in the calculation of the final balance of the programme).

3.3.2 Project costs

Payments to projects within the programme are eligible expenditure if they are in accordance with the Regulations, the PA and the project contract.

Payments to projects can take forms of:

- advance payments (to pre-finance activities);
- interim payments (based on incurred expenditure);
- final payments (payments of the final balance).

These payments are reported by the PO to the FMO via the regular IFRs and Final financial report.

The PO establishes the payment flows to PPs and ensures that the payments to projects are made in a timely manner. The advance payments are normally paid after the signature of the project contract, whereas interim and final payments are done following the approval of the project reports. The PO should monitor the cash flows (advance vs incurred expenditure) to ensure that the projects are incurring expenditure according to the project contracts and are not "sitting" on money.

Table below shows the eligible types of expenditure under the project costs provided they are proportionate and necessary for the implementation of the project.

Cost categories	Further information
Staff costs	Employees of PP/ project partner organisation (full-time, part-time, flexible engagement).
Travel and subsistence allowances	Travel and subsistence costs of participants in the project (covers participants beyond PP/ project partner organisation).
Costs of new or second- hand equipment	The full purchase price of the equipment could be eligible provided it is an integral and necessary component of the project needed for achieving the outcomes of the project.

Table 7. Eligible categories of project costs (Articles 8.4 and 8.5)

Purchase of land and real estate	In justified cases.
Costs of consumables and supplies	Provided they are identifiable and assigned to the project (otherwise, overheads).
Costs entailed by other contracts	Awarding should comply with the applicable rules of the Regulations and national rules.
Other costs	Costs that arise directly from the project contract.
Overheads	Indirect costs of PO.

Both actually incurred costs and simplified cost options may be used to reimburse eligible categories of project costs (except for the purchase of land and real estate category, where only actually incurred costs shall be used).

In exceptional and duly justified cases, the PO may suggest additional expenditures, including re-granting at the project level, to be eligible or exclude certain categories of costs/ expenditure. These exceptions should be explicitly described in the PA if approved by the FMC, and where relevant accompanied by the necessary terms and conditions with regards to the eligibility of the expenditure in question (Article 8.4.3).

Reimbursement of project expenditure

The forms of reimbursement of project costs should be established in the PA and further specified in the calls for proposals and project contract. The PO can use actually incurred expenditure, SCOs or combination of the two to reimburse project expenditure.

The PO can use off-the-shelf SCOs, establish their programme-specific SCOs, or use SCOs from national schemes/ Union policies.

Where SCOs are used together with real costs, categories of costs should be clearly defined to avoid double financing of the same expenditure (the same expenditure cannot be reimbursed as real costs and an SCO).

If the PO develops programme-specific SCOs, the methodology should be verified by the national AA before it is offered in the call for proposals.

3.3.3 Payments from the funds for bilateral relations

The PO is responsible for the management of the funds for bilateral relations <u>at programme level</u> in their programmes. The use of the funds is decided by the PO in consensus with the DPP(s) in the programme. The PO may, with the consent of the NFP and the FMC, entrust the use and management of a part of the bilateral funds at programme level to the DPP(s)¹².

The rules on eligibility of expenditure set out in Chapter 8 of the Regulations apply to the funds for bilateral relations with the exceptions as described in <u>section 2.8</u>.

The PO should report on the use of the bilateral funds in their programmes in IFRs and in the FPR.

¹² This is further explained in the Bilateral Guideline.

3.4 Eligible direct expenditure of a project

Direct expenditures are all those eligible costs which can be attributed directly to the project and are identified by the Project Promoter and/ or project partner(s) as such, in accordance with its accounting principles and its usual internal rules.

The following sections contain categories of direct expenditures that may be considered eligible¹³.

3.4.1 Staff costs

The cost of staff assigned to the project, comprising actual salaries plus social security charges and other statutory costs included in the remuneration, if this corresponds to the PP's and project partner's usual policy on remuneration.

Only the costs of the actual hours worked by the persons directly carrying out work under the project may be charged. Working time is the total number of hours, excluding holidays, personal time, sick leave, or other allowances. Working time should be recorded throughout the duration of the project by timesheets or suitable time recording system, adequately supported by evidence of their reality and reliability.

The following principles should also be taken into consideration:

- The existence of the employment/ work contract or an appointment decision. If a staff member is employed to work exclusively on the project (100%, full-time), a clear reference to the project should be included in the contract/ appointment decision to avoid any ambiguities. In that case, the time sheets are not required.
- Overtime may be accepted provided that this is necessary to the project, in line with the PP's and project partner's usual policy, and/ or in line with the national legislation. Systematic overtime payments are not in line with the Regulations' requirements for proportionality and sound financial management (Article 8.2.1).
- Overheads, daily allowances and any other travel related costs cannot be included under staff costs category.
- Any additional benefits (e.g., monthly transport costs) must be directly linked to the salary payments and be incurred and paid by the Project Promoter and/ or project partners in accordance with the employment contract/ appointment decision or relevant national legislation to be considered eligible under the staff costs category.

The costs of staff of national administrations for salaries are eligible to the extent that they relate to the cost of activities that would not be carried out if the project was not undertaken.

Calculation of staff costs

	Calculation methods			
Real	Real costs Simplified cost options			
Actually incurred costs	Fixed percentage method	Flat rates (off-the-shelf, FEV, from Union policies/ national	Unit costs; i.e., hourly rate (off-the-shelf, FEV, from Union policies/ national	Lump sums (FEV, from Union policies/ national schemes, draft budget method)

¹³ In exceptional and duly justified cases, the PO may suggest additional expenditures to be eligible or exclude some. Any deviation, if approved by the Donors, should be explicitly stipulated in the PA and where relevant be accompanied by the necessary terms and conditions regarding the eligibility of the expenditure in question.

schemes, draft budget	schemes, draft budget	
method)	method)	

Staff costs of an employee in the project can be calculated using the actually incurred costs ("real costs") or simplified cost options. Simplified cost options to calculate staff costs are described in detail in <u>section</u> <u>4.2.1</u>.

Article 8.6.5 provides for one additional way to calculate staff costs, the so-called **fixed percentage method**. It is not an example of a simplified cost option; it is one of the ways to calculate actually incurred costs ("real costs").

This method should be used to calculate staff costs for employees who work part-time on the project based on their involvement in the project. The percentage should be fixed individually for each employee in a document setting out the percentage of the working time to be spent by the employee on the project per month.

Using this method does not require establishing a separate working time registration system. This means that timesheets or any other equivalent document should not be used, as the fixed percentage covers the time worked on the project.

Staff costs of an employee = Total monthly salary (gross salary) * Fixed percentage

For example,

Staff costs = € 5,000 * 50% = € 2,500

Total monthly salary should include all compulsory payments (e.g., employer's social contributions).

The percentage should be fixed in the task assignment document or in the employment contract. The document should be up-to-date and reflect proportionally the level of engagement of an employee in the project activities. Ideally, the percentage should remain the same for the whole duration of the project and could be changed only in justified cases (the employer will have to issue an amendment to the document setting out the fixed percentage of time on the project).

3.4.2 Travel and subsistence allowances for staff and participants in the project

The following principles should be applied to travel and subsistence allowances:

- travel must be clearly linked to the delivery of the project and carried out by the staff of the PP, project partner and/ or participant in the project;
- any direct payment by individuals must be supported by a proof of reimbursement where actually incurred costs are used;
- an expenditure item covered by the daily allowance cannot be eligible in addition to the daily allowance;
- having regard to the principle of proportionality, travel costs including subsistence allowances can be calculated using the simplified cost options (flat rates, unit costs, lump sums), on the basis of defined rules approved by the PO (using the methods as provided for in Article 8.3.2);
- the principle of sound financial management should apply to the choice of transport and accommodation;

- travel and accommodation costs of external experts and service providers should not be included under this heading, but under costs entailed by other contracts awarded by a Project Promoter for carrying out the project;
- a proof of expenditure for costs actually incurred must be available (e.g., invoice of travel agent, plane tickets, e-tickets, boarding passes, meal receipts, list of participants, minutes, agenda, etc.).

Calculation of the travel and subsistence allowances cost category

Both actually incurred costs and SCOs can be used (flat rates, unit costs, lump sums). The Regulations do not provide for any off-the-shelf SCOs to calculate the travel and subsistence allowances costs; thus, other methods must be used (i.e., FEV, from other Union policies/ national schemes, draft budget method) should PO wish to use SCOs to calculate this cost category.

3.4.3 Equipment

Depreciation of equipment (new or second-hand) as recorded in the accounting statements of the Project Promoter and/ or project partner(s) is eligible provided that the asset has been purchased in accordance with the relevant conditions in the project contract and written off in accordance with the international accounting standards and the usual accounting practices of the Project Promoter and/ or project partner. Only the portion of the depreciation corresponding to the duration of the project and the rate of actual use for the purposes of the project may be considered eligible.

If the equipment (new or second-hand) has not yet been fully depreciated, the remaining depreciation (according to the amount of use, in percentage and time) can be eligible under the project and for the project duration.

For example,

A Project Promoter has a piece of equipment that is depreciated over 5 years, and at the start of the project the piece of equipment has been already in use for 2 years. Assuming that the equipment is used at 100% for the project purposes, the last 3 years of the equipment's useful lifetime form an eligible cost of the project (if the project lasts for those 3 years).

In case the PO determines that the equipment is an integral and necessary component for achieving the outcomes of the project, the entire purchase price of that equipment may be eligible. In this case, the PO should ensure that the Project Promoter (point (c) of Article 8.4.1):

- keeps the equipment in its ownership of the Project Promoter for a period of at least three years following the completion of the project and continues to use that equipment for the benefit of the overall objectives of the project for the same period;
- where possible, keeps the equipment properly insured against losses such as fire, theft or other normally insurable incidents both during the project implementation and for at least three years following the completion of the project;
- sets aside appropriate resources for the maintenance of the equipment for at least three years following the completion of the project.

The specific means of implementation of this obligation should be specified in the project contract. In case equipment for which the entire purchase price is considered eligible is in the ownership of a project partner, the project partner should comply with the above conditions. The PO may release any Project Promoter from the obligations above with respect to any specifically identified equipment, where the PO is
satisfied that, having regard to all relevant circumstances, the cost of maintenance or insurance in the above obligations would be disproportionate to the value of the equipment (Article 8.4.2 and 8.4.3).

Calculation of the equipment cost category

Both actually incurred costs and SCOs can be used (flat rates, unit costs, lump sums). The Regulations do not provide for any off-the-shelf SCOs to calculate the equipment costs; thus, other methods must be used (i.e., FEV, from other Union policies/ national schemes, draft budget method) should the PO wish to use SCOs to calculate this cost category.

3.4.4 Purchase of real estate and land

The costs of purchase of real estate¹⁴ and land not built on are eligible if compliant with the conditions set out in Article 8.8:

- there shall be a direct link between the purchase and the objectives of the project;
- purchase of real estate and/ or land may not represent more than 10% of the total eligible expenditure of the project, unless a higher percentage is explicitly authorised in the PA and set in the decision to award the project grant;
- a certificate should be obtained prior to the purchase from an independent qualified evaluator or duly authorised official entity confirming that the purchase price does not exceed the market value and that it is free of all obligations in terms of mortgage and other liabilities, particularly in respect of damage related to pollution. In case of purchase of real estate, the certificate must either confirm that the building in question is in conformity with national regulations, or specify what is not in conformity with national regulations but which is to be rectified by the Project Promoter under the project;
- the real estate and/ or the land should be used for the purpose and for the period specified in the
 decision to award the project grant. The ownership must be transferred to the Project Promoter,
 or those explicitly designated by the Project Promoter in the project application as recipients of
 the real estate and/or the land, prior to the completion of the project. The real estate and/ or the
 land cannot be sold or mortgaged within five years of the completion of the project, or longer if
 stipulated in the project contract. The Donors may waive this restriction if it would result in an
 unreasonable burden on the Project Promoter. The mortgage restriction does not apply to a
 mortgage taken in favour of the PO or the NFP when its purpose is solely to ensure compliance
 with the requirement as specified in this point;
- the real estate and/or land may only be used in conformity with the objectives of the project. In particular, buildings may be used to accommodate public administration services only where such use is in conformity with the objective of the project;
- the purchase of real estate and/ or land should be explicitly approved by the PO prior to the purchase, either in the project contract or by a later decision, and
- the real estate and/ or the land may be rented to third parties, if stipulated in the project contract, provided that this is consistent with the objectives of the project.

The cost of real estate and/ or land already owned, directly or indirectly, by the Project Promoter, or purchase of real estate and/ or land owned, directly or indirectly, by the project partner or a public administration, is not eligible. Under no circumstances shall real estate and/ or land be purchased for speculative purposes. The real estate and/ or

¹⁴ Real estate means buildings constructed or under development and the appropriate rights to the land on which they are built on.

the land shall not have benefitted from a national or external donor grant in the last 10 years which would give rise to a duplication of funding.

Calculation of the real estate and land cost category

Both actually incurred costs and simplified cost options can be used (flat rates, unit costs, lump sums). The Regulations do not provide for any off-the-shelf simplified costs options to calculate the real estate and land costs; thus, other methods must be used (i.e., FEV, from other Union policies/ national schemes, draft budget method) should the PO want to use simplified cost options to calculate this cost category.

3.4.5 Consumables and supplies

Costs of consumables and supplies refer to expenses for materials, goods, and items that are necessary for the implementation of the project. These costs are eligible provided they are identifiable, directly assigned to the project, and used for the project objectives.

Examples of eligible costs under this cost category include laboratory chemicals and reagents used in research projects, raw materials required for prototype development. Additionally, items such as software licences for project-specific tasks, small tools, safety items (e.g., protective goggles) may also qualify, provided their use is justified and directly linked to project implementation.

Calculation of the consumables and supplies cost category

Both actually incurred costs and SCOs can be used (flat rates, unit costs, lump sums). The Regulations do not provide for any off-the-shelf SCOs to calculate the consumable and supplies costs; thus, other methods must be used (i.e., FEV, from other Union policies/ national schemes, draft budget method) should PO wish to use simplified cost options to calculate this cost category.

3.4.6 Costs entailed by other contracts awarded by Project Promoter and/ or project partner for project purposes

Where the implementation of the project requires the use of contracts, the partner(s) must comply with the applicable (national and EU) public procurement legislation and with the respective provisions of the Regulation.

Sub-contracting refers to contracts concluded for the externalisation of specific tasks or activities which form part of the project as described in the proposal. Such contracts must satisfy the conditions applicable to any contracts following the procurement procedures.

Calculation of the costs entailed by other contracts cost category

Both actually incurred costs and SCOs can be used (flat rates, unit costs, lump sums). The Regulations do not provide for any off-the-shelf SCOs to calculate the costs entailed by other contracts; thus, other methods must be used (i.e., FEV, from other Union policies/ national schemes, draft budget method) should the PO wish to use simplified cost options to calculate this cost category.

3.4.7 Costs arising directly from requirements imposed by project contracts

Eligible costs arising directly from the requirements imposed by the project contract may include dissemination activities, report by an independent auditor, etc., provided that the corresponding services are purchased in accordance with the applicable rules on procurement.

Calculation of the costs arising directly from requirements imposed by project contracts cost category

Both actually incurred costs and SCOs can be used (flat rates, unit costs, lump sums). The Regulations do not provide for any off-the-shelf SCOs to calculate the costs arising directly from requirements imposed by project contracts; thus, other methods must be used (i.e., FEV, from other Union policies/ national schemes, draft budget method) should the PO wish to use SCOs to calculate this cost category.

3.4.8 Other categories of direct expenditure that may be considered eligible

In exceptional and duly justified cases, the PO may suggest additional expenditures, including re-granting at project level, to be eligible or exclude certain costs categories of expenditure listed in sections 3.4.1 - 3.4.7. Such deviations, if approved by the Donors, should be explicitly stipulated in PA and where relevant be accompanied by the necessary terms and conditions with regards to the eligibility of the expenditure in question.

Calculation of other categories of direct expenditure

Both actually incurred costs and SCOs can be used (flat rates, unit costs, lump sums). The Regulations do not provide for any off-the-shelf SCOs to calculate other categories of direct expenditure; thus, other methods must be used (i.e., FEV, from other Union policies/ national schemes, draft budget method) should the PO wish to use SCOs to calculate this cost category.

3.5 Indirect costs in the project (overheads)

Indirect costs are generally defined as costs that are necessary for implementing the project and that are not or cannot be connected directly to the implementation of the project in question, or that are related to the implementation of the project but represent auxiliary expenses that do not directly contribute to the achievement of its indicators/ results/ objectives.

Examples of indirect costs could be administrative expenses, for which it is difficult to precisely determine the amount attributable to a specific project (typical administrative/ staff expenditure, such as management costs, recruitment expenses, costs for the accountant or the cleaner, telephone, water or electricity expenses, and so on).

Calculation of the indirect costs category

The Regulations (Article 8.5.1) offer several ways to calculate indirect costs in the project:

- SCOs (off-the-shelf flat rates, as defined in points (a) to (e));
- actually incurred costs (point (f));
- relevant rules established by IPOs (bodies or agencies) where they participate in the projects as PP/ partners.

Irrespective of the method used to calculate indirect costs, it should be fixed in the project contract and partnership agreement between the Project Promoter and project partner. The method to calculate indirect costs (using SCOs or incurred costs) should not change during the implementation of the project.

Flat rates to calculate indirect costs

There are three off-the-shelf flat rates that can be used by the PO to calculate indirect costs:

- 1. up to 7 % of eligible direct costs (where the PO does not need to do any calculations to determine the percentage);
- 2. up to 15 % of eligible direct staff costs (where the PO does not need to do any calculations to determine the percentage);
- up to 25% of eligible direct costs, provided the rate is calculated using the fair, equitable and verifiable method (the PO needs to develop the calculation methodology to justify the percentage used).

Both flat rates (under points 1 and 2) may be used directly by the PO without any justification of the calculation of the rate, if it is within the ceiling set by the Regulation (any percentage below and including the ceiling can be used). The PO should ensure equal treatment of partners, and if differentiated rates are used, they should be justified by the PO.

Flat rates applied to direct eligible costs based on existing methods and corresponding rates applicable in EU policies for similar types of projects (point (e) of Article 8.5.1) are not subject to a ceiling.

It is very important to ensure that basis costs on top of which flat rates for indirect costs are calculated (being that direct costs or direct staff costs) are "clean" and have no ineligible costs. Any adjustments to the basis costs will have a direct impact on the amounts received by the project to cover indirect costs. For example, if a flat rate is calculated on top of the direct staff costs, should the staff costs be reduced due to irregularities, the amount reimbursed for indirect costs will be reduced accordingly.

Where an up to 40% flat rate (Article 8.7) is used to calculate the remaining costs of a project, indirect costs cannot be included on top of the flat rate. They are already part of the up to 40% flat rate.

More information on the off-the-shelf flat rates to calculate indirect costs is provided in section 4.2.1.

3.6 Excluded costs

Article 8.9 of the Regulations provides list of costs which are considered not eligible. These costs are not supported by the funds from the Grants under any types of costs.

The table below provides the list of non-eligible expenditure with further guidance and examples.

Table 9. Excluded costs under FMs 21-28 (Article 8.9)

Excluded costs Guidance and examples

charges and late payment charges	If a project takes a loan to cover its expenses (or must pay back the principal amount each month for the loan taken), the interest payments on that loan, repayments, along with any administrative or processing fees charged by the lender, cannot be reimbursed by the Grants. Penalties incurred for failing to make payments on time (e.g., for service delivered, utility bills) are not eligible.
and other purely financial costs, except costs related to accounts required by FMC, NFP or the	These include fees and charges incurred for banking and other financial services that are not directly related to project's required financial accounts. For example, if a project transfers funds between different bank accounts and incus transfer fees, these are not eligible.
contract;	A range of financial costs that are not essential to the project's execution are also not eligible. For example, charges for using credit cards, broker fees for investments, expenses related to hedging an exchange rate by buying a forward contract locking in a future exchange rate.
	Exception
	Costs related to maintaining accounts required by the Grants, the NFP or other applicable laws, as well as costs of financial services imposed by the project contract are eligible (e.g., opening a dedicated bank account for grant funds, bank charges of a monthly maintenance for the accounts).
future liabilities	Funds set aside to cover anticipated losses that have not yet occurred (e.g., potential bad debts, potential future legal claims, possible expenses related to a warranty claim on a product sold) are not eligible.
	Exchange losses are mostly relevant for the BS that do not use euro. The Donors are not responsible for losses resulting from the exchange rate fluctuations.
	If a project receives grant funding in euro but makes payments in other currencies, any loss resulting from the exchange rate difference at the time of conversion is not eligible under Grants.
	Exception
	Price increase due to exchange rate fluctuations external to the project are not considered exchange rate losses.
	The impact of such price increases must, however, fit within the budget of the project/ bilateral initiative and respective flexibility rules specified in the project contract.
	Practical tips
	To mitigate the risk of losses due to currency fluctuations, it is advised to include a buffer in the project budget to account for potential currency fluctuations (the buffer should be presented as a contingency for overall project expenses). In the end, the project will not be able to claim more than the amount in euro set in the project contract.
	Examples
	1. Price increase due to exchange rate fluctuations (eligible expenditure)
	If the price of a service or product increases because of exchange rate fluctuations external to the project, this is considered a cost increase and not an exchange rate loss. For instance, if a local Project Promoter needs to use more

	local currency to purchase a service or product sold in another currency by a foreign supplier or if a local supplier raises their prices due to a weaker local currency compared to the euro, the additional cost would be eligible as part of the overall project expenses (if the increase does not result in exceeding the grant amount in euro specified in the project contract).
	2. Losses during currency conversion within the project (non-eligible expenditure)
	If the PO converted the funding received from the FMO in euro to another currency for payments to projects, any losses incurred during the payment preparation process (e.g., due to an unfavorable change of the exchange rate from the time of conversion until the time of the payment to the project) are not eligible for reimbursement.
(e) Recoverable VAT	Value Added Tax (VAT) that Project Promoter/ partner can reclaim from the tax authorities at a later stage is considered recoverable VAT. If a project buys equipment for \in 20,000, including \in 4,000 VAT, and the partner can recover \in 4,000 VAT later, this VAT is considered as not eligible expense under for the project, irrespective of the timing of the VAT recovery.
(f) Costs that are covered by other sources	The purpose is to avoid double funding and covering costs which have already been funded by other sources and/or types of grants. For instance, if the full price of an equipment purchased previously has been funded from another grant, the depreciation of this equipment cannot be eligible within a project.
(g) Fines, penalties and costs of litigation, except where litigation is an integral and necessary component for achieving the outcomes of the project	Any fines or penalties charged to PP/ partner cannot be included as eligible expenditures. Examples: fines imposed by public bodies due to lack of security measures on a building site, parking fines, work accidents which result in claims.
(h) Excessive or reckless expenditure	This must be seen in relation to point (c) of Article 8.2.1 which states that expenditure should be "proportionate and necessary for the implementation of the project". For example, buying state of the art equipment where cheaper options would cover the same needs is not eligible.

IV. Simplified cost options (SCOs)

4.1 Setting up an SCO in the programme

Grants to beneficiaries may take form of real costs (eligible costs actually incurred) and/ or SCOs (unit costs, lump sums, flat-rate financing). The use of SCOs must be defined in advance. The Regulations provide that as a starting point, all the options for forms of grants are available to the beneficiary. However, the options for the forms of grants to beneficiaries can be limited in duly justified cases in the PA. The PO may also propose further call-specific limitations for the options for forms of grants during the development of the calls for proposals. In Donor partnership programmes, the relevant DPP must be consulted prior to making such limitations.

The PA may also include provisions on the programme-specific SCOs or any other specific rules regarding the use of SCOs under the programme.

