

Striking a Balance

Efficiency, Effectiveness and Accountability.

**The impact of the EU Financial Regulation on the relationship
between the European Commission and NGOs.**

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Report by F.M. Partners Limited

On behalf of:

Open Society Institute-Brussels

Concord

The Platform of European Social NGOs

SOLIDAR

The European Women's Lobby

Foreword

This report was produced by FM Partners Limited for, and with the support of:

- **Open Society Institute-Brussels**
 - OSI is a private operating and grant making foundation, aiming to shape public policy to promote democratic governance, human rights, and economic, legal, and social reform.
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 - Co-ordinating body of national and European non-governmental women's organisations.
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The European Policy Centre, an independent, not-for-profit think-tank, has also lent its support to the production of the report.

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This study has collected evidence through interviews, questionnaires and desk research. This material has been collated into themes and recommendations are made which it is believed will benefit both the European Commission (hereinafter referred to as the "Commission") and NGOs. Where possible, evidence collected through interviews has been substantiated through desk research, but where necessary interview evidence alone has been relied upon.

**F M Partners Limited can be contacted at:
PaulFirth@FMPartners.co.uk**

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Executive Summary

Introduction

Non-governmental organisations (NGOs) play an important role in democratic society. They are key contributors to both the policy making and political decision-making processes, complementary to democratically elected representatives and other social partners. They are often the primary means of implementing sustainable development or humanitarian aid programmes or programmes aimed at the elimination of poverty or discrimination. This is certainly the case in the European Union, both in the Member States and with the Commission, where NGOs are key partners in policy delivery.

This report was born out of the widely held belief that the Financial Regulation of the Commission and its implementation is harming the important relationship between the NGOs and the Commission because of a damaging and often inappropriate overemphasis on procedures and control.

Background

The Financial Regulation was adopted by the Council in June 2002 as a reaction to earlier financial scandals in Commission funding and subsequent demands from the Council and European Parliament for improved financial procedures. Its main objective is to tighten financial control and to minimise the risk of mismanagement, fraud and corruption. The Implementing Rules, were adopted in December 2002, and are a binding Commission document not requiring Council or Parliamentary approval. They have had the effect of further tightening controls.

These regulations are imposed by a bureaucratic organisation focused on risk avoidance and anxious to avoid scandal. The Parliament and the Council, also aware of negative press reports, continue to exert pressure for strict enforcement of procedures and are aided by powerful scrutineers such as the Court of Auditors.

The Financial Regulation adopted 'Sound Financial Management' as its theme. Its three key elements are 'economy' (procedural compliance), 'efficiency', and 'effectiveness'. Unfortunately, the Commission has focused on procedural compliance and risk avoidance and, at best, only partially implemented the other two elements.

This focus is placing onerous and inappropriate demands on the NGOs working with the Commission, raising their costs, increasing uncertainty and reducing their effectiveness.

The author of this report has the highest regard for the commitment and dedication of the staff of the Commission. It is an administration which is significantly smaller than many national government departments and the subject of much unfair criticism. This report is not a criticism of the Commission, but a critique of a system of management which has evolved to cope with the pressures exerted on it.

The objectives of this study are to:

- Gather a substantial body of evidence to support the widely held belief and experience of NGOs that there are major issues to address in the EC's grant funding process.
- Structure the issues into themes, and make recommendations to rectify those issues so that changes can be implemented.

Findings

Anecdotal evidence recounted by NGOs is supported by facts and most of the issues raised by them can be directly traced back to the Financial Regulation, Implementing Rules or Call for Proposal Procedures. The most consistently cited complaint was late payment resulting in the Commission putting partners at financial risk. Some other issues raised significantly increase the costs and uncertainty of NGOs.

A simple consultation exercise with NGOs before the introduction of the Regulation would have predicted that many of its clauses would cause unnecessary and avoidable operational problems to NGOs.

The problem is amplified by the interplay between the Regulation and the Commission's culture. It is an organisation that sees itself as responsible for policy making rather than implementing or managing programmes. As one senior insider put it "the Commission is an organisation without a management culture". It is an organisation ready to judge others, but seemingly unable to challenge itself.

Further problems are caused by the interpretation and implementation of rules by generalists who have insufficient training in financial control, who do not always understand them, and who often remain insulated from the environment with which they are dealing. To further complicate matters, new procedures were often inappropriately layered upon old procedures causing unnecessary bureaucracy. Few officials interviewed actually claimed to properly understand the very complex Financial Regulation and Implementing Rules.

It is clear that the Financial Regulation and Implementing Rules need to be changed, however part of the solution already exists within the Regulation under the heading Sound Financial Management. It requires the Commission to be:

- Effective and to measure that effectiveness.
- Efficient and to measure that efficiency.

NGOs continually highlight rules and procedures that damage effectiveness however, many officials, with a few exceptions, cite the Financial Regulation in their defence, or as one official put it "hide behind them".

The Commission could not give any measures of its administrative efficiency relating to grants they award to NGOs. DG Budget was unable, or unprepared, to give information on the total monies going through NGOs or on the efficiencies of grant making departments. The officials interviewed as part of this study had never considered it a priority.

This report describes the procedures and efficiency levels of some funds managed by the British, Swedish and Danish governments and compares them to those of the Commission. It was found that the procedures and attitudes adopted by national governments are more enlightened, more suited and relevant to the environment in which NGOs operate and arguably more effective.

Given the Commission's lack of available information on efficiency, the report assesses the administrative efficiency of three of the newly formed Executive Agencies and ECHO.

The executive agencies are quasi Commission organisations designed with the objective of managing grants cost effectively. They are being established for Directorates: Education and Culture; Health and Consumer Protection; and Transport and Energy. The European Parliament required cost benefit analyses prior to approving their formation.

The Commission's stand alone Humanitarian Aid Office (ECHO) fairs better in comparison to the rest of the Commission in terms of procedures, but improvements are still needed. Being stand alone, it has its own budget.

The efficiency of the three Executive Agencies analysed and ECHO was compared to the national government funds. **That comparison indicates that these three Executive Agencies and ECHO are planning to spend over €50 million per annum on unnecessary administration.**

The sample of Commission departments analysed covers grants worth approximately €1 billion. As each Commission Directorate operates differently it is not statistically valid to extrapolate the findings to the full value of Commission grants. However, the underlying factors driving the inefficiencies are the same: the Financial Regulation; the Implementing Rules; the Procedures; and the Commission's culture. These factors are not only relevant to grant making procedures but to the Commission's total spending.

This is a relatively small sample, but the influences behind it are pervasive: the Financial Regulation; the Implementing Rules; a culture of distrust; and an over emphasis on rigid procedures. Intuitively it could be concluded that, though it would not be statistically valid to do so, the Commission is spending hundreds of millions of euros each year unnecessarily on inappropriate administration and control.

The parties transacting with the Commission e.g. NGOs, as well as hundreds of other public and private organisations across the EU, have to comply with these onerous or inappropriate procedures and are consequently having to spend money unnecessarily.

Recommendations

Recommendations are suggested throughout the report and are all listed in appendix 1. These include:

1. The Commission should undertake a full and proper consultation, including NGOs and suppliers, on amending the Financial Regulation and Implementing Rules.

2. The Commission should fully implement Sound Financial Management with senior officials being urgently given performance targets based upon benchmarks of best practice. This must include measures of efficiency and effectiveness and must have an impact on the annual personal assessments of those officials.
3. The Financial Regulation and Implementing Rules should be combined and then redrafted. There should be a set of regulations by end user subject area e.g. complete regulations for administrators and beneficiaries of small grants, ensuring that they are intelligible and focused on the needs of the end user.
4. Update, enforce and monitor the article giving implicit approval to claims not approved within 45 days. Speed up payment cycles and make pre-financing, really pre-financing.
5. Create a department that is a central point of reference and expertise for all organisations that award Commission grants. This department should then introduce a programme of benchmarking efficiency between Directorates and with national governments of Member States.

Conclusions

The creative partnership between NGOs and the European Commission is being jeopardised by the too rigid application of the regulations which govern the financing of NGO activities. The Commission has over emphasised adherence to procedures at the cost of damaging the effectiveness of its programmes, and efficiency of its administration, so spending a great deal of money on unnecessary and ineffective bureaucracy. The Commission could have avoided many of the problems caused by the Financial Regulation had it consulted NGOs. **Now that the regulations are being revised the Commission is at risk of compounding its mistakes by once again not consulting with NGOs.**

The imminent revision of the Financial Regulation offers an opportunity for the Commission to enter into dialogue with civil society organisations and make changes for the better.

The Financial Regulation and its Implementing Rules place a great deal of pressure on Commission staff, many of whom are aware that these rules are increasing their administrative burden and reducing the effectiveness of their programmes.

Many of the procedures adopted by the Commission can be significantly improved and others are inappropriate. It is essential that the Financial Regulation and its Implementing Rules be rebalanced to give greater importance to the effectiveness and efficiency of the administration of programmes.

The Commission's efficiency levels are significantly worse than the national government grant making operations reviewed where there is just as much importance given to the transparency and accountability of public funds.

Chapter 1

Introduction

NGOs (Non Governmental Organisations) are key contributors to the policy development and political decision-making process, complementary to the democratically elected representatives and the social partners. This 'civil dialogue' has been recognized in Article 47 of the Constitutional Treaty which sets the consultation with civil society as one of the elements of a participative democracy.

The importance of giving aid and development funds to third world countries is also recognised as a political necessity. NGOs have successfully established themselves as partners to Governments and the Commission in implementing aid, and sustainable development projects as well as social programmes designed to fight social exclusion and discrimination.

At the EU level this success has not been matched with effective administration. An attempt made in the late 1990s to put the relationship between NGOs and the Commission on a sound footing (Strengthening the Relationship with Civil Society), did not have tangible or positive outcomes. As the Commission failed to give a political lead, the practical relationship between NGOs and the Commission became shaped by financial rules and procedures which have become increasingly burdensome and inefficient.

This study has resulted from the widely held belief that the Financial Regulation and Implementing Rules of the Commission and their implementation are harming the relationship between the NGOs and the Commission because of a destructive and often inappropriate overemphasis on procedure and control.

In May 2005 the Commission is expected to adopt changes to the Financial Regulation which have resulted from a process of inter-service consultation. These changes will directly affect the financial health and effectiveness of thousands of NGOs, however there is little confidence among the NGO community in the Commission's willingness to consult them and to take account of the issues raised by them so that they can address the problems that the Financial Regulation has caused. It is understood that the Commission's objective is to have the new regulations approved by Council in 2006.

Supporting the Financial Regulation are the Implementing Rules. These did not need the approval of the Council or Parliament, but are the mechanism for interpreting the Financial Regulation. To understand the legislation fully both documents have to be consulted and understood.

There is much anecdotal evidence as to the problems encountered by the NGOs including:

- Delayed payments causing financial difficulties.
- The regulations being both complicated and inconsistently applied.
- The regulations are applied by Commission staff who are reluctant to use their own initiative.
- Grant applications are rejected, or payment refused, based upon subjective, and debatable, interpretation of the Regulations.
- The annual grant process fails to facilitate a strategic approach to projects and consultation.

- The NGOs' limited administrative resources cannot deal with the ever greater demands of the new Regulation.
- There is financial uncertainty caused by the Commission's ability to re-open project accounts and demand repayments years after the original payments.
- The Commission acts in a heavy handed and arbitrary manner.
- Knowledge of NGOs within the Commission is variable and it is often very limited. This combined with an inflexible approach can lead to less than optimal actions.
- Communication and dialogue between the Commission and NGOs is poor, often limited to compliance with financial procedures, and is having a direct and negative impact on the quality of policy decision-making.

To date much of the evidence about the level of difficulties experienced by NGOs has been anecdotal and while some studies had been undertaken, either on a regional basis or for areas of specific interest, no one study had yet looked at the overall administrative relationship of all NGOs with the Commission and collated evidence supporting the issues raised by the NGO population as a whole.

Evidence for this study has been gathered through interviews, submissions and desk research, it has then been collated into themes and solutions have been proposed that it is believed will benefit both the Commission and the NGOs. Where possible evidence collected through interviews has been substantiated through desk research, however where necessary interview evidence alone has been relied upon.

It should be recognised from the outset that neither NGOs nor the Commission represent an homogeneous group.

NGOs include large global organisations, among them household names, that turn over hundreds of millions of Euros a year and many thousands of smaller organisations that struggle to raise over a hundred thousand euros. They cover every conceivable cause and measure success in many different ways. They deal with every part of the Commission and come from every part of Europe and the world. They are often supported by volunteer, or very lowly paid, workers.

The Commission itself is not homogeneous in its actions or outlooks. Each Directorate (DG), Agency and Delegation, has developed independent cultures, systems, and procedures over time. In the final analysis, even with such a large organisation, NGOs experiences' of the Commission very often come down to the capability, work load and motivation of the relevant officials.

There are nonetheless issues that embrace the full spectrum of NGOs and it is these issues that the report addresses.

The major sources of the problems are believed to be the Financial Regulation and the Implementing Rules that took effect in January 2003. However, to understand the Regulation it is important to understand the political environment out of which it evolved. This report briefly explains the background to the emergence of this excessive bureaucracy.

During the process of compiling the report it became clear that the excessive bureaucracy of the Commission is also a major concern for some of its own officials. Although many officials believe the Financial Regulation is a good thing, there is also a widespread belief

from committed individuals that the Commission should and could be more effective and that the joint work carried out by them with NGOs has suffered as a result of the Financial Regulation.

In the year 2005 the Commission will spend €14 billion implementing EU Policies. A proportion of which is channeled through or paid to, NGOs. The Commission was unable to give information on the total expenditure channeled through NGOs. Most NGO funding is used to implement actions intended to help achieve an objective forming part of E.U. policy; including external actions (aid or development). A very small part is used to support a body which pursues an aim of general European interest or has an objective forming part of a European Union policy.

There is a symbiotic relationship between NGOs and the Commission. The Commission is the servant of the Member State Governments and one of its roles is to ensure the implementing of policies. NGOs are one of the vehicles that the Commission uses for implementation. NGOs do, of course, need funding for projects and the Commission is a significant contributor of project funds.

The main categories of the Commission's 2005 Budget that use NGOs to implement its policies are:

1. Internal Policies focus on the implementation and development of the single market and cover four complete subsections of the budget:
 - Education, vocational training and youth
 - Energy, Euratom nuclear safeguards and the environment
 - Consumer protection, the internal market, industry and Trans-European Networks
 - Research and technological development. (These grants are outside the scope of this report).

The Internal Policies budget for 2005 totals €¹ billion of which approximately €6 billion is for Research and Development and programmes like nuclear decommissioning and the Galileo programme. Of the balance of €3 billion a significant proportion (over €1 billion) is spent on programmes that involve grants, a proportion of which will be channeled through NGOs.

2. External Action's main areas of interest are food aid/food security, humanitarian aid and financial and technical cooperation with Asia, Latin America, the Mediterranean countries, the Western Balkans, the New Independent States and Mongolia.

The Directorates-General for External Relations and Development are responsible for formulating policies for development cooperation, country/regional strategies and multi-annual programming. The EuropeAid Cooperation Office is responsible for the implementation of development cooperation. The Humanitarian Aid Office (ECHO) is fully responsible for humanitarian aid.

The external actions budget for 2005 totals €5 billion of which €3.5 billion is spent on External Relations, €1 billion on Development and Relations with ACP countries, and €0.5 billion on Humanitarian Aid.

¹ DG Budget: General Budget for the European Union for the financial year 2005

Of this money, the Commission has said that it channels over €2 billion through NGOs² to developing countries.³ A significant proportion of the €5 billion flows through International Institutions such as the United Nations or the OECD.

3. Some monies from the Structural Funds (budget over €32 billion) also flow through NGOs.

Very large amounts of money are flowing through the NGOs and proper accountability is therefore essential. So, while this report fully supports the need for procedures, rules and controls, it concludes that accountability can be better achieved by the Commission altering its purely procedural emphasis to the more balanced approach described in the Regulation as ‘Sound Financial Management’.

The report is therefore structured as follows:

1. An overview of the background to the introduction of the Regulation, the pressure exerted on the Commission and its culture.
2. An overview of the procedures in use.
3. A critical review of the Financial Regulation. This is important in order to understand the issues raised by the NGOs. Some are the result of the Regulation, some a result of poor implementation, and some a result of poor Commission procedures.
It is also intended to show that with proper consultation with end users, the Commission could have foreseen and avoided many of the problems that exist today.
4. Findings from interviews with national governments are summarised. This enables a comparative view of best practice of operations that have to account for public funds in a way that is accountable and transparent.
5. The research findings of the interviews and NGO submissions are then summarised and recommendations are made.
6. The efficiency and effectiveness of the Commission’s processes are then reviewed and compared with that achieved by national governments. The efficiency of the Commission is important to NGOs as it impacts on them directly.
7. Finally the strategic management choices available to the Commission and the role of the Auditors and Ombudsman are reviewed.

In total this process has resulted in approximately 20 pages of specific recommendations.

Given the complexity of the Commission and its procedures and rules, the Regulation and NGO activity, some prior understanding of the subject matter by the reader has had to be assumed.

² The need for a European Transparency Initiative, Siim Kallas, Commissioner for Administrative Affairs, Audit and Anti-Fraud, 3 March 2005. It is believed this includes approximately €1 billion of funding to the UN, etc

³ A request was made for this information to DG Budget; their estimate, from 2000, was ‘over €1 billion’.

Chapter 2

Background

The Commission has a strong civil service culture which means that many staff within the services:

- See themselves more as drivers of policy rather than ‘doers’
- Are resistant to change
- Are focused on their own internal procedures and insulated from the outside world
- Are risk averse

Staff Regulations and ‘open competitions’ cause difficulty in recruiting staff with relevant expertise or new ideas: change is therefore slow. Staff costs, including benefits, are relatively high as a result of the need to attract people away from their home countries.

A process of change did begin in the late 1990’s after the Commission was rocked by a series of scandals which resulted in the resignation of the Santer Commission. Pressure continued during the Prodi Commission.

The external Environment was also changing significantly as a result of:

- The closure of Technical Assistance Offices following the so called ‘Cresson’ scandal brought administrative, process driven work back into the Commission.
- The Enlargement which increased workloads.
- The European Parliament increasing its scrutiny.

The main reaction to these scandals and to the changing environment was to increase controls.

In 1999, following the introduction of a ‘Vademecum’ a new ‘Calls for Proposal’ procedure was introduced. It was based on the Calls for Tender procedure. This procedure is continually evolving with ever longer and more complex application forms.

