

## **EARTO Recommendations on HEU Implementation: Financial Aspects**

30 April 2019

The ambitions for the next EU Framework Programme (FP) for Research and Innovation, Horizon Europe (HEU), are high: foster excellent cross-border collaborative RD&I to create strong ecosystems and boost the uptake and scale-up of technology for industry to bring new products and services to the market, with high societal impact. To this end, Research and Technology Organisations (RTOs) will continue to play a key role in the next FP. Their excellent infrastructures, both physical and virtual (digital), are the backbone of dynamic RD&I ecosystems and key for EU cross-border collaborative research in FPs.

To be able to achieve these ambitious objectives, HEU needs to be built in the most efficient way: the framework conditions are at the core of its future success. Drawing on EARTO members' collective experience as active participants in the past and current FPs, EARTO strongly encourages the EU decision makers to take on board the following key recommendations for the HEU Model Grant Agreement.

### **1. Extend the acceptance of the usual cost accounting practices of the beneficiaries, which are based on continuity and consistency in their cost accounting system.**

Usual Cost Accounting Practices (UCAP) of an organisation are based on continuity and consistency in its (analytical) cost accounting system. They aim to make sure, for instance, that the costs of their RD&I activities are calculated in a consistent way in all the organisation's contracts, using the same allocation keys. Besides, such practices are based on the specific internal rules of an organisation, which are themselves based on national rules, law or guidelines, or on recommendations from ministries or other national authorities. Indeed, FP beneficiaries such as RTOs need to abide by their national accounting practices and are audited and controlled by their national/regional authorities. Usual Cost Accounting Practices are therefore systematically accepted by different funding bodies in different projects at regional and national level. Based on HEU Regulation (Art. 32 and Recital 47), this should be extended at EU level in the implementation of HEU, and substantially put forward in HEU Model Grant Agreement.

### **2. Broaden the acceptance of unit costs via allocation keys to better reflect the real costs of the beneficiaries, in particular for the use of technology infrastructures.**

The EU Financial Regulation (Art. 181, 125 and 186) states that indirect costs may be part of unit costs, which is also foreseen in HEU Regulation (Art. 31 and Recital 47). In Horizon 2020, the flat rate of 25% to calculate the indirect costs does not reflect the real costs of RTOs, especially for their technology infrastructures. Today, RTOs' technology infrastructures, both physical and virtual (digital), are the backbone of EU cross-border collaborative research in FPs.

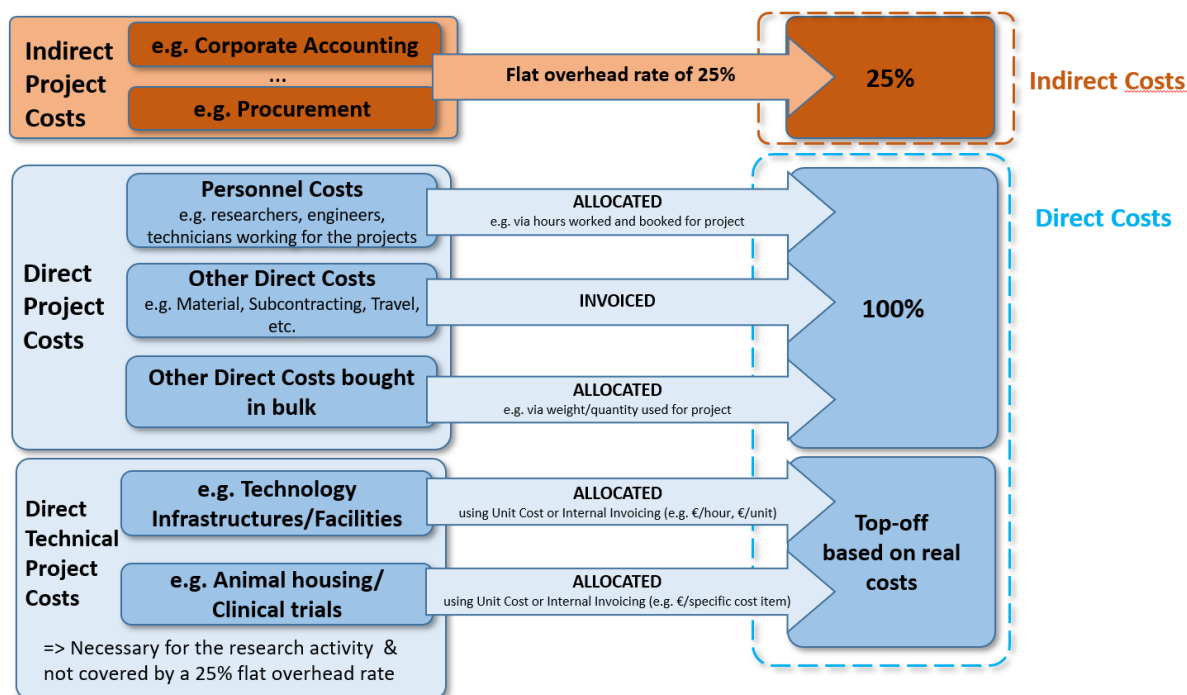
Such infrastructures can be of many different types and sizes, their use in projects therefore generates different types of direct costs. Besides, as these infrastructures are often used in several projects at the same time, such costs are quite impossible to be measured and allocated without allocation keys. Cost allocation mechanisms are therefore essential.

