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Hearing on the Financial Regulation at the European Parliament

"Cutting red tape: Has the last reform had effects in diminishing the administrative burden on NGOs working in development policy?"

1st June 2010

**CONCORD Funding for Development & Relief (FDR) working group
Izabella Toth, CORDAID**

CONCORD'S RECOMMENDATIONS:

- Revise the Financial Regulation and its Implementing rules to ensure a proportionate control of grant beneficiaries;
- Ensure the eligibility of VAT when it can not be re-claimed regardless of the concerned instruments;
- Authorise the use of actual exchange rates.
- Develop per DG a common manual for all users of the practical guide, both for EC Delegations and grant beneficiaries;
- Establish an independent arbitration mechanism in case of disagreements that can not be solved at Brussels and / or at Delegations level;
- Increase regular training provided on the practical guide and its annexes at delegation level and for grant beneficiaries.
- Be aware of the need for a stable legal framework for budget implementation at the level of the Unions Delegations, following the installation of the European External Action Service.

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My name is Izabella Toth, I am working for the Dutch Catholic Organisation for Relief and Development Aid CORDAID and today I will speak on behalf of CONCORD, the European confederation of development NGOs. CONCORD represents 24 national associations and 18 international networks, representing over 1600 NGOs throughout the European Union. CONCORD leads reflection and political actions and it regularly engages in dialogue with the European institutions and other civil society organizations.

The total turnover of funding within the CONCORD constituency amounts to approximately 7 billion of euros per year and there are around 25 million European private donors supporting the work of these members¹. Within CONCORD, we have set up different working groups; one of them is the Funding for Development & Relief (FDR) which I lead. Within the FDR we have set up a specific team dealing specifically with Financial Regulation and EuropeAid's Practical Guide and its annexes, including the grant standard contract.

CONCORD welcomes the opportunity to contribute today to the topic of whether ***the last reform had effects in diminishing the administrative burden on NGOs working in development policy***. This is based on the contribution that was elaborated following a large consultation in the fall of 2009 of CONCORD's constituency, particularly with those members active in the CONCORD Funding for Development and Relief (FDR) Working Group. I will start with a few preliminary remarks on the principles of the Financial Regulation and how these need to be taken into account in effective implementation of development policy. I will then address on the one hand improvements and problems that are actually linked to the Financial Regulation itself, and finally will touch upon some aspects of the varied interpretations of the EuropeAid Practical Guide and its annexes by the different stakeholders.

1. The Financial Regulation and effective development policy

First of all it should be stressed that NGOs appreciate the need for a comprehensive Financial Regulation that ensures financial accountability and best practice. We seek to deliver good quality programmes that respect financial regulations and are accountable to European tax payers, as well as the beneficiary communities we serve.

However, NGOs still identify administrative burden as one of the key barriers to accessing EC development aid. We are well aware that the control environment has been reinforced throughout the years following the fall of the Santer Commission, but a better balance should be sought between operationality and accountability. Furthermore, a review of the financial regulation should not (and does not need to) increase the administrative burden on NGOs, nor does increased administrative burden necessarily lead to increased efficiency, impact or financial rigour. Too much control may even have adverse effects in discouraging smaller, less experienced or established NGOs to apply for EC funding, hence discouraging creativity and innovation within the NGO sector.

Any review and possible changes of the Financial Regulation should be evaluated against the principles of: **economy, efficiency and effectiveness**. We also affirm that **all** the principles are **equally** important and require equal weight. CONCORD together with other NGO platforms produced in 2005 a deep analysis of the 2003 Financial Regulation, which still remains valid today on some issues and which was pointing out in particular the need to ensure a balance between

¹ Source: 2005 CONCORD survey "Insights into the objectives, structures, funding and capacities of CONCORD's wide membership

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these 3 principles of economy, efficiency and effectiveness (this is the report entitled "Striking a Balance - Efficiency, Effectiveness and Accountability – The impact of the EU Financial Regulation on the relationship between the European Commission and NGOs"²).

In addition, following the adoption of the Lisbon Treaty, we acknowledge that the present revision of the Financial Regulation has to be specially adapted to a legal framework for budget implementation that is stable and in line with the new Treaty, and the correct mandate of the European External Action Service (EEAS). In this sense, CONCORD agrees with and supports the European Court of Auditors' observations³ concerning the importance "to preserve and enhance accountability, responsibility, and quality of financial management at Delegation level. The future organizational structures of the Union Delegations should not put at risk the effectiveness of their operational and financial functions and their segregation of duties."

