

THE EUROPEAN COMMISSION'S SIMPLIFICATION AGENDA

SCOTTISH GOVERNMENT POSITION

MARCH 2010

Introduction

As part of its response to the economic downturn, the European Commission has embarked on a "Simplification" initiative designed to ease perceived bottlenecks in programme infrastructure which were impeding effective implementation.

The purpose of this paper is to summarise the range of the Commission's actions and proposals – to date – and set out the Scottish Government's position on how these will be taken forward in the implementation of the 2007-13 Structural Funds programmes in Scotland.

Many of the changes (actual and proposed) relate to arrangements between the Commission and Member States/Managing Authorities, whilst only a limited number potentially impact directly at project level. It is this latter group on which this paper concentrates and, specifically, the extent to which the Scottish Government – as Managing Authority – intends to adopt the changes.

This is not a fixed or static situation. Changes continue to be proposed and adopted in 'phases'. The rate of acceptance or rejection of proposals can vary considerably as they affect European Council Regulations (where Member States have to adopt any changes), Commission Regulations (where Member States are consulted and a degree of support is required) or Commission procedures where, for example, commitments to greater flexibility or faster processing of business remain to be tested. The Simplification initiative is drawing on the work of an Independent Group of Evaluation Experts (also known as the Simplification Task Force), on which a senior official from Department for Communities and Local Government represents the interests of UK Departments and Devolved Administrations.

For practical purposes and the purposes of this note, it is helpful to view the Commission's proposals as falling into two categories: those already adopted and those still being considered by the various Council and Commission committees. The details are given in **Annex A** and **Annex B**, respectively.

Background

In December 2008, the Commission proposed a number of regulatory changes to simplify the implementation rules for Cohesion Policy and to increase advance payments to Managing Authorities for the European Regional Development Fund (ERDF) and European Social Fund (ESF) programmes. The Commission proposal was subsequently adopted by the Council in May 2009 and the necessary changes to the Regulations brought into force.

In June 2009, the Commission published its paper on "*A Shared Commitment for Employment*". This was the forerunner for proposals which would give Member States the option not to provide match funding for European Social Fund projects during 2009 and 2010. As noted below, this proposal is unlikely to be adopted due to resistance from Member States.

This paper provides a snap shot of the current (March 2010) position and the Scottish Government's response to the (proposed) changes. It should be read in conjunction with the Regulations referred to.

In formulating our response, we have been mindful of the 3 basic principles underpinning the allocation of Structural Funds to projects in Scotland:

- Structural Funds should be the fund of "last resort" and grant should be the minimum necessary for the project to proceed;
- Support will be given to real costs that are genuinely additional;
- The best use of limited resources will be made by investing in "productive" activity and not on organisations' core costs.

Against this background, we have sought to:

- Take advantage of any increased flexibility and/or simplification, provided those changes offer real savings, additional flexibility or increased transparency in the delivery of the programmes in Scotland;
- Opt in to increasing the scope for eligible activities if those changes allow us to provide greater focus in support of the delivery of the Government's Economic Recovery Programme;
- Maintain a medium to long term perspective (whilst using opportunities for short term intervention as part of our response to the economic downturn);
- Ensure equity between potential project sponsors and between organisational sectors in the application of the Regulations;
- Provide continuity in governance and clarity in the implementation of programmes in Scotland (i.e. not making significant changes to the rules half way through the programme period);
- Promote due diligence in establishing eligibility and, as far as possible, transparency in document retention and audit trails to protect applicants and ultimately Scottish Ministers, who are accountable both to the (Scottish) Parliament and the European Commission for the proper use of the funds in Scotland.

Changes already made

The General Regulation (Council Regulation EC No 1083/2006)

New Regulation 284/2009 came into effect on 7 April amending Articles 44, 46, 56, 78 and 82 – see **Annex A**.

Article 82 provides for an additional advance of funds to Managing Authorities. The original regulation allowed for advances of 2% and 3%. A further advance of 2.5% has now been made. While this eases cash flow in the Scottish budget and makes a contribution towards N+2, it does not impact directly on applicants as it is our stated policy to pay grant within 30 days of receipt of valid claims regardless of our cash flow position. The Scottish Government effectively carries the cash flow exposure and exchange rate risk.

ERDF Regulation (Council Regulation EC No 1080/2006)

Energy Efficiency in (Social) Housing. New Regulation 397/2009 came into effect on 6 May and amends Article 7 by introducing as eligible energy efficiency improvements and renewable energy in housing. We fully intend taking advantage of this helpful addition to eligible activity. It sits well with the Government's initiatives on renewable energy and climate change. An additional benefit is the potential to reduce heating costs to tenants and contribute to reducing fuel poverty.

