



PRESENTATION TO ITRE COMMITTEE HEARING

"IMPLEMENTING THE RESEARCH FRAMEWORK PROGRAMME HOW TO REDUCE RED TAPE AND INCREASE EFFECTIVENESS" **EUROPEAN PARLIAMENT, BRUSSELS, 10TH NOVEMBER 2009**

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Chairman, honorable Members of Parliament, ladies and gentlemen,

I thank you for the invitation to address you on issues relating to the implementation of the Seventh Framework Programme.

Problems indeed exist - problems that require urgent attention – and I hope and believe that Parliament can be instrumental in helping to find the necessary solutions.

Before I address these problems, however, it is perhaps appropriate that I should briefly introduce the organisations which I represent here today.

EARTO AND RTOS

EARTO is the European Association of Research and Technology Organisations – RTOs as we call them for short – and the Association represents approximately 350 such organisations from across the EU and associated countries.

RTOs – to give a simplified definition – are mission-oriented R&D organisations. The major RTOs are government-sponsored, sometimes government-owned, organisations with a general mission of helping to tackle issues of social relevance (what are often referred to today as "grand challenges") and to support economic competitiveness.

It may be helpful if I simply name some of the larger, well-known RTOs which EARTO represents, going from North to South in Europe:

- VTT in Finland
- SINTEF in Norway
- Many of the Industrial Institutes in Sweden

- The Technological Institute in Denmark
- TNO in the Netherlands
- VITO in Belgian Flanders
- Fraunhofer in Germany
- Technology Partners Foundation in Poland
- Bay Zoltan Foundation in Hungary
- The Instituts CARNOT in France
- The Technological Centres (FEDIT) in Spain
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RTOs are major players in the Framework Programme:

- Fraunhofer, for example, was the 2nd largest individual participant in FP6, with over 500 project participations.
- The 5 largest of the RTOs just listed totalled over 1,400 project participations in FP6 for more than €520 million in EU funding
- In total, non-university research organisations accounted for about 1/3 of FP6 funding.

Allow me one final word of introduction. It is sometimes said that the Framework Programme accounts for just 5% of total public R&D spending in Europe. That could suggest that the Framework Programme is not particularly important. But that would be a wrong interpretation, for two reasons:

- The figure of 5% seriously understates the true importance of the Framework Programme. National R&D spending includes substantial expenditure on infrastructures, such as university buildings, as well as on salaries. By contrast, FP spending is mostly concentrated on **co-funding** specific research projects. Best estimates are that the FP represents about 25% of total public R&D project expenditure. It therefore has a substantial leverage effect on the direction of European research.
- Second, the FP is the only substantial programme supporting transnational R&D projects in Europe, which is a critical element in the realisation of a European Research Area.

It is therefore essential that the Framework Programme operates effectively and efficiently.

IMPLEMENTATION PROBLEMS IN THE FRAMEWORK PROGRAMME: SIMPLIFICATIONS IN FP7

Let us now turn to the issue of today. I could give you a more or less long list of specific things requiring improvement, but I do not want to get bogged down in technical issues and nitty-gritty detail. There are

some specific problems of implementation that can be solved by technical improvements. But there are others that are the consequence of an underlying systemic problem and until that problem has been resolved no real improvement will be possible. I wish, above all, to address that systemic issue.

Let me begin by recalling that FP7 was intended to bring substantial administrative **simplification**.

FP7 has, indeed, brought significant improvements, even if some are still subject to teething problems. I would mention: **Single Registration Facility, new electronic administrative tools, the establishment of Executive Agencies**. In time, they will all hopefully prove to have been valuable improvements.

There are other promised simplifications which are less welcome, and some which appear to be a failure.

Flat rates, lump sums, unit costs etc. – let us call them “fixed amounts” for the sake of simplicity – are surely a simplification for the Commission, but they are **NOT** a simplification for most major FP participants, whether large or small enterprises or research organisations. The Commission must realise that most FP participants operate full-cost accounting systems. When, for example, they make a journey for the purposes of an FP project, the price of the plane ticket, hotel etc. are entered into the organisation’s accounts at real cost. When the Commission re-imburses on a fixed-amount basis, the amount received does not equal the amount spent, so a further accounting operation is necessary in order to reconcile the amount spent and the amount received: thus fixed amounts generate additional accounting effort for contractors.

It is also to be feared that political pressures (e.g. about “wasting public money” or allowing, potentially, “contractors to make a profit”) is likely always to result in fixed amounts being set at levels significantly below real cost.

