

Special Report

## New options for financing rural development projects: Simpler but not focused on results

(pursuant to Article 287(4), second subparagraph, TFEU)



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OF AUDITORS

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This performance audit was carried out by Audit Chamber I Sustainable use of natural resources, headed by ECA Member Phil Wynn Owen. The audit was led by ECA Member João Figueiredo, supported by Paula Betencourt, Private Office Attaché; Robert Markus, Principal Manager; Charlotta Törneling, Head of Task; Ioan-Alexandru Ilie, Liia Laanes, Päivi Piki and Raluca-Elena Sandu, Auditors. Michael Pyper provided linguistic and Annette Zimmerman secretarial support.



*From left to right:* Liia Laanes, Michael Pyper, Paula Betencourt, Robert Markus, Charlotta Törneling, João Figueiredo, Raluca-Elena Sandu, Annette Zimmerman, Päivi Piki

## CONTENTS

	Paragraph
Glossary	
Executive summary	I - VII
Introduction	1 - 7
EU rural development policy	1 - 7
Audit scope and approach	8 - 11
The use of simplified cost options (SCOs) has simplified administration	12 - 28
They make it easier for beneficiaries to submit claims ...	12 - 15
... and while authorities face additional workload or costs when preparing methodology ...	16 - 20
... they save time during administrative checks	21 - 28
Good use of SCOs can help contain the cost of rural development projects	29 - 47
We found good examples of methodology and calculations ...	31 - 32
... but in some cases the underlying data were not available ...	33 - 35
... or data used for the calculations were not sufficiently justified	36 - 38
Abolition of the independent certification requirement brings new challenges	39 - 47
The Commission does not examine methodology and calculations during approval of RDPs, but only in some selected audits ...	41 - 44
... and the role of Certification Bodies in auditing SCOs is not specified	45 - 47
The new SCOs covered a small part of total spending on rural development	48 - 66
SCOs were not given priority in the preparation of the 2014-2020 RDPs, but the Commission does encourage their use	53 - 54
The wide variety of measures and beneficiaries make it difficult to use SCOs, but they can be used for a wide range of investments	55 - 60
Member State authorities are concerned about Commission audits	61 - 63

Recent changes to the legislation may encourage more use of SCOs in rural development	64 - 66
SCOs have not been linked to a greater focus on results	67 - 72
SCOs shift the focus from invoices to output but do not lead to greater focus on results	67 - 71
The Commission has proposed moving towards results-based payments	72
Conclusions and recommendations	73 - 82
Annex I – Rural development measures where SCOs are used for 20 RDPs	
Annex II.1 – Assurance on SCOs	
Annex II.2 – Performance of SCOs	
The Commission's replies	

## **GLOSSARY**

**Calculation (in the context of SCOs):** The mathematical determination of the SCO amount/rate.

**Common Monitoring and Evaluation System (CMES):** A system drawn up in cooperation between the Commission and the Member States to measure the progress and achievements of rural development policy, and assess the impact, effectiveness, efficiency and relevance of rural development support.

**European Structural and Investment Funds:** Five EU spending instruments set for a seven-year budgetary period: the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund (CF), the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF).

**Financial corrections:** Reductions in the amounts the Commission reimburses Member States for activities carried out under shared management to take account of system weaknesses, late or erroneous payments, and other deficiencies.

**Flat rate:** One of the simplified cost options. Specific categories of eligible costs which are clearly identified in advance. Calculated by applying a percentage set in advance to one or several other categories of eligible costs.

**Lump sums:** One of the simplified cost options. A lump sum is the payment in full of a grant (calculated in advance) to a project once the agreed activities and/or outputs have been completed.

**Measure:** An aid scheme for implementing a policy. A measure defines the rules, such as eligibility and selection criteria, for the projects that can be financed.

**Methodology (in the context of SCOs):** The method used to calculate the SCO.

**Off-the-shelf SCOs:** SCOs established in a regulation. The so called off-the-shelf SCOs can be used immediately by Member State authorities without any need to substantiate the amounts or rates used by means of a methodology or calculation.

**Operation:** A project, group of projects or other action selected according to the criteria laid down for the rural development programme and implemented by one or more beneficiaries with a view to achieving the programme's objectives.

**Rural development policy:** One of the pillars of the common agricultural policy, co-financed by the EAFRD. The policy's aim is to improve the countryside and the situation for people living there by enhancing competitiveness of the agriculture and forestry sectors, improving the environment and quality of life in rural areas and encouraging diversification of the rural economy.

**Rural development programme (RDP):** A programming document prepared by a Member State and approved by the Commission for use in planning and monitoring the implementation of the EU's rural development policy at regional or national level.

**Shared management:** A method of implementing the EU budget in which the Commission delegates implementation tasks to the Member States, while retaining ultimate responsibility.

**Simplified Cost Option (SCO):** The three types of financing defined in Article 67(b), (c) and (d) of Regulation (EU) No 1303/2013<sup>1</sup>: standard scales of unit costs, lump sums and flat-rate financing.

**Standard scales of unit costs:** One of the simplified cost options. Standard prices established in advance for defined quantities. Eligible expenditure is calculated by multiplying the standard cost by quantified activities, input, outputs or results.

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<sup>1</sup> Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 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 and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

## **EXECUTIVE SUMMARY**

I. Simplified Cost Options (SCOs) are a new method of reimbursement for certain rural development measures. Projects under these measures were, before 2014, reimbursed on the basis of costs incurred.

II. Granting of support on the basis of reimbursement of costs incurred is difficult and prone to error. As a result, there has been great interest in looking at simpler methods of calculating the EU financial contribution to projects and activities. Member States may now (in the 2014-2020 period) choose from three new methods (known as SCOs) to establish the support payable:

- standard scales of unit costs;
- lump sums; and
- flat-rate financing.

III. This report presents the findings of our audit of SCOs in rural development. Our main objective was to assess whether SCOs lead to simplification while ensuring economy and producing better results. We examined whether SCOs:

- simplify administration;
- ensure economy; and
- are widely used and increase the focus on policy objectives.

IV. Overall, we conclude that using SCOs can bring simplification and may decrease the administrative burden for both beneficiaries and Member State authorities. By basing payments on output, SCOs shift the focus away from invoices but do not increase the focus on results.

V. We found that SCOs can keep the costs of rural development projects under control, but only if set at the right level and based on a fair, equitable and verifiable methodology. However, as the role of the Certification Bodies in auditing SCOs is not specified, this creates a risk which needs to be addressed.

VI. We also noted that the new SCOs remain a marginal part of rural development spending. The main reasons for this are the diverse nature of rural development projects and the investment needed for developing methodologies.

VII. Based on these findings, we make the following recommendations:

- The Commission should update its guidance on SCOs to cover key principles for developing methodologies.
- The Commission should clarify who is required to check the methodology and calculations for SCOs.
- To facilitate the appropriate use of SCOs, the Commission should explore the options for developing more optional off-the-shelf SCOs and update its definitions of key and ancillary controls to reflect the use of SCOs.
- The Commission should examine the potential for moving away from reimbursement of costs incurred towards reimbursement based on results, taking on board experience gained to date.

## **INTRODUCTION**

### ***EU rural development policy***

1. The aim of the EU's rural development policy is to help rural areas in the EU to address a wide range of economic, environmental and social challenges. The EU spends around 14 billion euro on this policy each year through the European Union (EU) budget. Rural development spending accounts for around 25 % of common agricultural policy (CAP) spending. Member state co-financing represents a further 7 billion euro annually.
2. For around half of the spending on rural development from the EU budget, payment is based on farmed areas or animal numbers. For the remainder, support may take the form of fixed amounts or percentages linked to activities undertaken, or to the costs incurred by the beneficiary. **Box 1** sets out the mechanisms involved.

#### **Box 1 – How rural development support is paid**

For the measures paid based on area or animals, support is granted annually and paid per hectare or livestock unit. The support is, according to the relevant legislation<sup>2</sup>, calculated on the basis of standard additional costs and income foregone.

The rural development regulation introduces fixed payment methods for certain measures<sup>3</sup>. For example, start-up aid for young farmers, new non-agricultural activities in rural areas and the development of small farms are paid as predefined amounts.

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<sup>2</sup> Article 41(d) of Regulation (EU) No 1305/2013 of the European Parliament and of the Council of 17 December 2013 on support for rural development by the European Agricultural Fund for Rural Development (EAFRD) and repealing Council Regulation (EC) No 1698/2005 (OJ L 347, 20.12.2013, p. 487) and Article 10 of Commission Implementing Regulation (EU) No 808/2014 of 17 July 2014 laying down rules for the application of Regulation (EU) No 1305/2013 (OJ L 227, 31.7.2014, p. 18).

<sup>3</sup> Articles 19(1)(a) and 27 of Regulation (EU) No 1305/2013.

The remainder of the rural development support relates to investment measures in agriculture and forestry, basic services and village renewal, and cross-cutting measures such as knowledge transfer, innovation and cooperation. Projects funded under these measures were previously typically based on a system of reimbursement of costs incurred. This means that at the payment claim stage, the beneficiary submits the invoices and the Paying Agency checks their eligibility. The expenditure found eligible is then multiplied by the applicable support rate to arrive at the amount actually paid to the beneficiary.

3. Granting of support on the basis of reimbursement of costs incurred and paid is difficult and prone to error. We have found that errors in EU spending are concentrated in such support<sup>4</sup>. As a result, there has been great interest in looking at simpler methods of calculating the EU financial contribution to projects and activities. Member States may now (as of 2014) choose from three such methods<sup>5</sup> (known as simplified cost options – SCOs) to establish the support payable:

- standard scales of unit costs;
- lump sums; and
- flat-rate financing.

