EUROPEAN COMMISSION
Employment, Social Affairs and Equal Opportunities DG
ESF, Monitoring of Corresponding National Policies I, Coordination
Audit, controls

Regional Policy DG
Policy Coordination
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Article 11.3 (b) of Regulation (EC) No 1081/2006 as amended by Regulation (EC) No 396/2009
Article 7.4 of Regulation (EC) No 1080/2006 as amended by Regulation (EC) No 397/2009

Indirect costs declared on a flat rate basis
Flat rate costs calculated by application of standard scales of unit costs
Lump sums

DISCLAIMER:

This is a Document prepared by the Commission services responsible for the structural Funds. Within the limits of applicable Community law, it provides technical guidance to the attention of public authorities, practitioners, beneficiaries or potential beneficiaries, and other bodies involved in the monitoring, control or implementation of the Cohesion Policy on how to interpret and apply the Community rules in this area. The aim of the working document is to provide Commission services' explanations and interpretations of those rules in order to facilitate the implementation of operational programmes and to encourage good practices. However, this guidance is without prejudice to the interpretation of the Court of Justice and the Court of First Instance or evolving Commission decision making practice.

INTRODUCTION

In 2006 an important simplification introduced in the 2007-2013 ESF Regulation[1] allowed the Member States to declare indirect costs (overheads) on a flat rate basis, up to 20% of direct costs of an operation. The simplification of charging flat rates for indirect costs was welcomed by all stakeholders, including the European Court of Auditors.

In its annual report for 2007 the European Court of Auditors has suggested that the majority of errors found in structural actions expenditure are partly due to the complexity of the legal and implementing framework. For this reason it recommended to simplify *"the basis of calculation of eligible cost and making greater use of lump sum or flat rate payments instead of reimbursement of 'real costs*[2]*'"*. The Financial Regulation applicable to the general budget of the European Communities and its implementing rules[3] already allowed such approach for direct management expenditure.

In November 2008 the Commission published the Communication on a European Economic Recovery Plan[4], which called for a stepping-up of investments to stimulate Europe's economy. To this end, the implementation of the Structural Funds should be accelerated. The Commission committed itself to propose a series of measures, aiming *inter alia* "to widen the possibilities for eligible expenditure on a flat rate basis for all the funds"[5].

In this context, the Commission put forward a proposal for amending Article 11 of Regulation (EC) No1081/2006 (ESF Regulation) introducing the possibility of applying flat rate costs calculated by application of standard scales of unit cost and lump sums grants. The proposal was adopted on 26 November 2008. During the negotiations the Commission agreed to extend to ERDF the application of flat rate for indirect costs, standard scales of unit costs and lump sums grants by an amendment of Article 7 of Regulation (EC) No 1080/2006 (ERDF Regulation).

Therefore, the ESF Regulation as amended by Regulation (EC) No 396/2009[6] and the ERDF Regulation as amended by Regulation (EC) No 397/2009[7], include for both Funds the same possibility of applying flat rate for indirect costs, standard scales of unit costs and lump sums.

These provisions are an important step towards simplification. Experience in Member States has shown that a large proportion of the supporting documents inspected by controllers and auditors

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[1] Article 11.3(b) of Regulation (EC) No 1081/2006,

[2] Official Journal of the European Union – C286, Volume 51, 10 November 2008 "Court of Auditors – Annual Report of the Court of Auditors on the implementation of the budget concerning the financial year 2007, together with the institutions' replies", chapter 2, paragraph 42.

[3] Article 108a of Regulation (EC, Euratom) No 1605/2002 as amended by Regulation (EC, Euratom) No 1995/2006, Article 180a of Regulation (EC, Euratom) No 2342/2002 as amended by Regulation (EC, Euratom) No 478/2007

[4] Communication from the Commission to the European Council on A European Economic Recovery Plan, COM(2008) 800 final, 26.11.2008.

[5] Idem footnote 1.

[6] OJ L 126, 21.5.2009, p.1

[7] OJ L 126, 21.5.2009, p.3.

are needed to justify a minor part of expenditure. This means that a great deal of the human resources and administrative effort involved in the management of the structural funds is absorbed in accumulating and verifying documents, rather than focusing on the achievement of policy objectives. It is expected that the application of the provisions on simplified costs in the framework of the ERDF and the ESF will lighten the administrative burden on beneficiaries and management bodies and will contribute both to a more efficient and correct use of the Funds.

1. PURPOSE OF THE WORKING DOCUMENT

This Working Document was prepared by the Commission services responsible for the Structural Funds in consultation with the members of the ESF Technical Working Group and the Coordination Committee of the Funds (COCOF). It reflects the discussions held with the National Authorities during the COCOF technical seminars on simplified costs (19 February, 23 March, 30 April, and, exclusively for the ETC programmes, 29 June 2009) and in the framework of the seminar “Train the trainers” (9 June 2009).

It provides technical guidance on indirect costs declared on a flat rate basis, on flat rate costs calculated by application of standard scales of unit costs and on lump sums (herein after referred as "simplified cost options"). This working document is to the attention of public authorities, programme managers and auditors, beneficiaries or potential beneficiaries, and other bodies involved in the implementation, management, monitoring and control of the Cohesion policy. The aim of the working document is to provide guidance in order to facilitate the use of simplified costs, where appropriate and to reduce legal uncertainty and financial risk for the beneficiaries.

In parallel, the note encourages good practice thanks to examples aiming at illustrating the main points of implementation and at presenting a few possibilities on how Article 11(3) (b) of Regulation (EC) No 1081/2006 and Article 7(4) of Regulation No 1080/2006 could be implemented. The examples presented in this working document are purely illustrative: their presence does not constitute a requirement or a recommendation to use them in the implementation of the 2007-2013 operational programmes (OPs), even for similar operations.

2. THE NEED FOR AN AUDIT APPROACH

The use of simplified cost options is a concept with important implications for the management and control of the Structural Funds. All actors involved will have to adapt their working methods and practices, in order to achieve the positive effects of simplification, without compromising the legality and regularity of expenditure.

From the audit point of view, the provisions of Articles 11(3)(b) of Regulation (EC) No 1081/2006 as amended by Regulation (EC) No 396/2009 and 7(4) of Regulation (EC) No 1080/2006 as amended by Regulation (EC) No 397/2009 signify a departure from the principle of real costs. Flat or standard rates and lump sums involve approximations of costs based, for example, on averages and surveys of historical data or market prices. It is inherent in such fixed rates that they may on occasion overcompensate or "undercompensate" the costs incurred for the supported operation. Auditors will have to focus more on outputs rather than on inputs and costs of projects. It is important that Commission auditors make their audit methods as transparent as possible for these new simplified costs, in order to give Member States, namely the managing authorities, certifying authorities, audit authorities, intermediate bodies and beneficiaries, confidence that they can proceed with the application of these concepts without hesitation and uncertainty.

It is equally important that the national audit authorities and the Commission auditors maintain a common approach for the audit of flat rates for indirect costs, standard scales of unit costs and lump sums, in order to ensure uniform treatment when drawing conclusions on the legality and regularity of the declared expenditure. For this reason, Member States' audit authorities are encouraged to use the same audit approach when auditing these simplified cost options.

3. GENERAL PRINCIPLES GOVERNING NATIONAL ELIGIBILITY RULES

For the programming period 2007-2013, eligibility rules are determined at national level subject to the exceptions provided for in the specific Regulations for each Fund (Article 56(4) of Regulation (EC) 1083/2006). They shall cover the entirety of the expenditure declared under the operational programme. Moreover "*the managing authority shall be responsible for managing and implementing the operational programme in accordance with the principle of sound financial management*" (Article 60 of Regulation (EC) No 1083/2006) and has the possibility to apply stricter rules than those set out in the applicable European legal framework.

Therefore, managing authorities should determine and document the eligibility rules for ESF and ERDF operations, at the appropriate level (national, regional, local, by OP), make them available to potential beneficiaries, and indicate all relevant rules in grant decisions[8]. As part of these rules, the framework for applying article 11.3(b) of Regulation (EC) No 1081/2006 or Article 7.4 of Regulation (EC) No 1080/2006 as amended should also be set out.

