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## III

*(Preparatory acts)*

## COURT OF AUDITORS

**OPINION No 6/2012***(pursuant to the second subparagraph of Article 287(4) of the Treaty on the Functioning of the European Union)***on the proposal for a Regulation of the European Parliament and of the Council laying down the rules for the participation and dissemination in 'Horizon 2020 — the Framework Programme for Research and Innovation (2014-2020)'***(2012/C 318/01)*

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THE COURT OF AUDITORS OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 179 to 190 and 287(4), second subparagraph, thereof,

Having regard to Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities <sup>(1)</sup>, as last amended by Regulation (EU, Euratom) No 1081/2010 of the European Parliament and of the Council <sup>(2)</sup>,

Having regard to Commission Regulation (EC, Euratom) No 2342/2002 of 23 December 2002 laying down detailed rules for the implementation of Council Regulation (EC, Euratom) No 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities <sup>(3)</sup>, as last amended by Commission Regulation (EC, Euratom) No 478/2007 <sup>(4)</sup>,

Having regard to Regulation (EC) No 1906/2006 of the European Parliament and of the Council of 18 December 2006 laying down the rules for the participation of undertakings, research centres and universities in actions under the Seventh Framework Programme and for the dissemination of research results (2007-2013) <sup>(5)</sup>,

Having regard to the Commission's set of legislative proposals which consist of the proposal for a Regulation of the European Parliament and of the Council establishing Horizon 2020 — the Framework Programme for Research and Innovation (2014-2020) (COM(2011) 809 final), the proposal for a Regulation of the European Parliament and of the Council laying down the rules for participation and dissemination in 'Horizon 2020' — the Framework Programme for Research and Innovation (2014-2020) (COM(2011) 810 final), the proposal for a Council Decision establishing the Specific Programme implementing 'Horizon 2020' — the Framework Programme for Research and Innovation (2014-2020) (COM(2011) 811 final), and the proposal for a Council Regulation on the Research and Training Programme of the European Atomic Energy Community (2014-2018) complementing 'Horizon 2020' — the Framework Programme for Research and Innovation (COM(2011) 812 final),

Having regard to the Council's request of 6 January 2012 for an opinion on the rules for participation,

<sup>(1)</sup> OJ L 248, 16.9.2002, p. 1.

<sup>(2)</sup> OJ L 311, 26.11.2010, p. 9.

<sup>(3)</sup> OJ L 357, 31.12.2002, p. 1.

<sup>(4)</sup> OJ L 111, 28.4.2007, p. 13.

<sup>(5)</sup> OJ L 391, 30.12.2006, p. 1.

Having regard to the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on 'Horizon 2020' — the Framework Programme for Research and Innovation (COM(2011) 808 final) supported by staff working papers (SEC(2011) 1427 final and SEC(2011) 1428 final),

Having regard to Commission Decision C(2011) 174 final entitled 'Commission Decision of 24 January 2011 on three measures for simplifying the implementation of Decision No 1982/2006/EC of the European Parliament and of the Council and Council Decision 2006/970/Euratom and amending Decisions C(2007) 1509 and C(2007) 1625',

Having regard to the Court's Annual and Special Reports, and its Opinions No 1/2006 on the proposal for a Regulation of the European Parliament and of the Council laying down the rules for participation of undertakings, research centres and universities in actions under the Seventh Framework Programme and for the dissemination of research results (2007-2013) <sup>(6)</sup>, No 1/2010 on Improving the financial management of the European Union budget: Risks and challenges <sup>(7)</sup>, No 6/2010 on a proposal for a Regulation of the European Parliament and of the Council on the Financial Regulation applicable to the general budget of the European Union <sup>(8)</sup> and No 7/2011 on the proposal for a Regulation of the European Parliament and of the Council laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund covered by the Common Strategic Framework and laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1083/2006 <sup>(9)</sup>,

HAS ADOPTED THE FOLLOWING OPINION:

## INTRODUCTION

1. The predecessor to 'Horizon 2020', the Seventh Framework Programme for Research and Technological Development (FP7), has attracted widespread criticism due to the complexity of the programme (e.g. the variety of funding schemes and instruments) and its rules for participation (e.g. inconsistency in the application of rules or implementation of procedures) <sup>(10)</sup>. As a consequence, the European Parliament and the Council of the European Union have given the highest

<sup>(6)</sup> OJ C 203, 25.8.2006, p. 1.

<sup>(7)</sup> <http://eca.europa.eu>

<sup>(8)</sup> OJ C 334, 10.12.2010, p. 1.

<sup>(9)</sup> OJ C 47, 17.2.2012, p. 1.

<sup>(10)</sup> For instance, Interim Evaluation of the Seventh Framework Programme, Final Report, 12 November 2010, p. 56; European Court of Auditors Opinion No 1/2006, paragraph 12 et seq. and Annual Report concerning the financial year 2009, paragraph 6.7.

political priority to simplifying the management and implementation of the Union's research and innovation funding<sup>(1)</sup>. The Commission had already introduced measures to remedy some of the current weaknesses during the lifetime of FP7. For instance, the Commission Decision of 24 January 2011 made it possible, under certain conditions, for beneficiaries to use their own accounting practices when claiming project costs.

