



EUROPEAN CENTER FOR NOT-FOR-PROFIT LAW

**Response to the Public Consultation on the
Review of the Financial Regulation**

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INTRODUCTION

The European Center for Not-for-Profit Law (ECNL) welcomes this opportunity to contribute to the public consultation on the Financial Regulation review. We appreciate the efforts of the Commission to give space for beneficiaries to set in the spotlight the practical issues they face and suggest solutions based on good practices in order to enhance effectiveness and efficiency of Community funding. This consultation is also an important step in building a transparent, responsible and collegial relationship between the Commission and civil society actors.

ECNL is a public benefit organization working internationally, which promotes the strengthening of a supportive policy and legal environment for civil society in Europe and beyond. ECNL provides cutting-edge expertise in initiatives regarding regulation of civil society, including association and foundation law, public financing, philanthropy, counter-terrorism, public participation and partnerships between the state and civil society among others. We share alternative regulatory models, lessons learnt, and experiences across borders; and provide comparative information to assist partners in adapting or creating new solutions appropriate to their environments. ECNL has successfully undertaken projects for the Council of Europe, the World Bank, USAID, UNDP, UN Volunteers and a number of private donors. In addition to its extensive experience of working with other public donors, ECNL has first-hand experience in implementing EU grants financed through EuropeAid and a contract supported by the DG Freedom Security and Justice. For more information, please, see: www.ecnl.org.

In preparing this submission, through in-person inquiries and an online flash survey ECNL reached out to approximately 50 NPOs from several member states and beyond the EU in order to explore their priority issues regarding EU funding. An online flash survey was carried out in November 2009 and resulted in feedback from thirty human rights and accountability watchdog organizations from the new member states. Additionally, we conducted personal interviews with close to 20 NPOs from among our Europe-wide network. ECNL also cooperated with other contributors to the consultation, e.g. CONCORD and EUCLID to identify the issues of mutual concern for our networks. As part of this submission, we are including a reference list and an annex on in-kind contributions that provides resources for further research and comparative analysis of other donors' practices.

ECNL would like to thank the Commission for the opportunity to provide our comments to the Consultation and hopes that our contribution will help to ensure that the Community funds are spent effectively and efficiently while adhering to the principles of sound financial management, transparency and good practices.

We are happy to engage in any follow up discussions of the draft Financial Regulation and Implementing Rules and contribute with our comments and suggestions.

Sincerely,

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LIST OF ACRONYMS

ACEVO	Association of Chief Executives of Voluntary Organizations
CEO	Chief Executive Officer
CIDA	Canadian International Development Agency
CONCORD	European NGO Confederation For Relief and Development
CORDIS	Community Research and Development Information Service for Science, Research and Development
CSO	Civil Society Organisation
DANIDA	Danish International Development Agency
DCP	Decentralised Cooperation Programme
DG	Directorate-General
DG EAC	Directorate-General Education and Culture
DG JLS	Directorate-General for Justice, Freedom and Security
EC	European Commission
ECHO	European Commission Humanitarian Aid department
ECNL	European Center for Not-for-Profit Law www.ecnl.org
EU	European Union
FR	Financial Regulation
GHD	Good Humanitarian Donorship Initiative
HQ	Headquarters
ILO	International Labour Organization
IR	Implementing Rules
ISC	Indirect Support Costs
NICRA	Negotiated Indirect Cost Rate Agreement
NGO	Non-Governmental Organisation
NPO	Non-Profit Organization
OECD	Organisation for Economic Co-operation and Development
PADOR	Potential Applicant Dated Online Registration
PRAG	Practical Guide to Contract Procedures for EC External Actions
PRIAMOS	Programme Information and Activity Management Operational System
SIDA	Swedish International Development Agency
UK	United Kingdom
UNDP	United Nations Development Programme
US	United States of America
USAID	United States Agency for International Development
USG	US Government

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EXECUTIVE SUMMARY

The European Center for Not-for-Profit Law (ECNL) commends the European Commission for its efforts to consult beneficiaries and the wider public on the financial rules for the programmes funded by the budget of the European Union (EU). We are grateful for the opportunity to provide comments, which are summarized here below.

ECNL provides its detailed opinion to four key issues: (i) indirect rate; (ii) in-kind contributions; (iii) exchange rate losses; and (iv) information about upcoming and awarded grants and paperwork for applicants. ECNL selected these issues from among those that were raised by the European Commission (EC) because (a) these issues have been outlined as key challenges by the majority of approximately 50 partner NPOs that ECNL consulted in the preparation of this submission, and (b) ECNL has had direct experience with their application on projects funded by the EC.

ECNL recognizes that the combined impact of these barriers poses significant burdens on beneficiaries that limit their ability to successfully carry out future actions. Challenges associated with each issue mentioned in this report may result in a financial loss and weaken the capacity and viability of NPOs; taken together, they may strongly deter NPOs from engaging with the EC to carry out highly needed actions. This in turn may compromise the realization of the objectives of funding programmes of the EC. Even more significantly, the issues raised compromise the purposes of the Financial Regulation (FR) and Implementing Rules (IR), which are to ensure that Community funds are spent transparently, efficiently and effectively for the purpose intended by the budgetary and legislative authority.

Issues and overall recommendations:

1. Indirect rate

The current 7% cap on indirect expenses does not allow the majority of NPOs to fully recover their indirect costs from project income. Moreover, there is a strong contradiction between the EC's expectations that NPOs will reduce overhead costs, while at the same time become more professional in financial management, accounting and reporting. As our analysis will show, the unrealistically low cap on administrative expenses runs counter to the EC's efforts to increase transparency and accountability of the Community budget; weakens the capacity of NPOs to remain capable partners of the EC in implementing its policies in the EU and externally; and drives away capable organisations from engaging with the EC where they would be most needed. Managing taxpayers' funds and complying with highly sophisticated financial reporting requirements demands organisational capacities that come at a cost and donors, including the EC, should assume the responsibility of financing their fair share of developing and maintaining such capacities.

We recommend that the **EC make an explicit commitment to bearing its fair share of project funding, including full recovery of the indirect costs properly allocated to EC funded projects**. It is our recommendation that the EU increases the flat rate to a level that is closer to an estimated average indirect rate of an NPO; and that it also considers the development and introduction of its own method for calculating and allocating indirect costs for NPOs in order to allow for actual indirect cost reimbursement.

2. In-kind contributions

In-kind contributions to co-financing are allowed but scarcely applied in practice. This causes difficulties for NPOs but it also means that the EC is not taking full advantage of the resources that could be supporting its actions from a range of stakeholders. Recognizing such contributions would serve the budgetary principle of efficiency which is concerned with *the best relationship between resources employed and results achieved*. Further, the EC may miss opportunities to

support projects highly relevant to its policy objectives as the ineligibility of in-kind contributions for co-financing prevents NPOs from applying for EC grants.

Building on the successes of already existing good examples for allowing in-kind contributions, ECNL urges the EC to take the necessary measures to allow greater inclusion of in-kind contributions as a part of co-financing. We recommend that **in-kind contributions be accepted as a rule rather than an exception**. Appropriate guidance and criteria on recording and reporting in-kind contributions should be developed by the EU, with the help of a multi-stakeholder working group, to help ensure that rules respond to the good practice and consider the concerns related to proper accounting and reporting. A concern has been raised that allowing in-kind contributions may go against the non-profit principle. Our analysis demonstrates that according to general accounting principles such contributions cannot create a surplus for the organization. In an Annex, we also provide examples to assist in further elaborating this recommendation.

Furthermore, ECNL suggests that the co-financing principle itself may need further clarification in terms of its rationale and in terms of the criteria applied when determining the necessary level of co-financing for the action. This could be addressed through the development of a guide to implementing the co-financing principle.

3. Exchange rate losses

Organisations that carry out actions outside of the Eurozone face the burden of recovering exchange rate losses on several levels. Exchange rate losses are not eligible costs for the action, although they satisfy or could satisfy every condition for being eligible. The use of InforEuro rate creates an additional layer of reporting that may result in the violation of the 'non-profit rule'. Finally, the concept of 'exceptional fluctuations' in exchange rates is not clear. The related remedy of 'restructuring the action' may be reserved for more extreme occasions, while ordinarily, exchange rate losses could be recovered from a contingency reserve of the action.

We recommend that **exchange rate losses be eligible expenses for the action**; that where appropriate, beneficiaries should be enabled to use their own accounting systems rather than the InforEuro rate; and that projects are encouraged to incorporate a contingency reserve to cover for eventual exchange rate losses. Any profit gained through currency exchange should be regarded as part of the project income (thus, possibly leading to a decrease in community funding) or duly paid back to the Commission. Further explanation should be provided on what is considered as an exceptional exchange rate fluctuation and how the losses can be recovered.

4. Information about upcoming and awarded grants and paperwork for applicants

Information about upcoming and awarded grants: While FR and IR require DGs to publish information on awarded grants, in practice some DGs are lagging behind in making this information publicly available. Moreover, some fail to categorize and organize the data, which makes it practically impossible for stakeholders to obtain information on grantees with easy access. As for calls for proposals, although information concerning various EC funding opportunities is widely published, it is still too scattered and fragmented to be considered effective. These problems hinder timely access to information for the applicants and fail to ensure a sufficient level of transparency. We therefore recommend that in the long term **EC considers launching one well-structured portal which contains consolidated information from all DGs and financial instruments** with information on (1) annual work programmes of departments and financial mechanisms; (2) calls for proposals and tender opportunities; and (3) awarded grants and contracts.

Use of e-tools: The use of e-tools is still generally considered as a step forward as they substantially reduce paperwork, thus saving time, energy and resources for NPOs. We provide certain recommendations that could assist with the conceptualization and better implementation

of such tools. Specifically, we recommend that (1) derogation for the use of e-tools (i.e.: exemption allowing submissions in hard copy) is sustained in the long run so as to ensure that such applicants have equal access to funding opportunities; (2) e-tools allow applicants to upload documents, rather than obliging them to complete an online project application template; and (3) the EC develops more consistent practices with respect to the use of the e-tools.

Stages of application: Open call for proposals, i.e. the simultaneous submission of the concept note and full application, poses a formidable challenge for NPOs. We recommend that two-phase applications become the rule rather than the exception, except for small value projects (e.g.: below 25,000 EUR) or when it is in the interest of the project objective that a decision be made quickly.

Introducing a label system: ECNL welcomes the idea of introducing methods that ease the application process. We recommend that the proposed “label system” of EC is developed based on the eligibility criteria (conditions that may be supported by clear evidence and can be kept in a record which would need simple updating), rather than on selection criteria (e.g., whether the organization has successfully implemented a project/contract).

We hope that the comments and recommendations in this paper will be a helpful contribution toward EC efforts to create more efficient delivery mechanisms and a further simplification of rules and procedures. We remain open to further involvement in processes led by the Commission to reach these aims.

