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ERDF / ESF PROGRAMMES 2007 - 2013

NATIONAL RULES ON ELIGIBILITY OF EXPENDITURE

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HIGHLANDS & ISLANDS PARTNERSHIP PROGRAMME
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The Scottish Government

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ALL EXPENDITURE MUST BE ELIGIBLE, PROPERLY INCURRED AND DEFRAYED BEFORE BEING INCLUDED IN CLAIMS FOR GRANT

INTRODUCTION

The Scottish Government as Managing Authority has developed these rules in accordance with EC Regulation 1083/2006 Article 56 Para 4, which states:

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

The rules take account of the general and respective fund regulations (EC Regulations 1083/2006 (the Council Regulation - sometimes referred to as the General Regulation), 1080/2006 (ERDF) and 1081/2006 (ESF)) and are based on the key principles of real costs and actual project costs. They apply to all projects approved under the 2007-2013 operational programmes. The link to the EC Regulations is available here - http://ec.europa.eu/regional_policy/sources/docoffic/official/regulation/newregl0713_en.htm.

Applicants should include all project costs, including ineligible costs. The purpose of these rules is to distinguish clearly between eligible and ineligible costs, and to ensure that only eligible activity / expenditure features in applications and ultimately claims. While every effort has been made to produce clear guidance on eligibility, there remains an onus on applicants to apply for grant responsibly and reasonably and to ensure compliance – in cases of doubt, clarification should be sought from the respective IAB or the Scottish Government. A detailed breakdown of costs is required with the application to assist project appraisal, confirm eligibility and ensure value for money.

These are new rules for the new programmes and it is not necessarily appropriate to compare eligibility between programme periods. However, applicants may wish to note that:

- **there has been a significant change to the rules on in-kind contributions;**
- **match funding must be in place before accepting an offer of Structural Fund support;**
- **central overheads, core costs and administration costs of an organisation are ineligible; and**
- **lead partners in projects have particular responsibilities.**

This guidance is structured as follows:

- Section 1 – General Rules
- Section 2 – Capital Projects (ERDF) – Eligible Costs
- Section 3 – Revenue Projects (ERDF and ESF) – Eligible Costs
- Section 4 – Eligible Costs (ESF Specific) – Participant Costs
- Section 5 – All Projects – Ineligible Costs

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SECTION 1 – GENERAL PRINCIPLES

1.1 Definitions

Terms used in this guidance have the following meaning:

- **Final beneficiary** – the applicant for and direct / initial recipient of Structural Funds support
- **Participant** – person or organisation participating in a training course, grant etc scheme
- **Match funding** – own funds / resources or other partner contributions to a funding package
- **Final recipient** – ultimate recipient of support in, for example, ERDF grant schemes
- **Lead applicant** – legal entity responsible for application and claim
- **Project partner** – organisation contributing directly to project delivery

1.2 Geographical Flexibility

As a general rule, projects receiving grant from the Structural Funds should be located in the programme area. At project level, activity outside the programme area may be eligible if the project would have difficulty in achieving its objectives otherwise.

1.3 Fund Flexibility

While there is a general presumption against using the flexibility between funds provided for in the Regulations, we will consider on a case by case basis applications that seek to integrate ERDF and ESF eligible activities within one project and under one fund. Such flexibility will be limited to a maximum of 10% of approved eligible costs of the project.

1.4 Need for Structural Funds

The Structural Fund contribution should be the minimum amount required to allow the project to proceed.

1.5 Project Funding

Match funding must be from public or similar organisations. Direct private sector participation is not eligible as match funding and should be shown as a 'private sector participation'.

Evidence of all match funding must be provided prior to the issue of the grant offer package (for example, board minutes, committee minutes, budgets, grant offer letters).

If the match funding package changes, the Managing Authority (MA) should be notified immediately. The MA will adjust (reduce) the level of grant payable to the project if appropriate.

In the event of project costs being less than approved costs at final claim stage, the Structural Funds contribution will be the net amount required after the full value of confirmed match funding has been taken into account. Where match funding is provided by a third party and the original offer is in terms of a percentage of project costs (rather than a fixed amount), Structural Funds grant will be maintained at the original (percentage) level.

1.6 Project Costs – Expenditure Actually Paid Out, In-Kind Contributions and Depreciation

Payments eligible for grant must have been **incurred and defrayed** by final beneficiaries, subject to the exceptions explained below.

Payments into **venture capital, loan and guarantee funds** (including venture capital holding funds) are treated as 'expenditure actually paid out' provided that the funds meet the requirements of the rules on the respective funds (see Annex 2).

Arrangements for grant schemes are also set out in the annex (Annex 3).

The cost of **depreciation** of equipment, exclusively used in the project will be treated as eligible expenditure, provided that:

- national or Community grants have not contributed towards the purchase of such equipment; and
- the depreciation cost is calculated in accordance with relevant accountancy rules and the organisation's accounting policy; and
- the cost relates exclusively to the period of co-financing of the project in question.