Recognising this issue, the EC has offered improvements in H2020 by setting up the Large Research Infrastructures (LRI) scheme and by allowing internal invoicing. EARTO very much welcomed this broader range of methodologies to allocate real costs to projects, based on beneficiaries' Usual Cost Accounting Practices.

#### **2.1 Combine and enhance H2020 Large Research Infrastructure (LRI) and internal invoicing schemes in Horizon Europe.**

Combining these two concepts in Horizon Europe by broadening the acceptance of unit costs calculated via reasonable allocation keys would be an efficient simplification measure. Such allocation keys are part of the Usual Cost Accounting Practices of advanced research organisations such as RTOs, and are already accepted at national/regional level. It is also worth noting that the concept of allocation keys is already used in H2020, for instance for the allocation of personnel cost.

Figure 1: EARTO Recommended Cost Allocation to HEU projects - taking into account real direct technical project costs based on beneficiaries' Usual Cost Accounting Practices



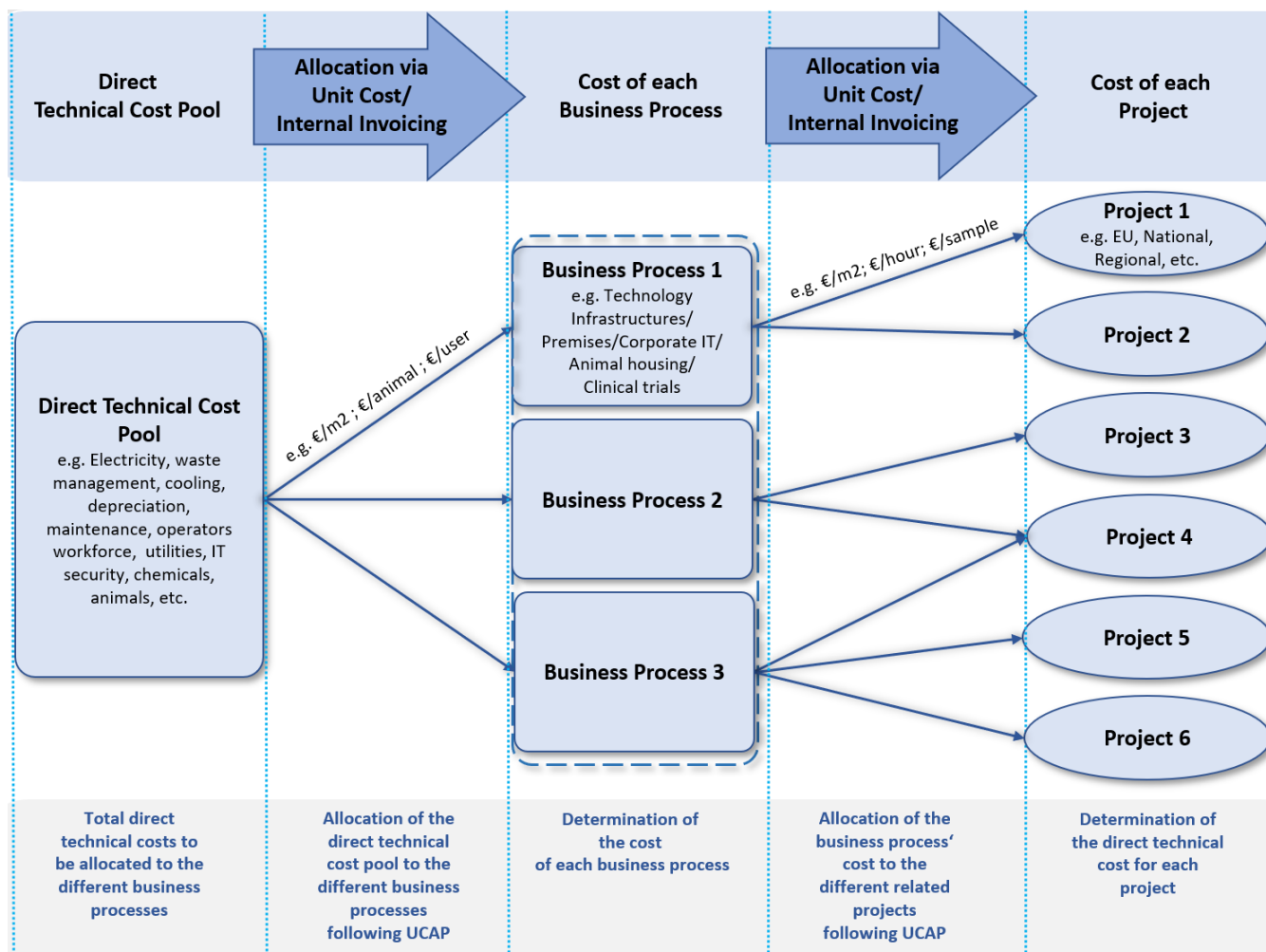
Taking this into account, Figure 1 shows EARTO recommended Cost Allocation for Horizon Europe projects, which includes:

- 1. Direct project costs as in H2020 financed at 100%**, including personnel costs allocated to projects via allocation keys (e.g. hours worked and booked to projects), but also supply costs (material, subcontracting, travels), and other direct costs bought in bulk.
- 2. Indirect projects costs financed through a flat 25% overhead rate** calculated based on the total direct project costs (point 1), as in H2020. These costs are by nature indirect, and include corporate accounting, procurement, etc.