ISSUE: INDIRECT RATE

Summary

Currently, the EC does not allow grant recipients to charge more than 7% of the total costs of the funded project as indirect costs. In the majority of cases, this rate does not allow NPOs to fully recover their indirect costs from project income. Maintaining the policy of an unrealistically low cap on administrative expenses runs counter to the EC's efforts to increase transparency and accountability of the Community budget; weakens the capacity of NPOs to remain capable partners of the EC in implementing its policies in the EU and externally; and drives away capable organisations from engaging with the EC where they would be most needed.

Moreover, there is a strong contradiction between the EC's expectations that NPOs will on one hand reduce overhead costs, and on the other hand become more professional in financial management, accounting and reporting. Managing taxpayers' funds and complying with highly sophisticated financial reporting requirements demands organisational capacities that come at a cost, and donors, including the EC, should assume the responsibility of financing their fair share of developing and maintaining such capacities.

FR Art 108a

1. Grants may take any of the following forms:
 - a. Reimbursement of a specified proportion of the eligible costs actually incurred;
 - b. Lump sums;
 - c. Flat-rate financing;
 - d. A combination of the forms referred to in points (a), (b) and (c)
2. Grant shall not exceed an overall ceiling expressed in terms of absolute value.

IR Art 181 Lump sums and flat rate financing

3. The grant decision or agreement may authorise, in the form of flat-rates, funding of the beneficiary's indirect costs up to a maximum of 7% of total eligible direct costs for the action, save where the beneficiary is in receipt of an operating grant financed from the Community budget. The 7% ceiling may be exceeded by reasoned decision of the Commission.

1. What are indirect expenses?

We have not found one single definition of indirect costs used across the various DGs and other EC institutions. The most commonly used definition is along the following lines:

The eligible indirect costs for the action are those costs which are not identifiable as being directly attributed to the performance of the action and which could therefore be booked to it direct, but which can be identified and justified by the beneficiary using his accounting system as having been incurred in connection with the eligible direct costs for the action.

The General and Specific Conditions of Grant Contracts of the various DGs further define which costs are eligible as direct and indirect costs. Although there are many items that are consistently categorised, there are also variations depending on the DG and the programme. Furthermore, in practice the determination of a certain cost as direct or indirect can ultimately be left to negotiation between the authorising officer and the beneficiary NPO and depend on the interpretation of the authorising officer of the "7% rule".

What is considered direct versus indirect costs is not straightforward. So called "administrative" costs, such as office rent, telephone, software or IT services can be considered as either direct or

indirect costs depending on the approach taken in accounting for them. For example, an NPO that has a clear system of tracking such administrative costs can clearly allocate them as direct costs to the project (e.g. based on an itemised phone bill or a transparent method of allocating the proportionate amount of office rent to the project). Some budgets of the EC grant programmes call these costs “administrative” costs and include them as direct expenses, while other donors may call them “other direct costs”. In such instances, indirect costs represent expenses that cannot be clearly connected with any one project, such as board meetings, legal costs, annual audits or e.g. the cost of investing in a knowledge management system for the whole organisation.

In other cases, however, “administrative” costs will also be part of indirect expenses, thus increasing the amount of indirect expenses and the indirect rate. Either method of determining indirect expenses may be sound and transparent; however, they will lead to different results in the amounts and rates applied.

We found that the method used by the EC to determine indirect costs in concrete cases may lead to situations in which the 7% limit does not cover all indirect costs incurred by the NPO.

Case study: ECNL

ECNL was not allowed under a Contract to bill a portion of the maintenance costs of its office based in Budapest, Hungary to direct expenses, even though ECNL has a system of clearly allocating such costs to the project (i.e. they could have been billed directly). Therefore all “headquarters costs” had to be included in the amount of indirect expenses allowable up to the 7% rate. Although the budget had headings of “office rent”, “utilities” and other such costs under direct costs of the project, these were reserved, under the EIDHR practice, to field offices of the applicant. But ECNL does not maintain field offices -- it aims to empower local partners through building their capacity, not the capacity of an ECNL field office. As a result, it considers field offices to be both more expensive for its programmes, and inconsistent with its methodology. “Administrative costs” of the Budapest office supporting the EC project had to be included in the indirect expenses portion of the budget. The limitation on 7% meant that ECNL was not able to cover all those expenses from the project income.

2. How to determine indirect costs for NPOs?

Generally, there are two key questions in determining indirect expenses and their rates in case of NPOs:

- What expenses are considered and categorised as “indirect” in the organisation? (I.e. what is the method of determining whether expenses belong to the indirect, as opposed to the direct pool of costs?)
- How are indirect expenses allocated in the organisations’ overall budget? (I.e. once determined as indirect, through what method are expenses allocated to programmes, projects, services?)

Responses to these questions may vary from NPO to NPO. In the discussion that follows, we aim to demonstrate that indirect cost levels of NPOs may be inherently different depending on the size, field of work, cost structure and other factors; and that they do not serve as an indicator of organisational efficiency or programme effectiveness. Any donor that aims to answer those two questions for the purposes of budgeting and reporting for the projects it wants finance needs to consider the specific situation of the NPO that it supports.

The EU, by requiring a flat rate to be used by all NPOs, regardless of size or field of work, discourages NPOs from investing in institutional capacities, undermining their effectiveness in programme implementation and leading to less than transparent accounting practices. This is to

the long-term detriment of the EC because it weakens the ability and the willingness of NPOs to engage in EC project implementation.

3. Why the limit on indirect expenses?

While donors generally admit that indirect expenses are a necessity, they also see the need to limit such expenses to a lowest possible level within the NPO. Based on our review, the limitation of indirect expenses by donors may originate from a number of different considerations and practices. Below, we list the main considerations and argue that low limits that restrict full recovery of costs are based on false premises and may even have the opposite effect of what was intended by introducing them.

a. “Grants should be supporting the beneficiaries, not the NPO.” The reason most often given for limiting indirect expenses seems to reflect the widespread belief among donors, whether public institutions, private companies, foundations or individuals, that a grant (donation) should be dedicated to the public benefit purposes (i.e., should reach the beneficiaries) to the greatest extent possible.

This argument is not sound for several reasons. First, an NPO is a vehicle to serve the beneficiaries by producing the project outcomes. If the vehicle is weak, inefficient and unsustainable, the project, and thus the beneficiaries, suffers. Available evidence clearly shows that inadequate infrastructure compromises organisational effectiveness.¹ By not supporting a part of the allocable indirect costs related to their funded projects, donors compel NPOs to cut back on essential staff and infrastructure expenses, or to rely on other donors to subsidise these costs.

Second, NPOs, as any other entity, need up-to-date, efficient infrastructure and capable management staff to be able to deliver high quality programmes and results. Therefore, **investment in administrative capacities and programme support will usually bring a return in terms of higher efficiency and added value to the beneficiaries** over the long term. For example, investing in more expensive software may bring increased efficiency in accounting and project administration. Investing in staff training may improve staff skills in empowering beneficiaries, thus making the projects more effective.²

b. “Low indirect rates indicate organisational efficiency.” Another commonly cited reason for the limit – strongly related to the previous one - is that donors perceive lower indirect expenses to be an indication of good management practice and increased organisational efficiency. However, several recent studies on this subject **clearly state that indirect rates are not an appropriate way to evaluate organisational performance.**³

Indirect cost rates depend on the size of the organisation, the type of work (activities) it generally carries out and the volume of its programmes in any given year, among others factors.

¹ See, for example: Nonprofit Overhead Cost Project, Facts and Perspectives, Brief #3. Center on Nonprofits and Philanthropy, Urban Institute and Center on Philanthropy, Indiana University, August 2004
<http://nccsdataweb.urban.org/kbfiles/311/brief%203.pdf>

² While not typical, sometimes NPOs can express such gains in monetary terms. E.g. one organisation calculated that an investment in technological infrastructure yielded \$350,000 per year by freeing up staff time and consolidating multiple dysfunctional systems. In: Gregory, Ann Goggins; Howard, Don 2009. “The Nonprofit Starvation Cycle”, Stanford Social Innovation Review http://www.ssireview.org/articles/entry/the_nonprofit_starvation_cycle/

³ See for example: The Unintended impacts of indirect cost policies, InsideNGO, December 2009
<http://www.insidengo.org/>; The Nonprofit Starvation Cycle, The Bridgespan Group, August 2009
http://www.ssireview.org/articles/entry/the_nonprofit_starvation_cycle/; Good Humanitarian Donorship Indirect Support Cost Study: Final Report, Development Initiatives, July 2008 www.icva.ch/doc00003032.doc

Newer and smaller organisations usually have higher indirect costs as they continue to grow and invest in their development. Small organisations which oftentimes provide needed services in niche areas or small communities, have a smaller pool of direct costs over which to spread their indirect costs, and thus often have a higher indirect rate. Grantmaking and humanitarian aid organisations, which manage high amounts of pass-through money, tend to have lower indirect rates than NPOs which are engaged in human-resources-intensive work, e.g. policy research or legal aid. In a year when an NPO receives fewer projects but decides not to lay-off staff and uses its reserves to engage in programme development and staff training for new programmes, the indirect costs of the NPO may be considerably higher than in a year when it was awarded several projects and its entire staff was fully engaged in project work. Yet, overall, this NPO may be more effective and more sustainable than the one which does not have reserves, does not invest in staff development and hires staff strictly for the duration of a project – thus, keeping its indirect costs low in times of recession.

Indirect rates also depend on the cost structure of the organisation and its accounting policies. These vary widely among NPOs. For example, while one NPO may include a laptop computer in its direct expenses budget (e.g. if it was bought and used solely for a certain project), another NPO will include any and all equipment into its indirect budget. One NPO may include the maintenance costs of its field office among direct costs (as it was opened in connection with a certain project); another one may charge those as indirect expenses (because it classifies indirect costs by function). Therefore, lower indirect cost rates do not necessarily reflect a lower amount of certain type of expenditure in comparison to another NPO. They may just mean that one NPO has a different way of identifying and allocating the same type of costs than the other.

“A percentage rate does not provide a true picture of indirect costs. An indirect support cost charge is the product of an organisation’s cost structure and several other factors, not an indication of its performance on delivery or its cost-effectiveness.”