In kind contributions will be treated as eligible expenditure only where they comprise the provision of land or real estate provided it is not owned by the applicant or a project partner and provided that**:**

- they are identified and independently valued by an independent qualified value or duly authorised official body at application stage; and
- their value can be independently assessed and audited; and
- they comply with the provisions of the rules on the Purchase of Land and Real Estate (see 2.1 and 2.2 below); and
- national or Community grants have not contributed towards the its purchase and / or development.

Staff or other costs are not contributions in kind but may be eligible project costs.

1.7 Proof of Expenditure

All payments by final beneficiaries must be supported by a fully transparent audit trail including transaction lists traceable through to bank statements. Receipted invoices vouching individual items of expenditure are ideal. Where this cannot be done, payments must be supported by accounting documents of equivalent probative value. For example, salaries must be supported by payroll records, BACS lists and bank statements. Or, where projects are executed in the framework of public procurement procedures payments by final beneficiaries must be supported by works certificates issued in accordance with the provisions of the signed contracts.

Final recipients grant schemes are under an equivalent obligation to maintain a properly vouched audit trail of payments by them in respect of activities and / or investments supported by ERDF funded grant schemes.

All expenditure **must** be incurred and defrayed (i.e. left the bank account) before it is included in any claim.

Documents must be retained for a period of 3 years following payment of the final balance of funds by the Commission to the Scottish Government, as Managing Authority. This means the end of 2019 at the earliest.

1.8 VAT

VAT which is recoverable, by whatever means, is ineligible, even if it is not actually recovered by the final beneficiary or individual recipient. **Irrecoverable VAT can be claimed as an eligible cost provided the claim is substantiated by appropriate evidence from the organisation's auditors or accountants.**

1.9 Other Taxes and Charges

Other taxes and charges (in particular direct taxes and social security contributions on wages and salaries) which arise from co-financing by the Structural Funds do not constitute eligible expenditure except where they are genuinely and definitively borne by the final beneficiary or individual recipient.

1.10 Responsibility of the Applicant

All applicants are responsible for ensuring:

- the project's sound financial management;
- the implementation, reporting, monitoring and control of the project, specifically, for ensuring no double funding for approved activity; and
- the availability and retention of all project documentation **with a clear audit trail through to bank statements in each case**.

1.10.1 Additional Responsibilities of Lead Applicant

Where there is a partnership project, a lead applicant will be appointed by the group. The lead applicant is responsible for ensuring:

- a clear relationship between partners participating in the project;
- that all expenditure presented by and declared on behalf of the partners participating in the project has been incurred and defrayed for the purpose of implementing the project and that it has met all other rules with regard to the programme;
- the availability and retention of all project documentation including those of all other partners **with a clear audit trail through to bank statements in each case**; and

- provision by other partners in the event of any requests for information etc. by the Managing Authority or its agents.

In the event of any recovery of grant the Managing Authority will pursue the lead applicant for payment.

1.11 Compliance

1.11.1 Procurement (Contracting)

Contracting for the provision of works and / or services is eligible. Contracts must be competitively tendered to ensure value for money. Applicants should pay particular regard to the thresholds for publishing invitations to tender in the Official Journal of the EU.

1.11.2 State Aids

Projects must comply with the prevailing State Aid Rules.

1.12 Accounting Treatment of Receipts

1.12.1 Project Income

These 'receipts' will tend to accrue immediately to revenue projects (ERDF and ESF) for the duration of the project, for example from services, enrolment / fees or other equivalent receipts representing income. This reduces the net cost of projects (in 'real' time) and thereby the amount of Structural Funds grant required for the project in question.

Applications must estimate income likely to be generated by the project and claims must show clearly actual income received and deducted from the claim.

1.12.2 Revenue Generation

Projects (largely capital ERDF) may also have the potential to generate revenue following completion of an asset (building or facilities) the use of which is charged for, for example, through rent or lease. Article 55 of the Council Regulation 1083/2006 (also know as the General Regulation) confirms the broad principles. However, in the absence of definitive Commission guidance / advice, particularly in relation to the calculation of net revenue, projects that have the potential to generate revenue will be assessed on a case – by – case basis.

The starting point is that before the Structural Funds' contribution is calculated and no later than at final claim stage, (estimated) revenue should be deducted from the eligible costs of the project. Where this is not possible, revenue generated within five years of the completion of the project should be deducted. In both cases, project revenue would have to be monitored and reported over the prescribed period.

This does not apply where the receipts generated within the framework of financial engineering measures referred to in the Rules on Venture Capital and Loan Funds, and Guarantee Funds (see below).

1.13 Winding Up

In the event of (or prospect of) liquidation of an applicant organisation, the Managing Authority should be advised as soon as possible. Catalogued archives of project documents should be retained. On no account should documents be destroyed without the prior consent of the MA.

