

Practitioners' Network Views and Suggestions # 1

on The Revision of the EU Financial Regulation

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The Practitioners' Network aims to strengthen cooperation, links and complementarity between European development players with a public service mission, creating opportunities for cooperation and synergies at the implementation level. It enables the exchange of information and experience between practitioners and provides feedback on European development policies from a practitioner's perspective, while enhancing the visibility of its Members. The *Views and Suggestions Series* results from the work and collective reflection of the Members on the Practitioners' Network strategic priorities. It reflects common views in a concise format for dissemination towards EU Institutions and an extended audience.

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Introduction

The note entails the views and suggestions of the Practitioners' Network for European Development Co-operation (PN) regarding the proposed text of the new Financial Regulation (FR) of the EU. Based on their critical practitioners' experience, Members of the PN have started to reflect on the EU Financial Regulation.

The analysis and action points presented in this note build on the results of the PN workshop on the subject from November 16, 2016. These were further elaborated by a PN task team led by GIZ (Members: AECID, AFD, British Council, BTC, Expertise France, FIIAPP, LuxDev). After consent and approval of the Steering Committee, the note provides all PN Members with an extensive basis for the further engagement on the subject. The views and suggestions aim to feed into the dialogue of the PN with the EU Institutions (COM, EP, Council), however, should not be seen as limiting individual Members to promote specific additional points. The note provides first insights about this work in process. Further reflection, including on an article by article basis, is to be carried out by the PN.

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I. General assessment of draft FR

Good intentions, but the text of the regulation lacks clarity and precision on important points.

1. The revision of the FR is presented as a way to achieve **simplification** of financial rules for beneficiaries and partners, to increase **flexibility** and to sharpen the **focus on results**. The PN welcomes these valuable objectives that are clearly mentioned in the Explanatory Memorandum, which, however, will not become part of the revised FR.

2. When analysing the text, in the parts relevant to implementing organisations under indirect implementation, one can indeed find some points which try to translate these good intentions into rules and articles (e.g. no more D+3 rule; choice of indirect implementation by entity instead of nature of the action). However, the **overall impression** is that the FR itself, admittedly shorter than the former one,
 - is **cumbersome to read** and understand, with many cross-references and many back and forth in the text (e.g. the rules covering indirect implementation can be found in 3 different sections plus the Grants section);
 - **lacks precision** and in our view often takes the guiding **principles forward in a half-hearted manner**;
 - contains many vague and non-binding statements, with a multitude of “**may`s**” and manifold references to the **need for further sectoral regulations**, which will have to specify many rules of the revised FR and their application;
 - allows for **conflicting interpretations downstream**, leaving leeway for controversial, case-by-case application. This may lead to high transaction costs for implementing organisations and run counter to the expected simplification.
3. A particular point of concern is the **dissolving of the current chapter on external action** and its merging with the rules for EU-internal programs. Rules for external action are now spread over many titles/chapters of the text, causing **user-unfriendliness**. In addition, **specificities of external action** cannot be clearly depicted in the FR revision proposal. External actions regularly play in highly volatile and risk-prone context. The political, legal and economic environment of the actions justifies the need for a particular treatment; e.g. mention of actions in fragile State contexts, or under Trust Funds.

II. Main Action Points/ Narratives of the PN

(1) **Cost Effectiveness: The intention for full reliance on the rules and procedures of Member States Agencies is de facto not yet consistently translated into the revised FR**

The new FR continues to rely on an ex ante assessment of the core financial management and control systems to certify MS organisations for indirect implementation. We appreciate this particular status, which is for MS organisations (MSO) and PN Members at the heart of the special European cooperation relationship with the Commission.

The new FR started with the objective to enhance cost effectiveness by relying more fully on the systems and procedures of the beneficiaries and its partners. To this end, sections on cross-reliance on audit and

assessment have been introduced (§122/123); or reference is made to additional “other systems” that the Commission may consider to assess (e.g. the administrative cost accounting structure)(§149/4).

In these instances, however, rules remain vague and un-committal, without sufficient guidance on their applicability; leaving the operationalization to further sectorial legislation or – frequently - assigning the decision-making to the Commission or the Authorising Officer, creating uncertainty of the applicability of rules.

To our understanding, this is not full reliance on the rules and procedures of MSO, which should follow the principle of “what is good enough for Member States should also be good enough for the EU”.

Decisive changes in this regard are needed to avoid further duplication of efforts, increased costs and additional rules imposed by the EU FR, where equivalent MS rules do exist and are already applied.

Recommendation:

- Expand cross-reliance, so that additional regular EU audits and the management declaration can be dispensed with for pillar-assessed MS organisations (as is the option for IO’s).
- Include reliance on the cost structure and cost accounting of MS Organisations in the FR (if needed with an additional EU assessment), leading to the full acceptance of the cost categorization of MSO and of certain hitherto excluded cost categories (e.g. the MSO’s internal cost charging system; performance related salary components; staff training).
- Cross-reliance should also apply in regard to the newly established need for regular ex-ante and ex-post evaluations (§32), in case of EU co-financing of a MS activity implemented by a Member State Agency, as MS have similar evaluation requirements.