I might also mention the absurdity that where, today, fixed rates are already in use, e.g. in Marie Curie, auditors have demanded proof that contractors have spent at least the value of the fixed amount which they have received! Why bother with fixed amounts in the first place?

Full-cost accounting is transparent, well-established and the simplest system for the great majority of FP contractors.

Methodology certification, another promised major simplification promised in FP7, appears today to be a failure. There are two

certification procedures. One allows FP contractors to use average personal costs, provided the method employed for calculating those costs meets criteria set by the Commission. The other allows larger FP7 contractors to ask the Commission to certify their overall financial reporting methodology, which also covers, for example, their indirect costs (or “overheads”).

After a delay of two-and-a-half years, the Commission finally published in June 2009 its criteria for permitting the use of average personnel costs. I regret to say that the evidence so far indicates that the average personnel cost methodology in its present form will prove to be an almost total failure. The criteria set by the Commission are so stringent that practically no company and practically no RTO can meet them.

The criteria are ill-adapted to most larger companies, which pool and average their costs using “cost-centre” methodologies. But my colleague from industry may wish to address that issue.

As regards RTOs, EARTO has collected data from 30 of the larger RTOs in Europe, which show that:

- most typically use average personnel costs when charging R&D work to third parties, including national funding programmes and, in the past, the Framework Programme (“their usual accounting and management principles and practices”)
- 80% of the 30 RTOs definitely cannot meet the Commission’s criteria for the use of average personal costs (in particular the 25% deviation criterion), and several of the remainder are not confident they can meet the criteria (this uncertainty has often to do with variability in remuneration profiles from one year to the next).
- Two of the 30, both of which used average personnel costs in FP6, have decided that in FP7 they will use individual personnel costs, even though they use average costs for non-FP projects and even though this means additional administrative burden for them. The reason why I will give you in a moment.

Frankly, unless the present rules are radically changed, this is a simplification which is practically pointless, because hardly anybody can meet the criteria. Indeed, its real effect will not be simplification at all, it will be to **prohibit the use of average personal costs**.

Audit certificates: This simplification represents, on the face of things, a major advance, since the number of audit certificates which contractors will be required to provide is dramatically reduced in FP7 compared with FP6.

But this improvement is, in truth, most probably an illusion. I refer here to the Commission's extensive campaign of ex-post FP6 audits and to the probable continuation of extensive auditing in FP7. The practical consequence of such extensive auditing will be to make audit certificates largely unnecessary.

AN EMERGING CULTURE OF DISTRUST

I have just made reference to the Commission's extensive campaign of ex-post FP6 project audits, and here we come to the major problem facing us in FP7.

The Commission's ex-post FP6 audit campaign is being conducted in such a manner that:

- it is destroying confidence in the Commission as a competent and reliable partner in EU research;
- it is damaging research partnerships among FP beneficiaries built up over many years and FPs,
- it is substantially increasing the administrative burden on FP participants,
- and, ultimately, it is undermining EU research policy by rendering participation in the FP less and less attractive.

A climate of distrust is forming. The effects are corrosive. It must be stopped as a matter of urgency. Otherwise, it must be expected that more and more organisations – companies, RTOs, SMEs – will cease to participate in the Framework Programme.

Let me give you one small example of this distrust. I talked a few moments ago about RTOs not being able to meet the Commission's criteria for the use of average personnel costs, and I mentioned that 2 of the 30 surveyed RTOs would prefer to continue to use average personnel costs in FP7 but have decided – many months ago already – to use individual personnel costs in FP7. The reason is that they no longer trust the Commission. They have lost faith in the reliability of Commission definitions of what are eligible costs: what is accepted as an eligible cost today may not be accepted as an eligible cost in six months time.

FP participants need a minimum of legal certainty: that minimum of necessary legal certainty is no longer given.

To understand this climate of distrust, you have to understand the nature and consequences of the Commission's ex-post FP6 audit campaign. The Commission is conducting these audits in such a manner

that it is, de facto, **retrospectively and unilaterally changing the definition of eligible costs** which it, the Commission, had previously accepted.

Let us be clear: this is not a problem limited to one or two FP6 beneficiaries. It is widespread. Allow me to explain with some simple examples and numbers. Among the top 20 individual FP6 participants are several research organisations and industrial companies which, according to the Commission, following ex-post audits of FP6 projects, have made so-called “systematic errors” in their cost claims to the Commission. You need to appreciate that over several years each of these organisations had reported their FP6 costs to the Commission consistently, always using the same definitions and methodologies – in other words, in the language of the Rules of Participation, “***in accordance with their usual accounting principles and practices***”.