SECTION 2 – CAPITAL PROJECTS – ERDF - (ELIGIBLE COSTS)

2.1 Purchase of Land

The cost of purchase of land not built on is eligible for co-financing by the Structural Funds under the following conditions:

- there is a direct link between the land purchase and the objectives of the project co-financed;
- the land purchase cost may not represent more than 10 % of the total other eligible expenditure of the project;
- a certificate is obtained from an independent qualified value or duly authorised official body confirming that the purchase price does not exceed the market value.
- only expenditure incurred and defrayed within the eligible programme period can be taken into account in this calculation, i.e. from 01 January 2007;
- the date the land was acquired is clearly indicated and evidence of this provided as an enclosure to the application form; and
- national or Community grants have not contributed towards the its purchase and / or development.

2.2 Purchase of Real Estate

2.2.1 General rule

The cost of purchase of real estate, i.e. buildings already constructed and the land on which they are built, is eligible for co-financing by the Structural Funds if there is a direct link between the purchase and the objectives of the project concerned under the conditions set out in point 2.

2.2.2. Terms of eligibility

A certificate is obtained from an independent qualified value or duly authorised official body establishing that the price does not exceed the market value and either attesting that the building is in conformity with national regulations or specifying the points which are not in conformity where their rectification by the final beneficiary is foreseen under the project.

The building should not have received, within the previous 10 years, a national or Community grant which would give rise to a duplication of aid in the event of co-financing of the purchase by the Structural Funds.

The real estate is used for the purpose and for the period decided by the MA in line with EC Regulation 1083/2006, Article 57.

The building may only be used in conformity with the objectives of the project.

2.3 Purchase of Equipment

For vocational training and research and development facilities, essential items of equipment for the sole purpose of project delivery such as information technology equipment, research equipment, some teaching furnishings, machinery for skills enhancement delivery may be considered. The eligibility of such items will be appraised on an individual project basis.

2.3.1 Moveable Infrastructure – Fixtures and Fittings

Fixtures and fittings are only eligible if they are purchased for and used specifically for the project. The eligibility of such items will be appraised on an individual project basis. For example:

- for vocational training and research and development facilities essential items of equipment for the sole purpose of project delivery such as information technology equipment, research equipment, teaching furnishings, machinery for skills enhancement delivery; and

- for community development, essential fixtures and fittings directly related to the sole purpose of the project may be considered.

In cases where items of equipment have been purchased, an inventory must be retained for audit purposes.

Note: Revenue projects please see Section 3.

2.3.2 Purchase of Second-Hand Equipment

The purchase costs of second-hand equipment are eligible for co-financing by the Structural Funds under the following three conditions:

- the seller of the equipment provides a declaration stating its origin, and confirm that at no point during the previous 10 years has it been purchased with the aid of national or Community grants;

- the price of the equipment exceeds its market value and is less than the cost of similar new equipment; and

- the equipment has the technical characteristics necessary for the project and comply with applicable norms and standards.

2.4 Pre- Contract and Contract Implementation

Pre-contract works including design, bills of quantity and tender preparation are eligible. **This does not include project feasibility studies, which are ineligible.** Project management and supervision associated with the implementation of the project works, including Clerk of Works are eligible.

- This expenditure must have been incurred within the Programme period.

- Fees for external consultants, are eligible where it can be demonstrated that they have been incurred as a result of a competitive tendering process, or where best value can be demonstrated in line with the applicant's 'standing orders'.

- Fees that have been subject to an approved tender process may be included at the market rate resulting from that exercise.

Such work must be advertised in the Official Journal, where the value is close to or exceeds public procurement thresholds.

2.4.1 Expenditure by public administrations relating to the execution of projects

The following expenditure of public administrations is eligible for co-financing if it relates to the execution of a project provided that it does not arise from the statutory responsibilities of the public authority or the authority's day-to-day management, monitoring and control tasks.

- Costs of professional services rendered by a public service in the implementation of a project. The costs must either be invoiced to a final beneficiary (public or private) or certified on the basis of documents of equivalent probative value which permit the identification of **real costs** paid by the public service concerned in relation to that project.

- Costs of the implementation of the project, including the expenditure related to the provision of services, borne by a public authority that is itself the final beneficiary and which is executing a project on its own account without recourse to outside engineers or other firms. The expenditure concerned must be certified on the basis of documents which permit the identification of real costs paid by the public service concerned in relation to that project. **On-costs / charge-out rates are ineligible.**

Where staff are also engaged in non-project related work only the portion of staff costs directly attributable to the project should be shown. Actual costs are required for claims and should be backed up by timesheets or other media where time spent on the eligible activity can be clearly demonstrated.

2.5 Other Eligible Costs

See Annex 1.

2.6 Contingencies

Contingencies are an acceptable and reasonable cost at application stage. In the claim form contingencies should be reported against the appropriate, approved expenditure heading where costs have simply overrun.

Where the contingency covers genuine, unforeseen eligible expenditure, the costs should be reported against the contingency heading with a full breakdown provided as a separate attachment to the claim.

2.7 Retentions

For the retention to be eligible, the retention must be paid within the eligible expenditure period of the Programme, and defrayed no later than final claim stage.

2.8 Capitalised Revenue Costs

This can include:

- value of leasing and hire purchase associated with the project, where, for example, it may be preferable to make a one-off payment up front rather than several payments over a period of time; and

- marketing costs associated with the development and pre-opening of the project. A copy of the costed marketing strategy may be required as justification.