In June 2002 the New Financial Regulation was introduced supported in December by the Implementing Rules. These two documents cover every aspect of the Commission’s Finance related operations. They have increased the work-load for both the Commission and grant applicants substantially.

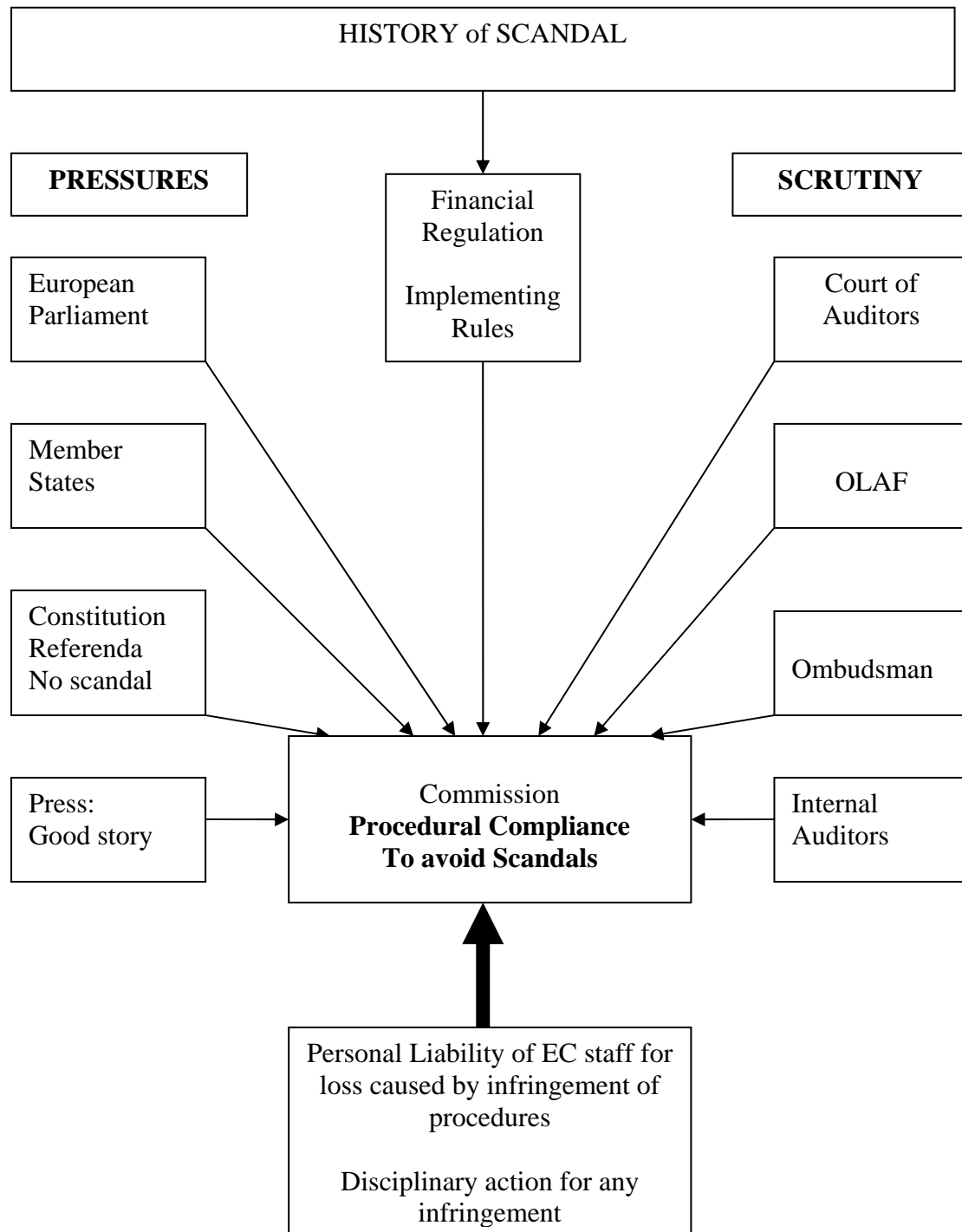
Principles such as transparency in conjunction with the new Regulation have lead to developments in procedures. For example, many in the Commission believe that they cannot meet or talk to grant applicants before awarding a grant. This is not a Regulation it is an interpretation of them. The complexity and poor implementation of the Regulation has led to the new procedural requirements being layered on top of the old procedures⁴ substantially increasing the workload of the Commission and of grant applicants.

The net result is a Commission that is paralysed by the fear of scandal and fraud, focused on onerous procedures, too busy to enter into dialogue with the potential beneficiaries and unable to spend time understanding the environment into which the grants are made. To

⁴ Strategic Evaluation of the Management Methods of Programmes, Technopolis report for the Commission June 2004

compensate ever more information is requested as part of the application process and NGOs are struggling to cope with these growing administrative demands.

This spiral of ever increasing control is largely a result of intense external pressures and scrutiny that focuses on finding procedural errors.



Chapter 3

Objectives and Scope

The objectives of this study are to:

- Gather a substantial body of evidence to support the widely held belief and experience of NGOs that there are major issues to address in the EC's grant funding process.
- Structure the issues into themes, and make recommendations to rectify those issues so that changes can be implemented.

The Grant Process – Commission perspective

Preparation

Pilots if applicable
Programme document
Ex-ante evaluation
Budget & operations planning
Basic Act
Legal & Budget line
Budget

Implementation

Call for Proposal
Awarding
Commitments
Contracting
Evaluation
Checks
Payments

Evaluation & Closure

Recovery if appropriate
Audit
Evaluations
Annual activity report
Discharge

This study has limited its focus to the implementation stage of the process as this is the main area that impacts NGOs.

Research and Development Grants are outside the scope of this study.

Chapter 4

Grant Call for Proposal and Payment Procedures

4.1 Summary of Procedures

Grant Award Procedures

The diagram below illustrates the process followed by the Commission in awarding grants. The procedures are further described in the narrative following the diagrams.

<u>Procedure</u>	<u>Comment</u>
<p><i>Consultation – usually inter-service only</i></p> <div style="text-align: center;"> <pre> graph TD A[Call for Proposal] -- "Normally 60 or 90 days" --> B[Submit Proposal] B -- "3 to 9 months from submission to contract signature. Commission give a date of intended notification in the proposal but this is not always adhered to." --> C[Notice of Intention] C -- "Expert evaluators normally used" --> D[Contract issued] D -- "Variable time frame" --> E[Contract signed] </pre> </div>	<p><i>The consultation procedure is variable in terms of occurrence & transparency. It is normally inter-service only.</i></p> <p>Usually published in an ‘annual cycle’ Content and timing of the call is often unclear to outside world.</p> <p>The cost of submitting a claim varies by size of contract but for large projects with multiple partners in multiple countries, it can be substantial to the organisations concerned. This money is often not recoverable.</p> <p>Experts of variable quality in NGO experience.</p> <p>Committee informs applicant of intention to send contract. No information is given on when or by whom.</p> <p><i>Success rates of applications usually vary between 10% and 35%.</i></p> <p>Contract arrives, sometimes with an instruction to change the budget. Budget changes can impact the agreements contracted with partners and co-financiers.</p> <p>It is only at this point that work can begin However, it is often well after the original planned start date for the project. (Exception for Aid)</p>
<p>Normally short timeframe requested by the Commission.</p> <p>‘Standard Contract’ for development projects.</p>	

Grant Payment Procedures

This diagram assumes a one year contract; multi-annual contracts will require interim reports and have interim payments, only payable when the interim report has been approved.

The Commission retains the power at the end of the contract to change their position on the 'signed-off' reports and reclaim funds.

<u>Procedure</u>	<u>Comment</u>
<div style="text-align: center;"> <div style="border: 1px solid black; padding: 5px; width: fit-content; margin: 0 auto;">Submit claim</div> <div style="border: 1px solid black; padding: 5px; width: fit-content; margin: 0 auto;">Commission questions</div> <div style="border: 1px solid black; padding: 5px; width: fit-content; margin: 0 auto;">Payment</div> <div style="border: 1px solid black; padding: 5px; width: fit-content; margin: 0 auto;">Audit</div> </div> <p style="margin-left: 20px;">Should be a maximum of 90 days 45 days approval 45 days to pay</p> <p>Possible: Internal Auditors Court of Auditors External Auditors</p>	<p>90 days after project completion date. No costs allowed after project completion date.</p> <p>Submit claim with full detail including list of invoices. Different Commission departments have different requirements.</p> <p>Such questions stop the clock and are often very detailed e.g. how many hours were actually worked and when.</p> <p>Payment delay is very often greater than 90 days. The final payment is often less than claimed, but reasons why are not usually given unless this information is requested.</p> <p>An audit can be before payment or up to 7 years after the contract is signed off. Any 'errors' as perceived by the auditor will be recovered, even if the contract has been signed off.</p>

Summary of Procedures - Description

Reaching agreement on the objectives of Calls for Proposal is usually part of a process of inter-service consultation. No consistent policy on consultation with third parties has been identified. The Call for Proposal may be written by a policy officer or by the person responsible for managing the grant process.

The Regulation does not demand a great deal of detail, only that the selection criteria are published, however different calls vary in their demands and can be complex and difficult to understand. With rare exceptions, new iterations of forms bring additional requirements but very rarely remove them. An example is the new forms used by DG Health and Consumer Protection that are designed to include partnerships of up to 20 organisations.

A call normally includes both general and specific objectives. These are not always internally consistent, a point which was both raised in research interviews, and which was also a finding from the Commission's own evaluations.⁵

The Call for Proposal also includes a description of eligible costs. These can vary by project. For example a DG Enlargement project⁶ disallowed the following costs that are normally eligible:

- Salaries to Directors, even though for small NGOs the role of the Director is key to any project.
- Notated on the budget spreadsheet it said that travel to conferences was not an allowable cost even though this is against the Commission's principle of equal access.

Applicants are normally given either 60 or 90 days to respond to the call depending upon its perceived complication by Commission services. If the applicant misses the deadline their proposal will not be considered. The full application must be submitted including proof of eligibility documentation and a detailed budget.

Eligibility

The eligibility of the applicant organisation is checked first. If the period taken by the Commission to award a grant is 4 months, from receipt of applications to contract, then the eligibility check can take a month or more. The statutory documents requested will normally be in the local language of the applicant, so support is needed by the grant administrator to understand them.

At present local language speakers who happen to work in that Commission Directorate General give support, but using people who have little knowledge of national company law is fraught with the danger of erroneous judgements. This is an important procedure given that 20% to 30% of applicants fail at the eligibility stage, with no right of appeal.

The same supporting documents must be sent with every proposal. Commission staff must review the same documents tens or even hundreds of times over the years.

⁵ <http://europa.eu.int/comm/budget/evaluation/pdf/Evaluation2003.pdf>

⁶ Call for proposals – DG Enlargement 2004 aimed at civil society and public Sector bodies in the European Union Reference number: APESC 2004/EU-25: Guidelines for applicants

Evaluation

The Commission normally requires applicant NGOs to submit applications in full. However, there have been a few instances where the call for proposals has been split into two stages: a concept stage followed, if selected, by the submission of a full proposal. This does appear to be a good model however its implementation has often been poor. The Commission has on occasion demanded too much information at the first stage, and there have often been repetitions as well as confusing differences between forms used in the concept and submission Stages. The European Commission Humanitarian Office (ECHO) is the main exception and uses this two-stage procedure successfully.

The applications are sometimes evaluated by Commission staff, but usually expert evaluators are engaged for this purpose. Some NGOs believe that these “experts” are a Commission euphemism for people who are not at all experienced in the subject matter. (One interviewee revealed that one “expert” even rang an NGO to be briefed on the subject they were evaluating, as they did not have any understanding of it). These experts are chosen through a Call for Tender.

As an example, for one programme examined for a small grant fund totaling €2.6 million with approximately 220 applications passing eligibility (of 269 submitted), there were 13 experts employed for a week. 2 experts reviewed each application. Each application, running to several pages, had a maximum of one hour’s attention per expert.

From this evaluation process each application is given a point score by the ‘experts’.

Committee (Jury)

The jury then reviews the applications and normally awards the grants based upon the point score of the experts. The highest scores are awarded first until the grant runs out.

Financial Review

This stage occurs after the jury has met and the grants have been awarded. The Commission reviews the budget in detail. The objective is to eradicate errors such as incorrect per diems and ineligible costs, but in practice, the review can be used by the Commission to request reductions in the budget, for example, if it is felt that the proportion of salaries is too high. It can also be used to request changes to the budget without explanation. The beneficiary is then requested to resubmit the budget with the changes.

Contract

This is often the stage that causes most delay, although without an obvious cause. Work cannot start on the project without the contract. The first payment by the Commission should be made 45 days after the contract’s signature by both parties.

ECHO – Humanitarian Aid Grants

ECHO operates differently from the other DGs and already uses a number of procedures recommended in this report. It reviewed the Regulation before their adoption and achieved some derogation. It would like further derogation in the revised Regulation. This may be a result of the fact that they have an important working relationship with NGOs and maintain regular communications with them.

The ECHO process is different in that:

NGOs are admitted to the ECHO process through the FPA (Framework Partnership Agreement). They can submit project proposals without ECHO having to launch an official and published call for proposals. ECHO deal with approximately 170 NGOs.

With a special derogation, NGOs can begin work before the contract is signed at their own risk. In this case, expenditures can be eligible before the date of the signature of the contract. In exceptional cases expenditure is eligible before the presentation of the funding request (Article 112 Financial Regulation (FR)).

Eligibility is pre-checked through Framework Agreements and a database system developed by ECHO which is called APPEL.

The first stage in the process of gaining grants from ECHO is to submit a “Single Form” application. This means that:

- Either after an emergency event such as an earthquake, an NGO can make a proposal outlining the project it is willing to implement.
- Or annually, Global Plans can be submitted according to a timeframe agreed between the NGO, ECHO desk officers, and ECHO field representatives.

The Single Form is based on a logical framework analysis and includes:

- Objectives
- Indicators
- Means and sector of intervention
- Financial budget at a summary level.

The proposal is evaluated through discussions between the NGO, ECHO, and their experts in the field. If that passes the evaluation then the next stage is a full proposal which should take into account conclusions of these discussions.

The budget used for evaluating grant payments contains only 3 titles, to which the 15% limit applies reducing claims disputes:

1. Goods and services directly delivered to beneficiaries
2. Support costs
3. Administration costs are granted at a 7% flat rate

There are bi-annual audits to check systems, assess organisational risk and to validate transactions.

Overall, ECHO has a reputation for being easier to work with than other DGs but the Financial Regulation still applies, and its implementation causes difficulties for the NGOs.

Co-incidentally, or perhaps as a result, efficiency levels in ECHO are superior to the other Commission Directorates and agencies studied⁷.

Although better than most Commission DGs, ECHO does NOT however represent the perfect model as:

1. It deals with comparatively few, but larger, NGOs
2. Comparisons with other funding organisations such as the UK's Department for International Development or Sweden's International Development Agency indicate that cost savings could still be made.

Areas where ECHO could reduce the burden on NGOs include:

Budget information required for internal use at the proposal stage is very detailed i.e. up to 6 digits (e.g. how much you have budgeted for basic food security). For instance:

Title:	0.1	Goods and services delivered to beneficiaries
Chapter:	01.01	Food security
Article:	01.01.01	Basic food security

At the stage of the final report, information is required up to 8 or 10 digits, e.g. (ex: 01.01.01.01: milk: how many litres, unit cost, etc.).

ECHO argues that this enables them to assess the operational efficiency of the NGOs ex-ante and ex-post. It also enables them to provide reference values.

ECHO's requirements for tendering procedures are considered extremely onerous especially given the environment in which these NGOs operate. The fact that all purchases over €200 have to be reported and procedures and prices etc. described in detail is an unreasonable administrative burden.

ECHO argue that this is the area of greatest potential fraud and has to be diligently managed, but are introducing changes. This is a good example of how anxiety about fraud has created inappropriate procedures where the process of acquisition can be greater than the cost of the goods required.

Concord's exchanges with the Commission in Appendix 5 explain these two issues and others more fully.

⁷ See Appendix 4. ECHO being a stand alone department has its own published budget.

4.2 Recommendations for Improving the Existing Application Procedure: Commission initiated projects.

There is a recommendation for a revised process of funding project grants that does not require a Call for Proposal given in section 4.5 of the report, but the existing process should also be improved for use for projects initiated by the Commission and separated into stages.

Recommendations: Existing Application Procedure

The application process should be in stages:

- 1. Eligibility – remote input into a database and use of Commission national representations and delegations.**
- 2. Concept paper of no more than 3 pages plus a Logical Framework Analysis.**
- 3. Full application, minimum information necessary for grant size and beneficiaries.**
- 4. Three line budget (as ECHO) with supporting information at a high level.**

The target beneficiaries should be kept front of mind when designing each Call for Proposal. On approval of the Call for Proposal, a Committee should sign a statement that the application requests only the minimum information necessary to judge and award the grants, taking into account:

- **The size and resources of the beneficiary**
- **The average value of the grants to be awarded**
- **The types of activity to be performed**

The eligibility requirement information should be removed from the application process and be replaced by a separate submission to an ‘Eligibility Database’.

- **Initial vetting could be through remote access to a database including questions that require yes/no answers, or values, that enable the system to ‘estimate’ eligibility.**
- **For first time applicants, the legal documents, which are usually in a local language and usually unique to a country, should be sent to the Commission’s national representation for checking by a national official. This would have to be completed before a contract could be signed.**
- **After the first application records would only need to be updated.**

In one EAC programme where the Commission administrator was interviewed this would have reduced the 4 months application process by over a month. It would also be a more accurate process, as real experts would check documents in their own language. This would also save the Commission significant amounts of effort on repeated eligibility checking.

ECHO’s database, APPEL, could be upgraded to manage this eligibility process or the database Connex could be re-developed.

Calls for Proposals within Programmes should be made more specific or be very general. They should not be a combination of the two.

A 3-page concept paper, plus an outline budget and a Logical Framework Analysis should be used to judge project relevance and give an overview of the activities. It should not be more than 3 pages.

The full application form should be completed only by those who are selected for the next stage. This can then show more detail of the project activities and the associated costs. It should include only enough information to form a reasonable view of the applicant's capacity and skills, whether the activities are likely to lead to the achievement of the objectives, that the activities are adequately costed, and that a contract can be agreed. It should expand on the 3 page concept paper that has already been approved for the application to reach this stage.