(Good Humanitarian Donorship Indirect Cost Study, 2009)

It is important for the EC to recognise that there is no one-size fits all approach; there are no established “industry standards”; and a flat rate, especially if unrealistically low, may pose a barrier to organisational efficiency, rather than enhancing it. While comparison with the for-profit sector is obviously not straightforward, it is notable that companies report an average of 25% indirect rate (average across the various industries). Significantly, in the services sector – probably the closest analogue to the nonprofit sector as a whole – none report average overhead rates below 20%.⁴

c. “Higher indirect costs allow for perks and unjustified personal gain” (e.g. through higher salaries, retreats, vehicles used for personal purposes and the like). Research available thus far indicates that such cases are the exception rather than the rule. NPOs are accountable to multiple stakeholders and are increasingly subject to public regulation and scrutiny.⁵ They have increasing pressures and incentives to be more accountable and transparent in both the developed and developing world; and in most contexts, NPO board and staff members are keenly aware of the necessity to use resources for public rather than private benefit. Moreover, a low indirect rate is not an effective means to control unwarranted cost. For example, a large organisation, which can more easily sustain a low indirect rate, will be able to incur those costs

⁴ In: Gregory, Ann Goggins; Howard, Don 2009. “The Nonprofit Starvation Cycle”, Stanford Social Innovation Review http://www.ssireview.org/articles/entry/the_nonprofit_starvation_cycle/

⁵ A recent study conducted by ECNL for DG JLS identified over 140 public and self-regulatory initiatives carried out over the past five years in the 27 member states that impacted on NPO accountability and transparency. See European Center for Not-for-Profit Law (ECNL) 2009. “Study on Recent Public and Self-Regulatory Initiatives Improving Transparency and Accountability of Non-Profit Organisations in the European Union”, Research Commissioned by the European Commission Directorate-General of Justice, Freedom and Security. http://www.ecnl.org/dindocuments/306_ECNL%20Accountability%20Study_published%20on%20DG%20JLS.pdf?PHPSESSID=3fe4391afd792783244c2b268b62a982

even within the low rate. Direct means of limiting abuse, e.g., improving incentives for transparency, are more effective.

“No organisation in our study was an extravagant spender on fundraising or administration. Yet, contrary to the idea that spending less in these areas is a virtue, our cases suggest that nonprofits that spend too little on infrastructure have more limited effectiveness than those who spend more reasonably.”

(Nonprofit Overhead Cost Project, Brief #3)

d. “NPOs should not have higher indirect rates than public bodies.” There is yet another conceptual misunderstanding that may play a role in the low percentage allowed for indirect costs in the case of EC and other donors. Public institutions, including, e.g., UN agencies and similar agencies that assume a non-profit form, often receive annual budgetary subsidies to run their basic office and human resources infrastructure (“core costs”). Thus, when they undertake projects, they need only raise the additional indirect costs that are specifically associated with the projects, to the extent these costs are categorised as indirect, or “administrative” costs. (e.g. new software or the cost of monitoring and reporting).⁶ In such cases, indirect rates should be low indeed, since they do not finance organisational costs. However, **NPOs do not operate like public institutions**; the vast majority of NPOs do not have their core costs funded on an ongoing basis by a donor they can depend on. For NPOs, every single donor needs to cover its fair share of indirect expenses for the whole organisation -- otherwise the organisation will quickly become unsustainable.

In summary, **there is a strong contradiction between the EC’s expectations that NPOs will on the one hand reduce overhead costs, and on the other hand become more professional in financial management, accounting and reporting.** Managing taxpayers’ funds and complying with highly sophisticated financial reporting requirements demands well qualified managerial and finance staff, an accounting software that can deal with various currencies, and effective data protection and internal systems that can track expenditure and performance. These come at a cost and when donors, including the EC, expect that NPOs possess that level of professionalism in project management, they should assume the responsibility of financing their share of developing and maintaining these capacities.

A note on “operational grants”

The EC provides core costs to some NPOs, in the form of “operational grants”. (FR Art 108, IR Art 162.) NPOs receiving operational grants are not allowed to include any indirect costs into their project application budgets. This method of separating core costs from indirect costs underscores the confusion around the financing of NPO operations. Moreover, disallowing all indirect costs for NPOs receiving operational grants is overly restrictive. Under good accounting practice, an NPO has one indirect cost rate reflecting the overhead expenses for the whole organisation (as shown above) and it allocates those proportionately to its programmes, activities and services (e.g., by project volume or by service unit). An operational grant or other institutional support funds overall organisational indirect costs rather than the indirect costs of any one project. Thus, the EC should require that the amount of an operational grant be deducted from the indirect cost budget of the organisation, and the indirect rate set accordingly (i.e. at a lower rate). Consequently, project related indirect costs will be lower than they would be without the core support. Based on the “fair share” principle, the EC should then allow NPOs to charge a proportionate amount of indirect costs as eligible costs to the project; however, it may request that these are covered from other sources of the NPO, thus avoiding indirect cost support above and beyond the operational grant.

⁶ In some cases, like with the UN these are termed „fixed” and „variable” indirect costs. The GHD Study revealed that in the cases of public bodies and those NPOs which receive core funding, core costs tend to subsidize the true cost of programme delivery, thus keeping indirect rates artificially at a lower level.

4. What is the result of limiting indirect costs to a low flat rate?

The studies on NPO indirect costs cited in this report, as well as ECNL's own experience and that of our NPO partners, consistently show that severe limits on indirect costs have a deleterious effect on NPOs and **endanger implementation of donor programmes** in the long term. An unrealistically low limit on indirect expenses leads to underinvestment in the management and infrastructure capacities of NPOs, thus weakening their ability to carry out their programmes successfully; forces NPOs to cross-subsidise projects and prompts them towards less transparent practices in allocating overheads; and prevents NPOs to apply for such grants.

A recent study of the Bridgespan Group demonstrated that such policies result in a vicious cycle. Donors' unrealistic expectations on how much it costs to run an NPO lead to pressure on NPOs to conform to such expectations. They react in two ways: they spend too little on overhead, and underreport their actual costs, which in turn perpetuates funders' unrealistic expectations.⁷ Based on findings from our limited research we can add one other consequence: donors using such policies will deter applications from some of the most effective and most transparent NPOs, which do not want to enter this vicious cycle.

a. Limiting recovery of indirect costs leads to inadequate management and infrastructure of NPOs, which compromises organisational effectiveness. Research has shown that especially in the case of smaller NPOs (under \$1.2M in this study)⁸, saving on indirect costs leads to high turnover of inexperienced administrative staff (junior people move on once they have sufficient training to attract a higher salary); overworked CEOs, who need to perform all management functions alone; no back-up personnel for key roles in finance, HR and fundraising; and obsolete facilities, and outdated and underperforming IT and organisational systems for accounting and monitoring. But even NPOs with large budgets suffer from inadequate programme support if the majority of their funding is restricted by a limited overhead rate that does not cover the necessary overhead expenditure.

*"To deal with the inadequate funding for administration, organisations resort to the strategies of low pay, make do and do without that diminish organisational effectiveness."
(Nonprofit Overhead Cost Project, 2004)*

b. Limiting the full recovery of indirect costs forces NPOs to subsidise the loss from other income, and may encourage less transparent practices in allocating indirect expenses. Not allowing NPOs to recover all indirect expenses that are actually incurred in relation to the project results in a loss for those NPOs. The NPO is then forced to subsidise the loss from other income, usually other donors' contributions. Therefore, in actuality, **other donors subsidise EC projects without a clear agreement to this effect and often without the EC's knowledge.** Considering that grants are distributed in order to achieve an objective forming part of the European Union policy (FR, Art. 108), it can be seen as unfair to other donors that the EC expects them to contribute to its projects without being recognised for it.

Even more disturbingly, this rule may promote less than transparent practices among NPOs in allocating overhead expenses. A low flat rate for indirect cost recovery may remove any incentive to track indirect expenses, since the NPO will not be able to recover them anyway.

⁷ In: Gregory, Ann Goggins; Howard, Don 2009. "The Nonprofit Starvation Cycle", Stanford Social Innovation Review http://www.ssireview.org/articles/entry/the_nonprofit_starvation_cycle/

⁸ Nonprofit Overhead Cost Project, Facts and Perspectives, Brief #3. Center on Nonprofits and Philanthropy, Urban Institute and Center on Philanthropy, Indiana University, August 2004 <http://nccsdataweb.urban.org/kbfiles/311/brief%203.pdf>

Instead, an NPO assumes that the indirect rate amounts to the threshold set by the donor.⁹ The NPO therefore refrains from investing in its own institutional capacity to track actual indirect expenses and to allocate them across programmes. Indeed, in some cases, the NPO may not even be aware of the loss they bear until later, when they have to deal with a budget deficit resulting from the aggregation of such losses.

“Donor pressure to reduce the rate does not necessarily cause an organisation to lower its costs. Instead, it will look for other ways to cover the existing level of costs, which may lead to less transparency.”

(Good Humanitarian Donorship Indirect Cost Study, 2009)

The NPOs we reached out to in our research followed various strategies in dealing with the cap on indirect expenses. Some subsidised the loss from other donors' contributions; this was easier to accomplish when they had an institutional (operational) grant from another donor (usually a private foundation). Others used their reserves or services income to subsidise the uncovered indirect costs; others worked overtime and without pay to accomplish the project goals; yet others did not allow their in-country implementing partners to charge any indirect costs. In the long run, **none of these strategies is sustainable** and they lead to an erosion of the organisational capacity of the NPO.

c. Limiting full recovery of indirect costs deters some NPOs from applying for EC projects.

In preparing this submission, ECNL reached out to approximately 50 NPOs from several member states through in-person inquiries and an online flash survey. In response to the online survey **ten out of thirty** respondents mentioned that the low indirect rate was among the reasons why their organisations have not applied for EU funding in the last two years. Furthermore eight NPOs indicated in in-person interviews that they made an organisational decision not to apply for EU funding except under very limited conditions, including the ability to recover indirect costs. In other words, 18 out of 50, or 36% of NPOs, stated that they chose not to engage in EU financing arrangements. It may be worth considering the impact of driving away certain types of NPOs, which hold themselves to high programmatic and financial standards, on the quality of the programmes that the EC aims to finance.

Case study: ECNL

The administrative expenses of ECNL in 2007-2008 equalled on average 20% of its operating budget. During this time, ECNL implemented an EU project financed through EIDHR, and since it could only allocate 7% of the related administrative costs to the project, it suffered a 13 cent loss for every one euro spent on (or 13% of the total cost of) the project. ECNL's board therefore decided that the organisation should not apply for EIDHR funding until such time as the full cost of projects can be recovered, despite the fact that ECNL believes it could greatly contribute to the objectives of the EIDHR and other programmes in several regions.

The EC commented most favourably on the project implemented by ECNL. *“Strengthening the Legal Framework for Citizen Action Through Freedom of Association”* was considered by all stakeholders and us here in Brussels as a real success at both regional and in-country levels.

This project could constitute a model which could inspire many participants and help them to better reflect on how to implement a project at regional level in a positive and result-oriented manner.”¹⁰ Unfortunately,

⁹ The Bridgespan study found a “routine misrepresentation of how much they actually spend on overhead” among youth organisations: although they reported 13-22% their actual overhead rates ranged from 17 – 35 %. See: The Nonprofit Starvation Cycle, The Bridgespan Group, August 2009
http://www.ssireview.org/articles/entry/the_nonprofit_starvation_cycle/

¹⁰ From the email of the responsible officer.