SECTION 3 - REVENUE PROJECTS (ERDF and ESF) ELIGIBLE COSTS

3.1 Staffing

Staffing costs are eligible for personnel directly engaged in a project, whether full or part time. This includes costs for direct activity essential to the delivery of the project. On that basis, reasonable and justifiable costs defrayed in managing and delivering eligible activities are eligible, provided that applicants can justify the involvement of staff in supported activity and evidence this, for example, in the form of timesheets. **We will not pay grant in respect of the running costs of an organisation. Only the real costs defrayed by the organisation in delivering eligible activity as set out in the approved application will be accepted for funding.**

3.1.1 Scope

Essentially the focus is on the type of activity undertaken to implement the project. Eligible expenditure should be for staff involved directly in project activity. This means activity explicitly set out in the approved application.

This **includes**:

- training to beneficiaries
- advisory/training services to business
- appraisal of grants/access to finance applications and management of successful applications
- research activities in funded research projects
- development of materials/courses for the project
- essential software programming for the project
- direct project management including financial management related to specific Structural Funds compliance requirements
- cleaning, where directly associated with and duly justified by the project
- repairs and maintenance directly associated with the project
- beneficiary recruitment, principally under projects in Priority 1 of the respective European Social Fund Operational Programmes, targeting the hardest-to-reach client groups

and **excludes**:

- project development
- application for EU funding
- human resources associated with the project
- procurement
- IT equipment administration/upkeep, unless there are special requirements associated with the project (e.g. dedicated IT equipment specially purchased for the project)
- costs associated with the project’s future
- the management of the organisation running the project

3.1.2 Applicant's requirements

The job descriptions of all staff employed to deliver elements of the project should accurately summarise their contributing activity. Where staff are involved in the project for only part of their working time, they must complete timesheets (vouched by a line manager) throughout the project's life, showing the division of time between project and other activity.

All staff costs included in a project should be in accordance with the following conditions:

- Staffing costs should include employer's National Insurance and Superannuation contributions (**commissions and benefits in-kind – such as bonuses – are ineligible**).

- Only **actual costs** can be included in claims.

- There should be a clear audit trail for staff costs from time sheets through payroll records, via BACs to the bank statement.

- Where staff are also engaged in non-project related work, only the portion of staff costs directly attributable to the project should be shown and must be backed up by timesheets or other time recording systems, showing project activity where time spent on eligible activity can be clearly demonstrated.

- Where staff are costed at an hourly rate, the calculations must be acceptable, i.e. the total staff cost divided by the number of hours worked per year. Hours worked are contracted hours and, if appropriate, include paid holidays – costed on the basis of the contract(s).

- Where staff are part-time or have joined / left the organisation during the year, a pro-rata rate should be calculated.

- Consultancy fees and sub-contractor fees should not be included in staff costs.

3.2 Consultancy Fees and Contractors Charges

Costs for work done by an independent consultant or sub-contractor will only be eligible if the work is **essential to the project** and the costs are reasonable: all consultancy fees and sub-contractors costs must be tendered.

- Where consultancy fees and contractors charges have been subject to an approved tender process, the market rate resulting from that exercise may be included for support, provided the original tender is no more than 3 years old.

- Costs associated with payment of consultants that provide support in completion of application / claim forms and with management fees are **not** eligible.

3.3 Project Evaluation Fees

Costs for independent project evaluations will be eligible if the work is essential to the project and / or a condition of grant. (See consultancy fees above). Where the grant award exceeds £ 2 million, the Scottish Government will undertake a separate evaluation.

3.4 Staff Travel

Staff travel costs must be directly related to and essential for the effective delivery of the project. Certified travel claims must be retained. Actual costs up to a maximum of mileage at the public sector rate per mile (or comparable) or economy class travel on public transport must be claimed.

3.5 Premises Costs

This should include actual cost of rent, rates, heat, light, cleaning and service charges associated with the premises where it can be clearly demonstrated that these are directly related to the delivery of the project and are additional, i.e. **project expenditure over and above existing operating costs, e.g. if you have to rent additional premises.**

If only a part of the premises is used for the project then the amount charged should be apportioned accordingly based on, for example, floor space occupied. In this case calculations should show the actual annual rental cost to the applicant, the period of project usage, the proportion of the building used for the delivery of the project and the resultant eligible rental cost.

Notional rental charges where the applicant owns the premises, or occupies premises rent-free, are ineligible.

3.6 Insurance

Similar principles apply. Insurance of buildings, contents and for public indemnity are eligible provided it can be clearly demonstrated that these directly relate to the delivery of the project and are additional.

3.7 Marketing

This heading may include costs related to appropriate and proportionate aspects of marketing specific to the project on, for example, design and production of marketing materials, facilitation of appropriate conferences and seminars, and targeted advertising campaigns.

3.8 Other Eligible Project Costs

This should cover software, ‘consumables’ and other reasonable costs **where it can be clearly demonstrated that these are directly related to the delivery of the project** and should not exceed 20% of total **approved** eligible costs. In the event of a project underspending, approved costs will remain the baseline for establishing the eligibility of other costs.

