EARTO comments on the Revision of the Financial Regulation

Grants Should Cover the Full Economic Cost of Research

As a general remark, it is essential that the Financial Regulation as it applies to R&D recognises in its wordings, interpretation and implementation certain essential realities of R&D practice[1]. Chief amongst these is that specific R&D work – and especially R&D to support competitiveness and other EU policy objectives, which are the very rationale of the FP – does not arise in a vacuum as the present rules, in a restrictive interpretation, imply *("necessary for the implementation of the project"*). They arise out of **upstream activities** to identify emerging needs and to develop promising generic technologies for future applications. They also require **downstream** activities to protect, promote and diffuse research results in order to ensure their widest beneficial application. The costs associated with these upstream and downstream activities are an essential part of what are frequently referred to as "**indirect**" or "**overhead**" costs. They must always be considered eligible costs in reasonable proportion. **In other words, the starting point for the Financial Regulation and related rules must be the full economic cost of R&D: the less the full economic cost of R&D is recognised and compensated, the less the relevance and incentive effect of the FP and the lower participation by the target beneficiary groups will be, and hence the more the programme will fail to meet its objectives.**

Non profit rule

The no-profit rule appears irrelevant, given the co-financing principle. Even in the absence of co-financing, a subsidy of 100% will not give rise to profit (assuming there are no direct receipts from the project).

If the intention of the Commission is to reserve for itself the right to judge whether a participant could or should provide more co-financing from its own or other sources, this would be to open a can of worms of infinite size. Why not also consider future income streams from licensing technology resulting from an EU-funded R&D project? Why not consider future income streams from the new or improved products or processes introduced by industry as a consequence of an FP project? To attempt to do so would, of course, be wholly unrealistic.

[1] See also the Council Conclusions on guidance on future priorities for European research and research-based innovation (http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/intm/111723.pdf) and the report from the Expert Group on the Role of Community Research Policy in Knowledge-based Economy.

The non-profit principle, if it is to remain, must be applied in such a way as to respect the financial margin of surplus which participants may apply to their **direct costs** in order to cover their **indirect costs**: this is to state again – see above – that the point of departure must always be the **full economic cost of R&D**. **If this is not the case, the non-profit rules should be reconsidered.**

Definition of eligible costs and full economic cost of research

The definition of **eligible costs** should be fair and reasonable, and should respect the full cost principle: direct and indirect costs, upstream and downstream of research.

Article 172a, Implementation Rules, alinea a of paragraph 1 should be abolished.

Article 172a, Implementation Rules, alinea c of paragraph 1 should be modified by replacing "implementation" by, for example, "purpose", whereby "purpose" should be understood to include necessary upstream and downstream activities related to the research.

Article 172a, §1, alinea c – Implementing Rules	**Amended Article 172a, §1, alinea c – Implementing Rules**
*They [eligible costs] are necessary for **the implementation** of the action or of the work programme which is the subject of the grant.*	*They [eligible costs] are necessary for **the purpose** of the action or of the work programme which is the subject of the grant.*

Reimbursement of non-recoverable VAT

Article 172a, Implementation Rules, paragraph 2 should be modified by replacing "may" by "shall". The current formulation is, for example, applied systematically by the Commission within the FP to justify not reimbursing VAT which is not recoverable by a beneficiary, even though the sense of the Financial Regulation is quite clearly that such reimbursement should be possible (according to Article 172a, §2, alinea c).

Article 172a, §2 – Implementing Rules	Amended Article 172a, §2 – Implementing Rules
*Without prejudice to paragraph 1 and to the basic act, the following costs **may** be considered as eligible by the authorising*	*Without prejudice to paragraph 1 and to the basic act, the following costs **shall** be*

officer responsible:	*considered as eligible:*
[...]	*[...]*
(c) value added tax paid, and which cannot be refunded to the beneficiary according to the applicable national legislation;	*(c) value added tax paid, and which cannot be refunded to the beneficiary according to the applicable national legislation;*

Use of flat rates for indirect costs

Article 181, Implementation Rules, paragraph 3, foresees a limit of 7% of direct costs for indirect costs, which is generally applied by the Commission to Coordination Actions within the FP and which is hugely dissuasive to many potential contractors because the figure is out of line with economic reality. The revised article proposed by the Commission (paragraph 4) would give the Commission the right to impose the use of flat rates of a maximum of 7% of direct costs for indirect costs via the Grant decision or agreement. The use of flat rates for indirect costs should remain optional - EARTO would argue for full-cost accounting and reimbursement on that basis.

Uniform Interpretation and Application of the Rules

European Commission vs. Authorising Officer by delegation

The Financial Regulation assigns a margin of discretion to "the authorising officer" – that is to say the Commission – which, in practice, then delegates its role and responsibilities to a Commission official acting as authorising officer by delegation. This is even more the case with the Commission proposals for revision of the Financial Regulation and its Implementing Rules. The text as it is goes counter to the principle of uniform interpretation and application of the rules, given that there is at least one authorising officer by delegation per DG, in practice. References to the role and margin of discretion of "the authorising officer" should be clarified and a provision stating that the ultimate liability remains within the Commission when the institution delegates should be added. The Commission should ensure a coherent practice in the interpretation and implementation of specific rules, even if its role and responsibilities must be delegated to Commission officials in practice.

Interpretation Board/Board of Appeal

EARTO considers that the current system does not allow for a unified interpretation and application of the rules and procedures. Different DGs, different units within the same DGs, and even different project officers within the same DG, sometimes interpret and implement rules and procedures in different ways. This creates confusion and discrimination for beneficiaries and is therefore unacceptable. The Commission must provide for uniform interpretation and application of rules and procedures. Guidance notes and training might prove useful but will not solve the problem of diverging interpretations across Commission services.