The cost of producing the full proposal, including planning costs and the cost of raising co-finance should be included as part of project costs eligible for a grant. They should be limited to a maximum percentage of the grant available.

The number of organisations selected to reach the full application stage should be limited to enable very high pass rates to minimize the costs of failed applications to both NGOs and the Commission.

The objective should be to keep the requirements to the minimum necessary so that applications:

- **Can be easily understood**
- **Can be reviewed cost effectively**
- **Minimise the cost of the process to the Commission and to applicants**

To facilitate this, any point scoring system should focus on key drivers, not detail.

Co-finance

The time given between concept paper and full application should take into account:

- **Value of co-finance to be raised and likely partners**
- **The number of partners who have expressed interest**

It is only at this stage that firm commitments need to be obtained from co-financiers and partners.

Contract

There should a published time limit set for completing contracts. The Commission should be bound by these time limits. If the deadline is missed, the NGO should be allowed to begin work on the project, and claim the costs of the work done prior to signature.

The time limit should be based upon central guidelines representing efficient working.

4.3 Project Budgets

Project budgets have two purposes:

- A. To support the level of funding required and to plan the expenditure at the beginning of the project.
- B. To enable the Commission to judge the validity of the expenditure at the end of the project.

Recommendations: Project Budgets

A. To support the level of funding required and to plan the expenditure at the beginning of a project.

The budget detail should be relevant to decision making. For example, under the present system, for a seminar in the EU with 100 people attending, it is necessary to say where the seminar will be held, where the attendees will come from, and the cost of the flights per attendee. This is an unnecessary level of detail and a process that is unlikely to be accurate or useful.

Where there are small general activities these activities should not have to be budgeted separately. Instead, if there are 20 seminars there should be an average cost per seminar. Note: Claims can only be made for actual expenditure for actual agreed activities.

This process will reduce the number of checks done by the finance officer, and most could be checked using a computer programme. This would save the Commission money and speed up the process.

For multi annual agreements, an outline budget should be submitted for the years after the first (showing total for all years after year 1). This budget should not need to be by activity, but should contain sufficient information to show that it is relevant to the activities proposed. At the beginning of each year, a more detailed budget, including changes to the original plan caused by learning from experience, changes in the environment, project delays and unforeseen circumstances should be submitted by the NGO for approval. There should be dialogue with and agreement on the budget by the Authorising Officer.

The greater the value of the individual grants and the greater number of activities requires recognition that averaging of costs is the most pragmatic way of budgeting.

Reduction of NGO budgets by the Commission should be a rare occurrence, but if done, it must be based on rational and explicit grounds. It cannot be arbitrary and should not be the result of trying to fund more applications.

Eligible costs should be standardised across the Commission departments and published in guidelines for applicants.

B. To enable the Commission to judge the validity of the expenditure at the end of the project.

There is a 10% rule in the Financial Regulation, which only applies to the Commission and movements between lines of the Commission budget, but **the 10% rule applying to grants is not a result of the Financial Regulation.**

However, a 10% rule is used for grants and requires that no one cost line can be more than 10% overspent compared to budget, or the extra costs over 10% become ineligible. (For Aid and Development this is now 15%). It is designed to ensure that the budget is carried out as planned, action by action. It enables a detailed check by finance of whether the actions happened. It pays no attention to effectiveness or whether the objectives were met or the circumstances in which the action happened. Even so, this check is the major reason for reducing funding from that claimed.

The question arises, therefore, if the Commission desk officer has agreed that the actions contracted have been carried out, why does this secondary finance control need to be in place? **Many decisions to reduce funding are subjective and this subjectivity is often exercised by Commission finance staff who have little knowledge and no experience of the situations that they are judging.**

Judgments should be based upon delivery of objectives, not on the ability to predict an uncertain future.

The allocation of costs causes a significant amount of work and cost, for both the Commission and NGOs, in producing the analysis, checking it and negotiating around it. This process gives rise to problems of subjective interpretation where there is only one loser, the NGO.

For example travel may be travel, but if it is travel to seminars then it has to be categorised as a cost of a seminar. Another example is the case of the cost of an accounting company paid to work on a project, budgeted for and contracted with the Commission on that basis. After the final claim was made, and previous years' claims had been approved, it was deemed an ineligible cost by the Commission on the grounds that an accountant's costs should be in employee's costs.

Recommendation – Judging the validity of the expenditure at the end of the project.

Implement a 3 line approach (as used by ECHO) and allow a 15% movement between lines. The 3 lines should be: goods and services; support costs; and an administration allowance of a fixed percentage of the eligible costs.

4.4 The Principle of Co-financing

The concept behind co-financing is one of allowing the Commission to enable NGOs to undertake their own projects. The projects supported are intended to help achieve an objective forming part of European Union policy.

Historically, NGOs had many project ideas that they could not afford to undertake although it was in the European Union's interest that they were undertaken in order to fulfil EU policy goals. Hence a process evolved wherein NGOs proposed ideas to the Commission and following discussions and amendments the Commission would support the projects by part financing them.

The process was simple but inconsistently applied and not transparent. It was also open to abuse. In 1999, the Commission introduced Calls for Proposals, based upon the "Calls for Tender" system. This is discussed in Appendix 7.

A view could be formed that the process now requires NGOs to subsidise the Commission's policy initiatives. The interview process clearly showed that NGO project applications are designed to meet the specific requirements of the Call for Proposal, and were not already designed by the NGO as potential initiatives.

Co-financing should be used to support NGO initiatives. It should not be about NGOs subsidising the Commission's initiatives.

Recommendations: Co-financing

Projects that are initiated by the Commission i.e. really Commission tasks, should continue with the present Call for Proposal system, but NGOs should receive up to 100% of the cost of the project from the Commission and be allowed to make a surplus if that surplus is the result of increased co-financing by third parties:

- 1. Up to a maximum margin**
- 2. If the surplus cannot be distributed and so will be used to implement other projects**

Interviews indicate that the Commission prefers dealing with the larger 'more professional' and more financially secure, private sector. As a result, the Call for Tender system is often used. This includes eligibility criteria that make it very difficult for NGOs to participate even though in many cases, NGOs could give better value for money than private companies. Indeed, NGOs often offer better value for money than the private sector because they have a speciality in the field, have access to experts at low or no cost, pay lower salaries and have no profit motive.

Recommendations: Tender or Proposal

Value for money should be considered at the stage of deciding whether a Call should be a Proposal or a Tender.

Where relevant the eligibility criteria of Calls for Tender should be consciously set to enable NGOs to participate.

4.5 Recommendations for a Second Application Procedure: NGO initiated projects

While the Call for Proposal procedure suits projects initiated by the Commission, a second procedure is required that facilitates projects initiated by NGOs to help achieve an objective of European Union policy. This approach would allow for more innovative projects and releases NGOs from an agenda controlled by the Commission. This method is currently used by the UK government's Department for International Development (see Appendix 6).

Recommendation: NGO initiated projects

- 1. The Commission publishes clear policies and strategies for each policy area. A specific Call for Proposal is NOT required.**
- 2. NGOs ensure eligibility for proposals using the eligibility database (see section 4.2)**
- 3. NGOs submit a 3 page concept paper to a Policy Committee of experts of whom some must come from outside the Commission**
- 4. The Committee give feedback and pass or fail the project. The concept paper can only be re-submitted once more and only if it has taken account of the feedback.**
- 5. If accepted, the NGO at its own cost produces a detailed proposal including budgets in line with published guidelines for the process**
- 6. Experts evaluate the full proposals and score them based on criteria such as alignment with policy, ability to implement, innovation, sources of co-financing and value for money. Each quarter, a Committee, again including experts from outside the Commission accept or reject the proposals.**
- 7. The proposals accepted are to the limit of the funds available in that quarter.**
- 8. A proposal can only be re-submitted if it was in the top 5% of those not chosen or if it is significantly reworked based upon feedback from the process.**
- 9. Budget changes made arbitrarily by the Commission should not be allowed. Changes may only be made as a result of a dialogue where the Commission show that they fully understand the project and can make a coherent case, in writing, why less resources than budgeted should be required.**
- 10. Contracts**
 - **A clear timetable should be set down for all parties to adhere to.**
 - **If the Commission breaches the timetable, they must pay the costs from the agreed date, prior to contract.**
 - **If it is the fault of the applicant that the contract is delayed, the Commission has the right to withdraw the offer of funding.**

Co-financing: As this is an NGO initiative, financing by the Commission should be from 50% to 90% with an independent source of funds involved.

The points raised on the project budget should also apply to this procedure.

Chapter 5

Sound Financial Management

‘Sound Financial Management’ is a principle specified in paragraph 3 of the Regulation as a central requirement of the Regulation. Implementing sound financial management is fundamental to the proper operation of the Financial Regulation.

FR paragraph 11

*“The principle of sound financial management should be defined by reference to the principles of economy, efficiency and effectiveness, and compliance with those principles checked by means of performance indicators established per activity and measurable in such a way that results can be assessed. The institutions should carry out *ex ante* and *ex post* evaluation, in accordance with the guidelines determined by the Commission.”*

FR Article 27

“The principle of economy requires that the resources used by the institution for the pursuit of its activities shall be made available in due time, in appropriate quantity and quality and at the best price.”

Calls for Tender and Calls for Proposal are procedures designed to ensure that a number of alternatives are solicited and that these are compared in a transparent procedure to ensure that the best ‘value for money’ is obtained through a system of pre-defined scores.

In summary, economy equals ‘best value’ through ‘procedural compliance’.

FR Article 27

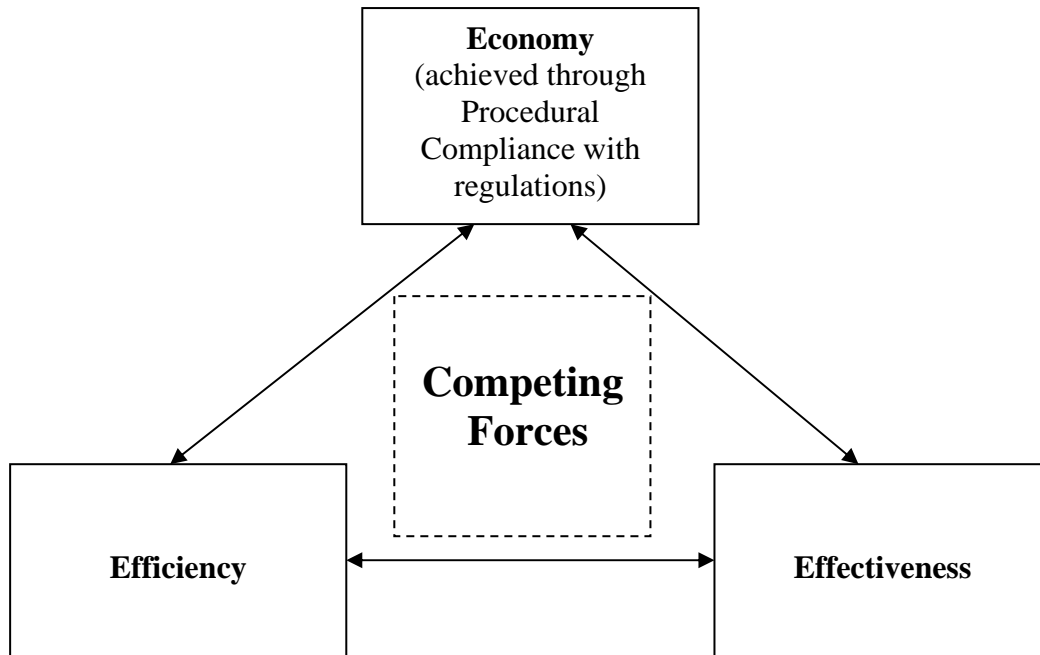
“The principle of efficiency is concerned with the best relationship between resources employed and results achieved.”

“The principle of effectiveness is concerned with attaining the specific objectives set and achieving the intended results.”

Each of these principles is in competition with the others, for example:

- Excessive procedures can ensure a good price, but are not efficient
- Effectiveness can be achieved through unlimited spending, but that is not efficient and against economy
- Economy can never be obtained if actions paid for are not effective.

The system can only work when the 3 competing forces are in balance. Unfortunately, the Commission is almost completely focused on the principle of economy, i.e. procedural compliance.



The reason for the Commission's emphasis on economy i.e. procedural compliance is explained in Chapter 2 of this report. The assumption by the Commission seems to be that if it rigorously follows the procedures, previously agreed by the Council, European Parliament, national governments and auditors, then they will be blameless in the face of any future scandals.

Compliance with procedures, in theory, ensures transparency. They do promote transparency, but it is only in theory that they ensure it. In the end all decisions, no matter how much detail is involved come down to a level of subjectivity. The point scoring system in the evaluation process is an example of this.

What is not theoretical however is that an over reliance on rigid procedures that are inefficient, inflexible, and apply to all types of actions and beneficiary types has a cost, namely a drastic reduction in the efficiency and effectiveness of the Commission's actions.

One set of procedures can only cover a limited number of actions. The path to economy is therefore by necessity a "one size fits all" approach and the same rules are applicable whether subsidising the implementation of a global satellite system, fighting world poverty, building a latrine, or promoting a socially inclusive EU.

A lack of focus on efficiency and effectiveness is clearly against the spirit of the Financial Regulation, but is harder to demonstrate than a breach of procedure. Although it may lead to awkward moments in the European Parliament it is unlikely to lead to a scandal as it is a comparative notion and complex to prove. The Commission can always cite the small number of differences with similar operations rather than focusing on the vast number of similarities.

However, the long-term effects of this imbalance are extremely harmful as the EU will fail to meet its policy objectives and its efficiency, increasing costs, and effectiveness will come under increasing scrutiny.

While it is recognised that procedural compliance is important, the procedures must be relevant to the action, the beneficiaries and their resources, as well as to the value of the grant.

Procedures must enable efficient and effective implementation.

Recommendations: Sound Financial Management

The Commission should urgently implement sound financial management principles fully as required under the Regulation including the measurement of performance indicators per activity⁸.

The achievement of performance indicators should have an impact on the number of points staff earn in their annual personal appraisals.

The Commission must initiate a greater dialogue with the outside world. It should not let procedures act as a substitute for dialogue. Knowledge and understanding of the environment in which actions are to take place is essential for the Commission.

⁸ As required by paragraph 11 of the Financial Regulation.

Chapter 6

User friendliness and Usability

The Financial Regulation covers every subject relevant to the Commission's financial procedures. A full list of the subjects is in Appendix 8. To investigate a specific user's area of interest it is necessary to understand two documents, the Financial Regulation and the Implementing Rules, in full. For example, there is a specific section for grants in both documents, but other areas cover subject matter that is required reading if the subject of grants is to be properly understood⁹.

For the average reader, a reasonably intelligent generalist, the subject matter is too wide and confusing. Most people find the Financial Regulation incomprehensible and few, including senior Commission staff, claim to properly understand it.

The Financial Regulation describes the structure as "a better hierarchy of rules and make the Financial Regulation easier to read"¹⁰. This does not seem to be a commonly shared opinion and it is arguable that they have completely failed in this objective.

This inability to properly understand the Financial Regulation leads to unquestioning adherence to poor and inefficient pre-defined procedures, to multiple interpretations and to inconsistent demands and actions.

For example the eContent programme is reportedly targeting SME start-ups and yet the programme requires participants to have three years financial history. The mid-term evaluation showed more that 80% of SMEs participating had more than 5 years financial history, and therefore were not the original target audience.

It also inadvertently leads to a crossing over between subject areas. For example, rules for tendering have been adopted by grant administrators e.g. applying the tendering requirement of applicants to furnish evidence that they have no criminal record rather than having to certify it as required by the Regulations for grant applications.

Practical differences arise when procedures and the real world collide. The grants sector is made up of many different organisations from large infrastructure organisations, governmental bodies, large humanitarian organisations operating in remote areas in need of rapid access to funds and discretion in its use, to new and growing SMEs, and small NGOs. This includes capacity building and annual operating grants, and one off projects that operate in distinct timeframes delivering more specific objectives.

With this in mind, the Commission needs to recognise that **one size does not fit all**. To make the point we can look at the Commission itself. Internally, operations between DGs vary significantly, but in the Commission's view, the entirety of the outside world is meant to be governed and to operate with homogeneity as far as grants are concerned.

While recognising that the Regulation is a legal document, an effort should be made to make the language more accessible to the expected user. A good benchmark is the Swedish

⁹ Appendix 8 'Financial Regulation and Implementing Rules' pertaining to Grants

¹⁰ Financial Regulation paragraph 2

International Development Agency's 11 page rule book written in clear and comprehensible language (including an English version).

The Financial Regulation is currently under review and is likely to be updated to reflect some recent concerns. Within the Commission there are two thought processes regarding the update. DG Budget is proposing a review of the Regulation, followed by a review of the Implementing Rules. Others believe that both documents should be updated and combined to create one new, streamlined, user friendly set of Regulations.

From a user perspective it is the combination and consistency of the application of the two that has an impact, not either one individually. As the Regulation and Rules are produced to direct the behaviour of the end users, then they should be considered as one.

Recommendations: Structure of the Regulations and Rules

The Commission should treat the Financial Regulation and Implementing Rules as one, redraft them in a single coherent process, and the Council and European Parliament should review and adopt the newly combined set of Regulations.

The Financial Regulation and Implementing Rules should be re-drafted. As part of this process they should be broken down into multiple end user orientated regulations. In this case it should be subject by end-user group e.g.: Commission staff involved in internal budgetary processes; Commission staff and beneficiaries of grants for humanitarian aid. Common themes such as sound financial management should be repeated in each regulation if appropriate. While not changing the regulations conceptually this would make each regulation easier to understand, require less reading for each subject and therefore be more likely to be understood and followed.

Representatives of the end users (e.g. Commission officials for budgets; external parties and Commission officials dealing with grants) should be involved in the drafting so that there is a 'real world' applicability test as part of the process.

The Regulations should specify the performance indicators required of the Commission.

These recommendations have the benefit of moving away from the 'one size fits all' approach and enabling the rules to adapt to contract values, environmental conditions, beneficiary types and levels of risk.

An attempt should be made to use clear and simple, rather than legalistic, language. There should also be an attempt to use generally accepted terms rather than "jargon" specific to the Commission.

Updating the present Regulations and Rules that are incomprehensible to most of its users will lead to continuing confusion, inconsistent interpretation, high levels of errors, high staffing, high costs to the NGOs and ever more complex documentation.

If, and only if, the Financial Regulation and Implementing Rules cannot be changed from their present format, the Commission should publish DEFINITIVE guides by end user group.