Consumables may include items such as the actual cost of teaching materials, telephone, postage, stationery, and other costs, which the applicant can demonstrate are essential to the effective delivery of the project and where an itemised audit trail can be provided. Items that do, or would normally, feature on an organisation’s asset register or would be, or are later, capitalised in the organisations accounts are ineligible. However, depreciation of these items is potentially eligible.

3.9 Dependent Care – Provision for dependents to allow participation in projects

- Actual payments made for nursery provision (running costs only)
- Actual payments made for care for other dependants

3.10 Purchase of Equipment

3.10.1 ERDF (Revenue) purchase of equipment / depreciation

The purchase of equipment on an ERDF Revenue project is **ineligible**. However, any items of equipment exclusively used in the project can be depreciated (see Depreciation section for further detail).

3.10.2 ESF

EC Regulation 1081/2006, Article 11 Paragraph 2 precludes the purchase of furniture, equipment and vehicles from a contribution from ESF; however, depreciation costs in respect of project delivery related items used exclusively in the project are eligible (See Depreciation section for further detail).

3.11 Repairs and Maintenance

These costs must relate to equipment specifically included as eligible items of expenditure within the approved application and within the lifetime of the project (i.e. start and finish date). Repairs and maintenance are **only eligible** for Structural Fund support in the following circumstances:

- Where the equipment has been accepted as eligible for **depreciation** under the project, or

- Where the equipment has been accepted as eligible for **leasing** and the applicant is responsible for repairs and maintenance.

3.12 Depreciation

It is important to establish here what the applicant's depreciation policy is and how old the equipment concerned is, e.g. IT equipment might reasonably be written down over 4 years. IT equipment less than 4 years old related to a project would be eligible.

No depreciation can be claimed in respect of property / goods, which have benefited from national or European grants at the time of their purchase. Depreciation, directly linked to the project, should be calculated in line with the applicant's organisation's accounting policy.

Claims for depreciation should be based on the original purchase costs of the owned equipment.

Depreciation may be claimed on second-hand equipment provided the equipment was not originally purchased using a national or European grant.

Where deferred credits are used to offset depreciation costs, the amount of the deferred credit must be deducted from the depreciation costs for grant purposes.

Documentation showing how depreciation costs have been calculated must be kept for audit purposes. This will include: invoices; payments records including BACs lists and bank statements; descriptions and location of the items purchased; the method of depreciation; and, where relevant, the estimated residual value.

3.13 Leasing

Expenditure incurred and defrayed in relation to leasing operations is eligible for co-financing under the Structural Funds subject to the rules set out in points in Annex 2.

SECTION 4 – ELIGIBLE COSTS (ESF SPECIFIC) PARTICIPANT (BENEFICIARY) COSTS

4.1 Participant Allowances

4.1.1 Wages for wage subsidy schemes / allowances for training and counselling projects

Wages and allowances may include Employers' National Insurance and Superannuation costs.

- ESF can contribute towards a wage subsidy.

- The employer may pay beneficiaries a higher sum but this should be entered under ineligible costs in the application / claim form.

- Where intermediate labour market projects also provide training allowances, allowances should be equivalent to the minimum wage.

- Wage subsidies may be used to support either temporary or permanent jobs but must lead to enhanced employability or stable employment, including self employment. ESF cannot be used to support or substitute for permanent jobs in the public sector, e.g. local or central government, or health authorities. Projects delivering wage subsidy actions must be able to demonstrate an improvement in the trainee's job skills by the end of the action or project.

- Participant allowances can only be used to purchase specialist items, specifically related to delivery of the project, but not for general capital costs (e.g. purchase of a suit to attend an interview or tools).

4.2 Participant Travel Expenses

Participant travel costs must be directly related to and essential for the effective delivery of the project. Certified travel claims must be retained. Actual costs, up to a maximum of mileage at the public sector rate per mile or economy class travel on public transport must be claimed.

4.3 Participant Subsistence

For external courses, only the actual costs of travel, board and lodgings may be claimed. Claims should be submitted on the basis of actual expenditure and supported by receipts.

4.4 Transnational Projects (ESF only)

This kind of activity is eligible. All items of expenditure claimed under this heading must conform to the National Rules on expenditure. In the case of accommodation, travel and subsistence only standard / economy class travel is eligible. Subsistence amounts must be reasonable, justified in advance and supported by appropriate receipts. Standard (daily) rates are not acceptable as eligible expenditure. No other additional payments to staff or participants are eligible.

Travel outside of the EU would need additional justification.

SECTION 5 – ALL PROJECTS: INELIGIBLE COSTS

Applicants should include all project costs, including ineligible costs in applications and claims distinguishing clearly between the two!. This list is intended as a point of easy reference. Definitive guidance is to be found in earlier sections of this document.

5.1 Financial and Other Charges and Legal Expenses

Bank charges on accounts.

Costs of guarantees provided by a bank or other financial institution.

Financial charges.