2. Remarks on the Financial Regulation and its implementing rules

Regarding GRANTS:

2.1 Information about grant opportunities

CONCORD Members recommend that the EC introduces one single central system which contains consolidated information from all DGs and financial instruments on the following:

- Annual work programs of instruments
- Calls for proposals and grant contracts
- Statistics of recipients of grants and grants awarded.

Specifically:

- **The general appreciation is that the current system for publishing calls for proposals works well.** EuropeAid online announcement system is perceived as a fairly easy tool that does however require a good understanding of EC systems, which all organisations might not necessarily have.
- CONCORD welcomes the improvements that have been made in the last months of 2009 with the online publication of annual action plans and annual work programmes for thematic and geographic programmes as well as the publication of a calendar of upcoming global centralized calls in October 2009. However, as mentioned in CONCORD desk study on calls for proposals published under the Non State Actor and Local Authorities Thematic Programme ("Monitoring the NSA&LA thematic program for calls for proposals under the Annual Action Plan 2008", dated July 2009), discrepancies when calls are published at EC Delegation level continue to be observed.
- **The need for an accurate calendar of upcoming calls**, which would encompass both **general calls managed from Brussels** and those **directly launched by each EC Delegations** is very strongly felt. EuropeAid should develop a systematic, accessible and reliable publication of complete forecasts, indicating well in advance (6-12 months) what will be coming up, for all Instruments and Programmes (both geographic and thematic priorities).
- **Information on the specific priorities of local in-country calls** should be published in advance. The centralised and early **publication of draft annual action plans and annual work plan** for thematic and geographic programmes on EuropeAid website would enable an equitable access to information for all potential applicants.

² Report by F.M. Partners Limited on behalf of Open Society Institute Brussels, CONCORD, the platform of European Social NGOs, SOLIDAR and the European Women's lobby, April 2005.

³ European Court of Auditors' Opinion No4/2010, pursuant to Article 322, TFEU.

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2.2 Co-financing and contributions in kind (Art. 109 FR and Art. 172 IR)

CONCORD members strongly support **the need for more flexibility in co-financing requirements**. More flexibility is essential if the European Commission wants to support all types of Non State Actors, including organizations in developing countries, and also European organisations, in particular those from the new Member States, which may have less capacity in terms of fundraising.

The current rules, that allow for the Co-Financing requirement to be satisfied over the implementation period of a project, and that do not require the EC Co-Financing share to be earmarked to specific budget headings, should remain.

2.3 Performance-based grants (Art. 108a FR and Art. 180a & 181 IR)

On Lump Sums: CONCORD members **do not support** the introduction of lump sum charging in the direct costs of an action. We recommend that the EC maintains the current system of reporting against actual incurred costs. While the use of lump sums seems to simplify grant management in general, it also comes with the major drawback that it does not allow full recovery of costs. As it stands, most NGOs have standard allocation policies which ensure that all costs are fully recovered but also that all donors contribute a fair share of these costs according to the financial contribution. The use of lump sums would distort this.

Payments for outputs

Cost coverage, based on the expected outputs, is not a realistic option for grants. It exposes the grant beneficiaries to major disallowances if the objectives are not achieved, which is sometimes subjective and open to interpretation, and often hard to measure in "softer" development projects. It implicitly bares the risk of NGOs redrawing from working in the most difficult places.

Related Recommendations

The key issue is to find a system that allows simplicity in budget management (which is the main advantage of a lump sum system), while assuring that all costs of the NGO's are covered and that the donor is not paying for costs that do not exist. We believe a system that allows for real cost charging, but reduces the administrative burden in reporting those costs, would be the most progressive policy change.

The main challenge experienced during grant management is not the calculation and justification of actual costs itself, but rather all the administrative burden requested in particular with intermediate and final reports (reporting by currency, reporting by units and unit costs, provision of a list of expenses that is in practice only a copy of the booking accounts of the organization, but that needs to be classified according to the budget headings of the EuropeAid budget template, etc.).

So rather than performance-based arrangements, simplification and reduction of the administrative burden, in particular for financial reporting (while keeping the audit requirements) would ease the process of managing grants.

On the **Non profit rule** (Art. 109 FR and Art. 165 IR)

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As there is already flexibility provided for in the interpretation of this rule within the Practical Guide to contract procedures for EC external actions, CONCORD wishes to maintain this flexibility and ensure that it is applied in a more widespread manner. CONCORD would therefore propose that the Financial Regulation makes a more specific reference to this exception in the text, and that this exemption should be more systematically applied during its interpretation by the services and Authorizing officers.