4. A PROVISION RESTRICTED TO GRANTS

The simplified costs options concern only operations and projects[9] implemented in the **form of grants**, for which otherwise the real costs principle is usually applied i.e. all declared expenditure is justified by paid invoices and other accounting documents of equivalent probative value. Therefore, simplified cost options are not available to operations or projects subject to public procurement contracts[10].

4.1 The determination of the exact scope of use of the simplified costs options

Given the variation of what is considered as an operation or a project it is necessary to give some guidance on how to determine the exact scope of use of the simplified costs options.

In the case where the simplified cost options are applicable to the operation, one has to determine if it can be applied to all parts of the operation. This depends on the nature of what is considered as

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[8] For the purpose of this note "Grant decision" should be understood as a general term encompassing all legally binding forms of granting assistance to beneficiaries, which may vary according to the administrative set up of the Member States: grant agreements, grant letters, grant awards etc

[9] An operation is defined as "a project or group of projects selected by the managing authority of the operational programme concerned or under its responsibility according to criteria laid down by the monitoring committee and implemented by one or more beneficiaries allowing achievement of the goals of the priority axis to which it relates" (Article 2(3) of Regulation (EC) No1083/2006)

[10] By operations "subject to public procurement contracts" the Commission aims at designating the operations implemented through the award of public contracts in accordance with Directive 2004/18 (including its annexes) or public contracts below the thresholds of the same Directive.

an operation by the Member States. In some Member States an operation consists of and is implemented through a group of projects (the definition depends on the set-up of the operational programmes, supported by the Funds under their respective scope of assistance). In order to assess in which projects of the operation the simplified costs options can be applied, it is necessary to define the projects constituting the operation at the lowest possible scale. If the beneficiary outsources the implementation of some of the projects, in their entirety, via public procurement contracts (training, seminar, personalised support, etc see example 1 below) or all the projects, the simplified cost options cannot be applied to these projects subject to public procurement contracts.

4.2 Outsourcing within a project implemented by the beneficiary itself

If the beneficiary implements itself a project (keeping full control on the management and implementation of the project), the simplified costs options are applicable, even if some of the **budget lines or expenditure items** within the project (part of the project execution like cleaning services, external expertise, purchase of furniture, etc) are outsourced.

In the case of flat rate for the indirect costs it should be taken into account that the extent of outsourcing by the beneficiary can have an impact on the proportion of indirect costs. Therefore, Member States should assess the impact that the extent of outsourcing within operations has on the proportion of indirect costs and hence the flat rate. Mitigating measures should be introduced in the methodology. If the extent of outsourced activities has a significant effect on the proportion of indirect costs, the flat rate should either be reduced proportionally to the extent of outsourcing or the flat rate should be applied only to those costs which are not outsourced. However, it may also be that the extent of outsourcing has no effect on the proportion of indirect costs or that this effect is insignificant. In this case no mitigating measures might be needed. The effect of outsourcing should however be analysed (for example on the basis of similar past measures or the previous projects) and should be taken into account when establishing a methodology for the application of the flat rate.

It is important to recall that all operations financed by the structural Funds have to comply with all applicable Community and national rules. The issue of implementing correctly public procurement rules within the project is not linked to the use or not of the simplified costs options. For this reason the audit of operations about the implementation of simplified costs options will focus on elements quoted under paragraph IV.3 of this note without considering the underlying procedures followed by a beneficiary for public contracts[11]. Nevertheless, horizontal thematic audits on the compliance with rules applicable could analyse also procedures followed for public procurement. With regard to document retention for public contracts under simplified costs, national rules apply.

4.3 Recommended approach for projects outsourced even where beneficiaries belong to categories that are not covered by Directive 2004/18

The Commission services recommend to apply the approach developed above (Point 4.1 applied by analogy.Point 4.2 adhered to in all cases) for projects outsourced, even where beneficiaries belong to categories that are not covered by Directive 2004/18, in order to respect the intention to restrict the simplified cost options to grants.

[11] In the case of flat rate rule for indirect costs, **direct costs** justified on the basis of real costs are not considered as using simplified cost options.

The examples below illustrate the abovementioned principle:

Example 1: A grant of € 20,000,000 is allocated to a public employment service ("beneficiary") to organise, during two years, the re-integration of 5,000 long term unemployed people ("the operation"): this operation will be implemented via several projects: € 7,000,000 of personalised support projects implemented directly by the beneficiary, trainings, implemented directly by the beneficiary for € 5,000,000 and outsourced via public procurement contracts for the remaining part (€ 8,000,000). Since the beneficiary is a public entity, training institutions for the part outsourced will have to be chosen through the national (and if applicable, Community) "public contract award procedures" and the simplified cost options will not be applicable to this part of the grant. It will be applicable only to an amount of € 12,000,000. For the trainings that the beneficiary implements by its own means it is accepted that some of the expenditure items are outsourced and included in the simplified cost options (for example external experts, cleaning services, etc.).

Example 2: A municipality receives a grant of € 1,000,000 for the construction of a road. For this the municipality has to award a public work contract of an estimated value of € 700,000. In addition the municipality incurs certain related costs of € 300,000 (expropriations, litigation costs, monitoring of the progress on the ground, environmental studies realised by its own staff, campaigns, tests for the reception of the road etc). For the amount of € 300,000 of direct costs and insofar as these costs are eligible under the National and EC provisions, simplified costs (eg. indirect costs on a flat rate basis of direct costs) can apply.

CHAPTER I:
Indirect costs declared on a flat rate basis

The guidance provided in this chapter (except point 1.6) was discussed and agreed by the ESF Technical Working Group and the European Court of Auditors in July 2006. This guidance is also applicable to ERDF operations. The amendments introduced in the ESF and the ERDF Regulations do not change the implementation of this rule.

Preliminary remarks:

Experience from previous programming periods showed that the justification of indirect costs constituted a high source of risk for beneficiaries, and frequently a disproportionate administrative cost for ESF operations, particularly small projects.

Therefore the Commission proposed **to simplify the administrative and financial file pertaining to grant-assisted ESF operations** in relation to the treatment of indirect costs. In adopting the regulation, the Council welcomed the simplification and agreed on an **option** - not an obligation - for this provision. This simplification benefits both the beneficiary and the administration (management and audit).

I.1. Purpose of this note

In order to facilitate the implementation of the provisions of article 11.3(b) of the ESF Regulation [and Article 7(4) of the ERDF Regulation] and to avoid legal uncertainty and financial risk for beneficiaries, the practicalities of implementing this option are addressed below.

In the following text [an “ERDF” or] an “ESF operation” means an operation selected for funding, the costs of which are included in an operational programme co-funded by [the European Regional Development Fund or] the European Social Fund.

I.2. General principles governing national eligibility rules

For the programming period 2007-2013, eligibility rules are determined at national level: (Article 56 of Regulation (EC) N°1083/2006):

> 4. The rules on the eligibility of expenditure shall be laid down at national level subject to the exceptions provided for in the specific Regulations for each Fund. They shall cover the entirety of the expenditure declared under the operational programme.

Moreover "*the managing authority shall be responsible for managing and implementing the operational programme in accordance with the principle of sound financial management*" (Article 60 of Regulation (EC) N° 1083/2006).

Therefore, at the start of the programming period, managing authorities should determine and document the rules of eligibility for ESF [and ERDF] operations, make these rules available to potential beneficiaries, and indicate all relevant rules in granting decisions. As part of these rules, the framework for applying [Article 7(4) of Regulation (EC) N° 1080/2006 or] Article 11.3(b) of Regulation (EC) N° 1081/2006 should also be set out.

In the case of grants, the ***options*** provided for in the regulation include:

- the declaration of indirect costs on the basis of real costs (i.e. no flat rate, with full justification of expenditure);
- the declaration of indirect costs at flat rate (i.e. without justification), at a rate to be set by national rules but inferior or equal to 20% of direct costs. The managing authority should clearly state which rate it applies, in which circumstance the rate may be 20% of direct costs and in which circumstances the rate is less than 20% of direct costs and whether the rate varies according to the type of [ERDF or]ESF operations, beneficiaries, size of entities or types of grants concerned, etc.