Debit interest (other than expenditure on interest subsidies to reduce the cost of borrowing for businesses under an approved State aid scheme), charges for financial transactions, foreign exchange commissions and losses, and other purely financial expenses are not eligible for co-financing by the Structural Funds.

Loan charges – the nature and amounts of any loan charges included in the overall project costs should be brought to the attention of the IAB.

Service charges – arising on leases and hire purchase arrangements.

Costs resulting from the **deferral of payments to creditors**.

Costs involved in **winding up** a company.

Bad debts.

Fines, financial penalties and expenses of litigation.

Legal fees for advice, notary fees and the costs of technical or financial expertise .

5.2 Moveable Infrastructure

Purchase of moveable infrastructure, such as motor vehicles, is ineligible. Equipment can be eligible in the circumstances described previously.

5.3 Recoverable VAT

Recoverable VAT is not eligible whether or not the applicant elects to recover.

VAT does not constitute eligible expenditure except where it is genuinely and definitively borne by the final beneficiary. **VAT which is recoverable, by whatever means, cannot be considered eligible**, even if it is not actually recovered by the final beneficiary or individual recipient. The public or private status of the final beneficiary or the individual recipient is not taken into account for the determination whether VAT constitutes eligible expenditure in application of the provisions of this rule.

It is recognised that some final beneficiaries are unable to recover VAT. **Non-recoverable VAT can be claimed as an eligible cost provided their claim is substantiated by appropriate evidence from the organisations auditors or accountants.**

VAT which is not recoverable by the final beneficiary or individual recipient by virtue of the application of specific national rules will only constitute eligible expenditure where such rules are in full compliance with the Sixth Council Directive 77/388/EEC on VAT (1).

Where the final beneficiary or individual recipient is subject to a flat-rate scheme under Title XIV of the Sixth Council Directive 77/388/EEC on VAT, VAT paid is considered recoverable for the purposes of point 6.1.

5.4 Finance Leases

Finance leases are similar to hire purchase agreements – at the end of the lease the equipment becomes the property of the lessee. These are ineligible costs.

5.5 Staff Related Costs

- Staff costs that are not directly attributable to project delivery
- Staff training, except where set out as eligible activity under Priority 3 of both ESF Programmes
- Training that is mandatory under statutory provision
- Redundancy payments
- Payments for unfunded pensions
- Maternity or sick pay

5.7 Other Ineligible Costs

- Expenditure defrayed outwith the eligible programme period, including site acquisition
- Related to research or studies carried out in respect of the project prior to the official project start date
- Volunteer costs
- Gifts
- Repairs and maintenance unless covered by the eligible cost description
- CCTV for town centres and / or as a stand-alone initiative
- Civic sculpture
- Compensation for loss of office
- Costs of works being carried out as a statutory requirement.
- Any actions previously funded by European Structural Funds under other Programmes or EU-funded initiatives
- Purchase of ID

ANNEX 1

ERDF CAPITAL – OTHER ELIGIBLE COSTS

Site Investigation: This should take account of specialist investigations required to identify contamination and recommend particular treatments etc.

Site Decontamination: Specialist treatments to clear a site of particular contamination and dangers.

Site Preparation / Clearance: This should include demolition works and the general preparation of sites, which is not part of specialist decontamination works.

Site Servicing: This may include the following elements:

- The provision of external utilities such as telecommunications, electricity and gas provision to the entire site and / or building
- The provision of water and sewerage services within the site / project boundary
- The construction / improvement of access roads and junctions within the site boundary

Preliminaries: As detailed in the Bill of Quantities.

Main Building Contract Works: This may include the following elements of work:

- External / structural refurbishment of existing premises
- Internal sub-division of existing premises
- New build premises
- External decoration and associated works as part of a larger project
- Internal decoration and associated works as part of a larger project

Internal Services: This should include the provision of services/utilities within a building such as heating, lighting, plumbing and telecommunications.

Main Environmental Contract Works: This may include the following elements of work:

- Hard and soft landscaping as part of a larger industrial / commercial development
- Hard and soft landscaping as part of a larger tourism / cultural development
- Hard and soft landscaping to promote environmental sustainability
- Street furniture and lighting
- Traffic management and urban centre regeneration works
- Creation and improvement of footpaths
- Creation and improvement of cycle paths
- Improvements to inland waterways

Specialist Treatments as part of a Larger Project: This should cover any specialist treatments not included under other headings such as:

- Stone cleaning
- Floodlighting
- Asbestos removal
- Damp and rot
- Special needs accessibility

Applicants should specify the type of treatment(s) in an appendix. If treatments are associated with listed buildings they should be in accordance with the guidelines set down by Historic Scotland.

Security Provision: This should only include eligible security provision, which will ensure the success of the wider project.

Signage: This should include relevant signs including those acknowledging the contribution of the Structural Funds to the project.

ANNEX 2

VENTURE CAPITAL AND LOAN FUNDS

1. General Rule

1.1 The Structural Funds may co-finance the capital of venture capital and / or loan funds or of venture capital holding funds (hereinafter funds) under the conditions set out in point 2. For the purposes of these Rules, 'Venture capital funds and loan funds' means investment vehicles established specifically to provide equity or other forms of risk capital, including loans, to small and medium-sized enterprises as defined in Commission Recommendation 96/280/EC (2) as last amended by Recommendation of 6 May 2003. 'Venture capital holding funds' means funds set up to invest in several venture capital and loan funds. The Structural Funds' participation in funds may be accompanied by co-investments or guarantees from other Community financing instruments.