The ex-ante definition of SCOs in the PA does not exclude the possibility for the POs to introduce SCOs during programme implementation. However, this will require an amendment of the PA. Equal treatment of beneficiaries should be ensured (e.g., if an SCO is offered in the call for proposals, it should be available for all partners unless differentiated treatment in the forms of grants and/ or amounts/ percentages used is justified).

The use of SCOs, their amounts and the way they are established is finally determined in the project contract and in the partnership agreement between the Project Promoter and project partner.

Once the units (unit costs), percentages (flat rates) or the amounts (lump sums) are established, they should not be changed to compensate for an increase in costs or underutilisation of the available budget during the project implementation, unless an adjustment method over time is foreseen in the SCOs methodology and is indicated in the call for proposals. The use of SCOs implies potential (inherent) over-/ under-compensation of actual costs. Retrospective application of SCOs for projects already selected and being implemented based on real costs is not allowed.

4.2 Methodologies to set up an SCO

The methodologies for establishing SCOs are set out in Article 8.3.2. In general, there are five ways to introduce an SCO in the programme.





We will delve into specificities of each of these methods in the next sections.

4.2.1 Off-the-shelf SCOs

Off-the-shelf SCOs are the easiest to set up as they are described and defined in the Regulations, hence, the name, "off-the-shelf", ready to use.

The Regulations provide for the following off-the-shelf SCOs:

Table 10. Off-the-shelf SCOs

Flat rates		
	Up to 7% of eligible direct costs to calculate indirect costs of a project	Eligible direct costs should be clearly defined.
	Up to 15% of eligible direct staff costs to calculate indirect costs of a project	Eligible direct costs should be clearly defined.
Article 8.5.1	Up to 25% of eligible direct costs to calculate indirect costs of a	A fair, equitable and verifiable method should be used to calculate the percentage, or a method applied under schemes for grants funded entirely by the BS for similar types of projects.
	project, where the PO is required to develop the	The PO must justify the similarity of projects.
	calculation methodology	Other eligible direct costs should exclude indirect costs and
		any flat rates (even if used in the project to calculate direct costs).
		Eligible direct costs should be clearly defined.
Article 8.6.1	Up to 20% of eligible direct costs other than direct staff costs to calculate staff costs	Other eligible direct costs should exclude indirect costs and any flat rates (even if used in the project to calculate direct costs).
Article 8.7	Up to 40% of eligible direct staff costs to cover all remaining eligible costs of a project	Technically, there will be 2 cost categories in the project: staff costs and the rest, covered by the up to 40% flat rate. Staff costs can be calculated using the hourly rate (unit costs) or

		actual costs. A flat rate to calculate staff costs cannot be used in such projects. Indirect costs are included in "all remaining eligible costs of a project" and cannot be added on top of the staff costs and an up to a 40% flat rate.
		NB: Indirect costs (or any other costs) cannot be included on top of the staff costs and an up to 40% flat rate! An up to 40% flat rate should cover all the remaining costs of the project.
Unit costs (ho	urly rates) to calculate staff costs of a	project
Article 8.6.2(a)	Hourly rate calculated by dividing the latest documented annual gross employment costs by 1,720 hours ¹⁵ for persons working full time or by a corresponding pro-rata of 1,720 hours for persons working part- time	The total number of hours declared per person for a given year cannot exceed the number of hours used for the calculation of the hourly rate (1,720 hours or pro-rata). Where annual gross employment cost is not available, it can be derived from the available documented gross employment costs or from the employment contract or equivalent duly adjusted to a 12-month period.
Article 8.6.2(b)	Hourly rate calculated by diving the latest documented monthly gross employment costs by the average monthly working time of the person concerned	Only productive working hours can be reported (sick leaves and other leaves are not covered as already deducted in the denominator). The time-registration system should be in place (e.g., time sheets).

For the off-the-shelf flat rates¹⁶, the "**up to X%**" means that the PO can choose any percentage below (and including) the threshold set in the Regulations. The PO does not need to justify the choice of the percentage if it does not exceed the threshold (to the Audit Authority, for instance) with their own calculation methodology. However, they need to ensure equal treatment of partners (or have a justification in case differentiated treatment is used).

For example,

The PO may offer a flat rate of 11% for reimbursing indirect costs (calculated on top of staff costs) in a call for proposals, without needing to justify why this rate is lower than the 15% specified in point (b) of Article 8.5.1.

The Regulations provide for the off-the-shelf flat rates and unit costs. **There are no off-the-shelf (ready-made) lump sums.** If the PO wants to use them, the lump sums will have to be developed using other methods.

Off-the-shelf flat rates for indirect costs

Indirect costs (overheads) are all eligible costs that cannot be identified by the Project Promoter and/or the project partner as being directly attributed to the project. They may not include any eligible direct costs. Indirect costs could include, for example, administrative expenses, for which it is difficult to precisely determine the amount attributable to a specific project (typical administrative/staff expenditure, such as: management costs, recruitment expenses, costs for the accountant or the cleaner, etc.; telephone, water or electricity expenses, and so on).

¹⁵ 1,720 hours is a standard annual "working time" that can be used directly, without there being a requirement for the PO to perform any calculations. This figure is based on the Member States' average weekly working hours multiplied by 52 weeks and from which annual paid leave and average annual public holidays were deducted.

¹⁶ Except for the up to 25% flat rate for indirect costs.

The Regulations provide for the three off-the-shelf methods (flat rates) for PPs and partners to calculate their indirect costs:

- 1. up to 15% of eligible direct staff costs;
- 2. up to 7% of eligible direct costs;
- 3. up to 25% of eligible direct costs, where the PO is required to develop the calculation methodology.

The methods above cannot be combined and only one method should be used, normally, throughout the implementation of the project. The flat rates are always calculated as a percentage of other cost category(ies). In the case of up to 15% of eligible direct staff costs, the flat rate is calculated on the basis of the staff costs category.

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For example,
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If the project's staff costs are €100,000, the indirect costs will be calculated as:

€100,000 * 15% = 15,000.

If the flat rates of 7% or 25% are used, the basis costs will be all other direct costs of the project (e.g., staff costs, equipment, travel, external costs).

? Other methods to calculate indirect costs (as provided for in Article 8.3.2) can be also used, along with the real costs method.

Off-the-shelf flat rate for staff costs

The Regulations (Article 8.6.1) offers an up to 20% flat rate of the eligible direct costs other than the direct staff costs of that project, provided that the direct costs of the project do not include public works, contracts or supply or service contracts which exceed in value the thresholds set out in Article 4 of Directive 2014/24/EU¹⁷ of the European Parliament and of the Council on public procurement. If the condition is fulfilled, the PO is not required to perform a calculation to determine the rate. If otherwise, the calculations to justify the applicable rate will be required.

Cost category	Budget (EUR)	Clarifications
Staff costs	54,000	(Travel and subsistence allowance + New or second-hand equipment + Land and real estate) * 20% Sum of other than staff direct costs of the project Indirect costs are excluded
Travel and subsistence allowances	20,000	Real costs
New or second-hand equipment	100,000	Real costs
Land and real estate	100,000	Real costs
External contracts	50,000	Real costs

¹⁷ Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC, OJ L 94, p. 65–242.

Indirect costs	10,000	Real costs
Total costs	334,000	

If the up to 20% flat rate is used to calculate the direct staff costs, the staff costs can still serve as the basis costs to calculate the indirect costs (overheads); i.e., one flat rate can be built on top of the other cost category which is calculated as a flat rate itself.

Table 12. An example of the project budget with a flat rate calculated on top of another flat rate

Cost category	Budget (EUR)	Clarifications
Staff costs	54,000	20% flat rate (Travel and subsistence allowance + New or second- hand equipment + Land and real estate) * 20% Sum of other than staff direct costs of the project Indirect costs are excluded
Travel and subsistence allowances	20,000	Real costs
New or second-hand equipment	100,000	Real costs
Land and real estate	100,000	Real costs
External contracts	50,000	Real costs
Indirect costs	8,100	15% flat rate of direct staff costs €54,000 * 15%
Total costs	332,100	

Off-the-shelf unit costs to calculate staff costs

The Regulations provide for two off-the-shelf unit costs (hourly rates) to calculate staff costs:

- hourly rate by dividing the annual gross employment costs by 1,720 hours (Article 8.6.2, point a)), and
- by dividing the monthly gross employment costs by the average monthly working time (Article 8.6.2, point b)).
- 1) The first option is to calculate the hourly rate is to use the so-called 1,720 hours method:

Hourly rate = Latest documented annual gross employment cost/ 1,720 hours

Staff costs = Hourly rate * Number of hours actually worked on the project

The **denominator**, 1,720 hours, is a standard annual "working time" that can be used directly, without there being a requirement for the BS to perform any calculations. This figure is based on the European Commission's average weekly working hours multiplied by 52 weeks and from which annual paid leave and average annual public holidays are deducted. This figure can be used for all employees working full-time (in most of the countries it is based on a 40-week working week). However, if in accordance with the national law or the applicable collective agreement, the full-time equivalent corresponds to less than 40 hours/ week, the same number (1,720 hours) should be used.

This method can also be used in the following situations:

 where the annual gross employment cost is not available – in this case, the data available (e.g., for 3-4 months) can be extrapolated to the annual gross employment cost. The annual gross employment cost should be determined with the applicable national rules;

NB: "**latest**" documented annual gross employment cost means that the most recent data needs to be used. It **does not have to be related to a calendar or financial year though**. The important part is that the data should cover 12-month period (being that the 12-month preceding the end of the reporting period, the 12-month before the project contract is signed; the 12-month of the previous calendar year, and so on).

The annual gross employment costs can be based on the real employment costs of this person. When the person has not worked the whole month (e.g. the start of the contract does not take place at the beginning of the month and, thus, the available data does not cover the entire month), extrapolated values may be taken to arrive at a good proxy to real costs of a 12-month period.

The annual gross employment costs may also be based on the average of the employment costs of a larger aggregate of employees, for example, those of the same grade or some similar measures, which correlate to employment cost level. This means that this method can be used for new employees too.

The latest annual gross employment costs need to be **documented**: this can be done through accounts, payroll reports, referencing to publicly available agreements or documents, etc. The supporting documents have to be auditable.

• for employees working part-time on the project. In this case, the corresponding pro-rata of 1,720 hours should be used.

🔎 For example,

If a person works 50% on the project (e.g., 0.5 of the full-time equivalent), the denominator would be 860 hours:

Hourly rate = 0.5 * Latest documented annual gross employment costs/ 860 hours

The staff costs are then determined by multiplying the hourly rate by the number of actual working hours the employee spent on the project. The public holidays and annual leave cannot be covered as they are already deducted in the denominator (1,720 hours or pro-rata). Sick leave may be declared as staff costs if the related costs are borne by the beneficiary (if they are incurred by the beneficiary). If a new staff member is hired to replace an employee on sick leave (or another type of leave), their working hours constitute a separate set of 1,720 hours. This means that the replacement staff member's hours should not be counted within the original 1,720-hour limit of the absent employee. Instead, a new 1,720-hour allocation applies to the replacement staff, ensuring that the total eligible staff costs are correctly calculated. Failure to treat these hours separately may result in exceeding the 1,720-hour limit, leading to ineligible costs.

The number of declared per person for a given year or month should not exceed the number of hours used for the calculation of the hourly rate: for employees working full-time – not more than 1,720 hours; for part-time – not more than the corresponding pro-rata of 1,720 hours (Article 8.6.3).

 Hourly rate calculated by dividing the monthly gross employment costs by the average monthly working time When calculating an hourly rate to determine direct staff costs, it is for the BS to establish the average monthly working time, in accordance with applicable national rules referred to in the employment document/ contract.

The hours declared as average monthly working time of the person concerned do not necessarily need to be the number of hours actually worked; the average monthly working time as set in the employment document, in accordance with applicable national rules, must be taken into account. However, the hours declared for calculating the eligible staff costs cannot exceed the number of hours per month used for the calculation of that hourly rate.

Off-the-shelf flat rate to cover the remaining costs of a project

The up to 40% flat rate to cover the remaining eligible costs of the project is defined in Article 8.7 of the Regulations is one of the off-the-shelf flat rates; meaning, the PO does not need to develop a calculation methodology to define the rate, and any percentage up and including 40% can be used without the justifications of the percentage chosen (provided the PO ensures equal treatment of the programme beneficiaries).

Since the 40% flat rate covers the remaining costs of the project and is calculated on the basis of eligible direct staff costs, there are only 2 cost categories in the project that is using this particular flat rate:

- direct staff costs basis costs for the flat rate;
- a flat rate of up to 40% covering the remaining costs of the project.

If a 40% flat rate is used, it is not possible to have in the partner's budget, for example, any overheads or travel/ equipment cost categories. All other cost categories except the staff costs are covered by up to 40% flat rate. As for the direct staff costs category, where the 40% flat rate is used, it is logical that it cannot be calculated as a flat rate itself (otherwise, there will be no basis costs to calculate this flat rate). It can be reimbursed using real costs (including the fixed percentage method¹⁸) or unit costs or even a lump sum. The basis costs to calculate the 40% flat rate are eligible direct staff costs.

Other remaining costs of an operation = Eligible direct staff costs * 40%

▶ It is not correct to assume that the project budget is composed of 60% for direct staff costs and 40% for the remaining costs of an operation!

This means that the flat rate amount is directly linked to the eligibility of the direct staff costs: if there are any mistakes or irregularities in the staff costs category, the amount calculated on the basis of the flat rate is reduced proportionately.

Because of its nature, the 40% flat rate might not be suitable for all types of projects and beneficiaries. For example, it might not be suitable for projects with investment-related activities, or projects with a high share of external expertise and services budgets, since these costs will have to be covered by the 40% flat rate. Also, in projects where lots of activities are externalised and direct staff costs do not represent a significant share of the partner's budget, the 40% flat rate will not be the best option since it is calculated on the basis of the staff costs category. However, in projects where the direct staff costs represent a significant share of the partner's budget and where many activities are done "in-house", it could be a good choice to use the 40% flat rate. Thus, labour-intensive, R&D, small projects with many other low-value

¹⁸ As defined in Article 8.6.5 of the Regulations.

large-volume costs than staff, small innovation projects, educational & vocational projects, and soft activities projects are best suited for the 40% flat rate. There are no limitations to the types of beneficiaries that can use the 40% flat rate.

Points for attention where the up to 40% flat rate is used

1. Project's budget is calculated not as a 60% vs 40% flat rate. Instead, a 40% flat rate is applied on top of the planned direct staff costs.

2. Proper planning and budgeting of direct staff costs is crucial – this defines the overall project budget. Improperly planned direct staff costs can cause severe project problems and delays (but don't artificially inflate direct staff costs – whether or not they are adequate will be confirmed at the quality assessment stage).

3. Detailed description of the project's outputs and results is a must!

4. Changes to project outputs/ results are limited (since the only variable in the project's budget is direct staff costs).

5. Need for "clean direct staff costs" - errors in staff costs will lead to lower amount of the flat rate.

6. Assessment stage will confirm whether the direct staff costs are adequate for delivering the promised outputs/ results.

7. Delays in implementation will have a bigger impact on the reimbursed budget; no staff costs reported means no 40% flat rate received.

8. If the direct staff cost is lower, then it triggers a reduced 40% flat rate.

9. Eligibility of expenditure rules stay and are not removed (even though not checked)!

10. Not for all - the 40% flat rate is suitable for certain types of projects/ beneficiaries.

4.2.2 SCOs from Union policies

This method allows the POs/ FOs to make use of corresponding lump sums, unit costs and flat rates applicable in Union policies for a similar type of projects. The main aim of this method is to harmonise the rules between the Union policies and to avoid duplication of efforts under different policies and instruments.

All the applicable methods under Union policies can be used for similar projects provided the Union policies are in force at the time of the design of the methodology. The methods from Union policies can be used without additional calculations and the methodologies should not be subjects to audits (audits only assess whether the chosen methods are well justified and whether they are correctly applied as explained in <u>Chapter V</u>).

The method needs to be re-used in its entirety; i.e., not only the final amounts/ percentages, but also the definitions of the direct/ indirect costs, eligible expenditure, scope, updates. As a general principle, all elements of the method that could have an impact on the unit cost / lump sum / flat rate should be taken into consideration. A case-by-case examination is required.

The Regulations do not prescribe the definition of the "similar projects". The PO needs to assess this on a case-by-case basis whether in a particular case the condition of similarity of projects is fulfilled.

If the method under the Union policy is modified during the programming period, then the same modification should be mirrored in the projects funded by the Grants.

Examples of SCOs in different Union policies are:

Erasmus+: lump sums and unit costs (e.g., rates for travel distance, linguistic support, preparatory visits, course fees, organisation of the intensive programmes);

Citizens, Equality, Rights and Values (CERV) programme: lump sums per participant in in-situ and physical events as defined in the EC decision authorising the use of lump sums for actions under the CERV programme (2021-2027);

Horizon Europe: 3 types of SCOs can be found in Horizon Europe (flat rate, unit costs, lump sums) set out in the Commission decisions; e.g., unit costs for salaries of SME owners, unit costs for staff mobility, lump sums and unit costs for Marie Skłodowska-Curie actions;

European Solidarity Corps: the decision authorising the use of lump sums, unit costs (e.g., travel costs, organisational support, project management support, staff costs, linguistic support, coaching costs) and flat-rate financing for volunteering, traineeships, jobs and Solidarity Projects.

4.2.3 SCOs from national schemes

This method allows the POs/ FOs to make use of corresponding lump sums, unit costs and flat rates applicable in the BS or the Donors in case of donor project partners for a similar type of projects. SCOs under national schemes can be used in projects funded by the Grants if the schemes are in force at the time of the design of the methodology. SCOs from national schemes can be used without additional calculations and the methodologies should not be subjects to audits (audits only assess whether the chosen methods are well justified and whether they are correctly applied as explained in <u>Chapter V</u>).

All the applicable national methods can be used for similar projects. The Regulations do not prescribe the definition of the "similar projects". The PO needs to assess this on a case-by-case basis whether in a particular case the condition of similarity of projects is fulfilled.

If the method under the national policy is modified during the programming period, then the same modification should be mirrored in the projects funded by the Grants.

The method from the national schemes should also be re-used in its entirety and not only its final amounts/ percentages. The methods from the national schemes should be used within the respective BS (the Donors in case of donor project partners).

4.2.4 Programme-specific SCOs (FEV)

The Regulations allow the PO to establish programme-specific SCOs. There are no limitations on which SCOs (flat rates, lump sums, or unit costs) or for which cost categories programme-specific SCOs can be designed. It is totally up to the PO.

A methodology for programme-specific SCOs must be designed in advance and it should be set up using the "fair, equitable and verifiable" calculation method (the so-called "FEV method"):

- *fair* the calculation has to be reasonable; i.e., based on reality, not excessive or extreme. The PO has to justify its choices in the rates used.
- equitable the method and rates used should not favor certain beneficiaries or projects (initiatives). The differences in the rates/ amounts/ percentages are acceptable (differentiated treatment is possible), however, such differences should be based on objective justifications; i.e., objective features of the beneficiaries or projects.

 verifiable – the rates/ amounts/ percentages should be based on documented evidence that can be verified. The PO has to be able to demonstrate the basis on which the SCO has been established. The following elements should be documented as a minimum: the description of the calculation method, including key steps of the calculation (not only the final amounts/ rates, but steps that led to these amounts/ rates); the source of data used for the analysis and the calculations, including an assessment of the relevance of the data to the envisaged projects, and an assessment of the quality of the data; the calculation itself to determine the value of an SCO.

Sources of data

When setting up an SCO, the data used should be relevant to the SCO in progress. For instance, if the PO wants to establish an hourly rate for staff costs, the data used to calculate the hourly rate should be relevant to the staff costs.

The data sources should be documented. There is no pre-defined minimum set of data required to calculate SCOs.

Data can be taken from different sources. Reliability of data used will depend on the source of data used. For example, data coming from national statistical offices, or the European level (EUROSTAT) is considered reliable. For some sources of data, more detailed checks could be needed to confirm the reliability of data. In some cases, the professional judgement of the Audit Authority could be used to decide whether additional checks on a sample basis should be carried out or not (taking into account any information available to the Audit Authority on the type of data, the way of compilation, internal procedures of bodies for approving the provided information, etc.).

The PO when establishing their SCOs can use statistical data (from different sources), verified historical data (on projects or operations funded from a CPR Fund) or usual cost accounting practices.

1. The use of statistical data, other objective information or an expert judgement

When the PO decides to use statistical or historical verified data, it should describe:

- the categories of costs covered;
- the calculation method used;
- the length of the series to be obtained: accounting data over at least three years should be obtained so as to identify any potential exceptional circumstance which would have affected actual costs in a specific year as well as the tendencies in the cost amounts. The three-year reference period should be used to take yearly fluctuations into account. However, if the PO can demonstrate that the use of data over a period of less than three years is justified, this can be acceptable. For example, where a new programme has been set up and data for only two years is available, this could suffice; where three-year data does not exist, depending on the particularities of the case, two-year data may be accepted. However, this needs to be assessed on a case-by-case basis.
- the reference amount to be applied, for example, the average costs over the reference period or the costs as registered over the last years;
- adaptations, if any, that are needed to update the reference amount. Adjustment may be applied to update costs from previous years to current prices.

Other objective information could, for instance, take the form of:

- surveys, studies, market research, etc. (need to ensure a proper documentation);
- data on remuneration for equivalent work.

Expert judgements should be based upon a specific set of criteria and/or expertise that has been acquired in a specific knowledge area, application or product area, a particular discipline, an industry, etc. It needs to be well documented and specific to the particular circumstances of each case. The Regulations do not define the expert judgment. It will be for the PO to specify the requirements for a judgment to qualify as expert and to ensure that there is no conflict of interests. For any expert chosen, the PO would need to demonstrate his/ her expertise in the relevant field as well as his/ her independence.

Thresholds, ceilings or other maximum values set in national rules can be considered as other objective information sources. However, they cannot be applied directly but the PO needs to demonstrate that they represent fair value and a reliable proxy.

The use of verified historical data from previous funding periods of the Grants is possible if it can be demonstrated that the amounts are still relevant and reflect the reality (an SCO should be the best possible approximation of real costs, thus, it might need to be adjusted). In any case, if methodologies from the previous funding periods are used, the PO needs to ensure that it is adapted to the new regulatory framework of the Grants and that it meets the eligibility rules.

The PO can also use individual beneficiary-specific data to establish SCOs applied to individual beneficiaries. Given the requirements involved in the use of beneficiary-specific data, these methodologies are simplifications for beneficiaries who will implement many projects over the funding period.

2. The use of the verified historical data of individual beneficiaries

This method is based on the collection of past accounting data from the beneficiary, for actual costs incurred for the categories of eligible costs covered by the simplified cost option defined. Where necessary, this data should cover only the cost center or department of the beneficiary that are related to the project. This, in fact, presupposes the existence of an analytical accounting system at a beneficial level. Furthermore, it implies that any ineligible expenditure is filtered out from any calculation supporting the simplified cost options.

3. The application of the usual cost accounting practices of individual beneficiaries

Usual accounting practices are practices which the beneficiary uses to account for all of its usual day-today activities and finances (including those not linked to the Grants). These methods must comply with national accounting rules and standards. The length of use is not critical; i.e., it does not have to stretch over a three-year period. An accounting method is not 'usual' if it has been customised for a particular project(s), for example, those receiving support from the Grants, and differs from the accounting method(s) used in other cases.

It is important to differentiate between actual costs and costs determined according to the usual cost accounting practices of individual beneficiaries.

Actual costs mean costs calculated as exactly as possible (costs actually incurred by the beneficiary and paid) for the time period of the project.