4. This means in practice that all or a portion of the amount reimbursed is based on (for example): standard costs calculated according to a predefined method, units of project output, or percentages applied to other costs<sup>6</sup> (see **Figure 1**). Combinations of the different types of SCOs are allowed.

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<sup>4</sup> Annual report of the Court of Auditors on the implementation of the budget concerning the financial years 2014 (paragraph 1.25), 2015 (paragraph 1.29) and 2016 (paragraph 1.15).

<sup>5</sup> Article 67(1)(b), (c) and (d) of Regulation (EU) No 1303/2013.

<sup>6</sup> Section 1.2.2 of the Commission's guidance on Simplified Cost Options (EGESIF\_14-0017: Guidance on Simplified Cost Options (SCOs). European Structural and Investment (ESI) Funds).

**Figure 1 – The different types of SCOs**

Standard scales of unit costs	Lump sums	Flat rate financing
<ul style="list-style-type: none"> <li>• Eligible costs are calculated on the basis of quantified activities (outputs or results produced) multiplied by a standard scale of unit costs</li> </ul>	<ul style="list-style-type: none"> <li>• Not tied to a quantity</li> <li>• Predetermined financial amount paid for achieving the agreed output or results</li> </ul>	<ul style="list-style-type: none"> <li>• Eligible costs are determined as a percentage of other eligible costs</li> <li>• Commonly used for salaries and other indirect costs</li> </ul>

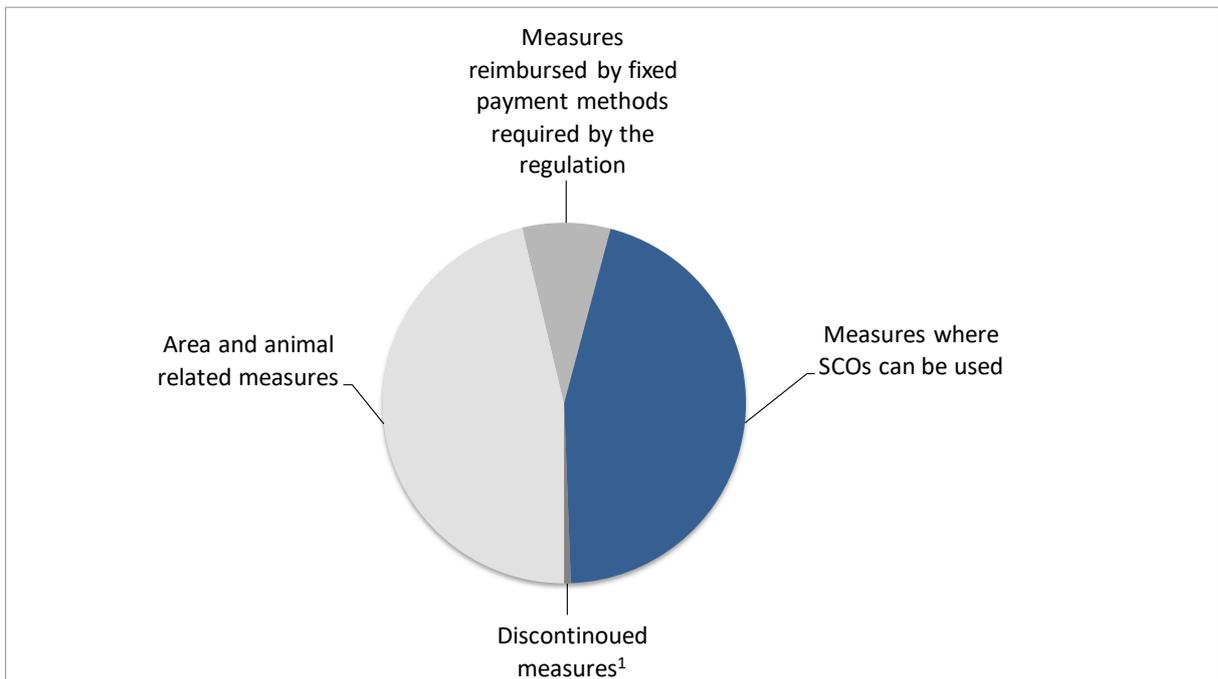
Source: ECA, based on Commission guidance on SCOs.

5. The SCOs introduced in the 2014-2020 period are only relevant for the measures that are not paid based on area or animals or covered by fixed payment methods set out in the regulations (see **paragraph 2**). **Figure 2** presents the planned 2014-2020 rural development funding, indicating the likely share of measures for which some costs may be paid on the basis of SCOs. The use of SCOs for these measures is a new development in rural development policy but other funds<sup>7</sup> already used them during the 2007-2013 period.

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<sup>7</sup> Such as the European Regional Development Fund and European Social Fund.

**Figure 2 – The scope for SCOs**



<sup>1</sup> Discontinued measures are payments related to projects started during the 2007-2013 period for measures that are not used in 2014-2020 (early retirement of farmers and farm workers, meeting standards and training and information).

*NB:* The figure presents a rough split, as, fixed payment methods are established for parts of some measures, but no breakdown of the budgeted amounts at sub-measure level is available.

*Source:* ECA based on financial information from the Commission (retrieved 20 November 2017).

6. In accordance with the applicable rules<sup>8</sup> SCOs should be established in one of the following ways<sup>9</sup>:

- based on a fair, equitable and verifiable calculation method;
- set in accordance with the SCO rules applicable in other EU policies for a similar type of operation and beneficiary;
- set in line with a Member State's national grant schemes for a similar type of operation and beneficiary;

<sup>8</sup> Article 67(5) of Regulation (EU) No 1303/2013.

<sup>9</sup> Additional methods could be established by Fund-specific rules; however, this has not been done for rural development.

- based on rates set by the regulations.

7. SCOs are not mandatory – the Member States are free to decide whether or not to use them.

### **AUDIT SCOPE AND APPROACH**

8. Our audit covered the design and the first three years (2015-2017) of paying rural development support through SCOs. The measures concerned are included in **Annex I**.

9. Our main objective was to assess whether SCOs lead to simplification while ensuring economy for the EU budget, and whether better results are achieved by using SCOs. To answer this main audit question, we examined whether SCOs:

- simplify administration;
- ensure economy; and
- are widely used and enhance the focus on policy objectives.

10. To obtain an overview of the use of SCOs, we screened the 118 Rural Development Programmes (RDPs) and selected 20<sup>10</sup> of them for desk review<sup>11</sup>. We selected the following six RDPs for an audit visit: Flanders (Belgium), Denmark, Saxony (Germany), Canary Islands (Spain), Languedoc-Roussillon (France) and Sweden. During our audit visits, we compared Member State procedures and guidance for beneficiaries before and after introducing SCOs. We also compared project files and, in two Member States<sup>12</sup>, visited final beneficiaries.

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<sup>10</sup> Flanders (Belgium), Denmark, Saxony (Germany), Canary Islands (Spain), Languedoc-Roussillon (France), Sweden, Wallonia (Belgium), Bulgaria, Estonia, Ireland, Greece, Provence-Alpes-Côte d'Azur (France), Croatia, Tuscany (Italy), Veneto (Italy), Cyprus, Luxembourg, Netherlands, Austria and Mainland Finland.

<sup>11</sup> We selected the RDPs based on the following criteria: different levels of use of SCOs in the RDP, coverage of SCOs for different measures, use of different types of SCOs, mix of national and regional programmes and reasonable geographical coverage, using SCOs from other policy areas, programmes approved at different points in time by the Commission.

<sup>12</sup> Canary Islands (Spain) and Sweden.

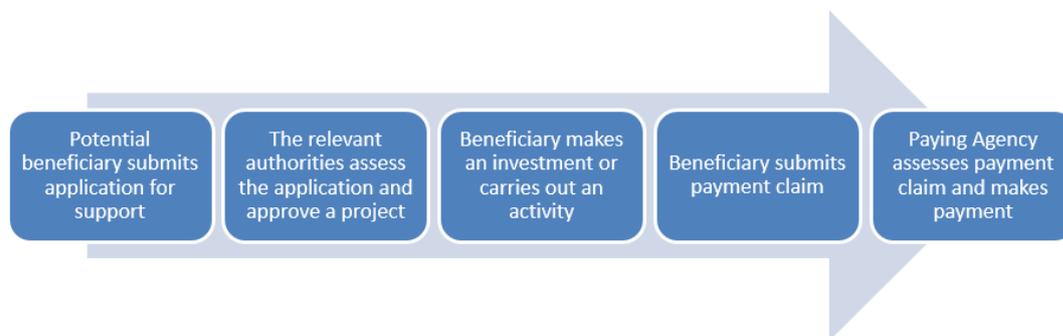
11. To understand the applicable rules and the Commission’s role, we reviewed the legal framework, Commission guidance to the Member States, and the Commission’s internal procedures and checklists. At the Commission we carried out interviews, reviewed correspondence with the Member States, and attended events where the Commission provided information about SCOs to the Member States.

### **THE USE OF SIMPLIFIED COST OPTIONS (SCOs) HAS SIMPLIFIED ADMINISTRATION**

#### ***They make it easier for beneficiaries to submit claims ...***

12. Receiving aid for rural development projects is a two-stage process. Applicants first submit applications for support to the relevant authorities, which checks and approves projects based on eligibility and selection criteria. After completing the project, beneficiaries submit payment claims, which the Paying Agency checks before payment. This process is illustrated in **Figure 3**.

**Figure 3** – From application to payment



Source: ECA.

13. Applicants need to provide several documents when applying for support. Where the EU budget will reimburse a share of eligible costs, they often need to provide offers to demonstrate that expected costs are reasonable, and then submit invoices and proofs of payment with their payment claims. For one 2007-2013 project we examined in Sweden, in which a beneficiary built a cow shed, the two payment claims included 134 invoices and proofs of payment. This requirement extends to indirect costs (see **Box 2**).