2. The main aim of the rules for participation under 'Horizon 2020'<sup>(2)</sup> is to build on the simplification measures already implemented in FP7. The 'rules' lay down the conditions for project selection, participation of entities in the projects, financing the projects, determining funding conditions such as funding rates and eligibility requirements, and disseminating results. These issues are not only important for beneficiaries, but they can also have ramifications for the overall performance of the Horizon 2020 Framework Programme. For instance, reduced attractiveness due to complex rules increases the risk of failing to achieve the programme's overall objective of supporting the Europe 2020 strategy.

3. As far as possible, the Court's opinion follows the structure of the Commission's explanatory memorandum of the 'proposed rules'. However, it also takes into account the overall context of the 'regulatory package' and, more specifically, the management measures covering the new control strategy set out in the proposal for the 'Horizon 2020 regulation'.

## SUMMARY

I. Simplification is the major cross-cutting principle behind the measures contained in the 'proposed rules'. In general, the Court considers that the measures, if implemented as intended, will significantly contribute to addressing the major challenges faced by the Union's research funding. As the success of these measures will primarily depend on their effective implementation, timely, practical, clear and unambiguous guidance will be crucial in this regard.

II. 'Horizon 2020' should identify coordination mechanisms with other EU policies, such as Cohesion policy, with a view to potentially increasing the multiplier effect of Union resources, speeding up progress towards a unified European Research Area, and mitigating the potential risk of accumulation of different EU funding for a single action.

(1) Council of the European Union (10268/10) — Council conclusions adopted by the Competitiveness Council at its meeting on 26 May 2010, p. 2; and the European Parliament Resolution of 11 November 2010 (P7\_TA(2010)0401), No 7 et seq.

(2) The set of proposals for Horizon 2020 (hereinafter referred as to the 'Horizon 2020' or 'regulatory package') consists of the regulation establishing Horizon 2020 (COM(2011) 809 final) (hereinafter referred as to the 'Horizon 2020 regulation'), the proposal for a regulation laying down the rules for the participation and dissemination in Horizon 2020 — the Framework Programme for Research and Innovation (2014-2020) (hereinafter referred as to the 'proposed rules' or 'rules'), COM(2011) 810 final, and the proposal for a Council Decision establishing the Specific Programme implementing Horizon 2020, COM(2011) 811 final.

III. By introducing a single set of rules, and allowing deviations only where justified by specific needs, the Commission would be strengthening the move towards a coherent set of rules for participation. The Court emphasises the need for the 'proposed rules' to be applied consistently across all actions under 'Horizon 2020', and in close coordination between the various implementing bodies. Any exceptions from the scope of application of the 'proposed rules' should be clearly justified and reduced to a necessary minimum.

IV. The Court considers that the radically simplified cost-funding model will improve the reliability of the model, decrease the risk of irregularities in beneficiaries' cost claims, make project accounting less complex, and eliminate some of the verification steps required under the current FP7 funding model, thereby facilitating and accelerating the application process.

V. However, the 'proposed rules' should clearly differentiate between actions eligible for 100 % reimbursement and those limited to a maximum of 70 % (close-to-the-market activities). The implementing rules should clearly state what is meant by 'close-to-the-market activities'.

VI. The Court notes that the removal of the option of funding indirect costs on the basis of real costs is a major departure from FP7. It is not clear how this change will individually affect participants. The Commission should provide assurances that the new approach will not lead to undesired situations where participants significantly lose out, thereby adversely affecting the attractiveness of the programme.

VII. The envisaged reimbursement of non-recoverable VAT as an eligible cost is a positive measure. However, the Court considers that it is essential that the Commission provide clear guidance as to what constitutes recoverable VAT.

VIII. In the Court's view, the optimised internal control framework built around a risk-based strategy, which in turn is intrinsically linked to the proposed new funding model, provides a very good starting point for reducing the risk of error. However, there are limitations to this approach, as some risks — by their very nature — need to be addressed by effective preventive controls.

IX. The Court considers the proposed wider coverage of the Participant Guarantee Fund to be a positive development. However, including instruments in the form of public-private partnerships in the Fund's coverage requires assessments to be made regarding possible legal risks.

X. The Court welcomes the Commission's intention to have a single mandatory audit certificate on financial statements at the end of the project. However, recent audits by the Court have confirmed that audit certificates are of limited reliability and so this control is only partially effective. Similarly, the Court's audits have pointed to low participation and acceptance rates as regards certificates on methodologies. Without improvements in these two areas, the Commission's revised control strategy would be negatively impacted.

XI. In the Court's view, the use of prizes should result in stimulating (technological) innovation so as to ensure leverage on additional funding sources. The Commission should therefore ensure that non-financial aspects, such as a solid image and a reputation based on excellence, exclusivity and international recognition, are enhanced.

XII. The Court considers that procurement should be used only in duly justified cases resulting in additional benefits which would not accrue if grants were used.

XIII. The 'regulatory package' does not provide a clear indication of what is to be understood as an innovation activity. The Court would welcome a clear definition, as well as an appropriate limitation in the scope of fundable innovation activities to those that are genuinely new to the world.

#### GENERAL OBSERVATIONS

4. With 'Horizon 2020' the Commission has set itself the objective of attracting the most accomplished researchers and innovative enterprises. In this context, the major cross-cutting principle of simplifying the rules for participation plays a vital role. Simplification is strongly reflected in the key features of the 'rules' (for a complete overview of the objectives and priorities driving the simplification measures in the 'regulatory package', see *Annex*):

- to deliver a single set of rules for participation and dissemination applying to all components of 'Horizon 2020', with exceptions possible only when justified by specific needs,
- to provide participants with simpler and more user-friendly funding rules and financial provisions (e.g. cost reimbursement rates), and
- to implement a new control strategy with a balance between trust and control <sup>(1)</sup>.