I.3. Definition of direct and indirect costs:

In the absence of a European accounting definition of direct or indirect costs, managing authorities or their intermediate bodies should identify clearly what constitutes direct and indirect costs for each type of [ERDF or] ESF operation concerned.

a) Direct costs are those costs which are directly related to an individual activity of the entity, where the link with this individual activity can be demonstrated.

b) Indirect costs, on the other hand, are costs which are not or cannot be connected directly to an individual activity of the entity in question. Such costs would include administrative expenses, for which it is difficult to determine precisely the amount attributable to a specific activity (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.).

Both direct costs, fully demonstrated by supporting documents, and indirect costs at flat rate are regarded as real costs, in line with Article 11 of Regulation (EC) 1081/2006.

I.4. Scope of the article:

The option of declaring indirect costs on a flat-rate basis concerns only operations managed in the framework of grants, where declared expenditure is normally justified by paid invoices and other accounting documents of equivalent probative value**.** The rule under Article [7(4) of ERDF] or 11.3(b) of ESF Regulations means that once direct costs have been clearly defined in the granting decision and properly justified by the beneficiaries by means of supporting paid invoices, **beneficiaries can apply the agreed flat rate to declare and justify indirect costs linked to this ESF [or ERDF] operation, without any further justification.**

Within the same operation, only one of the options can be selected: either the indirect costs are declared on the basis of real expenditure (and justified with all the supporting documents, up to the amount declared[12]), or they are declared on a flat-rate basis (with no supporting documents / no justification needed), within the ceilings fixed by the granting decision.

[12] It should be noted that in certain Member States, under the 2000/2006 period, a maximum ceiling has been set for indirect costs justified on the basis of real costs, in relation to other well-defined cost categories.

I.5. Justifying indirect costs declared on a flat-rate basis:

It is important to note that the option of declaring indirect costs on a flat-rate basis must be foreseen at the stage of programming the [ERDF or] ESF operations.

The objective is to dispense with the need to justify in detail the individual costs (i.e. no provision of copies of paid invoices and no request for specific prorata breakdown for each type of expenditure), which make up the indirect costs. This simplifies matters both for the beneficiary and for the administration managing and controlling the ESF [or ERDF] operation.

The simplification of the justification of indirect costs implies, however, **careful verification of the declared direct costs, in accordance with the granting decision**. This verification of direct costs allows to justify the amount of declared indirect costs and constitutes part of the management checks (Article 60.b of Regulation (EC) N° 1083/2006) and of audits on operations (Article 62.b of Regulation 1083/2006).

On a cautionary note, this simplification should not artificially inflate direct costs, nor increase indirect costs declared under ESF [or ERDF] operations.

Finally, it is also clear that

– Since actually incurred direct costs serve as the basis for calculation of indirect costs, any reduction in these direct costs (i.e. in relation to the estimated budget or following a financial correction) will have an impact on the flat-rate amount of indirect costs, which can be validated by the managing authority;

– Where the flat rate option is chosen, any (unexpected) income generated on the ESF [or ERDF] operation ought to be deducted from total costs declared on this ESF [or ERDF] operation (having calculated indirect costs at flat rate).

I.6. Audit approach

In the case of flat rate for indirect costs, the Member States may wish to submit the description of the system and calculation method to the responsible Directorate General (DG Employment, Social Affairs and Equal Opportunities or DG Regional Policy) for *ex ante* agreement. The DGs will consider the systems submitted with regard to the conditions described in Chapter IV point 2. Once the responsible DG is satisfied with regard to those elements, the Director General will inform the responsible national authority in writing to confirm that the system is accepted. Any subsequent audits carried out by the Commission may verify (1) the basis for the determination of the calculation of the flat rate (verification of the raw data and methodological elements, not previously examined by the Commission), (2) that the agreed system has been correctly applied to operations and (3) the direct costs of the project – or their calculation method – to which the flat rate is applied. The national authorities and the Commission will not check the supporting financial documents for indirect costs.

In cases where a description of a system has not been submitted and agreed by the Commission in advance, audits carried out by the Commission, in line with the general approach described in section IV.3, will cover both the calculation method - to ensure that the conditions "established in advance on the basis of a fair, equitable and verifiable calculation" have been observed - and correct application of the flat rate, which will involve auditing the direct costs of the operation to which the flat rate is applied. Verifications of the calculation method will be carried out at the managing authority or intermediary body level, whilst checking of the application of the flat rate will be at beneficiary level.

It is expected that the national systems should provide a clear and non equivocal definition of direct costs and/or indirect costs or a pre-established list of all eligible direct costs on which the flat rate is based. Auditors will, during audit missions to beneficiaries, verify the correct classification of costs and the absence of double declaration of costs both as direct and as indirect. Only items of expenditure which are declared as directs costs are subject to audit of the supporting financial documents, as the beneficiary is not obliged to report or prove indirect costs reimbursed on the basis of a flat rate.

National Authorities should not allow practices such as the front-loading of the bulk of "indirect costs" in order to avoid for example n+2/n+3 losses, without underlying direct costs having been incurred.

Findings which could be considered as irregularities, for instance, are:

- If the results of the calculation method have not been respected while setting the rates;
- Where a beneficiary has not observed the rates set or has declared ineligible direct costs not included in the categories of eligible direct costs established by the managing authority;
- Double declaration of the same cost item : as “direct” cost (calculated on the basis of the real cost principle) and as “indirect” (included in the flat-rate)
- When the direct costs are reduced without a proportional reduction of the flat rate amount of indirect costs**.**

If auditors detect an irregularity in the direct costs of a project, a pro rata reduction should also be applied to the indirect costs, as otherwise they will exceed the rate set with regard to eligible direct costs.

CHAPTER II
Flat rate costs calculated by application of standard scales of unit costs

II.1. GENERAL PRINCIPLES GOVERNING FLAT-RATE COSTS CALCULATED BY APPLICATION OF STANDARD SCALES OF UNIT COST

In the case of flat rate costs calculated by application of standard scales of unit cost, the operation will receive public grants on the basis of quantified activities, outputs or results multiplied by standard scale-of-unit costs established by the Member States. The option can be used for any type of grant, project or part of project, when it is possible to define quantities related to an activity and standard scale of unit costs. Standard scales of unit costs apply typically to easily identifiable quantities, such as training hours, training days, certificates obtained, training modules finalised, consultant hours worked, hotel nights, or meals.

The standard scale of unit costs can be process-based, that is aiming at covering through a best approximation the real costs for delivering the operation.

Example 3: For an advanced IT training of 1,000 hours provided for 20 trainees, the public grant may be calculated on the basis of a cost per hour of training x number of hours of trainees. The cost per hour has been defined in advance by the managing authority and is set in the grant decision. Assuming for example that the managing authority sets the training cost at € 7 per hour of training per x trainee, the maximum grant allocated to the project would be 1,000 hours x 20 trainees x €7 /hr/ trainee = € 140,000.

At the end of the operation the final grant will be paid on the basis of the real number of hours for each trainee (that could include some justified absences, see key point c in point 3 of this chapter for details), following real participation of the trainees and delivered courses. If finally only 18 people participated in the training, 6 of them 900 hours, 5 of them 950 hours, 5 of them 980 hours and the remaining 2 1,000 hours, the number of total hours x trainees will be equal to: 900x6 + 950x5 + 980x5 + 1,000x2 = 17,050 total hours of training x trainees. The grant paid will be: 17,050 hours of training x €7 = €119,350 .

The payment scheme can also foresee intermediary payments on the basis of declared implemented hours. But in any case the grant is paid on the basis of the physical progress of the operation, without justification of underlying real costs.

Example 3a: The beneficiary, a regional Chamber organises an advisory service for the SMEs of the region. This service is supplied by the advisers of the regional Chamber. Based on past accounts of the "advisory" department of the Chamber, a day of advice is estimated at € 350 / day. The assistance will be calculated on the basis of the following formula: number of days x € 350.