**Box 2 – Indirect costs**

Indirect costs are costs incurred by an organisation that are not directly attributable to a project. Examples of indirect costs can be office rent, insurance, office supplies, postage and telephone costs. These costs are eligible for some types of EU-funded project. When claiming indirect costs based on costs incurred, beneficiaries must provide supporting evidence for each item and justify the share of the cost allocated to the project (the distribution key). In addition, they must demonstrate that these costs are reasonable.

14. We reviewed applications for support and payment claims for 2014-2020 projects paid through SCOs and compared them to projects from the 2007-2013 period (when SCOs were not used) to assess whether the application and claim procedures became easier. In all six Member States visited, we found that beneficiaries of SCO-based projects do not need to submit offers with their applications nor invoices or proofs of payment with their payment claims. **Table 1** provides examples of supporting documents attached to applications for support and to payment claims during 2007-2013 (reimbursement based on costs incurred) and 2014-2020 (reimbursement based on SCOs).

**Table 1 – Comparison of supporting documents for selected SCOs in Sweden**

Type of SCO	Stage	2014-2020 (with SCOs)	2007-2013 (no SCOs)
Flat rate: indirect costs paid as 15 % of eligible <u>direct</u> staff costs	Application for support	None	Detailed budget of indirect costs
	Payment claim	None beyond those required to support the direct costs <sup>1</sup>	Invoices Proofs of payment Salary slips (if indirect costs include staff costs) Time sheets Calculation and justification of distribution key (i.e. proportion of indirect costs allocated to the project)
Unit costs for livestock housing paid per animal place or m <sup>2</sup>	Application for support	Template showing number of units, i.e. animal places or m <sup>2</sup> (costs calculated automatically)	Detailed budget Offers
	Payment claim	Intermediary payments (to support starting date and progress of works): - invoice for the groundworks - photo for building including floor, roof and walls Final payments: - Number of units achieved	Cost specification Invoices Proofs of payment

<sup>1</sup> The direct staff costs must be supported by salary slips and evidence of the staff's employment rate (full/part time), but this is the case irrespective of whether flat rates are based on staff costs.

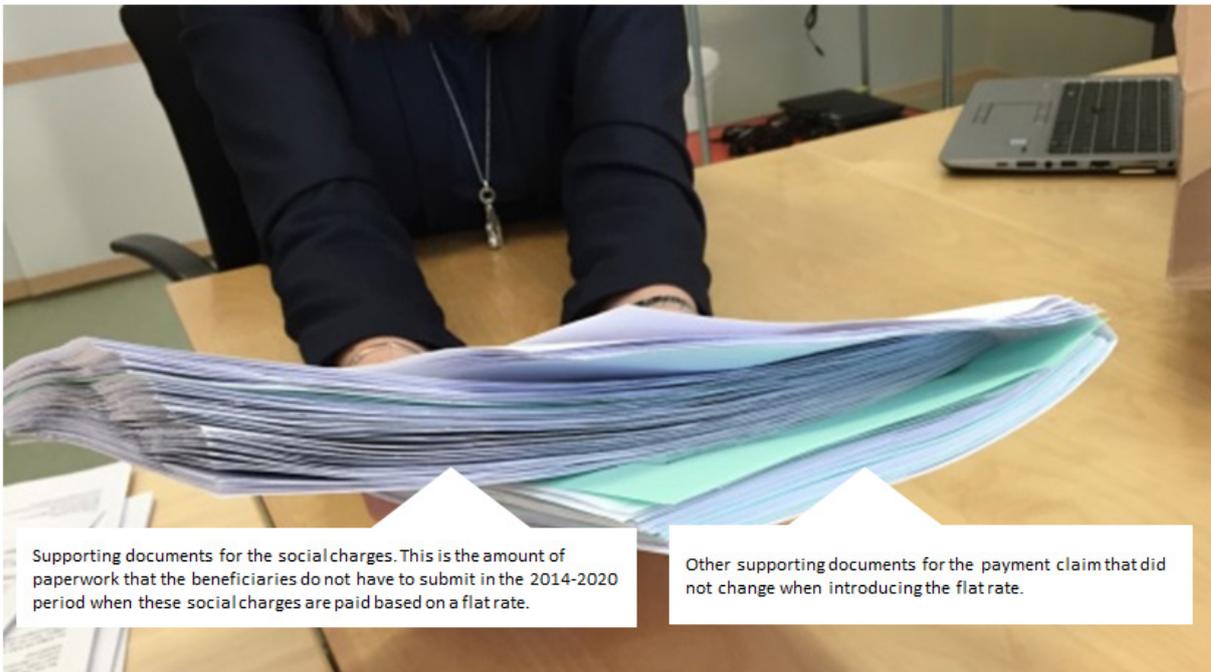
*NB:* The table includes only the supporting documents affected by using SCOs.

*Source:* ECA, based on Member State documentation.

15. As shown in **Table 1**, using SCOs frequently means that beneficiaries have fewer documents to submit. In **Box 3**, we present an example.

### Box 3 – Flat rate for social charges in Sweden

The Swedish Board of Agriculture, in cooperation with the Swedish European Social Fund Council and the Swedish Agency for Economic and Regional Growth, developed a common rate for social security charges. In Sweden, most projects include salaries and hence also social charges. These costs vary based on type of contract and age; they can involve multiple invoices from several organisations and usually complex calculations. Previously, many small beneficiaries did not apply for these charges as they considered it too cumbersome.



The picture shows the documents submitted by a beneficiary for one single payment claim in the 2007-2013 period when the social charges were not paid based on a flat rate.

*... and while authorities face additional workload or costs when preparing methodology ...*

16. Managing Authorities must<sup>13</sup>, if using SCOs, develop a methodology and calculate levels of payment (see **paragraph 45** for an overview of the bodies involved at Member State

<sup>13</sup> Unless using the so called off-the-shelf SCOs described further in **paragraph 19**.

level). This is additional work that is not needed when grants are paid based on costs incurred. To assess whether the time or costs for preparing the methodology and calculations is proportionate to the time savings throughout the period, we interviewed the Member State authorities visited and examined their documentation of methodology and calculations. **Box 4** includes an example of the amount of work involved in developing the methodology.

**Box 4 – The Canary Islands Managing Authority developed its methodology in-house**

The Canary Islands Managing Authority developed unit costs for eight categories of investments in agricultural holdings (irrigation, adaptation of farms, plant material, farm buildings, general infrastructure, greenhouses and other infrastructure, agricultural machinery and general facilities). Each of these categories consists of multiple subcategories (up to 49 per category, 192 in total); the Canarian authorities calculated one unit cost for each of them. The document describing the methodology is 125 pages long, and includes references to other documents only available electronically.

17. During our desk review, we asked the authorities responsible for the 20 selected RDPs for their main reasons for not making more extensive use of SCOs. The most frequent explanation was the wide variety of projects and beneficiaries supported. Six<sup>14</sup> out of 20 mentioned the administrative burden and time-consumed in designing methodologies.

18. Three of the six Managing Authorities visited chose to outsource this task for at least some of their SCOs as they did not have the resources or expertise available in-house: Denmark, Languedoc-Roussillon and Sweden. Despite the additional workload or cost for developing SCOs, the Managing Authorities in the Member States visited found it worth investing in developing the SCO methodology, given the (expected) simplification and time savings at administration and beneficiary level during implementation.

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<sup>14</sup> Ireland, Languedoc-Roussillon (France), Provence-Alpes-Côte d'Azur (France), Tuscany (Italy), Luxembourg and Austria.

19. The legislator can include in the regulations rates and amounts to be used as SCOs. If these SCOs are ready to be used by the Member State authorities without preparing any methodology or calculations, these are called off-the-shelf SCOs. See **Box 5** for examples of off-the-shelf SCOs currently available for rural development support<sup>15</sup>.

**Box 5 – “Off-the-shelf” SCOs in rural development**

Indirect costs: Member States authorities can calculate them as a flat rate of up to 15 % of eligible direct staff costs without having to prepare any calculation to justify the rate used.

Staff costs: Member State authorities can calculate the hourly rate by dividing the latest documented annual gross employment costs by 1 720 hours.

20. For off-the-shelf SCOs provided for in the regulation, such as flat rate compensation for indirect costs, the Managing Authorities do not need to justify the percentage used. This is particularly advantageous for the Member State authorities as they do not need to prepare any methodology, yet can reap the benefits from a simplified application and payment procedure.

***... they save time during administrative checks***

21. Staff of the relevant authorities needs to carry out administrative checks on applications for support and payment claims. We investigated how these checks change when payments are made with SCOs, by examining relevant legislation<sup>16</sup>, Member State procedures and checks carried out for projects paid with and without SCOs. **Table 2** provides examples of this.

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<sup>15</sup> Articles 68(1)(b) and 68(2) of Regulation (EU) No 1303/2013.

<sup>16</sup> Commission Implementing Regulation (EU) No 809/2014 of 17 July 2014 laying down rules for the application of Regulation (EU) No 1306/2013 of the European Parliament and of the Council with regard to the integrated administration and control system, rural development measures and cross compliance (OJ L 227, 31.7.2014, p. 69).

**Table 2 – Comparison of administrative checks for flat rates and unit costs**

Type of SCO	Stage	2014-2020 (with SCOs)	2007-2013 (no SCOs)
Flat rate: indirect costs paid as 15 % of eligible <u>direct</u> staff costs	Application for support	None	Check on reasonableness of costs and justification of the distribution key
	Payment claim	Calculation of 15 % of eligible staff costs <sup>1</sup>	Check on costs incurred and payments made: - Examination of invoices, proofs of payment, salary slips and time sheets (if salaries are included in indirect costs) - Examination and recalculation of distribution key for indirect costs
Unit costs for livestock housing paid per animal place or m <sup>2</sup>	Application for support	Verification of number of units compared to the project scope (costs calculated automatically)	Check on reasonableness of costs, through comparison of offers or another evaluation system such as reference costs
	Payment claim	Verification of quantities claimed	Check on costs incurred and payments made: - Examination of cost specification, invoices and proofs of payment

<sup>1</sup> The eligibility of the direct staff costs must be checked, but this is the case irrespective of whether flat rates are based on staff costs.