To ensure equal treatment among beneficiaries and that the grant does not cover ineligible costs, the document setting out the conditions for support authorising beneficiaries to use their cost accounting practices must provide for minimum conditions. Those minimum conditions aim at ensuring that the cost accounting practices result theoretically and practically in a fair and equitable system. This implies the

existence of an acceptable analytical accounting system at a beneficiary level. It furthermore implies that any ineligible expenditure is filtered out from the calculation.

The PO will have to verify individual beneficiary-specific data through a case-by-case approach. This needs to be done at the latest when establishing the document setting out the conditions for support to the beneficiary (project contract). Depending on the assurance obtained from the beneficiary's internal management and control system by the PO, it may be necessary for beneficiary-specific data to be certified by an external auditor or, in the case of public bodies, by a competent and independent accounting officer, to ensure reliability of the reference data used by the PO. Certification of historical data may take place as part of statutory audits or contractual audits. Any certification carried out in this manner would require in-depth knowledge, by the external auditor or independent accounting officer, of the Regulations in respect of, e.g., the audit trail, the eligibility of the underlying costs and applicable law. Therefore, the Audit Authority may well be invited to support this process.

Where the risk of error or irregularity in past accounting data is deemed low, for instance, the calculation method may also be based on data not certified by an auditor ex-ante. The PO would need to be able to demonstrate, in an objective manner, that the risk is indeed low and why it considers that the beneficiary's accounting system is reliable, complete and accurate.

4.2.5 SCOs established using the draft budget method

The draft budget method is a method to calculate an SCO(s). It can only be used in projects of a certain size: where the total cost of the project does not exceed €200,000. It is used on a case-by-case basis for an individual project.

In essence, this method works as follows. The beneficiary proposes a draft budget of his project based on the eligibility criteria set out by the PO. The PO then assesses the proposal and converts the budget into one or several SCOs (lump sums, flat rates and/ or unit costs). In the project contract the SCOs amounts are included and the amounts from the original draft budget are documented by the PO for audit purposes but are not carried out to the project contract. The project is then implemented and reimbursed according to the SCOs established in the project contract (the real costs from the draft budget are no longer used). During the project implementation, no justification of real costs from the draft budget is required; costs are verified according to SCOs verification principles.

The draft budget method requires a solid stock of cost benchmarks (cost references) since the budget proposed in the application should be thoroughly assessed before it is transformed into an SCO(s). A systematic approach should be developed as the PO might have to provide evidence that the method was used correctly. Market research for frequent cost items in budgets as well as data from TA (such as venues, interpretation, and translation) or other historical data might be used to build a catalogue of cost benchmarks.

To demonstrate how the draft budget method works, see the example below.

The project focuses on empowering underprivileged youth in a local community by providing skills training, entrepreneurship workshops, and mentorship programmes. The project aims to reduce youth unemployment, promote social inclusion, and encourage community engagement

The beneficiary submitted the following budget table:

Table 13. An example of the draft budget submitted by the beneficiary

Costs	Description	Amount (EUR)
Trainers and Facilitators fees	Compensation for professional trainers conducting skill development workshops (3 trainers, 3 workshops)	60,000
Venue and Equipment rental	Rental of spaces and equipment for training sessions and community meetings (10 meetings)	30,000
Workshops material	Materials, tools, and resources required for training and workshops	20,000
Mentorship Program Coordination	Costs related to organizing mentorship sessions and monitoring	15,000
Project Staff Salaries	Salaries for project coordinator and administrative staff	40,000
Monitoring and Evaluation (M&E)	Data collection, analysis, and reporting to assess project outcomes Data collection, analysis, and reporting to assess project outcomes	15,000
Total		180,000

The beneficiary also provided details as to how the costs were calculated and supporting documents to justify them.

There are different options as to how this project budget could be converted into an SCO(s). Below are just 2 scenarios but there can be many more.

Scenario 1. The whole project will be implemented as a single lump sum of 180,000 euro. The PO agreed with the beneficiary that the following conditions need to be met for the payment of 180,000 euro to happen:

- 1. 3 skill development workshops should be organised with a minimum of 100 young people to be trained;
- 2. 10 community meetings;
- 3. 15 young people should participate in the mentorship programme.

The following supporting documents will have to be provided to justify the above conditions (the so-called "payment triggers"):

- 1. for skills development workshops participants list of minimum 100 young people from 3 workshops (cumulative), photos from the workshops;
- 2. 10 publications in the local newspaper on the community meetings and their results;
- 3. for mentorship programmes 15 short reports from the participants on skills and lessons learned and future application of skills acquired.

Provided all the above is met, the project will be paid the agreed amount in the project's contract of 180,000 euro. Since it is a single lump sum and single payment, all 3 conditions have to be met. If some of them are not met at 100%, the payment should not be made.

To reduce the risk, it is possible to design 3 lump sums to cover this project (e.g., one for mentorship programmes, one for community meetings and one for skill development workshops) and link 3 payments to the delivery of these outputs. In that way, the risk for the beneficiary of not being paid at all is reduced as payments are associated with smaller outputs.

Scenario 2. It is possible to design unit costs per skill development workshop and a unit cost per participant in the mentorship programme and, for example, a lump sum to cover community meetings.

- a unit cost of 1,000 euro per workshop (total cost 1,000 * 3 = 3,000 euro);
- a unit cost of 150 euro per participant in the mentorship programme (based on the number of participants, the costs of the mentorship programme will be calculated as unit cost per participant multiplied by number of participants);
- a lump sum per community meeting or a single one for a certain number of meetings.

As you can see from the example above, it is possible to establish a single SCO using the draft budget method or several SCOs. When combining SCOs it is important to remember that the same cost cannot be covered by different SCOs as double declaration of costs (double financing) is not permitted. It is essential to clearly define the types of costs that are covered by different SCOs. You will find more on the combination of SCOs in <u>section 4.4</u>.

4.3 Ex-ante assessment of SCOs methodologies by the AA

Depending on how an SCO is established, there might be a need for the methodology to be verified by the national AA.

For off-the-shelf SCOs¹⁹ (established in Regulations), there is no need for the AA to verify how the methodology was developed, as these SCOs are offered by the regulatory framework of the Grants and the legal certainty is there. The audits will only focus on the correct application of the off-the-shelf SCOs.

For SCOs from Union policies or national schemes, there is also no legal requirement for the AA to verify the methodology itself and in advance. During the implementation, when auditing such SCOs, the AA will confirm conditions for application of such SCOs (whether they have been used for similar projects, whether they are in place under the Union policy/ national scheme, etc.) and how they are used.

SCOs established using the draft budget method are also not audited in advance as they are developed on a case-by-case basis for an individual project. However, when checking the SCOs designed using the draft budget method, the AA will check how the amounts/ percentages were established, whether the conversion to an SCO(s) of the draft budget was done correctly, etc.

For programme-specific SCOs established using the fair, equitable and verifiable method it is a legal obligation to have the methodologies verified by the national AA in advance; i.e., before such SCOs are used in projects (point (e) of Art. 8.3.2). This is mandatory since there is a high risk of systemic errors and irregularities in projects should there be mistakes in the methodologies when establishing SCOs. Moreover, the analysis of the most common irregularities when it comes to SCOs shows that the majority of them are due to mistakes and flaws in the SCOs methodologies rather than in the application of the SCOs.

It is, thus, compulsory that the PO ensures the SCOs that they designed are verified by the national AA. Make sure to document the programme-specific SCOs properly (as explained in the section above) to provide the AA with all the required information for the ex-ante audit of an SCO methodology.

¹⁹ Except for the up to 25% flat rate for indirect costs (point (c) of Article 8.5.1).

To facilitate the ex-ante assessment of the programme-specific SCOs, the AAs are encouraged to use the checklist developed by the European Commission²⁰.

The summary of different audits per type of an SCO is provided in the table below.

Table 14. Assessment of SCOs by the AA

SCOs	Off-the-shelf	Programme-specific (fair, equitable and verifiable method)	SCOs from Union policies/ national schemes	SCOs established using the draft budget method
SCO methodology	No audits ²¹	Ex-ante audit	No audits	During the implementation as case-by-case
SCO application	Audit of application	Audit of application	Audit of application	Audit of application

4.4 Combinations of SCOs and/ or real costs

Different types of SCOs can be combined in the same project and for the same beneficiary, "provided that each form covers different categories of costs, or where they are used for successive phases of a project" (Reg. Art. 8.3.1). This means that SCOs can be combined with real costs, as well as with other SCOs. Different types of SCOs (off-the-shelf, programme-specific, and/ or SCOs from Union policies/ national schemes) can be combined if they are applied to different cost categories of a project or in different distinct phases of a project ("successive phases of a project"). These conditions are in-built to prevent double financing of costs (i.e., when the same cost is reimbursed as a real cost and an SCO).

Some projects²², for instance, funded by the Civil Society Fund must be implemented entirely as SCOs (i.e., flat rates, unit costs, lump sums or combination of the three). For "regular" programmes, there is no legal obligation to implement projects of a certain size entirely by the SCOs. The PO, however, can make SCOs mandatory in their programmes – e.g., for certain cost categories (e.g., indirect costs) or for certain types of activities (e.g., unit cost to cover travel and accommodation costs). In any case, it is important to have a proper definition of different cost categories/ phases of a project to avoid double declaration of costs.

Below you will find some examples of the combination of SCOs in projects.

🔎 Example 1

In the same project, the two SCOs are used:

- one to calculate indirect costs using an off-the-shelf flat rate (point (c) Art. 8.5.1) up to 15% of the eligible direct staff costs, and
- another one to calculate eligible direct staff costs using the off-the-shelf unit cost (i.e., hourly rate) established based on point (a) of Article 8.6.2.

²⁰ The FMO can provide the checklist upon request from the AA.

²¹ Except for the up to 25% flat rate for indirect costs (point (c) of Article 8.5.1).

²² Where the total cost of a project does not exceed €25,000 (under Civil Society Fund).

2 off-the-shelf SCOs are used for the same project, but for different categories of costs. A flat rate is built on top of the unit cost, which is allowed by the Regulations.

🔎 Example 2

A 40% flat rate is used to calculate the remaining costs of a project (Reg. Art. 8.7) and is calculated on top of the direct eligible staff costs.

Eligible direct staff costs are calculated using the off-the-shelf unit cost (hourly rate) established based on Article 8.6.2 (point a) of the Regulations.

2 off-the-shelf SCOs are used in the same project, but for different categories of costs. A flat rate is built on top of the unit cost.

Example 3

A programme-specific lump sum is used for the organisation of the kick-off meeting of the project. The lump sum covers costs of the venue, rental of equipment, translation costs, catering.

Indirect costs are reimbursed at a flat rate on the basis of direct staff costs of the project.

The rest of the project is implemented using the real costs.

In this example, it has to be ensured that costs covered by the lump sum and indirect costs are not included as real costs under other cost categories.

Example 4

We have a project in the field of health. The first phase is about production of the tangible output - the solar-powered health monitoring device. The second phase is about distribution of the product developed in phase 1 to rural communities with limited access to healthcare. In phase 1, the project used a lump sum to develop the solar-powered health monitoring prototype. In phase 2, the project used staff costs and a 40% flat rate to cover the remaining costs of phase 2. Here we have a clear separation of phases in the project, which means that different SCOs can be combined.

Further examples of SCOs combinations

The table below gives an overview of possible combinations of off-the-shelf SCOs, but it is by no means legally binding. Each situation must be analysed case-by-case. The PO must clearly define the categories of costs (direct/indirect) and ensure that there is no double funding of costs covered.

Combinations	Up to 7% indirect costs	Up to 15% indirect costs	Hourly rate staff costs	Up to 40% all other costs
Up to 7% indirect costs		Ν	Y	Ν
Up to 15% indirect costs	Ν		Y	Ν
Hourly rate staff costs	Y	Y		Y
Up to 40% all other costs	N	Ν	Y	

Table 15. Combination of off-the-shelf SCOs in projects

4.5 Stakeholders' roles in SCOs

Simplified cost options differ greatly from the actually incurred costs; hence, it is of utmost importance to ensure the commitment of all relevant stakeholders when introducing SCOs in the programme. Understanding the advantages and disadvantages of SCOs will help national stakeholders to make better decisions when choosing the forms of grants for projects.

The overall responsibility for the design and implementation of SCOs in the programme is with POs. If the PO is not entirely satisfied with the ready-made options offered in the Regulations, they are free to design their programme-specific SCOs using different methods and data sources. It is, however, important to ensure that all partners are treated equally or if there is a differentiation between amounts/ percentages, it can be properly justified. When designing programme-specific SCOs, it is recommended to establish working groups on SCOs and involve all relevant stakeholders.

AA plays an important role in the SCOs stakeholders' matrix as they are the ones who verify the programme-specific SCOs established using the fair, equitable and verifiable method ex-ante and the ones who audit the application of the SCOs during the programme implementation (through their audits of projects). It is, thus, recommended that the PO remains in close contact with the AA when developing programme-specific SCOs and consult, where appropriate, on the methodological approach, sources of data used, etc. Developing a programme-specific SCOs is a process; it can sometimes take a long time (depending on the availability and quality of data), and it is important to have an informal green light from the national AA when starting the process. Since AA will be performing an ex-ante validation of the SCO methodology, their involvement will be limited, however, they can still provide feedback on the general principles, ideas and approaches undertaken by the PO when developing programme-specific SCOs.

In Donor partnership programmes, the PO has to develop SCOs in consultation with the DPPs. Involving DPPs is also crucial if the PO decides to limit forms of grants or methods to establish SCOs in the call for proposals. If a working group on SCOs is established, the PO needs to ensure involvement of the relevant DPPs in it.

The PPs/ project partners are the ones who are directly affected by the SCOs. The PO needs to ensure that beneficiaries understand what SCOs are, how to use them, what the advantages/ disadvantages are, how the reporting looks, what they need to provide to support the amounts reported. The PO should ensure that training/ seminars are conducted for PPs and partners in programmes/ projects where SCOs are used.

Building necessary capacity on both sides – programme authorities and end-users, partners – will take time and effort. However, it is highly recommended to invest in this step all the required resources and efforts. This will allow for smooth implementation, streamlining reporting, verification and audit processes.

💡 A few reminders

When working with SCOs (especially programme-specific SCOs), the main workload for national authorities is shifted upfront; however, the actual implementation is greatly simplified, for both partners and programme authorities.

The relevant programme authorities (PO, AA, CA) should revise their procedures/ checklists/ manuals that concern only actually incurred expenditure and expand them to account for SCOs.

Where SCOs are used, the expenditure underlying the SCOs should not be checked as it is not part of the audit trail/ supporting documents.

The accounting system of PP/ partner where SCOs are used is not part of the verification/ audit work (for amounts/ percentages covered by SCOs).

4.6 Documentation of SCOs

The use of SCOs should be defined in the PA with the relevant references to the legal framework of the Grants. The use of flat rates, unit costs and lump sums should be specified in the calls for proposals, project contracts and partnership agreement between the Project Promoter and the project partner (Article 8.3.3).

If the PO develops its programme-specific SCOs, they should ensure the proper documentation of the SCO methodology. All steps undertaken should be recorded in the programme internal documents (e.g., using a template for the description of the SCOs methodology as provided below). This is important as it will be checked by the AA.

Below you will find an example of how an SCO methodology developed using the fair, equitable and verifiable method may be documented.

Table 16. A template for the description of the SCO methodology developed using the fair, equitable and verifiable method (point (e) of Article 8.3.2)

Item	Brief explanation
Type of SCO	Flat rate, lump sum, unit cost
Type of projects covered	Opened for all projects, pre-defined project, under specific Outcome(s), calls for proposals, etc.
Type of beneficiaries covered	Opened for all partners, under specific outcome(s), calls for proposals, public/ private, etc.
Categories of costs covered by the SCO	Provide a clear description of cost category(ies) covered by the SCO. Describe arrangements to ensure that no double financing of costs occur (especially in case of SCO combinations). E.g., staff costs, indirect costs, external costs.
Amounts/ % for the SCO	Amounts for unit costs and lump sums; % for flat rates
Indicator triggering reimbursement and its unit of measurement	The type/ description of the SCO should explain what will be measured in order for the SCO to be paid. For instance, a lump sum to cover costs of application preparation.
Basis of the calculation methodology	 Include a reference to the Article in the Regulations (Article 8.3.2): fair, equitable and verifiable calculation method; draft budget method; SCOs applicable in Union policies for a similar type of operation; SCOs applicable in Beneficiary/ Donor State schemes for a similar type of project.
Justification for the method selected	Why the selected method was the most suitable.
Source of data used to calculate unit costs, lump sums or flat rates	Include a reference to the Article in the Regulations (point (e) of Article 8.3.2): (i) statistical data, other objective information or an expert judgement, (ii) the verified historical data of individual beneficiaries, (iii) the application of the usual cost accounting practices of individual beneficiaries. Also, who produced, collected, and recorded the data; where the data are stored; cut-off dates; validation, etc.

How the calculations were done (including any assumptions made in terms of quality or quantities)	Where relevant, statistical evidence and benchmarks should be used and attached.
Verifications – what will be checked during the PO verifications (including on- the-spot)	Which documents will be used to verify the achievement of indicators/ milestones/ outputs; what arrangements will be made to collect and store relevant data/ documents.
Adjustment method of the calculation methodology, how/ if it will be updated, how often, etc.	It is possible to foresee an update of the amounts/ percentages. It should be part of the methodology, including the basis for the update, relevant references and frequency of the updates.

It is recommended to use a 'simplified' description of the programme-specific SCOs when communicating them to programme's stakeholders, such as beneficiaries, decision-making bodies, etc. (e.g., omitting parts which describe in details how the calculations where done, but rather focusing on what simplifications the SCO brings, what will be checked during the verifications and by whom, what documents need to be kept for the audit trail, etc.).

The programme-specific SCOs should be included with the relevant details in the programme documents and templates; i.e., description of the management and control system (if any), manual for beneficiaries, calls for proposals, templates of the partnership agreement and project contract.

4.7 SCOs and horizontal issues

Simplified cost options do not lift or cancel eligibility rules as defined in the Regulations. However, the audit and verification work look very different for the SCOs as compared to the actually incurred costs. Horizontal rules also apply to projects implemented using the SCOs.

4.7.1 SCOs and public procurement

SCOs can be used without hindrance in projects where there is some public procurement.

The PO has to ensure the compatibility between the rules on SCOs and the national rules on the award of public contracts, and, if applicable, with EU public procurement rules (depending on the thresholds applicable).

The fact that there is a procurement in the project should not have an impact on the calculation methods established by the Article 8.3 of the Regulations, which are the same for all types of projects, irrespective of whether procurement is part of the project or not. The PO should design a methodology based on sufficient reliable data and foresee adjustment methods which would ensure that the amounts of SCOs remain a proxy to real costs during the implementation of the projects. Adjusting the amount of SCOs with the prices resulting from a new public procurement is not allowed as it would undermine the entire principle of SCOs (established in advance).

The relevant procurement rules should be respected and followed by the projects irrespective of whether SCOs or actually incurred costs are used. **However, the auditors should not examine the related documentation of public procurement for amounts declared under SCOs.** Public procurement documentation should only be checked in relation to the basis costs of the flat rates (if the basis costs are

incurred costs). Consequently, the underlying financial or procurement documents should not be requested to check the amounts (expenditure) incurred and paid by the beneficiary as SCOs.

Public procurement rules should be respected even if the underlying documents will not be checked for the purposes of reimbursement from the Grants!

4.7.2 SCOs and State aid

The PO should ensure that the categories of costs for which SCOs are established, are eligible both under the Grants and under state aid rules. They must also ensure that the maximum aid intensities set out in State aid rules and the incentive effect are respected. In case of compensation for services of general economic interest, which constitutes state aid, the amount of compensation has to be respected.

When using SCOs, state aid and de minimis rules are to be considered at the stage of the methodology preparation as well as at the stage of selection of projects/ implementation, depending on individual cases.

V. Verification, certification and audit

5.1 Assurance model in the Grants

The assurance model in the Grants is based on several levels of checks and controls ("lines of defense").

Duplication of controls should be avoided though; i.e., same checks of the same expenditure item should be avoided.

In this chapter, the following control levels will be explained in further detail.

Figure 5. Assurance model in the Grants



5.2 Proof of expenditure and proof of fulfilment of conditions

Proof of expenditure for incurred costs

The main rule is that all the costs incurred by the PO, the Project Promoter and project partners need to be supported by receipted invoices or alternatively by accounting documents of equivalent probative value to be considered eligible under the grant agreement (Article 8.12.1).

However, this does not mean that the PO is obliged to set up a system where all the invoices or accounting documents are required to be submitted each time a Project Promoter submits a financial report. The Regulations oblige the PO to set up a system and control mechanism which ensures a sufficient level of control over the expenditure that is incurred by the Project Promoter or a partner. However, within this requirement there is a reasonable amount of flexibility as long as certain fundamental aspects are fulfilled. The PO should take proportionality into account (e.g., audit costs vs. incurred expenditure to be certified) and request proof of expenditure accordingly.

When required to submit proof of expenditure, the Project Promoters and project partners may also opt for a report by an independent auditor qualified to carry out statutory audits of accounting documents. It is also possible to go for a certificate issued by a competent and independent public officer (see further clarifications below under <u>section 5.2.1</u>). This report shall be accepted by the PO as sufficient proof of expenditure incurred. However, the PO may require Project Promoters and project partners <u>from the Beneficiary State</u> to submit receipted invoices or documents with equivalent probative values where these entities receive more than €100,000 in a project. Please note that entities located in another Beneficiary State or one of the Donor States are always permitted to choose between all three options when submitting proof of expenditure.

The frequency of submission of proof of expenditure depends on the total grant allocation from the programme to the Project Promoter/ project partner within a project.

▶ It is the **total grant allocation** from the programme to the Project Promoter/ project partner within a project that defines the frequency of submission of proof of expenditure by Project Promoter/ project partner (as specified in the project contract and partnership agreement) and not the **final declared amounts**²³!

Total grant allocation from the programme to the respective Project Promoter/ project partner within a project			
≤ €10,000	€10,000 < X ≤ €100,000	>€100,000	
Proof of expenditure shall not be submitted.	Proof of expenditure shall be submitted once, at the end of the project. Any options for submission of proof of expenditure (receipted invoices or accounting documents of equivalent probative value; a report by an independent auditor; a report by a competent and independent public officer) can be used.	Proof of expenditure shall be submitted no more than once per year. Any options for submission of the proof of expenditure (receipted invoices or accounting documents of equivalent probative value; a report by an independent auditor; a report by a competent and independent public officer) can be used, however, the PO may require the Project Promoter/ project partner whose primary location is within the BS to submit proof of expenditure as receipted invoices or accounting documents of equivalent probative value only.	

Table 17. Frequency of submission of proof of expenditure for actually incurred costs

The supporting documents need to be in place and available even if they are not required to be submitted alongside the individual financial report. This is to ensure a proper audit trail to track the use of money. Proof is needed also in case the programme/ project(s) are audited.

Supporting documents regarding incurred expenditures must be kept either in the form of originals or in versions certified to be in conformity with the originals for a period of at least three years following the approval of the FPR (Article 9.7), without prejudice to more stringent national rules.

²³ This rule is different for projects funded under Research and Innovation programmes and explained in detail in the Research Guideline (available on the EEA and Norway Grants website).

Proof of fulfilment of conditions for simplified cost options

Where simplified cost options are concerned, reimbursement of expenditure is carried out on the basis of fulfilment of conditions. This depends on the type of simplified cost option used.

1. Flat rates

Flat rates can be calculated on the basis of actually incurred cost and/ or unit costs and lump sums.

- Where a flat rate is calculated on actually incurred costs, the fulfillment of the condition for the reimbursement of the flat rate is that the incurred costs are eligible and meet the proof of expenditure requirements for real costs;
- Where a flat rate is calculated on lump sums and/ or unit costs, the fulfillment of the condition for reimbursement is that the said unit costs or lump sums have been correctly established and correctly applied as per Article 8.3.2 of the Regulations.