(2) Fair treatment: Pillar assessed MSO should benefit from the same treatment as International Organisations when implementing EU funds

International Organisations, who – as a group - still remain the main recipients of EU external assistance when it comes to indirect implementation, often enjoy already today more favourable conditions than MSO (e.g. UN-FAFA: indirect costs exceeding the 7% limit can be charged as direct costs, if eligible as such for the EU; WB-Framework Agreement: in addition to remuneration (2-5%), WB can charge up to 17% staff costs for managing EU-funds in case of Recipient-Executed and Hybrid Trust Funds).

The proposed FR continues this trend and grants International Organisations privileges that pillar-assessed MSO do not enjoy, e.g. exemption from audit opinions, management declaration (§150/1 d), verification of financial capacity (§191/5).

European pillar assessed Organisations have a strong added value in implementing EU funds in international contexts. This added value comes from European expertise, shared goals, principles and values with the EU and the partner countries. They should therefore (at least) enjoy equal treatment with International Organisations.

Recommendation:

- In order to create a level playing field, expand privileges/ exemptions granted for International Organisations e.g. with regard to audits and management declaration also to pillar-assessed MSO.

(3) Financial Viability: The EU should be paying the full implementation costs for its contributions.

The FR uses the terminology “remuneration” for organisations implementing EU assistance under indirect management. In our view, this term is misleading. PN Members who are not-for-profit entities with a public service mission do not want (or need) a remuneration. They perceive themselves as partners of the EU Commission, collaborating for greater effectiveness, efficiency and significance of European solutions.

When implementing indirectly through MS organisations, the EU makes full use of their systems and resources. So, what we would like to see is that the EU should, beyond any remuneration, pay the real costs of its actions, and this includes the administrative/indirect costs that arise from implementing EU contributions.

Even, if the EU is only co-financing an action, it should fully pay for the related indirect costs; otherwise a third party has to be sought to cover these costs. If this is not the case, there is a risk that cooperation is financially not feasible, and – more generally - the future cooperation potential will be seriously limited.

Recommendations:

- Use the same terminology for indirect implementation as for grants (i.e. direct/ indirect costs).
- The FR should allow for the full financing of direct and indirect costs of EU-funded activities, by recognising and relying on the cost structure of MSO (including their direct/ indirect cost categorisation); if needed, the flexibility to charge administrative costs as direct costs should be allowed (similar to the UN FAFA).

(4) Introduction of a specific grant format for Twinning

Since its introduction in 1998 Twinning has served as a very successful instrument in the European Commission's external assistance to foster peer-to-peer transfer of experience and know-how between public administrations of EU Member States and enlargement as well as European Neighbourhood countries. In 2014 EU Member States have launched an initiative to streamline procedures and recommending simplifications of administrative practices related to Twinning projects. The discussion on the new financial rules offers a good opportunity to consider Twinning in the light of a special form of grant.

Recommendations:

As Twinning operations due to their particular nature do not fit in a single set of rules as it concerns only public sector expertise provided by EU Member States, we propose that Paragraph 2 of Art. 174 should read:

“2. Grants are direct financial contributions, by way of donation, from the budget in order to finance any of the following: ...

(c) **the implementation of peer-to-peer administrative cooperation by Member State public authorities ('Twinning grants'). ...**

The form of Twinning grants shall be established by a Commission Decision.”

Introducing Twinning as a specific form of a grant will provide more flexibility to adjust the specific rules of the instrument, less need for derogations from the common rules and a look forward to a possible future expansion of the instrument to other regions.

Additional Points (not prioritized, but still relevant):

- **Performance related remuneration** is difficult to apply in external action, as many sectors do not easily lend themselves to linking higher level outcomes and impacts to specific interventions. Contribution (and not direct attribution) of an intervention to outcomes and impact is the rule. In addition, External action often takes place in very volatile or fragile situations. Thus, the performance of an implementer can hardly be measured by achievement of outcomes or impact. In addition, for MSO it poses a financial risk, as the current 7%-cap imposed on the remuneration level excludes higher remuneration levels for better than expected performance, while allowing for reductions in remuneration of less good performance. The inherent financial risk would have to be borne by the implementing organization, without the possibility to compensate for the reductions across their portfolio.
- Regarding a comprehensive “**payment for results**” approach (§121) the definition of the term “results” is key (output or outcomes?). Again, payment for results may not be applicable for large parts of the field of external action. In cases where this approach is chosen, the EU should relinquish control of eligible costs and inputs.

III. Next Steps/ Suggested Process

In view of the above main points (section 2) and the findings of the technical analysis of relevant FR articles (Annex 1) the Task Team recommends to the PN to follow-up on two main issues:

1. **Article on Indirect Implementation with Member State Organisations:** The close partnership between the EU, the Member States and the Member State Organisations to achieve an effective, efficient and visible “European response” in the field of external action warrants a separate additional paragraph on “indirect implementation with MS organisations”; similar to the existing one on “indirect implementation with International Organisations (§151) or the one on “indirect implementation with third countries” (§152)). A new article should clarify the status of Member State Organisations and confirm the possibility of expanded cross-reliance on their rules, systems and procedures in indirect implementation, as these are accepted and supervised by Member States authorities.
2. **Added value of Member State Organisations:** In the field of external action, Member State Organisations often have close and trustful relationships with the partner country, based on their long-standing presence and on-going activities in the country. In order to avoid duplicating structures on the ground while making the best use of donors’ expertise, indirect implementation with Member State Organisation should be the preferred option, if the European solution provides at least the same quality of services and impact as other implementation solutions. In this respect, an additional sentence should be added to the Preamble of the text.