ECNL will not be in the position to engage with the EC in future projects until issues such as the 7% cap on overhead are resolved.

In sum, maintaining the policy of an unrealistically low cap on administrative expenses runs counter to the EC's efforts to increase transparency and accountability of the Community budget; weakens the capacity of NPOs to remain capable partners of the EC in implementing its policies in the EU and externally; and drives away capable organisations from engaging with the EC where they would be most needed.

5. What is the experience of other donors?

Examples we reviewed show that unfortunately, low percentage limits on indirect costs are still prevalent among donors, particularly public donors. However, a handful of donors have paved the way in sustainable financing by applying what we would call the “fair share principle” in their indirect funding policies. These donors have created **mechanisms that allow for actual indirect cost reimbursement, with certain conditions based on principles** that serve mutual interests of the donor and the supported NPO. Interestingly, leading these efforts are donors that support two of the most developed NPO sectors: the US and the UK. However, other donors and governments have also taken initiative to reimburse the “fair share” of incurred overhead costs. There are good practices already developed within the EC as well.

a. Donors of Humanitarian Organisations

The Good Humanitarian Donorship Initiative (GHD) brings together 36 donor countries, UN agencies, NPOs and the Red Cross and Red Crescent Movement, including ECHO and practically all OECD DAC members. GHD recently commissioned Development Initiatives (DI) to conduct a study on Indirect Support Costs (ISC), with the aim to gain a better understanding of ISC charge policies among donors and beneficiaries, and with a view to achieve greater harmonisation around ISC in the humanitarian field. In the study, the draft final report of which was made available in the summer of 2009, DI inquired with members on their indirect cost policies towards funding recipients. Out of 17 donors that responded to this question, 5 did not have any set policies. Of the remaining 12 donors, 8 donors set a specific rate. These range from 3-15% although most set their rate at 5-7%. Three donors had a more nuanced approach to the issue: Belgium applies a sliding scale of charges, with maximum amounts based on the size of the grant; Norway makes special provisions for fundraising NPOs with large budgets; the US applies the NICRA mechanism (see below).

These average rates of 5-7% seem low, but one needs to consider that they are set for humanitarian organisations, which are most often large organisations with multi-million euro budgets and managing large amounts of in-kind and monetary aid as pass-through organisations. As pointed out before, due to the “economy of scale” this type of organisation generally requires a lower percentage of overhead to recover its full costs of delivery. Regardless, the GHD study found that donors are often unclear about what costs they are being charged for and there is no consistent way of applying a flat rate for ISC charges across beneficiaries. The study recommends that donors should, among other efforts:

- Make explicit that they are willing to fund fully their fair share of indirect costs¹¹;
- Develop a much more thorough understanding of the cost structures of humanitarian organisations so that they can assess their cost-effectiveness more accurately;
- Explore the feasibility of a more flexible approach to indirect support costs of NPOs, including actual rate reimbursement, reimbursement within a range of percentage and sliding scale methodologies.

¹¹ An assumption that the study made noting that a lack of such willingness will “limit progress on the recommendations”.

b. USAID

The United States Agency for International Development (USAID) allows recovering overheads to the extent that such costs **are reasonable, allowable, allocable and they are a legitimate cost of doing business** payable under a U.S. Government (USG) grant. In practice this most often means a recovery of the full costs of the project based on properly allocated actual indirect rate charges. To recover their indirect expenses, potential grantees are required to submit a rate proposal and related materials (including audit reports) with their financial proposals, in accordance with government issued guidance. Each organisation then negotiates its indirect cost rate (**NICRA - Negotiated Indirect Cost Rate Agreement**) that is binding on both parties. Initially a "provisional" rate is issued, in which the rate is established based upon the expectation of future costs. The rate is adjusted at the end of the period in which it was applied, usually after the close of the awardee's fiscal year, to reflect actual costs. If overcharging or undercharging occurred, financial adjustments are made to the affected awards, up to the maximum agreed amount of the grant. An NPO should conclude the NICRA with the USG department from which it receives the highest volume of funding and is then able to apply that rate to all its projects awarded by a USG donor.

The GHD study cites the NICRA model as best practice and recommends that GHD members consider introducing an adapted version of NICRA. Without doubt, this requires more effort on part of the donor, especially at the initial stage of developing the principles and guidance for indirect cost budgeting; however, this system is seen as fair and useful by both the USG and its NPO partners. It allows full cost recovery and at the same time builds the capacity of the NPO (e.g., by providing guidance in good accounting practices); and as such enhances organisational capacities, transparency, and ultimately, effective and efficient programme implementation.

c. United Kingdom

Another government that has committed to full recovery of incurred indirect costs of NPOs is that of the UK. The **UK Government's commitment to full cost recovery** was for the first time outlined in the HM Treasury's 2002 Report on *The Role of the Voluntary and Community Sector in Service Delivery - a Cross-Cutting Review*¹². Since then a number of government departments adopted policies or announced their support to full cost recovery. Under full cost recovery, third sector organisations must cost their projects and services on an **accurate, defensible and sustainable basis**. Funders must permit the inclusion in prices of a **relevant and reasonable** portion of overheads and ensure that the prices are determined on a realistic basis.

Implementation of the principle is aided by the Association of Chief Executives of Voluntary Organisations (ACEVO), which has been promoting the full cost recovery since 1999. They developed a method of cost allocation which ensures that appropriate portions of overheads are allocated to different projects and services in NPOs. This template has been endorsed by various government departments and is being widely used among the NPOs.

*"Full Cost Recovery, as we see it, is quite simply integral to achieving our aims as a funder. Without fair contributions to overheads from their project funders, organisations face a never-ending scramble to find the money to oversee and administer projects."
(Mind the gap: A funder's guide to full cost recovery, Big Lottery Fund, 2006)*

While there are challenges on the way to consistent application of the full cost recovery by all governmental departments, the 2007 report by the National Audit Office on the *Office of the Third Sector- Implementation of the Full Cost Recovery* states that "the issue of full cost recovery has been kept high on the policy agenda since 2002"¹³; and that "there is no dispute from the departments on the fairness of the financial principles underpinning full cost recovery."

¹² See "The Role of the Voluntary and Community Sector in Service Delivery - A Cross Cutting Review" 2002, available at: <http://www.hm-treasury.gov.uk/d/CCRVolSec02.pdf>

¹³ "Office of the Third Sector- Implementation of the Full Cost Recovery" Report 2007, available at: http://www.nao.org.uk/publications/0607/full_cost_recovery.aspx

The Report helped clarify how the principle can be applied across a variety of funding relationships, including contracts and project funding (grants). Practice has shown that departments providing project-based funding have become more engaged in applying the scheme: “the concept of full cost recovery makes more sense here as funders will have a due diligence interest in the specific project being fully and sustainably funded.”¹⁴

d. EC

Under the IR, funding of the beneficiary’s indirect costs is allowed up to a maximum of 7% of total eligible direct costs for the action. The IR of the FRs already contain a provision that allows exceeding the 7% ceiling “by a reasoned decision of the Commission” [Art. 181.(3)]. However, this provision lacks any further instructions or guidance as to how it should be carried out and is rarely implemented in practice. The large majority of calls under the current instruments limit administrative expenses chargeable to the project to 7%.

Nevertheless, there are a few examples of DGs that have already embarked on designing policies that provide more flexibility in applying the 7% rule. The most elaborated practice is that of DG Research.

- DG Research FP7 – research institutions under the Framework Programme for Research and Technological Development may choose to account for their actual indirect costs or to apply a flat rate. In this case the default flat rate is 20%, and a transitional 60% rate is also applied temporarily (“to help organisations adjust to reporting their actual indirect rate for the calls issued before Jan 1, 2010”). The use of this flat rate is subject to a number of conditions (regarding, e.g. legal status, accounting systems, type of funding scheme, etc.). At the same time, in the case of Coordination and Support Actions the maximum applicable indirect rate reverts to 7% and organisations should declare actual indirect expenses.¹⁵

The attempt of DG research (and some other DGs to a more limited extent) to determine alternative rates for indirect costs is an acknowledgement of the fact that there is no one size fits all solution for indirect cost support. It is clear that the EC accepts that research institutions have higher indirect cost rates due to the nature of their work (need for infrastructural investments and highly trained professionals, labour intensive activities and the like). Therefore, it should also be acknowledged that NPOs which conduct similar activities (e.g., technical assistance on legal and policy reform) may also require higher indirect costs.

Recommendations:

We recommend that the EC make an explicit commitment to bearing its “fair share” of project funding, including full recovery of the indirect costs properly allocated to EC funded projects.

It is our recommendation that the EU **increases the flat rate** to a level that is closer to an estimated average indirect rate of an NPO; and that it also considers the development and introduction of its own method for calculating and allocating indirect costs for NPOs in order to allow for **actual indirect cost reimbursement**. This methodology should then be applied to all operational grants and to projects above a certain size, should the NPO request it. In addition, NPOs that receive operational grants from the EC should be allowed to charge an adjusted rate

¹⁴ “Office of the Third Sector- Implementation of the Full Cost Recovery” Report 2007, available at: http://www.nao.org.uk/publications/0607/full_cost_recovery.aspx

¹⁵ “Guide to Financial Issues Relating to FP7 Indirect Actions” available at: ftp://ftp.cordis.europa.eu/pub/fp7/docs/financialguide_en.pdf

of indirect costs to their EC projects in case the core cost contribution does not cover all project related indirect costs, as substantiated by the approved methodology.

1. At the minimum, EC should apply a default flat rate of 15% for NPOs.
2. EC should develop principles in line with those used by US and UK Governments; and an approved methodology of calculating indirect expenses; in consultation with regulators, financial experts, and NPO sector experts.
3. In operational grant funding: EC may want to request that NPOs employ such approved methodology for all operational grants, or for operational grants that contribute over a certain percentage of the indirect or overall budget of the NPO. At the same time, EC could allow NPOs to charge indirect costs as eligible to awarded EC projects at an adjusted (lowered) rate.
4. In project funding: EC should allow alteration from the 15% rate on request of the NPO, if the project budget is above a certain size (e.g. EUR 25,000) and if NPO can prove that it calculates indirect rate and allocates indirect costs in accordance with EU approved methodology.

Such approval could come from DG Budget or from the DG which concludes the grant agreement, and could be periodically reviewed (e.g., every year or every three years). Approval of the indirect rate by DG Budget or the responsible DG could also lead to a NICRA type agreement with the NPO, thus could be applicable for that particular NPO in all EC grant agreements.

We are aware that recommendations 2-4 constitute the development of a complex assessment system and require serious efforts and investment of time and resources on part of the EC as well as other stakeholders. However, we are convinced that this is the best – and indeed, the only -- way to ensure a fair and sustainable solution to the recovery of indirect support costs related to EC projects. ECNL is prepared to provide assistance to the EC in developing principles appropriate for the EC and NPOs active within and beyond the EU.