Example 3b: Innovation projects of SMEs

Certain types of projects targeted to SMEs in the field of R&D and innovation often involve personnel costs as a key element. The application of standard scales of unit cost as an option is a welcome simplification for these SMEs. The unit cost for activities is expressed in this case as an hourly rate applied to hours effectively worked by the staff. It is defined in advance in the grant decision that foresees the maximum amount of financial assistance as the maximum worked hours allowed multiplied by the unit cost (the calculated costs of the staff involved).

Aiming at covering through a best approximation the real costs and to take into account distinctions of regions and branches, the cost for a standard unit is defined as an hourly rate according to the following formula:

Hourly rate = gross annual salary (including legal charges) divided by average legal working hours (taking into account annual leave).For example: Hourly rate = € 60,000 / (1980 hours – 190 hours of annual leave) = 60,000/1,790 = 33.52 €/hr

The financial assistance to the operation is calculated as the hourly rate multiplied by the real and verified number of hours worked. This requires SMEs to keep all supporting documents for hours worked by staff on the project. By principle, a reduction in the verified hours worked results in a reduction in the final amount to be paid.

The standard scale of unit cost can be process based, as in the above examples, or outcome based, as described in the following example:

Example 4: a job-search assistance programme lasting 6 months (hereafter "the operation") could be financed on the basis of a standard scale of unit costs (for example €2,000/person) for each of the 20 participants on the operation who gets a job and retains it for a pre-established period, for example six months. Calculation of the maximum grant allocated to the operation: 20 persons x 2,000 €/placement = € 40,000.

The final public grant is paid on the basis of the real output of the operation: if only 17 persons were placed on the labour market and retained their jobs for the requested period, the final grant to be paid to the beneficiary is 17 x € 2,000 = € 34,000.

A managing authority can also foresee different scales of unit costs applicable to different activities (for example, one unit cost for an hour of “theoretical training” per individual, another different unit cost for an hour of “practical training” per trainee, and another for an hour of “follow-up per individual”).

II.2. CONSEQUENCES IN TERMS OF FINANCIAL MANAGEMENT

In addition to advance payments to beneficiaries, the payment scheme of operations can foresee intermediary payments or only final payment, on the basis of real progress of the operation (declared and verified implemented hours x trainees, as in example 3). In any case the final amount of the grant is paid on the basis of the physical completion of the operation, duly certified by the beneficiary and verified by the managing authority/intermediary body, without the need for the beneficiary to justify its underlying real costs. One of the main differences with "real cost" based operations is that there is no reference to individual financial supporting financial documents for expenditure calculated on the basis of standard scale of unit costs. **In fact the application of the standard scale of unit costs gives by principle an approximation of the real costs of the operation.** Contrary to the “lump-sum”, the “standard scale of unit costs” method is not based on an a priori defined total allocation for a given outcome of the operation but the amount finally paid to the beneficiary depends on the achieved quantities outcome.

As a result, when using the standard scales for unit cost the following elements should be taken into account:

1) The basis for calculating the scale of unit costs used in the operation must be fair, equitable and verifiable. Setting up the "Standard scale of unit costs" (for example € 7 per hour of training per trainee or the €2,000 allocation as in examples 3 and 4) should be justified.

2) Given that payments will be calculated on the basis of quantities, declared quantities should be certified by the beneficiary, justified and archived in view of future verifications and audits. Verifications by intermediary bodies, managing authorities or auditors will require supporting documents to justify the quantities declared by the beneficiary– that is, **to show that the activities or the outputs claimed were in fact realised**. In particular, it means that the focus of verifications under Article 13 of Regulation (EC) N°1828/2006 -will move, especially for immaterial operations, from the predominance of financial verifications (justifying real costs but also giving concordant elements demonstrating that the operation took place) towards technical and physical aspects of operations, **with a particular importance to on-the-spot checks.**

Under such conditions the grant **calculated and reimbursed on the basis** of the application of a **standard scale of unit costs is considered to be proved expenditure, just as real costs supported by invoices.**

II.3. KEY POINTS FOR THE MANAGING AUTHORITY

When a managing authority decides to use standard scales of unit costs it will require specific attention to the following points:

<u>(a) For the purposes of Article 7(4)(ii) of Regulation (EC) No 1080/2006 and Article 11(3)(b)(ii) of Regulation (EC) No 1081/2006, *standard scales of unit costs apply only to grants*</u>

(b) <u>Calculation of the standard scales of unit cost</u> must be established in advance on a fair, equitable and verifiable basis (see Chapter IV, point 2).

(c) <u>Correlation between the realised quantities and the payments</u>

By principle, when declared quantities decrease (in comparison with the maximum foreseen), the final payment should decrease, "independently" of the underlying real cost of the operation.

However, the management system should also be able to differentiate cases where the quantitative objectives (whether they are activity based or outcome based) are not met because of external factors out of the beneficiary's control, rather than because of the beneficiary. For example, if the payment is made on the basis of "hours x trainees", the payment should not be reduced because of the justified absence of participants, for instance due to sickness leave. Moreover, the grant decision should clarify the maximum number of authorised absences, the minimum number of training hours to be justified for a trainee to remain eligible on the operation, the type of training scheme (compulsory participation as from the start of the training, replacement of trainees who leave from the training, etc). Such "exceptions" must of course be clearly defined ex ante in the grant decision or in an act with an equivalent legal effect and be set up for all similar operations.

(d) Justification of declared quantities

It should be also underlined that some types of standard scales of unit costs could be more difficult to justify than others. Therefore the choice on the right unit cost to be used will have an important impact in terms of simplification, administrative workload and risk of errors for the managing authority and the beneficiaries.

Considering that the funding in examples 3 & 3a is process-based, the need for accurate timesheets detailing the training activities and certifying the real presence of trainees/trainers will continue to exist.

On the other hand, if, as in example 4, unit prices are set to calculate the grant for the number of people who get a job and retain it for an agreed period, the only supporting evidence required would consist of the justification of the eligibility of the person against predefined eligibility criteria, the proof of the initial employment of the person placed and his/her employment during at least 6 months. These types of scales are clearly "output" oriented and lighter to justify, but cover only one aspect of the operation.

(e) Choice of the standard scales of unit cost

As a general principle, the choice of the standard scale(s) of unit cost should reflect the activity (ies) of the type of operations funded. For example, even if a standard scale such as "people in employment after 3 months" is politically important and is an expected outcome of many operations, it would not be appropriate to pay all the operations according to this criteria if the funded activity (training for example) is not directly linked to job placement, that could be affected by many other external events (financial and economic crisis for example).

A purely "outcome based" system of standard scales of unit cost may prove to be particularly risky. If part of the outcome does not depend on the outputs and quality of the operation, there is a risk to under-pay operations and beneficiaries. It is particularly relevant in the case of operations dedicated to groups "in difficulty": expected results and outcomes are generally low; any granting system based on these results and outcomes would lead the beneficiary to have to chose between the following options: a) refusing to implement the operation with such a granting system; b) implementing the operation while knowing in advance that it will lose money unless it can find additional funding sources (risk of double funding); or c) "creaming" the participants (choosing the most capable of reaching imposed results and outcomes) or lowering the standards to reach the expected results.

A combination of different standard scales of unit (for example combining output and result based standard scale of unit) within the same operation is possible as far as the different scales of units cover different costs.

Finally, the choice of standard scale of unit costs could allow the beneficiary to cover its fixed costs, compared to variable costs linked to the effective participation of trainees or persons. In example 3 above, the beneficiary will bear fixed costs for the training facilities, the trainers etc, independently from the daily and final number of trainees in the training room. The payment of the final balance on the operation with 2 trainees less than foreseen in the grant decision and almost 3,000 hours less than planned could result in a final grant paid-out below the underlying real costs incurred by the beneficiary.