5. The Court considers that, in general, the measures proposed by the Commission, if implemented as intended,

<sup>(1)</sup> Simplifying the rules for participation is a prerequisite for the implementation of the proposed control strategy; COM(2011) 811 final, p. 105 (management measures).

will significantly contribute to addressing the major challenges faced by the Union's research funding (e.g. non-coherent rules for participation, complexity and administrative burden). For instance, the proposed integration of research and innovation-related actions (e.g. the research-related Joint Technology Initiatives (JTIs)) addresses the common criticism of non-coherent application of the rules under FP7 and eases interoperability and compatibility between research activities in the Union (see paragraph 10).

6. The 'rules' introduce many simplification measures reflected in the cost-funding model <sup>(2)</sup> (see paragraph 15) and the financial provisions (e.g. time-recording requirements and proposed inclusion of VAT in the definition of eligible costs, see paragraph 21) <sup>(3)</sup>. The Commission has followed a two-fold approach: on the one-hand, the proposed measures aim to reduce the administrative burden for beneficiaries (for example, a less complex funding model simplifies the cost declaration and calculation of the EU contribution for participants); on the other hand, these measures aim to reduce the Commission's management and control work and thereby facilitate the implementation of the proposed control strategy with a balance between trust and control. For example, optimising and simplifying the funding arrangements should, *inter alia*, help to achieve better Commission control <sup>(4)</sup> (see paragraph 24) <sup>(5)</sup>.

7. Overall, the 'proposed rules' tackle the urgent and important issues mentioned in paragraph 1. The success of these measures, however, depends on their effective implementation <sup>(6)</sup>. The Court reiterates its recommendation that the Commission should provide timely, practical, clear and unambiguous implementation guidance so as to offer adequate guarantees both to beneficiaries and to the Commission <sup>(7)</sup>. The detailed implementation rules should be communicated no later than the date of publication of the first calls for proposals.

8. It should be noted that the implementation of a number of the proposed measures (e.g. eligible VAT and no interest-bearing accounts for pre-financing) depends on the adoption of

<sup>(2)</sup> COM(2011) 810 final, Articles 22 and 24.

<sup>(3)</sup> COM(2011) 810 final, Articles 23 and 25.

<sup>(4)</sup> At the same time, it makes it easier to achieve the general objective of reducing the staff of each European institution and agency by 5 %; COM(2011) 890 final, p. 4.

<sup>(5)</sup> COM(2011) 809 final, p. 97 et seq.

<sup>(6)</sup> As stated in a European Parliament study regarding the 'Financial Rules in the Research Framework Programmes — Streamlining rules for participation in EU research programmes': 'One of the main conclusions of this study is that the manner in which the rules are implemented is more problematic than the rules themselves. This leads to lack of mutual trust between beneficiaries and the Commission as well as unnecessary administrative burden on both sides.'; Directorate-General for Internal Policies, Policy Department D: Budgetary Affairs (PE 411.275), 26/05/2010; p. 62.

<sup>(7)</sup> European Court of Auditors Special Report No 1/2004, paragraph 12; Special Report No 9/2007, paragraph 71; Special Report No 8/2009, paragraphs 47 to 49; and Opinion 1/2006, paragraph 11.

the new Financial Regulation (FR) <sup>(1)</sup>. On the date this opinion was issued, the legislative procedure and Implementing Rules for the new FR had not yet been completed.

## SPECIFIC OBSERVATIONS

### Common Strategic Framework

9. The Commission proposes bringing together the full range of research and innovation support in one common strategic framework <sup>(2)</sup>. As previously stated by the Court <sup>(3)</sup>, 'Horizon 2020' should also identify coordination mechanisms among other EU policies (for example, the European Regional Development Fund and the Cohesion Fund). This coordination would make it possible to set the programme's co-financing rate for operational programmes whilst taking account of the various EU funding sources, thereby potentially increasing the multiplier effect of Union resources. This would therefore speed up progress towards a unified European Research Area <sup>(4)</sup>. In addition, it would mitigate the potential risk of accumulation of different EU grants for a single action <sup>(5)</sup>.

### Coherent set of rules for participation

10. By introducing a single set of rules, and allowing deviations only where justified by specific needs, the Commission would be strengthening the move towards a coherent set of rules for participation. Under FP7, there were several layers of rules (e.g. a standard set of rules for participation and specific rules for coordination and support actions (CSA) <sup>(6)</sup> or each research JTI <sup>(7)</sup>). As a consequence, the FP7 set of rules was perceived by the research community as complex and incoherent <sup>(8)</sup>.

11. The proposed integrated approach (for example, a broadly consistent application of the rules with regard to issues such as eligibility and evaluation criteria and intellectual property rights to all components of 'Horizon 2020') <sup>(9)</sup> may be an important step in terms of:

<sup>(1)</sup> COM(2010) 815 final.

<sup>(2)</sup> COM(2011) 809 final, recital 15 and Article 4.

<sup>(3)</sup> Opinion No 7/2011, paragraph 14.

<sup>(4)</sup> The European Research Area is composed of all research and development activities, programmes and policies in Europe which involve a transnational perspective. Together, they enable researchers, research institutions and businesses to increasingly circulate, compete and cooperate across borders.