2. Unit cost and lump sums

Where the project grant takes the form of a lump sum or unit costs, proof of conditions fulfilled is limited to proof of outputs and/ or results delivered and the relevant units, respectively.

Underlying expenditure covered by simplified cost options shall not be part of audits or verifications.

5.2.1 Auditor's certificates

On top of the receipted invoices or accounting documents of the equivalent probative value, the project contracts and/ or partnership agreements may include an option for the Project Promoter or project partners to provide proof of expenditure by way of a report issued by

- an independent auditor, or
- a competent and independent public officer

certifying that the reported costs are incurred in accordance with the Regulations, national law and relevant national accounting practices. These reports can vary depending on the scope of the work carried out by the auditor/ public officer, but should generally cover basic requirements such as a confirmation that:

- the expenditure has been incurred within the eligible period and is in line with the eligibility rules;
- it relates to items approved under the project contract;
- the terms of the contract have been complied with and that adequate supporting documentation, including accounting records (for actually incurred costs), exists.

If the report is issued by **a competent and independent public officer**, the officer needs to be recognised by the relevant national authorities as having a budget and financial control capacity over the entity incurring the costs. In addition, this public officer needs to be independent meaning that he/ she has not been involved in the preparation of the financial statements (financial reporting) of the project. Some examples of such officers could be the internal financial controller of the institution, internal auditor, head of finance (if not involved in preparation of the financial statements) or officers holding equivalent responsibilities, in accordance with the relevant governing/ administrative acts of the organisation/

institution.

If the report is issued by **an independent auditor**, it is essential that the PO provides guidance on the scope of the work to be done and an indicative template of the report which should not be simply a one sentence certificate on the regularity of the expenditure, but should describe the purpose, procedures and results of the engagement in sufficient detail to enable the reader to understand the nature and the extent of the work performed.

The costs of audit reports are eligible project costs and should be planned for in the project's budget!

The International Federation of Accountants (IFAC) has issued an International Standard on Related Services (ISRS) 4400 "Engagements to perform agreed-upon procedures regarding financial information" which establishes standards and provides guidance on the auditor's professional responsibilities when an engagement to perform agreed-upon procedures regarding financial information is undertaken and on the form and content of the report that the auditor issues in connection with such an engagement. This type of agreed-upon procedure could be used for this purpose.

The objective of an agreed-upon procedures engagement is for the auditor to carry out procedures of an audit nature to which the auditor and any appropriate parties have agreed and to report on factual findings. Matters to be agreed include:

- the nature of the engagement;
- the purpose of the engagement;
- the identification of the financial information to which the agreed-upon procedures will be applied;
- the nature, timing and extent of the specific procedures to be applied;
- the anticipated form of the report of factual findings.

The ISRS 4400 also sets out useful templates for engagement letters and for reports on factual findings.

The annually audited financial statement of an entity cannot replace the specific auditor's report.

A template for certification of costs claimed by donor project partners is provided in Annex VII.

In general, in projects where an IPO is a project partner, a partnership agreement will be signed with the Project Promoter specifying the IPO's role in the project, whereas the financial aspect of this collaboration will be paid directly from the IPO Fund. The financial agreement will as such be between the IPO and the FMO, and the IPO will report on their expenses related to the project as agreed with the Donors/ FMO. Other international organisations that are not defined as IPOs should, however, be paid by the project.

5.3 Verifications by the PO

In line with the key requirements as defined by the Regulations, one of the tasks of the PO is to ensure appropriate verifications and procedures for confirming that the incurred expenditure is legal and regular and appropriate procedures for checking fulfilment of conditions for simplified cost options.

Verifications carried out by the PO should cover administrative, financial, technical and physical aspects of the projects, as relevant. These verifications should be risk-based and proportionate to the risks identified by the PO. In practice, this means that the PO should conduct a risk assessment of the projects (prior to any checks) and perform verifications in accordance with the risks identified: riskier projects should be checked more thoroughly, while lighter verifications should be carried out on projects with lower

risks. There is no need to check 100% of the expenditure of all projects, a risk-based selection should be used instead.

Verifications should take the form of:

- administrative verifications in respect of incurred expenditure and fulfilment of conditions for simplified cost options (on a representative basis) reported by the PP/ project partners;
- on-the-spot verifications of projects.

Organisational aspects

1. Resources

The PO is responsible for planning, administering and assessing its internal capacities to identify a number and value of projects which can be appropriately managed. It should seek to have adequate human resources with an appropriate experience in grants management. In particular, the PO staff performing the verifications need to have both skills as a controller and knowledge of national, EU and EEA/ Norway grants rules and regulations (e.g., eligibility rules, state aid rules, public procurement rules). In situations where, due to a high volume or technical complexity of the project to be verified, and where the PO finds that it does not have sufficient staff or expertise to carry out the verifications needed, the PO can outsource some or all elements of the verifications to an external expert.

2. Separation of functions and segregation of duties

To ensure compliance with the principle of separation of functions between and within the entities and to avoid risks arising where the PO is responsible for (i) selection and approval of projects and implementation of the programme, and (ii) verifications and (iii) payments, an adequate separation of duties should be ensured between these functions. Where the PO is also a Project Promoter, an adequate segregation of duties may be achieved by, e.g., using a separate division within the same organisation, independent of the division where the Project Promoter is located, to carry out the verifications and/ or payments. The staff performing the verifications should not be involved in systems audits or audits of expenditure carried out under the responsibility of the AA and vice versa.

Scope, procedures and records

The PO verifications should cover administrative, financial, technical and physical aspects of projects, in particular:

- compliance with the Regulations, the PA as well as the applicable national and EU law;
- adequacy of supporting documents and existence of an adequate audit trail;
- compliance of incurred expenditures with all the eligibility rules;
- no double-funding (when the same Project Promoter implements more than one project at the same time or receives funding under various forms of support; i.e., incurred costs and simplified cost options, or funds from other Donors, there should be a mechanism in place to verify potential double funding of expenditure items);
- physical progress of the project;
- delivery of the product or service;
- respect of the rules on publicity and visibility (photographs of billboards, copies of promotional brochures, training course materials and diplomas may be used to provide evidence of the verification of compliance with the publicity and visibility requirements).

? To limit the potential risk of double funding, the following is considered a good practice:

- All invoices for incurred costs (or similar accounting documentation) should have the project's unique number/ accounting cost center. This should also be marked on any documentation relating to each invoice. Marking them in pencil does not serve the purpose!
- An original document is more reliable than a copy, as it is difficult to alter and offers better protection against recording the same expense item twice. Require Project Promoters/ partners to present you with original invoices at least during the on-the-spot verifications.
- Require that staff are asked to prepare a timesheet on a weekly or monthly basis covering all projects and activities (100% of working time) where actually incurred costs are used. They should record their time using actual time spent on each project activity, irrespective of what time is budgeted for that project. Not signed and not approved timesheets do not serve the purpose!
- Require that all staff costs are paid using bank transfers.
- Where different forms of reimbursement are used in the same project (i.e., real costs and simplified cost options), it should be ensured that:
 - categories of costs covered by SCOs and those reimbursed using other forms of reimbursement are clearly distinguished; if successive phases are used, a clear demarcation of phases (when one ends and another begins) is described;
 - all costs are declared only once by checking that the methodologies applied ensure that no expenditure of a project can be charged under more than one type of an SCO and, if applicable, cost category, or in different phases of a project, if the case (double declaration of costs, for example, both as direct and indirect costs);
 - o the basis costs of the flat rates or any other real costs do not include costs that fall under the flat rate applied.

Procedures

The standards and procedures used by the PO for carrying out the verifications should be set out in the procedures' manuals, identifying which points are checked during the administrative verifications and during the on-the-spot verifications respectively and referring to checklists to be used for different checks. The manuals should also include a detailed description and justification of a risk assessment and methodology for the selection of items for verifications to be applied.

When the administrative and on-the-spot verifications are carried out by different people, the procedures should ensure that both receive relevant and timely information on the results of the verifications carried out.

9 Good practice on checklists

1. Ensure that written checklists are used for verifications and conclusions of the verifications are properly documented;

2. ensure that checklists are up-to-date;

3. verification checklists should cover different forms of grants if relevant (i.e., both incurred costs and simplified cost options if applied);

4. ensure that checklists cover procedures for verification of absence of double funding;

5. should there be any recommendations towards the checklists as a result of system audits/ audits of projects carried out by the AA, ensure the recommendations are incorporated in the checklists.

Records

The PO should demonstrate, through adequate documentation of verifications carried out, that the overall intensity of the verifications, both administrative and on-the-spot, is sufficient to give a reasonable assurance of the legality and regularity of the expenditure declared under the programme. The PO should establish written procedures and standards for the verifications carried out and records.

All the verifications should be documented (e.g., in the form of checklists). All verifications should adhere to risk assessment and verification plans established by the PO, for example, on an annual basis.

The verification records should, as a minimum, include:

- a summary of the work performed;
- details of the financial report/ expenditure items reviewed;
- value of checked expenditure; i.e., the amount tested to source documentation;
- results of the verifications including the overall level and frequency/ nature of the errors detected;
- description of irregularities detected with a clear identification of the related rules infringed and the corrective measures taken (follow-up action may include the submission of an irregularity report and a procedure for recovery of the funding);
- name and position of the person(s) performing the verification;
- date and signature.

Good practice on verification checklists

Checklists, which act as a guide for carrying out the verifications, are often used to record actions performed and results obtained. Checklists should be sufficiently detailed. For example, when recording verifications on the eligibility of the expenditure, it is not enough to have one box stating that the eligibility of the expenditure has been verified. Instead, a list of each of the eligibility points verified should be detailed with reference to the related legal basis (e.g., expenditure paid within the eligibility period, conformity of supporting documents and bank statements for incurred costs, appropriate and reasonable allocation of overheads). For public procurements, it is recommended to have detailed checklists which cover the key risks in the procurement procedure. For more straightforward verifications such as checking the sum of a list of transactions, a simple tick beside the total figure would suffice to record the work done.

As a minimum, the checklist should include questions on:

- all general eligibility criteria listed in the Regulations and the specific criteria for each type of expenditure, including actually incurred costs and SCOs if applicable;

- the identification of ineligible expenditure as defined in the Regulations.

5.3.1 Administrative verifications by the Programme Operator

Administrative verifications carried out by the PO should be performed in respect of the expenditure incurred and fulfilment of conditions for simplified cost options reported by the Project Promoter and project partners. The PO's verifications serve as the first line of control (see Figure 5 in section 5.1) in assuring that all expenditures declared to the FMC are legal and regular and that all procedures are compliant with the Regulations, PA, and national and EU rules.

Administrative verifications are desk-based examinations of the financial reports and relevant supporting documents for incurred expenditure and simplified cost options. Examples of supporting documents for incurred expenditure are proof of expenditure; e.g., invoices, proof of payment, timesheets, bank

statements, etc.; examples of supporting documents for simplified cost options are delivery of outputs/ results (reports, studies, participants/ signature lists); reporting of units (e.g., hours worked – in the timesheets, participants in the training, etc.).

The main principles of administrative verifications are:

- financial reports submitted by the Project Promoter should be verified by the PO before they are approved (however, in line with the requirements for the submission of the proof of expenditure being proportional to the total grant allocation to each Promoter/ partner as specified in Article 8.12.5);
- where documents are submitted by the Project Promoter, they should be comprehensive to
 enable the PO to verify the legality and regularity of the expenditure declared and fulfilment of
 conditions for simplified cost options. The supporting documentation required might include: a
 schedule of the individual expenditure items, totaled and showing the expenditure amount, the
 references of the related invoices, the date of payment and the payment reference number and
 list of contracts signed (if applicable), proof of delivered outputs/ results (for SCOs). Moreover,
 ideally, electronic invoices and payments or copies of invoices and proof of payment should be
 provided for all incurred expenditure. However, where this would involve a large volume of
 documentation, an alternative approach might involve requesting only the supporting
 documentation in respect of a sample of expenditure items selected for the detailed review as
 explained below;
- in the case of a large volume of transactions/ supporting documents accompanying the financial reports, it is advisable to focus verifications on samples of transactions/ items, selected based on risk factors;
- the risk-based selection is used and a reasonable percentage of declared project expenditures to be verified against the proof of expenditure (per each risk level) should be established ex-ante by the PO;
- in the case that serious errors are found in the sample tested, it is recommended to extend the sample to determine whether the errors have a common feature (i.e., type of transaction, location, product, period of time) and then either extend the verifications to 100% or project the error in the sample to the unchecked population;
- best practice is to verify compliance with the public procurement procedures during the administrative verifications (for incurred expenditure). It is recommended to verify all contracts above the EU thresholds²⁴ and a sample of contracts below the thresholds selected using a riskbased approach.

Underlying expenditure of simplified cost options are not part of the verification work and should not be looked into by the PO. Verification of SCOs is described in <u>5.5.5</u>.

Invoices and other proof of expenditure should not be asked where the total grant allocation to the Project Promoter/ project partner within a project does not exceed €10,000 (as explained in section 5.2).

Good practice

A risk-based selection

²⁴ EU directive on public procurement (Directive 2014/24/EU) - Legal rules and implementation

The following risk factors (inherent and control) can be considered by the PO when selecting a sample of transactions/ items for a detailed review in the case of large volume of transactions/ extensive documentation:

- type of Project Promoter/ partner/ project;
- value and type of expenditure item;
- physical progress indicators;
- past experiences (e.g., number and gravity of
- problems identified when reviewing previous reports of the Project Promoter);
- existing control procedures in place at the Project Promoter level (however, this does not substitute the PO

verifications).

The sample selected based on the risk factors should be complemented by a random sample of invoices/ transactions to ensure that all items have equal probability of being selected.

5.3.2 On-the-spot verifications of the Programme Operator

While administrative verifications involve reviewing documents and records to ensure that everything is in order, on-the-spot verifications provide a more comprehensive and accurate assessment of compliance and project progress and involve visiting the actual site where activities are taking place.

On-the-spot verifications of projects should be carried out by the PO to verify:

- the reality/ physical existence of the project;
- delivery of the product or service in full compliance with the project contract;
- physical progress of the project;
- compliance with the rules on publicity and visibility;
- existence of original supporting documents (especially when the same Project Promoter implements more than one project at the same time or receives funding from other Donors/ funds);
- accuracy of information regarding the physical and financial implementation of the project submitted by the Project Promoter.

The intensity, frequency, and coverage of on-the-spot verifications should be proportionate to the financial support and to risks identified. On-the-spot verifications may be carried out on a risk-based selection basis. Where risk-based selection of projects for on-the-spot verifications is used, the PO should keep records describing and justifying the selection and a record of projects selected for verification. No project should be excluded from the possibility of being subject for the on-the-spot verification. The selection criteria used and a reasonable percentage of projects to be verified on-the-spot should be established exante by PO.

For the selection of the expenditure items to be verified within each project the same rules apply as for the administrative verifications.

As a rule, the notification of the on-the-spot verifications should be given to the Project Promoter and project partners to ensure that the relevant staff (e.g., project manager and accountant) and documentation (in particular, financial records including bank statements and original invoices for incurred expenditure) are made available during the verification. However, in some cases (e.g., suspected fraud,

risk that documents will be forged, etc.), it may be appropriate to carry out on-the-spot verifications without prior notice.

🔎 For example,

If the Project Promoter is a government ministry and checks on the expenditure have already been carried out by a separate part of the ministry as part of their own control procedures (i.e., with appropriate separation of functions), the PO may treat them as contributing to the assurance to be obtained, whilst still being responsible for carrying out the verifications. The checks carried out directly by the Project Promoter cannot be the equivalent of the verifications under Article 5.6.2, which is a task of the PO.

Good practice on selection of projects

The following risk factors can be considered when selecting projects for on-the-spot verifications:

- complexity of the project;
- amount of the public support (grant);
- scope of checks during the administrative verifications;
- risk(s) identified during the administrative verifications (i.e., problems, irregularities, transactions that appear unusual or suspicious and require further examination);
- audit findings and recommendations of the AA;
- control procedures in place at the Project Promoter level.

A random sample of projects should be selected to complement the sample. Where problems are identified in the onthe- spot verifications from the random sample, the size of the sample should be increased to determine whether similar problems exist in the unchecked projects.

Timing of on-the-spot verifications

The nature, specific characteristics of a project, amount of public support, risk level and the extent of administrative verifications, will often influence the timing of on-the-spot verifications. In general, it is recommended to carry out on-the-spot checks before the project is completed to enable corrective actions in case problems are identified and to avoid irregular expenditure.

Where the same forms of support are awarded following an annual call for expressions of interest, on-thespot verifications carried out in the first year should help to prevent recurrence of problems in later years.

The recommended timing for the on-the-spot verifications is:

- when the project is well under way (in terms of physical and financial progress);
- projects of intangible nature- during project implementation to attest reality of activity;
- projects for which the entire purchase price of an equipment item was allowed by the PO additional verification after the project's completion should be considered to verify compliance with additional obligations for the equipment purchased (Article 8.2.3);
- multiannual infrastructure projects at various occasions, with an initial visit to ensure preventive effect; final visit after completion of investment to verify the reality of the project.
Visits to projects as a preventive measure to verify the capacity of an applicant do not replace the on-thespot verification of projects selected for funding.

5.3.3 Verifications of the Programme Operator versus audits

There is a fundamental difference between the verifications carried out by the PO and audits performed by the AA. The verifications of the PO are part of the PO's internal control function within the management and control system. Their purpose is to verify that the incurred expenditure is legal and regular, and appropriate procedures for checking fulfilment of conditions for simplified cost options; and that the projects comply with the applicable rules as laid out in the Regulations, PA as well as applicable national and European Union law. The aim of such verifications is to identify and correct irregularities or problems in the expenditure declared by the Project Promoter and project partners.

Audits are ex-post engagements performed by auditors who are external to and independent from the PO. Audits can reveal whether the verifications of the PO are appropriate as to their design and whether they operate effectively. Audits aim to provide independent assurance on the proper functioning of the management and control system and on the legality and regularity of the expenditure declared to the FMC. Controls testing is normally performed through system audits which examine design and operating effectiveness of controls by re-performing several verifications. The two types of work must, therefore, be clearly distinguished in their planning, organisation, execution, content and documentation.

Although the verifications by the PO and the audits under the responsibility of the AA should be separated, exchange of information between the PO, NFP, CA and AA is fundamental and must be ensured.

In terms of vocabulary, where the PO verifications take place, *a risk-based selection of items* for verification is used. Where audits are concerned, the AA uses a *sampling approach* (the word "sampling" is reserved for the audit purposes).

5.3.4 Verifications of the Programme Operator versus monitoring

Monitoring is an observation of programme and project implementation to ensure that agreed procedures are followed, to verify progress towards agreed outcomes and outputs and to identify potential problems in a timely manner to allow for corrective action.

Results-based monitoring serves as a comprehensive framework that encompasses various oversight mechanisms, including on-the-spot verifications. While results-based monitoring aims to assess the broader effectiveness, and long-term outcomes of a program, on-the-spot verifications function as a crucial subset within this approach, focusing on real-time administrative checks, financial audits, and compliance inspections. These verifications provide immediate insights and help ensure procedural adherence at the operational level, feeding into the larger results-based monitoring system. By integrating on-the-spot verifications within a results-based monitoring framework, organizations can achieve a more holistic oversight process that balances real-time compliance with long-term performance evaluation

For more information on monitoring, please consult "Results-Based Management Guidance".

5.4 Certification of expenditure by the CA

The CA is responsible for certification and submission of the following documents to the FMC:

- certified IFRs and FPRs;
- forecasts of likely payment applications (as integral part of the IFRs);
- Interim Reports for TA.

Furthermore, the CA is also responsible for:

- declaring to the FMC any interest earned or paid over the reporting period and the cumulative interests over the whole Financial Mechanisms (on an annual basis, as an integral part of the IFRs);
- taking account of all audits results carried out by or under supervision of the AA (for certification purposes);
- maintaining accounting records in electronic form of expenditure declared to the FMC;
- ensuring the availability of funds to all POs;
- making sure that amounts cancelled in a programme or project are reimbursed to the FMC prior to the closure of the programme.

Scope of the CA's certification

All expenditures reported by the POs in each IFR should be certified by the CA.

The CA should certify that:

- for declared expenditure (actually incurred expenditure and SCOs):
 - the supporting documents for incurred expenditure and fulfilment of conditions for SCOs have been examined and found to be authentic, correct and accurate;
 - o payments to projects have been executed as reported;
 - o co-financing in relation to declared expenditure has been paid;
 - o when relevant, that the interest to date has been reported in the relevant IFRs;
- for actually incurred expenditure:
 - the summary of eligible expenditure submitted by the PO is in full conformity with the supporting documents;
 - the summary of eligible expenditure is based on verifiable accounting which is in compliance with generally accepted accounting principles and methods;
 - the summary of eligible expenditure falls within eligible expenditure under the Regulations;
 - the summary of expenditure is incurred as part of the implementation of the programme in accordance with the PA;
 - sufficient audit trail exists.

The CA should not check the expenditure of the projects (incl. the audit trail and supporting documents). However, the CA checks the expenditures under programme management costs, and expenditures of the funds for bilateral relations at the national level declared by the NFP (however, costs declared by the bilateral funds' promoters are verified by the NFP).

The CA submits Interim Reports for TA to the FMC, but it does not certify costs as the TA is paid as the fixed amounts conditional upon delivery of certain outputs (defined in Article 8.11).

Procedures

The procedures used by the CA should be set out in a procedure manual, identifying which points are checked and referring to checklists to be used.

When designing the certification process, the following main questions should be taken into consideration:

Figure 6. Certification of the IFR by the CA – the process



Good practice - IFR content by the POs

The procedure clearly defining communication methods between the PO and the CA, and the deadlines for submission of necessary information should be agreed before the programme implementation starts.

The verification of the expenditure reported by donor project partners and DPPs (when acting as donor project partners) should be agreed between the PO and the CA in advance.

SCOs used by the PO and projects should be clearly communicated to the CA in advance.

Records

To conclude that it has sufficient assurance to submit a certified IFR to the Donors, CA must have adequate evidence concerning the correctness, legality and regularity of the incurred expenditure and fulfilment of conditions for SCOs. The evidence required and procedures to ensure that CA receives it on a regular and timely basis should be defined ex-ante and communicated to the POs.

5.5 Audits

5.5.1. Single audit and proportionality principles

When carrying out audits, the Audit Authority should consider the principles of "single audit and proportionality" in relation to the level of risk to the implementation of the Grants (Article 5.5.5).

In practice, this means that the audit work should be planned to avoid duplication of audits and verifications of the same expenditure with the objective to minimise the costs of the verifications and audits and administrative burden on beneficiaries. However, this does not mean that if an expenditure selected in the audit sample was checked during the verifications by the PO it has to be automatically excluded from the sample drawn by the AA. These are two different notions, and they are explained in <u>Chapter V</u>.

When carrying out audits, the AA should first use all the information and records from the monitoring systems used to record and store in computerised form for each project under the programme. The AA should consider results of the verification work of the PO and then based on the professional judgement decide how to audit that expenditure. The AA should only request additional information from the beneficiaries concerned (auditees) where, based on their professional judgement, this is necessary to support robust audit conclusions (point (I) of Article 5.6.1).

If a sample unit is a project, and if the same project appears in a different sample of the AA, the AA can replace that project with a different one (if the project is very small in terms of budget and has already been audited by the AA in a previous accounting year)²⁵. If the AA applies a non-statistical sample and wants to focus on a specific area (e.g., public procurement) based on its risk assessment, it can happen that the same project audited earlier can appear in the new sample.

The single audit and proportionality principles imply that the audit results by the external auditors of the bodies implementing the Grants should be taken into account.