Chapter 7

The Financial Regulation : A Critique

7.1 ‘Onerous’ Clauses

This chapter identifies issues that the Commission could have foreseen as unreasonable or problematic if the Regulation had been drafted after a proper consultation process.

A. Interest on pre-financing

Article (4) of the Implementing Rules states

(4). Where pre-financing which remains the property of the Communities yields interest, this interest should be paid to the budget as miscellaneous revenue.

This is unnecessary administration for the NGOs, which receive no benefit for that effort. It restricts and disincentivises good investment of funds as well as increasing administrative costs. This is evidenced by the widespread use by NGOs of non-interest bearing accounts for dealing with Commission grant funds.

Recommendation: Interest on Pre-financing
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Remove the requirement to account for and pay to the Commission any interest accrued on pre-financing.

B. Requirement for Financial Guarantees

Article 118 of the Financial Regulation¹¹ and article 182 of the Implementing Rules.

In general, if the organisation is perceived by the Commission as a financial risk then why would a bank see them as less of a risk?

A financial guarantee is issued by a bank and is the equivalent of giving a loan facility on onerous terms. A loan usually requires security. Given that NGOs tend to be non-profit making, they usually do not have large assets against which a bank can secure a loan or guarantee. This leads to the paradoxical situation whereby “one of the reasons for supporting NGOs is so that they can undertake activities that would not normally be financially viable and yet at the same time, the organisations are expected to demonstrate financial viability in order to meet the requirements”¹²

In many cases the ‘security’ on offer by NGOs, if assets are not available, would be the contract with the Commission. The Commission is the decision maker in terms of awarding and paying grants and if the Commission believes there is too great a risk in awarding an NGO grant, a bank, which has no control over the grant award or payment, must therefore see it as an even greater risk. **Therefore, often when a guarantee is needed, it is unlikely that NGOs will actually be able to obtain one.**

¹¹ The authorising officer responsible may require the beneficiary to lodge a guarantee in advance in order to limit the financial risks connected with the payment of pre-financing.

¹² Strategic Evaluation of the Management Methods of Programmes – Technopolis June 2004 for the Commission

Secondly, if a bank guarantee is obtained (which has the same impact on borrowing as an existing loan facility) then the NGO will have reduced its ability to obtain further facilities i.e. borrow more money. When the Commission is late paying (and 100% of interviewees stated that this is a problem) NGOs may then not be able to borrow the money needed in order to sustain their activities.

In summary, not only is a financial guarantee an inappropriate instrument for the purpose intended, it actually increases the risk to the NGO of non-performance and therefore non payment by the Commission.

If the Commission took a more strategic and holistic approach they would realise that a portfolio approach is already a good risk avoidance strategy. They spread awards across a large number of NGOs hence diversifying risk.

The Commission must take a more supportive view. There are three main reasons why an NGO could become a financial risk:

1. It does not undertake the actions contracted for and therefore cannot be paid;
2. Partners do not meet their co-financing commitments;
3. The Commission does not meet its own payment commitments on time.

This research indicates that the third reason is by far the most likely scenario.

It appears that the biggest risk to NGOs is the Commission and late payment of grants. Therefore, by improving its own procedures the Commission would reduce its own risk.

Recommendation: Financial Guarantees

Remove the option to require financial guarantees from the Financial Regulation. If there is a significant risk to advance funding, the Commission should change to paying quarterly in advance. Allow grants to be refused on the basis of significant financial risk, but only after taking into account the beneficiaries being targeted.

For quarterly payments in advance:

- a. **Payments should be made upon receipt of a claim and description of work done against plan.**
- b. **The authorising officer is bound only to review these claims, not certify their correctness.**
- c. **No supporting documentation to the claim should be required.**
- d. **Internal auditors of national representations or delegations should undertake ad-hoc inspections to vouch for the project's progress.**
- e. **On policy issues, the Commission should arrange review meetings on progress.**

This method is used by both the U.K. and Swedish governments and it should therefore be possible for the EU Member States to agree to such a process to be used for the use of public monies through the Commission's grant programmes.

The Commission should view risk as a whole, in effect taking a portfolio approach. Spreading activities across a number of NGOs reduces risk.

C. Default Interest

Paragraph 23 of the Regulation¹³ allows creditors who are paid late to claim default interest. NGOs are fearful of requesting this since they do not want to upset the authorising officers that they have to work with in the Commission.

Recommendation: Default Interest

Make it a requirement for the Commission to automatically pay interest on late payments rather than the beneficiary having to request it.

D. Implicit Approval

Article 106 of the Implementing Rules states:

3. For contracts or agreements under which payment depends on approval of a report, time for the purposes of the payment periods referred to in paragraphs 1 and 2 shall not begin to run until the report in question has been approved, either explicitly with the beneficiary being informed, or implicitly because the time allowed by the contract for approval has expired without being suspended by means of a formal document sent to the beneficiary.

This means that a claim is authorised implicitly if the 45 days for its authorisation has run out without the 'clock' having been officially stopped. This is a sensible rule designed to protect the beneficiary but is often ignored by the Commission on the grounds that it contradicts other articles of the Implementing Rules, the breaching of which would leave the authorising officer financially liable. This clause is therefore unenforceable by beneficiaries.

If the authorising officer authorises payment when the claim has not been certified as correct, as specified in Article 99 Implementing Rules, then the officer is in breach of the Regulation. The officer is only personally liable if he/she makes a payment or the Commission suffers a loss when acting in breach of the Regulation. Hence if no payment is made, there is no loss to the Commission, and so no personal liability.

The Commission can withhold payment while awaiting the outcome of an audit. The authorising officer only needs to ask the Internal Auditors to begin an Audit and payment can be automatically withheld.

This leaves NGOs with no protection against late payment. Payments can even be years late. In this case, default interest is no protection to NGOs from the financial consequences of such delays.

There should also be protection from the Commission stopping the clock by 'making up' unreasonable questions or issues. Amongst the interviewees there is a belief that questions are asked merely to stop the clock.

¹³ This Regulation should stipulate that the operations of validation, authorisation and payment must be completed within a time limit which will be set in the implementing rules and that in the event of failure to respect this time limit creditors will be entitled to default interest to be charged to the budget.

Recommendations: Implicit Approval

Change the Regulation to state that after 45 days authorisation by default or implicit approval occurs, and that in this case all other rules of checking, personal liability and audit are overruled. It should be treated as a damages payment.

A report of all such payments should be made to the Secretary General and European Parliament each quarter.

To ensure that this system operates equitably, a report summarising the questions to claimants that stop the clock, categorised into themes, values and length of time remaining, should be made to the Secretary General and Parliament each quarter.

E. Payment periods

Article 106 of the Implementing Rules:

1. Sums due shall be paid within no more than forty-five calendar days from the date on which an admissible payment request is registered by the authorised department of the authorising officer responsible; the date of payment shall be understood to mean the date on which the institution's account is debited.

The payment request is not admissible if at least one essential requirement is not met.

2. The payment period referred to in paragraph 1 shall be thirty calendar days for payments relating to service or supply contracts, save where the contract provides otherwise.

3. For contracts or agreements under which payment depends on approval of a report, time for the purposes of the payment periods referred to in paragraphs 1 and 2 shall not begin to run until the report in question has been approved, either explicitly with the beneficiary being informed, or implicitly because the time allowed by the contract for approval has expired without being suspended by means of a formal document sent to the beneficiary.

The time allowed for approval may not exceed:

- a) 20 calendar days for straightforward contracts relating to the supply of goods and services;*
- b) 45 calendar days for other contracts and grant agreements;*
- c) 60 calendar days for contracts involving technical services which are particularly complex to evaluate.*

This article is confusing, illogical and very difficult to interpret. It appears to say that the period for approval and payment is 45 days except for goods and services when it is 30 days.

Clause 3 states that for grants, AFTER approval the Commission has a further 45 days to pay. If the claim is approved, then the payment processing is simple and should require no more than a few minutes elapsed time. It certainly should not take longer than the total process for goods and services.

There is no reason for the process to require a further 45 days. **Such payment delays damage NGOs financially.**

Recommendation: Payment period

The Regulations should clearly separate approval periods and payment periods for all transactions.

The approval period may stay at 45 days, but should ideally be reduced.

The payment period of an approved claim should be no more than 5 working days.

F. Certifying claims as ‘correct’

Article 99 of the Implementing Rules states:

(b) the payment request itself, or an internal document accompanying the payment request received, has been endorsed ‘certified correct’ and signed by an official or other servant technically competent, empowered by the authorising officer responsible; by such endorsement, he certifies that the action or work programme carried out by the beneficiary is in all respects in compliance with the grant agreement;

Certifying as correct is too onerous a requirement and can lead to excessive checking and often requests for additional information. With returns, a list of all transactions is required, but the level of checking is increasing and more information is often requested. Overall, this process is excessive and checking is very costly in terms of time and therefore money, for both the Commission and claimants.

External auditors would not normally certify accounts as correct. Indeed, the Court of Auditors believes that it is enough to obtain reasonable assurances. They do not set out to prove or certify accounts as correct. In the UK the words “true and fair view” are used. There needs to a corresponding level of reality and reasonableness applied by the Commission. Currently, the system of very detailed checks damages the efficiency of the system.

A Commission lawyer argued that the clause should be sensibly interpreted in the context of the law and normal practice. This is reasonable, but most people, Commission officials as well as those outside the Commission do not really understand the law and therefore take what they read literally.

Article 47 of the Implementing Rules states

4. The ex post verifications on documents and, where appropriate, on the spot shall check that operations financed by the budget are correctly implemented and in particular that the criteria referred to in paragraph 3 are complied with. These verifications may be organised on a sample basis using risk analysis.

Article 47 and Article 99 are incompatible. If a statistically based sample check is carried out then it is only possible to certify that “on the balance of probability (to a level of confidence) that the claim is correct”.

If a totally random sample is used then it is possible to say that given the sample results it is likely to be correct.

Using sample checks, it is not possible to certify a claim as correct.

Claims can be made up of hundreds or even thousands of invoices. To apply the Regulations properly means that all these invoices are being checked in many instances. On top of this, further support is requested such as hotel invoices to support per diem claims or a record of the exact hours worked (grant beneficiaries are often small NGOs not lawyers sitting behind a desk with sophisticated time management systems in place). DG Education and Culture alone makes over 10,000 payments a year. Supporting these must involve hundreds of thousands of transactions.

Recommendations: Certifying Claims as Correct

Authorising officers should have to declare that “the checks undertaken give reasonable assurance, given the Directorate’s normal procedures that the claim is in accordance with the contract”.

A Commission-wide review should be undertaken to assess the level of checks required and so consider the efficiency and effectiveness of the programme.

Note one possible system of control is described in section 7.4 of this report.

G. Changing Agreements. (Article 164 of the Implementing Rules)

3. Grant agreements may be amended only by written additional agreements. Such additional agreements shall not have the purpose or the effect of making such changes to agreements as would call into question the grant award decision or be contrary to the equal treatment of applicants

This clause requires equal treatment after the event and leads to a reluctance to change grant agreements. As a result they are not changed when they should be. (The research showed that the ability to obtain agreements for change varied by programme).

There needs to be an acceptance of humanity. We cannot foresee the unforeseen, we learn and evolve from that learning, the environment generates new needs and removes others e.g. a Government change, or even new legislation. In fact the one most cited reason for changing project plans was late payment by the Commission forcing a change of plan.

The use of experts and a jury should ensure that grants are awarded based upon the best information available at the time.

For multi-year grants it leads to rigid budgets being adhered to that were constructed up to 4 years in advance. This means that learning and the ability to adapt to a changing environment are lost. This inflexibility can significantly reduce the benefit of a project.

Recommendations: Changing Agreements

Changes to grant agreements should be allowed if circumstances have changed through environmental, political or operational change or if the learning process supports better options for future implementation. Decisions can only be made on the basis of knowledge that is held today. Hindsight cannot be used in advance.

Proposals for change supported by examples of changes should be approved whether or not it would have affected the initial decision to award a grant. The procedures for award ensure that the decision is made based upon the best information available at the time.

If the Commission official refuses to allow a change, there should be a fast track process of appeal.

H. Procurement

Article 164 of the Implementing Rules states :

- (h) where implementation of the action involves procurement, the principles referred to in Article 184 or the procurement rules which the beneficiary must comply with;*
- (i) the responsibilities of the beneficiary, in particular in terms of sound financial management and submission of activity and financial reports;*

The Commission's procurement rules are onerous for Commission officials to adhere to let alone small NGOs with few staff or NGOs operating in developing countries within short time frames. Further information on this point is available from Concord's comments in Appendix 5.

Recommendation: Procurement

Procurement procedures should be variable and reasonable depending upon the grant beneficiaries, values and environment of the action. There should be separate guidelines that the Commission can use for insertion into a grant contract.

These guidelines should be drafted in consultation with, and require the approval of, end users.

J. Start Date

Article 112 of the Financial Regulation states:

“A grant may be awarded for an action which has already begun only where the applicant can demonstrate the need to start the action before the agreement is signed”.

This is essentially an admission that projects “belong” to the Commission and not NGOs, if NGOs are not allowed to start work without the permission of the Commission.

If the NGOs are delivering a service for the Commission, then this is reasonable, but in this case the quid pro quo is that the Commission should properly remunerate the NGO for the service. See chapter 4.

Recommendation: Start Date

An NGO should be allowed to start a project after the proposal submission but before the contract date at its own risk. If the grant is won, costs should be recoverable from the start of the project.

7.2 Issues not included in the Financial Regulation and Implementing Rules, but often considered to be

No dialogue during selection

There is an assumption that the Financial Regulation does not allow the Commission to talk to applicants prior to an award. This “rule” is not specified and has been inferred from the principles of equal treatment and transparency.

Recommendation: Dialogue

The Regulations should specifically address this point and clearly allow the practice of asking for clarifications where questions arise during the project evaluation phase.

The final selection criterion should involve interviews. Costs of attendance should be covered by the Commission.

Contingency

It is widely believed that the Regulation has stopped the use of contingencies. These are small funds which allow for unforeseen changes in circumstances such as exchange rate fluctuations which will impact upon project costs or costs that are necessary to incur but that could not have been foreseen at the start of the project. However, this is an interpretation of section 173 of the Implementing Rules by DG Budget. The section requires the application to show clearly the eligible costs for financing. Contingency is therefore ruled out as it is not a specific cost that ‘can be shown clearly for financing’. However, prior to the new Regulation entering into force, contingencies were always included in grant contracts.

This point needs to be addressed explicitly in the Regulation. It is important in changing circumstances to cope with such items as exchange rate fluctuations, environmental changes or amendments to project plans, especially those made at the suggestion of the Commission.

Recommendation: Contingency

Enable contingencies to be budgeted for in projects involving an element of uncertainty or when exchange gains or losses are possible.

7.3 Personal Liability: The Management Incentive scheme

Research has proved that incentive schemes are very effective in eliciting required responses. Even more successful are sanctions systems, particularly those driven by fear coupled with close supervision.

The Financial Regulation inadvertently introduced a management incentive scheme.

Article 66 of the Financial Regulation states:

The authorising officer shall be liable to payment of compensation as laid down in the Staff Regulations, which specify that an official may be required to make good, in whole or in part, any damage suffered by the Communities as a result of serious misconduct on his/her part in the course of or in connection with the performance of his/her duties, in particular if he/she determines entitlements to be recovered or issues recovery orders, commits expenditure or signs a payment order without complying with this Financial Regulation and its implementing rules. The same shall apply where, through serious misconduct, he/she omits to draw up a document establishing a debt or if he/she neglects to issue a recovery order or is, without justification, late in issuing it, as the issuing of a payment order may involve third-party liability of the institution.

The report author has been informed that there has only been one case where this article has been enforced and another is in process.

However, the wording is clear, a breach of the Regulation, in any way, intentionally or not, can lead to personal liability if the Commission suffers a loss. The most likely way to suffer a loss is through making an “incorrect” payment.

Understandably, this is a clause that can lead to fear and it is a strong disincentive to authorising officers to make payments. The burdensome procedures may be due to a lack of understanding of controls, but also a desire to diffuse responsibility by tying as many people as possible into a payment decision.

Some Commission officials argue that the clause should be read sensibly and interpreted in a way that it would be treated in Court where the benefit of the doubt would be given. They say that it is a clause behind which certain officials choose to hide and that the real issue is a management not a regulatory one.

Many people read what is written and take it literally. This is understandable where inexperienced officials start work on grant programmes without sufficient understanding of the Regulation and see that incorrect interpretation could in fact, threaten their livelihood.

From an NGO perspective, payments are almost always late. This clause is almost certainly part of the cause, with only the degree to which it is the cause being unclear. What is clear however, is that NGOs need changes that facilitate timely payment.

This should also be considered from the perspective of the other rewards and sanctions for adhering, or not, to the principles of sound financial management. The reward and sanction system in the Commission awards promotion largely on the basis of time worked at a specific

grade and contacts. This leads to an unbalanced system not based on any kind of performance indicators. The diagram below displays the consequences for Commission officials of adhering or not to the principles of sound financial management.

<u>Principle</u>	<u>Reward for success</u>	<u>Sanction for breach</u>
<u>Economy:</u> <u>Compliance – revenue & expenditure operations</u>	None known	Liable to payment of compensation and disciplinary action as laid down in the Staff Regulations
<u>Efficiency</u>	None - not generally measured	None - not generally measured
<u>Effectiveness</u>	None- not universally measured	None- not universally measured

Paragraph 11 of the Financial Regulation should be kept in mind:

The principle of sound financial management should be defined by reference to the principles of economy, efficiency and effectiveness, and compliance with those principles checked by means of performance indicators established per activity and measurable in such a way that results can be assessed.

The Commission's budgeting and accounting systems have not been set up to measure efficiency. Indeed, full costs of any operation cannot be easily identified.¹⁴

Can it be concluded that the Commission is in breach of its regulations for not establishing performance indicators for all of its activities and then measuring performance against them? If so the question remains, apart from the difficulty in implementing the Financial Regulation, why are such apparent breaches of the Regulation occurring? One likely reason is that there is no sanction for not, nor reward for, implementing them. The whole focus is on the one area where sanctions exist: procedural compliance.

Interviews showed that the Regulation is used as an operating manual within the Commission. The wording is therefore very important to its understanding and implementation. For the interpretation, authoring officers should not have to search other documents or regulations for explanations.