*NB:* The table includes only the administrative checks affected by using SCOs.

*Source:* ECA.

22. The Paying Agency staff in the six Member States visited told us that checking the reasonableness of costs<sup>17</sup> used to be time-consuming, especially in the cases where clarifications were needed or the offers were not of sufficient quality. At the payment claim stage, Paying Agencies save time by not checking invoices or proofs of payment when payments are based on SCOs.

23. Before making a payment, Paying Agency staff check compliance with the conditions for receiving support. They compare the completed operation with the operation for which support was granted and normally carry out a visit to verify that the operation has in fact been completed<sup>18</sup>. These checks do not change when using SCOs.

24. For payments based on unit costs, Paying Agency staff needs to verify quantities. Member States can decide for themselves how to check this. Many of them use visits to the beneficiaries to verify the quantities and to ensure that the completed operation is in line with the aid decision. For operations not visited, the Member States need to find other

<sup>17</sup> For more details on checks on reasonableness of costs when support is paid based on costs incurred, see [paragraph 29](#).

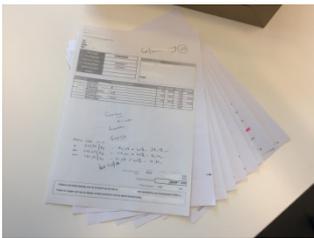
<sup>18</sup> Article 48(3)(a) and 48(5) of Regulation (EU) No 809/2014.

means to verify the quantities involved and that the operation is genuine. The Canary Islands Paying Agency, for example, uses registers of agricultural vehicles to verify ownership, and Denmark uses satellite images to verify the existence of manure storage facilities.

25. When using flat rates, the eligible costs are calculated as a percentage of other categories of eligible costs. All six<sup>19</sup> RDPs selected for an audit visit use flat rates for indirect costs, and the Member State authorities cited this as a good illustration of simplification. An example is provided in **Box 6**.

**Box 6 – Example of documentation for indirect costs**

In Flanders, we compared payment claims, including supporting documentation, from before and after the flat rate was introduced. For the former, we found a single item of 12 euro which was supported by nine documents.



When using flat rates, beneficiaries do not have to submit such documents and the Member State authorities do not need to verify them.

26. The authorities in Saxony told us that the time taken to check payment claims has been cut by at least 50 % due to the reduced checks on indirect costs. In the previous period, verifying each invoice during checks on indirect costs took at least 10 minutes. If a beneficiary claimed rent costs for one year, the administrator would have to check 12 invoices and proofs of payment, which would take approximately 120 minutes. Now, the administrator only needs to check that the calculation of the 15 % indirect costs is correct

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<sup>19</sup> Flanders (Belgium), Saxony (Germany), Canary Islands (Spain), Languedoc-Roussillon (France), and Sweden use flat rates for indirect costs. Denmark used them in 2014-2016, but no measures where indirect costs are eligible are implemented since the start of 2017.

and that no indirect costs are included in the list of invoices declared for direct costs, which takes about 10-15 minutes.

27. The Swedish authorities estimated that checking indirect costs based on costs incurred took 3-5 hours per payment claim, compared to some 50 minutes using a flat rate.

28. Our audit shows that using SCOs can lead to simplification and time savings, mainly for beneficiaries but also for relevant authorities. However, the advance investment needed for the Managing Authority to develop an SCO methodology needs to be proportionate to the expected time savings for authorities and beneficiaries from applying SCOs. This is one of the reasons for the low uptake of SCOs in rural development policy, as discussed below in **paragraphs 48 to 50, 55 to 56**.

#### **GOOD USE OF SCOs CAN HELP CONTAIN THE COST OF RURAL DEVELOPMENT PROJECTS**

29. For projects funded on the basis of reimbursement of incurred costs, national authorities are required to check at the approval stage whether expected costs are reasonable. Both DG AGRI and ECA reports have highlighted weaknesses in these checks (see **Box 7**).

##### **Box 7 – Reasonableness of costs when grants are paid based on costs incurred**

For projects supported based on reimbursement of costs incurred and paid, national authorities typically check whether the project costs claimed are reasonable by: a) examining offers submitted by the applicant together with the application for support, or b) by comparing them with reference prices<sup>20</sup>.

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<sup>20</sup> Article 48(2) of Regulation (EU) No 809/2014.

For the 2014-2016 period, out of 193 projects examined, 66 (34 %) provided insufficient evidence showing that costs were reasonable<sup>21</sup>. The Court has previously questioned<sup>22</sup> whether the Commission and the Member State authorities use the most effective approaches to keep the costs of rural development grants under control.

30. When SCOs are used, these checks are considered covered by developing a sound methodology. Effective use of SCOs can keep the costs of rural development projects under control. Achieving this requires SCOs to be set at the right level, based on a sound methodology, regularly reviewed and updated when needed. Errors in the calculations would mean all projects using the rates would be affected by the same error.

***We found good examples of methodology and calculations ...***

31. We set out to examine the methodologies developed by the Member States visited. We noted that most of the measures supported by the EARFD during the 2014-2020 period are similar to those supported in 2007-2013<sup>23</sup>. Many Member States therefore have access to historical data on actual costs incurred and paid for operations in the previous period. An example of unit costs based on historical data is provided in **Box 8**.

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<sup>21</sup> Annual report of the Court of Auditors on the implementation of the budget concerning the financial year 2016, paragraph 7.39.

<sup>22</sup> Special Report No 22/2014 “Achieving economy: keeping the costs of EU-financed rural development project grants under control” (<http://eca.europa.eu>).

<sup>23</sup> Only three measures were discontinued: early retirement of farmers and farm workers, meeting standards and training and information.

**Box 8 – Methodology based on historical data in Denmark**

Some areas are particularly important for biodiversity. In Denmark, farmers are paid to fence off such areas for grazing on the basis of unit costs. Danish authorities used data from previous projects to develop such unit costs. The calculation is based on the cheapest offers submitted together with 82 applications for support during 2013-2014. They split the offers for these applications into 1-2 wire (52 offers) and 3-4 wire (30 offers) fences, and calculated unit costs as an average of these offers. The calculations resulted in unit costs of 19 DKK (around 2.50 euro)/m for 1-2 wire fences and 28 DKK (around 3.75 euro)/m for 3-4 wire fences.

If fewer than 20 offers of good quality were available for a specific type of expenditure, they carried out market research. They also analysed the spread of the data to ensure the equitable treatment of beneficiaries and concluded that the variation in costs between different regions and for the different materials used was not large enough to justify diversifying SCOs on that basis. Danish authorities plan to assess the need to update their SCO calculation before each annual application round and consider adjusting their SCOs based on a price index.

32. Member States using SCOs generally do not have the means to continue monitoring actual costs. This is because when Paying Agencies switch to making payments based on SCOs, they cease collecting information on real costs. They therefore may not have relevant data available to update their calculations. Because of this in Saxony (Germany), authorities had involved consultants to develop new methodologies based on external expert data in order to update their SCOs when historical data is no longer available.

***... but in some cases the underlying data were not available ...***

33. To assess whether a methodology is fair and equitable, it has to be verifiable. Auditors need to have access to the data underlying the SCO calculation as long as the SCO is used<sup>24</sup>. We selected individual elements of the calculations and traced them back to the source data in order to check verifiability.

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<sup>24</sup> Section 5.2.1.3 of the Commission Guidance on SCOs.

34. The methodology described in **Box 8** (see **paragraph 31**) provides an example where we could easily trace the selected items back to the underlying data. However, we found issues with the verifiability of some of the methodologies developed for unit costs. DG AGRI's auditors reported similar findings on verifiability in two<sup>25</sup> of the six audits that they have carried out to date covering SCOs.

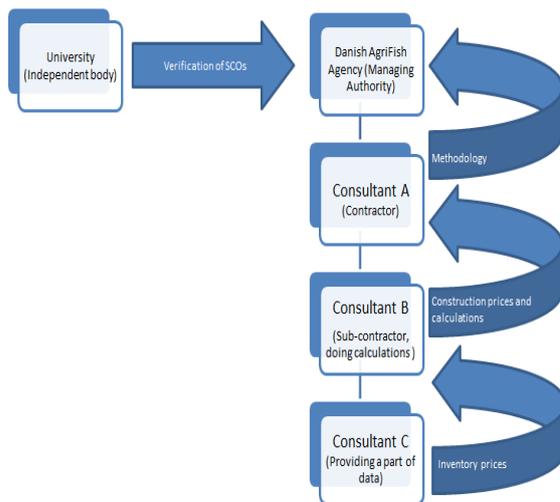
35. In our limited selection of examples, the issues we found related to cases where authorities had outsourced calculations. In Sweden, the Managing Authority had no access to the data underlying some of the calculations and instead relied on independent reviews. In Denmark, the set-up of the outsourcing involved three layers of consultants and complicated the verification process, as explained in **Box 9**.

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<sup>25</sup> Bulgaria and Sweden.

### Box 9 – Involving multiple consultants can complicate verification

The Danish authorities outsourced the development of SCOs to Consultant A. No historical data was available for livestock housing. Consultant A hired a subcontractor (Consultant B) to define unit costs, whom, in turn, requested data from Consultant C. In addition, an independent body reviewed the calculations based on its own expertise and data sources. The figure below gives an overview of the parties involved in developing the unit costs for livestock housing in Denmark.