In conclusion the choice of appropriate standard scale(s) of unit costs by the managing authorities will be of the utmost importance and should take into account all potential advantages and disadvantages. An ideal standard scale of unit cost could include the following qualities: clear and direct link with the operation, quantities easy to justify, ensure the economic balance of the operation and of the beneficiary, lower the risk of "creaming" participants and clear distinction between grants and public tendering. In the case of standard scale(s) of unit costs the focus of verifications under Article 13 of Regulation (EC) N°1828/2006 -will move, especially for immaterial operations, from the predominance of financial aspects to technical and physical aspects of operations, **with a particular importance to on-the-spot checks.**

II.4 AUDIT APPROACH

The Commission will not check the supporting financial documents for costs covered by the standard scale of unit costs. Audits will cover the calculation method for arriving at the standard scales of unit costs and the correct application of the method in the individual projects. Verifications of the calculation method will be carried out at the managing authority/intermediary body level, whilst the correct application of the rate will be checked at beneficiary level.

The main focus of the audits will be to verify whether the conditions set in terms of outputs for the reimbursement of costs have been fulfilled. This may be training hours (a predetermined amount paid per training hour executed, in which case the auditor should verify the number of training hours executed), hours worked (a fixed amount paid per hour of work in, for example, research programmes, in which case the auditor should verify how many hours have been worked), subsistence allowances (a fixed amount paid per day, in which case the auditor should verify the actual travel days) or other units set according to the type of projects.

In all cases, the auditor will verify whether the amount declared equals the standard rate per unit of product or service multiplied by the actual units delivered. If other conditions are set in the call for proposals or in the grant decision, the auditors will also verify the fulfilment of those conditions.

The rates according to standard scales of unit costs for certain goods or services may include a component for indirect costs (overheads).

Findings which could be considered as irregularities, for instance, are:

§ Disregard of the results obtained when applying the calculation method set for reimbursement of costs. For instance, if the standard rate that can be charged is €10 per hour of training, a financial correction will be applied where a higher amount is declared per hour;

§ Lack of supporting documents to justify the outputs or outputs only partially justified but paid in totality. For example, if 100 000 hours (x trainees) are charged but, only 85 700 hours are justified with supporting documents, a financial correction will be applied on the difference.

CHAPTER III
Lump sums

III.1. GENERAL PRINCIPLES GOVERNING LUMP SUMS

For small operations and small bodies lump sums could constitute a considerable simplification as Structural Funds financial rules are quite strict. The system of reimbursing real costs has often required small, local beneficiaries to buy in very specialised expertise in this field. In consequence, these beneficiaries tend to be very reluctant to apply for Structural Funds support even if their operations are fully in line with EU strategic priorities.

In the case of lump sums, all eligible costs or part of eligible costs of an operation are reimbursed on the basis of a pre-established lump sum (the setting up of the lump sum should be justified), in accordance with pre-defined terms of agreement on activities and/or outputs. The grant is paid if the pre-defined terms of agreement on activities and/or outputs are completed.

The lump sum possibility is an application of the proportionality principle aiming at alleviating the administrative workload for small operations and at enhancing the access of NGOs (but not exclusively NGOs) to the Structural Funds.

That is the reason why lump sums falling within the scope of Article 7(4)(iii) of Regulation (EC) No 1080/2006 and Article 11(3)(b)(iii) of Regulation (EC) No1081/2006 are restricted to amounts below €50,000. This amount corresponds to the public contribution for the activity supported through the lump sum (excluding private participation if any). Even if several lump sums could be combined to cover different categories of eligible costs or different projects within the same operation (see Chapter IV point 5) the total of the lump sums shall not exceed €50,000 for a given operation.

Example 5: A NGO managing a "crèche" requires support to launch a new activity. It requests a lump sum by submitting a draft detailed budget to start the activity and run it over a period of one year. The activity would be maintained after the initial year independently. For example, the lump sum would cover expenditure related to the salary of one person in charge of looking after the children during one year, depreciation of new equipment, publicity costs linked to this new activity and indirect costs related to it management and accounting costs, water, electricity, heating, rental costs, etc). On the basis of a draft detailed budget and in comparison to similar operations the managing authority grants a lump sum of €47,500 covering all these costs. At the end of the operation, this amount would be paid to the NGO on the basis of the output, if a conventional number of additional (10) children were looked after. It would therefore not be necessary to justify the real costs incurred related to this activity.

The lump sum arrangement could also be used in the case of grants where standard scales of unit costs are not an appropriate solution, such as, the production of a toolkit, organisation of a small local seminar, etc.

Example 6: A Roma NGO requests to organise a local seminar and to produce a tool kit on the socio economic condition of the Roma community in a region of a Member State. The grant decision will contain a draft detailed budget and the objectives of the grant, (1) the organisation of the seminar and (2) the production of a toolkit to sensitise the employers of the region to the specific Roma problems.

Due to the size and objective of the operation (small operation with costs not easily quantifiable via standard scale of unit costs) and the nature of the beneficiary (local NGO) the managing authority decides to use the lump sum arrangement.

In order to calculate the amount of the lump sum, the managing authority will require a draft detailed budget for each of the operations: after negotiation on the draft detailed budget, the lump sum is established to: €45,000 split in two projects €25,000 for the seminar and €20,000 for the toolkit.

If the conditions of the grant are respected (organisation of the seminar, production of the toolkit) €45,000 will be paid at closure. The supporting document required to pay the grant (and then to be archived) will be the proof that the seminar was organised and the final complete toolkit. If only one of the projects (for example the seminar) is realised the grant will be reduced to this part (€25,000), depending on the conditions of the grant (a conditional clause could exist according to the link between the two projects).

Example 7: In order to promote local products, a group of small enterprises wishes to participate in common to a commercial fair. Due to the low cost of the operation, the managing authority decides to use the lump sum for the calculation of the public support. For this, the group of enterprises is invited to propose a budget for the costs of renting, setting up and running the stand. On the basis of this proposal, a lump sum of €20.000 is established. The payment to the beneficiary will be made on the basis of a proof of participation at the fair. The agreed budget of €20,000 should be kept for audits (verification of the ex ante calculation of the lump sum).

III.2. CONSEQUENCES IN TERMS OF FINANCIAL MANAGEMENT

In addition to advance payments to the beneficiaries, the grant decision can foresee intermediary payments and a final payment or only a final payment. In any case the final payment is made on the basis of the completion of the operation only, duly certified by the beneficiary and verified by the managing authority/intermediary body, without the need for the beneficiary to justify underlying real costs. One of the main differences with "real cost" based operations is that there is no reference to individual financial supporting documents for expenditure calculated on the basis of the application of a lump sum. **As for the standard scales of unit costs, the application of the lump sum gives by principle an approximation of the real costs on the operation.**

As a result, when using the lump sums the following elements should be taken into account:

1) The calculation of lump sum must be fair, equitable and verifiable. Setting up the "lump sum" (for example €45,000 as in example 6) should be justified and this justification with all its details for setting the lump sum is part of the audit trail of the operation.

2) Given that payments will be calculated on the realisation of an operation specified in the grant decision, proof(s) of execution of the operation should be certified by the beneficiary, justified and archived in view of future verifications and audits.

Verifications by intermediary bodies, managing authorities or auditors will require supporting documents to demonstrate that **the actions claimed were in fact realised**. As for standard scales of unit costs, the focus of verifications under Article 13 of Regulation (EC) No1828/2006 will move, especially for immaterial operations, from the predominance of financial verifications (justifying real costs but also giving concordant elements demonstrating that the operation took place) towards technical and physical aspects of operations. Particular importance should be given to on-the-spot checks.

As for standard scale unit costs method, under such conditions, the expenditure **calculated and reimbursed on the basis** of a **lump sum is considered to be proved expenditure just as real costs supported by invoices.**

III.3 KEY POINTS FOR THE MANAGING AUTHORITY

When the managing authority decides to use lump sums it will pay a specific attention to the following points:

(a) For the purposes of Article 7(4)(iii) of Regulation (EC) No1080/2006 and Article 11(3)(b)(iii) of Regulation (EC) No1081/2006, lump-sums apply only to grants.

(b) Calculation of the lump sum that must be established in advance on a fair, equitable and verifiable basis (see Chapter IV, point 2).