Recommendation: Personal Liability

Clarify the clause making authorising officers personally liable for loss to the Commission (Article 66). The Regulation should explicitly place the burden of proof on the Commission to prove intention to defraud or negligent behaviour. If this is already the reality, the wording must reflect it.

¹⁴ Technopolis report for Commission: Strategic Evaluation of the Management Methods of Programmes June 2004

7.4 Systems of Financial Control and Segregation of Duties

The Regulation includes a section on “Segregation of Duties.” It is the responsibility of the authorising officer to implement the system of control. The accounting officer (responsible for record keeping and reconciliation) is another recognised position that has legal liability.

Segregation of duties is a basic, key internal control of any organisation. It is used to ensure that errors or irregularities are prevented or detected on a timely basis by employees in the normal course of business. The Commission internally calls this the system of “four eyes”.

Segregation of duties provides two benefits:

- 1) A deliberate fraud is more difficult because it requires collusion of two or more persons,
- 2) It is much more likely that innocent errors will be found.

If a single person can carry out and conceal errors and/or irregularities in the course of performing their day-to-day activities they have generally been assigned or allowed access to incompatible duties or responsibilities.

There are five general categories of duties or responsibilities, which are examined when ensuring adequate segregation of duties in dealing with the provision of services: initiation, authorisation, record keeping, reconciliation and payment. In the case of goods or cash, custody can be added.

Examples of incompatible duties are:

- Initiating a transaction e.g. choice of beneficiary
- Authorising a transaction as fit for payment
- Making a payment
- Updating the accounting records
- Reconciling accounts

In the case of grants, initiation of a specific transaction is by an award committee or jury. In a reasonable system, different employees would perform each of these four other major functions. In other words, no one person should have two or more of these responsibilities.

A ‘normal’ segregation within the Commission to approve payments would be:

1. Desk officer checks conformity to plan and budget
2. Head of Unit authorises
3. Finance Officer checks and approves
4. Accountant authorises
5. ‘Vericon’ (a person not involved in the process so far) verifies that the process has been respected
6. Final approval – order to pay

Person 4 and 6 are often the same person

Accounting and physical payment are carried out by different Commission officials.

A procedure requiring 3 signatories, not 6, would normally represent good control.

For grant payments the basic checks are currently:

1. Evaluation checks whether the work contracted has been carried out.
2. Checks include ensuring that all the costs of doing the work are:
 - a. not overstated
 - b. are reported in the prescribed format
 - c. are within tolerance levels by line (10% or 15% rule)
3. Confirmation that the checks have been done.

A major reason for late payment seems to be that the payment authorising procedures are excessive and inefficient. Also, the 'annual cycle' means that all the claims arrive at a similar time. This creates an imbalanced workload and periods of extreme pressure.

The Commission normally has 45 calendar days for approval and 45 days for payment i.e. 90 days. The national government procedures researched for this study are able to approve and pay claims in 30 days or less.

It should be noted that late payments are those exceeding the defined period for payment plus any time where the 'clock has been stopped'. Errors by claimants stop the clock, and so do not cause 'late payments'. It is only Commission procedures or administrative backlogs that cause 'late payments'.

As explained above, normal Commission approvals require 6 signatories. However there can be more. One Commission finance official explained that grant payment approvals in their DG required a minimum of 7 and a maximum of 15 signatories.

Each approval requires:

- Actual checking of projects
- Explaining projects to non participants prior to signatory
- Dealing with subjective issues raised by signatories
- Having the necessary people available.

The 45 calendar day requirement will not be met if there are too many checks and too many signatories.

Too many signatories create additional work but do not normally strengthen control. The major benefit to Commission officials of too many signatories is that the more people who sign, the less likely that any one can be held responsible i.e. it can reduce perceived responsibility and so control.

One of the signatories is a Commission finance officer. NGO feedback indicates that in an increasing number of cases every invoice is checked. In many cases the Commission finance officer will do a check of every invoice and request further information. Many of these officers do not have finance training, but are comfortable doing detailed work.

Interviews indicate that NGOs believe that some questions are asked by the Commission merely to stop the clock. This view is supported by cases where the NGO is unlikely to have the requested information or it appears unnecessary. Often, after complaints by the NGO, the Commission has withdrawn the request, suggesting that the requested documentation was indeed unnecessary.

For most transactions the number of signatories and the level of checks are excessive.

This is important for a number of reasons, not least because:

1. It inflates the Commission's costs.
2. The detail of the claims and the follow up questions cause significant work loads for the claimants and consequently extra costs.
3. It delays payments.

The reasons that the procedures are onerous include:

1. Lack of understanding of systems that have been implemented or approved by generalists, rather than by officers with financial training.
2. The layering of new requirements on top of old ones rather than re-assessing the systems¹⁵
3. The Financial Regulation requires transactions to be 'Certified as Correct' and payments can lead to personal liability of authorising officers. See separate comments section 7.1, F.
4. Pressure from the Internal Auditors and Court of Auditors to ensure control, but no pressure to ensure efficiency or effectiveness.
5. General lack of measurement of efficiency despite the requirement to do so in the Regulation (see Chapter 12).

Recommendations: Systems of Financial Control and Segregation of Duties

- 1. Each department should review its systems and segregation of duties based upon the requirements of economy, efficiency and effectiveness as required by the Financial Regulation.**
- 2. The key project approval check should be: was the project completed as contracted? It should not be "has the expenditure been the same as the budget?"**
- 3. Reduce the detail of the budget against which transactions are checked see 4.3.**
- 4. The finance officer undertakes detailed checks on a sample basis. This will NOT include a review of every invoice unless errors are found.**

Normal checking will include:

- **Basic checks such as correct budget, correct additions, 10% rule etc. and there should be IT systems to do these checks automatically. Electronic submission by claimants would automate this process.**
- **A review of costs against budget and an understanding of the variances. These should be explained in the claimant's project report.**
- **A review of major cost items for reasonableness.**
- **A general review for reasonableness.**

¹⁵ Technopolis report for Commission: Strategic Evaluation of the Management Methods of Programmes June 2004

- 5. Where questions are asked that stop the clock, the authorising officer should approve the request and certify that it is a reasonable request to make. A report of all questions that stop the clock is recommended.**
- 6. Internal audit should be charged with reporting and making recommendations on both the adequacy of internal control, on efficiency and on unnecessary procedures.**
- 7. The Financial Regulation should be amended in order to remove the requirement of the authorising officer to ‘Certify Correct’ a transaction for these recommendations to be implemented (see Chapter 7 F). A better approval would be “the agreed systems of controls and sample checks give reasonable assurance that the claim is correct’.**
- 8. For interim claims the Commission official should be able to sign off after reading a brief update report from the beneficiary. The amount of the claim should be pre-defined. If there is real reason for concern, the maximum that a payment could be held up should be 15 days for investigation, and should begin with a dialogue with the counter party.**

**Interim claims should be paid within a maximum of 30 days.
Pre-financing should be paid immediately a contract is signed.**
- 9. The authorisation procedures and segregation of duties should be reviewed and considered from a context of efficiency and effectiveness. A proposed procedure is described on the next page.**
- 10. Give authorising officers training in efficient and effective financial control and segregation of duties.**
- 11. Re-assess the interpretation of “annuality”. The creation of annual cycles to fit with budgetary requirements creates unnecessary peaks and troughs in the workload for Commission officials, but has also lead to multiple interpretations which have impacted work programmes.**

Suggested standard segregation of duties:

There is not a definitive set of authorisation procedures that can be recommended but the example below is an efficient and effective way of authorising transactions with good segregation of duties.

Original Budget

1. The '**Contracts Manager**' finalises a contract with a beneficiary on the instructions of the **Award Committee**.
2. The '**Contracts Manager**' inputs the 3 line budget details into 'The System'. This should trigger an immediate payment instruction of the agreed pre-financing for the '**Accounts Manager**' to approve and initiate.
3. A representative of the '**Awards Committee**' reviews the input on a sample basis.

Changes/updates to the Budget

4. The '**Project Task Manager**' agrees changes or new years of multi year contracts with the 'Beneficiary'.
5. The '**Head of Unit**' approves the changes.
6. The '**Contracts Manager**'s department updates the budget.

This input is used as the base for future checks, but also updates the Commission's overall budgeting system. The input is also used by Finance to update accounting records and forecasts. No one outside the Contract Managers department can update the budget in 'The System'

Claim

7. Ideally the 'Beneficiary' enters the Claim into 'The System' remotely (otherwise a Finance clerk inputs the data)
8. 'The System' does standard checks such as additions, or variances against budget. 'The System' automatically emails the Beneficiary of any errors in the claim, which the beneficiary must correct remotely.
9. The '**Task Manager**' reviews the project report and claim, and approves that the work done is in accordance with the Contract. If it is not there should be a separate procedure. *Note, the Task Manager should be having an ongoing dialogue with the beneficiary and have at least received interim reports if not visited larger projects.*
10. Disallowed amounts will be emailed to the Finance Department which will make adjustments to the claim in 'The System'. The beneficiary is simultaneously emailed. Note, the '**Task Manager**' cannot update the source of the accounting records in 'The System'.
11. The '**Head of Unit**' reviews and approves the sign off of the '**Task Manager**'.
12. 'The System' instructs Finance to check claims on a random, but statistically valid basis, plus highlights unusual variances to budget for checking. *Note, projects that have been externally audited should not be checked again.* The '**Finance Manager**' checks as instructed. Errors found are updated in 'The System' by the '**Finance Manager**', and the Beneficiary and '**Task Manager**' are notified by email. Questions are asked by email.
13. 'The System' automatically notifies the Beneficiary if the clock is stopped and why.
14. The '**Accounts Manager**' approves the payment on the basis that the correct process has been performed i.e. the '**Head of Unit**' and '**Task Manager**' have approved it and where 'The System' shows a requirement, the '**Finance Manager**' too.
15. The '**Payments Clerk**'; makes the payment.
16. Internal audit performs random checks, but this process does not hold up payments.

This example separates the authorising and originating personnel as required in the explanation of how effective segregation of duties should work. It also uses automation to speed up the process and ensure proper communication with the beneficiary as required by the requirement for 'good administrative behaviour' and a transparent system of control.

This process requires 3 signatories for most transactions and a fourth where extra financial checks are performed. It removes the need for the involvement of the 'Vericon' and the finance head of unit. It facilitates sample checking and reliance on external audits. It should significantly speed up and reduce the cost of claims administration.

Where external auditors have been relied upon, if internal audit later finds that the external auditors have not undertaken their audit to the specification of their brief (to be specified in the contract), then the Commission should set an example, and begin legal proceedings.

This process would require the Commission to review their personnel resources. Firstly, it would require fewer finance officers, secondly finance officers will need to be adequately trained, not necessarily to accountant level, but enough to ensure relevant experience and training in order to undertake reviews as well as tick numbers.

The reporting requirement should be stated in the grant agreement and should include the right of the Commission to ask for a list of all transactions but not including proof of payment of each transaction or details behind flat rate allowances. It should not require photocopies of all invoices nor supporting documentation relating to flat rate allowances. For larger projects the list of transactions should be restricted to those over a certain value.

The finance officer may request copies of invoices, but must be reasonable in this request and give reasons for any requests in addition to system-generated random tests.

The sampling required should take into account whether or not the grant (not the beneficiary organisation overall) has already been subject to an external audit. If there has been an external audit, there should be no need to check it again.

Chapter 8

National Government Procedures: Summary

The workings of 4 national government funds were reviewed with the objective of enabling comparisons of best practice. Three are international development funds and the fourth is a national fund.

The Funds chosen were:

International Funds

- Department For International Development (DFID: United Kingdom government)
- Swedish International Development Agency (Sida: Swedish government agency)
- Danida from Denmark (Danish Ministry International Development Agency)

National Fund

- The Big Lottery Fund, UK

See appendix 6 for a more detailed description of each fund.

Summary of findings

The funds covered a mixture of strategic partnerships and discrete project funding.

The most significant differences are in the approaches of the national government funds compared to the Commission as explained below. In general, national government funds exhibit:

- A much more strategic approach to funding
- Greater use of partnerships which are both strategic and long term
- Simpler processes and documentation
- A less adversarial approach and a culture and approach of innocent until proven guilty.
- A more efficient and realistic review process
- Recognition of the value that the NGOs bring
- A greater reliance on external audit
- More emphasis on dialogue and visits
- Significantly fewer finance people involved
- Much more efficient operations which are much less costly to operate.

Experts are used in different ways to the Commission, and only for project funding.

- DFID use experts, but have a contract with an organisation that they know and with whom they have a long term relationship.
- Danida do not use experts.
- Sida use large Swedish NGOs to give grants in their field of expertise that they describe as 'umbrella' organisations. For grants that go directly to NGOs Sida undertake strategic reviews and monitoring.

The impact is that a pool of knowledge has been, and continues to be, built by these national operations, something that the Commission is not developing. One Commission official argued that its knowledge of the NGO community is rapidly depleting.

A limited sample indicates that the attitudes of the NGOs towards these fund managers are much more positive than towards the Commission.

DFID Challenge Fund

This is a £14 million (€1 million) fund that finances discrete projects with a maximum grant of £0.5 million (€0.7million) over a 5 year period. NGOs submit their own projects for funding, and there is no Call for Proposal process. An organisation of experts is used for project evaluation, on a long term contract.

The application process is in stages beginning with a 2 page concept note covering intention and method. It is based on a logical framework analysis which is also used for project reporting.

If the Concept paper is approved then full proposals must be submitted and are assessed according to the broad objectives of the fund as stated in the Fund literature. The full proposal is assessed by the same organisation of experts who passed the Concept paper.

The final funding decision is made by the DFID team after consultation with the experts and taking into account input from country and policy officers. It is a qualitative process. Each of the Challenge Fund managers has their own portfolio of projects and they all try to meet with the funded projects' teams.

Monies are paid quarterly based upon claims and can be advanced based upon requests supported by reasoning. Claims are paid based upon work done and not on detailed checks against budget. The 10% rule applies but can be overridden. An external audit is required. DFID undertakes to pay all claims within 30 working days of receipt of a valid claim.

DFID estimated their efficiency for the fund at 3.5%, but a review indicated that this may not be properly overheaded, so for comparison purposes, and to ensure fairness to the Commission, efficiency has been estimated by the author at 4.9%.

DFID: Partnership programme

Three people manage this fund, which provides longer term core funding for 5 or more years to large international aid organisations like Oxfam and Action Aid. A total of 19 NGOs are currently beneficiaries. For 2004-2005, the fund was approximately £64 million (€3 million) and this is expected to rise to £79million (€15 million) in 2005-2006.

There is no annual call for proposal process, instead as policy and budgets allow, calls for expressions of interest are published. After an initial review, organisations are then invited to submit a full proposal. Decisions to enter into Partnership Programme are approved and negotiated by DFID.

Successful PPA applicants receive funding for 5 years and will renegotiate funding towards the end of the 5 year period for a future funding period. There is no requirement to go through the application process again.

Claims are made for quarterly payments. Controls require an annual report, not in a pre-specified format, and communications are informal with regular communication encouraged. Communication takes place regardless of expenditure status.

The administration cost is 0.11% of allocated budget of £79.14m according to DFID, but again this has been increased to 0.3% for use in the report to ensure that overheads are properly accounted for and to again ensure fairness to the Commission when comparisons are made.

Sida (Swedish International Development Agency)

The government identifies priorities for the development budget and with parliament decides expenditure by theme and region/country. Sida's role is purely operational. It awards grants of approximately €130 million a year. Sida funds 6 large NGOs directly and uses 7 umbrella NGOs to fund smaller NGOs. Overall it is believed that the monies reach directly 400 to 500 NGOs and through them, 2,000 to 3,000 NGOs.

Documentation is concise and simple to understand. Sida takes a very strategic approach to reviewing and approving projects selected by the NGOs. There is a reliance on external audit and the sanction of being able to withdraw financing to ensure adherence to the rules.

Payment is normally quarterly in advance.

Efficiency at Sida is not directly measured, but this is a minor cost area and has been estimated by the author at below 1% of the grant value based upon the staffing levels given at the interview.

The guidelines limit administrative costs of the 13 main NGOs. For umbrella organisations it is 9.5% (4.5% retained, 5% for sub-grantee). For others the administration fee is 8% (similar to the Commission allowance of 7%). This gives an estimated efficiency of 3.25% cost to grants awarded.

Danida from Denmark (Danish Ministry International Development Agency)

Danida awards annual framework contracts to 5 large NGOs. They are selected based on their capacity and their strategies for development work, not on the basis of individual projects. The total budget available for framework contracts in 2005 is €48 million.

Besides the framework contracts there are two calls for (other) proposals annually. The total budget for these projects in 2005 is €49 million. In principle all budget appropriations are annual, but multi-annual projects are also financed under a budget framework where the allocation for each year is made.

Calls for proposals are published. Applications are evaluated internally (sometimes with input from Danish missions in recipient countries) and experts are only involved in evaluating a specific HIV/AIDS programme. The process is informal with frequent contacts between the officials and NGOs.

The administration has been simplified by moving away from checks of individual projects, requiring only sample checks, and demanding an audit by a statutory auditor for each NGO. The administrative focus is now on reviewing strategies, results and outcomes.

A service has been established to provide assistance for NGOs to improve their administrative and delivery capacity. This gives NGOs support in managing projects. This has been proven to greatly improve the quality of project management as well as reducing the administrative time required from Danida officials.

An administration allowance of 7% is common. Little budget flexibility is possible but a reserve of 10% is often included in project budgets. NGOs can move up to 10% of costs from one budget line to another without consulting Danida.

Payments are made twice per year on the basis of a cash-flow plan from the NGO. All financing is therefore “advance payment”. Payments are made very quickly and bank guarantees are not required. However, the funds are placed in a special bank account where Danida has a priority right to the funds in case of project failure. Only three signatories are required for payments, which happen promptly.

No efficiency figures were available, however it can be implied from the process and the similarities with DFID and Sida that the costs of administration will be low.

Big Lottery Funds

Community Fund

The principal activity of this fund is to give grants to help those most disadvantaged in society and to improve the quality of life in local communities. It is a UK based fund although 6% of funds are spent outside the UK.

New Opportunities Fund

The principal activity is to support education, health and environmental projects under initiatives specified by the government.

In 2003-2004, both funds were independently managed and efficiency numbers have been taken using the published accounts for these years. The costs used for this calculation are the full costs as specified in the organisation’s published accounts. Therefore, they include all support costs including finance, budgeting, administration and internal audit (the equivalent in the Commission would be to include allocations for DG Budget, DG Administration DG Policy co-ordination and legal, and audit).