What would most likely be required is the creation of a high-level coordinating body across all of the relevant Commission services, which would issue guidance at the launch and during the execution of an FP that would be binding on all Commission services and officials. It could also act as an appeals tribunal when beneficiaries considered that the rules had been wrongly applied. The adversarial procedure mentioned in draft article 119, §3 of the revised Financial Regulation and in draft article 183, §3 of the revised Implementation Rules should be monitored by this "interpretation board".

Single Audit Approach

EARTO calls for a single audit policy whereby the results of an audit create legal certainty for a beneficiary during the remainder of a Framework Programme.

Proportionate System of Control

Audit certificates

With regard to reports by external auditors ("audit certificates") – cf. Article 180, Implementation Rules – the Commission should be held to explicitly accept or reject with reasons such reports within a reasonable period, such as 90 days. Such accepted reports should be binding and not subject to ex-post audit or evaluation unless there is new, *prima facie* evidence of fraud, for legal certainty.

Article 173, paragraph 4 of the Implementing Rules should be revised accordingly.

Article 173, §4 – Implementing Rules	Amended Article 173, §4 – Implementing Rules
Where the application concerns grants for an action for which the amount exceeds *€500 000 or operating grants which exceed*	*Where the application concerns grants for an action for which the amount exceeds*

€100 000, an audit report produced by an approved external auditor shall be submitted. That report shall certify the accounts for the last financial year available.	*€500 000 or operating grants which exceed* *€100 000, an audit report produced by an approved external auditor shall be submitted. That report shall certify the accounts for the last financial year available* ***and the European Commission shall explicitly accept or reject the auditors' report within 90 days, in writing. Once accepted by the European Commission, such reports shall become binding and shall not be subject to ex-post audits or evaluation unless there is new prima facie evidence of fraud.***

To the same end, the following sentence should be added to article 180: *The European Commission shall explicitly accept or reject the auditors' report within 90 days, in writing. Once accepted by the European Commission, such reports shall become binding and shall not be subject to ex-post audits or evaluation unless there is new prima facie evidence of fraud.*

Time limits on suspension of payments during ongoing audit procedures

EARTO considers that there should be a time limit on suspension of payments during an ongoing audit process. 90 days seems reasonable for both parties. We therefore recommend that draft article 183 paragraph 1 in the Implementing Rules should be amended accordingly.

Draft Article 183, §1 – Implementing Rules	Draft Article 183, §1 amended by EARTO – Implementing Rules
1. The execution of the grant agreement or decision or the participation of a beneficiary in their execution may be suspended in order to verify whether presumed substantial errors or irregularities or fraud or breach of obligations have actually occurred. If they are not confirmed, execution shall resume as soon as possible.	*1. The execution of the grant agreement or decision or the participation of a beneficiary in their execution may be suspended* ***for no longer than 90 days*** *in order to verify whether presumed substantial errors or irregularities or fraud or breach of obligations have actually occurred. If they are not confirmed, execution shall resume as soon as possible.* ***Beneficiaries shall be entitled to payment of interest should this suspension last longer than 90 days.***

Ex-post audits

Where a report by an external auditor, or an ex-post audit, reveals errors made in good faith by a beneficiary, administrative penalties should not be imposed in addition to any corrective payments[2].

In addition to this, the cost of ex-post audits and costs associated with these audits (such as the cost of re-calculating financial statements) should be covered by the Commission and recognised as eligible. Article 172a of the Implementing Rules, §2, alinea b should be amended to cover ex-post audits.

Article 172a, §2, alinea b – Implementing Rules	Amended Article 172a, §2 – Implementing Rules
(b) costs related to external audits required by the responsible authorising officer either upon the request for financing or upon the request for payment;	*(b) costs related to external audits required by the Commission either upon the request for financing or upon the request for payment,* ***and costs related to ex-post audits****;*

Errors to the advantage of the beneficiary

Where a report by an external auditor, or an ex-post audit, reveals errors to the advantage of a beneficiary, the Commission should be obliged to make corresponding payment (whereas today it is known to plead "absence of available budget"), or the amount owned by the Commission should be set against any amount owned by beneficiaries .

Outputs-based controls

The Commission's proposals for moving towards output-based monitoring are attractive in principle and, indeed, correspond to practice in certain funding programmes within Europe and elsewhere. But we find it difficult to express full support for such ideas without having prior assurance that they would be fully supported by Parliament and the Court of Auditors. The current EU "control culture" gives good reason for doubt. A reform in this sense which then became contested by Parliament and/or the Court could have disastrous consequences of legal uncertainty. We therefore prefer to reserve our

[2] Cf. Article 114, §4 – Financial Regulation

position at present.

However, should there be a cross-institutional consensus on this issue, it will be crucial to implement the new control mechanisms in a uniform way across Commission services, to maintain a certain level of legal certainty. Article 180, §3 of the Implementing Rules needs to be clarified in this sense.

Reduce Red Tape and Bureaucracy

Pre-financing payments to beneficiaries

The recent excessive interpretation whereby participants are being asked to maintain separate bank accounts for each EU-funded project creates huge administrative burdens for large beneficiaries with many, even hundreds, of FP project participations.

The best approach may well be for the Commission simply to forgo its right to the interest (i.e. consider any gains for the beneficiary to be part of the subsidy), as proposed by the Commission.