2. Conditions

2.1. A prudent business plan must be submitted by the co-financiers or sponsors of the fund specifying, inter alia, the targeted market, the criteria, terms and conditions of financing, the operational budget of the fund, the ownership and co-financing partners, the professionalism, competence and independence of the management, the fund's bylaws, the justification and intended utilisation of the Structural Funds' contribution, the investment exit policy, and the winding-up provisions of the fund, including the reutilisation of returns attributable to the contribution from the Structural Funds. The business plan will be carefully appraised and its implementation monitored by or under the responsibility of the managing authority.

2.2. The fund will be set up as an independent legal entity governed by agreements between the shareholders or as a separate block of finance within an existing financial institution. In the latter case the fund will be subject to a separate implementation agreement, stipulating in particular the keeping of separate accounts distinguishing the new resources invested in the fund (including those contributed by the Structural Funds) from those initially available in the institution. All participants in the fund will make their contributions in cash.

2.3. The Commission cannot become a partner or shareholder in the fund.

2.4. The contribution from the Structural Funds will be subject to the limits laid down by the MA.

2.5. Funds may invest only in SMEs at their establishment, early stages (including seed capital) or expansion and only in activities which the fund managers judge potentially economically viable. The assessment of the viability should take into account all sources of income of the enterprises in question. Funds will not invest in firms in difficulty within the meaning of the Community Guidelines on State aid for rescuing and restructuring firms in difficulty.

2.6. Precautions should be taken to minimise distortion of competition in the venture capital or lending market. In particular returns from equity investments and loans (less pro rata share of the management costs) may be preferentially allocated to the private sector shareholders up to the level of remuneration laid down in the shareholder agreement, and after that, they will be allocated proportionally between all shareholders and the Structural Funds. Returns to the fund attributable to the Structural Funds' contributions must be reused for SME development activities in the same eligible area.

2.7. Management costs should be actual costs but may not exceed 5 % of the paid-up capital on a yearly average for the duration of the assistance unless, after a competitive tender, a higher percentage proves necessary.

2.8. At the time of the closure of the project, the eligible expenditure of the fund (the final beneficiary) must be the capital of the fund that has been invested in or loaned out to SMEs, including the management costs incurred.

2.9. Contributions to funds from the Structural Funds and other public sources, as well as the investments made by funds in individual SMEs, are subject to the rules on State aid.

2.10 The financial contribution of the private sector should be above 30 %.

3. Recommendations

3.1. The MA recommends the standards of good practice set out in points 3.2 to 3.5 for funds to which the Structural Funds contribute. The MA will regard compliance with these recommendations as a positive element when it examines the fund's compatibility with State aid rules. The recommendations are not binding for the purposes of the eligibility of expenditure.

3.2. Funds should be large enough and cover a wide enough target population to ensure that their projects are potentially economically viable, with a time-scale for investments compatible with the period of the Structural Funds' participation and focusing on areas of market failure.

3.3. The timing of payments of capital into the fund should be the same for the Structural Funds and the shareholders, and pro rata to the stakes subscribed.

3.4. Funds should be managed by independent professional teams with sufficient business experience to demonstrate the necessary capability and credibility to manage a venture capital fund. Management teams should be chosen on the basis of a competitive selection process, taking into account the level of fees envisaged.

3.5. Funds should not normally acquire majority stakes in firms and should pursue the objective of realising all investments within the life of the fund.

2. GUARANTEE FUNDS

1. General Rule

1.1 The Structural Funds may co-finance the capital of guarantee funds under the conditions set out in point 2. For the purposes of this Rule, ‘Guarantee funds’ mean financing instruments that guarantee venture capital and loan funds within the meaning of that rule and other SME risk financing schemes (including loans) against losses arising from their investments in small and medium-sized enterprises as defined in recommendation 96/280/EC as last amended by Commission Recommendation of 6 May 2003. The funds may be publicly-supported mutual funds subscribed by SMEs, commercially-run funds with private-sector partners, or wholly publicly-financed funds. The Structural Funds' participation in funds may be accompanied by part-guarantees provided by other Community financing instruments.

2. Conditions

2.1. A prudent business plan must be submitted by the co-financiers or sponsors of the fund in the same way as for venture capital funds, mutatis mutandis, and specifying the target guarantee portfolio. The business plan will be carefully appraised and its implementation monitored by or under the responsibility of the managing authority.

2.2. The fund will be set up as an independent legal entity governed by agreements between the shareholders or as a separate block of finance within an existing financial institution. In the latter case the 'fund' will be subject to a separate implementation agreement, stipulating in particular the keeping of separate accounts distinguishing the new resources invested in the fund (including those contributed by the Structural Funds) from those initially available in the institution.