(c) Correlation between the realised operation and the payments

The main difference between the lump sums and the standard scales of unit cost system is that the payment of the beneficiary is not proportional to quantities. In the case of standard scales of unit cost, when quantities decrease the grant decreases proportionally. In the case of lump sums, this "proportional link" between quantities and payments does not apply. The calculation of the grant will be much more “binary”. In example 6 for instance, if the seminar is organised €25,000 of grant will be paid, if it is not organised, nothing will be paid.

Such an approach has an important consequence: even if it is not compulsory the possibility to have several levels of final payments should be envisaged in order to escape from a "too binary" approach: in the case of the organisation of a seminar for example, two stages could be introduced, a first one for the conceptual stage (programme to be defined, circulation of the invitations, …), a second one for the realisation of the seminar itself (room costs, meals, …).

For small operations where some quantities could be defined the authorities should choose between lump sums or standard scales of unit costs. For example in a “simplistic” example 5 on the crèche, the grant would be paid on the basis that the job in the crèche was created and maintained during 12 months. A binary approach could lead to pay €0 if the job was created and maintained for only 10 months. One alternative solution could be to use a standard scale of unit cost, based on the monthly costs that would be much more favourable than lump sums in such a case. Another solution with lump sums would be to pay if the job was created and maintained for 12 months within a period of 15 months.

(d) Justification of the final amount of the lump sum

The grant decision with the beneficiary should be drafted very carefully in order to define on which basis payments will be made and how they will be reduced in case the objectives are not reached. This issue of reduction of the grant is crucial in the case of lump sums because of the potential problems that could be created by a binary approach where there are no other choices than paying 0% or 100% of the grant. (see point c).

Specific attention should be given to the possibility to apply in practice the payment of the lump sum grant. Given that some lump sums could be totally independent from quantities, there is a risk of too general or too qualitative wordings about activities /outputs/outcomes to be implemented or reached to trigger the payment, that could lead to the impossibility to pay a grant on transparent and fair bases. Directly linked to the problem of wording of activities / outputs / outcomes is the question of supporting documents necessary to assess them: they should also be specified in the grant decision. In the case of immaterial operations this point is of the uttermost importance in order to give guarantees that the operation was really organised.

For example, if the payment of the lump sum grant is triggered by the organisation of a seminar, it should be specified by the managing authority in the grant decision what types of supporting documents should be produced in order to justify the organisation of the seminar: attendance lists, acts of the seminar, pictures of the seminar, press articles, etc.

(e) Choice of the lump sum

The choice of activities / outputs / outcomes covered by a lump sum follows the same principles as standard scales of unit cost:

- It should reflect the type of operations funded, trying to mitigate external factors that could affect the implementation of the operation;

- Purely "outcome" based lump sums are risky and should not add to the risk of a "too binary" approach.

In conclusion the choice of appropriate lump sum(s) by the managing authorities should take into account all potential advantages and disadvantages, including the question to use lump sums rather than standard scale of unit costs, real costs or flat rate for indirect costs. An ideal lump sum could include the following qualities: clear link with the operation, easy and univocal way to justify the activities / outputs / outcomes, ensure the economic balance of the operation and of the beneficiary (especially by introducing several levels of payments), lower the risk of "creaming" participants, clear distinction between grants and public tendering.

Communicating to the beneficiaries in the grant decision the exact requirements to substantiate the specific outputs or outcomes to be reached will be of the utmost importance. For example, if **only part of** the outputs or outcomes specified in the grant decision are reached, then no payment will be issued.

III.4 AUDIT APPROACH

The Commission will not check supporting financial documents for costs covered by the lump sum. Audits will cover both the calculation method for arriving at the lump sums for particular outputs and its correct application in the individual project. Verifications of the calculation method will be carried out at managing authority/intermediary body level, whilst the correct application of the lump sum will be checked at beneficiary level.

As in the case of standard scales of unit costs, the main focus of the audit will be the verification of the output required for the reimbursement of the lump sum. For example, if the payment of a lump sum concerns the conclusion of a training programme within a specific timeframe, the audit should verify whether indeed the programme has been concluded within the required period, whether it has been carried out in accordance with the conditions set out in the grant decision, etc.

As in the case of standard scales, lump sums may include a component for indirect costs.

It is generally expected that payments of lumps sums are linked to the completion of the project. Auditors should not accept lump sums that have been paid and declared to the Commission in advance and in full, without prior implementation of the corresponding part of the project.

Usually, the payment of lump sums will be linked to the delivery of certain product or service. Contrary to standard scales of unit costs, the payment of the beneficiary is not proportional to delivered quantities (units). For lump sums delivery of a product or service leads to a 100% payment, whilst non-delivery or delivery of part of the service or product leads to a non-payment of the grant (except if intermediary steps are clearly specified in the grant decision, with payments related to these intermediary steps). The auditors will verify whether provisions of the grant decision have been correctly applied and the sums paid and certified reflect the payment foreseen in the grant decision. A finding which could be considered as an irregularity is that the beneficiary did not deliver in full services or products provided for in the grant decision. In such cases, a full correction of the lump sum paid and declared is applied.

CHAPTER IV
Common horizontal provisions

IV.1. CALCULATION OF FLAT RATE FOR INDIRECT COSTS, STANDARD SCALES OF UNIT COSTS AND LUMP SUMS

Article 11(3)(b) of Regulation (EC) 1081/2006 and Article 7(4) of Regulation (EC) No 1080/2006 set out four conditions to be met by the methods to establish flat rate for indirect costs, lump sums and standard scales of unit costs, rather than setting out a method to calculate them: the calculations must be done in advance, and must be fair, equitable and verifiable. These conditions allow the management of grants to be simplified, while maintaining an effective control of expenditure. Indeed, while with the real cost system the control of both the value and the quantity of project inputs is done ex-post, with the proposed provisions on standard scales of unit cost and lump sums**, the control of the value of the input is done ex-ante and only the control of the quantity is done ex-post**.

IV.2. CONDITIONS TO BE MET FOR SIMPLIFIED COSTS

*IV.2.1 It must be **established in advance:***

It is important to communicate to the beneficiaries in the grant decision the exact requirements to substantiate the declared expenditure and the specific output or outcome to be reached.

Therefore, simplified cost options have to be defined ex ante and must be included for example in the call for proposals or at the latest in the grant decision. The relevant rules and conditions should be incorporated in the national eligibility rules applicable to the operational programme[13]. It also means that once the standard scale of unit, the rate or the amount (in the case of lump sums) are established, it cannot be changed during or after the implementation of an operation to compensate for an increase in costs or underutilisation of the available budget.

The scope of the simplified cost options to be applied, i.e. the category of projects, activities of beneficiaries for which they will be available, should be clearly specified.

Member States should try to strike a balance between a wider scope of application, ensuring conformity with the conditions "fair and equitable", and a narrower scope, which risks over-differentiation of rates and might defeat the objective of simplification.

*IV.2.2 It must be **fair**:*

The calculation has to be reasonable, ie based on reality, not excessive or extreme. If a given standard scale of unit cost has in the past worked out at between 1€ and 2€ the Commission services would not expect to see a scale for 7€. From this point of view the method used for identifying the unit cost or the flat rate or the lump sum will be of the utmost importance. The Managing Authority must be able to explain and to justify its choices. An "ideal" fair calculation method could adapt the rates to specific conditions or needs. For example, the execution of a

[13] Either at national or regional level or specific to the particular programme.

project may cost more in a remote region than in a central region because of higher transport costs; this element should be taken into account when deciding on a lump sum or rate to be paid for similar projects in the two regions. In any event, simplified costs should not be misused (eg the flat-rate rule should not lead to inflation of costs of the operation and operations should not be split in order to permit the systematic use of lump-sums).

The objective of the audit work will be to examine the basis used for establishing the rates and whether the rates finally set are indeed in line with this basis.

*IV.2.3 It must be **equitable**:*

The main notion underlying the term "equitable" is that it does not favour some beneficiaries or operations over others. The calculation of the standard scale of unit cost, lump sum or flat rate has to ensure an equal treatment of beneficiaries and/or operations.

Examples would be differences in rates or amounts that are not justified by objective features of the beneficiaries or operations, or by express policy objectives.