- 3. Direct technical project costs which are necessary for the research activity: they should constitute a top-off based on real costs in HEU.** In H2020, such costs were not covered in the direct costs nor in the 25% flat overhead rate, but could be claimed via the Large Research Infrastructure (LRI) scheme or internal invoicing based on beneficiaries' Usual Cost Accounting Practices. Combining these two concepts in HEU is now necessary to increase simplification. This pool of direct technical costs indeed requires the use of unit costs or internal invoicing to be attributed directly to projects via reasonable allocation keys. This includes the costs related to the use of technology infrastructures and facilities, but also animal housing and clinical trials for instance, which are necessary for the implementation of R&I projects.

## 2.2 Enable the allocation of direct technical costs to projects using unit costs or internal invoicing, via reasonable allocation keys based on the usual cost accounting practices of the beneficiary.

Direct technical project costs are necessary for the research activity and are not covered by the 25% flat overhead rate in H2020: they should constitute a top-off based on real costs in HEU. The fundamental issue is how to allocate these direct technical expenses (e.g. of a technology infrastructure or animal housing facility) to each project. The goal is to allocate or assign part of these costs to projects by using relevant, well-known and sufficient allocation keys, instead of merely spreading the costs. This is done through a process as shown in Figure 2, using unit cost or internal invoicing, and well-integrated into the Usual Cost Accounting Practices of advanced research organisations.