ISSUE: CO-FINANCING AND CONTRIBUTIONS IN KIND

Summary

In-kind contributions to co-financing are allowed but rarely applied in practice. This causes difficulties for NPOs but it also means that the **EC is not taking full advantage of the resources that could be supporting its actions from a range of stakeholders**. Recognizing such contributions would serve the budgetary principle of efficiency which is *concerned with the best relationship between resources employed and results achieved*. Further, the EC may miss opportunities to support projects highly relevant to its policy objectives, as the ineligibility of in-kind contributions for co-financing prevents some NPOs from applying for EC grants.

Building on the successes of already existing good examples for allowing in-kind contributions, ECNL urges the EC to take the necessary measures to allow greater inclusion of in-kind contributions as a part of co-financing. We recommend that **in-kind contributions be accepted as a rule rather than an exception**. Appropriate guidance and criteria on recording and reporting in-kind contributions should be developed by the EU, with the help of a multi-stakeholder working group, to help ensure that rules respond to the good practice and consider the concerns related to proper accounting and reporting.

Furthermore, ECNL suggests that the **co-financing principle itself may need further clarification in terms of its rationale and in terms of the criteria** applied when determining the necessary level of co-financing for the action. This could be addressed through the development of a guide to implementing the co-financing principle.

IR Article 172(1) provides that the beneficiary shall supply evidence of the co-financing provided, either by way of own resources, or in the form of financial transfers from third parties, or in kind, (...). Paragraph 2 further specifies that the authorising officer responsible may accept co-financing in kind, if considered necessary or appropriate. In such cases the value of such contributions must not exceed: (a) either the costs actually borne and duly supported by accounting documents; (b) or the costs generally accepted on the market in question.

1. In-kind contributions to co-financing are allowed but rarely applied in practice.

According to the IR, in-kind contributions are recognized as co-financing contributions, pending the decision of the authorising officer and based on his assessment of whether they are necessary and appropriate. The IR do not give further guidance or criteria on what is "necessary and appropriate". In practice, most of the calls for proposals list in-kind contributions as ineligible to be considered co-financing.

Specific guidelines for some DGs further limit the rule. For example, PRAG, Guidelines to Applicants 2.1.4, states that *"Given the difficult evaluation of the contributions in kind if accepted as co-financing, the Contracting Authority should limit to accept the contributions in kind as co-financing to exceptional cases, subject to possible evaluation of such contributions."*

An example of EC funding where the in-kind contributions have been accepted can be found in the Decentralised Cooperation Programme (DCP) in Mauritius. In this case, the contracting authorities decided to allow for in-kind contributions in the second round of calls for proposals. The lesson learnt from the first round was that obliging beneficiaries to raise their cost share in cash was so challenging for local NPOs that their actions were unsustainable. Thus, the Commission reconsidered its policy and *"has agreed to a less literal interpretation, more conducive to local organisation's capacity to contribute"* despite the fact that in-kind contributions are difficult to assess, evaluate and monitor.

Case study: DCP Mauritius

The DCP Guide for the call provided that *“the value of such co-financing in kind must not exceed either the costs actually borne and duly supported by accounting documents, or the costs generally accepted on the concerned market of reference.”*

The following criteria for determining eligibility of in-kind were outlined:

- (1) *The applicant must be able to demonstrate at the proposal evaluation stage that the co-financing in kind is necessary for the successful realisation of the project and the completion of the funding package.*
- (2) *Any items or services offered as a contribution to co-financing in kind must be capable of being independently assessed. A notional value will not normally be sufficient –i.e., an objective means of quantifying the monetary value of the contribution must be employed.*
- (3) *Co-financing in kind must be capable of leaving an auditable trail in order that the DCP can check the evidence that it has indeed been provided and at the scale required.*

The Guide further elaborates the calculation of volunteer labour, professional services provided free of charge by a third party as an act of charity or in pursuit of a company’s corporate social responsibility strategy, donations of equipments and materials, etc.¹⁶

2. In-kind contributions should become widely accepted as co-financing.

ECNL urges the EC to encourage a more wide-spread use of in-kind contributions as an element of co-financing. Examples such as the case of the DCP in Mauritius demonstrate that in-kind contributions can be a reasonable source of co-financing. Beneficiaries of EU grants, especially NPOs, rely on different types of resources to implement their projects, some of which include contributions in-kind from different donors (e.g., computers to conduct research, free access to venues to organize events). Recognizing such contributions is also in line with the budgetary principle of efficiency which is *concerned with the best relationship between resources employed and results achieved.*

Further, many NPOs (especially human rights NPOs) rely on members and volunteers in planning and implementation of their activities. Volunteering is a significant added value that NPOs can bring to the implementation of the EC’s objectives and it should be “celebrated” rather than ignored. Undoubtedly, assigning value to volunteering is a challenging task. However, in recognition of volunteers’ contributions to the sector, efforts are being made to create methods for valuation which could be considered by the EC.¹⁷

A concern has been raised that allowing in-kind contributions may run counter to the non-profit principle which outlines that *“Grants may not have the purpose or effect of producing a profit for the beneficiary.”* (FR Art. 109) Under general accounting principles, however, in-kind contributions cannot result in a surplus. In-kind contributions should be recorded as Revenue with an equal amount of Expense, resulting in no impact on the bottom line. For instance, if ECNL received an in-kind contribution of \$5,000, that would be recorded as:

- Revenue \$5,000 In-kind Award
- Expense \$5,000 In-kind Professional Services.

Revenue minus Expense is zero (0), so there is no profit.

¹⁶ Decentralised Cooperation Programme Guidance Note on Contributions to the Costs of Actions Funded Under Calls for Proposals, Mauritius

http://www.gov.mu/portal/sites/ncb/dcp/presentations/guide_inkind_en.doc

¹⁷ Exposure Draft ILO Manual on the Measurement of Volunteer Work, http://www.ilo.org/wcmsp5/groups/public/---dqreports/---integration/---stat/documents/meetingdocument/wcms_100574.pdf

(When equipment is involved, the same principle applies and may be subject to depreciation rules as well. For example, a computer could be recorded as income and expense over the course of two consecutive years to reflect depreciation.)

The EC could devise simple requirements for NPOs to identify and track in-kind contributions separately, so that their impact on programmes can be measured. Evidence of expenses would need to be determined for the various types of costs that NPOs may incur. We provide examples in the Annex.

3. To encourage a more widespread recognition of in-kind contributions, specific guidance should be developed by the EC relating to its application.

ECNL is unaware of any specific guidance or criteria to help contracting authorities value contributions in-kind so that they can be accepted as co-financing. An appropriate guidance and evaluation matrix developed by the EU could help ensure that in-kind contributions, if accepted as co-financing, are appropriately valued and closely relate to the action. Recognizing that in-kind contributions can provide essential support to NPO activities and can reduce the burden on beneficiaries to raise money to meet the co-financing requirement, other agencies have already established rules to allow for in-kind contributions (see Annex I).

Recommendation:

We recommend that in-kind contributions be accepted as a rule rather than an exception. We recommend that EC defines in advance (1) an indicative list of goods and services that can be accepted as in-kind and (2) the rules by which a value is attributed to them (e.g., cost principle, fair market value, current market valuation). This would help ensure that in-kind contributions are accounted for in a transparent and accountable manner. For these purposes, we recommend that EC develops specific guidance and criteria on recording and reporting in-kind contributions as part of the co-financing requirement. A multi-stakeholder working group could be established to ensure that the rules respond to good practice and consider the concerns related to proper accounting and reporting. To support the Commission in determining the best possible approach we have compiled examples from other public donors (see Annex).

Here we provide a preliminary list of rules and criteria for eligibility of in-kind contributions that could be considered by the EC:¹⁸

- Beneficiaries of EU grants could be asked to show a direct link between the contribution and the objectives of the project;
- Beneficiaries may not report as in-kind those contributions which are already owned by the applicant or a project partner;
- If the good or service has been utilized in the past, beneficiaries should provide an explanation of how it has been done and what has been the value calculated (e.g., using pro-bono services of professionals, volunteers, or getting a room free of charge for events)
- Where possible, beneficiaries should envisage in-kind contributions in the application for the grant;
- EU grants should not have previously contributed towards purchase and / or development of the in-kind contributions.

¹⁸ The following sources have been used in compiling the possible list of criteria: Scottish Government, "General Rules on Match funding and In-Kind Contributions" www.scotland.gov.uk/Topics/farmingrural/SRDP/RuralPriorities/HowItWorks/SchemeRules/MatchfundingandInkind; Scottish Arts Council, "Guidance Note on Contribution to Partnership Funding Provided by In-kind Support and/or Voluntary Labour" www.scottisharts.org.uk/1/information/publications/1006149.aspx; Ireland San Filippo's Non-Profit Organization Group, "In-kind Contributions - What non-profits need to know to properly record non-cash contributions" www.isflip.com/pdf/knowledge/InKindContributions_InfoCast.pdf

- EC could require a letter of justification for in-kind contributions, the way of utilizing them and the benefits for the EC action;
- For volunteers and professional staff, beneficiaries could calculate the rate at the appropriate market value for what it would cost the organization to actually hire the labour or the market value of the services donated. Beneficiaries could be asked to provide the following evidence: published daily rates for consultancy or legal advice; estimates of what reasonable annual salaries for the type of work being donated would be and the allocation of an appropriate proportion related to the project; certified letter by the professional staff providing services as to what the appropriate rates would have been.
- Beneficiaries could be asked to record in-kind contribution based on the cost principle, or fair market value, or lower than market value (depending on what EC determines is the best policy) and could be asked to substantiate that with evidence.
- Beneficiaries would need to follow the same standards of documentation of in-kind contributions as for other expenditures; for example, such documents would need to contain the name and signature of the donor, date and location of donation, description of item/service, exact or estimated value.

4. The co-financing principle may need further clarification in terms of its rationale and in terms of the criteria applied, possibly through the development of a guide to implementing the co-financing principle.

a. The rationale of co-financing is not clearly communicated by the EC, which may lead to misunderstandings in the interpretation of its application.

FR Article 109 provides that all grants must involve co-financing.

IR Article 165 provides that co-financing shall require that part of the cost of an action or of the running costs of an entity is borne by the beneficiary of a grant, or by contributions other than the Community contribution.

IR Article 90 provides that work programmes for grants should specify the maximum possible rate of co-financing and if different rates are envisaged the criteria to be followed for each rate.

According to FR and IR the application of the co-financing rule is mandatory in the distribution of EU grants. Co-financing is elaborated to mean that part of the action (in case of grants) or part of the running costs of an entity (in case of operational grants) must be borne by the beneficiary of the grant and come from non-Community contributions. However, the rationale behind applying the co-financing principle is not clearly communicated nor defined, which may lead to different approaches in the application of the principle.