The practical application of the single audit principle will also be ensured by the regular exchanges and contact between the AA and the FMC. These exchanges (meetings) will take place at least once a year, unless otherwise agreed, to examine the audit strategy, annual audit report and opinion, to coordinate the audit work and plans and methods, and to exchange views on the issues related to the improvement of the management and control systems.

5.5.2 Audit strategy

As described in <u>Annex II</u>, one of the tasks of the Audit Authority is to prepare an audit strategy covering the entire allocation to the BS and all programmes within nine months of the approval of the last programme. The audit strategy should be risk-based, meaning that the audit efforts and resources should focus on the areas with the highest potential risks. The Regulations do not prescribe a special method for risk assessment; however, it is mandatory that it is documented and used.

The audit strategy should provide a structured framework to guide the work of the AAs for the whole Financial Mechanism 2021-28 (up to and including 31 December 2032, when the closure declarations have to be submitted).

²⁵ In practice, the substitution will require further technical guidance as provided in the <u>European Commission guidelines on</u> <u>sampling for Audit Authorities</u>.

The audit strategy should clearly identify the date when the document is drawn up and provide a reference to the original document if it is updated.

The audit strategy should, as a minimum, cover the elements described below.

Mandate

The AA should have a clear mandate to perform the audit function in accordance with Article 5.5. This mandate is usually documented in an audit charter/ statute if the mandate is not already set out in national legislation. Where an audit charter exists for the audit function as a whole, the mandate specifically related to the function of the AA should be incorporated in that charter and should be formally accepted by the AA. A strong audit charter helps increase the independence of the AA.

This section should include a clear identification of the AA, statute and issue date, and legal framework for the work of the AA.

Independence

The strategy should include confirmation by the AA that bodies carrying out audits pursuant to Article 5.5 have the requisite functional independence. Independence is freedom from conditions that threaten the ability of the AA to carry out its responsibilities in an unbiased manner. To achieve the degree of independence necessary to effectively carry out its responsibilities, the AA must have direct and unrestricted access to senior management at all levels, including the POs, the NFP and the CA. During all stages of the audit cycle, the AA should ensure that its work is performed in an independence implies a sufficient degree of independence to ensure that there is no risk that linkages between different authorities create doubts as to the impartiality of decisions taken. To ensure that sufficient degree of independence, the MCS should provide for measures such as the AA's staff not being involved with the POs, NFP or CA functions, the AA's autonomy of decision on recruitment of staff, clear job descriptions and clear written arrangements between authorities. It is essential that the AA can express disagreements with the POs, the NFP or the CA and communicate in full independence its audit results to the stakeholders, particularly to the FMO.

The organizational placement and status of the AA may pose a practical constraint or a limit on the scope of the AA work, where the AA is in the same public body as (some of) the audited entities. In general, the higher the reporting level, the greater the potential scope of engagements that can be undertaken by the AA while remaining independent of the audited entity. At a minimum, the head of the AA needs to report to the hierarchy level within that public body that allows the AA to fulfil its responsibilities; the AA must be free from interference in determining the scope of its audit work, performing work, and communicating results.

The AA should indicate in the audit strategy how the mentioned functional independence is ensured, describing the relations with the NFP, the CA, and POs. This can also be supported with charts and tables of the organisational structure and subjects involved in the implementation of the Grants.

Risk assessment

Audits on the functioning of the management and control systems of programmes (referred to as "system audits") and audits of expenditure declared (referred to as "financial audits") should be performed by the AA using the risk assessment and risk-based approach.

The aim of the risk assessment is to identify areas, structures and processes which are more exposed to different risks.

The identification and assessment of risk factors by the AA are key elements to ensure the proper functioning of the MCS of the programme!

Risk assessment²⁶ normally covers the following steps:

- identification of the scope and programme stakeholders programmes to be implemented in the BS, their objectives, defined outcomes, implementation framework of the programme and tasks, responsibilities and organisational structure of all subjects involved in the implementation of the programmes;
- definition of the risk factors *inherent* (i.e., before the existing internal controls and procedures in the MCS and/ or risk response) and *control* risks (i.e., risks arising from the weaknesses in the internal controls and procedures in the MCS);
- analysis of the risks in terms of their likelihood and impact (this is oftentimes done using the risk matrix to determine the risk level);
- definition of the audit scope and planning of the audit activities with the focus on the key risks.

Based on the results of the risk assessment, the AA will be able to prioritize the system audits of programmes and bodies for which the detection risk is higher over the audit period.

Some examples of risk factors are provided below:

- financial allocation of the programme (share of the programme allocation in the overall BS portfolio);

- complexity of the organisational structure (new PO, changes to the structure, external bodies involved in the implementation);

- management competence and capacity to implement the programme;

- quality of internal controls;

- degree of change of stability in the control environment;

- time of last audit engagement and previous audit findings;

- type of projects (e.g., pre-defined, with donor project partners, with big number of partners, complexity and novelty of projects);

- type of beneficiaries implementing projects (e.g., with/ without previous experience with the Grants);

- risk of fraud, etc.

Recommendations for the risk assessment:

- do not re-invent the wheel use the existing results and findings, such as previous risk assessments, available audit reports, quality reviews, results of audits conducted by other authorities, etc.;
- make the assessment actionable the assessment should prioritise the risks, as well as indicate how they should be mitigated or remedied;
- use external input when appropriate on emerging risks.

The audit strategy should include a reference to the internal procedures for updating the risk assessment,

²⁶ For the risk assessment process (input, tools and output), you can check the framework provided by the European Court of Auditors in their <u>Guideline on Risk Assessment</u> (2013).

since it is a continuous task of the AA and should be reviewed at least on an annual basis, as well as ad hoc once the changes occur.

9 Good practice

Document the results of the risk assessment in a table where the programmes and the main bodies involved in the MCS are classified by the risk level.

Methodology

With reference to the methodology, the audit strategy should contain at least the following information:

- reference to audit manuals or procedures containing the description of the main steps of the audit work, including the classification and treatment of the errors detected;
- reference to the internationally accepted audit standards that the AA will take account of for its audit work;
- reference to sampling and projection methods in line with the "Sampling Guidance on how to carry out sampling strategies under the EEA and Norwegian Financial Mechanisms for 2021-2028";
- reference to the procedures in place for drawing up the annual audit report and audit opinion to be submitted to the Donors (Article 5.5.1).

The AA's audit manual should provide a description of the working procedures for the different phases of an audit, i.e., audit planning, risk assessment, performance of engagements, recording and documentation, supervision, reporting, quality assurance process and external review, using the work of other auditors, use of any computer-assisted audit techniques, AI tools, sampling methods, etc. The audit manual should contain reference to materiality thresholds and other quantitative and qualitative factors to consider when assessing the materiality of audit findings for system audits and audits of projects. The audit manual should also include a description of the different phases of reporting (such as draft audit reports, contradictory procedure with the auditee and final audit reports), deadlines for reporting as well as follow-up processes which should allow the AA to conclude that appropriate and sufficient remedial actions were implemented.

Audits of the functioning of the MCS (system audits)

One of the tasks of the AA is to carry out audits to verify the effective functioning of the management and control systems at the national and programme level.

Regulations no longer prescribe at least one system audit for all programmes in the BS. Systems audits will no longer need to be carried out on all programmes.

Audits should be planned and carried out based on the appropriate sample, taking into account the principles of single audit and proportionality (described in <u>section 5.5.1</u>) and based on a risk assessment.

► A programme-level description of the management and control system is no longer required by the Regulation. It is not excluded that the NFP and POs will still draft a specific document for the POs procedures, but they can also agree to apply existing procedures or to include them in the national ones. This is entirely up to the national authorities to agree upon how to deal with this.

This section of the audit strategy should include the list of the bodies to be audited (i.e., POs, NFP, CA) and the related key requirements (as defined in Article 5.1.2) in the context of system audits.

The AA should have tailored checklists and work programmes for its system audits, ensuring that appropriate key requirements and procedures are covered either through full audits or follow-up audits to enable the AA to conclude on the functioning of the MCS from the first annual audit report onwards. Concerning the frequency and scope of system audits, the AA should decide based on its risk assessment, taking account of International Standard on Auditing 330 on the auditor's responses to assessed risks. Based on the above assessment, the AA can decide to focus on a selection of the key requirements when performing the system audit on a specific programme. Note, it is no longer required for the AA to carry out at least one system audit at the level of each individual programme. In any case, system audits should be carried out in a timely manner to contribute to the adequate planning and selection of audits of projects and to the expression of the annual audit opinion.

If during implementation of the programme(s), the MCS is subject to substantial changes (e.g., modification of procedures affecting the key requirements), the AA should perform a new system audit of the MCS, covering the new aspects and update the risk assessment accordingly. Audits carried out in the period 20142021 may be used as a reference point for the AA, in particular in the risk assessment, when planning the systems audits for 2021-2028 when the MCS are similar.

However, system audits still need to be carried out in 2021-2028, with the aim of assessing whether the MCS is properly functioning in this period. When performing audits, the AA should first use all the information and records from the PO's monitoring system for recording and storing accounting records for each project under the programme. The AA should only request additional documents and audit evidence from the beneficiaries concerned where, based on their professional judgement, this is required to support robust audit conclusions. The actual content of each audit should be adjusted by the auditor to take account of the control environment as part of the preparation stage for the audit.

In system audits, attribute sampling is normally used to test several attributes of the population at stake. In any event, the sample selection method for system audits is a matter for the AA's professional judgment. In particular, the choice between statistical and non-statistical sampling is based on costbenefit considerations and the nature of the controls.

During system audits, the AA has to test the different key internal controls established. When determining the number of items for controls testing, one should consider certain overall factors, taking account the internationally accepted audit standards (e.g., ISA 330 on the auditor's responses to assessed risks, the ISSAI 4100 on the factors to be taken when defining materiality, ISSAI 1320 on materiality in planning and performing an audit, ISSAI 1450 on evaluation of misstatements identified during the audit) and the principles established in the "Sampling Guidance on how to carry out sampling strategies under the EEA and Norwegian Financial Mechanisms for 2021-2028".

When planning a system audit, the AA should define in advance the threshold above which a deficiency will be considered material, i.e., what is the tolerable deviation for the assumed (planned) level of risk. When the system audit concludes that the deviation rate detected is higher than the tolerable deviation defined by the AA for that audit, this means that the MCS does not meet the criterion set for planned level of risk. As a result, the MCS must be classified as having a higher level of risk than the assumed one, with implications over the opinion about the functioning of the audited systems and consequently on the determination of the sample size of the audits of projects.

To evaluate the effectiveness of the functioning of the MCS at the programme level, the AA can use the following categories²⁷:

Category	Evaluation	Description	Assurance level
1	Works well. No or only minor improvement(s) needed.	There are no deficiencies or only minor deficiencies. These deficiencies have no, or minor impact on the effective functioning of the assessed key requirements/ authorities/ system.	High
2	Works. Some improvement(s) needed.	There is one or some (non-serious) deficiency (ies). These deficiencies have a moderate impact on the effective functioning of the assessed key requirements/ authorities/ system. Recommendations have been formulated for implementation by the audited body.	Medium - high
3	Works partially. Substantial improvement needed.	There is one or more serious deficiency(ies) that exposes the grants to the risk of irregularities. The impact on the effective functioning of the assessed key requirements/ authorities/ system is significant. Recommendations have been formulated to substantially improve the system for implementation by the audited body.	Medium - Iow
4	Essentially does not work.	There are numerous serious and/ or wide-ranging deficiencies which expose the Grants to the risk of irregularities. The impact on the effective functioning of the assessed key requirements/ authorities/ system is significant – the assessed key requirements/ authorities/ system function poorly or do not function at all. Recommendations have been formulated to radically improve/ reform the system by the audited body.	Low

Table 18. Categories of the MCS based on AA's evaluation of the effectiveness of the functioning of the MCS

Audits of expenditure declared

This section should include a description of (or reference to internal document specifying) the sampling methodology to be used in line with Article 5.5.4, and other specific procedures in place for audits of projects, namely related with the classification and treatment of the errors detected, including suspected fraud.

Sampling method, sampling unit and the parameters for calculating the sample size should be determined by the AA based on framework defined in "Sampling Guidance on how to carry out sampling strategies under the EEA and Norwegian Financial Mechanisms for 2021-2028" and taking into account the regulatory requirements and factors such as the characteristics of the population, confidence level and the expectation regarding the level and variability of errors. The need for revising the sampling methodology should be assessed regularly and especially before each sampling exercise.

The confidence level for sampling is determined according to the reliability level obtained from the system audits.

As a rule, the sampling to verify legality and regularity of expenditure declared and the fulfilment of conditions for simplified cost options should be carried out using the statistical method. Statistical method is typically used for large populations and when it is important to ensure random selection of items. Non-

²⁷ The categories for classification of the MCS are set out in Table 2 of Annex XI to the Regulation (EU) 2021/1060.

statistical sampling may be used on the professional judgment of the AA, in duly justified cases, in accordance with internationally accepted audit standards and in any case where the number of projects for a year is insufficient to allow the use of a statistical method (Article 5.5.4).

The non-statistical sample method should cover a minimum of 10% of projects for which expenditure has been declared during the reference period and a minimum of 15% of the expenditure which has been declared during that period.

The non-statistical sampling would normally be used in smaller populations (below 100 sampling units) and when the AA wants to focus on specific areas of higher risks rather than selecting items randomly.

▶ Audit of expenditure declared should cover all forms of eligible expenditure as defined in Article 8.3.1; i.e., incurred expenditure, expenditure declared using the simplified cost options (unit costs, lump sums, flat rates) and their combinations. Audit of expenditures differs depending on its form and is described in detail in <u>sections 5.2</u> and <u>5.5.5</u>.

The Regulations define the reference period for the audit of declared expenditure as 12-month; i.e., 1 July N to 30 June N+1. The table with the description of reference periods in the Grants is provided in <u>section</u> 5.5.3.

Audit work planned

This section should include a description and justification of the audit priorities and specific objectives in relation to the current accounting year and subsequent accounting years, together with an explanation of the linkage of the risk assessment results to the audit work planned. A description of the criteria used to determine the audit priorities, and the justification should be included. The results of the risk assessment exercise should be the main basis for prioritising the system audit work planned. It is recommended that the AA prepares a general plan for the funding period to cover the entire MCS to obtain reasonable assurance on its effectiveness, in addition to the mandatory detailed planning setting out the priorities for the current accounting year and the subsequent accounting year.

♀ It is recommended that each year together with the Annual Audit Report (AAR), the AA submits the audit plan for the upcoming year.

Resources

The AA should confirm that its resources²⁸ are sufficient to perform the audit work for the implementation of audit activities throughout the Grants.

5.5.3 Annual Audit Report and audit opinion

The Annual Audit Report (AAR) and the audit opinion (AO) by the AA is an important element through which the Donors obtain reasonable assurance on the proper functioning of the MCS in the BS, the legality and regularity of the expenditure declared, and completeness, accuracy and veracity of IFRs and the final balance. The AA should carry out all the audit work necessary to draw a valid audit opinion for each accounting year. Any irregularities detected by the AA should be reported to the Donors in accordance with the Regulations.

²⁸ In terms of audit resources, guidance is provided by the INTOSAI European Implementing Guidelines N° 11 and the IIA standards.

The accounting year is defined in the Regulations and runs from 1 July N-1 to 30 June N (where N is a year). Respectively, the AAR should cover findings from the audits performed on the expenditure declared in the reference period of 12 months preceding 30 June of the previous calendar year (1 July N-1 to 30 June N).

The table below demonstrates the accounting years/ reference periods for expenditures and the deadlines for submitting the AAR.

Table 19. Accounting years/ reference periods and deadlines for the submission of the AARs and AO in FMs 21-28

Accounting year/ Reference period	Submission of AAR and AO to FMC
Up to 30 June 2026	15 February 2027 – first AAR
1 July 2026 – 30 June 2027	15 February 2028
1 July 2027 – 30 June 2028	15 February 2029
1 July 2028 – 30 June 2029	15 February 2030
1 July 2029 – 30 June 2030	15 February 2031
1 July 2030 – 30 June 2031	15 February 2032
1 July 2031 – until submission of FAR	By 31 December 2032

The AAR should, at least, include the elements described in the sub-sections below.

Introduction

- Identification of the AA and other bodies that have been involved in the preparation of the report;
- reference period²⁹ (i.e., the accounting year);
- reference to the version of the audit strategy applicable;
- audit period (during which the audit work took place);
- identification of the programme(s) covered by the report and of its/their PO(s) (with information broken down per programme);
- description of the steps taken to prepare the report and to draw the audit opinion (preparatory phase, documentation analysed, coordination with other bodies (if applicable), audit work conducted and drawing up of the audit opinion).

Significant changes in management and control system

- Details of any significant changes in the management and control systems related with responsibilities of authorities involved at the national and programmes' level. Significant changes refer to changes which could have an impact on the proper functioning of the MCS and the level of assurance they provide. It is expected that the AA confirms that these modifications do not affect the conclusions of the opinion previously issued based on point (e) of Article 5.5.1;
- the dates from which these changes apply as well as the impact of these changes onto the audit work are to be indicated.

The Regulations do not require a description of the management and control system at the programme level. Furthermore, the AA is not obliged to perform a system audit on each programme in the BS (but apply a risk

²⁹ The reference period is set by the Regulations – from 1 July year N to 30 June N+1 (see Table 19 for a detailed overview).

assessment and approach to choosing which programmes to audit). Where the description of the MCS at the programme level exists, the AA should provide details on any significant changes in the programme's MCS in this section too (including dates from which the changes apply as well as the impact of these changes on the audit work).

Changes to the audit strategy

Details of any changes made to the audit strategy (compared to the previous version), and related explanations (including dates from which the changes apply). In particular, any changes to the sampling method used for the audit of expenditure declared, any changes in the MCS related to the PO's responsibilities, especially with respect to the delegation of functions should be indicated here.

Audits of the functioning of the MCS (system audits)

The following information should be included in this section of the AAR:

- Details of the bodies (including the AA) that have carried out audits on the proper functioning of the management and control system of the programme(s) ("system audits"). If part of the systems audits has been outsourced, the tasks outsourced to the contractor(s) should be specified.
- Description of the basis for the audits carried out, including a reference to the audit strategy applicable, more particularly to the risk assessment methodology and the results that led to establishing the audit plan for system audits.
- Indication of the key requirements (Article 5.1.2) covered by the system audit and their assessment³⁰.
- Information concerning the state of implementation of the audit strategy with regard to system audits. In case the audit strategy was not (fully) implemented, the AA should explain the reason for it. Where no system audits have been carried out in relation to the accounting year, information should be provided and references to the results of the risk assessment made. In any case, the AA should implement all the audit work necessary to draw a valid audit opinion for each accounting year.
- Description of the main findings (per key requirement), clearly separated by programme, and conclusions drawn from system audits should be included. The bodies concerned by the findings should be clearly indicated.
- Indication of whether any problems identified were of a systemic character, and of the measures taken, including a quantification of the irregular expenditure and any related financial corrections should be provided. In case no systemic problems are identified, this should also be indicated in the report.
- Information about the state of implementation of any action plans following the AA system audits carried out in relation to the accounting year to which the report refers should be included. The financial impact should be indicated as well as the status of the corrections. The IFR in which the corrections have been deducted from declared eligible expenditures should be indicated.
- Information on the follow-up of audit recommendations from systems audits from previous accounting years. In the case of financial corrections, the IFR in which the corrections have been deducted from declared eligible expenditures should be indicated.
- Level of assurance obtained following the system audits (low/ average/ high) and justification. This refers to the degree of assurance which can be attributed to the MCS, as to their ability to ensure the legality and regularity of expenditure and fulfilment of conditions for simplified cost

^{30 5} For assessment of the key requirements as defined in Article 5.1.2, the EC's Methodological note on the Assessment of Management and Control Systems in the Member States can be used (although, it has to be used accordingly to slightly different key requirements as defined in Regulations to the ones established in the CPR). Request the document from the FMO, if needed.

options. The assessment by the AA is based on the results of all system audits related to the accounting year and, if appropriate, previous accounting years, and the corresponding conclusions.

Audits of expenditure declared (financial audits)

- Details of the bodies (including the AA) that have carried out audits of expenditure. If part of the audits has been outsourced, the tasks outsourced to the contractor(s) should be specified. The AA is expected to explain the measures taken to supervise the work of the bodies that carried out the audits of expenditure on its behalf (delegated or outsourced). The AA should confirm that the work done by those bodies can be relied on for purposes of the AAR and allow the AA to draw-up a valid audit opinion.
- Description of the sampling methodology applied and information whether the methodology is in accordance with the audit strategy and the Sampling Guidance. The audit trail for the selection of the sample should be ensured.
- Indication of the parameters used for statistical and non-statistical sampling, as well as an explanation of the underlying calculations and professional judgement applied. The sampling parameters should include:
 - o materiality level,
 - confidence level (chosen in accordance with what is prescribed in the "Sampling Guidance on how to carry out sampling strategies under the EEA and Norwegian Financial Mechanisms for 2021-2028"),
 - populations considered,
 - o information on grouping of populations (if applicable),
 - o sampling units for each population (i.e., a project or a financial report by a PP),
 - expected error or error rate,
 - o expected standard-deviation(s) for the errors,
 - o sampling interval (if applicable),
 - population expenditure,
 - o population size,
 - o sample size,
 - o information on stratification (if applicable),
 - o description of the used sampling methods,
 - o description of how populations have been grouped for purposes of error projection.
- Where non-statistical sampling approach was used, indicate the reasons for using the method in line with Article 5.5.5, the percentage of items and of expenditure covered through audits³¹, the selection method of the sample and the projection method of sample errors. In case of nonstatistical sampling, the AA should describe the reasoning made to select the sample, with reference to its professional judgement, regulatory requirements and applicable internationally accepted audit standards. In particular, the AA should explain why it considers the sample representative of the population from which it was selected and enables the AA to draw up a valid audit opinion. A total (projected) error rate should also be calculated where non-statistical sampling method has been used.
- Where a two-stages approach to sampling was used, all the parameters used in subsample size calculation and selection should be presented in line with the ones presented for the main sample. The strategy used for subsample size calculation and for projecting the errors of the

³¹ In line with Article 5.5.5, the non-statistical sample method shall cover a minimum of 10% of projects for which expenditure has been declared during the reference period and a minimum of 15% of the expenditure which has been declared during that period.

subsamples should also be shown. Normally, if statistical sampling is used to select the main sample, the same method (statistical sampling) should be used when selecting units for the subsample.

- Analysis of the principal results of the audits of projects, describing the number of sample and subsample items audited, the respective amount and types of errors by project, the nature of errors found (e.g., public procurement, eligibility, State aid), the stratum error rate and corresponding main deficiencies or irregularities, root causes, corrective measures proposed (including those intending to avoid these errors in subsequent payment applications) and the impact on the audit opinion. In case of stratification or grouping of populations is used and whenever the above-mentioned analysis is not uniform over all strata/populations, separate analysis is to be performed by stratum or population. The errors reported should relate to findings disclosed in a final audit report; i.e., after the contradictory procedure with the auditee has been concluded. In duly justified cases, where such contradictory procedure was not concluded before submission of the annual audit report, this could constitute a limitation in scope. The quantification in the audit opinion may be calculated based on the maximum amount of error that the AA considers reasonable on the basis of the information it has available at the time of expressing its audit opinion.
- Comparison of the total error rate and the residual total error rate with the set materiality level, in order to ascertain if the population is materially misstated and the impact on the audit opinion. In case statistical sampling is used, precision measures and the upper error limit (UEL) should complement the calculation of the projected error rate to show that results are conclusive, and audit opinion is based on an adequate risk level. The results are to be presented for each population or group of populations for which separate audit opinions are required. On the basis of the results of the audits of projects for the purpose of the audit opinion and the annual audit report, the AA shall project calculate a total error rate (TER), which shall be the sum of the projected random errors and, if applicable, systemic errors and uncorrected anomalous errors, divided by the population. The TER and the upper error limit (UEL) should then be compared with the materiality threshold; i.e. the maximum of 2% of the expenditure included in the population. Where corrective measures have been taken before the annual audit report is finalized, the AA should also calculate the residual TER, i.e., the TER less financial corrections applied as a result of the AA's audit of projects. The residual TER should then be compared with the materiality threshold. Errors found in systems audits (control testing) are not added to the total error but should be corrected and disclosed in section "Audits of the functioning of the MCS (system audits)" of the AAR.
- Details of whether any problems identified were considered to be systemic in nature, and the measures taken, including a quantification of the irregular expenditure and any related financial corrections.
- Information on the follow-up of audits of projects carried out in previous years, in particular on deficiencies of systemic nature.
- A table categorising errors identified by type (Annex VI).
- Conclusions drawn from the overall results of the audits of projects regarding the effectiveness of the management and control system (a valid audit opinion).