<sup>(5)</sup> Opinion No 1/2006, paragraph 16.

<sup>(6)</sup> Coordination and support actions (e.g. ERA-nets or Article 185 initiatives) are identified on the basis of the criteria set out in the Seventh Framework Programme. However, implementation through dedicated implementation structures may impose additional requirements and must fulfil the national eligibility criteria set out in the joint research programme.

<sup>(7)</sup> JTIs, an integral part of EU research, are explicitly excluded from the scope of FP7 rules for participation. As a result, each JTI has its own corpus of rules and procedures for calls for proposals and financial provisions.

<sup>(8)</sup> European Commission Fourth FP7 Monitoring Report 2010, p. 50; European Commission Interim Evaluation of the Seventh Framework Programme, p. 56.

<sup>(9)</sup> COM(2011) 810 final, recital 6.

— reducing the complexity of the rules for participation,

— integrating the research base by overcoming fragmentation of EU policy rules; while simultaneously,

— gearing research towards further alignment of and cooperation between research implementation bodies (Directorates-General, executive agencies or JTIs).

12. However, it is not clear how and to what extent the participation rules will be applied consistently across all actions under 'Horizon 2020', e.g. in respect of the Competitiveness and Innovation Programme (CIP), the JTIs and the activities managed by the European Institute of Innovation and Technology (EIT). The Court wishes to underline that any exceptions should be clearly justified and reduced to a minimum, otherwise exceptions become rules. In this context, legal certainty would be greater if the regulation listed those activities and actions where exceptions from the single set of rules were envisaged.

13. Furthermore, the full integration of activities currently falling within the scope of other programmes or initiatives (such as those listed in paragraph 12) requires considerable coordination between the bodies concerned. The Commission has proposed <sup>(10)</sup> that the management of 'Horizon 2020' should be further extended to the existing executive Commission agencies and other outside bodies such as the joint undertakings managing the JTIs <sup>(11)</sup>.

14. The Court would like to repeat its previous recommendation that these management arrangements should be properly supervised by the Commission so that full advantage can be taken of the opportunities offered. In particular, integrating the joint undertakings as vehicles for delivering EU policies involves close coordination. To this end, the joint undertakings first need to build up a robust and comprehensive internal control system. In this context, the Commission should monitor the implementation of the action plans <sup>(12)</sup>. The Court also points out that effective and consistent application of the rules is vital. It recommends that the Commission should considerably expand key alignment mechanisms such as the Research Clearing Committee (RCC) <sup>(13)</sup> to strengthen horizontal measures further.

<sup>(10)</sup> COM(2011) 809 final, p. 95.

<sup>(11)</sup> In this respect, the use of the executive agencies will be optimised through a possible redistribution of tasks to achieve specialisation. Further mandates for existing joint undertakings will be renewed and new ones will be set up, COM(2011) 809 final, pp. 95 and 96.

<sup>(12)</sup> European Court of Auditors Special Report No 13/2009, paragraphs 61 to 66; Opinion No 1/2010, paragraph 17, and Annual Report concerning the financial year 2009, paragraph 5.56.

<sup>(13)</sup> In 2011, the Commission Decision on three measures for simplifying the implementation of Decision No 1982/2006/EC established the Research Clearing Committee (RCC) with the mandate to take final positions on horizontal matters related to the implementation (e.g. consistency in the Commission Directorates' *ex post* strategy, application of the financial provisions, certification procedure etc.); (C(2011) 174).

### New cost-funding model

15. The Commission proposes (Articles 22 and 24 of the 'rules') a funding model consisting of:

- a single rate of funding for all participants and activities in one action (this rate may be up to 100 % of total eligible (direct) costs and should be limited to a maximum of 70 % for close-to-the-market activities), and
- a single flat rate of 20 % of the total direct eligible costs for indirect (overhead) costs.

16. The model is radically simplified and is meant to address the problems beneficiaries faced under FP7, where the complexity of the funding model was directly related to the number of combinations available between cost categories, methods for calculating costs and reimbursement rates<sup>(1)</sup>. For instance, under FP7 funding rates are dependent on the legal status (e.g. as a non-profit public body or for-profit company), the type of activity (i.e. research, demonstration, management and other) or the type of costs (i.e. personnel, subcontracting, or other direct and indirect costs)<sup>(2)</sup>.

17. In the proposed model, the distinction between different types of activity, which exacerbated the complexity of the FP7 model<sup>(3)</sup> has been completely removed. Furthermore, the introduction of funding for the total direct costs of research (one reimbursement rate for direct costs set at the inception of each project), together with a nominal fixed contribution towards indirect costs (20 %) for all beneficiaries and types of activity, make the cost-funding model simpler and less error-prone.

18. The Court notes the fact that these simplification measures:

- improve the reliability of the model (e.g. simplify the cost declaration) and this, in turn, should decrease the risk of irregularities in beneficiaries' cost claims (accountability and sound financial management),

<sup>(1)</sup> European Court of Auditors Annual Report concerning the financial year 2010, paragraph 6.7.

<sup>(2)</sup> European Parliament Report on simplifying the implementation of the Research Framework Programmes (2010/2079(INI)), paragraph 17; Conclusions on simplified and more efficient programmes supporting European Research and Innovation, 3016th Competitiveness Council meeting of 26 May 2010, p. 4; COM(2010) 187 final, p. 8.