One notion appears to be that EC grant funding is motivated by two purposes simultaneously: to realise EU policy objectives; and to support activities of beneficiaries that contribute towards those objectives. Based on such understanding, both parties should have the obligation to invest resources and ensure that the objectives are achieved. In order to succeed with programme implementation, however, the co-financing principle should consider the interests of both parties in achieving the objectives, and acknowledge that each party has different strengths and resources to contribute.

At the same time, other interpretations exist: some NPOs tend to see the co-financing condition as unjust, given that they are implementing a “project for the EU”, while some EU officials may believe that the EU merely supports, rather than prescribes, the objectives of an action, the responsibility for which should primarily be borne by the NPO. A more clearly communicated rationale could provide for further consistency in the application of the principle, and will

contribute towards improved understanding and compliance by the authorising officers and beneficiaries.

b. The EC is already exercising flexibility in the application of the co-financing principle; however, guidance based on more comprehensive criteria may lead to more consistent practices in setting co-financing rates.

FR Art. 169, Point 41 and IR Art. 253 provides that derogation is possible from the principle of co-financing, in particular to grants in humanitarian aid, including assistance for refugees, uprooted persons, rehabilitation and mine disposal; aid in crisis situations; actions for the protection of the health or fundamental rights of peoples; actions resulting from the implementation of financing agreements with third countries or actions with international organisations; where it is in the interests of the Community to be the sole donor to an action, and in particular to ensure visibility of a Community action.

Paragraph 2 provides that grounds shall be provided in the award decision relating to the action in question in the case of any derogation from the co-financing requirement. The authorising officer must be in a position to show that financing in full is essential to carry out the action in question. However, in the case of where it is in the interests of the Community to be sole donor, grounds shall be provided in the financing decision of the Commission.

FR and IR already recognize that certain fields of action may allow for full funding and they provide for a possibility of derogation from the principle of co-financing. However, the list of exceptions does not address all areas in which derogation may be needed.

The prescribed derogations appear to apply to circumstances where there is a need for increased involvement to protect and safeguard local needs. The list is currently limited to certain fields of actions. However, emerging issues appear routinely (e.g., counter-terrorism efforts) and many of these could easily be justified as exemptions under the FR/IR. In addition, many grants issued in past years cover some issues mentioned in the FR/IR – especially those related to fundamental rights of people -- yet it was not clear when the derogation could be applied. The decision is left to the authorising officer to determine the grounds, without further criteria or guidance, which may mean that the rule could be applied subjectively and not in a consistent manner.

Recommendation:

We recommend that EC consider introducing a more specific **guide and criteria for implementation of the co-financing principle and its derogations**¹⁹. This would provide a more coherent policy and a more consistent approach regarding the application of the co-financing requirement and could address the practical problems raised by the beneficiaries. It would give guidance for better implementation of the co-financing principle, and would help implementers determine a proportion of co-financing which is realistic and responsive to local circumstances.

By way of example, the guidance could potentially include some of the following considerations:

- The size of the organization (in terms of annual budget): should smaller organization be entitled to lower percentage of co-financing;

¹⁹ See for example, EEA Financial Mechanism and the Norwegian Financial Mechanism – Guide On Co-Financing Ceilings (Grant Rates) (Approved 16 November 2006. Amended 28 November 2007) http://www.eeagrants.org/asset/331/1/331_1.pdf (page accessed on December 10, 2009). Or, United States Agency for International Development (USAID) Policy on Cost Sharing: Code of Federal Regulations Referenced in the ADS, Part 226. – Administration of Assistance Awards to U.S. Non-Governmental Organizations, 226.23 (http://edocket.access.gpo.gov/cfr_2007/aprqr/22cfr226.23.htm)

- The size of the grant: should bigger grants have a reduced rate;
- The type of activities (with perhaps special consideration of activities in the field of human rights);
- The geographical location of the action;
- The external funding environment;
- The purposes of the grant (e.g., if it aims to support capacity building of the organization should it promote or reduce co-funding requirements);
- The purposes of the derogation and criteria for application;
- The types of costs which can be considered as co-financing (e.g., co-financing of third parties which is not in a form of financial transfer);
- Under what circumstances the co-financing rate can be re-negotiated, etc.

ISSUE: EXCHANGE RATE LOSSES

Summary

Organisations that carry out actions outside of the Eurozone face the burden of recovering exchange rate losses on several levels. Exchange rate losses are not eligible costs for the action and therefore cannot be recovered from project income. The use of InforEuro rate²⁰ creates an additional layer of reporting that is not consistent with national accounting obligations and may result in the violation of the 'nonprofit rule'. Finally, the concept of 'exceptional fluctuations' in exchange rates is not clearly explained by the Commission. The related remedy of 'restructuring the action' may be reserved for more extreme occasions, while ordinarily, exchange rate losses could be recovered from a contingency reserve of the action.

We recommend that **exchange rate losses be eligible expenses for the action**; that where appropriate, beneficiaries be enabled to use their own accounting systems rather than the InforEuro rate; that clarification on the 'exceptional fluctuation' be provided; and that projects be encouraged to incorporate a contingency reserve to cover for eventual exchange rate losses. Further, any profit gained through currency exchange should be regarded as part of the project income (thus, possibly leading to a decrease in community funding) or duly paid back to the Commission.

These issues are, of course, of special concern in case of external actions and when the projects are implemented in countries with weak national currencies and unstable economies where exchange rates are volatile; but they are relevant in every case when another currency other than the Euro is involved, within and outside the EU.

1. Exchange rate losses should be eligible costs of the action

According to Art.14.6 of the Practical Guide to Contract Procedures for EC External Actions (PRAG), Annex II General Conditions, currency exchange losses are **not** considered eligible costs of the action.

According to IR Art. 172(a), eligible costs are the costs incurred by the beneficiary that meet all of the following criteria:

- (a) they are incurred during the duration of the action or of the work programme, with the exception of costs relating to final reports and audit certificates;
- (b) they are indicated in the estimated overall budget of the action or work programme;
- (c) they are necessary for the implementation of the action or of the work programme which is the subject of the grant;
- (d) they are identifiable and verifiable, in particular being recorded in the accounting records of the beneficiary and determined according to the applicable accounting standards of the country where the beneficiary is established and according to the usual cost accounting practices of the beneficiary;
- (e) they comply with the requirements of applicable tax and social legislation;
- (f) they are reasonable, justified, and comply with the requirements of sound financial management, in particular regarding economy and efficiency.

²⁰ To read more about InforEuro, please, see:
<http://ec.europa.eu/budget/inforeuro/index.cfm?fuseaction=about&Language=en>

Exchange rate losses are generally not regarded as eligible costs of the action and, thus, cannot be recovered from project income. The financial risk of currency exchange losses is borne primarily by the lead organization and, usually to a lesser extent, its implementing partners. In fact, almost 70% of our survey respondents mention exchange rate variations as one of the challenges in implementing an EU project. This creates a disproportionate burden, especially on small and medium sized NPOs for which the losses represent a larger share of revenue. In addition, it could be argued that it is unfair, as a general principle, for the grant recipient beneficiary to bear all the financial risks of programme implementation in regard to exchange rates when successful programme implementation is equally in the interest of the EC.

We therefore recommend that **currency exchange losses should be recognised and allowed as eligible costs of the action**. In our assessment, these expenses fulfil all the criteria for eligible costs listed in the IR.

To the extent there is any question about eligibility under the IR, it is raised by the following paragraphs:

- (b) they are indicated in the estimated overall budget of the action or work programme;
- (d) they are identifiable and verifiable, in particular being recorded in the accounting records of the beneficiary and determined according to the applicable accounting standards of the country where the beneficiary is established and according to the usual cost accounting practices of the beneficiary.

Ad (b) As a possible solution for recovering the exchange losses, some beneficiaries prepare their budget proposals to donors with a 10% contingency reserve (when the donor's funding policy allows for such measure). In case of the EC, there is already a provision for 5% contingency reserve for external actions, but it cannot cover currency exchange losses as they are not recognised as eligible costs. As an alternative, in countries with unstable economies, the contracting authority may advise keeping the accounts in Euro, not in national currency, in order to mitigate the exchange rate fluctuation risks. However, operating an account in Euro is not always practical in a local context.²¹

We believe that the Authorising Officer should be able **to allow the use of the contingency reserve to recover these losses**, which in such case will be indicated in the estimated overall budget of the action and fulfil the criterion.

Ad (d) When the beneficiary has in place appropriate accounting systems, exchange rate losses are indeed identifiable and verifiable, recorded in the accounting records and determined according to the applicable accounting standards of the country where the beneficiary is established; and as such, fulfil this criterion for eligible expenditure. Under current application of the IR, however, most beneficiaries have to use the InforEuro rate, a method which may not fulfil these requirements. In essence, the report provided to the EC based on the InforEuro rates is not consistent with the official books of the NPO, since in its own accounting it is obligated to follow national regulations on exchange rates (see discussion and example below). Thus, while using the InforEuro rate seems a more straightforward, or "controllable" method by the EC, it, in fact, amounts to a less transparent reporting practice than using the records of the beneficiary under national law, especially if the beneficiary's financial reports are audited.

2. Use of own accounting system should be allowed and encouraged where appropriate

In accordance with "the principle of unit of account", FR Art. 16 provides that the "budget shall be drawn up and implemented in euro and the accounts shall be presented in euro", unless the authorising office allows for carrying out operations in national currencies. The rule on currency

²¹ See the Q&A to the Call for Proposals "Strengthening the Role of Civil Society in Cambodia": <http://www.delkhm.ec.europa.eu/en/calls/100309/EuropeAid-questions.pdf>

exchange rates to be used is not directly addressed by the FR or IR. However, in accordance with Article 7 of the IR the conversion between euro and other currencies is regulated by special arrangements outlined in grant and other financial agreements.

According to the PRAG Actions Annex II General Conditions Art.15.8, the Contracting Authority may "make payments in the currency of the country to which it belongs or in euro" and the conversion into euro of the real costs borne in other currencies is "made up by the average of the rates published in InforEuro for the months covered by the relevant report, unless otherwise provided in the Special Conditions."

The above regulations allow for the option of payments in local currencies and reporting based on other rates than the InforEuro if so provided in the Special Conditions of the contract. In practice, however, this rarely happens. Based on our research, most NPOs are compelled to use the InforEuro rates in their expenditure reporting.

However, the NPO accounts are usually maintained in local currency if they are based outside the Eurozone. Conversion for other currencies happens at the rates provided by the organization's internal accounting manual, e.g. at the national bank rate monthly average. Reporting to the Contracting Authority in euro (with the InforEuro rates) oftentimes results in an exchange rate variation with the organization's internal accounting and national accounting. As a result, the beneficiaries have to prepare parallel reports and uptake the burdensome risks and responsibilities for covering eventual losses. The problem is further aggravated for activities taking place in several countries, e.g. in the case of regional projects. Having the local implementing partner report to the non-eurozone based lead organisation (or vice-versa) creates another layer of exchange rate risks (since here there are two or more non-eurozone currencies involved, which both have to be valued as compared to the Euro, whereas their direct exchange rate may be different).