The New Opportunities Fund states that the administration costs are 5.2% over the life of the fund. The Community Fund has lower efficiency but gives out very small grants.

Performance Indicators

An important lesson that can be taken from these funds is the use of the performance indicators such as efficiency levels or beneficiary complaint numbers which the funds publicly report against. See Appendix 6 for examples.

Chapter 9

Operating Grants

Research Results and Recommendations

Operating Grants support the functioning of a body which pursues an aim of general European interest or has an objective forming part of a European Union policy. An NGO with an operating grant is often referred to as “core funded”. These grants support the ongoing operations of NGOs rather than specific projects. Grants can cover from 5% to 90% of the NGOs annual expenditure, but always require at least 10% co-financing.

In interviews with the NGOs that receive operating grants, open questions were asked about issues to do with the Commission’s funding process. The issues raised by the NGOs showed a very high level of consistency.

The Key issues raised were:

- A. Co-financing
 - a. Ability to raise funds
 - b. Reduction in funds by the Commission
 - c. The insolvency trap
- B. Payment delays
- C. Relevance of the financial information supplied
- D. Double funding

Interviews on this subject were held with the European Policy Centre, European Association for Education of Adults, World Wildlife Fund for Nature, The European Women’s Lobby, plus one other NGO that prefers to be nameless. A submission was received from Soul for Europe which is in the process of being wound up.

Financial Perspectives 2007 to 2013

The new financial perspectives will bring changes to the funding process that will be both positive and negative in the eyes of the NGOs. Many core funded NGOs have become reliant on banks for their survival as a result of late payment by the Commission and the co-financing mechanism, referred to as the insolvency trap, (see section A. c.).

This heavy reliance on banks means that the Commission must communicate with the banking and NGO communities their intentions for core funded NGOs. If, under the new financial perspectives, banks have reasonable concerns that the NGOs are not going to receive their funding from the Commission, then a crisis could occur as banks recall their NGO loans.

Clear and early decision making that is properly communicated is imperative for the financial health of these NGOs.

A. Co-financing

The major issues are:

- a) Ability to raise co-financing and how much
- b) Reduction in funding
- c) The insolvency trap

a. Co-financing: Ability to raise funding

The Commission applies its 'one size fits all' approach to co-financing. Some NGOs believe that from 2007 all 'core funded' NGO's will have to raise 20% or more in co-financing.

At present the co-financing requirement takes no account of the potential sources of co-financing available to an NGO e.g. membership profile of international NGOs. If the national memberships are small volunteer groups the ability to raise finance is significantly different from that of large institutions such as international development NGOs.

Recommendations: Co-financing and the ability to raise funds

The co-financing percentage should not be fixed, but based upon the perceived ability of the beneficiary to achieve the co-financing target, their potential 'target market' and their history of fund raising.

The Commission should appoint authorising officers with the ability, training and knowledge to be responsible for setting co-financing limits of each NGO.

This same person should be responsible for the recommended strategic review.

b. Co-financing: reduction in funding and planning

An NGO must co-finance a percentage of eligible expenditure and all its ineligible expenditure. If an NGO does not achieve its co-financing target, the Commission decreases its funding pro-rata.

As an example, there is a total budget of €100 of funding for €100 of costs. Funding consists of a Commission contribution of €80 and co-financing of €20. If the NGO spends its budget but only raises €15 in co-finance, then the Commission will reduce its contribution from €80 to (80 multiplied by 15/20) to €60.

If the NGO was going to make a loss of €5 as a result of its inability to raise the co-financing budgeted, the Commission turns this into a loss of €25. The Commission does this with the intention of giving an incentive to NGOs to raise co-financing and to gain maximum leverage from the Commission's funding.

In order to better manage the process, NGOs could budget to spend costs based upon a prudent view of achievable co-financing. However, if they do this, the Commission cap the grant at below the maximum amount available, because the allocation is based strictly upon the NGO budget. If the NGO then raises co-finance of a higher level, the grant will not be increased accordingly. Also, certain activities such as conferences have long lead times so cannot be changed to reflect the funding position easily.

If the budget is lower and the NGO carries out fewer activities to spend less, the NGO's ability to raise co-finance decreases accordingly as its activity decreases, it delivers less, it receives less exposure and has less access to funders.

Therefore, the system necessitates that NGOs budget an amount of costs that enable it to claim the full grant.

The system could be maintained by having two budgets: one for the Commission and one to manage the NGO. However, this would undoubtedly leave the NGO open to allegations of misleading the Commission.

In summary, where there is any doubt about the ability to raise co-finance these organisations have impossible management decisions to make, so adhere to the plan, and hope that they achieve the co-finance targeted.

Recommendations – Co-financing structure

Use an incentive method rather than a sanction method.

NGO funding from the Commission should be in 2 'tranches'.

- **The first is a minimum grant that it receives, as long as it spends it.**
- **The second is variable and a multiple of the co-finance raised.**

The Commission review process should be more strategic, based upon objectives and effectiveness, rather than the present 'ticking the boxes' approach.

The authorising officer should sign off the base budget from a strategic point of view i.e. what will be the effect of the expenditure (deliverables).

The officer should then sign off how the extra money would be spent if it becomes available, again from a strategic, and effectiveness perspective.

Where organisations have an operating grant that is only a small proportion of the budget (less than 60%), at present the grant is reduced if the whole of the organisation's cost budget is not spent.

Recommendations – Percentage of operational funding below 60%

Where organisations receive a grant that is less than 60% of the budgeted costs, remove the link between total spend and the grant, unless reports show a very significant under spend in the budget.

This will drastically improve the efficiency of the process for all concerned.

c. Co-financing: The ‘insolvency’ trap

The co-financing funding mechanism is explained above, except for the point that in any year, the NGO cannot make a surplus. An example explains this:

Year 1

- The NGO begins with net assets of zero
- It loses €100 giving net assets of minus €100

Year 2

- The NGO makes a surplus of €50
- The Commission takes away €50 of its grant because of that surplus
- Net assets remain at -€100

Therefore losses continue to reduce net assets and surpluses that could repair the deficit are not allowed. NGOs can come to a point where the net assets are so negative (i.e. it owes money to creditors or the bank), that the bank will feel that it can no longer continue support and the NGO will be deemed insolvent.

This regulation may be discriminatory as under certain national laws, organisations are not allowed to have negative net assets and would have to be wound up.

Recommendations: remove the insolvency trap

Adopt the recommendations above:

- 1. Co-financing target is based on the specific NGOs circumstances.**
- 2. The base budget and incentive payment approach is adopted.**

Rather than state a core funded NGO cannot make a surplus in any period, state that:

- **It cannot distribute that surplus**
- **That a year’s surplus cannot be more than 10% of the grant unless it is clearly labelled to be spent in the following year.**

Sustainability

Operating grants are intended to decrease over time although there can be exceptions. However, there is no view on a case by case basis of where the new funding should come from. This is particularly relevant given the financial position (negative net assets) that the Commission rules can leave NGOs in.

B. Payment Delays

The financial part of the grant making process is:

1. Prepare a budget
2. Agree a contract based upon the budget
3. Agree a contract
4. Submit audited prior year accounts
5. Sign a contract
6. Receive funding within 45 days: 40% of grant
7. Receive a further 40%
8. Receive 20% after audited accounts for year submitted and approved

For an organisation with a December year end, given that it will take an organisation at least 2 months to prepare accounts and have them audited, the Commission will not be able to sign the contract until March or April. This means that the 40% is not received until April or May (30% through the year). This has been as late as August for one NGO.

Given that the 20% from the previous year has not been paid, then the NGO inevitably operates on a bank overdraft. In this case NGOs continue to exist as a result of the goodwill of the banks who believe that the Commission funding will arrive at some point. This fact makes the ineligibility of interest costs all the more ironic. One NGO interviewed operates on an overdraft all year which at times reaches €400,000, an amount that is 40% of its income.

A December year end makes receiving payment early in the year impossible. However, an organisation interviewed with a June year end was still awaiting payment at the beginning of March even though everything had been agreed for payment by mid-November.

Recommendations: payment delays

Implement a similar process to the UK and Swedish Governments.

Treat the relationships as strategic and not as an accounting exercise. Value the outputs of the programmes (as the Commission's political masters must do to initiate the grants)

- 1. Form a real strategic partnership. Move to a programme of annual review for a given period (e.g. 5 years) and away from a process of annual application.**
- 2. Fund the NGOs a quarter in advance.**
- 3. Bank overdraft interest costs should be eligible costs.**
- 4. There should be a quarterly claim form requiring only summary level information. No transaction list and no copy invoices should be required.**
- 5. Automate the payment process and pay based upon the claim very quickly after its receipt, say 15 to 30 days.**
- 6. Give deadlines for submission of audited accounts, which if breached result in the suspension of payments.**
- 7. Have a half yearly, or quarterly, financial and strategic review depending on the size of the organisation. This should be a high level review undertaken by Commission staff capable of undertaking an overview and aware of the policy dialogue.**

C. Relevance of the financial information supplied

At present each budget must provide an enormous amount of detail showing how many meetings will be held, who will attend and why, where they are coming from, and how much it will cost for each. Two NGOs interviewed said this was unduly onerous. One of these was very small; the other held over 150 meetings a year.

The audit or checks on the NGO prior to final payment are then carried out at this level of detail which is generally perceived to be beyond the level of detail that should rationally be required. This detail has no strategic value; it is required purely for audit purposes. The Commission's auditing does not take account of effectiveness, nor is it an efficient way of operating by the Commission. It significantly reduces an NGOs ability to re-allocate budgets in response to unforeseen events.

While the 10% rule (maximum cost variance per line) has not been flagged as an issue, changing it would save the Commission and auditors from having to check cost allocations in detail and so save costs for both the Commission and NGOs.

Recommendations: financial information supplied

Annual reviews should be strategy reviews rather than detailed budget reviews.

Review expenditure at the year end with a view to ensuring that all monies were spent in pursuit of the objectives agreed with the Commission, not to ensure that the plan was rigidly adhered to.

Develop key performance indicators that enable a view to be taken of whether or not objectives are being achieved.

D. Double Funding

A core funded NGO cannot include 'core' costs in specific project costs i.e. it cannot include costs such as extra rent or telephone charges in its project costs. Two of the NGOs interviewed have operating grants and also undertake projects with the Commission. One is 80% Commission funded the other approximately 33% Commission funded.

If an NGO undertakes a large project it will increase its overheads. For any organisation, administration costs rise as the number of people increases. The history of the Commission's own support departments' costs as a percentage of "direct" costs would make very interesting and relevant reading.

It is, therefore, difficult to fund projects when extra costs cannot be included in the cost of the grants. Non-recovery of costs acts as a disincentive to applying for project support.

Recommendation – double funding

Allow overheads to be included in projects for organisations that receive operating grants at 7% of the direct eligible costs.

Chapter 10

Project Grants

Research Results and Recommendations

The results of interviews with and contributions from NGOs showed the following key issues:

- A. Late payment, including pre-funding
- B. Withholding payments / suspension
- C. Failure to communicate reasons for underpayment
- D. Commission recover monies after contracts are signed off
- E. Payments delayed awaiting audit
- F. Lack of support / access to the Commission
- G. Transparency
- H. Failure to act consistently
- I. Inconsistent objectives or low relevance to the environment
- J. Onerous and costly application procedures
- K. Timescales
- L. Minimum project sizes too large
- M. Flexibility
- N. Overhead recovery too low
- O. No recognition of planning costs
- P. Co-financing
- Q. Inappropriate tendering requirements

A summary of the responses is shown in appendix 3.

In general these issues have been supported by examples, however, most can also be traced back to the procedures adopted and are supported by the Commission's own documentation, or reports on the Europa website.

Further issues relating mainly to the aid and development NGOs are included in the papers written by Concord's FDR working group in Appendix 5.

A. Late payment, including pre-funding

The payment periods are explained in Chapter 7.1: E

Late payment was noted as an issue by every respondent. Recommendations elsewhere in the report cover this issue and include:

- Clarifying the Commissions certification of correctness requirement: see 7.1 F
- Explicitly clarify official's legal liability in the Regulations: see 7.2
- Enforce the implicit approval rule: see 7.1D
- Speed up the payment procedure: see 7.1E
- Other Governments can make payments of approved claims in less than 30 days. The Commission's time for payment, after approval, should be reduced.
- Implement the principals of Sound Financial Management and use sample checking, reduced signatory levels and proper reliance on external audit.
- Review the qualifications of finance staff. Ensure that finance staff are capable of checking by review.

Recommendations – late payment

A move away from the annual cycle and/or adoption of the procedures proposed in chapter 4 would reduce peaks and troughs in workloads. This would be facilitated by the use of the second procedure for giving grants as recommended in section 4.5.

Automate the procedure and require NGOs to remotely update their bank details into the eligibility database.

Give payments which are meant to be in advance, properly in advance. Pre-financing should be paid within 5 days of contract signature.

B. Withholding Payments / Suspension

Recommendation: Withholding payments

The Commission should have 45 days to resolve disputes to the satisfaction of both parties, or disputes must be sent to the Ombudsman by the Commission.

C. Failure to Communicate Reasons for Underpayment to Beneficiaries

This is in contravention of the Regulation, but is a recurring issue.

Recommendation: Communication of Underpayment

The procedures should be systemised. There should be a proper tracking system including a 'note pad' system. The system should automatically notify beneficiaries by email as soon as the decision to deduct amounts from the claim is made (see example procedures section 7.4).

D. Commission recover monies after contracts are signed off

These changes can be the result of Commission personnel changes meaning that a different subjective view of a previously made decision is taken, but it can also be the result of a different interpretation of the Regulation.

It has already been recommended that the Commission should move to the 3 line budget system used by ECHO for claims (goods and services, support costs, flat rate administration). Increase the 10% allowance for movement between budget lines to 15%. This will reduce disputes and the time required to complete and check a form as well as the likelihood of reduced payments resulting from allocations to lines.

Recommendation: Retrospective recovery of funding

If there are contract sign offs in multi year projects then the Commission should adhere to the sign off. It should only be overruled if auditors find fraud, negligence, or significant errors.

E. Payments delayed awaiting audit

Recommendations: Payments delayed awaiting audit

Move to an innocent until proven guilty approach and move the burden of proof to the Commission to prove errors in a claim, rather than delaying payment on the assumption that they will find errors.

Project payments should not be held up awaiting project audits unless reasons for suspicion have been explicitly stated to the claimant or unless the audits are delayed by the claimant.

There should be a fast track review with the Ombudsman if the claimant contests the explicitly stated suspicion.

The Commission should only be able to require an organisation's audit report for the year ended that precedes the end date of the project.

F. Lack of support / access to the Commission / inconsistent actions

Recommendations: Lack of support / access to the Commission / inconsistent actions

There should be a central reference point of best practice in order to:

- **Promote consistency across Commission services of best practice, procedures and interpretation of the regulations.**
- **Facilitate economies of scale**
- **Undertake benchmarking studies**
- **Offer 'experts' as the resource centre and focal point for any questions on the Regulation.**

Each department should have trainers who arrange tutorials for applicants and claimants.

G. Transparency

Reducing Grant Budgets Arbitrarily

Cases have been reported where the amount of a grant is reduced between award and contract, often without explanation.

Recommendation: Reducing Grant Budgets Arbitrarily

Projects should be accepted or rejected. Adjustments to budgets should be discussed at interviews and further suggestions for reductions should be based on rational analysis and debate, not a demand based upon power.

During one Commission interview, it was implied that a percentage limit of the total grant may be placed on salaries. This is typical Commission thinking, one size fits all, with no consideration of the relevant facts.

Feedback on rejected proposals

This is generally poor, partly because expert evaluators have very little time to review proposals and therefore make generic comments that the grant administrator cannot translate into real feedback to applicants.

Recommendations: Feedback on rejected proposals

All scores and comments should be placed on the system database that is also used for eligibility. Applicants should have access to the experts for direct comments.

This would provide the benefit of feedback directly from the evaluators.

Moving away from the annual cycle would allow a pool of expertise to be built and retained by the Commission.

Tracking applications and payments

At present queries as to the status of applications, contracts or payments meet with uninformed staff or erroneous answers. There are workflow systems operating in the Commission. These should be updated and each applicant or beneficiary should be able to track the progress of their query. This would save both sides a significant amount of time, and therefore money as well as improve transparency.

Recommendation: tracking transactions

Implement a web enabled workflow system whereby applicants or claimants can track the status of their applications and claims.

H. Failure to act consistently

This is a result of a number of factors including the transition to the new rules. A significant cause is lack of real understanding of the regulations and fear of breaching them. Recommendations already proposed attempt to address this problem. These are:

- Simplify the Regulation and make it end user focused (see Chapter 6)
- Combine the Regulation and Implementing Rules
- Ensure that auditors take a view based upon Sound Financial Management principles.
- Central point of reference within the Commission and benchmarking best practice.

Recommendation: Failure to act consistently

Project Managers should undertake at least one visit each year to a project.

The Commission should consult fully on the redrafting of the Financial Regulation and ensure that they are easily understood and relevant to user groups.

I. Inconsistent Objectives or low relevance to the environment

A new process whereby NGOs can apply directly to the Commission to have their specific project ideas funded should be introduced. See section 4.5. This will leverage the NGOs knowledge of the environment in which they specialise.

Recommendations: Objectives

The Commission should issue draft calls for consultation prior to publication of Calls for Proposals.

Calls should be more regular, with more clearly defined objectives but there should be a limit to the number of applications any one applicant can make a year.

The Commission must re-initiate a dialogue with the outside world in order to ensure it is funding an appropriate range and balance of NGO projects.

J. Onerous and Costly application Procedures

These issues are covered in Chapter 4.

K. Timescales

The Commission allows itself too long a time period in which to award contracts while simultaneously minimising the time given to applicants. The Commission does not commit itself to timetables, instead only providing indicative dates.

The application process should be in defined stages and introducing an automated eligibility process should speed up the process. See Chapter 4.

Recommendations: Long timescales in the Commission

The Commission should publish a definitive timeframe for funding to which they have an obligation to adhere. That timeframe should be benchmarked against other programmes and external parties to ensure reasonableness.

The Commission should be given clear targets by the new central benchmarking department depending upon the type of grant and its complexity.

Recommendation: Short timescales for applicants

The deadlines given should reflect the complexity of the project. Reducing the level of planning required pre-contract should facilitate shorter application cycles particularly where multi-partner and multi-country projects are concerned.

If co-financing and partnership agreements are required, then the time given to applicants should reflect the value and sources of that co-finance and the number and involvement of those partners.