<sup>(3)</sup> Instances were noted during the European Court of Auditors' financial audits. Beneficiaries in FP7 classify their costs into 16 cost categories. Each category has different levels of funding. As a consequence, incorrectly classified cost items may result in a different funded amount, because the same item under one category (e.g. demonstration activities) is funded at a rate of 50 %, whereas the rate under other categories (e.g. management activities) is 100 %.

- make project accounting less complex, which should enable the effective management of financial and administrative aspects (reduction of administrative effort for the beneficiaries and the Commission),

- should eliminate some of the verification steps required under the current FP7 funding model (e.g. legal status). In this way, the proposed funding model would facilitate and accelerate the application process, and

- represent a cost reimbursement model that already operates effectively in practice in national research funding across Europe<sup>(4)</sup>.

19. However, the 'rules' do not clearly differentiate between actions eligible for 100 % reimbursement (standard activities) and those limited to a maximum of 70 % (close-to-the-market activities). The definition of close-to-the-market activities such as prototyping, testing, demonstrating, experimental development, piloting or market replication is not clear, since several definitions exist. The implementing rules should clearly state what is meant by 'close-to-the-market activities'.

20. The Court notes that the proposed funding model is a major departure from FP7 since the option of funding indirect costs on the basis of real costs has been removed. It is not clear how the proposed cost reimbursement model will individually affect participants. In this respect, the Commission should provide assurances that the new approach will not lead to undesired situations where participants significantly lose out, which would make the programme considerably less attractive.

### Simplified eligibility and funding criteria

21. The 'rules' provide for the introduction of additional measures to simplify the eligibility rules. The intention is to align these rules with beneficiaries' practices (e.g. time-recording requirements<sup>(5)</sup>).

22. The Court notes that the use of time-recording systems is to continue and regards this as appropriate since it is essential to substantiate personnel costs actually incurred<sup>(6)</sup>. However, eliminating time-recording for staff working exclusively on EU projects by allowing them to sign a corresponding declaration is a positive measure. In order to ensure an entity-wide consistent approach, the Commission should ensure that the beneficiary

<sup>(4)</sup> A study by an expert group on the 'Impact of external project-based research funding on financial management in Universities — Expert Group report chaired by Sabine Herlitschka, November 2008' showed, for instance, that a funding approach covering full direct costs plus a flat rate of indirect (overhead) costs (typically 20 %) is commonly used in Europe (e.g. Germany's Deutsche Forschungsgemeinschaft, and Switzerland's Fonds National Suisse).

<sup>(5)</sup> COM(2011) 810 final, Article 25 (Annual productive hours).

<sup>(6)</sup> Opinion No 1/2006, paragraph 67.



complies with its own usual accounting and management practices, otherwise the new measure will be prone to irregularities. For instance, a declaration from the beneficiary should be reconcilable with other evidence (e.g. hours worked on the project, or references to the tasks or type of activity should be consistent with employment contracts or other internal arrangements).

23. The 'rules' allow for the reimbursement of non-recoverable value added tax (VAT) <sup>(1)</sup>. The importance of modifying the rules with a view to accepting non-recoverable VAT as an eligible cost was already highlighted in Court Opinion No 1/2006 <sup>(2)</sup>. It is essential to provide clear guidance as to what constitutes recoverable VAT. In the Court's view, in order to qualify as eligible, VAT must not be refundable to the beneficiary under the applicable national legislation.

### The Commission's control strategy

#### *Revised strategy and control measures*

24. Simplification as the central aim of 'Horizon 2020' is also strongly reflected in the proposed financial management of the programme <sup>(3)</sup>. Alongside the introduction of the cost-funding model (see paragraphs 15 to 20), the 'Horizon 2020 regulation' <sup>(4)</sup> intends to implement a revised control strategy. This strategy shifts focus from the minimisation of error rates towards risk-based control and fraud detection, while simultaneously achieving:

- a residual error rate close to 2 % of total expenditure over the lifetime of the programme,
- an overall number of *ex post* audits limited to what is strictly necessary for the achievement of this target and the strategy, and
- a maximum of 7 % of 'Horizon 2020' participants subject to audit over the whole programming period.

25. The important building blocks of the control strategy are intrinsically linked to the proposed funding model. As described in the 'Horizon 2020 regulation', the benefits of certain simplification measures (e.g. elimination of a recurrent source of errors) should decrease the risk of irregularity and thereby allow a simpler and more effective control and audit system. For instance, the introduction of simplified rules governing indirect costs (see paragraph 17) would subsequently reduce

<sup>(1)</sup> Value added tax is ineligible under FP7; Regulation (EC) No 1906/2006 of the EP and of the Council, Article 31(3)(e). This provision is omitted from the proposed 'Horizon 2020 regulation'. The proposal refers to the Financial Regulation, which includes non-recoverable VAT as eligible.

<sup>(2)</sup> Opinion No 1/2006, paragraph 64.

<sup>(3)</sup> COM(2011) 809 final, recital 32.

<sup>(4)</sup> COM(2011) 809 final, p. 97.

the error rate <sup>(5)</sup>. Furthermore, a well designed and correctly implemented strategy to reinforce risk-based controls and fraud detection could prevent errors from occurring.

26. The Court notes the development of a risk-based strategy with the target of achieving a residual error rate close to 2 %. An optimised internal control framework built around a risk-based strategy provides a very good starting point for reducing error risk. However, there are limitations to this approach. Some risks, by their very nature, need to be addressed by effective preventive controls.