Ceilings for small grants

CONCORD believes the thresholds for low and very low value grants are appropriately set. This being said, in any case and whatever the value of the grants may be, fair competition and equal treatment among grant beneficiaries should remain key principles.

'Cascading' grants involving third parties

In line with the general trend in the development community towards partner ownership and implementation responsibility, it would be justified **to loosen the restrictions on grants to third party local partners, e.g., by defining a maximum percentage share according to the total volume of the project.** Currently these organizations often do not qualify as official partners or applicants, while implementation through them is highly relevant. The current levels of sub-granting available allow only for minimal inclusion and do not allow these organizations to be transferred sufficient levels of responsibility, necessary for their organizational development.

3. THE COMMISSION'S HANDLING OF FINANCIAL FILES

Pre-financing payments to beneficiaries (Art. 5a FR)

The Concord constituency is of the opinion that the interest received on pre financing should be used for project activities and/or for creative additional ideas related to the Action and be verifiably reported as such.

It should be noted that grant beneficiaries also endorse a share of pre-financing, since the EC pre financing is limited to 90% of the total grant in the case of EuropeAid and to 80% of the total grant in the case of DG ECHO.

Pre-financing guarantees (Art. 152 IR)

The Concord constituency would like to propose the use of one of the following two suggestions:

1. Derogation should be granted on the basis of a risk assessment of the applying organization.
2. Create a collective fund as done by DG Research whereby a revolving fund is created by retaining e.g. 5% of each project for the duration of that project to cover an eventual risk of a beneficiary going bankrupt or not respecting contractual obligations.

Tendering thresholds for low value contracts (Art. 129 IR)

CONCORD believes that current thresholds are adequate and reasonable. In the case of framework contracts that some organizations have with car manufacturers, computer manufactures, travel agencies or pharmaceutical companies, etc. should give the possibility to award contract based on a single offer for that particular case.

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Paperwork for applicants (notably Art. 143 IR, Art. 172c IR and Art. 138a IR)

We believe that this issue is more related to the way EuropeAid application procedures and less to the Financial Regulation as such. At the same time we believe that the observations are important.

The application procedure has generally speaking improved dramatically over the last few years with the introduction of concept notes and PADOR registration.

- **The two-step procedure, first the concept note and then the full proposal, is an improvement and should be systematically used.** However, experience shows that many EC Delegations as well as some centralised / global calls ask for concept note and full proposal at the same time, which creates additional workload compared to the previous one-stage procedure. **CONCORD reiterates once more its request to the EC to apply the restricted procedures as a general rule.** In addition if an open procedure does take place, EuropeAid should limit its requirements to the full application and adapt the underlying evaluation procedure to assess solely the full application.

In any case, the concept of the two stage approach should not be questioned, as the advantages it provides outweigh the longer delays above-mentioned.

- Another remaining bottleneck related to the application process is **the short time allowed for preparing full proposals after acceptance of concept notes.**

- Regarding **PADOR**, while we can consider it as a step in the right direction, it is also important to underline that it has been very difficult to use as an e-tool and could be further streamlined and secured against technical difficulties.

- The submission of project proposals via e-mail as carried out during the recent Food Facility Call is also a welcomed innovation as it reduces time and costs and should be used more widely. In that respect, CONCORD welcomes the proposed system for the **online project application PROSPECT** as we believe this will ease the application process for both grant beneficiaries and the EC.

- CONCORD supports the use of a **standardized / uniformed application form** and cooperates at present with EuropeAid towards this goal.

Other CONCORD recommendations

CONCORD would like to put forward a number of additional issues that should be taken into account when revising the Financial Regulation and its implementing rules.

a. VAT and taxes ineligibility:

CONCORD proposes that the DCI and EIDHR regulations conform with the current text of the Financial Regulation Implementing Rules.

Article 172a of the Implementing Rules to the Financial Regulation allows that "value added tax paid, and which cannot be refunded to the beneficiary according to the applicable national legislation" may be considered as eligible costs by the Authorizing Officer responsible, without prejudice to the basic act. However, since the coming into force of the new instruments under the 2007-13 financial framework, VAT and other taxes have been considered ineligible costs under the

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DCI and EIDHR basic acts (“*Community assistance shall not be used for paying taxes, duties or charges in beneficiary countries.*” Articles 25.2 and 13.6 of the DCI and EIDHR regulations respectively), which concerns the grants for development cooperation under the “thematic programmes” and Human Rights Instrument.

This effectively means that grant beneficiaries unable to negotiate full tax exemptions in the concerned country are faced with taxes, including VAT, being considered ineligible. With the 2007-2013 DCI and EIDHR instruments, the burden of paying tax has been transferred from the EC to NGOs and other grant beneficiaries, and even indirectly to other donors.