Around one third of the underlying data was not available at the time of our audit. The Danish authorities informed us that they would need to sign a new contract with the third layer of consultants (Consultant C) in order to obtain the underlying data to support the estimates. Outsourcing and using data from a hierarchy of consultants complicated the process of verifying the calculations and made it time-consuming. The Danish authorities could have avoided this by requesting the underlying data from Consultant A, with whom they signed a contract, or stipulating in the contract that the calculations had to be verifiable.

### ***... or data used for the calculations were not sufficiently justified***

36. Calculations are fair if they are based on reality, and the assumptions and data used for the methodology are well justified<sup>26</sup>. We set out to examine whether this was the case by checking the methodology for selected SCOs in the Member States we visited. We also tested the calculations by tracing a sample of items back to the source data (see also

<sup>26</sup> Section 5.2.1.1. of the Commission guidance on SCOs states: “The managing authority must be able to explain and justify its choices”.

**paragraphs 33 to 35**). In most cases, we found that the methodology and calculations were sound.

37. In one Member State visited, authorities could not justify the data used. The Canary Islands' methodology for unit costs and lump sums states that three offers or invoices are sufficient to establish an SCO. The amount of data used in the actual calculations varies, but on several occasions, the authorities could not justify why and how the specific data used had been selected. An example is provided in **Box 10**.

**Box 10 – Member State authorities could not always explain their selection of data for the SCO calculations**

In one calculation of unit costs for greenhouses, the Canarian authorities used 12 source documents (invoices and offers), of which only four were invoices from past projects. They could not provide us with the total number of invoices available from the 2007-2013 period. Nor were they able to explain how and why they had selected the 12 source documents used in the calculation.

To calculate a lump sum for organising one-day events, the authorities used an average of offers from three hotels, two of which belong to the same hotel group. The Canarian authorities could not explain how or why they had selected those three hotels. Furthermore, the offers used for the calculations included VAT, which is not eligible for rural development support<sup>27</sup>.

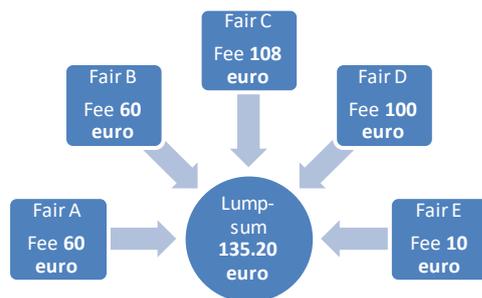
38. In other cases, for calculating the SCOs the authorities used offers that are not comparable. An example is provided in **Box 11**, which also shows that using SCOs does not always bring added value compared to the reimbursement of costs incurred.

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<sup>27</sup> Except when the beneficiary cannot recover the VAT under national legislation.

### Box 11 – Lump sum based on incomparable offers that did not lead to any savings

On the Canary Islands, local action groups that participate in at least two fairs can receive support through a lump sum payment covering the participation fees. The Canarian authorities calculated the lump sum as the average cost of five events multiplied by two. The five events are related to agriculture and livestock, crafts and restoration. Beneficiaries receive the lump sum payment for visiting any two of the events.



Had these activities been reimbursed based on costs incurred, the beneficiary would probably have had to submit two invoices and proofs of payment to substantiate the costs. He or she would also probably have had to submit an invoice or attendance certificate to prove that he or she had attended the two fairs in order to receive the lump sum payment. In this case, using a lump sum payment hardly reduced the volume of documents the beneficiary needed to submit or the number of checks the Paying Agency needed to carry out. Nor did it help to keep project costs under control, as the variation between the offers demonstrates.

### ***Abolition of the independent certification requirement brings new challenges***

39. An independent check is important to ensure that SCOs are based on fair, equitable and verifiable methodologies. Independent checks on the design of an SCO can be carried out before the implementation ('ex-ante') or during or after the implementation ('ex-post'). We set out to obtain an overview of the checks carried out on SCO methodology and found that, for rural development, there had recently been a change in the rules.

40. The introduction of SCOs for rural development was accompanied by a mandatory independent body statement<sup>28</sup>. This was the only independent ex-ante control measure. Recent changes to the legislation<sup>29</sup> mean that investment measures are no longer covered by these statements. As a result, from 2018 onwards there will be no mandatory independent checks on SCO methodologies and calculations. However, the Managing Authorities will still have the option of involving an independent body to establish or review the methodology and calculations.

**The Commission does not examine methodology and calculations during approval of RDPs, but only in some selected audits ...**

41. The Commission reviews and approves RDPs<sup>30</sup>. Validation of the SCO calculations is not part of the RDP approval process.

42. The Commission carries out audits to verify that payments are in conformity with applicable laws<sup>31</sup>. The Commission auditors examine methodologies and calculations if they select expenditure made using SCOs. In 2017, most of the expenditure covered in the audits still related to measures from the 2007-2013 period and was paid based on costs incurred.

43. Errors in an SCO methodology may affect all projects using the SCO in question. Several Member States<sup>32</sup> expressed concerns about potential financial corrections and mentioned

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<sup>28</sup> Article 62(2) of Regulation (EU) No 1305/2013.

<sup>29</sup> In December 2017, Council and Parliament adopted Regulation (EU) No 2393/2017, abolishing the mandatory independent body statement for SCOs in EAFRD, with effect from 2018.

<sup>30</sup> Article 10 of Regulation (EU) No 1305/2013.

<sup>31</sup> Article 52 of Regulation (EU) No 1306/2013 of the European Parliament and of the Council of 17 December 2013 on the financing, management and monitoring of the common agricultural policy and repealing Council Regulations (EEC) No 352/78, (EC) No 165/94, (EC) No 2799/98, (EC) No 814/2000, (EC) No 1290/2005 and (EC) No 485/2008 (OJ L 347, 20.12.2013, p. 549).

<sup>32</sup> Flanders (Belgium), Denmark, Saxony (Germany), Canary Islands (Spain).

this as a barrier to using SCOs. Like other financial corrections imposed by the Commission's auditors, their impact is limited to 24 months of expenditure<sup>33</sup>.

44. For the European Social Fund, the Commission can, at the request of a Member State, validate the SCO methodology and calculations ex-ante. It does this by adopting a delegated act<sup>34</sup>, which creates legal certainty for the Member State. As none of the other European Structural and Investment Funds opted for this mechanism in the Omnibus proposal<sup>35</sup>, it will remain limited to the European Social Fund.

**... and the role of Certification Bodies in auditing SCOs is not specified**

45. Three national bodies are involved in the management and control of funds; their responsibilities relating to SCOs are described in **Figure 4**.

**Figure 4 – Responsibilities at Member State level regarding SCOs**

Managing Authority	Paying Agency	Certification Body
<ul style="list-style-type: none"> <li>• Responsible for SCO design</li> <li>• Prepare SCO methodology and calculations</li> </ul>	<ul style="list-style-type: none"> <li>• Responsible for SCO implementation</li> <li>• Assess applications for support and payment claims based on SCOs</li> </ul>	<ul style="list-style-type: none"> <li>• Annual opinions on the legality and regularity of the expenditure</li> <li>• Check detailed SCO implementation if in their substantive sample</li> </ul>

Source: ECA, based on Regulation (EU) No 1305/2013.

<sup>33</sup> Article 52(4) of Regulation (EU) No 1306/2013 stipulates that financing may not be refused for expenditure effected more than 24 months before the Commission notifies the Member State in writing of its inspection findings.

<sup>34</sup> Article 14(1) of Regulation (EU) No 1304/2013 of the European Parliament and of the Council of 17 December 2013 on the European Social Fund and repealing Council Regulation (EC) No 1081/2006 (OJ L 347, 20.12.2013, p. 470).

<sup>35</sup> In September 2016, the Commission proposed changes to several provisions in its so-called Omnibus regulation (COM(2016) 605 final) that affect the implementation of rural development policy.

46. Independent Certification Bodies issue an annual opinion covering the Paying Agencies' annual accounts, the functioning of the internal control system and the legality and regularity of expenditure<sup>36</sup>. The Commission's guidelines<sup>37</sup> for the Certification Bodies do not mention SCOs<sup>38</sup>.

47. To ensure that costs are kept under control, it is important to set SCOs at the right level. The issues we found with the calculations show that an independent check is needed.

### **THE NEW SCOs COVERED A SMALL PART OF TOTAL SPENDING ON RURAL DEVELOPMENT**

48. At the time of our audit the Commission did not have an overview of the proportion of spending covered by SCOs. Our selection of RDPs included those with the highest apparent use of SCOs<sup>39</sup>, yet we did not find any examples of a full measure being implemented by SCOs.

49. Each rural development measure is divided in several sub-measures, which in turn cover many different types of projects. From our desk review of 20 RDPs we found that the use of SCOs was limited to certain types of projects or expenditure. See **Figure 5** for an example.