27. In this context, the Court concluded <sup>(6)</sup> that a significant proportion of audit certificates (*ex ante* certification of beneficiaries' costing methodologies and *ex post* audit certification of cost claims, two important elements in the Commission's new control mechanism), were considered to be only partially effective (see also paragraphs 30 to 32). Therefore, the proposed measures run the risk of having only limited effectiveness and not contributing sufficiently to achieving the targeted reduction of the residual error rate. Furthermore, the Commission should ensure that any predetermined *ex post* audit activity level will not prevent the Commission from reaching a residual error rate close to 2 % <sup>(7)</sup>.

#### *Participant Guarantee Fund*

28. The Commission has proposed that the Participant Guarantee Fund ('the Fund') should be maintained for the entire duration of Horizon 2020. The Fund, already in operation under FP7 <sup>(8)</sup>, forms an integral part of the Commission's control strategy. It aims to protect the EU budget by acting as collateral to grants to beneficiaries <sup>(9)</sup>. As a consequence, no additional guarantee or security shall be imposed on participants <sup>(10)</sup>. Unlike FP7, the coverage of the Fund would include the CIP, EIT activities and instruments such as the JTIs <sup>(11)</sup>.

29. The Court notes that the introduction of the Fund under FP7 reduced the administrative burden on beneficiaries. For instance, as it provided security in the form of collateral, the

<sup>(5)</sup> As described in the legislative financial statement to the 'Horizon 2020 regulation', around 28 % of errors for FP7 audits by amount relate to indirect costs. This rate is therefore expected to decline under Horizon 2020; COM(2011) 809 final, p. 100.

<sup>(6)</sup> Annual Report concerning the financial year 2010, paragraphs 6.19 to 6.28.

<sup>(7)</sup> To mid-June 2012, approximately 7,25 % of FP7 beneficiaries were audited or scheduled for audit. Under FP6, 8,45 % of beneficiaries were audited. For both framework programmes, the error rate has not decreased to the expected 2 % level. Information provided by the European Commission — Directorate-General for Research and Innovation (RTD).

<sup>(8)</sup> COM(2011) 810, Articles 32 to 33.

<sup>(9)</sup> The beneficiaries contribute 5 % of the total EU contribution for their project to the Fund, which in total represents collateral on which the EU can draw in the event of financial losses linked to the projects.

<sup>(10)</sup> COM(2011) 810, Article 32, paragraph 4.

<sup>(11)</sup> SEC(2011) 1427 final, Volume 2 — part 2/2, Annex 3.

Commission was able to reduce the number of financial viability checks for the majority of participants and abolish other forms of collateral (e.g. bank guarantees). In this respect, the wider coverage ensured by including the CIP, the EIT and JTIs under the Fund's umbrella is a positive development. However, including instruments such as public-private partnerships (e.g. JTIs) in the Fund's coverage requires an assessment of possible legal risks (different legal structures<sup>(1)</sup>), especially if any amount recovered is to constitute revenue assigned to the Fund<sup>(2)</sup>.

#### Certification procedures

30. The Commission proposal provides for two certification procedures<sup>(3)</sup> performed by an independent auditor. Both procedures constitute an element of the revised internal control framework under Horizon 2020<sup>(4)</sup>. The procedures are:

- the certificate on the financial statements (compulsory *ex post* audit certification at the end of the project for cost claims equal to or greater than 325 000 euro which should confirm the accuracy, authenticity and eligibility of the declared costs), and
- the certificate on methodology (optional *ex ante* certification for beneficiaries certifying their costing methodologies for direct personnel costs on the basis of scale of unit costs).

31. In order to reduce the administrative burden on beneficiaries, the Commission proposes a reduction in the number of certificates on the financial statements when compared with FP7<sup>(5)</sup>. In terms of simplification, the Court welcomes the Commission's intention to have a single mandatory certificate at the end of the project. However, whether the certification process constitutes an effective control procedure primarily depends on the reliability of the audit certificates. Recent audits by the Court have confirmed that this control was only partially effective for the previous two years<sup>(6)</sup>. The Court reiterates its recommendation that the reliability of the audit certificates should be improved by raising the certifying auditor's awareness of the eligibility of expenditure.

<sup>(1)</sup> For instance, the specific legal structure of the JTIs, using the 'Community Body' framework, was chosen to enable the Commission to contribute the resources envisaged in a direct and controllable way. However, as things stand no final decision has been taken about how to continue with the recognition of the JTIs. For the set-up of new JTIs, other types of legal structure (e.g. special bodies) are currently under discussion as part of the current revision of the EU Financial Regulation. Rights given to private partners, profit allocation or insolvency risks should therefore be taken into consideration when including the CIP, the EIT and JTIs under the Fund's umbrella.

<sup>(2)</sup> COM(2011) 810, Article 33, paragraph 4.

<sup>(3)</sup> COM(2011) 810, Articles 28 to 30.

<sup>(4)</sup> COM(2011) 809, p. 99.

<sup>(5)</sup> Under 'Horizon 2020', only one such certificate (triggered by the threshold of 325 000 euro) is required per beneficiary at the end of the project instead of the interim certificates required under FP7.

<sup>(6)</sup> Annual Report concerning the financial year 2010, paragraphs 6.19 to 6.21.