Auditors will not accept calculation methods which unjustifiably discriminate against particular groups of beneficiaries or types of operations.

*IV.2.4 It must be **verifiable***

The determination of flat rates, standard scales of unit costs or lump sums should be based on documentary evidence, which can be verified. The managing authority has to be able to demonstrate the basis on which it has been drawn up. It is a key issue to ensure compliance with the principle of sound financial management. This verification will be part of the audit trail. It will not be accepted to define "ex nihilo" standard scales of unit costs, flat rate or lump sums.

In setting the standard scales of unit costs, the lump sums or the flat rates for indirect costs the managing authority should take a documented decision (rather than an informal acceptance), and this reasoned decision should set out the basis applied. In fact, the experience gained on the "flat rate rule for indirect costs" demonstrates that many methods can be used to establish lump sums and standard scale of unit costs in advance, the most common amongst them being the analysis of historical data (survey, statistical analysis, etc).

However, other methods basing the calculation on an analysis of current real costs structure linked to the scale of unit cost, such as daily allowances, training scholarships, market prices, similar scales used by public authorities could also be used as far as they comply with the conditions set out in Article 11(3)(b) of Regulation (EC) 1081/2006 and Article 7(4) of Regulation (EC) No 1080/2006 and apply for similar cases.

Even if this creates additional administrative workload for their determination, it is also possible to calculate unit costs or lump sums on the analysis of a draft detailed budget proposed by the candidate beneficiary, compared with the expected outputs and with comparable operations.

It could also be envisaged that Member States work by call for proposals: a Member State would publish in advance the basis on which it is going to calculate lump sum grants and that this is, again, *fair, equitable and verifiable.* This means that applicants should know the criteria on which the grant will be based, and that these criteria should be standard and apply to all applicants for the same types of projects. For example, in the case of a call for proposals, the managing authority should be able to answer such questions as: “Is the call for proposals complete in the details needed? Are the elements needed to determine the lump sum well specified and explained in advance? Does the managing authority check that the costs included in the draft detailed budget submitted, for example, are reasonable and acceptable in view of determining the lump sum in the grant decision?". Another solution could be that the Member State defines a lump sum for a specific activity and calls for proposals on the basis of this amount, funding the best proposals.

IV.2.5 Audit trail

While auditing the calculation method, the Commission will focus on verifying the respect of the abovementioned conditions and will not question the reasons for selecting a specific method over another. The responsible authorities should keep adequate records of the calculation method and should be able to demonstrate the basis on which the flat rates, standard scales of unit costs or lump sums have been decided. The records kept for documenting the calculation method will be subject to the requirements of Article 90 of Regulation (EC) N° 1083/2006.

IV.2.6 Adaptation of flat rate for indirect costs, lump sums and standard scales of unit costs

Article 11(3)(b) of Regulation (EC) 1081/2006 and Article 7(4) of Regulation (EC) No 1080/2006 do not specify any provision on the adaptation of flat rate for indirect costs, lump sums and standard scales of unit costs. Therefore adaptation is not compulsory. However, the managing authority may consider necessary to adapt the rates when launching a new call for proposal or it may do so periodically in order to take account of indexation or economic changes e.g. in energetic costs, levels of salaries, etc. The rates may be linked to an appropriate index or reviewed periodically[14].

Adapted rates should apply only to projects to be implemented in the future, not retrospectively (see Chapter IV point 3).

For any revision which is undertaken, there should be adequate supporting documentation to justify the adapted rates or amounts.

IV.3 GENERAL AUDIT APPROACH

The application of the simplified cost options signifies a departure from the approach of tracing every euro of co-financed expenditure to individual supporting documents. Therefore, in cases where these options are used, for the purposes of determining the legality and regularity of expenditure, the auditors will not audit the real costs underlying the flat rate for indirect costs, standard scales of unit costs or lump sums. Where the simplified cost options are applied, the Commission and national audit authorities will continue to verify the costs of co-financed operations and perform legality and regularity audits. Nonetheless, these audits will be carried out in a different manner, on the basis of the calculation method used to set the flat rates and lump sums and not on the basis of supporting financial documents per project.

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[14] The review may also be based on the "success" of the rate. For example, if there is insufficient or no interest in training long-term unemployed persons for a given rate, that may mean that the rate is incorrectly set (bad balance between payments for process and payment for success factors).

It is crucial to underline that, provided that the Member State has put in place a well established methodology respecting the principles of sound financial management and there are no indications of fraud or abuse, the Commission will not call into question the national system.

The audit methodology that will be applied in cases where flat rates for indirect costs, standard scales for unit costs and lump sums are used will consist of the following verifications:

1. Verification of the calculation method for establishing the flat rates, standard scales of unit costs or lump sums, which should be established in advance and be fair, equitable and verifiable;
2. Verification of the correct application of the established method through examination of outputs/outcomes of the project ;
3. Verification on the basis of the "real cost" principle of the direct costs (or of their calculation in case of use of other simplified cost options to calculate them) in the case of flat rates for indirect costs.

It is important to note that the simplified cost options aim at reducing the burden of keeping detailed supporting financial documents. This does not waive the obligation to fully observe all applicable Community and national rules, such as publicity, public procurement, equal opportunities, sustainable environment, state aids, etc.

IV.4. Retrospective entry into force of the standard scales of unit costs and lump sums

The provisions on standard scales of unit costs and lump sums (and for indirect costs on a flat rate basis for ERDF) apply with effect from 1 August 2006.

This possibility of retroactive applicability was created in order to ensure legal certainty in relation to the eligibility of expenditure for some operations that already used some particular cases of standard scales of unit costs under national schemes.

Given that the flat rate, lump sums and the standard scales of unit costs have to be defined in advance, a retroactive application for operations that are already being implemented on the basis of real costs, in principle, could be problematic. In fact, such a retroactive application would mean in general a modification of all the legal acts and the opening of the possibility to all the operations in order to ensure equal treatment. This would imply an important workload for the national authorities and the beneficiaries, with potential inconsistencies between real costs and the simplified cost options.

In any case, if a managing authority intended to apply retroactively the simplified cost options, this should not be done at the closure of the operation. That is the reason why as a general principle the Commission strongly recommends to avoid retrospective use of the simplified cost options. However, in the case of multiannual operations it is possible to settle the accounts and the corresponding activities of the operation after a first part of the operation has been carried out and then to introduce the option of standard scales of unit costs or lump sums for the remaining part/period of the operation. In such cases, the period for which real costs are declared should be clearly separated from the period for which costs are declared on the basis of the simplified cost options, in order to avoid project costs being declared under both systems and double declaration.

IV.5. COMBINATION OF OPTIONS

Article 11(3)(b) of Regulation (EC) 1081/2006 and Article 7(4) of Regulation (EC) No 1080/2006 create the possibility for the managing authority to choose between four options to manage grants co-financed by an ERDF or ESF programme:

(a) real costs, including both direct and indirect costs,
(b) indirect costs calculated on a flat rate basis of direct costs
(c) flat rate costs calculated using standard scales of unit costs,
(d) lump sums.

The options may be combined only in the following cases, in order to prevent any double financing of the same expenditure:

(1) they must each cover different categories of eligible costs,

or (2) they must be used for different projects in the same operation (by definition, an operation is a project or group of projects).

Case 1: Different categories of eligible costs

Example of a training session combining:
- a standard scale of unit cost for the wages of the trainers, for example € 450 / day ;
- real costs: room rented = €800 / month during 6 months
- a flat rate for the indirect costs, for example 10% of direct costs.

At the end of the training if 100 days of trainers were justified, the grant will be paid on the following basis:

Direct costs:

wages of the trainers 100 days x €450 = €45,000
training room: 6 months x €800= €4,800

subtotal direct costs : €49,800

Indirect costs: 10% of direct costs = 10% x €49,800 = € 4,980

Grant to be paid: [€45,000 + €4,800] + € 4,980 **= €54,780**

In that case different categories of costs seem to be concerned: wages of trainers, rent costs for the room, indirect costs. However, in order to verify the absence of double financing the authorities must ensure that the standard scale of unit cost does not relate to any costs linked to the renting of the room or to other indirect costs (salary of administrative staff or of the accountant for example). Reciprocally the same applies for the definition of indirect costs that should not relate to costs covered by the standard scale of unit costs or real costs of renting the room.