Case Study: ECNL

ECNL implemented a two-year regional project contracted through EuropeAid. During the action four implementing partners from Southern Caucasus and Moldova reported to ECNL on a quarterly basis. The financial reports to the Commission were drawn in five currencies and euro. ECNL is based in Hungary, thus each foreign currency was converted to forints applying the Hungarian National Bank's official exchange rate dated on 30th of previous month. Further adjustments were made in the annual report according to the average annual rate provided by the National Bank as of December 31. In its report to the Commission, however, ECNL had to draw another report that used the InforEuro rate. ECNL, as the lead organization, had to cover variations between the Hungarian National Bank forint exchange rate and the official InforEuro rate, but also to make adjustments between the quarterly and the annual average exchange rate for each project country. As the result, solely the lead organization, ECNL, incurred a loss of 0.7% of the total value of the action that was not considered as an eligible cost, which is **a substantial amount for a small or medium size organization, especially considering that in addition ECNL had to raise funds to generate income for covering the losses in relation to the low indirect cost rate and in order to meet the co-financing requirement.** We do not have exact data on the loss borne by the local partners; however, based on our assessment their local banks' actual exchange rates may have varied drastically from InforEuro rates.

Furthermore, on the rare occasions when the variations between the official and the actual exchange rate create a profit, it stays unaccounted for due to the nature of parallel reporting to the Contracting Authority when the InforEuro rate is used in the budget report. **This contradicts EU's non-profit principle, but is also detrimental to the organisation's financial transparency.**

Alongside allowing the exchange rate loss to be an eligible expense, there is a need to allow for derogation to the rule of using the InforEuro rates (or the European Central Bank rates) with the Contracting Authority's permission if beneficiaries provide proper justification and sustain a proper accounting policy. **Beneficiaries with well developed accounting practices and a robust accounting system based on the national accounting law and compatible with EU principles should be allowed to convert costs incurred in other currencies according to their usual accounting practices**, e.g. using the national bank exchange rates. The review of the organizational accounting policy could be done at the beginning of the project and exchange rate sheets can be considered as sufficient proof for reporting to the Contracting Authority. This would ease the financial burden on the beneficiary, but also would establish a clear and transparent reporting system that would prevent generation of unanticipated profit due to the difference in the official and the actual exchange rates. Such profit would need to be considered as part of the project income (possibly leading to a reduction in the EC contribution) or duly paid back to the Commission.

3. Clarification of 'exceptional fluctuation' and provision for contingency reserves would be needed

Lastly, we consider it important that the Commission **provides further clarification on what is regarded as exceptional exchange rate fluctuation and how it can be mitigated**. The PRAG states that "in the event of an exceptional exchange-rate fluctuation, the Parties shall consult each other with a view to restructuring the Action in order to lessen the impact of such a fluctuation. Where necessary, the Contracting Authority may take additional measures." (Art 15.8) While this is an important provision that recognises financial risks for the beneficiary and aims to minimise its losses, it lacks practical information on how it can be implemented: what is an exceptional exchange rate fluctuation, how the Action can be potentially restructured, what additional measures can the Contracting Authority take? Given that currently there are no other measures to address the problem, parties may revert to this provision in cases when simpler methods could be used to mitigate the effects of exchange rate fluctuations.

The exchange rate fluctuation risks **should be addressed in a way to minimise the negative impacts on the action's overall objectives**. Only in exceptional cases should the parties need to agree on restructuring the action and renegotiating the agreement. We would like to suggest that rather than emphasising restructuring, which could be detrimental to its objectives, the EC focuses on how to make up for losses in cases of "ordinary" exchange rate fluctuations ("ordinary" and "exceptional" could be defined, for example, as below and above a certain percentage of all eligible costs of the action). This can be done e.g., through establishing a **contingency reserve rule** for covering exchange losses in these cases.

Summary of Recommendations:

Currency exchange losses should be recognised and allowed as eligible costs of the action. They could be recovered with authorisation of the contracting authority through using the contingency reserve.

Beneficiaries that have a robust accounting system and policy in place and compatible with their national and EU accounting principles should be allowed to use the rates laid out in their own accounting policy in preparing the budget report. Any profit generated would need to be considered as part of the project income (possibly leading to a reduction in the EC contribution) or duly paid back to the Commission.

Further explanation should be provided on what is considered as an exceptional exchange rate fluctuation and how the losses can be recovered.

ISSUE: INFORMATION ABOUT GRANT OPPORTUNITIES AND PAPERWORK FOR APPLICANTS

In this section, ECNL provides its opinion and recommendations as a response to some questions raised by the Commission in its *Review of the Financial Regulation Public Consultation* document concerning the information about upcoming and awarded grants and paperwork for applicants.

1. Information about upcoming and awarded grants

In terms of access to information, we would like to raise two separate issues for the consideration of the Commission: the availability of information about (1) awarded grants and contracts and (2) funding opportunities.

In terms of **awarded grants and contracts**, the Commission requires DGs to publish annually all grants awarded in the course of a financial year *“with due observance of the requirements of confidentiality and security”* (Art.110 FR) and *“in a dedicated and easily accessible place of the Internet site of the Community institution concerned during the first half of the year following the closure of the budget year in respect of which they were awarded”* (Art. 169 IR). However, in practice some DGs are lagging behind in making this information publicly available. Moreover, some fail to categorize and organize the data, which makes it practically impossible for stakeholders to obtain information on grantees with easy access.

As for **calls for proposals**, although information concerning various EC funding opportunities is widely published, it is still too scattered and fragmented to be considered effective. Calls are posted on various websites which makes it challenging for potential applicants to track down all opportunities in time and plan their programme development activities accordingly.

Both of the problems outlined above hinder **timely access to information** for the applicants and fail to ensure a sufficient level of **transparency**. We therefore recommend that in the long term EC considers **launching one well-structured portal which contains consolidated information** from all DGs and financial instruments with information on:

- annual work programmes of departments and financial mechanisms;
- calls for proposals and tender opportunities; and
- awarded grants and contracts.

While we realize that creating such a separate portal demands extra resources in terms of development and maintenance, we believe it will be a significant step in **ensuring transparency of EC grants and in building trust with the beneficiaries**. A consolidated and systemized portal will make it easier for beneficiaries of EU grants and contracts to identify in a timely manner all planning documents, forecast tenders and other financing opportunities as well as to obtain information on awarded projects and beneficiaries of grants and contracts. It will enable potential applicants to learn more about the types of projects and actions the EC aims to support, to plan their fundraising activities according to upcoming tenders (e.g., to try to secure co-funding for potential actions ahead of time), and to look for partners with similar activities.

Importantly, the EC should adopt further **guidelines for the operation of the portal**, as to when information must be uploaded and what type of information should be available, so that it is done in a timely manner and also in a harmonized and efficient way by all agencies. In terms of the design and set-up of such a joint portal, it is essential that results can be filtered easily by means of multiple search aspects so that access to information is made easier. EuropeAid’s website on funding opportunities is a good example of a user-friendly tool, and can serve as a useful model.

2. Paperwork for Applicants

The administrative burden is unequivocally viewed as one of the major challenges of preparing an application for EC funding (over 91% of the respondents of ECNL's survey agreed on this) and all initiatives are welcome that aim to tackle these issues.

▪ Use of e-tools

Despite their sometimes complicated structure, the use of e-tools is still generally considered as an improvement as they substantially reduce paperwork, thus saving time, energy and resources for NPOs. Therefore, the introduction of tools such as PADOR for EuropeAid grants, DG JLS's PRIAMOS mechanism or the proposed system of PROSPECT are welcome and encouraged for all DGs.

However, we would like to outline some issues for the consideration of the Commission so as to assist with the conceptualization and better implementation of such tools. First, some beneficiaries may have difficulties in securing internet access and therefore it is essential that a **derogation for the use of e-tools** (i.e.: exemption allowing submissions in hard copy) is sustained in the long run so as to ensure that such applicants have equal access to funding opportunities. Second, we recommend that the **e-tools allow applicants to upload documents**, rather than obliging them to fill in an online project application template, as the former is a more time-efficient mechanism and more effective in areas where internet access is unreliable. Third, the efficiency of e-tools is dependent on the extent to which the Commission itself is utilizing and observing them. For instance, the PADOR-system requires potential beneficiaries to upload administrative data and supporting documents (such as statutes or financial and audit reports). According to EuropeAid's reasoning, an organization registered with PADOR will no longer have to re-submit its data and supporting documents at the time when the contract is signed. The application of this principle however sometimes falls short of the objective, as for instance Delegations have been additionally requesting the submission of official documents in hard copies thus creating duplication of work. We therefore recommend that the Commission develops **more consistent practices with respect to the use of the e-tools**.

▪ Stages of application

An open call for proposals, i.e. the simultaneous submission of the concept note and full application poses a formidable challenge for NPOs. In our survey over 76% of the respondents claimed that the one-step procedure creates additional and redundant workload as well as increases costs for applicants. We recommend that **two-phase applications become the rule rather than the exception**, except for small value projects (e.g.: below 25,000 EUR) or when it is in the interest of the project objective that decision be made quickly. Even though two-phase submissions in some circumstances will delay the award process, we believe that the benefits for the applicants outweigh the concerns, because applicants invest such significant resources in the application processes.

Furthermore, we strongly support the measure recommended by Mrs. Grybauskaite, former Commissioner for Financial Programming and Budget. As pointed out in her Communication "Streamlining financial rules and accelerating budget implementation to help economic recovery" in the two-stage procedures ***"the first stage should involve minimum efforts from applicants: for instance, applicants should be required to submit only a short concept note describing, in general lines, the principal elements of their project (summary description, objectives, results, time frame and implementing framework) together with a summary implementing budget. Only those applications upheld in the first phase will submit a complete proposal."***²²

²² Communication from Mrs Grybauskaite in agreement with the President to the Commission: Streamlining financial rules and accelerating budget implementation to help economic recovery, Brussels, 8/04/2009
SEC(2009) 477 final
http://ec.europa.eu/budget/library/documents/sound_fin_management/management_systems/sec_2009_477_en.pdf

- **Supporting application and implementation processes**

As pointed out above, while information regarding funding opportunities, application submissions and project implementation is available on the various websites of the Commission, NPOs still find it burdensome to identify, understand and efficiently cope with all the administrative and financial requirements. In order to enhance the existing capacity of applicants to respond to funding opportunities and their diverse conditions and requirements, we encourage the Commission to support **trainings on a regular basis** on specific elements of project cycle management (application / implementation / reporting). We recognize that the Commission is already supporting one-off projects that aim at capacity building and appreciate these efforts. However, we consider it very important that these workshops are continuously available for a wider range of beneficiaries. Also on-going and regular trainings would be excellent tools to help address the formalistic challenges NPOs face when developing proposals. They could help minimizing the rejection of proposals on the grounds of solely administrative omissions (e.g., for not signing each page of the application with initials), thus facilitating a more substantive evaluation process. Another support tool that would facilitate potential beneficiaries to find their way through funding opportunities easily is the development of **client-friendly guides that summarize relevant information on funding**. For instance, the Practical Guide of DG Research²³ is a good example of a user-friendly guidance document that was conceived to provide a concise description of funding sources and their use.