L. Minimum project sizes too large

There appears to be an increasing preference for funding larger projects in the Commission in order to optimise “economies of scale” or mask its inefficiency. Programmes should explicitly consider the likely beneficiaries when deciding minimum project sizes. It should be an externally focused decision, not an internally focused one.

Recommendation: Minimum project size

Programme management including minimum grant sizes and co-financing percentages should be designed specifically for the programme taking into account the objectives, the environment and the target beneficiaries.

Experts with real knowledge of the beneficiaries should be used for this otherwise there should be a consultation process with target beneficiaries.

M. Flexibility

The financial plan is used to judge activity rather than the outputs of the project. Instead, actual proof of activity should be used to judge activity rather than rigid and detailed financial plans. The Commission must recognise that the environment changes, new needs emerge and lessons are learned.

Recommendations made elsewhere in this report would improve flexibility. These include:

- Move to a system more focused on effectiveness, see Chapter 13
- Seek evidence of actions (e.g. publication, video, witnesses)
- Reduce the detail against which to check in the budget
- Remove the clause in the Regulations requiring no changes if it would have resulted in a different decision in the first place (see Chapter 7.1 G).
- Detailed planning should only be for a year in advance
- Multi-annual projects will have an annual planning cycle (not a new application) with activities and budgets updated which the Commission should approve

Recommendation: Flexibility

A contingency should be available for use subject to approval by the Commission.

A contingency should always be allowed where there is an exchange rate risk.

N. Overhead recovery too low

With each claim a flat rate allowance of 7% of direct costs is allowed to cover administrative costs. Some Directorates are however, combining this with the €5,000 limit rule mentioned in the adjoining clause and requiring specific proof of the claim. (Article 181 Implementing Rules).

Recommendation: Overhead recovery

The Commission should publish the calculations that gave rise to the 7%.

In those calculations they should include an analysis of Commission overhead rates.

The reasons for this are:

- **If the Commission's overheads are excessive it has a 'knock on' effect on the organisations dealing with them and so should be taken into account in the decision**
- **It would clarify what is included as overheads. At present this is a point of dispute between the Commission and NGOs.**

The relationship of the 7% to the €5,000 limit in the adjoining clause should be clarified.

0. No recognition of planning costs

Detailed planning is a necessary part of the project and the costs should be recoverable as other project costs in the claim. See section 4.2.

P. Co-financing

Co-financing rates do not take into account the importance of the project to the Commission or the ability of the target beneficiaries to raise co-funding, which can vary according to the size and activities of the NGO as well as its geographic location and the purchasing power parity of that region.

Recommendations – Co-financing

The amount of co-financing should not be prescriptive. In a grant application the beneficiary should be allowed to make a case for lower co-financing than that indicated in the proposal. The Commission should then decide on a case by case basis within specific guidelines.

Q. Inappropriate Tendering Requirements

See points raised in appendix 5. Prescriptive tendering procedures are more relevant in certain environments than others and should recognise the importance of the relationship between the cost of the purchases made and the cost of acquisition.

Recommendations: Tendering Requirements

The requirements should be set per programme taking into account the project objectives, beneficiaries, the environment and value of individual purchases.

Chapter 11

Commission: Overview of Interviews

Face to face Interviews were held with nine Commission staff working with grants in administration, finance or management. Most officials asked not to be named in this report. These interviews were important to gain an understanding of how the systems and procedures work in practice. The input and support of the people interviewed is therefore greatly appreciated.

All officials with only two exceptions, acknowledged that there was an acceptance within the Commission that the Financial Regulation and Call for Proposal procedures must be rigidly followed. The two exceptions were trying to change the Regulation, one more radically than the other, both recognising the inherent limitations of the current system.

It is clear that Commission officials have different attitudes to the Financial Regulation:

- Some felt that they are procedurally led and that the procedures consumed all resources, that dialogue and knowledge development are being lost and that a project-based approach has stopped capacity building.
- Some felt that the strict guidelines laid down by the Regulation gave clarity to their role which was not there before.
- Others simply felt immense frustration.

One senior official felt that the Regulation itself was not the issue but that the biggest problem was “people hiding behind the Regulation”. This was coupled with another view that there is “a lack of a management culture in the Commission.”

Other comments include:

- The Regulation has helped reduce the worst of the payment backlogs.
- The project-based approach would reduce capacity building and the ability of smaller NGOs to operate in small, but key areas.
- A new system where the Commission vetted NGO proposals, rather than the present system, would work better and generate more innovative projects.
- All efforts now are dominated by the call for proposal rather than managing the projects.
- The increasing use of experts was destroying the Commission’s knowledge base.
- The beneficiaries find the forms difficult to understand.

Messages that were consistently repeated were:

- Everything is about preventing fraud and any means of control was reasonable to ensure its eradication.
- The Regulation and Implementing Rules were continually being referred to, and it was better to interpret them prudently.
- The culture is one of total mistrust of the outside world.
- No one had any idea about the efficiency levels. All claimed to be under resourced. The closest to an answer on efficiency was that this could be checked under the Commission’s “Activity Based Budgeting”, but they themselves had not checked it, or been made aware of it.

Chapter 12

Efficiency

12.1 Commission Efficiency

The Financial Regulation states in paragraph 11:

“The principle of sound financial management should be defined by reference to the principles of economy, efficiency and effectiveness, and compliance with those principles checked by means of performance indicators established per activity and measurable in such a way that results can be assessed”.

The Financial Regulation states in Article 27:

“The principle of efficiency is concerned with the best relationship between resources employed and results achieved.”

Despite this, the lack of importance actually given to efficiency can be highlighted in a number of ways:

The 2005 budget commentary mentions efficiency only in terms of issues such as agricultural efficiency. The only two exceptions were:

- The Europe Aid Co-operation Office where it is believed that the cost of administering grants is 4% of the grants given (it did not say if this included all costs including internal staff and overheads or just external costs, so it could not be used as a reference point in this project. It is also likely that it includes very significant grants to intermediate organisations like the United Nations);
- Internal Audit listed it as the last of the areas that it advises on. It states “...and finally efficiency and effectiveness of operations”.

DG Budget undertook an evaluation called “Strategic evaluation on the relevance, effectiveness and efficiency of small-scale actions” in 2001. From this report an insight into internal management efficiency was expected, however the report stated:

“.... However, while some data on external management costs relating to technical and administrative assistance are available, the evaluation study was not able to quantify the use of internal resources specific to the management of small budget lines for different reasons.”

The Commission grant administrators interviewed were not aware of any efficiency measurements.

In an attempt to gather some information on efficiency levels, DG Budget was asked the following questions:

1. What value of grants was paid out in 2002, 2003 and 2004 to NGOs or public bodies by each Directorate General?
2. What value of appropriations was in the budgets for the same years by DG?
3. What is the cost to the Commission of administering these grants by DG? Please include the full cost shown by administration departments, finance departments, translation, other (e.g. committee attendance by external parties).
4. What controls are imposed centrally e.g. numbers of signatories for authorising payments?

5. Can you please give details of comparative costs, comparing the cost of an executive agency compared to the cost of the DG undertaking the grant process for transport (Intelligent Energy) and DG Education and Culture and any other studies done?

The answers received referred to a discussion paper from the year 2000 which estimated the value of grants going through NGOs at over €1 billion. As for the rest, it was suggested that it would be possible to look up each grant and grant programme by budget line using the Europa website.¹⁶ This information is not complete and available on the site. Nor is the cost of staff working with grants separated from other staff costs.

In programme management, efficiency is normally ignored, but again there are exceptions. In the Commission's Framework Programme for Research and Technological Development a target efficiency rate of 6.5% is given. In the Court of Auditors report from 2003 point 6.66 states that the efficiency achieved over the life of the project was 6.4%. **Unsurprisingly, setting a target and measuring performance, impacts performance.**

This chapter of the report focuses on:

1. **The ratio of the Commission's cost of administration to the value of the grants;**
2. **The beneficiaries' costs of applying, administering and accounting for the grant.**

The reason for choosing the efficiency measure, costs as a percentage of grants awarded is that the resources used should be proportional to the value of the grant awarded.

Why not measure cost per contract?

The measure of costs per contract awarded would support the idea that each contract, no matter what the value, merits equal scrutiny. This is not the case. For example, one grant of €1 million gives rise to much greater risk both financially and in terms of effectiveness than 20 grants of €50,000.

One grant of €1 million relies on the financial security of one organisation and the capability of one management team.

Twenty grants of €50,000 rely on the performance of 20 organisations and are, after being selected from say over 100 proposals, likely on average to give above average effectiveness. The financial risk is also spread across 20 organisations.

Hence the ratio of costs to value given ensures that more resources can be used to scrutinise and manage higher value 'investments'.

The Commission also discuss efficiency in another erroneous way when evaluating projects: The output of the whole project is examined against the funds provided by the Commission alone. As a result, projects tend to be assessed as efficient because:

- Co-financing from the NGOs and other sources is counted as value added;
- Volunteer labour is counted as value added but not paid for.

There are 2 problems with this approach:

¹⁶ See appendix 11

1. The Commission should not take credit for the whole project including the contributions of others. It is effectively evaluating the project as if it were a tender.
2. Even if the Commission enabled the project, the likelihood is that the co-finance (e.g. often monies earmarked by national governments or foundations) would have been spent on other projects in the same sector or region if the Commission supported project had not taken place.

Measurement of Efficiency: Cost of administration to the value of Grants awarded

As previously stated, the Commission could not provide data on the efficiency of grant making departments, so information was found by other means.

Interviews enabled estimates of efficiency to be made for two small grant administration departments. Despite the claims that these departments are under resourced, it is estimated that the cost of administering the grants was around 16% of the value of grants awarded. Small value grants (€14,000 to €100,000) in small funds are relatively expensive to administer but one of the small funds had an efficiency of 11% while the other was 28%. This type of imbalance clearly highlights the need for benchmarking if only to better allocate staff resources.

ECHO is a stand alone Commission agency (not an Executive Agency which is only quasi Commission and has no right to use discretion in matters that relate to policy). It has its own budget and with small adjustments for issues such as pensions, school costs and 7% administration, its efficiency can be estimated at 4.6%.

A figure of 7% administration was used; however the **Commission's support departments' costs are actually 29% of the direct DG's administration costs**. This is despite each DG having its own budget, legal and administrative staff. It was felt that ECHO's efficiency should not be distorted by adding this inexplicably high level of support costs.

The efficiency of the other DGs is hidden amongst the total costs of those DGs. However, the Commission is currently undergoing a process of "deconcentration" which means that some DGs are creating so-called Executive Agencies for managing grant programmes. As part of this process, cost-benefit analyses were undertaken and presented to the European Parliament to support the case for the required changes in legislation. Cost benefit analyses were therefore available for the Intelligent Energy Executive, DG Education and Culture and DG Health and Consumer Protection.

These Executive Agencies are being set up to enable the management of grants by specialists, a large proportion of whom will be on contract. They have been developed to save money. They are intended to be more administratively efficient than the Commission.

The first thing that stands out from these analyses is that they did NOT specify target efficiency levels, made NO reference to best practice, made NO comparisons with other DGs or external operations despite the Regulation's requirements to measure efficiency.

Under the legislation allowing the creation of agencies, the Commission must retain control and must not delegate responsibility where discretion can be exercised. As a result, part of the

Call for Proposal process must remain in the “parent” DG. In the analyses, no cost impact was included as a result of organisational behaviour issues. Only EAC’s analysis gave it explicit consideration:

“The separation between policy and some implementation tasks has two consequences. Firstly there is a risk that either the Commission is unwilling to give the agency the freedom to operate within its area of expertise, but instead tries to micromanage the operation, or that the agency itself develops ambitions to move into the areas surrounding policy. Both these scenarios would result in less than optimal operation, and increased costs (both real and intangible), and underscore the need for setting clear boundaries between the various parties. At least initially, there may be some tensions as this balance is established.

Secondly, there is a perceived risk that the agency would be perceived as a “poor relation” of the Commission where only second-rate staff would be seconded. It should be clear that the skills required to manage the agency successfully are different to those needed for policy work, but no less valid. Any other attitude would threaten the ability of the agency to work effectively.”

The Commission itself in a review of the Agency system stated:

*“The Agencies’ **relations with the European Commission** are mentioned frequently as an area of tensions or frictions, with several Agencies striving for a maximum degree of independence, while the Commission sees difficulty in obtaining outputs that meet precise information needs with a view to policy making.”¹⁷*

It also stated: *“As regards financial management, a considerable number of comments relate to what is perceived as “excessively burdensome” procedures – procedures that are not always well adapted to the operating environment of Agencies (such as the constraints of the annual budgeting cycle of the EU).”¹⁸*

The cost benefit analyses for DG SANCO and the Intelligent Energy Executive, carried out by external consultants, were produced using the same methodologies. They took the Commission staffing levels plus extra staff ‘required’ to give the staffing for the two comparable scenarios: in-house and externalised. They then looked at which roles could be ‘externalised’. The numbers that could be externalised were then assumed to be part of the Agency. The costs of the agency staff were then calculated on the assumption that the majority would be contractors.

This methodology made the conclusion inevitable: i.e. that an agency should be set up. Given that the staff numbers are the same, the scenario with the cheaper staff was always going to be the less costly.

DG EAC’s present position is different from the other two DGs and they used a task force to evaluate the staffing required by the agency. The methodology used is not explicit in the cost-benefit analysis. DG EAC seems to have taken the most pragmatic approach to managing programmes, given the legislative restrictions involved.

¹⁷ Meta-Evaluation on the Community Agency System: DG Budget 15 September 2003: http://europa.eu.int/comm/budget/evaluation/pdf/meta-evaluation_agencies.pdf

¹⁸ Meta-Evaluation on the Community Agency System: DG Budget 15 September 2003: http://europa.eu.int/comm/budget/evaluation/pdf/meta-evaluation_agencies.pdf

In summary, it could be concluded that the major benefit of the agencies is that they can employ more people on contracts than the Commission which makes them cheaper and easier to recruit. There is an argument that it also enables the recruitment of specialists.

While stand alone organisations resourced with the right people are a good solution for the management of grants, there should be concern about the analysis used to reach that conclusion and the management structure required by the legislation to operate it (see Chapter 14).

Efficiency Calculations

In the cost benefit analyses, salaries and a percentage for physical overheads were given, however, it was assumed that other costs like missions, translation or evaluation costs would be the same in each scenario. As a result, to obtain a total cost it was necessary to estimate the costs of: missions, proposal evaluations, translations and ex-post evaluations. The assumptions are described in appendix 4. Please note, these estimates are based upon published information from the Commission but are not definitive.

The results were:

Agency	Grants (€m)	Costs (€m)	Efficiency
EAC	291	45	15.5%
IEE	61	10	17%
SANCO	71	17.5	25%

The main difference between the EAC and IEE analyses is the cost of staff. The Commission staff costs use in the analyses by the consultants who did the analyses on behalf of the Commission were:

- EAC overheaded staff cost on average is approximately €107,000
- Sanco overheaded staff cost on average is approximately €123,000
- IEE overheaded staff cost on average is approximately €136,000

This spread of costs per person cannot be easily explained. The EAC analysis included lower overhead costs and more lower level staff, but other than that the explanation of the difference is not clear.

Looking at the Commission's 2005 Budget for Administration, the total fully overheaded cost per person appears to be in the region of €126,000 taking into account schools, pensions etc. For further explanation, see appendix 4.

It would therefore appear that, if anything, these percentage efficiencies are more likely to be understated rather than overstated.

In terms of overall staff, the EAC agency has a much bigger proportion of contractual staff, and hence is less costly. This shows the subjectivity of the methodology used.

Agency	Total staff	Agency staff	% agency
EAC	68	38	56%
IEE	443	300	68%
SANCO	132	34	26%

It is difficult to understand why the same type of processes assessed using the same methodology could conclude that in one department only 26% of the roles could be externalised while in another 68% could be externalised.

The obvious conclusion is that defining actions as having or not having discretion is almost impossible and inevitably becomes subjective. One NGO, EuronAid, has asked the Ombudsman for help in understanding how the concept should be interpreted.

Comparable Funding Organisations

In Appendix 6 the information obtained from DFID (UK), Sida (Sweden) and the Big Lottery Fund (UK) is summarised.

The percentage efficiency estimated for these organisations is:

- DFID projects 4.9%¹⁹
- DFID Partnership Grants 0.3%
- DFID combined 1.0%
- Sida - Umbrella 5.5%
- Sida – Direct 1.0%
- Big Lottery Fund 6.8%²⁰

Commission

- Energy 17.0%
- EAC 15.5%
- SANCO 24.7%
- ECHO 4.6% (assuming grant budget increased to 2004 level)
- RTD programmes 6.5%

It can be seen that the Commission is comparatively VERY inefficient even with the new 'low cost' executive agencies.

If the executive agencies' efficiency was 6.5% (the same as the RTD Framework programme) it would represent a saving of approximately €45 million per annum.

It could be argued from the national government information that 5% may be a better benchmark.

¹⁹ DFID say 3.5%, but it is not clear that this includes overheads and it is important not to overstate efficiency.

²⁰ This is a fully self accounting operation making the efficiency calculation clear from its published accounts. It therefore includes all costs of operation. Its grants vary in size and include very small amounts, values which are normally expensive to manage.

ECHO looks relatively efficient in comparison, but works with framework agreements, meaning that there is a relatively small group of pre-registered NGOs who apply for funding. Its methods of operation therefore compare to a combination of the 2 DFID funds whose combined efficiency is 1.0%.

If ECHO's cost were half way to DFID's at say 3% that would represent a saving of € million per annum.

Support departments in the Commission are the Legal Service and DGs Administration, Budget and Audit (distinct from the Court of Auditors). These have a total staff of 6,413. This means a staggering 1 official from a support DG for every 3.6 people in the other DGs. Please note that all the "non-support" DGs already have their own legal, administration, audit and budget departments.

Adding these support overheads to the percentages above we have:

- Energy 22 %
- EAC 22 %
- SANCO 32 %

These can be more directly compared with

- Big Lottery Fund 6.8%²¹

The fully overheaded numbers give a picture of unintelligible levels of inefficiency.

The comparative operations above each discussed separately in the report in Chapter 8 and more fully in Appendices 6.

Beneficiaries also receive a better service from the other funds, for example DFID guarantees to pay correct claims within 30 days but often does it sooner. The limited feedback obtained from beneficiaries of these funds is also more positive than that from counterparties to the Commission.