If there were risks of overlaps the managing authority would have to choose the more appropriate option to grant the operation in order to suppress any (risk of) double financing.

Given that the standard scales of unit costs or the flat rate for indirect costs shall be verifiable, it will be possible at any time to check the absence of double financing. However, this check should already be done ex ante by the managing authority, at the moment the option of management is chosen.

<u>Case 2</u>: Funding of different projects in the same operation

Example of an operation in two steps, combining a training project for young unemployed people, followed by a seminar for potential employers of the region:
The costs related to the training could be paid on the basis of standard scales of unit costs (for example 1 000 € / day of training). The seminar would be paid on the basis of lump sums.

Given that they are two different projects within the same operation, there is no risk of double financing as far as each project costs are clearly separated.

From an audit point of view, in case of combination of options, in addition to the checks required for the individual types of "simplified costs" described in the previous chapters, the audit should verify that parts of an operation have not been charged using more than one type of options, thus leading to a double declaration of costs.

IV.6. IMPACT OF SIMPLIFIED COST OPTIONS ON THE CERTIFICATION OF EXPENDITURE

The simplified cost options modify the concept of expenditure "paid" by beneficiaries that have to be certified in the statement of expenditure. Member States have still the possibility to make advance payment to the beneficiaries in addition to interim payments or final payment but the definition of what is considered as an advance payment will be different. In the case of flat rate for indirect costs, indirect costs are considered as "paid" in due proportion of direct costs: if 50% of the direct costs are paid by the beneficiary, 50% of the indirect costs (in any event, not exceeding the 20% of the direct costs) may be considered as paid. Reciprocally, where the bulk of "indirect costs" have been front-loaded, without underlying direct costs having been incurred, they should be considered ineligible to be certified to the Commission at the time of the declaration of related expenditure because they would be considered as an advance payment to the beneficiary.

In the cases of standard scale of unit costs and lump sums there is also no “paid expenditure” in the usual sense. "Paid expenditure" will be calculated on the basis of declared and certified quantities and not on payments made to the beneficiaries. Even if they could coincide, expenditure to be certified to the Commission is calculated on the basis of certified quantities, not payments made to the beneficiary. For example, payments to the beneficiaries could be done on a monthly basis (1/10 of the grant each month during 9 months + final payment) without any justification of quantities, except for the final payment. Such a system should be deemed acceptable but, the monthly payments are considered as advances and must not be certified to the Commission (except in the case of State Aids under the conditions of Article 78(2) of Regulation (EC) No1083/2006). National authorities would have to wait for the final payment, where quantities are certified and verified, in order to declare expenditure from the operation.

IV.7. DECLARING THE ACTIONS FALLING UNDER ARTICLE 34(2) OF REGULATION (EC) NO1083/2006 IN RELATION TO THE SIMPLIFIED COST OPTIONS

Pursuant to Article 11(4) of Regulation (EC) 1081/2006 and Article 7(3) of Regulation (EC) 1080/2006 "cross financed" actions will apply the eligibility rules of the other Fund: given that ERDF and ESF have now the same eligibility rules as far as simplified costs are concerned, it is now possible to apply simplified cost options to cross financed actions.

Specifically for flat rate rule for indirect costs in case of cross-financing, two flat rates should apply related to each "ESF" and "ERDF" part of the operation. The ESF and the ERDF flat rates for similar operations will be applied respectively to the ESF and the ERDF parts. Using an average of the two rates is impossible because the relative share of each part could vary during the implementation. Where no rate exists for the other Fund for a similar type of operations (for example because the rule is not applied for the other Fund or because there are no similar operations funded by the other Fund), the managing authority has to decide on the applicable rate according to the general legal principles (fair, equitable, verifiable).

The application of the simplified cost options still requires that Member States respect the 10% ceiling by priority axis. The "cross financed" amount should be assessed, operation by operation, on the basis of the data used to define the simplified cost options.

If the standard scale of €6 / hour x trainee includes purchase of equipment for € 0.50 / hour, the cross financed amount will be € 0.50 x number of "hours x trainee" realised. The same principle applies for lump sums: if the draft detailed budget includes some "cross financed expenditure" they will be accounted and monitored separately. For example within a € 20,000 lump sum funded by an ESF OP, ERDF type of expenditure represents € 5,000. At the end of the operation the cross financed amount will be the amount defined ex ante (€ 20,000 out of which €5,000 of ERDF type of expenditure) or "zero" if the grant is not paid. The binary principle of lump sums will also apply to cross financed expenditure.

In the case of flat rate for indirect costs, the cross financed amount will be the amount of "cross financed direct costs" , added to indirect costs calculated by the flat rate applicable to these "cross financed direct costs". For example, within a € 15,000 operation funded by an ERDF OP, the "ESF type" direct costs represent €3,000 and indirect costs are calculated as 10% of direct costs (€ 300). The cross financed amount would be €3,300[15]. If at the end of the operation the direct costs are reduced, the cross financed amount would be reduced according to the same formula.

IV.8. COMPATIBILITY OF SIMPLIFIED COST OPTIONS WITH STATE AID RULES

Simplified costs options set out in Article 7(4) of Regulation (EC) No 1080/2006 as amended by Regulation (EC) No 397/2009 and Article 11(3)(b) of Regulation (EC) No 1081/2006 as amended by Regulation (EC) No 396/2009 should apply without prejudice of the State aid rules such as, in particular, those applying to schemes exempted from the notification requirement (e.g. aid granted under the General Block exemption Regulation (EC) No 800/2008). Equally, the provisions of Regulation (EC) No 1998/2006 on the "de minimis" aid have to be taken into account.

Before deciding on the application of simplified costs for projects to be implemented through State aid schemes, managing authorities should ensure the eligibility of expenditure to which simplified costs apply and the compliance to the aid ceilings and assess whether the simplified costs are appropriate for a given scheme.

[15] The "ERDF type" direct costs would represent €9,750 and with a flat rate of 20%, flat rated indirect costs for this part would be €1,950.

Annex: Relevant legal provisions

Article 11.3 (b) of Regulation (EC) No 1081/2006 as amended **by Regulation (EC) No 396/2009**

3. The following costs shall be expenditure eligible for a contribution from the ESF as defined in paragraph 1 provided that they are incurred in accordance with national rules, including accountancy rules, and under the specific conditions provided for below:

…

(b) in the case of grants:

> *(i) indirect costs, declared on a flat-rate basis, of up to 20 % of the direct costs of an operation;*
>
> *(ii) flat-rate costs calculated by application of standard scales of unit cost as defined by the Member State;*
>
> *(iii) lump sums to cover all or part of the costs of an operation.*
>
> *The options referred to in points (i), (ii) and (iii) of point (b) may be combined only where each of them covers a different category of eligible costs or where they are used for different projects within the same operation.*
>
> *Costs referred to in points (i), (ii) and (iii) of point (b) of the first subparagraph shall be established in advance on the basis of a fair, equitable and verifiable calculation.*
>
> *The lump sum referred to in point (iii) of point (b) shall not exceed EUR 50 000.*

Article 7(4) of Regulation (EC) No 1080/2006 as amended **by Regulation (EC) No 397/2009**

4. In the case of grants the following costs shall be expenditure eligible for a contribution from the ERDF, provided that they are incurred in accordance with national rules, including accountancy rules, and under the specific conditions provided for below:

(i) indirect costs, declared on a flat-rate basis, of up to 20 % of the direct costs of an operation;

(ii) flat-rate costs calculated by application of standard scales of unit cost as defined by the Member State;

(iii) lump sums to cover all or part of the costs of an operation.

The options referred to in points (i), (ii) and (iii) may be combined only where each of them covers a different category of eligible costs or where they are used for different projects within the same operation. The costs referred to in points (i), (ii) and (iii) shall be established in advance on the basis of a fair, equitable and verifiable calculation. The lump sum referred to in point (iii) shall not exceed EUR 50 000.".