Coordination between audit bodies and supervisory work of the AA

• Description of the procedure for coordination between the AA and any audit body that carries out audits as foreseen in Article 5.5.1, where appropriate. The procedure should cover coordination in relation to audit planning and coordination and verification of audit results with a view to reaching definitive conclusions and establishing the audit opinion.

 Description of the procedure for supervision and quality review applied by the AA to such an audit body. The description should include an overview of the supervision actually performed in relation to the accounting year, considering the existing internationally accepted audit standards or guidance³².

Other information

Where applicable, information on reported fraud and suspicions of fraud detected in the context of the audits performed by the AA (including the cases reported by other bodies and related to projects audited by the AA) has to be included in the report, together with the measures taken. If allowed by national rules for on-going investigations, the AA should gather information on the nature of the fraud and assess if this is a systemic issue and, if yes, whether mitigating actions have been taken. The state of implementation of financial corrections in relation to fraud or suspected fraud and the information about the IFR in which the corrections were included should be reported in the annual audit report, if applicable.

Overall level of assurance

- Indication of the overall level of assurance on the proper functioning of the management and control system, and explanation of how such level was obtained from the combination of the results of the system audits and audits of expenditure declared. For the purposes of the audit opinion to be drawn up by the AA, the assurance on the legality and regularity of expenditure and the proper functioning of the MCS is based on the combined results of both the system audits (section System audits above) and financial audits (section Audits of expenditure declared above).
- Assessment of any mitigating actions implemented, such as financial corrections and assess the need for any additional corrective measures necessary, both from a system and financial perspective.

The audit opinion

The audit opinion is based on the conclusions drawn from the audit evidence obtained. Four types of the audit opinion can be issued: unqualified opinion, qualified opinion (with limited or significant impact), and adverse opinion. The AA may also include emphasis of matter, not affecting its opinion, as established by internationally accepted auditing standards. A disclaimer of opinion can be foreseen in exceptional cases³³, as well as scope limitation.

In cases of qualified or adverse opinion, the AA is expected to design the corrective actions to be taken by the auditees. The AA should follow up if these actions have been implemented and report the following year on the implementation of recommendations in the respective sections of the AAR.

While establishing the audit opinions and setting the levels of assurance, appropriate professional judgement should be applied to decide whether the gravity of findings justifies a qualified or an adverse opinion.

Scope limitation could be issued when, based on external factors (e.g., pandemic, refusal of an auditee to provide access to documents) the AA is not able to perform all the necessary audit work that was

³² In this respect, the AA should consider Guideline No 25 of the European Implementing Guidelines for the INTOSAI Auditing Standards, related to the concept of using the work of other auditors and experts by the European Supreme Audit Institutions. Further guidance is provided by ISSAI 1600 concerning group audits, ISSAI 1610 (includes ISA 610) on the use of the work of internal auditor, and by ISSAI 1620 on using the work of an auditor's expert.

³³ E.g., auditors decide they cannot be impartial or independent regarding the organisation audited, the audit scope was substantially limited, insufficient audit evidence, in exceptional cases related to unforeseeable, external factors outside the remit of the AA, etc.

planned, and which would have allowed it to draw a valid and substantiated audit opinion on the management and control system and expenditure declared.

The most preeminent and objective instruments that the AA can use to issue such an opinion are:

- the results of tests of controls (categorisation of the control systems);
- the results of substantive testing (projected error rate and conclusions about its possible materiality);
- other complementary criteria (for example, quality of remedial actions) could be considered.

The categorisation of the audit opinion is defined by the following 4 categories:

- unqualified;
- qualified (with limited impact);
- qualified (with significant impact);
- adverse.

The criteria suggested for establishing such an option are presented in the table below.

Table 20. Audit opinion categorisation

Results of the system audit ³⁴	TER (results of the audit of projects)	Audit opinion
System in category 1	and TER ≤ 2%	Unqualified
(works well) or 2 (works with some improvements	and/ or 2% < TER < 5%	Qualified with limited impact
needed)	and/ or 5% ≤ TER ≤ 10%	Qualified with significant impact
	and/or TER > 10%	Qualified with significant impact
	and TER ≤ 2%	Unqualified
System in category 2	and/ or 2% < TER < 5%	Qualified with limited impact
(works with some improvements needed)	and/ or 5% ≤ TER ≤ 10%	Qualified with significant impact
	and/or TER > 10%	Qualified with significant impact
	and TER ≤ 2%	Qualified with limited impact
System in category 3	and/ or 2% < TER < 5%	Qualified with significant impact
(works with substantial improvements needed)	and/ or 5% ≤ TER ≤ 10%	Qualified with significant impact
	and/or TER > 10%	Adverse
	and TER ≤ 2%	Qualified with limited impact
System in category 4 (essentially does not work)	and/ or 2% < TER < 5%	Qualified with significant impact
	and/ or 5% ≤ TER ≤ 10%	Qualified with significant impact
	and/or TER > 10%	Adverse

³⁴ See Table 20 for the details on the results of the system audits.

Audit opinion	Corrective measures needed
1 - Unqualified	Corrections of the individual errors in the sample.
2 – Qualified with limited impact	Corrections of the individual errors in the sample + improvements to overcome any deficiencies in the MCS.
3 – Qualified with significant impact	Extrapolated financial corrections to bring the RTER (TER mitigated by implemented financial corrections) to $\leq 2\%$, taking account of corrections already applied as a
4 – Adverse	result of the AA's audits (including corrections of individual errors in the sample as accounts are inadmissible if RTER is above 2%) + improvements to overcome any deficiencies in the MCS + implementation of the adjustments to be made in the accounts.

Examples of the audit opinions are presented below.

Unqualified opinion

In my opinion and based on the audit work performed on the management and control system, the programme functions effectively to provide a reasonable assurance that statements of expenditure declared to the FMC/ NMFA are correct and, therefore, reasonable assurance that the underlying transactions are legal and regular and conditions for simplified cost options are fulfilled [if applicable].

Qualified opinion (with limited or significant impact)

In my opinion and based on the audit work performed on the management and control system, the programme functions effectively to provide a reasonable assurance that statements of expenditure declared to the FMC/ NMFA are correct and, therefore, reasonable assurance that the underlying transactions are legal and regular and conditions for simplified cost options are fulfilled [if applicable], except in the following aspects:

In relation to material matters related to the legality and regularity of the expenditure: ...

and/or [delete as appropriate] in relation to material matters related to the functioning of the

management and control system: ...

Therefore, I estimate that the impact of the qualification(s) is [limited] / [significant]. [Delete as appropriate]

This impact corresponds to [Amount in \in and %] of the total expenditure declared. The Donor States contribution affected is thus ... [amount in \in].

- * The AA should:
- detail and explain the qualifications,
- estimate their impact: limited or significant,
- quantify the impact, in relation to the expenditure declared and in absolute terms.

The estimation of the impact of a qualification as "limited" is deemed appropriate when it relates to irregularities (not yet corrected) corresponding to expenditure above 2% but below or equal to 5% (TER) of the total expenditure certified in these accounts. If those irregularities exceed 5% of the total expenditure certified in these accounts, the corresponding qualification should be estimated as "significant". The same reasoning applies when the exact amount of the irregularities cannot be quantified precisely by the AA and a flat rate is used; this may be the case of system deficiencies.

The AA should make very clear whether the qualifications relate to the legality and regularity of expenditure or the management and control systems.

Adverse opinion

In my opinion and based on the audit work performed on the management and control system, the programme does not function effectively to provide a reasonable assurance that statements of expenditure declared to the FMC/ NMFA are correct and, therefore, reasonable assurance that the underlying transactions are legal and regular and conditions for simplified cost options are fulfilled [if applicable].

This adverse opinion is based on the following aspects:

- In relation to material matters related to the legality and regularity of the expenditure: ...

- and/ or [delete as appropriate] in relation to material matters related to the functioning of the management and control system:

Scope limitation

Where the scope limitation is deemed necessary, the AA should estimate the impact (if any) on the expenditure presented to the FMC/ NMFA. In case the impact is material, an unqualified opinion cannot be issued. In such cases, the AA should issue a qualified opinion or, in exceptional cases, consider a disclaimer of opinion.

Disclaimer of opinion

Because of the significance of the matter described in the scope limitation paragraph above, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion whether the management and control system functions effectively to provide a reasonable assurance that statements of expenditure declared to the FMO are correct and, therefore, reasonable assurance that the underlying transactions are legal and regular and conditions for simplified cost options are fulfilled [if applicable].

5.5.4 Final Audit Report and closure declaration

The Final Audit Report (FAR) along with the closure declarations should be submitted to the Donors by the AA at the latest by 31 December 2032.

The Final Audit Report (FAR) should cover the information concerning audits carried out for the reference period from 1 July 2031 and until the submission of the report. The structure of the FAR mostly follows the structure of the AAR. The only new elements of the report are information on additional work undertaken by the AA in preparation for the closure declarations (e.g., review of the closure procedures of the POs/ CAs if any; summary of the follow-up audits and reported irregularities).

The closure declaration should be issued by the AA for each programme in the BS and it is supported by the FAR (at the country level) and audit opinion (issued for each programme). Closure declaration should be based on all the audit work carried out by, or under the responsibility, of the AA in accordance with the audit strategy for the whole Financial Mechanisms (until submission of the closure declaration, whichever is earlier). The main objective of the closure declaration is to assess the validity of the application for the

payment of the final balance claimed in the FPR (Final Country Report) (point (f) of Article 5.5.1). The closure declaration should include the following information:

- programme's name;
- total contribution from the EEA/ Norway Grants;
- total co-financing;
- total eligible expenditure;
- amount claimed in the final balance;
- any (irregular) amounts identified during the final audit that affect the final balance claimed in the FPR;
- if applicable, the proposed corrected amount of the final balance.

The templates for the FAR and closure declaration will be provided by the FMO in due course.

5.5.5 Auditing SCOs

Audit and control work of simplified cost options is very different from the incurred expenditure (real costs). The starting point is that where SCOs are used, there is no need to trace every single euro of expenditure. Instead, checks are limited to the verification of the delivered outputs/ deliverables (for unit costs and lump sums), or basis costs (for flat rates). Verifications do not cover individual invoices of underlying expenditure reimbursed on the basis of SCOs (as is the case for real costs). Where SCOs are used, there is no need to justify the real costs of the categories of expenditure covered by the SCOs or specific procedures underlying the expenditure based on SCOs (e.g., public procurement, depreciation, in-kind contribution, etc.).

Audit and control of SCOs are focused on 2 elements:

- 1) the verification of the correct establishment of the method (task of the national AA);
- 2) the correct application of the method (task of the national AA and part of the verification work by the PO).

Depending on the way SCOs are established, the audit and control work will be different.

Table 21.	Audit and	control	of SCOs
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Ways to establish SCOs	Verification of correct establishment of the method	Verification of the correct application of the method
Off-the-shelf SCOs (from Regulations)	X ³⁵	\checkmark
SCOs from Union policies/ national schemes	Х	\checkmark
Programme-specific SCOs (fair, equitable and verifiable method)	\checkmark	\checkmark
SCOs established using the draft budget method	\checkmark	\checkmark

For off-the-shelf SCOs and SCOs from Union policies/ national schemes, there is no need to verify the methodology, as they come either from the Regulations or are established by programmes under EU policies, thus, the required legal certainty is there. For programme-specific SCOs and SCOs established using the draft budget method, the methodology has to be checked. For programme-specific SCOs, it is

³⁵ Except for the up to 25% flat rate for indirect costs (point (c) of Article 8.5.1).

mandatory to have the methodology verified by the national AA ex-ante; i.e., before it is used in the projects (point (e) of Article 8.3.2).

♥ The EC produced a checklist for national AA with a detailed description on how to verify the SCOs methodology. It is advised to use this document as a reference for the AA when verifying the methodology of the SCO.

This section will focus on the verification and audit part of the correct application of SCOs.

Verification of flat rates

Verification of the correct application of a flat rate includes verification of the cost category(ies) that form the "basis costs" (cost category(ies) to which the flat rate is applied). The actual costs incurred by the beneficiary and related supporting documents of the cost category reimbursed as a flat rate are not checked.

Types of flat rates:

- off-the-shelf flat rates, specified in the Regulations. They are established as a ceiling in the Regulations ("up to"), therefore, the PO should decide on the percentage of the flat rate ex-ante;
- programme-specific flat rates, established by the programme based on methodology (Article 8.3).

Check	Do not check
 Programme rules to confirm: the flat rate is established by the PO ex-ante (in advance); the cost category(ies) covered by the flat rate were planned in PP/ partner budget; the flat rate is indicated in the document setting out the conditions for support (project contract); the flat rate covers the correct cost category(ies), as defined ex-ante by PO, and uses the correct cost category(ies) as basis costs for the flat rate the flat rate percentage is correctly applied. 	Underlying expenditures of the cost category(ies) reimbursed as a flat rate
 Basis costs to verify: the basis costs are legal and regular. There are no ineligible expenditure in the basis costs. 	Supporting documents to make sure the amount of the flat rate was spent on the correct cost category
No double financing – expenditure covered by the flat rate is not reimbursed by other means (real costs, other SCOs).	Evidence that the actual amount spent corresponds to the amount of the calculated flat rate.

Examples of the verification/ audit work of the correct application of the off-the-shelf flat rates

Up to 15% flat rate of the eligible direct staff costs to calculate indirect costs (point (c) of Article 8.5.1)		
Check	Do not check	
The flat rate set by the PO ex-ante is part of PP/ partner budget and indicated in the document setting out the conditions for support (project contract)	Underlying expenditures of indirect costs (the expenditure has been incurred and paid)	

The flat rate covers indirect costs, and it is applied to eligible direct staff costs as the basis costs	Supporting documents to make sure that the amount reimbursed based on the flat rate was actually spent on the expenditure of indirect costs
A correct percentage of the flat rate (as set in the programme's rules and in project contract) is applied and the calculation is correct	Evidence that the actual amount spent corresponds to the amount of the calculated flat rate
Basis costs (direct staff costs) do not contain ineligible costs (verification of the staff costs will depend on the reimbursement method used – either incurred expenditure or SCOs)	
Indirect costs are not included in other cost categories (no double financing)	

Up to 40% flat rate of the eligible direct staff costs to calculate the remaining costs of the project (Article 8.7)

Check	Do not check
The flat rate set by the PO ex-ante is part of PP/ partner budget and indicated in the document setting out the conditions for support (project contract)	Underlying expenditures of other than staff costs cost categories (the expenditure has been incurred and paid)
The flat rate covers all remaining costs of the project and uses eligible direct staff costs as the basis costs	Supporting documents to make sure the amount of the flat rate was spent on expenditures other than staff cost categories
A correct percentage of the flat rate (as set in the programme's rules and in project contract) is applied and the calculation is correct	Evidence that the actual amount spent corresponds to the amount of the calculated flat rate
Basis costs (direct staff costs) do not contain ineligible costs (verification of the staff costs will depend on the reimbursement method used – either incurred expenditure or unit costs)	Evidence that other cost categories (indirect costs, travel and subsistence allowances, equipment, costs of consumables, etc.) exist
No other cost categories exist in the project (only two cost categories in the project – staff costs and remaining costs covered by the flat rate)	

Verification of unit costs

Verification of unit costs is built around verification of the units delivered by the project.

Types of unit costs:

- off-the-shelf unit costs, established in the Regulations (Article 8.6.2). The Regulations define two hourly rates as off-the-shelf unit costs, calculated either using the 1,720 hours method or by diving the latest documented monthly gross employment costs by the average monthly working time;
- programme-specific unit costs, established by the PO ex-ante, based on a methodology (Article 8.3).

Check	Do not check
Programme rules to confirm:	Underlying actual costs of the units
 the unit cost is indicated as a form of reimbursement in the 	(the expenditure has been incurred
document setting out the conditions for support (project contract);	and paid)

 If conditions set in the programme documents/ project contract regarding process, outputs/ results for reimbursement of costs have been fulfilled (unit costs) and they are supported by documents; the correct price of the unit is used to calculate the amount declared (correct multiplication) 	
Units delivered:	Supporting documents/ evidence
 units delivered are properly documented and real (evidence supporting the number of units declared); expenditure covered by the unit cost are not reported as real costs in other cost categories. 	to justify that the actual amount spent corresponds to the amount calculated as unit cost

Examples of the verification/ audit work of the correct application of the unit costs

Hourly rates (unit cost for staff costs) established by dividing the latest documented annual gross employment costs by 1,720 hours (for full-time employees) or corresponding pro-rata of 1,720 hours (for part-time employees) based on Article 8.6.2

Check	Do not check	
The unit rate set by the PO ex-ante is part of the PP/ partner budget and indicated in the document setting out the conditions for support (project contract)		
Employment/ work contract and job description (one-time check, when the staff costs of an employee are reported for the first time)	Payslips (after the hourly rate is established)	
Payslip(s) or other documents of equivalent probative value (e.g., accounts, payroll reports) - to verify the correct establishment of the hourly rate (latest documented gross employment costs/ 1,720h or pro-rata of 1,720h)	Proof of payment of salaries and the employer's contributions (the expenditure has been incurred and paid)	
Data from the working time registration system (e.g., timesheets) to check the total number of hours worked for the project	Indirect salary costs (e.g., annual leave, overtime pay, other benefits, pension plans)	
The total number of hours declared per person for a given year/ month does not exceed the number of hours used for the calculation of the hourly rate (in this case, it does not exceed 1,720h)	Checking how the hourly rate was established by comparing what is behind the "full-time" working system in the country/ partner organization (i.e., whether it is 40 hours or 37.5 hours according to the national law).	
Correct calculation (number of hours declared multiplied by a correct hourly rate)		

Verification of lump sums

Verification of the lump sums implies checking that the pre-defined outputs/ results have been delivered by PP/ partner as agreed upon in the project contract.

There are no off-the-shelf lump sums defined in the Regulations. All lump sums are programme-specific and established based on the methodologies as provided in Articles 8.3.

Table 24. Verification of the correct application of lump sums

Check	Do not check
 Programme rules to verify: the lump sum is indicated as a form of reimbursement in the document setting out the conditions for support (project contract); 	Underlying expenditures of the lump sum (the expenditure has been incurred and paid)

 if conditions set in the programme document(s)/ project contract regarding the delivery of output(s) have been fulfilled and are supported by relevant documentation; amount of a lump sum is the amount corresponding to the milestones defined in the methodology; pre-defined outputs/ results to be delivered or other conditions for payment trigger(s) have been met, based on supporting documentation 	
Costs covered by the lump sum amount are not reported under other cost categories	Supporting documents for the actual costs to justify that the amount of the lump sum was actually spent on the predefined types of costs/ activities
	Evidence that the actual amount spent corresponds to the amount of the lump sum

Example of the verification/ audit work of the correct application of the lump sum

A lump sum to cover costs of organisation of events (programme-specific lump sum, established using the fair, equitable and verifiable method)		
Check	Do not check	
A lump sum is approved to reimburse costs of organisation of events in PP/ partner budget and indicated in the document setting out the conditions for support (project contract)	Underlying expenditures of the lump sum (the expenditure has been incurred and paid)	
The amount of the lump sum for organisation of an event is correct, according to the document setting out the conditions for support and it corresponds to the milestone set in the methodology	Supporting documents for the actual costs to justify that the amount of the lump sum was actually spent on the organization of event(s)	
Pre-defined outputs are delivered; i.e., the event is organised based on the verification of the pre-defined supporting documents (e.g., signature list, agenda, x number of participants, etc as agreed in advance by the PO and the PP)	Evidence that the actual amount spent on the organisation of the event corresponds to the amount of the lump sum	
Costs associated with the organisation of the event (covered by the lump sum) are not reported in other cost categories as real costs		

5.5.6 Audits and on-the-spot verifications arranged by the FMC

In line with the FMO's audit strategy for the Financial Mechanisms 2021-2028, the FMC may also conduct audits and on-the-spot verifications of programmes and projects, as well as the national authorities involved in the implementation of the Grants. The audits may involve staff of the FMO, or consultants contracted by the FMO. The FMO will inform³⁶ the NFP and the PO or other national authorities about any planned audit/ on-the-spot verification at least two weeks in advance (Article 11.2).

When planning external audits, the FMO will, where possible, take into account single audit and proportionality principles (Article 5.5.5), as well as assurance obtained from the work of the AA, audit opinion, FMO's verifications of the AARs, IFRs of the programmes, AA's audit strategy and annual audit plans, etc. The objective of such coordination is to avoid duplication of work and to avoid the situation

³⁶ Except in urgent cases or forensic (fraud) investigations, where the FMO reserves the right not to inform the NFP/ PO/ national authority about the audit within the deadline.

where the same expenditures are audited multiple times by different bodies. The audit plans are built on the risk assessment at the BS and programme level and is carried out by the FMO.

The NFP/ PO or other audited bodies will be given an opportunity to provide comments to an audit report before it is finalised during the contradictory procedure. Should there be any follow-up recommendations and follow-up plan because of the external audits/ on-the-spot verifications, the NFP/ PO are responsible for duly implementation of the corrective measures and improvements.

In line with the FMO's audit strategy, the following types of audit assignments are foreseen in the FMs 2021-2028:

- review and re-performance audits of the work of the AAs the objective of this audit is to obtain an assurance on the audit work of the national AAs and to assess to what extent reliance can be placed on their audit results, audit opinions and reported error rate;
- audits to verify the effective functioning of the management and controls systems at the national and programme level (system audits);
- audits to verify legality and regularity of expenditure declared and the fulfilment of conditions for simplified cost options at the programme and/ or project level (financial audits);
- thematic audits/ reviews at the country/ programme level;
- other assignments as appropriate (e.g., forensic audits).

The decision on the type of audit commissioned by the FMO is based on the annual risk assessment performed by the FMO. In line with the FMO's audit strategy, the review and re-performance audits of the work of the Audit Authorities will be prioritised by the FMO.

The EFTA Board of Auditors may also conduct audits of all programmes and projects funded through the Grants as well as the management of the Grants by the national authorities in the BS in line with Article 11.1 of the Regulations.

VI. Reporting and payments

6.1 Reporting and payments

Payments to programmes should take the form of advance payments, interim payments, and payments of the final balance. The underlying principle is that requests for pre-financing may be submitted throughout the implementation period to pre-finance estimated future expenditure.

The payment requests shall be supported by reports that include:

- actual level of expenditure, including management costs and relevant descriptions;
- planned expenditure for which pre-financing is requested (payment of proposed expenditure) together with relevant assumptions and explanations;
- forecast of likely payments applications until the end of the relevant Financial Mechanism, together with relevant assumptions.

This information, further detailed in <u>section 6.2.2</u>, should build a financial plan covering all the phases of the programme and support cash flow analysis and mid-long term budget planning.

Payments to programmes are made when all relevant conditions for payments stipulated in the PA and the Regulations have been fulfilled. Payments to programmes are calculated by applying the co-financing rate laid down in the PA. The principle of pro-rata financing should be applied, meaning that the payments of the programme grant from the FMO should be matched within one month by payment from the entity or entities responsible for providing co-financing.