32. The objective of the Certificate on Methodology is to promote the use of correct methodologies by beneficiaries when claiming direct personnel costs on the basis of scale of unit costs<sup>(7)</sup>. Presuming their implementation to be effective, beneficiaries would opt to have their methodology certified and, consequently, the overall number of errors related to personnel costs would decrease. However, as previously stated by the Court<sup>(8)</sup>, the low participation and acceptance rates in FP7 undermine the Commission's efforts to simplify procedures. The Court encourages the Commission to simplify and speed up the application process and to clearly specify simple criteria for obtaining this certificate. If this is not achieved, the effective implementation of the Commission's revised control strategy could be negatively impacted.

#### New forms of funding

33. The 'proposed rules' introduce prizes, pre-commercial procurement and public procurement of innovative solutions as new forms of funding<sup>(9)</sup>. The Commission intends to use prizes as an award for the achievement of pre-specified research-oriented targets<sup>(10)</sup>. Procurement will allow the Commission to procure research and development services and act as a launch customer for innovative solutions<sup>(11)</sup>.

34. The basic rationale of prizes is to stimulate investment in research and innovation that is worth far more than the cash value of the prize. Thus, in addition to administrative simplicity, prizes may have the advantage of a high leverage effect<sup>(12)</sup>. For this effect to be realised, the prize must induce private investment. Without a leveraging effect, the prize will serve merely as an instrument for coordinating different research efforts financed from the public purse, and will not attract additional investment into research. Prizes should therefore be linked to stimulating (technological) innovation so as to ensure leverage on additional funding sources. To give this aspect more weight, the Commission should focus on enhancing the non-financial attractiveness of the prizes, e.g. by creating an image and reputation for the prize based on excellence, exclusivity and international recognition.

35. The rationale of the pre-commercial procurement and public procurement of innovative solutions is to drive demand for innovative goods or services, thereby supporting market uptake<sup>(13)</sup> and consequently enhancing European competitiveness. Compared to grants, the contracted procurement price entails not only the contractors' costs but also their profit margin. This factor could make procurement a more expensive instrument than grants as far as the funding of research is concerned. Procurement should therefore be used

<sup>(7)</sup> Certificates issued by external auditors — Guidance notes for beneficiaries and auditors, version 1 July 2010, p. 13.

<sup>(8)</sup> Annual Report concerning the financial year 2010, paragraph 6.25.

<sup>(9)</sup> COM(2011) 810 final, Articles 34 to 35 and 48 to 49. Pre-commercial procurement pilot projects were already launched during FP7 (e.g. under FP7-ICT-2011-12). Prizes were included in the FP7 rules but not used as a separate form of funding.

<sup>(10)</sup> COM(2011) 810 final, p. 3.

<sup>(11)</sup> COM(2011) 810 final, Article 2, paragraphs 1(13) and 1(14).

<sup>(12)</sup> COM(2010) 187, p. 6 (last paragraph).

<sup>(13)</sup> SEC(2011) 1427, p. 19.

only if it is justified by the expectation of additional benefits (e.g. the creation of a new market or encouraging innovation) which would not accrue if grants were used. The reasons for using procurement should be clearly outlined before any approach is made towards potential contractors. In this respect, procurement should not be used for the sole purpose of administrative simplification of the framework programme.

### Innovation

36. The legislative proposal on 'Horizon 2020' integrates research and innovation by providing seamless and coherent funding from idea to market<sup>(1)</sup>. The term 'innovation' is referred to throughout the 'proposed rules' and the 'regulatory package'<sup>(2)</sup>.

37. The Court noted in Special Report No 4/2011<sup>(3)</sup> that the concept of innovation was interpreted in a broad way.

The 'regulatory package' does not provide a clear indication of what is to be understood as an innovation activity. Instead, in order to illustrate the meaning of the word, it uses a wide range of descriptive terms such as social, world-leading, technological, research-based, industrial, societal, green, technical, well-being and applied innovation<sup>(4)</sup>. The fact that the definition of innovation is ambiguous may lead to misunderstandings and increased complexity in project implementation. The proposal should provide an exact definition.

38. Recognising the risk of funding being diluted through a wide range of innovation projects with limited potential impact on the competitiveness of European industry, Horizon 2020 should clearly limit the scope of the innovation activities that can be financed. The 'regulatory package' should make reference to a recognised innovation framework such as the Oslo Manual<sup>(5)</sup> and limit the scope to innovation activities which are new to the world.

This opinion was adopted by the Court of Auditors in Luxembourg at its meeting of 19 July 2012.

*For the Court of Auditors*

Vitor Manuel da SILVA CALDEIRA

*President*

<sup>(1)</sup> COM(2011) 808, p. 4.

<sup>(2)</sup> For instance 'public procurement of innovative solutions' (COM(2011) 810, point 14 of Article 2(1), Article 19(8) and Articles 35 and 49). Article 22(5) limits the funding rate for listed innovation (close-to-market) actions.

<sup>(3)</sup> <http://eca.europa.eu>

<sup>(4)</sup> COM(2011) 809 final, 'Social innovation' (recital 11 and Annex I (p. 30)) 'world-leading' (Annex I, Part I, p. 32); 'technological, research-based' (Annex I, Part I, p. 36); 'industrial' (Annex I, Part II, p. 47); 'societal' (Annex I, Part II, p. 48); 'green' (ditto); 'technical' (Annex I, Part II, p. 51); 'well-being' (Annex I, Part III, p. 60); and 'applied' (Annex I, Part III, p. 68).