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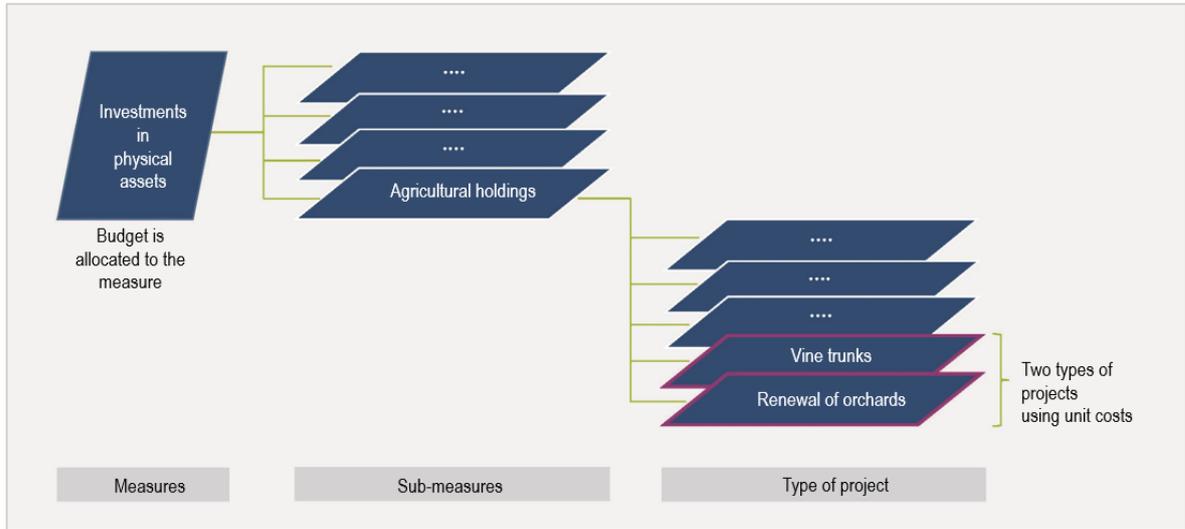
<sup>36</sup> Article 9(1) of Regulation (EU) No 1306/2013.

<sup>37</sup> The Certification Bodies are guided by the Commission's guidelines when carrying out their assessments. For further details on the Certification Bodies' role, see Court's Special Report No 7/2017 "The Certification Bodies' new role on CAP expenditure: a positive step towards a single audit model but with significant weaknesses to be addressed" (<http://eca.europa.eu>).

<sup>38</sup> Guideline 1 on accreditation requirements, Guideline 2 on the annual certification audit, Guideline 3 on reporting requirements, Guideline 4 on the Management Declaration and Guideline 5 on irregularities.

<sup>39</sup> We also used other criteria for our selection, see **paragraph 10**.

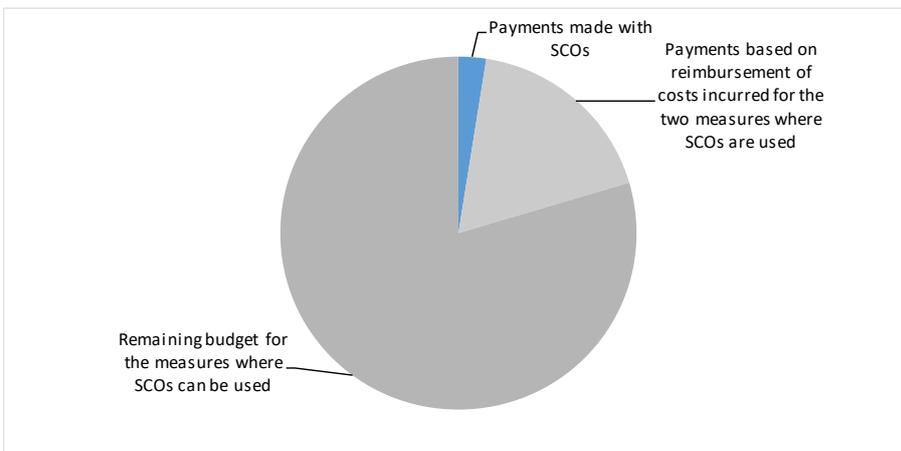
**Figure 5 – SCOs used only for specific project types in Languedoc-Roussillon**



Source: ECA, based on Languedoc-Roussillon RDP.

50. When only part of a sub-measure or a specific type of costs are reimbursed by SCOs, it is not possible to trace the amounts involved. Budgeting within RDPs only extends down to measures, and Member States generally only monitor payments per project (i.e. not for each type of expenditure). However, to demonstrate the impact of SCOs on one particular RDP (Wallonia), in which there are two measures using SCOs, **Figure 6** shows the proportion of the budget for these two measures accounted for by SCOs. For these two measures, the programme uses a 14 % flat rate for indirect costs.

**Figure 6 – Payments expected to be made with SCOs in Wallonia**



Source: ECA, based on Commission documentation.

51. The measures where SCOs are used in the 20 RDPs selected for our desk review are included in ***Annex I***. The most frequently used SCOs are off-the-shelf ones (see ***paragraph 19***); most of the 20 RDPs use flat rates for indirect costs. ***Figure 7*** shows how the different types of SCOs are commonly used.

***Figure 7*** – How SCOs are most commonly used

Standard scales of unit costs	Lump sums	Flat rate financing
<ul style="list-style-type: none"> <li>• Mainly used for staff costs and travel allowance</li> <li>• Used for specific types of investment projects, for example: livestock housing paid per animal place, fences paid per meter</li> </ul>	<ul style="list-style-type: none"> <li>• Lump sums is the least used SCO</li> <li>• Used for setting up an European Innovation Partnership Group: a one-off payment for establishing the group and developing a project plan</li> </ul>	<ul style="list-style-type: none"> <li>• Mainly used for indirect costs</li> <li>• The off-the-shelf flat-rate for indirect costs is the most used SCO</li> </ul>

Source: ECA, based on desk review of 20 RDPs.

52. Unit costs are mostly used for staff costs<sup>40</sup>, travelling costs or accommodation allowance<sup>41</sup>. For full projects, unit costs are mostly used for investments in physical assets<sup>42</sup>. ***Figure 8*** shows the types of SCOs used in the six RDPs selected for an audit visit.

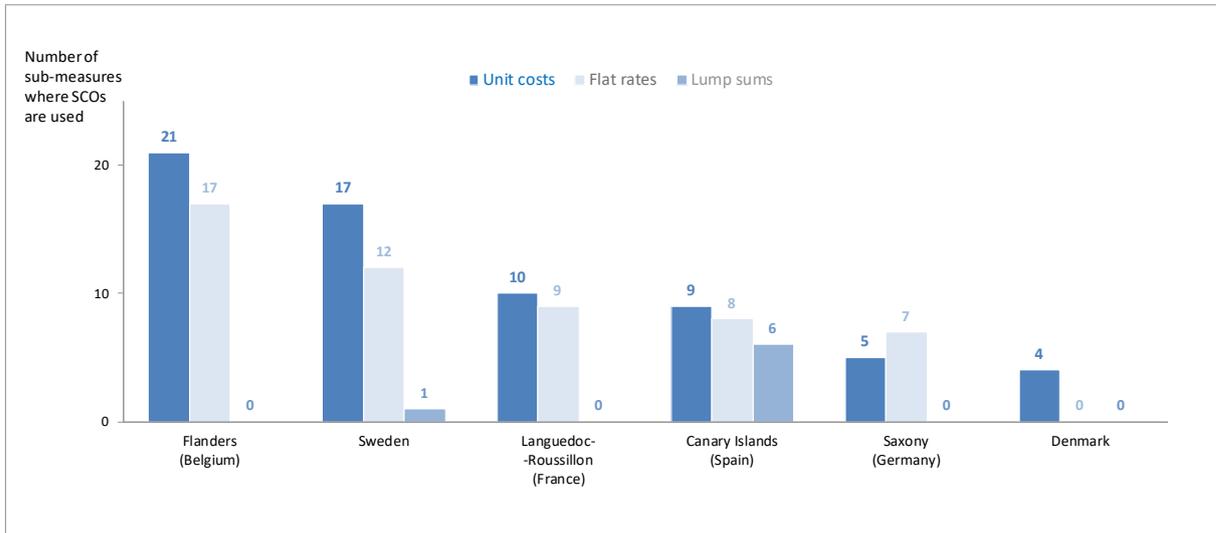
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<sup>40</sup> E.g. Flanders (Belgium), Canary Islands (Spain), Languedoc-Roussillon (France), Croatia, Cyprus, Netherlands and Sweden.

<sup>41</sup> E.g. Languedoc-Roussillon (France), Croatia, Austria and Sweden.

<sup>42</sup> E.g. Denmark, Spain, Languedoc-Roussillon (France), Provence-Alpes-Côte d'Azur (France) and Sweden.

**Figure 8 – Unit costs and flat rates are most used in the selected RDPs, while lump sums are rarely used**



*NB:* SCOs are only used for specific types of projects or cost categories, never for a complete measure. The figure shows the number of sub-measures applying each type of SCO in the selected RDPs. Different types of SCOs can be used for the same sub-measure. The figure thus does not give an indication of the total expenditure made using SCOs but merely shows the preferred types of SCOs.

*Source:* ECA based on Member State documentation.

***SCOs were not given priority in the preparation of the 2014-2020 RDPs, but the Commission does encourage their use***

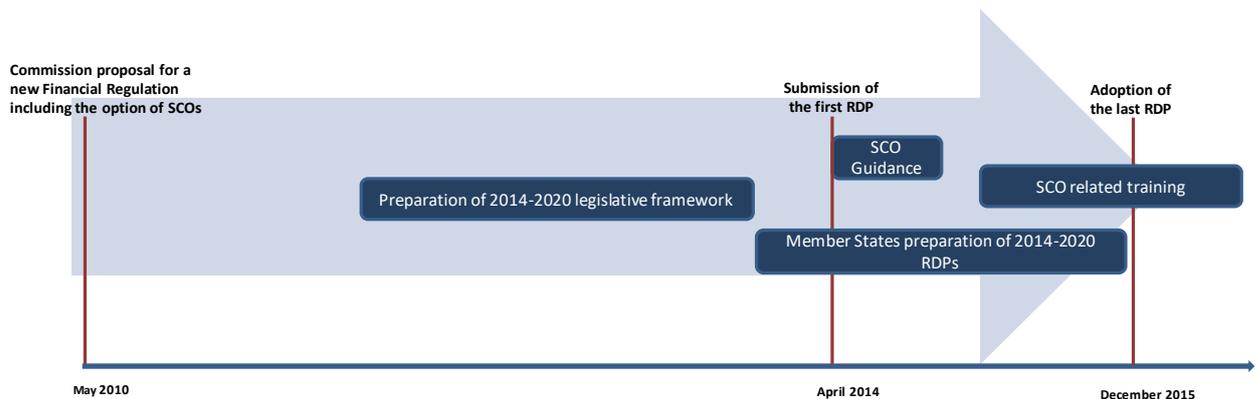
53. Parliament and Council approved the rules for the 2014-2020 period in December 2013<sup>43</sup>. The four DGs<sup>44</sup> responsible for the European Structural and Investment Funds prepared a common guidance document<sup>45</sup> (the Commission guidance on SCOs), and published the final document in September 2014. **Figure 9** shows the timeline for the preparation of the 2014-2020 RDPs.