Payments from the FMO to entities in the BS, to DPPs and IPOs should be denominated and carried out in **euro**.

Templates for the reports and relevant workflows associated with each type of report are implemented in GrACE.

6.2 Pre-financing model at the programme level

The general rule is that the grants are paid out by the FMO in the form of advance instalments to the PO based on:

- the actual expenditure of the PO, in addition to management costs;
- amounts paid to projects and affected by the PO in the form of bank transfers; i.e., disbursed amounts;
- the future cash needs of the PO, considering the funds previously received, reported declared expenditure and new pre-financing requests.

Amounts disbursed by the PO to projects should not be confused with declared project expenditure. In practice this means that the amounts included in the IFRs are not the amounts incurred and paid by the beneficiaries of the projects, but these are payments made by the PO to the projects, including management costs.

Up to 10% of the management cost allocation to the programme will be retained by the FMC until the FPR has been approved by the FMO. The 10% retention is calculated from the total management cost allocation (including national co-financing), not from the proposed management costs within each IFR.

For example,

Table 25. Management cost allocation

Budget heading	EEA	Co-financing	Total
Management costs	€ 850,000	€ 150,000	€ 1,000,000

- Co-financing for this programme is 15%.
- Amount retained for final balance 10%: € 100,000.
- Until the FPR has been approved, the payments to the programme for programme management are limited to € 900,000.
- The 10% retention is not calculated over advance and interim payment to the programme.

6.2.1 Advance payments

The PO may receive advance payments. An advance payment of up to 20% of the programme's grant allocation may be requested during the programme preparation phase and included in the PA³⁷ (Article 9.2). The amount of the advance should be calculated as the part of the programme grant necessary to cover its share of the justified estimated programme expenditure from the first date of eligibility of the programme until the first interim payment is due. The advance payment required must be broken down by budget heading and justification should be provided. In case there is a need for a larger amount that the up to 20%, the amount should be requested via the first IFR.

6.2.2 Interim payments and forecasts

Interim payments shall be paid based on IFR submitted by the PO, certified by the CA, and approved by FMO as shown below. Furthermore, FMO may also modify the amount of the interim payment if the proposed expenditure following the FMO's assessment is unjustified. After the IFR has been approved by FMO, the payment will be processed and transferred to the CA who will then transfer the funds to the PO.

Figure 7. IFR flowchart

³⁷ For more information on the PA see <u>section 2.3</u> of this document.



IFRs are submitted through GrACE in accordance with a set workflow. IFRs are customised to the specific programme; i.e., the report contains programme-specific data, such as contact details of the PO, financial information from previously submitted reports, applicable exchange rate, etc. GrACE provides all necessary explanations to the POs through all steps of completing and submitting the IFR to the FMO in <u>a dedicated manual</u>.

In FMs 21-28, financial reports should be submitted with a pre-defined frequency, covering two reporting periods in each calendar year:

- actual expenditure a statement of expenses declared during the previous reporting period (1 January to 30 June for reports due by 15 September, and 1 July to 31 December for reports due by 10 March);
- proposed expenditure a statement of planned expenses for the upcoming reporting period (1 January to 30 June for reports due by 15 September, and 1 July to 31 December for reports due by 10 March).

Amounts in the IFRs in GrACE are established as **rounded to two-decimal places**. Payments to the programmes will also follow the amounts with decimals.

The purpose of the IFR is **three-fold**. Firstly, the PO should provide a statement of actual expenditure declared for the reporting period preceding the submission deadline of the report (i.e., if the submission deadline is 15 September, reporting should cover the period 1 January – 30 June; if the submission deadline is 10 March, reporting should cover the period 1 July – 31 December). All amounts in this part of the IFR should be inserted in GrACE in local (national) currency and they will be automatically converted to euro

by GrACE using the monthly accounting exchange rate of the European Commission³⁸ in the month during which the expenditure was registered in the accounts of the PO of the programme concerned.

Secondly, the PO should provide a statement for the proposed expenditure for the reporting period immediately following the submission deadline of the report (i.e., if the submission deadline is 15 September, the proposed expenditure should cover the period 1 January – 30 June; if the submission deadline is 10 March, the proposed expenditure should cover the period 1 July – 31 December). All amounts in this section should be denominated in euro. The FMO will disburse the grant part of the proposed expenditure, unless the expenditure proposed by the PO is considered unjustified. Also, the amount of any previously disbursed but unused funds will be taken into consideration when assessing and approving the report.

For example,

Table 26. Calculation of the cash balance

Calculation of the cash balance: 15 September IFR	
Forecasted eligible expenditure for the next reporting period (1 January to 30 June)	+€800,000
- Previous payments to the programme (deduct)	-€1,000,000
+ Total actual eligible expenditure reported until 30 June (add)	+€600,000
+ Expected actual eligible expenditure between 1 July - 31 December (add)	+ € 100,000
Proposed eligible expenditure for the next reporting period (1 January to 30 June) in the IFR	€ 500,000

For a payment to be approved, any conditions set out in the Regulations and the PA must be fulfilled. The FMO will provide the NFP, CA and the PO with a justification of any corrections/ adjustments made to the payment request in the IFR. A flowchart showing the reporting periods and structure of the IFR can be found in <u>Annex V</u>.

Reporting on actual expenditure as well as on proposed expenditure should be broken down by the budget heading as set out in PA.

IFRs received after their due date but on, or before, the following due date will be processed by the FMO as the report would have been received on its following due date.

For example,

An IFR is due on 15 September 2026. This IFR covers the incurred expenditure for 1 January – 30 June 2026. The IFR is submitted late in July 2027. This is more than 12 months after the end of the reporting period in which expenditure has been incurred; i.e., June 2026. The actual expenditure for the period January - June 2026 is declared ineligible and cancelled.

If an expenditure has not been reported within the 12 months of the end of the reporting period in which it should have been declared, it will be considered ineligible and cancelled unless otherwise decided by the FMC (Article 9.3.5). In practice, this means that all expenditure should be declared to the FMO in the IFR for the corresponding reporting period. However, in justified cases, previously non-reported expenditure could be included in the subsequent IFRs if approved by the FMO.

³⁸ InforEuro provides the European Commission's official monthly accounting rates for the euro, the corresponding conversion rates for other currencies and historic conversion rates from 1994.

Thirdly, the IFR should also provide a justified forecast of likely payment applications from the CA, in a format provided by the FMO, covering the duration of the programme.

The forecast of likely payment applications is a document prepared by the CA (point (b) of Article 5.4.1) of each BS on the basis of the input provided by the POs (point (s) of Article 5.6.1), representing an overview of estimated payments by the FMO to the BS under the Grants per calendar year.

The forecast should be submitted by CA to the Donors twice per year (Article 9.3.4) by 10 March and 15 September. The CA should submit the forecast and the related justifications of forecasted amounts through GrACE as part of the IFR.

► The forecast represents only the estimated programme grant amounts to be requested by the BS from the FMO per calendar year through advance, interim or final programme payments and, thus, it should exclude the national co-financing.

The forecast must be as accurate as possible since this input is essential for the financial management of the Grants. Particular attention should be paid to the current and the following year as this information will be used by the Donors and the FMO for budgetary and planning of the cash flow purposes.

For the preparation and submission of the forecast, the following points must be adhered to:

- The amounts should be realistic. There is no need to include a reserve in the forecast. Any reasonably under-forecasted amount will not limit the amount to be paid by the FMO.
- During the current year the estimated total payment application for that year should include already paid amounts earlier in the same year (e.g., September's forecast should take into account the amount paid to the programme following the approval of the March IFR).
- The forecast should always include justifications of the forecasted amounts (e.g., why and how the amounts were included in the forecast and calculated), especially regarding any changes from the previous forecast.
- The forecast should include estimated payment applications for each programme and year, including the current year and up to 2031.
- Each forecast should be updated and reviewed carefully by the POs and quality assured by the CAs prior to submission as this input is important for the FMC/NMFA.

To ensure optimal accuracy and timely submission, the forecast should be consulted with relevant stakeholders and prepared well ahead of the deadline. During the preparation, the following elements should be considered:

- timing of the calls for proposals it will affect the timing of the contracting phase and, thus, the timing of the payments to projects;
- call size and maximum project grant the funds needed to make payments to projects will vary depending on the size of the call and of the contracted projects;
- level of advance being normally set in PA, it impacts the cash flow needs of the programme when releasing the first payments;
- frequency of payments to projects and the pace of project implementation;
- payments from the FMO IFR payments are normally made twice a year, by 30 April and 15 November and the timing of these payments influences the future forecasted amounts (e.g., the forecast to be submitted in September should match the amounts paid in April of the same year);

- unspent funds from previous year should be considered in the forecast since they are deducted from the requested amounts in the IFRs and, thus, decrease the payment to the programme;
- delays during the implementation at programme or project level they may influence the amount requested to be paid from the FMO through the IFR and, thus, reduce the forecast (e.g., delays in public procurement, in launching calls or contracting projects, or in meeting PA pre-eligibility conditions).

6.2.3 The Final Programme Report (FPR) and final balance payment

The FPR

According to Article 6.8, the PO should submit the FPR through the CA (via GrACE) to the NFP and the FMO using the template provided by the FMO (the FOs should submit their FPRs directly to the FMO). The FPR should provide an assessment of the programme's contribution to the overall objectives of the Grants, assessment of the implementation of the programme, including lessons learned, findings of relevant evaluations, and financial information (with the calculation of the final balance as explained in the section below). The deadline for the submission of the FPR to the FMO is 30 April 2032.

After the submission of the FPR, the national authorities should remain available to provide clarifications and/ or additional information (i.e., in relation to open irregularities, if any) or make adjustments to the report upon the FMO's request.

Separate Closure guidance will be provided by the FMO at a later stage of the FMs 21-28 implementation along with the FPR template explaining the relevant rules and concepts needed for the successful completion of projects and closure of programmes.

Final balance

The final balance is calculated and reported in the financial annex of the FPR. It should be certified by the CA and submitted to the FMO via GrACE. After that it is checked and approved by the Donors in accordance with Article 9.4.

In essence, the final balance is the difference between the total eligible expenditure of the programme reported by the PO and everything the FMO disbursed to the programme.

The final balance is calculated as follows: from the total eligible expenditure reported by the PO, taking into account any previous reimbursements, the following amounts need to be deducted:

- the total advance and interim payments paid to the programme;
- any co-financing from sources other than the Grants;
- total interest earned until the date of the FPR, and
- any funds reimbursed from the Project Promoter to the PO, not paid to other projects or reimbursed to the Donors. Amounts recovered from the Project Promoter should be included and accounted for either IFRs or the final balance.

The final balance will either be an amount payable from the FMC/ NMFA to the PO, or an amount payable from the PO to the Donors. The final balance payable to the PO or to the Donors should be transferred/ reimbursed no later than one month after the approval of the FPR. Any interest earned in the bank account of the PO between the date of the FPR and the reimbursement date should be included in the reimbursement.

Table 27. Calculation of the final balance

	EEA Grants	Norway Grants	Total	
Total reported eligible expenditure of the programme				
Total eligible expenditure incurred	1,000,000	1,000,000	2,000,000	
(-) Total (national) programme co-financing incurred (X% rate)	150,000	150,000	300,000	
(=) Total grant contribution incurred (X% rate)	850,000	850,000	1,700,000	
Amounts to be deducted from the total grant	Amounts to be deducted from the total grant contribution			
(-) Total advance and interim payments to the programme from the Donors	700,000	800,000	1,500,000	
(-) Any co-financing from sources other than the Donors/ national	0	0	0	
(-) Total interest earned reported	5,000	5,000	10,000	
Final balance				
(=) Final balance payable to the PO	0	0	0	
(=) Final balance payable to the Donors	145,000	45,000	190,000	

Final reporting on the use of the TA and bilateral funds are parts of the Country Report. The final Country Report should be submitted to the FMO no later than 31 August 2032 (Article 2.6.4).

6.3 Credit and debit notes

Credit notes may be used by the FMO to make payments to a CA/ PO/ DPP/ IPO, if necessary, in justified cases. These are used to make exceptional payments between the standard IFR payments (April and November).

Debit notes may be used to receive payments from a programme. A debit note may be generated if the IFR results in an amount to be recovered from the programme rather than payment to the programme as is usually the case. A debit note may also be used to receive payment from a programme in between standard IFRs.

The use of credit and debit notes is exceptional.

6.4 Use of the euro

The Grants operate with the euro, which means that the amounts set out in the MoU, the PA, used in Interim (final) Financial Reports, Country Reports and FPRs should be denominated in euro. Payments from the Donors to entities in all BS are carried out in euro, irrespective of the national currency in the BS.

The BS that have not adopted the euro as their national currency will have to convert amounts incurred/ declared in their national currency into euro using the monthly accounting exchange rate of the <u>European</u> <u>Commission</u> in the month during which the expenditure **was paid** by the PO of the programme concerned. The same approach applies to recovered amounts (for example, due to irregularities or errors), as well as adjustments due to the return of unspent funds or other reasons (see below).

Conversion of payments/ declared expenditure

Programme level

- Payments of the programme grant to the PO/ NFP are made in euro

- Payments by the PO/ NFP to the Project Promoter are made in national currency/ euro (it is recommended to use the EC monthly accounting exchange rate³⁹ for conversion of euro into national currency due to the reporting requirements specified in Article 9.5.2, see the next bullet point)

- Programme expenditure declared in national currency/ SCOs is reported by the PO/ NFP in IFRs (financial part of the FPRs) to FMO in euro using InforEuro exchange rate in the month during which the expenditure was paid by the PO/ NFP to the Project Promoter (Article 9.5.2)

- When recovering unspent funds from the Project Promoter, it is recommended that the PO agrees in advance with the Project Promoter (at the contracting phase) that the same exchange rate will be used when paying and recovering the funds.

Project level

- PPs receive project grant payments (advance/ interim/ final) in national currency/ euro

- Expenditure incurred/ SCOs by Project Promoters is reported to the PO in national currency/ euro
- Unspent funds (savings/ surplus funds) are returned to the PO in national currency/ euro

Payments to donor project partners participating in the projects

- The currency and method for calculating the exchange rate for payments to donor project partners should be fixed in the project contract and the partnership agreement

- The same currency (fixed in the project contract/ partnership agreement) should be used by donor project partners when reporting to the Project Promoter

- For projects under the Research programme, payments to the donor project partners should be made in euro (as defined in the Research Guideline).

Since the cash flow between the FMO and the PO is in euro (payments, reporting), it is recommended that PO makes all payments (where possible) in euro.

Irrespective of the currency used by a BS in the implementation of programmes and projects, including the currency of the project contract, the Donors are not responsible for losses resulting from exchange rate fluctuations.

³⁹ InforEuro

6.5 Interest earned/ paid on the re-granting accounts

Any interest earned or paid on the following accounts should be regarded as a resource for the Donors and needs to be declared annually:

- in the interim financial report for the bilateral funds for accounts held in the BS on which funds from the Donors are kept until they are transferred to the PO (point (a) of Article 9.7.1);
- in the interim financial report of the programme concerned for accounts established by the PO for funds intended for re-granting (point (m) of Article 5.6.1 and point (b) of Article 9.7.1).

Interest generated on the account where TA funds are kept is not to be reported (in line with Article 9.7.1).

Interest earned (positive) is regarded as a resource for the Donors.

Interest paid (negative) is considered as an eligible expenditure within the budget of the programme management costs or TA.

The CA should annually declare any interest earned/ paid as part of the IFR after verifying the correctness of the declared interest. Below you can see an example. The total interest earned/ paid is then taken into account when calculating the final balance at the programme closure stage (see more in section 6.2.3).

Interest Earned	
	EEA Grants
Interest generated on accounts established by the Programme Operator for funds intended for regranting for 2023	€ 615.08
Cumulative interest generated on accounts established by the Programme Operator for funds intended for regranting	€ 1,998.16
Comments	

Comments Interest generated on accounts established by the Programme Operator for funds intended for regranting for 2023 was 615.08 euro.

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The BS that has not adopted the euro as their currency and use accounts held in the national currency should convert the interest earned/ paid into euros using the average of the monthly accounting exchange rates of the <u>European Commission</u>.

ANNEXES

ANNEX I – Key requirements of the MCS in the Grants⁴⁰

Key requirements of the national MCS	Additional information (the list is non-exhaustive)	Authorities concerned
(a) The definition of the functions of the entities concerned and the allocation of functions within each entity	 A clear description of the structure of the MCS to ensure clear allocation and separation of tasks and functions (tasks carried out by the NFP, AA, CA, entity responsible for complaints; tasks delegated to other bodies); procedures are in place (in relation to who carries out) the selection of projects, verifications, risk management, irregularities, payments to projects. 	NFP/ AA/ CA/ PO/ other national authorities involved in the implementation of the Grants
(b) Appropriate separation of functions between and within such entities and, where relevant, written arrangements for reporting, supervising and monitoring of delegated tasks.	 Procedures to monitor and supervise the tasks delegated to other bodies; independence and functional separation of the tasks of verification and authorisation of payments from tasks related to implementation of the programme should be ensured; separation of functions within the organisation of NFP and other national authorities: where the NFP acts as the PO, arrangements are taken to ensure the appropriate separation of functions between the verifications and the activities of the NFP as the PO; where the NFP takes on the role of the PO, NFP should not take over the tasks of preparing and submitting irregularities reports on behalf of the BS (Article 5.2.5); where the NFP takes on the tasks of the CA, arrangements are in place to ensure the adequate separation of tasks related to payments from other tasks within the NFP (Article 5.2.2). It is good practice for the NFP/ PO to ensure separation of functions for verification and control, authorisation of payments and implementation of the programmes at the level of different departments/ divisions in the organisation. 	NFP/ PO/ CA/ AA
(c) Appropriate criteria and procedures for the selection of projects and initiatives, in compliance with the Regulations.	 Appropriate methodology is in place for identification of pre-defined projects (Articles 2.5 and 6.5); appropriate methodology is in place for selection of projects/ initiatives through calls for proposals (Chapter 7 of the Regulations); well-defined eligibility rules for the programme are laid down at the national level; procedures to ensure that calls for proposals follow the requirements as set out in Article 7.3; procedures to ensure that all applications are assessed in accordance with the applicable criteria; decisions on the acceptance or rejection of applications are taken by the PO following the recommendations from the Selection Committee. The PO should notify the applicants about the 	PO/ NPF

⁴⁰ The information on the key requirements in Annex I adopts the elements from the guidance from the European Commission (EC) on the assessment of the key requirements for the management and control system (as defined in the Common Provision Regulation, Regulation (EU) 2021/1060). The AA may use the EC's guidance documents, methodological notes or other relevant resources when assessing the MCS of the BS.

(d) Appropriate information to beneficiaries on applicable conditions for support for the selected projects and initiatives.	 results of the selection process and publish the results. The PO should provide the FMC with the list of selected projects no later than two weeks after the decision on the grant awards; appropriate documentation relating to the overall selection procedure and approval of the projects. Appropriate systems and procedures are in place ensuring that beneficiaries have access to necessary and relevant information and receive appropriate guidance on applicable conditions for support; calls for proposals are published on the website of the PO in the national language(s) and in English and notified to FMC (Article 7.3.3) and contain as a minimum information as defined in Article 7.3.2; 	PO/ NFP
	 the rights and obligations of beneficiaries are effectively communicated to them with reference to the applicable eligibility rules, state aid rules, etc. The information and publicity obligations as well as the durability requirements are clearly explained and communicated to beneficiaries. In addition, beneficiaries and potential beneficiaries are communicated their rights to file complaints. 	
(e) Appropriate verifications and procedures for confirming that the incurred expenditure is legal and regular and appropriate procedures for checking fulfilment of conditions for simplified cost options.	 Appropriate procedures are in place and are adequately used ensuring that verifications (both administrative and on-the-spot) carried out by the PO are risk-based and proportionate to risks identified; appropriate procedures to ensure updates of risks based on, for example, results from previous verifications and audits; written procedures and checklists are used for verifications and conclusions are properly documented for incurred expenditures and for simplified cost options; evidence is kept relating to the verifications, evidencing the administrative and on-the-spot checks carried out by the PO and the follow-up of the findings detected. 	PO/ NFP
(f) Effective systems to ensure that all documents necessary for the audit trail are held.	 Appropriate systems and procedures are in place to ensure that all documents required for the audit trail as set out in the Regulations are kept at the appropriate level and in accordance with the requirements on availability of documents. 	PO/ NFP
(g) Reliable electronic systems for recording and storing data for financial management, reporting, monitoring, verifications, audits and evaluation, including appropriate processes to ensure the security, integrity and confidentiality of the data and the authentication of users.	 Appropriate systems for submitting and transferring information electronically to FMC via Grant Management System, GrACE (Article 5.1.3)); appropriate procedures are in place to ensure the reliability of the recording and storing data on each project and that the data on implementation necessary for financial management, reporting, monitoring, verifications, audits and evaluation are collected and processed (point (k) of Article 5.6.1); adequate procedures are in place to ensure the security and maintenance of the electronic system; data integrity and data confidentiality; the authentication of the users; storage of documents and data; the NFP/ PO is responsible for ensuring that secure communication from GrACE can be received by their organisations. 	NFP/ PO

(h) Effective implementation of proportionate anti-fraud measures.	 The NFP/ PO carries out a timely fraud risk assessment, including the risks related to conflict of interest and regularly updates the fraud risk assessment. The NFP/ PO has the obligation to have in place effective and proportionate anti-fraud measures; appropriate procedures ensuring that competent national authorities, in accordance with national law, report any suspected cases of fraud to the national responsible anti-fraud bodies (Article 12.5.5). 	NFP/ PO
(i) Appropriate procedures for drawing up, submitting and confirming completeness, accuracy and veracity of Interim Financial Reports and the final balance.	 IFRs (incl. TA) should be submitted electronically in GrACE to the FMO after the PO verification and the CA certification; procedures for the CA to certify the eligible expenditure submitted by PO (point (a) of Article 5.4.1); procedures for the PO to draw up and submit the IFRs/ FPR in accordance with Articles 6.8, 9.3, 9.4 and 9.6; procedures for the PO to submit to the CA a forecast of likely payment applications necessary for the CA to fulfil its obligations in accordance with Article 9.3. 	PO/ NFP
(j) Audit work carried out in accordance with internationally accepted audit standards.	 Procedures for ensuring that audit work is carried out in accordance with internationally accepted audit standards, including but not limited to International Organization of Supreme Audit Institutions (INTOSAI), the International Federation of Accountants (IFAC); procedures for determining the number of items for controls testing (e.g., ISA 330 on the auditor's responses to assessed risks, the ISSAI 4100 on the factors to be taken when defining materiality, ISSAI 1320 on materiality in planning and performing an audit, ISSAI 1450 on evaluation of misstatements identified during the audit); procedures where the work of other auditors or experts is used (ISSAI 1600 concerning group audits, ISSAI 1610 (includes ISA 610) on the use of the work of internal auditor, and by ISSAI 1620 on using the work of an auditor's expert). 	AA
(k) Appropriate audits of the management and control systems.	 Procedures for auditing of the management and control systems at the level of the BS in accordance with the risk-based audit strategy (point (b) of Article 5.5.1); procedures for carrying out audits to verify the effective functioning of the management and control systems at the level of the programmes (on the basis of the sample taking into account the principles of single audit and proportionality and based on a risk assessment); procedures to ensure that the audit scope covers the key requirements of the management and control system applicable to the relevant bodies (NFP, CA, AA, PO) as defined in the audit strategy (Article 5.1.2); procedures for AA to follow-up and monitor the implementation of recommendations and corrective measures resulting from system audit reports. 	AA
(I) Appropriate audits of expenditure declared.	 Procedures ensuring that audit of operations is performed in accordance with AA audit strategy and covers expenditures declared to FMO in the accounting year (point (i) of Article 5.5.1) on a basis of a representative sample and, as a general rule, on statistical sampling methods. A non-statistical sampling method may be used by AA in justified cases (Article 5.5); procedures ensuring that AA keeps appropriate documentation; 	AA
	 procedures ensuring that audits of operations are carried out based on supporting documents, taking due account of principles of single audit and proportionality (point (c) of Article 5.5.1) and cover the legality and regularity of expenditure incurred and fulfilment of conditions for simplified cost options; procedures ensuring that audit of operations include on-the-spot verification of the physical implementation of the project only where, based on the auditor's professional judgement, this is required by the type of project to support robust audit conclusions' procedures to ensure that AA has effective procedures in place for the follow-up and monitoring of the implementation of recommendations and corrective measures arising from the audits of expenditure. 	
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(m) Appropriate procedures for providing a reliable audit opinion and for preparing the Annual Audit Report and the Final Audit Report.	 Appropriate procedures are in place to ensure that AA express an independent and reliable audit opinion on (i) whether the management and control system put in place functions properly, reflecting the conclusions drawn from the system audits and audits of expenditures; (ii) whether expenditure for which reimbursement has been requested from FMC is legal and regular. AA keeps sufficient evidence and documents about how it obtained the assurance level expressed in the Annual Audit Report (AAR)/ Final Audit Report (FAR); appropriate procedures are in place to ensure that AA provides a complete AAR/ FAR which supports the annual audit opinion and sets out a summary of findings, including an analysis of the nature, extent, root causes and, in particular if the reported total error rate is material, and impact of errors; procedures ensuring an appropriate reporting in AAR/ FAR on deficiencies in the systems as well as the proposed and implemented corrective actions; all detected errors are appropriately reported and treated in view of the resulting total error rate and residual error rate for the expenditure declared to FMC; where deficiencies detected appear to be systemic in nature and therefore entail a risk for other operations under the programme, appropriate procedures are put in place to ensure that AA (i) conducts further examination, including, where necessary, additional audits to establish the scale of such problems, (ii) recommends the necessary corrective actions, and (iii) presents the measures taken, including a quantification of the irregular expenditure and any related financial corrections; AA has in place procedures to ensure timely submission of the audit opinion and the AAR to FMC by 15 February of the following accounting year. 	AA
(n) Reporting and monitoring procedures for irregularities and for the recovery of amounts unduly paid.	 Appropriate measures to prevent, detect and nullify any cases of suspected or actual irregularities are in place, and measures to ensure that they are efficiently and properly recorded and remedied, including making any financial corrections that may be appropriate exist (point (y) of Article 5.6.1); appropriate measures exist for reporting and monitoring of irregularities, cases of (suspected) fraud, including conflicts of interest; irregularities are reported to the FMC by the CA/ NFP/ AA; appropriate procedures ensuring that competent national authorities, in accordance with national law, report any suspected cases of fraud to the national responsible anti-fraud bodies (Article 12.5.5). 	CA/ AA/ NFP

ANNEX II – Description of the national MCS – organisational structure of the Grants

National Focal Point (NFP)

The NFP is a national public entity identified in the MoU, with the overall responsibility for ensuring that programmes contribute to the objectives of the Grants and for implementing the MoU.