Now, after ex-post audits, the Commission declares that these beneficiaries had made systematic errors in calculating their costs, and the Commission demands that the affected organisations recalculate all of their cost statements for all of their FP6 projects (often several hundred cost statements, within the ridiculously short period of 45 days, and at the beneficiary’s own cost – one of my members was obliged to spend €75,000 hiring the services of PWC in order to meet the Commission’s demands!)

Now, please consider these numbers - and please remember we are talking in this particular example only about a few cases known to me among the top 20 FP6 players. These few cases together totalled around 2,500 project participations. Each FP project generally involves three cost statements; thus we have 7,500 cost statements. Each cost statement had been accepted by the Commission and had been signed off by at least two Commission officials: a Project Officer and a Financial Officer; thus we arrive at 15,000 Commission signatures. Evidently, we are not talking about one or two Commission officials who may have made mistakes in signing off cost statements which contained errors. No, we are clearly talking about probably hundreds of individual Commission officials.

The only possible conclusion from all of this – if indeed mistakes have been made – is that the Commission experienced a massive management failure in the execution of FP6 project payments. The affected contractors had acted in good faith, according to their usual accounting principles and practices, and the Commission had consistently confirmed their behaviour by signing off cost statements. If errors were made, they were made also by the Commission. But now,

it seems, the Commission expects FP6 participants to pay the price of the Commission's own mistakes.

This is not acceptable behaviour. As I described it earlier, the Commission is **retrospectively and unilaterally changing the definition of eligible costs**. In legal terms, such behaviour contradicts a fundamental principle of contract law, and therefore it should not come as a surprise for you to learn that two of the research organisations to which I refer have decided to take legal proceedings against the Commission. Others may well follow.

WHAT IS THE ORIGIN OF THE PROBLEM AND WHAT TO DO ABOUT IT?

The problem has several origins, but the proximate cause is that the Rules of Participation do not specify in any detail the nature of eligible costs. They state only general principles: **real, economic, necessary, in accordance with the usual accounting principles of the participant**.

The Court of Auditors, in particular, has criticised these imprecise rules and in its own audits it has applied strict definitions and, hence, appears now to have pushed the Commission into doing likewise. But one must presume that the legislator knew what it was doing in adopting these not so precise rules. Indeed, it has always been the practice of the Commission in the past – including during the course of FP6 – to interpret these general principles with **intelligent discretion**. In this way, the Commission could take account of the important differences between countries, and between types of organisations, in the way they account for their costs.

Now, it seems, that is no longer to be allowed: one size must fit all. That is not realistic.

WHAT TO DO?

May I suggest that we distinguish the past, the present and the future.

The past is FP6. This House, in the discharge vote on the 2007 budget, recommended the Commission – and I quote: "... as a requirement for legal certainty, to refrain from re-calculating the financial statements of projects under The 6th Framework Programme that it has already approved and settled ..." That was a wise recommendation.

If we continue to pursue ex-post FP6 audits in the current manner, we shall do more damage to European research than we may do good to the European budget. If mistakes were made in FP6, they were made on all sides, and they were made in good faith. **Let us stop trying to fix the past. Let us focus instead on fixing the future.**

The future is FP8. We need urgently to put in place a coherent and realistic framework of management principles and definitions for the FP. That will take time, which is why I set the target as FP8. It may be that we need a separate or modified Financial Regulation for the FP. We certainly need clearer, commonly agreed Rules of Participation. And we need an auditing framework that recognises that research is not the same thing as subsidising livestock-farming in remote regions of the Community or co-funding public works.

I should like to propose that Members of this House – perhaps more particularly members of this Committee and of the Budget Control Committee – take the initiative to invite senior representatives of the Commission and of the Court of Auditors to sit down around the table and develop and agree a meaningful management and auditing framework for European research programmes, and I would hope that it would be possible to associate representatives of the relevant stakeholder groups with this work. This is an urgent task. The time for pointing the finger of accusation at this or that institution is passed. There is a serious problem and it must be resolved.

Which leaves the present, and the present is FP7. To repeat: FP contractors need a minimum of legal certainty. Or, as someone put it the other day in a different forum: “simplification is, above all, medium-term stability”. If there is agreement to work together towards an improved management and control framework for FP8, we need in the meantime to adopt a tolerant approach in FP7. With good will on all sides, that need not be difficult. The basis is there in the **Rules of Participation, Art. 31.3 (c), which states that eligible costs shall be determined “in accordance with the usual accounting and management principles and practices of the participant”.**

I urge you to give this important matter your fullest attention so that the Framework Programme can operate effectively and efficiently and make its critical contribution to the achievement of ERA .

I thank you for your kind attention.

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