ERDF and ESF Regulations (Council Regulations EC Nos 1080 and 1081/2006)

Flat Rate Costs, Unit Costs and Lump Sums.

New Regulations 396/2009 (ESF) and 397/2009 (ERDF) came into effect on 6 May and amend Articles 11 and 7, respectively, to allow:

- i) indirect costs, declared on a flat-rate basis, of up to 20% of the direct costs of an operation (project);
- ii) flat-rate costs calculated by application of standard scales of unit costs, as defined by the Member State;
- iii) lump sums to cover all or part of the costs of an operation.

The existing methods of calculating costs also remain valid.

As regards flat rates, the Commission has confirmed that 20% is a mandatory upper limit for claiming indirect costs, including overheads, on a flat rate basis. Organisations may claim overheads at a higher rate, but they would have to provide detailed supporting evidence.

The Regulations go on to say that flat rates must be established in advance on the basis of a fair, equitable and verifiable calculation, and that they are agreed in the offer-of-grant letter to the applicant.

After careful consideration, we do not intend introducing flat rates in the Scottish programmes for the 2007-13 period. We have well established and understood eligibility criteria which concentrate our relatively limited resources on real costs defrayed undertaking productive activities. While we see some merit in this more flexible option, we are concerned not to change our approach at this stage in the implementation of the 2007-13 programmes, when over half of the resources available have already been committed to projects. Projects have already been funded on the basis of the existing national rules and outcomes will be delivered under the more focussed eligibility rules now operating in Scotland. We do not believe that, in these circumstances, reintroducing indirect costs would offer any real simplification; indeed, it would serve to complicate the delivery of the funds.

We are also concerned that we are not yet in a position to establish appropriate flat rates at project level "*in advance on the basis of a fair, equitable and verifiable calculation*". This is a formidable analytical exercise which, whilst we will consider undertaking for any post-2013 Structural Funds programmes, does not fit in with the timetable for implementing the 2007-13 programmes. In the event of audit, we would not wish to expose project sponsors to challenge on the methodology of benchmarking exercises undertaken at short notice to compare 'real costs' with flat rate costs. In effect, the only way to defend such a challenge would require equivalent record keeping and document retention to our current standards.

Nevertheless, and in preparation for implementation of any post 2013 programmes, we may consider a one-off pilot on a specific project to investigate the issues and necessary processes involved; any such pilot would be an exception and the project would be chosen at the discretion of the Scottish Government, as Managing Authority.

The 10% Rule

At a general level, the Scottish Government are mindful of the need to ensure that the guidance on the National Rules is clear and up-to-date. Our assessment of the Commission's Simplification Agenda has provided us with the opportunity to clarify the so-called "10% rule".

The 10% limit or threshold is a qualification (note) of the National Rule, Section 3 – Revenue Projects (ERDF and ESF) Eligible Costs 3.1 Staffing. For the avoidance of doubt, there are two "flexibilities" that apply to the 10% limit:

- i) Intensive input required at key points in project implementation duly justified in advance in the project application and subsequently supported through timesheets.

It is recognised that, in a limited number of cases, there might be a requirement for intensive staff inputs at key stages of the project implementation which fall below the 10% limit, but which are essential to the project, for example due to their highly specialised nature. Such inputs will be regarded as eligible, by exception, based on the judgment of the IAB and subject to approval by the Portfolio Manager in the MA.

- ii) Accumulation of concurrent inputs across a number of projects, where an individual member of staff's time for any single project is under 10%. Accumulation is allowed where there is more than one project running concurrently per organisation, provided the aggregate effort for the period (normally quarter) is greater than or equal to 10% of the individual's contracted hours.

It should be noted that, while the 10% threshold does not have to be met in individual progress reports and claims, applicants will be required to demonstrate at final claim stage – through the provision of sufficient supporting information - that 10% has been achieved, either directly or by accumulation. Failure to do so will result in recovery of any grant paid in respect of these staff.

The application of these flexibilities maintains the principle of supporting real costs defrayed on activity directly in support of project implementation, ensures consistency through the implementation of the programmes and ensures transparency in eligibility and accounting for project expenditure.

While this is essentially a clarification of the degree of flexibility available in assessing the eligibility of staff input to projects, in some cases it may be that applicants have not applied this flexibility hitherto. Where projects have not been closed, it remains open to applicants to claim under the flexibility, subject, as noted, to sufficient justification being provided, including timesheets, for (i) above and sufficient supporting information being held re (ii). In the case of (ii), time spent on closed projects may be aggregated with live projects to allow staff time to be claimed on live projects provided the 'concurrency' requirement has been met.

It should be noted that, while the 10% threshold does not have to be met in individual progress reports and claims, applicants will be required to demonstrate at final claim stage that 10% has been achieved, either directly or by accumulation. Failure to do so will result in recovery of any grant paid in respect of these staff.