Figure 2: Process to directly allocate a pool of Technical Costs to projects via allocation keys based on beneficiaries' usual cost accounting practices



Such process, always based on the Usual Cost Accounting Practices of the organisation, can be broken down as follows (Figure 2):

1. The different types of technical costs that can be directly connected to the projects are accumulated in a direct technical cost pool at the level of an organisation or institute. This can include electricity, waste management, cooling, but also operators' workforce dedicated to the running of a facility (e.g. taking care of the animals in animal houses), chemicals, etc.
2. The direct technical cost pool is then assigned to the different business processes (e.g. technology infrastructures, premises, clinical trials or animal houses), via allocation keys. The objective is to determine the specific direct cost pool of each of the business processes (also called technical cost centres) that are then used for the projects. This needs to be done via unit cost or internal invoicing.
3. Finally, the cost of each specific business process is assigned to the different related projects, using once again the most relevant allocation key. Such allocation also needs to be done via unit costs or internal invoicing.

It is also important to note that:

- Costs can be based on normal usage and actual data from the previous year.
- The costs to be assigned to new business processes (e.g. a new technology infrastructure or equipment) could use the actual costs of for e.g. 3 months as a basis for the costs of the running year.

Unit costs or internal invoicing using direct allocation keys in a RD&I context are very similar amongst RTOs. EARTO members are ready to provide concrete examples of direct allocation keys schemes commonly used in their organisations.

**3. Reduce the audit burden on beneficiaries by ensuring efficient cross reliance on audits: EU-level audits need to rely on each other, and relevant elements of national audits performed by recognised independent auditors should be accepted at EU level.**

Today, FP beneficiaries such as RTOs need to undergo many different audits, at both EU and national levels. EU-level audits are most of the time specific to projects or programmes in which the beneficiary is involved, whereas national/regional level audits can also be carried out at the level of the organisation in general in the form of system audits and (yearly) audits on financial reports.

<b>EU-level audits</b> e.g. H2020, KICs, Structural Funds, JUs	<ul style="list-style-type: none"> <li>• Certificate on financial Statements (CFS) as 1<sup>st</sup> level audit to check whether costs declared in the financial statements are eligible (project or programme based)</li> <li>• Ex-post audits performed by the EC Common Audit Service (CAS) or contracting auditors (project or programme based)</li> <li>• Additional layer of audits by the European Court of Auditors (project or programme based)</li> </ul>
<b>National/regional-level audits</b>	<ul style="list-style-type: none"> <li>• System Audits (general)</li> <li>• Audits on Financial (annual) reports (general)</li> <li>• Audits on specific Public Funding (project or programme based)</li> </ul>

Ensuring an efficient cross-reliance by connecting these different audit levels together would be an important source of simplification, both for auditing parties and for beneficiaries.

EU-level audits need to rely on each other (e.g. FPs, KICs, JUs-Art.185, structural funds). EARTO welcomes the efforts undertaken by the EC to harmonise the rules of EU Funded programmes for the Post-2020 period by relying as much as possible on the rules stated in the EU Financial Regulation. Increased efforts in this direction will contribute to significantly reduce the audit burden.

However, real simplification can only be achieved by broadening the scope of cross-reliance on audit, as foreseen in the Financial Regulation (Art. 127) and HEU Regulation (Art.48 and Recital 52).

*Figure 3: Cross-Reliance on Audits at National & EU levels*

		Audit level	
		National	EU
What is audited	System	(A) HEU Art.48§3	(B) LRI
	Projects	(C)	(D) CFS

In blue: area of possible cross-reliance of audits  
In red: no possibility of cross-reliance of audits

Accordingly, as shown in Figure 3, EARTO would like to recommend that:

- At EU-level, since HEU projects will be based on Certificates on Financial Statements (CFS), the focus should be put on the auditors' report on CFS assurance (D). The control should then be on the auditors that performed the CFS rather than on the beneficiary.
- Relevant (elements of) audit reports performed at national level by recognised independent audit firms should be accepted at EU level. It is important to note that this is not about the basis of the funding or eligibility rules, but rather about the acceptance of the common elements of national-level independent audit reports (e.g. System Audits of an organisation) by EU-level auditors for their own project-based audits. Cross-reliance of the EU on system audits performed by National auditors (A) is a convincing and feasible form of simplification (see §4 below).
- It is also worth noting that cross reliance at National projects' level (C) is not viable since National funding rules differ between countries, and countries even have multiple funding programmes.
- Besides, system audits are becoming ever more complex and time consuming. System audits to be performed by the EU could therefore result in an inefficient and time-consuming process for both the EU and the auditees, making it too burdensome for such audits to be performed by the EC (capacity issue) (B). Reliance on system audits performed by National auditors (A) could prevent such inefficiencies.