- **Introducing a label system**

ECNL welcomes the idea of introducing methods that ease the application process. However, having reviewed the Commission's proposal about the 'label' system, we are not certain what it would entail exactly and how it is expected to reduce paperwork.

We believe that there is a need to distinguish between eligibility and selection criteria when conceptualizing the 'label' system. Eligibility criteria are objective conditions that may be supported by clear evidence and can be kept in a record which would need simple updating. Selection criteria usually refer to conditions that are based on the specific circumstances and purposes of the grant and are subject to evaluation by the contracting authority. Eligibility criteria establish the entry threshold; selection criteria establish the winning bid. The extent to which the selection criteria are fulfilled will inevitably be subjectively measured. Thus, we do not believe that it is appropriate to develop a label system that would give priority or automatic qualification to issues related to past experience and capacity of the applicants (i.e. selection criteria) on a universal basis, as this is a factor that changes based on experience in the implementation of projects. Further, not all past experience is equally relevant for any given tender.

If the label system is **developed based on the eligibility criteria**, rather than on selection criteria, such as whether the organization has successfully implemented a project/contract, then we would support this idea. This approach would be broadly equivalent to the PADOR website; the current PADOR system does reduce paperwork and could also be enhanced in a way that it includes the identification numbers of the applicants' previous financial agreements / grant contracts (if applicable). Building on already available information, this addition would enable the Commission to check the credibility of applicants without increasing red tape. The system could be extended for all DGs.

²³ Competitive European Regions through Research and Innovation, Practical Guide to EU Funding Opportunities for Research and Innovation
ftp://ftp.cordis.europa.eu/pub/fp7/docs/practical-guide-rev2_en.pdf

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Annex I. Other Donors' Practice regarding Eligibility of In-kind Contribution.

DONOR	ELIGIBILITY OF IN-KIND	PROVISION ON IN-KIND	POLICY DOCUMENT + HYPERLINK
<p>CIDA</p>	<p>In-kind is eligible as co-financing for the following organizations:</p> <ul style="list-style-type: none"> ▪ “not-for-profit organizations that have an annual revenue of less than \$100,000 per year may make up to 25% of their required cost-sharing contribution in kind. ▪ not-for-profit organizations that meet the definition below of “membership and specialized organizations” (MSOs) may make up to 100% of their required cost-sharing contribution in kind. <p>To be considered as an MSO an organization must:</p> <ul style="list-style-type: none"> ▪ represent a specialized Canadian constituency (profession or sector) through a formal membership or through a network of active stakeholders; ▪ have active members or stakeholders who are volunteer participants in the organization’s achievements and development. These volunteers bring a hands-on, practitioner’s perspective to improving the capacity of their counterparts in developing-country organizations; ▪ have a program orientation that is primarily domestic such that international activities are an extension of their Canadian mandate; and ▪ be self-financing through membership fees and not derive significant revenue from public fund-raising appeals.” 	<p>“While CIDA’s contribution is always made in cash, VSF allows some types of applicants to make part or all of their contribution as in-kind services or materials.</p> <p>In-kind contributions may include donated equipment, services, and facilities necessary to directly implement a project that would otherwise have to be purchased if they were not donated by the applicant organization or elicited from other Canadian sources. These may include:</p> <ol style="list-style-type: none"> a. professional, technical, managerial, and administrative services given by the organization’s staff, calculated at actual salary rates, plus benefits, for the amount of their time allocated to the program. b. personal services (as described above) elicited from members, the public, or other Canadian institutions. These will be monetized at reasonable market values for the type of work involved. For example, a person-year of managerial input will usually be calculated at the person’s current salary rate, plus benefits, if the person is currently doing that level of managerial work. Otherwise, it will be calculated at the average salary level for that kind of managerial work. Work done by volunteers, in the office or overseas, can also be included at market rates for the type of work involved, provided that these services are essential for the delivery of the program and would otherwise have to be purchased. c. equipment, facilities, and other services such as the cost of office space, telephone service, office equipment used in the program, and donated tools and books.” 	<p>Voluntary Sector Fund Application Guidelines and Application Form 4.3 Cost-Sharing Requirements of the Voluntary Sector Fund</p>
<p>EuropeAid</p>	<p>Only if description of the action foresees contributions in-kind.</p>	<p>“Any contributions in kind, which must be listed separately at Annex III, do not represent actual expenditure and are not eligible costs. Unless otherwise specified in the Special Conditions, the contributions in</p>	<p>Practical Guide for External Actions General Conditions Annex II, Art. 14.5</p>

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		kind may not be treated as co-financing by the Beneficiary. The cost of staff assigned to the Action is not a contribution in kind and may be considered as co-financing in the Budget of the Action when paid by the Beneficiary or its partners. Notwithstanding to the above, if the Description of the Action foresees the contributions in kind, such contributions have to be provided."	
DCP	<p>Any organisation that complies with the following eligibility criteria:</p> <ul style="list-style-type: none"> ▪ "The applicant must be able to demonstrate at the proposal evaluation stage that the co-financing in kind is necessary for the successful realisation of the project and the completion of the funding package. ▪ Any items or services offered as a contribution to co-financing in kind must be capable of being independently assessed. A notional value will not normally be sufficient –i.e. an objective means of quantifying the monetary value of the contribution must be employed. ▪ Co-financing in kind must be capable of leaving an auditable trail in order that the DCP can check the evidence that it has indeed been provided and at the scale required." 	<p>"This refers to non-financial forms of support towards the true, auditable costs of a project, to be provided by the applicant, his partners, associates or other third party sponsors, or final beneficiaries themselves. The value of such co-financing in kind must not exceed either the costs actually borne and duly supported by accounting documents, or the costs generally accepted on the concerned market of reference. It is also important to ensure that in-kind contributions do not represent 'double counting' by overlapping with items appearing in the financial budget. This is particularly pertinent in relation to <i>indirect costs</i>, i.e. the flat rate administrative overheads budget line.</p> <p>The most common types of co-financing in-kind include:</p> <ol style="list-style-type: none"> a. unpaid voluntary work; b. donation of professional services free of charge; c. provision of professional services at a subsidised or reduced rate; d. donation of equipment or materials; e. provision of equipment or materials at a subsidised or reduced rate; f. use of a building, room, office space, land, etc; g. provision of buildings or land; h. general administrative overheads." 	<p>DCP Guidance Note on Contributions to the Costs of Actions Funded under Calls for Proposals</p>
ILO	Eligible	Valuing of volunteer work will be included in Chapter 7 to be completed following ICLS	<p>Exposure Draft ILO Manual on the Measurement of Volunteer Work</p>
Scottish Arts Council	Eligible for all	"This could include computers or other equipment donated for the purpose of the project; use of premises donated specifically for the project and the provision of office space and associated costs provided by the host organisation. In-kind contributions should be valued as	<p>Guidance Note on contribution to partnership funding provided by in-kind support and/or voluntary labour</p>

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		<p>follows:</p> <ul style="list-style-type: none"> ▪ Equipment which is donated should be included at the advertised market price if new, or at a reasonable estimate of the second-hand price if not new. ▪ Use of premises provided for the project should be calculated at the appropriate market value; and ▪ Office space and associated costs such as telephone charges, photocopying etc. Should be calculated at appropriate market value. <p>Voluntary labour: You should calculate rate at the appropriate market value for what it would cost you to actually hire in the labour or services being donated. We will need to see clear evidence on how you have arrived at the rates you are using. For example your evidence may include:</p> <ul style="list-style-type: none"> ▪ Published daily rates for consultancy or legal advice; ▪ Estimates of what reasonable annual salaries for the type of work being donated would be, and the allocation of an appropriate proportion related to your project; and ▪ If you are receiving donated labour from local authority staff, you should ask them to provide you with the appropriate rates.” 	
<p>SIDA</p>	<p>Not eligible</p>	<p>“A Swedish organisation that receives a grant from Sida for its development cooperation shall normally finance a part of the expenses with its own funds. This self-financing is to be seen as an expression of the Swedish organisation’s priorities and ability to mobilise a commitment for its development cooperation.[...]The self-financing shall consist of private cash funds raised in Sweden. The cash can have come either from normal fund-raising activities or from gifts, company sponsorship fees for services, or other income that the association receives from private persons. Own or collected material may not be counted as a part of the self-financing, nor may the value of the organisation’s own work. Nor may contributions from abroad or funds that come from some other public grant be counted as self-financing.”</p>	<p>Guidelines for Grants from the Appropriation for NGO, 4.5 Self-financing</p>

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<p>The Scottish Government – Scotland Rural Development Program</p>	<p>Eligible for all beneficiaries</p>	<p>“For Rural Priorities, the only in-kind contribution that will be treated as eligible expenditure is the provision of land or real estate and this applies only where all of the following apply:</p> <ul style="list-style-type: none"> ▪ there is a direct link between the land acquisition and the objectives of the project to be funded; ▪ they are not already owned by the applicant or a project partner; ▪ they have been identified and valued by an independent, qualified valuer or duly authorised official body, which has then provided a certificate confirming that the valuation price does not exceed the market value; ▪ the value of the land / real estate does not represent more than 10% of the total, other eligible expenditure of the project; (value in excess of 10% would be ineligible) ▪ national or European Community grants have not previously contributed towards their purchase and / or development. <p>For Rural Priorities, staff or other costs are not eligible as in-kind contributions, but may be counted as eligible project costs.”</p>	<p>General Rules – Match Funding and In-kind Contribution</p>
<p>USAID</p>	<p>Eligible for all beneficiaries</p>	<p>"All contributions, including cash and third party in-kind, shall be accepted as part of the recipient's cost sharing or matching when such contributions meet all of the following criteria.</p> <ol style="list-style-type: none"> (1) Are verifiable from the recipient's records. (2) Are not included as contributions for any other federally-assisted project or program. (3) Are necessary and reasonable for proper and efficient accomplishment of project or program objectives. (4) Are allowable under the applicable cost principles. (5) Are not paid by the Federal Government under another award, except where authorized by Federal statute to be used for cost sharing or matching. (6) Are provided for in the approved budget. (7) Conform to other provisions of this part, as 	<p>USAID 2007. "Code of Federal Regulations, PART 226 Administration of Assistance Awards to U.S. Non-Governmental Organizations, Sec. 226.23 on Cost Sharing or Matching"</p>

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		applicable." "Values for recipient contributions of services and property shall be established in accordance with the applicable cost principles.[...]"	