<sup>(5)</sup> 'The Measurement of Scientific and Technological Activities' — Oslo Manual — Guidelines for collecting and interpreting innovation data, third edition, a joint OECD and Eurostat publication.

## ANNEX

## Objectives and priorities driving the simplification measures in the 'regulatory package'

Objectives and priorities	Simplification measures derived from the objectives and priorities
Single set of rules for participation	<ul style="list-style-type: none"> <li>— Horizon 2020 will combine <b>all research and innovation funding</b> currently provided through the Framework, the innovation related activities of the Competitiveness and Innovation Framework Programme (CIP) and the European Institute of Innovation and Technology (EIT) <sup>(2), (3)</sup></li> <li>— A <b>single set of participation rules</b>, on issues such as eligibility, evaluation or IPR, will apply to all components of Horizon 2020, with deviations only possible when justified by specific needs <sup>(1), (3), (4)</sup></li> <li>— A <b>clear set of criteria</b> for joint programmes under Article 185 and joint undertakings under Article 187 will enable a stronger set of initiatives to go forward, taking account of the experience and evaluations under FP7 as well as the changes in the Financial Regulations <sup>(1)</sup></li> <li>— The Commission will continue to <b>streamline, harmonise</b> and accelerate procedures and processes linked to programme and project implementation <sup>(1), (3)</sup></li> <li>— The EIT will <b>contribute towards the knowledge</b> triangle by combining excellent research, education and innovation, and will align its work closely to the priorities of Horizon 2020 <sup>(1)</sup></li> </ul>
Facilitating implementation	<ul style="list-style-type: none"> <li>— <b>Information and communication</b> measures will be an integral part of Horizon 2020 implementation, generating a better public understanding, engagement and debate <sup>(1)</sup></li> <li>— Higher consistency, quality and efficiency of implementation will be obtained through a <b>single IT platform</b> <sup>(1), (3), (4)</sup></li> <li>— <b>Processes and procedures</b> will be rationalised, including detailed provisions on the content and shape of proposals, the processes for turning proposals into projects, the requirements for reporting and monitoring and related guidance documents and support services <sup>(3), (4)</sup></li> <li>— Existing <b>agencies will be optimised</b> through the redistribution of tasks and higher specialisation <sup>(1)</sup></li> <li>— <b>Less paperwork</b> in preparing proposals (simplifying the terms and procedures <sup>(1)</sup>)</li> <li>— The <b>Financial Regulation</b> will also contribute towards the simplification of research and innovation funding (e.g. no interest-bearing account for pre-financing, eligible VAT, limitation of extrapolation of systematic errors) <sup>(1), (2), (3)</sup></li> </ul>
Simpler and more user-friendly funding rules	<ul style="list-style-type: none"> <li>— Simpler funding rule through one <b>single reimbursement rate</b> applied for all participants in the same project (instead of three different rates by type of participant), resulting in an easier-to-use cost reimbursement model <sup>(1), (2), (3)</sup></li> <li>— Broader acceptance of beneficiaries' <b>accounting practices</b> <sup>(1), (3)</sup></li> <li>— 100 % reimbursement of <b>direct costs</b> <sup>(1), (2), (3)</sup></li> <li>— <b>Indirect costs</b> will be covered by a single flat-rate applied to direct costs, reducing error rates in cost reimbursement claims <sup>(1), (2), (3)</sup></li> <li>— <b>New forms of funding</b> (prizes, pre-commercial procurement, procurement of innovative solutions) will allow for more flexibility, for projects in specific areas where they have proven appropriate <sup>(1), (2), (3)</sup></li> <li>— The possibility of using <b>average personnel cost</b>, including for SME owners without a salary <sup>(1)</sup></li> <li>— <b>Time-recording</b> obligations for staff exclusively working on a Horizon 2020 project will be abolished <sup>(1), (2)</sup></li> <li>— Objective references regarding the <b>annual productive hours</b> will be provided <sup>(3), (4)</sup></li> <li>— The system of unit costs and flat rates for <b>mobility and training actions</b> (Marie Curie) will be continued <sup>(3), (4)</sup></li> </ul>

Objectives and priorities	Simplification measures derived from the objectives and priorities
New control strategy	<ul style="list-style-type: none"> <li>— Revised strategy <b>shifting focus</b> from the minimisation of error rates towards risk-based control and fraud detection, should reduce the control burden for participants <sup>(2)</sup>, <sup>(4)</sup></li> <li>— Reduction of administrative burden by performing <b>fewer audits</b> (a maximum of 7 % of Horizon 2020 beneficiaries), while aiming for an error rate of 2 % and also by <b>reducing the limitation period</b> for <i>ex post</i> audits from five to four years <sup>(1)</sup>, <sup>(3)</sup></li> <li>— Extension of the <b>Participants Guarantee Fund</b> to all actions in Horizon 2020, thus covering risk for all types of indirect action <sup>(1)</sup>, <sup>(3)</sup></li> <li>— <i>Ex ante</i> <b>financial capacity checks</b> will only be required for coordinators, thus reducing the administrative burden <sup>(1)</sup></li> <li>— The number of <b>certificates on financial statements</b> will be reduced by requiring only one such certificate per beneficiary at the end of the project <sup>(1)</sup></li> </ul>

## Sources:

<sup>(1)</sup> COM(2011) 808 final.<sup>(2)</sup> COM(2011) 809 final.<sup>(3)</sup> COM(2011) 810 final.<sup>(4)</sup> COM(2011) 811 final.





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