Proposed changes to the General Regulation (Council Regulation EC 1083/2006)

More detail of the Commission's proposals can be found in **Annex B**. However, the main points affecting applicants are set out below:

Article 44

This amendment makes possible the setting up of dedicated financial engineering investments in support of actions on energy efficiency and the use of renewable energy across the EU. This includes the possible use of the value of buildings as co-financing. We recognise the potential which such an option would bring and would be prepared to consider proposals, subject to resources being available and other programme priorities.

Article 55

This amendment aims to simplify the monitoring of revenues from projects that are revenue-generating. The Article will be amended to divide projects into three categories:

- i) Investment in infrastructure
- ii) rent or sale of buildings
- iii) services which require payment

Article 55(3)

This will be amended to say that, where revenue cannot be estimated in advance, the net revenue within 5 years of completion of an operation should be deducted.

Article 55(4)

This will be amended to say that, where net revenue has not been deducted earlier, the Certifying Authority should deduct it at the time it submits the claim for the final balance of the Operational Programme. This confirms that the reference period for estimating revenue will not extend beyond closure of the relevant OP.

These changes will be explained more clearly in a Working Paper to be produced by the Commission. The Commission seems unwilling to consider a further increase in the current *de minimus* limit of €1m. Nevertheless, clarification on accounting for revenue generation in projects is welcome. However, this clearly introduces a risk that ERDF contributions to individual projects will be reduced at closure and require repayment with no opportunity to recycle the funds in Scotland.

Conclusion

The Scottish Government welcomes the Commission's Simplification initiative and the opportunity to consider which of the actions and proposals would be most appropriate in Scotland during the remainder of the 2007-13 programmes. As noted, however, we are a significant way through the programming period and, at this stage, we wish to avoid the creation of a two-tier regulatory basis for the Scottish Government to apply and, crucially, for applicants to comply with. Any material change would risk dislocation in the administration of the programmes and could potentially expose projects to audit challenge.

We consider that the timing of a number of the simplification proposals is best suited to the development of implementing arrangements for the next round of programmes – to the extent that they apply in Scotland. We are therefore working closely with colleagues in the other Devolved Administrations and UK Departments to ensure that what does emerge is both fit for purpose and offers a genuine opportunity to simplify administration of the funds for Managing Authorities and project applicants..

**European Structural Funds Division
Scottish Government
March 2010**

CHANGES ALREADY MADE

General Regulation (Council Regulation EC No 1083/2006)
New Regulation 284/2009 came into effect on 7 April 2009

Article 44	Financial Engineering	Engagement of the EIB/EIF in structural funds programmes.
Article 46	Technical Assistance	Engagement of the EIB/EIF in TA funded activities.
Article 56	Eligibility of expenditure	Brings a more flexible approach to counting contributions in kind within financial engineering projects.
Article 78	Statement of expenditure (by MA to Commission)	Clarifies requirements in terms of supporting information for the audit trail.
Article 82	Pre-Financing: Payment	Provides for an additional advance of funds to managing authorities. The original regulation allowed for advances of 2% and 3%. A further advance of 2.5% has now been made.

ERDF Regulation (Council Regulation EC No 1080/2006)
New Regulation 397/2009 came into effect on 6 May 2009

Article 7	Amends Article 7 by introducing energy efficiency improvements and renewable energy in housing. Up to 4% of the OP ERDF allocation may be spent on energy efficiency and renewable energy in existing housing.
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ERDF and ESF Regulations (Council Regulations EC Nos 1080/2006 and 1081/2006)
New Regulations 396/2009 (ESF) and 397/2009 (ERDF) came into effect on 6 May 2009

ESF Article 11	Amend Articles 11 and 7, respectively, to allow:
ERDF Article 7	
	<ul style="list-style-type: none"> i) indirect costs, declared on a flat-rate basis, of up to 20% of the direct costs of an operation (project) ii) flat-rate costs calculated by application of standard scales of unit costs as defined by the Member State iii) lump sums to cover all or part of the costs of an operation <p>The existing methods of calculating costs also remain valid.</p> <p>As regards flat rates, the Commission has confirmed that 20% is a mandatory upper limit for claiming indirect costs, including overheads, on a flat rate basis. Organisations may claim overheads at a higher rate, but they would have to provide detailed supporting evidence.</p> <p>The regulations go on to say that flat rates must be established in advance on the basis of a fair, equitable and verifiable calculation, and that they are agreed in the offer-of-grant letter to the applicant.</p>

PROPOSED CHANGES TO GENERAL AND ERDF REGULATIONS

Proposed changes to General Regulation (Council Regulation EC No 1083/2006)