This section of the MCS should provide organisation chart of the NFP and its relationship with any other bodies or divisions (internal or external) that carry out functions and tasks as defined in Article 5.3.

The description of the functions of the NFP should describe the following procedures (the minimum scope is defined in Article 5.3):

- monitoring the progress and quality of the implementation of the programmes (Article 5.3.3). The MCS should describe how the monitoring of the programmes will be carried out, how the findings of the monitoring will be reported and how the recommendations and follow-up measures will be implemented. For more information on monitoring, please consult "<u>Results-Based Management</u> <u>Guidance</u>";
- regular monitoring of the programmes with regards to their progress towards the programme outputs, outcome(s) and objective(s) according to the agreed results framework and financial requirements specified for the programmes (Article 5.3.4 and from the perspectives of results, risk and compliance) and preparing and submitting to the FMC the annual Country Report covering all programmes and bilateral activities implemented in the BS (Article 2.6.1);
- continuously and in a structured manner assessing the risks to the implementation of programmes (Article 5.3.3);
- the role of the establishing and chairing the Joint Committee for the Bilateral Funds (Article 4.9);
- payments, cash flows and reporting routines between the NFP and the PO for the programmes;
- organisation and procedures of the fund for bilateral relations at the national level (Article 4.7). This should comprise the detailed procedures for the financial management of the bilateral fund including payment flows, verification and certification processes (for more information on the bilateral funds see the Bilateral Guideline);
- organisation and procedures for management of the TA and ensuring that entities covered by the TA receive a sufficient share of the contribution to perform their duties.

Good practice

The MCS section on the NFP could provide an indication of planned human resources to be allocated in relation to different functions of the NFP (including information on any planned outsourcing and its scope, where appropriate).

It should describe procedures on preparation and submission of irregularities reports on behalf of the BS if the task is assigned to the NFP in the MoU.

Certifying Authority (CA)

The CA is a national public entity, functionally independent of the AA and the PO, identified in the MoU and responsible for certifying financial information.

The functions of the CA should describe the following procedures (the minimum scope is defined in Article 5.4):

• submission of certified IFRs and financial sections of the FPR. The national MCS should describe

the procedures and checks performed by the CA to verify the expenditure declared by the PO, management costs of the PO, and the NFP with regards to the expenditures of the NFP under the funds for bilateral relations at national level. The procedures need to ensure that the expenditure declared is correct and regular. More details on the certifications by the CA can be found in <u>section 5.4</u>;

- submission of a forecast of likely payment applications as part of IFRs;
- submission to the FMC of the Interim Reports for the TA;
- declaration of any interest earned or paid;
- taking account for certification purposes of the results of all audits carried out by or under the responsibility of the AA;
- maintenance of accounting records of expenditure in electronic form;
- ensuring availability of funds to the PO;
- ensuring that amounts cancelled in a programme or project are reimbursed to the FMC prior to the closure of the programme;
- conversion into euro of the amounts of expenditure declared in the BS that have not adopted the euro as their currency;
- establishment and maintenance of a separate interest-bearing bank account (Article 5.4.2);
- preparation and submission of irregularities and fraud reports on behalf of the BS, unless this function is assigned to another entity in the MoU (Articles 12.3.1 and 12.5). Otherwise, this point should be covered in the description of the functions of that other entity;
- certification of the financial information in the Final financial report and final balance of the programme.

💡 Good practice

The MCS should include description of how the work of the CA is organised (workflows, processes, internal divisions), what procedures apply and when, how these are supervised.

The section on the CA could provide an indication of planned human resources to be allocated in relation to different functions of the CA (including information on any planned outsourcing and its scope, where appropriate).

The CA is responsible to check the forecast from the financial perspective, ensuring consistency across the programmes and that all information supporting forecast data is reported. The NFP/ PO are, however, responsible for ensuring the accuracy and reliability of the forecast data.

Audit Authority (AA)

The AA is a national public entity, functionally independent of the NFP, CA, PO and the auditees, identified in the MoU and responsible for verifying the effective functioning of the management and control system.

The description of the functions of the AA should describe the following procedures (the minimum scope is defined in Article 5.5):

• preparing a risk-based audit strategy within nine months of the approval of the last programme covering the entire allocation to the BS (including audit methodology, sampling method for audits, indicative planning of audits). The audit strategy should be submitted to the FMC in English upon request within one months (point (a) of Article 5.5.1);

- performance of audits to verify the effective functioning of the management and control system at the national level (point (b) of Article 5.5.1);
- performance of risk-based audits to verify the effective functioning of the management and control system at the programme level. Audits should be carried out on a sample of programme and based on a risk assessment (point (c) of Article 5.5.1);
- performance of audits on the basis of the appropriate sample to verify legality and regularity of expenditure declared and the fulfilment of conditions for simplified cost options (point (d) of Article 5.5.1);
- submission of an Annual Audit Report with findings of the audits carried out for a 12-months
 reference period ending on 30 June of the previous calendar year, including an opinion on the
 effective functioning of the management and control system and providing a reasonable
 assurance level as to legality and regularity of incurred expenditure and fulfilment of conditions for
 simplified cost options (points (i) and (ii) of Article 5.5.1);
- submission of the Final Audit Report and the closure declaration assessing the validity of the application for payment of the final balance (points (i) and (f) of Article 5.5.1);
- the MCS should describe procedures for conducting audits in accordance with internationally accepted audit standards (Article 5.1.2).

The Regulations no longer require the AA to perform at least one audit of the effective functioning of the management and control system at programme level! The AA should apply the single audit and proportionality principles and base its audits on the risk assessment!

Good practice

Include a description of how the work of the AA is organised (workflows, processes, internal divisions), what procedures apply and when, how these are supervised;

The section on the AA could provide an indication of planned human resources to be allocated in relation to different functions of the AA.

Include information on any planned outsourcing and its scope, where appropriate, supervision and monitoring of delegated functions.

Describe procedures on preparation and submission of irregularities reports on behalf of the BS if the task is assigned to the AA in the MoU (Article 12.3.1).

Entity responsible for complaints

The BS should establish a complaints mechanism in line with Article 12.7. The role of such a mechanism is to ensure that any complaints about suspected non-compliance with the principles of the good governance in relation to the implementation of the Grants in the respective BS are effectively processed.

The NFP should make information on how to submit a complaint prominently available on its website.

The BS should report to the FMC immediately on any complaints including suspected/ alleged irregularities where the alleged irregularities are of such a nature that they would be required to be reported immediately.

Other bodies

The description of the MCS should include any other authorities involved in implementation of the Grants in the BS (e.g., centralised procurement bodies, implementing agencies).

ANNEX III - Overview of deadlines for eligibility of expenditure

Arti cle	Expenditu- re type	Start date	End date	Payment pre-conditions
8.14	Project expenditure	Defined in the project contract (no earlier than the date of entry into force of the PA)	Defined in the project contract (no later than 30 April 2031)	Prior to disbursing first payment, the AA should provide the Donors with the opinion on the national-level management and control system. If this is not received within 12 months of the entry into force of the MoU, the Donors may suspend payments to the programme (Article 5.7.5). Payments to programmes should be made when all relevant conditions for payments stipulated in the PA and the Regulations have been fulfilled (Article 9.1.1).
4.7	Fund for bilateral relations at the national level	Entry into force of MoU (whichever is signed first)	30 April 2032	The advance payments can be done upon signature of the Bilateral Fund Agreement at national level. In exceptional cases, extraordinary advance payments may be made prior to the signing of the Bilateral Fund Agreement (Article 4.6.4). Prior to the disbursement of the first payment, the AA should provide the Donors with the opinion on the national-level MCS. If this is not received within 12 months of the entry into force of the MoU, the Donors may suspend payments to the programme (Article 5.7.5).
4.10	Fund for bilateral relations at the programme level	Entry into force of MoU (whichever is signed first)	31 December 2031	Prior to the disbursement of the first payment, the AA should provide the Donors with the opinion on the national-level MCS. If this is not received within 12 months of the entry into force of the MoU, the Donors may suspend payments to the programme (Article 5.7.5). The Donors can make an advance payment directly to the POs to cover the costs of the activities referred to in Article 4.5 during the development of the programme. The payment shall be made in agreement with the NFP following the designation of the PO (Article 4.6.6).
8.10	Programme manageme nt costs	Designation of the PO (entry into force of MoU)	30 April 2032	The eligibility of costs under this article is conditional on the approval of the programme by the Donors unless earlier date is specified in the PA (Article 8.10.6). Extraordinary advance payments towards costs related to preparation of the programme may be disbursed to the BS. Prior to the disbursement of the first payment, the AA should provide the Donors with the opinion on the national-level management and control system. If this is not received within 12 months of the entry into force of the MoU, the Donors may suspend payments to the programme (Article 5.7.5).
8.11	ТА	N/a	N/a	The first disbursement is conditional upon the signature of the TA Agreement. Payments of the consequent equal instalments is conditional upon submission of deliverables (Article 8.11.6). Payment of the final tranche is conditional upon submission of deliverables.

Article	Responsible	Document	Deadline	Points of attention
5.7.3	AA	An opinion (report) concerning the management and control system of the BS (national level)	12 months after the entry into force of the MoU	Prior to disbursing the first payment, the AA should provide the Donors with an opinion on the national-level MCS. If this is not received within 12 months of the entry into force of the MoU, the Donors may suspend payments to the programme (Article 5.7.5).
6.2.2	NFP	The Concept Note for each programme	Within 6 months from the date of entry into force of the MoU	The template provided by the FMO should be used.
6.2.4	FMC	Review of the Concept Note	Within 2 months of the Concept Note submission	
6.3.2	NFP/ FMO	PA for each programme identified in the MoU	Within 4 months from the conclusion of the FMCs review of the Concept Note	The template provided by the FMO should be used. The BS should provide any supplementary information requested by the FMC.
5.5.1(a)	AA	Risk-based audit strategy	Within 9 months of the approval of the last programme covering the entire allocation to the BS.	The audit strategy should be submitted to the Donors upon request within one month.
2.6.4	NFP	Final Strategic Report	By 31 August 2032	The approved Report should be published on the website of the NFP within one month of the approval by the Donors.
6.8.2	PO through the CA	FPR	By 30 April 2032	The approved Report should be published on the website of the NFP within one month of the approval of the report by the Donors.
5.5.1(e)	AA	Final Audit Report	By 15 February 2032	The Final Audit Report should cover audits carried out for the reference period from 1 July 2031 until the end of the programme.
5.5.1(f)	AA	Closure declaration	By 31 December 2032	The declaration should assess the validity of the application for payment of the final balance claimed in the FPR.
9.4.3	PO through the CA	Final balance	With Final Programme Report (by 30 April 2032)	Any final balance payable to the PO should be transferred by the Donors no later than one month after the Donors' approval of the FPR. Any final balance payable to the Donors shall be reimbursed to the Donors no later than one month after the Donors' approval of the FPR. Any interest earned/ paid on the bank account of the PO between the date of the FPR and the reimbursement date should be included in the final balance calculation.

One-off submission of documents

Continuous reporting

Article Responsi Document	Deadline	Points of attention
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5.5.1(e)	AA	Annual Audit Report with audit opinion	By 15 February 2027 – 2031 (incl.)	The Annual Audit Report should cover the findings from the audits carried out for a twelve-months reference period ending on 30 June of the previous calendar year.
5.6.1	PO	Project-level information (PLI) in GrACE	Upon signing project contracts; continuous updates	The PO is responsible for keeping information on PLIs updated in GrACE.
2.6.3	NFP	Annual Country Report	10 March each year	Should cover calendar year and should be written in English. Approved Report should be published on the website of the NFP within one month of the approval by the Donors
7.6.7	PO	List of selected projects	No later than 2 weeks after the decision on the grant awards	The Donors should be provided with any relevant documents in English upon request.
9.3.4	CA	IFRs and interest earned/ paid	Twice per year By the last day of February By 15 September	Payments by the FMO to be made by 30 April and by 15 November (2 months after reports submission) respectively.
9.3.6	CA	Forecast of likely payments	Twice per year Together with IFRs: by the last day of February and by 15 September	Forecast of likely payments for the periods: - Feb IFR – forecast for Jan- June N+1 - Sep IFR – forecast for July- Dec N+1
12.5.2	CA/ NFP/ AA	Quarterly irregularity reports	Within two months of the end of each quarter Immediately for irregularities as described in paragraphs 1 in Article 12.5	Any new suspected or actual cases of irregularities discovered during the quarter, and the progress made in the investigation and remedy of previously reported irregularities. If there are no irregularities to report on during the quarter, the CA/ NFP/ AA should inform the FMO.

ANNEX V – Financial reporting flowchart and periods

						Ye	ear O											Yea	ar 1								Yea	ır		
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	Мау	Jun
Advance payment					AP			(II) Pr	roposed exp	enditure																				
Sep IFR					(I) A exper	ictual nditure			IFR					(11)) Proposed	l expenditu	re						(III) Forec	cast of like	ely paymen	ts				
Feb IFR					(0) Previou and interin				(I) Actual e	expenditur	е				IFR					(11) Proposed	l expenditu	ıre			(111)	Forecast o	f likely pay	ments	
Sep IFR							(0) Previo	revious advance and interim payments						(I) Actual e	xpenditure			IFR						(II) Proposed expenditure						
Feb IFR										(0) Previo	us advano	ce and inte	rim payme	ents							(I) Actual e	xpenditure)				IFR			
Legend																														
AP - adva	ance pa	ayment																												
Compone (0) Previo (I) Actual (II) Propo (III) Foree	ous adv l expen osed ex	vance a diture c openditu	nd inte leclare ire for	d in th the ne	e currer xt repor	nt report ting per	ting per iod	iod	and of the	FMs																				

ANNEX VI – Typology of errors

Types of findings defined by the European Commission are used as an example of possible categorization of errors identified by the Audit Authority

No	Category	Sub-category
		Lack of publication of contract notice or unjustified direct award (i.e. unlawful negotiated procedure without prior publication of a contract notice). Artificial splitting of works/services/supplies contracts. Non-compliance with - time limits for receipt of tenders; or - time limits for receipt of requests to participate; Or Failure to extend time limits for receipt of tenders where significant changes are made to the procurement documents. Insufficient time for potential tenderers/candidates to obtain tender documentation; Or Restrictions to obtain tender documentation. Lack of publication of extended time limits for receipt of tenders; Or Failure to
I.	Public procurement – contract notice and tender specifications	extend time limits for receipt of tenders. Cases not justifying the use of a competitive procedure with negotiation or competitive dialog. Failure to publish in the contract notice the selection and/or award criteria (and their weighting); or conditions for performance of contracts or technical specifications; Or Failure to describe in sufficient detail the selection and/or award criteria (and their weighting); Or Failure to communicate/publish clarifications/additional information.
		Use of - criteria for exclusion, selection, award; or - conditions for performance of contracts; or - technical specifications that are discriminatory on the basis of unjustified national, regional or local preferences. Use of - criteria for exclusion, selection, award; or - conditions for performance of contracts; or - technical specifications that are not discriminatory in the sense of the previous type of irregularity (i.e. illegal, disproportionate) but still restrict access for economic operators. Insufficient or imprecise definition of the subject-matter of the contract. Lack of justification for not subdividing contract into lots.
	Public procurement – Selection and evaluation of tenders	Selection criteria (or technical specifications) were modified after opening of tenders or were incorrectly applied. Evaluation of tenders using award criteria that are different from the ones stated in the contract notice or tender specifications; Or Evaluation using additional award criteria that were not published. Negotiation during the award procedure, including modification of the winning tender during evaluation. Competitive procedure with negotiation, with substantial modification of the conditions set out in the contract notice or tender specifications. Unjustified rejection of abnormally low tenders. Conflict of interest with impact on the outcome of the procurement procedure. Irregular prior involvement of candidates/tenderers towards the contracting authority. Insufficient audit trail for the award of the contract. Bid-rigging (i.e. identified by a competition/anti-cartel office).
	Public procurement – Contract implementation	Modifications of the contract elements set out in the contract notice or tender specifications, not in compliance with Directive 2014/24/EU.
	Procurement – Requirements in the national legal frameworks	Non-compliance with the national rules on procurement carried out by entities other than Contracting Authorities.
١١.	State aid	Failure to notify State aid. Wrong aid scheme applied. Misapplication of the aid scheme, including ineligible beneficiaries/undertaking. Monitoring requirements not fulfilled. Reference investment not taken into account in the applicable aid scheme.

		No consideration of revenue in the conditable aid achores
		No consideration of revenue in the applicable aid scheme.
		No respect of the incentive effect of the aid.
		Aid intensity not respected.
		De minimis threshold exceeded.
III.	Ineligible project	Project is ineligible.
		Expenditure incurred before or after the eligibility period.
		Expenditure not paid by beneficiary.
		Expenditure not related to the project.
		Ineligible taxes (e.g., VAT) and costs according to the national legislation.
		Non-compliance with rules on purchase of land or real estate.
		Ineligible beneficiary.
		Ineligible participants/final recipient for grant projects/ Ineligible target group.
		Conflict of interest.
N /		Double financing.
IV.	Ineligible	Expenditure for works not performed or goods/services not delivered/executed.
	expenditure	Ineligible expenditure incurred due to changes in the project's scope or objectives
		without obtaining the necessary approvals or amendments to the project's
		contract.
		Ineligible staff expenditure (e.g. incorrect productive hours, incorrect
		remuneration, unjustified hours in timesheets).
		Ineligible expenditure linked to travel and accommodation.
		Expenditure noncompliant with specific contractual arrangements and/or with
		regulations on eligibility requirements (i.e., national or project level).
		Other ineligible expenditure.
		Wrong methodology.
V.	Simplified cost options	Wrong application of the methodology (e.g., wrong calculation, wrong input data, wrong adjustment method, follow-up error in the application of flat rates), including non-compliance with the conditions for reimbursement.
VI.	Information and publicity measures	Non-compliance with the responsibilities as defined in the Regulations.
VII.	Missing supporting	Missing, incomplete or incorrect supporting information or documentation.
	information or	Lack or incomplete audit trail.
	documentation	
	A (* 1	Accounting and calculation errors at project level (for incurred expenditure).
1/11	Accounting and	Failure to keep separate accounting records or failure to use appropriate
VIII.	calculation errors at	accounting codes for transactions reimbursed based on costs actually incurred by
	project level	a partner.
IX.	Sound financial	Non-compliance with the principle of sound financial management (e.g., poor
IA.		project management, failure to comply with obligations assumed by the partner,
	management	including failure to respect the deadlines for submitting documents).
Х.	Data protection	Non-compliance with the rules of data protection.

ANNEX VII - Template for the certification of costs of the donor project partner

This is issued for the certification purposes as required by Article 8.12.4 of the Regulations on the implementation of the EEA/ Norwegian Financial Mechanisms 2021-2028.

We confirm that procedures have been performed to provide assurance as to the relevance and conformity with the Regulations, national law and relevant national accounting practices of the costs declared by the Donor project partner.

Project/ initiative reference:	Fill in
Project/ initiative title:	Fill in
Donor project partner:	Name of Donor project partner
Entity responsible for the certification:	Name of entity
Type of entity:	Auditor/ Competent and independent public officer
Start date of declared expenditure:	DD.MM.YYYY
End date of declared expenditure:	DD.MM.YYYY
Expenditure declared ⁴¹ this period:	Fill in amount [e.g., EUR/ NOK] ⁴²

The [Auditor⁴³/ Competent and independent public officer⁴⁴] hereby certifies that:

- i. The costs declared by the Donor project partner are in accordance with the Regulations on the EEA/ Norwegian Financial Mechanisms 2021-2028⁴⁵.
- ii. The costs declared are in accordance with the relevant law and national accounting practices.
- iii. The [Auditor/ Competent and independent public officer] has not been involved in the preparation of the relevant financial statements and is independent from the Donor project partner.

	Auditor/ Competent and independent public officer	Optional second signature
Name		
Signature		
Position		
Date		

⁴¹ A breakdown of costs certified (per cost category) must be provided as an annex to the certificate.

⁴² The reporting currency and exchange rate should be fixed in the project contract/ partnership agreement.

⁴³ An auditor (in Norway, "statsautorisert revisor") shall be qualified to carry out statutory audits of accounting documents.

⁴⁴ For organisations having public entity status, the audit report can be issued by an employee who holds the responsibility of verification of the organisation's expenditure. For example, in Norway this can be a "regnskapsrapport" issued by a qualified employee. For organisations who do not have the status as a public entity, an external audit report is required (in Norwegian this is equivalent to a "revisorrapport").

⁴⁵ Provisions on eligibility of expenditure are specified in Chapter 8 of the Regulations.