<sup>43</sup> Regulations (EU) No 1303/2013, 1305/2013 and 1306/2013.

<sup>44</sup> DG REGIO, DG EMPL, DG MARE and DG AGRI.

<sup>45</sup> European Commission: Guidance on Simplified Cost Options (SCOs). European Structural and Investment (ESI) Funds.

**Figure 9 – SCO timeline: from proposal to guidance and training**



Source: ECA.

54. The four DGs managing the European Structural and Investment Funds have commissioned a study on SCOs, which is currently ongoing. The study collects information, through a survey, about measures and types of SCOs used in each of the funds, the amounts involved and the projects implemented using SCOs, as well as the benefits of using SCOs. The Commission aims to use this information when developing the rural development framework for the next period (post-2020).

***The wide variety of measures and beneficiaries make it difficult to use SCOs, but they can be used for a wide range of investments***

55. For the 2014-2020 period, there are 118 different RDPs in the 28 Member States, with 20 single national programmes and eight Member States opting for regional programmes<sup>46</sup>. Depending on specific economic, natural or structural conditions, RDPs can include up to 20 measures contributing to the achievement of the EU's rural development priorities<sup>47</sup>.

<sup>46</sup> Belgium (2), Germany (15), Spain (19), France (30 RDPs), Italy (23), Portugal (3), Finland (2) and the UK (4).

<sup>47</sup> Based on Annex I of the Commission Implementing Regulation (EU) No 808/2014, the rural development priorities address: (1) knowledge transfer and innovation; (2) farm viability and competitiveness, sustainable forest management; (3) food chain organisation, risk management and animal welfare; (4) environment and climate change; (5) resource efficiency, low carbon and climate resilient economy; and (6) social inclusion, poverty reduction and economic development.

56. Using SCOs makes most sense when there are a certain number of similar operations or types of expenditure. The authorities responsible for the 20 RDPs selected for our desk review cited diverse types of operations and beneficiaries as the main reason for not using SCOs more extensively. The measures supported by the European Agricultural Fund for Rural Development (EAFRD) are divided into sub-measures. There are 49 different sub-measures for which SCOs can be used (listed in [Annex I](#)). Many different types of projects and/or expenditure can be supported under each sub-measure.

57. Despite the diversity of projects and types of expenditure in rural development policy, we found examples of where SCOs had been developed for a wide range of investments. For instance, the Canary Islands RDP includes unit costs for eight categories of investments in agricultural holdings, see [Box 12](#).

**Box 12 – Unit costs can be developed for a wide range of investments, but they only bring advantages when applied to a certain number of projects**

The Canarian authorities have developed separate unit costs for eight categories of investments in agricultural holdings: irrigation, adaptation of farms, plant material, farm buildings, general infrastructure, greenhouses and other infrastructure, agricultural machinery and general facilities. Each of these categories consists of multiple sub-categories (up to 49 per category, 192 in total); the Canarian authorities calculated one unit cost for each of them.

58. However, when the number of projects is limited for a certain type of investment, SCOs do not add any value. For example, the Canarian authorities have developed a unit cost for purchase of a mist collector. The unit cost is based on one offer from the only supplier available. At the time of our audit, only one project had purchased a mist collector. Rural development projects make least use of lump sums. Three of the six Member States visited<sup>48</sup> indicated that they chose not to use lump sums because they considered them riskier. In order to receive a lump sum payment, a beneficiary must fulfil all conditions – partial payments are not possible.

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<sup>48</sup> Saxony (Germany), Canary Islands (Spain) and Languedoc-Roussillon (France).

59. The Member States also have the possibility of combining different types of SCOs for one type of project, so can limit lump sums to activities where all conditions need to be fulfilled in order to achieve the desired results. For example, the Canary Islands RDP includes all three SCO types – unit costs, lump sums and flat rates – for projects supported under the measures on cooperation and on support for Leader local development (see **Box 13**). The option of combining different types of SCOs provides flexibility in the way SCOs can be used.

**Box 13 – Example of how different SCOs can be used for one project**

For projects supported under the measure on cooperation, beneficiaries on the Canary Islands can receive payments combined from the three types of SCOs. For example, a payment for a project creating and developing short supply chains and a local market could be made up of:

- A lump sum for promotional activities in written press and specialised magazines to raise awareness about, and communicate the benefits of, the short supply chain and local market;
- Unit costs for staff costs involved in the project; and
- A flat rate of 15 % for indirect costs.

60. Member State authorities can take advantage of methodologies or rates already developed for national or EU schemes when they introduce SCOs. We found several RDPs<sup>49</sup> using travel allowances or unit costs for staff costs from national systems. However, based on our desk review of 20 RDPs, Member State authorities rarely use experience from other policy areas when developing SCOs. We found just two examples of this (see **Box 14**).

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<sup>49</sup> Flanders (Belgium), Languedoc-Roussillon (France), Croatia, Netherlands, Sweden.

**Box 14 – Examples of using an existing methodology**

Tuscany's RDP uses unit costs and lump sums<sup>50</sup> for supported projects promoting vocational training and skills acquisition. The RDP uses three different unit costs for training activities, depending on their length (less than 20 hours; 21 to 60 hours; more than 60 hours) and a lump sum for coaching activities. The amounts set for unit costs and lump sums are based on methodologies already developed and used during 2007-2013 and 2014-2020 by the regional Operational Programme on competitiveness and employment, funded by the European Social Fund.

Cyprus' RDP uses unit costs for travel and daily allowances from Erasmus+ for short-term farm and forest management exchanges and farm and forest visits.

***Member State authorities are concerned about Commission audits***

61. During our audit visits, several Member State authorities mentioned that they were uncertain as to how the Commission examines SCOs, and some cited this as a barrier to using SCOs<sup>51</sup>. During visits to Member States Commission staff check Member States' management and control systems using a list of key and ancillary controls<sup>52</sup>. We examined DG AGRI's audit approach and found that their definitions of these controls had not been updated for the introduction of SCOs. Updating the Commission's definitions of key and ancillary controls to reflect SCOs is one way to address the Member States' concerns. The checks relevant to SCOs are presented in ***Figure 10***.

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<sup>50</sup> The Tuscan authorities introduced these SCOs in their first amendment of the RDP, which they submitted to the European Commission in July 2016.

<sup>51</sup> E.g. Denmark, Saxony (Germany) and Canary Islands (Spain).

<sup>52</sup> Only weaknesses in key controls can lead to financial corrections.

**Figure 10 – Administrative checks the Commission expects Member State authorities to carry out for SCOs**

<p>Key control: Appropriate evaluation of the reasonableness of costs</p> <ul style="list-style-type: none"> <li>• Methodology and calculations of the SCO</li> </ul>	<p>Key control: Appropriate checks on the eligibility of the costs</p> <ul style="list-style-type: none"> <li>• Correct application of the SCO at the application stage</li> </ul>	<p>Key control: Adequate verification of all payment claims</p> <ul style="list-style-type: none"> <li>• Correct application of the SCO at the payment claim stage</li> </ul>	<p>Ancillary control: Adequate audit trail</p> <ul style="list-style-type: none"> <li>• Traceability of data used for the calculations</li> </ul>
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Source: ECA, based on interviews and Commission documentation.

62. In this context, we have developed a list of common assurance requirements and performance principles in **Annex II.1 and II.2**.

63. Despite the challenges discussed above, five of the six Member State authorities visited envisage more extensive use of SCOs in the future. For instance, Sweden wanted to use lump sums more in its initial 2014-2020 RDP but was limited by the (now abolished) provision that SCOs must be approved ex-ante<sup>53</sup>.

***Recent changes to the legislation may encourage more use of SCOs in rural development***

64. In September 2016, the Commission proposed changes<sup>54</sup> to several provisions that affect the implementation of rural development policy. In October 2017, Council and Parliament agreed to remove, with effect from 2018, a rural development-specific provision<sup>55</sup> that limited the use of SCOs.

65. The agreed changes further harmonise the rules between the European Structural and Investment Funds and increase the possibilities of using SCOs. The abolition of an ex-ante certification of the methodology and calculations for the EAFRD may facilitate wider use of SCOs. The ex-ante certification meant that SCOs had to be established at an earlier stage for the EAFRD than was the case, for example, for the European Social Fund. For the latter, it is

<sup>53</sup> Article 62(2) of Regulation (EU) No 1305/2013.

<sup>54</sup> COM(2016) 605 final (Omnibus regulation).

<sup>55</sup> Article 62(2) of Regulation (EU) No 1305/2013, which for the EAFRD required an ex-ante certification of methodology and calculations.

sufficient to establish SCOs no later than at the time of granting the aid, which is now also the case for the EAFRD. Further proposals affecting the use of SCOs for the EAFRD are still being discussed by Council and Parliament; they are outlined in **Box 15**. If adopted, these additional changes will widen use of SCOs.