Article 33	Revision of Operational Programmes	No change. However, the Commission are encouraging Managing Authorities to discuss and agree relatively minor changes to Operational Programmes bilaterally with their desk officers without the need for a formal Decision. This would not apply to changes to the financial tables.
Article 34	Specific character of the funds	No change to the 10% derogation; further flexibility may be proposed, possibly broadening the concept of an 'operation' (project).
Article 39	Major projects: Content	<p>The Commission has agreed to raise the threshold for environmental projects to €50m, although additional reporting will be required for projects between €25-50m. The Article will also be amended so that a major project can comprise several operations and, therefore, cover more than one Priority Axis. However, for the major project process it will still count as a single project. The Commission is also proposing that a single major project may be funded under more than one Operational Programme.</p> <p>We understand that this does not include financial engineering projects where, although they are over the €50m threshold, the major project process does not apply. The Commission consider that Article 44 provides this flexibility.</p>
Article 40	Major projects: Information submitted to the Commission	The Commission will require a timetable for implementing the project, including the phases between 2007-13, when the period of implementation will be longer than the programming period.
Article 41	Major projects: Decision of the Commission	This will be amended to refer to consistency with the priorities of the OP or OPs concerned. This allows a major project to cover more than one OP or Priority axis (see Article 39 above).
Article 44	Financial Engineering	This will be amended to include financial engineering investments in energy efficiency improvements in housing and the possible use of the value of buildings as co-financing.
Article 46	Technical Assistance	Flexibility in the rules for Technical Assistance. For example, ERDF rules could apply to ESF programmes.
Article 48	Evaluation: Member state responsibilities	To clarify that evaluation evidence should be provided when an Operational Programme is revised.
Article 55	Revenue generating projects	<p>To simplify the monitoring of revenues from projects that are revenue-generating. This will be amended to divide projects into three categories:</p> <ul style="list-style-type: none"> i) Investment in infrastructure ii) rent or sale of buildings iii) services which require payment

Article 55(3)		This will be amended to say that, where revenue cannot be estimated in advance, the net revenue within 5 years of completion of an operation should be deducted.
Article 55(4)		<p>This will be amended to say that, where net revenue has not been deducted earlier, the Certifying Authority should deduct it at the time it submits the claim for the final balance of the OP. This confirms that the reference period for estimating revenue will not extend beyond closure of the relevant OP.</p> <p>These changes will be explained more clearly in a Working Paper to be produced by the Commission. The Commission seems unwilling to consider a further increase in the current <i>de minimus</i> limit of €1 m.</p>
Article 56	Eligibility of expenditure	To clarify when eligibility dates apply to (a) new categories of expenditure and (b) to new expenditure on already eligible categories.
Article 57	Durability of operations	To confirm that the Article only applies to operations comprising investments in infrastructure or productive investment. It does not apply to financial engineering or other revenue projects; nor does it apply to ESF projects unless they involve productive activity and the State Aids rules apply.
Article 67	Annual Report and final report on implementation	To simplify the information required for inclusion in Annual Implementation Reports.
Article 77	Interim payments (by the Commission to MAs)	<p>To change temporarily the ways in which interim payments to programmes co-financed by the European Social Fund are calculated. Commission proposals to bring in 100% ERDF financing during 2009 and 2010 have also been considered. This would involve introducing a temporary option for Member states to request reimbursements made by the Commission at 100% during 2009 and 2010, thus removing the need to provide national co-financing during that period.</p> <p>The vast majority of Member States have opposed this on the grounds that it would potentially leave them in difficulties finding the higher level of domestic co-financing later in the programme. It is therefore unlikely to be adopted.</p>
Article 78	Statement of expenditure (by MA to Commission)	<p>To clarify the definition of admissible guarantees in the context of advance payments on State Aids. Also, to allow the treatment of management fees as eligible expenditure.</p> <p>The Commission will amend Article 78.2(a) to read: 'they shall be subject to a guarantee provided by a bank or other financial institution established by a public entity or by the Member State'. Article 78.6 will be amended to allow for financial engineering instruments to cover energy efficiency improvements in housing. There will be no change to Article 78.6(b). Article 78.7 will be amended to align with modification to Article 44 on</p>

		financial engineering instruments.
Article 88	Partial closure	This will be amended to make it clear that, in cases of partial closure, should the Member State subsequently detect an irregularity, the value can be replaced by the Member State prior to final closure.
Article 94	Decommitment: Major projects	This will be amended to allow more flexibility in the decommitment rule for major projects.

Proposed change to the ERDF Regulation (EC 1080/2006)

Article 7(2)	To specify the types of housing that can be supported in Member States which acceded after 1 May 2004. There are no amendments to Article 7(1), which allows the older Member States to spend up to 4% of their ERDF allocation on energy efficiency and renewable energy in existing housing
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