2.3. The Commission cannot become a partner or shareholder in the fund.

2.4. Funds may only guarantee investments in activities that are judged potentially economically viable. Funds will not provide guarantees for firms in difficulty within the meaning of the Community guidelines on State aid for rescuing and restructuring firms in difficulty.

2.5. Any part of the Structural Funds' contribution left over after the guarantees have been honoured will be reused for SME development activities in the same eligible area.

2.6. Management costs must be actual costs and not exceed 2 % of the paid-up capital on a yearly average for the duration of the assistance unless, after a competitive tender, a higher percentage proves necessary.

2.7. At the time of the closure of the project, the eligible expenditure of the fund (the final beneficiary) will be the amount of the paid-up capital of the fund necessary, on the basis of an independent audit, to cover the guarantees provided including the management costs incurred.

2.8. Contributions to guarantee funds from the Structural Funds and other public sources, as well as the guarantees provided by such funds to individual SMEs are subject to the rules on State aid.

ANNEX 3

GRANT AND LOAN FUNDS

1.1 Grant and loan funds are established with the sole purpose of providing direct financial support to Small and Medium Sized Enterprises (SME) and other eligible beneficiaries.

1.2 Grant and loan funds should be set up as separate legal entities and meet the management and reporting procedures required by the Scottish Government.

1.3 Grant and loan funds must be established with all match funding committed and in place from the outset. This enables ERDF to be drawn down in a single claim.

1.4 Grant funds normally make one-off non-repayable awards to eligible beneficiaries. The full value of the grant fund must be fully allocated by the final spend date for the programme – 31 July 2015.

1.5 Loan funds by definition provide financial assistance to SMEs and other eligible beneficiaries that will be repaid and which in turn will replenish the loan fund. The full value of the original approved loan fund must be fully allocated by the final spend date for the programme – 31 July 2015.

1.6 Grant schemes are defined as financial support to SMEs and other eligible beneficiaries and provided as part of a wider business support service. A grant scheme should not normally be set up as a single separate entity. ERDF should be drawn down retrospectively in the usual manner.

ANNEX 4

LEASING

Aid via Lessor

The lessor is the direct recipient of the Community co-financing, which is used for the reduction of the lease rental payments made by the lessee in respect of assets covered by the leasing contract.

Leasing contracts for which Community aid is paid will include an option to purchase or provide for a minimum leasing period equal to that of the useful life of the asset to which the contract relates.

Where a leasing contract is terminated before expiry of the minimum leasing period without the prior approval of the competent authorities, the lessor will undertake to repay to the national authorities concerned (for credit to the appropriate fund) that part of the Community aid corresponding to the remainder of the leasing period.

The purchase of the asset by the lessor, supported by a receipted invoice or an accounting document of equal probative value, constitutes the expenditure eligible for co-financing. The maximum amount eligible for Community co-financing will not exceed the market value of the asset leased.

Costs connected with the leasing contract (notably tax, lessor's margin, interest refinancing costs, overheads, insurance charges), other than the expenditure referred to in point 2.4, are not eligible expenditure.

Community aid paid to the lessor must be used in its entirety for the benefit of the lessee by means of a uniform reduction in all the leasing rentals for the duration of the leasing period.

The lessor will demonstrate that the benefit of the Community aid will be transferred fully to the lessee by establishing a breakdown of the rental payments or by an alternative method giving equivalent assurance.

The costs referred to in point 2.5, the use of any fiscal benefits arising from the leasing operation, and other conditions of the contract will be equivalent to those applicable in the absence of any Community financial intervention.

Aid to Lessee

The lessee is the direct recipient of the Community co-financing.

The leasing rentals paid to the lessor by the lessee, supported by a receipted invoice or an accounting document of equivalent probative value, constitute the expenditure eligible for co-financing.

In the case of leasing contracts which include an option to purchase or which provide for a minimum leasing period equal to the useful life of the asset to which the contract relates, the maximum amount eligible for Community co-financing must not exceed the market value of the asset leased. Other costs connected with the leasing contract (tax, lessor's margin, interest refinancing costs, overheads, insurance charges, etc.) are not eligible expenditure.

The Community aid in respect of leasing contracts referred to under point 3.3 is paid to the lessee in one or more tranches in respect of leasing rentals effectively paid. Where the term of the leasing contract exceeds the final date for taking account of payments under the Community assistance, only expenditure in relation to leasing rentals falling due and paid by the lessee up to the final date for payment under the assistance can be considered eligible.

In the case of leasing contracts which do not contain an option to purchase and whose duration is less than the period of the useful life of the asset to which the leasing contract relates, the leasing rentals are eligible for co-financing by the Community in proportion to the period of the eligible project. However, the lessee must be able to demonstrate that leasing was the most cost-effective method for obtaining the use of the equipment. Where the costs would have been lower if an alternative method (for example hiring of the equipment) had been used, the additional costs will be deducted from the eligible expenditure.

Sale and Lease-Back

Leasing rentals paid by a lessee under a sale and lease-back scheme may be eligible expenditure under the rules set out in point 3. The acquisition costs of the asset are not eligible for Community co-financing.