Conclusions

The Commission's efficiency levels are significantly worse than the national government grant making operations reviewed where there is just as much importance given to the transparency and accountability of public funds.

It can be concluded that the Commission's efficiency levels should be around 5% (before support overheads). Achieving 6.5% for the executive agencies alone would give savings of approximately €45 million a year.

Comparisons show that it should be possible for ECHO to save monies, but on a smaller scale.

²¹ This is a fully self accounting operation making the efficiency calculation clear from its published accounts. It therefore includes all support department costs. Its grants vary in size and include very small amounts, values which are normally expensive to manage

This is a relatively small sample, but the influences behind it are pervasive: the Financial Regulation; the Implementing Rules; a culture of distrust; and an over emphasis on rigid procedures.

Intuitively, for the Commission as a whole it could be concluded that, though it would not be statistically valid to do so, the Commission is spending hundreds of millions of euros each year unnecessarily on inappropriate administration and control.

The analysis of procedures clearly indicates that there are inefficiencies in the system. Arguably the biggest issue is that despite all the checks on its payments, the Commission does not measure the necessity to pay its own very significant costs, or its wastage.

It should also be asked if there is a loss suffered by the Commission:

- It is a requirement of the Regulations to measure efficiency, but efficiency is not being measured.
- If efficiency had been measured, identifying the inefficiency, would have almost certainly led to action to reduce costs.

Note: Breach of the Regulations requires that an authorising officer be liable for any loss.

Recommendations: Commission Efficiency

Urgently implement a system for measuring internal efficiency.

Give each head of unit efficiency targets against which they are measured. The results should impact the staff assessment evaluation points total e.g. no manager who is more than 20% outside the benchmark should be eligible for promotion.

Create a mechanism or culture that enables procedures to be changed in the interest of efficient and effectiveness at a unit level.

Review and change procedures in order to implement the requirements of sound financial management. Equal weighting should be given to economy, effectiveness and efficiency.

The Commission should urgently undertake a benchmarking review of best practice. It should break its normal modus operandi and look for best practice from other organisations' funding procedures. It should benchmark itself against the best examples and monitor improvement.

12.2 Efficiency: The Impact on NGOs

The inefficient processes in the Commission cause equally excessive costs for the NGOs. Long and complicated application forms have to be completed, calls for tenders written for supplies, invoices have to be copied, procedures followed and questions answered.

As non profit making organisations, money saved on administration could go directly to benefit the activities that the Commission is trying itself to support.

Applications: examples of costs

One grant application required that each of the 27 individual actions e.g. conference, seminar, exhibitions be separately costed in detail. These projects covered 4 countries over 3 years. Three partners were involved. The application took at least 3 person months giving a total cost of nearly €20,000. It is understood that there were approximately 250 submissions for this project, of which 50 will be awarded grants totalling €20 million. If an average cost per application was €10,000 (half the example given) per NGO then application costs alone are estimated at €2.5 million, or 12% of the grant.

Another programme's fund is €2.4 million. One organisation invested approximately 3 person weeks in its application. This gives a cost of at least €3,000. There were 269 proposals, giving an estimated total cost of application of €800,000 or 33% of the grant.

Add to this the Commission cost of around 20% and it can be seen that half of the value of the grant is lost in administrative costs.

One report²² which studied a large number of programmes on behalf of the Commission, estimated that the application costs to all participants was in the region of €30 million.

One large NGO interviewed has a policy of only applying for any grants of more than €500,000. They believe that the cost of application and the success rates do not justify the resources of applying for smaller projects.

Conclusion

Evidence and common sense indicate that with application failure rates of up to 90%, the cost to the NGO world of failed attempts to apply for Commission grant funding is unacceptably high.

Streamlining the procedures should reduce the costs for NGOs in dealing with the Commission. See chapter 4.

Overall between the Commission and NGOs tens of millions, if not hundreds of millions of euros are being wasted unnecessarily on administration of grants to NGOs. This is money that could be better used to implement real projects.

As an organisation with a public service mission, the Commission needs to take a holistic view of efficiency, both its own and that of the society it serves.

²² Strategic Evaluation of the Management Methods of Programmes

Recommendations: NGO efficiency

Include creating efficient procedures for counterparties to a transaction as an objective for head of units in all relevant Commission Directorates and Agencies.

In the Commission's drive for greater transparency, the first step should be to produce a comparative study of how efficiently and effectively it uses tax payers' money compared to its member state governments.

Chapter 13

Effectiveness

Taking a view on effectiveness is not in this study's brief, however, given the importance of 'sound financial management' it has to be given at least some consideration.

The starting point is not bright:

- This report was born out of NGO frustration with the Commission's procedures
- In its Communication on the Externalisation of the Management of Community programmes, the Commission states that "Implementing and managing projects is a profession in itself. Achieving excellence in this profession requires specialist staff and precise methods". The communication then states that the Commission should be focused on its core tasks.

Information on effectiveness available included:

NGOs

- NGOs interviewed expressed frustration with the unresponsive bureaucracy, the complex and often onerous rules, the unrealistic co-financing demands that take them away from their core activities, and the need to carry out actions that they no longer believe to be the best for the beneficiaries targeted.
- Documents emanating from the Palermo conference²³ which state that "*the current policy, procedural and management framework for dealing with the NGO co-financing is much too rigid. It promotes tension rather than trust among the Commission and the European NGO community. It leaves little scope for structured dialogue between the actors involved nor does it provide much scope for the EC to manage the budget line in a strategic and effective manner*".

It goes on to say "All this, combined with the management problems affecting (understaffed) EC units in charge of processing the stream of project proposals leads to a situation whereby the risk of implosion of B7-600 is real." (B7-600 is related to AidCo).

(Please note: this report does not indicate that the Commission is understaffed. It indicates that too many people are employed to undertake unnecessary procedures and that there are too many finance people in comparison to those interacting and working with the NGOs).

- Procedures make projects very difficult to amend since they are often planned and budgeted 4 years earlier. The environment changes, needs emerge, organisations learn. The Commission often refuses to acknowledge this and activities that are much less relevant than when they were planned still have to be implemented to ensure the grant is paid, while new, more relevant issues go unaddressed and unfunded.
- EuronAid claim that, amongst other things, owing to the Commission suspending payments, they "ran into cash flow disruption and had to suspend all commitments".

²³ Conference involving Development NGOs and the Commission in Palermo.

EuronAid have a complaint with the Ombudsman who kindly gave access to the information in the complaint.

The Commission

Many Commission staff were unable to meet and discuss procedures, however those who did fell into two categories:

1. Those who are happy with the status quo as it gives them very clear guidelines to work with. None of these people talked about, or showed any understanding of, the beneficiaries in this process.
2. Those who are frustrated with the overwhelming focus on paper work and procedures, the lack of dialogue, lack of focus on outcomes and the lessening knowledge base within the Commission. These people were more experienced and more externally focused than the first group.

Evaluation Consultants

Every year, the Commission employs external consultants to undertake analysis and evaluations of grant programme. The evaluations for 2003²⁴ were on the whole positive but made frequent mention of bureaucracy, vague and inconsistent objectives, the need for greater flexibility, and the excessive volume of information required both for the submitting of a proposal and for accounting purposes.

Also included are comments like:

“the key factors for the success of the approach were: the high degree of discretion of the Intermediary Body, which allowed adaptability of its method of operation to local conditions, needs and characteristics of target groups and problems it aimed to address as well as the internal (cohesion and capacity) and external (in particular its delivery strategy) characteristics of the partnership approach”.

This raises concerns since in reality, a high degree of discretion for non-Commission intermediaries is against the Regulations, and it is almost certain that this success story will not be easily repeated under the present regulations.

Many of the evaluations are rather neutral but then the evaluations are commissioned, approved and paid for by the Commission. Given that some believe that the first rule of consultancy is “never bite the hand that feeds you”, perhaps it is not realistic to expect external evaluators to be critical.

Conclusion

Programmes are not being managed effectively. This does not mean that funds are not having an impact for they surely are. However, it does mean that with better management, programmes could be a lot more effective.

²⁴ Evaluation Report 2003:
http://europa.eu.int/comm/budget/evaluation/Key_documents/evalguide_study_en.htm

Recommendations: Effectiveness

Create a new (small and focused) institution, external to the Commission to manage the project evaluation process. This should be a body both able to judge policy and to understand the reality of implementation, and it should consist of those who have touched and understand the worlds of the poor and socially disadvantaged.

This body should manage the evaluation budget which in 2003 was €30.97 million and it should have the right to review Calls for Proposals and on appeal, make changes in ongoing programmes.

This recommendation is central to raising the importance of effectiveness and creating the necessary tension with economy (procedural compliance) and efficiency required to enable the principle of sound financial management to be realised.

Chapter 14

Strategic Management

In 2000 the Commission²⁵ proposed the outsourcing of various tasks, the first of which was to be management of Community programmes. This was intended to allow the Commission's permanent staff to be assigned to its essential tasks.²⁶ The Commission does not see programme management as a core task, but after the various fraud scandals in the late 1990s, it was not clear of the best way to ensure effective properly devolved management.

It was these scandals that led to a new financial regulation, which now states that grant programmes can be delegated in the following circumstances:

- The Commission retains effective control. It can delegate no tasks of public authority involving the use of discretionary powers. Externalisation of management tasks should stay within the limits set by the institutional system as laid out in the Treaty.
“This means that missions assigned to the Institutions by the Treaty where anything is left to the discretion of the Institution concerned and which involve translating political choices into practice may not be externalised. Such acts will remain the exclusive responsibility of the competent Institutions.”
- The entity operates under the principle of sound financial management.
- The entity has adequate systems of control as defined by the Commission.
- The entity undertakes transparent procedures.
- The entity is a Government agency or has a public service mission.
- The Commission can ensure regular monitoring, evaluation and checks on tasks delegated to a national agency²⁷.

The legislation proposed that externalisation can take several forms:

- (i) Devolution, i.e. delegating executive responsibilities to Community public bodies (executive agencies) conceived as part of an expanded Community administrative architecture;
- (ii) Decentralising, i.e. delegating executive responsibilities to national public bodies with a public service mission backed by the State, to act as partners in implementing some Community policies;
- (iii) Outsourcing was dealt with separately but was not possible for the ‘management’ of programmes.

The Commission is also delegating programme management to its own “in-country” delegations. This is referred to as ‘deconcentration’ as these bodies are still part of the Commission.

²⁵ Communication from the Commission on 13 December 2000 on the “Externalisation of the management of Community programmes including presentation of a framework regulation for a new type of executive agency”. The Commission made a Proposal for a Council Regulation laying down the statute for executive agencies to be entrusted with certain tasks in the management of Community programmes.

²⁶ White Paper on administrative reform: COM(2000) 200 final/2, 5 April 2000.

²⁷ This is therefore a different style of management from shared and decentralised management (in which the Commission entrusts tasks to the Member States and to non-member countries respectively).

Reviewing the Cost Benefit Analysis for the setting up of the Executive Agencies, the argument for them comes down to the fact that Executive Agencies are subject to nearly all Commission rules but can take on more contractors which gives 2 benefits:

- a. They can hire specialists
- b. They can have a higher proportion of (less expensive) contractors

Considering things critically:

- How can an agency be created, including staff numbers specified, without a critical review of the likely beneficiaries, grant sizes, market structure, key national organisations, market maturity, type of expertise is required, and assessing levels of support, education and service requirements?
- How can a cost benefit be undertaken without reference to best practice, at least within the Commission, if not more widely viewed?
- How can an Agency which has to go to another institution for direction on any decision that requires discretion be as efficient as one that is able to take the decision itself?
- How can any operation where parts of the same document have to be collated by separate institutions be as efficient as when it can be done as one?
- How can an agency that does not have control over its own procedures be held responsible for its own efficiency?

The Agency concept seems flawed. However the key issue for the NGOs is that nothing will really change. There may be some more market expertise in the Agency, but these experts can only advise the generalists who still retain decision making authority.

A conclusion is that this new approach will make things worse not better. It has merely added another level in the hierarchy.

Best Practice

The question then becomes where to look for examples of best practice? The Commission is different from national governments at first sight, but looking beyond that there are many more similarities between funders than differences.

It can be seen that national government bodies from mature democracies, where expertise and programmes are well established, have the same key requirements as the Commission: transparency; effective financial control; efficiency; programme effectiveness; national and trans-national operations; and clear policy guidelines. These bodies have budgets, accounts and are accountable to their national government.

Other than translation and a pan-European remit it is difficult to find differences other than it appears to be that other funders are more efficient and arguably more effective than the Commission.

The main things that really stand out as differences between these national funders and the Commission are:

- A strategic approach to managing programmes.
- A greater focus on effectiveness, dialogue with the NGOs and visits to programmes.
- A real understanding of the difficulties faced by the NGOs and the timeframes required to impact regional poverty or rights for the socially excluded.
- More flexibility in terms of allowing changes to programmes.
- Payment terms that support the NGOs operations and payment deadlines that are met.
- Management of financial risk through knowledge, diversification and supportive programme management rather than through crude, inappropriate financial instruments.
- A culture of innocent until proven guilty, as compared to the Commission's adversarial approach of guilty until proven innocent.
- More reliance on properly briefed external auditors working to well understood International Accounting Standards.

These differences are nothing to do with the grant giving process, or geography, or language. They are cultural, a response to the scandals that haunted the Commission during the 1990s.

Where programme management is delegated to national agencies such as Country delegations, the key complaint is one of inconsistent interpretation of the Financial Regulation and Implementing Rules. Given their complexity this is not surprising.

Recommendations: Strategic Management

The Executive Agencies should be 're-absorbed' into the Commission, and be given the discretionary powers needed to do the job, but they should be allowed to recruit as many experts on contracts as is necessary to properly perform the duties, and to keep staff costs low. This will enable all the relevant staff to operate under one responsible management team and still cost less than an organisation staffed by Commission Administrators.

The Executive Agencies should define their own procedures, quantities, beneficiaries served, and controls to be adopted etc. and from that identify staffing needs. They should not copy the DG from which they were spawned.

Careful attention should be paid to the culture of the organisation. Bringing in large numbers of outsiders could enable a more positive, pro-active, "can do" culture if the leadership is strong and clearly communicates its vision and objectives.

The Agencies should stay self-accounting and have clear efficiency and effectiveness targets.

Simplifying the Financial Regulation and making them more user friendly to improve consistency, establishing a central 'hot-line' that gives definitive rulings on Regulation interpretation and comparative benchmarking have been recommended elsewhere in the report.

Chapter 15

Role of the Auditors and the Ombudsman

Internal Audit

Article 86: FR

The internal auditor shall advise his/her institution on dealing with risks, by issuing independent opinions on the quality of management and control systems and by issuing recommendations for improving the conditions of implementation of operations and promoting sound financial management.

The Internal Audit function is required to promote Sound Financial Management. The report's author has not had access to the Internal Audit reports, but it is difficult to find examples of where Efficiency or Effectiveness of actions have been promoted.

Recommendations: Internal audit

Ensure that Internal Auditors fully understand the concept of Sound Financial Management, and when reviewing procedures form a view of excessive control, damage to effectiveness and efficiency.

Bring in a requirement that Audits can only lead to the recovery of funds if they are undertaken within one year unless there is evidence of fraud or negligence when recovery can go back to up to 7 years.

Court of Auditors

This exchange from the Court of Auditors report 2003²⁸ makes the point

Auditors point

1.40. Substantive testing of transactions in the Internal Policies sector revealed weaknesses in the Commission's internal control systems and numerous errors at final beneficiary level, which confirms the Court's previous observations on the legality and regularity of the underlying transactions and corroborates the weaknesses identified in the control procedures applied (see paragraphs 6.17 to 6.26 and 6.42). An analysis of the Commission's ex post financial audits in the Internal Policies sector also showed that a large number of final beneficiaries overdeclared the costs relating to the operations cofinanced by the European Union. In this regard, the Court believes that the corrective measures provided for in the case of the sixth RDT Framework Programme to reduce the risks affecting the legality and regularity of the underlying transactions are inadequate (see paragraphs 6.27 to 6.33 and 6.43).

From this it could be construed that controls need further tightening.

Commission Response

1.40. In particular since the implementation of its administrative reform, the Commission is confident that it respects the requirements of the Financial Regulation regarding ex-ante and ex-post controls on directly managed expenditure. The Commission constantly seeks to improve its supervisory systems and controls, and welcomes the recommendations the Court makes to this effect. At the final beneficiaries' level, the analysis of ex-post financial audits by the Commission shows that final beneficiaries make mistakes often due to the complex nature of the fifth Framework Programme model contract. These mistakes are made in two senses, some contractors overstate, and others understate their expenditure. The net impact of the errors on the Commission's budget remains limited. Measures have been introduced and the sixth Framework Programme has been considerably simplified, leading to substantial improvements in management at the level of participants.

If the Commission is right, then the procedures need simplifying, NOT more controls imposing.

Recommendations: Court of Auditors

When making comments on findings the Court of Auditors should also be obliged to:

- **Make clear recommendations to solve the problem that they are raising.**
- **Indicate the impact of the solution on efficiency and value it, if appropriate.**
- **Indicate the impact on effectiveness.**

²⁸ Court of Auditors Report 2003: http://www.eca.eu.int/index_en.htm

Ombudsman

The Ombudsman's department was extremely helpful and pro-active in supporting this study however the views and recommendations expressed here are those of the author.

From the information provided there were 87 complaints from NGOs in 2003 and 101 in 2004. This is less than might have been expected given the level of complaints from the NGOs interviewed, especially concerning late and withheld payments. The reasons given by the NGOs to the author for not complaining were:

- Worries about the workload.
- A real fear of losing grants as a result.

The grant system is procedurally driven by people. Those people approve the payments and assess the experts who do the scoring. They have a real and tangible influence on the process.

Other points from a general perspective were:

- The period of time taken to reach conclusions was too long.
- The Ombudsman could not impose penalties on the Commission.

Recommendations: Ombudsman

The Ombudsman should be given a maximum of 8 months to finalise cases.

There should be a fast track procedure e.g. payment issues, simple complaints.

The Ombudsman should be empowered to impose financial penalties on the Commission in favour of a complainant.

If an NGO goes to the Ombudsman, all grant applications by the NGO for the next 5 years should be under the 'Ombudsman's watch'. This means that the Commission has to give an explanation of why a grant application failed to the Ombudsman as well as the applicant.

The Ombudsman has a definition of maladministration; it should add over-administration to this definition.

In assessing the Commission's administration, the Ombudsman should consider procedures in the light of the pressures for efficiency and effectiveness.