#### **4. Improve measures for ex-ante assurance and legal certainty by relying on System & Process Audits performed by National auditors**

With the rapid and increasing digitalisation of organisations' accounting departments, system audits have become an important factor in establishing assurance in audits. Authorised digital workflows are more and more replacing paper trails. This can sometimes lead to severe audit burden when such digital workflows are not accepted in the audit process of certain types of EU projects (e.g. Interreg).

Most of the time, the System and Process Audit of an organisation such as RTOs are performed by external independent auditors. These auditors evaluate the system's internal control design and effectiveness and examine its conformance with regulatory requirements. They then verify that processes are working efficiently, consistently and within the established limits.

EARTO very much welcomes the System and Process audits as mentioned in HEU Regulation (Art.48). Its implementation is necessary in today's digitalised world, and it can provide the legal required by the reliance on beneficiaries' Usual Cost Accounting Practices. The implementation of a System and Process audit needs to feed on the experiences of the Large Research Infrastructures (LRI) scheme and of the Certificate on the methodology for unit cost (CoMUC), which have proven to be burdensome both for the Commission and for beneficiaries, leading to very few participants. Besides, System and Process audits require deep knowledge of auditing IT systems, which probably makes it too burdensome for the EC to carry out (capacity issue).

For many RTOs, system audits including audit of transactions are already being performed by their current public auditors when auditing the annual accounts. The EC could lean on this system audit provided that they have been performed by a *"competent independent auditor qualified to carry out statutory audits of accounting documents in accordance with Directive 2006/43/EC"* (HEU Art.48.3). The use of such audit firms is indeed in line with Financial Regulation (Art.127) and HEU Regulation (Art. 48.4): *"In accordance with Article 127 of the Financial Regulation, the Commission or funding body may rely on audits on the use of Union contributions carried out by other independent and competent persons or entities, including by other than those mandated by the Union Institutions or bodies"*.

The System and Process audits then needs to be completed by an ex-post audit to be decided upon by the financing body in order to establish the eligibility of costs, building on the System and Process audits as starting point. However, to ensure legal certainty and ex-ante assurance, the work performed within the System and Process Audit should not be re-audited in ex-post audits. Besides, such System and Process audits should aim at being accepted for the different EU programmes.

EARTO Financial experts are ready to further discuss the format and modalities of such System and Process Audit with the EC and external audit firms.

We hope that this paper will contribute to further simplification and improvement of the EU RD&I Framework Programme. EARTO and its financial experts remain ready to further discuss these recommendations with the relevant EU institutions.

---

#### **RTOs - Research and Technology Organisations**

*From the lab to your everyday life. RTOs innovate to improve your health and well-being, your safety and security, your mobility and connectivity. RTOs' technologies cover all scientific fields. Their work ranges from basic research to new products and services' development. RTOs are non-profit organisations with public missions to support society. To do so, they closely cooperate with industries, large and small, as well as a wide array of public actors.*

#### **EARTO - European Association of Research and Technology Organisations**

*Founded in 1999, EARTO promotes RTOs and represents their interest in Europe. EARTO network counts over 350 RTOs in more than 20 countries. EARTO members represent 150.000 highly-skilled researchers and engineers managing a wide range of innovation infrastructures.*

**EARTO Working Group Financial Experts:** *composed of 35 Financial Controllers and Specialists working within our membership. Established in 2013, this Working Group is following EU R&I Framework Programme's simplification, the financial aspects of Horizon 2020 implementation (including the Large Research Infrastructure scheme (LRI), audits, cost models, lump-sums), as well as the preparation of the financial and simplification aspects of HEU.*

**EARTO Contact:** *Sophie Viscido, Senior Policy Officer, [viscido@earto.eu](mailto:viscido@earto.eu), Tel: +32 2 502 86 98*