A much needed amendment to the DCI and EIDHR regulations, to re-allow taxes including VAT as eligible costs, was planned to be in force as of the 1 January 2010, but is now at risk due to further delays in the decision making process. This will mean that grant beneficiaries will stay for even longer subject to the non-eligibility of taxes, which will increase the financial risk even further. Grant beneficiaries need a rapid solution to this very problematic issue, taking into account all grant contracts signed since 2007, including as well the possibility of applying the new regulations retroactively on this issue.

b. Indirect costs

Indirect costs are regularly questioned by EC authorizing officers and EU Delegations in particular. It should be however acknowledged that the current 7% percentage for administrative costs are usually insufficient to cover the actual indirect expenditures that organizations have when managing development projects overseas.

Having said this, it is important to keep in mind that each organization has different indirect cost policy according to own functioning and structure. The majority of European grant beneficiaries have for instance an indirect cost practice according to which they consider all their costs incurred by the organisation in Europe as indirect, except when they can show a direct link to the action with supporting documents (e.g. airplane tickets), and all their costs in the country of operation as direct.

Hence, indirect costs must remain eligible as long as:

- they are necessary for the implementation of the project and comply with the other requirements set out in grant agreements, and
- they do correspond to the organisation’s practice regarding direct and indirect costs, hence ensuring that there is no double-funding of the same costs between direct and indirect budget headings.

CONCORD therefore recommends that direct costs associated to the administration of the project should clearly be borne by appropriate direct costs headings, leaving the 7% for actual indirect costs, which shall not be questioned by essence.

c. Exchange rates

The Financial Regulation does not mention anything on how to deal with exchange rates. In the case of EuropeAid, grant beneficiaries are requested to use the InforEuro rates for converting into euro all the costs borne in non Euro currencies. These rates do not coincide with the actual rates as used by the banks when transferring funds from one country to the other and though they are used for reporting purposes, the EC considers them also for liquidity purposes which leads to sometimes important discrepancies between what has been actually spent and what is reported to have been spent.

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The Concord constituency is therefore of the opinion that the Financial Regulation and/or its Implementing Rules should contain instructions on how to deal with exchange rates. **The CONCORD constituency recommends the use of the actual exchange rates.**

d. Late payment interests:

The European Commission should automatically pay interests for late payment rather than the grant beneficiary having to request it. This practice of DG ECHO for humanitarian aid should be generalized to all EC services managing grant contracts.

e. Rule on assets

We recommend the European Commission to define a threshold below which low value equipment can be kept by the organization, even if it has not its headquarter in the country of operation (concept of low value equipment of DG ECHO, or see guidelines of other donors such as DFID in that respect.). The EC could also refer to the grant beneficiary's internal definition of equipment for its assets management.

f. Audits:

Article 117 of the Financial Regulation and article 180 of the Implementing Rules state the rules on audits. CONCORD recommends to ensure that audit requirements are more proportional to risks represented by grant beneficiaries, having due consideration to the amount of the EC grant per project.

The current guidelines of EuropeAid for expenditure verification request a review of 65% of all receipts of all projects above 100.000 euros. This requirement is in our opinion disproportionate.

g. Need for an arbitration mechanism on issues linked to grant management

Finally, CONCORD would like to stress the need to establish an independent arbitration mechanism – Ombudsman - that can address divergences of interpretation of rules, in particular when these ones contradict the accepted common interpretation and would ensure that the rules are applied with consistency across all EC services in Brussels and Delegations.

Conclusion

Coming back to the question whether ***the last reform had effects in diminishing the administrative burden on NGOs working in development policy***, it is clear that even following up on several revisions of the Financial Regulation over the past years, there are still many topics that add a lot of administrative and technical burden to the daily work of NGOs. The European Parliament has the leverage and the power to address them during the revision exercises of the Financial Regulation and its implementing rules. We call upon the stakeholders (be it EC, EP, Court of Auditors, Council) to consider the contributions of the Beneficiaries when finalizing the revision of the Financial Regulation.

CONCORD'S concrete RECOMMENDATIONS:

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- Increase regular training provided on the practical guide and its annexes at delegation level and for grant beneficiaries.
- Be aware of the need for a stable legal framework for budget implementation at the level of the Unions Delegations, following the installation of the European External Action Service.

To conclude, I would like to re-iterate Concord's willingness and commitment to continue to develop a real and fruitful partnership with the different EC Services dealing with external actions and in particular with EuropeAid. I thank you very much for your attention.

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