**Box 15 – Proposed changes to the legislation increase the possibilities of using SCOs**

Proposed amendments of Article 67 and 68 of Regulation (EU) No 1303/2013 would mean:

- Ceiling for lump sums abolished;
- Draft budgets established on a case-by-case basis allowed for all European Structural and Investment funds;
- Direct staff costs for an operation may be calculated at a flat rate of up to 20 % of direct costs other than the staff costs for that operation; and
- A flat rate of up to 40 % of eligible staff costs may be used to cover the remaining eligible costs for an operation without Member States needing to calculate the applicable rate.

66. The possibility of basing SCOs on a draft project budget means that SCOs can be established for an individual operation while assessing the application for support. Swedish and Finnish authorities informed us that they had already considered using lumps sums based on draft budget for several measures until the Commission informed them that this was not possible for the EAFRD<sup>56</sup>.

**SCOs HAVE NOT BEEN LINKED TO A GREATER FOCUS ON RESULTS**

***SCOs shift the focus from invoices to output but do not lead to greater focus on results***

67. One reason given to promote more extensive use of SCOs is the potential for increased focus on output and results. The Commission guidance on SCOs includes several references to this effect<sup>57</sup>. For RDPs selected for an audit visit, we examined individual projects to check

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<sup>56</sup> Finland: measure 1, 7, 16 and 19; Sweden: measure 1, 2, 7, 16 and 19.

<sup>57</sup> For example, section 1.3 states that the use SCOs is recommended if Member States want ESIF management to focus more on outputs and results instead of inputs, and section 1.2.2 mentions

that the Member State authorities focused their verifications on output or results rather than invoices, and whether the eligibility of the SCO payment had been determined based on the achievement of planned output or results. We also compared payments made with and without SCOs.

68. We found examples of project output and results contributing to a measure's objectives (see **Box 16** for one of them), but no indication that the results achieved were better than they would have been with reimbursement of costs incurred.

**Box 16 – Output-based payments in Saxony**

Saxony's RDP finances building natural stone walls on the basis of unit costs. Natural stone walls are intended to help to restore, preserve and enhance biodiversity in steep and hilly vineyards. Payments are based on m<sup>2</sup> of wall constructed.



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Beneficiaries apply for aid only after receiving an assessment of the environmental value from a nature protection expert. After completing the project, beneficiaries claim the number of units (m<sup>2</sup>) realised. The Saxon authorities visit the beneficiaries to verify the quantities claimed. They explained that this, together with the nature protection expert's assessment, is how they ensure that project output contributes to achieving the desired results.

69. SCOs could be differentiated based on desired results, as long as they reflect costs and equal treatment of beneficiaries is ensured. This is one of several possibilities for achieving a greater focus on results (others include using selection criteria and varying the 'aid intensity',

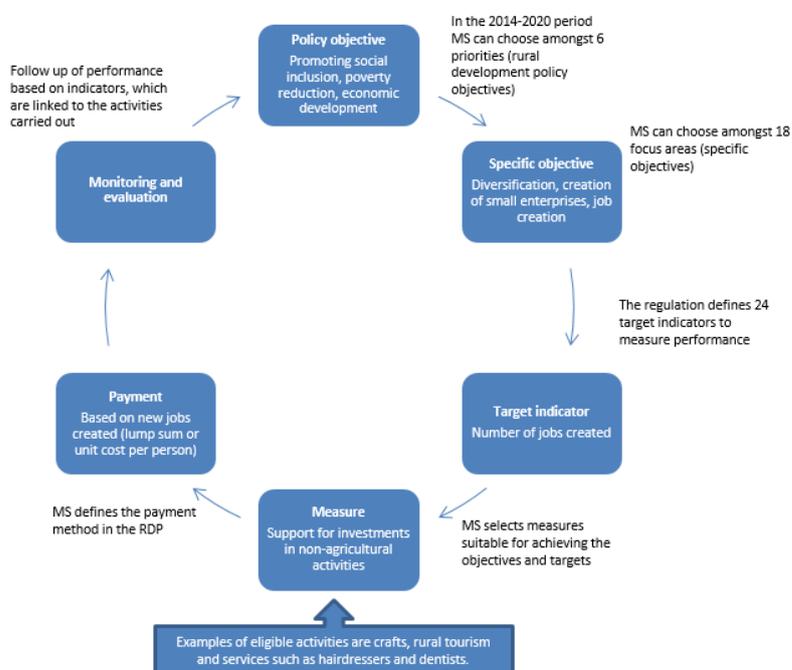
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as an advantage of simplified cost options that "eligible costs are calculated according to a predefined method based on outputs, results or some other costs". Specifically for unit costs, section 3.1 mentions that, as well as being process-based (aimed at covering the real costs through a best approximation), these can be outcome based (output or result) or defined based on both an approximation of the real costs and outcome.

i.e. the percentage of the project supported by the EAFRD). We did not find any examples of where this had been done in practice.

70. The Commission monitors the implementation of rural development policy through the Common Monitoring and Evaluation System (CMES). The CMES sets indicators<sup>58</sup> at EU level: reporting from Member States needs to be comparable in order for any evaluation of the policy to be meaningful. The indicators are meant to reflect policy objectives, thus we looked for a link between these and the payments as illustrated with a fictive example in **Figure 11**.

**Figure 11 – There should be a link between objectives, indicators and SCO payments**



Source: ECA.

71. In most cases, we could not establish a direct link between the payments for the selected projects and the indicators. In reality, CMES indicators, set at EU level, do not monitor the implementation of rural development policy at project level, so it would not be feasible to base SCO payments on them. Nevertheless, in order to monitor the results of the policy, operations financed under the EAFRD need to be clearly linked to one of its

<sup>58</sup> Annex IV of Regulation (EU) No 808/2014.

objectives. Improving the link between payments and objectives for individual projects could contribute to a greater focus on achieving objectives.

***The Commission has proposed moving towards results-based payments***

72. Recent proposed changes to the legal framework<sup>59</sup> also introduce, in addition to more possibilities for using SCOs, the option of results-based payments. Specifically, the Commission proposed that Article 67 of European Parliament and Council Regulation (EU) No 1303/2013 include the option of financing that is not linked to costs for the relevant operation but is rather based on meeting conditions related to progress in implementation or the achievement of programme objectives.

**CONCLUSIONS AND RECOMMENDATIONS**

73. Using SCOs has several potential advantages. The administrative burden may decrease as there is no need to trace every euro back to individual supporting documentation. The beneficiaries provide, and the Member State authorities check, fewer documents.

74. By basing the payments on output, SCOs shift the focus away from invoices but do not increase the focus on results. SCOs can keep the costs for rural development projects under control, but only if they are based on a sound methodology and fair, equitable and verifiable calculations. Planned results-based payments have the potential to increase the emphasis on performance and generate a greater focus on achieving objectives.

75. Our audit shows a shift and overall reduction of the administrative burden. While Managing Authorities invest (time or money) in methodology and calculations in advance, staff saves time when checking applications for support and payment claims and beneficiaries have fewer documents to submit (see **paragraphs 13 to 18, 21 to 22, 26**).

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<sup>59</sup> Amendments of Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002 and Regulation (EU) No 1303/2013 proposed by the Commission in COM(2016) 605 final.

76. If SCOs are used effectively, they can keep the costs of rural development projects under control. However, ensuring costs are reasonable requires the application of a sound methodology so that levels of financing are set at the right level (see **paragraphs 33 to 38**).

77. Although there is no legal requirement to update the methodology or calculations, based on the principles of sound financial management the calculations should be up to date for the SCO to reflect reality.

#### **Recommendation 1**

The Commission should update its guidance on SCOs to cover key principles for developing methodologies. This should include:

- minimum data-requirements;
- acceptable variation in prices used; and
- consideration of data sets containing extreme values and volatile data.

Target implementation date: 2018.

78. The Commission does not assess the SCO methodology or calculations during its approval of the RDPs. DG AGRI auditors cover SCOs in their audits if they select payments made with SCOs, but do not systematically select Member States or RDPs using SCOs. Certification Bodies are functionally independent bodies but their role in auditing SCOs is not specified. This leads to a risk that SCOs are not examined by an independent body (see **paragraphs 40 to 47**). In this context, the requirements and principles included in **Annex II.1 and II.2** could be relevant for bodies using and checking SCOs, including the Certification Bodies (see **paragraph 62**).

**Recommendation 2**

The Commission should clarify who is required to check the methodology and calculation of SCOs.

Specifically, the Commission should, taking into account the assurance requirements set out in Annex II.1, clarify the Certification Bodies' role and include in its guidance for the Certification Bodies specific reference to the audit of SCOs and related internal control systems.

Target implementation date: 2018.

79. Our audit shows that SCOs remain a marginal part of rural development spending. The most significant reason for this is the difficulty of establishing cost measures for a large and diverse range of projects, activities and beneficiaries. This contributes to the significant investment needed to develop the SCO methodology. Developing SCOs is only useful where many projects are similar or have similar expenditure. SCOs are not suitable to all types of operations and expenditure but could still be used more often and better (see **paragraphs 16 to 17, 48 to 51**). While the regulations allow use of SCO methodologies and rates developed in other policy areas, we found that Member States rarely take advantage of this possibility.

80. The legislator can include in the regulations rates and amounts to be used as SCOs. A particular advantage with these off-the-shelf SCOs is that Member State authorities do not have to establish any methodology or calculations (see **paragraphs 19 to 20**). However it is important that such rates be soundly based, and properly coordinated with costs financed on the basis of invoices and other documentation.

**Recommendation 3**

To facilitate the appropriate use of SCOs, the Commission should

- explore the options for further developing soundly based off-the-shelf SCOs; and
- update its definitions of key and ancillary controls to reflect the use of SCOs.

Target implementation date: 2018.

81. Although the Commission promotes an increased focus on output and results as one of the reasons for using SCOs, we have not found an increased focus on results. SCOs shift the focus from invoices to output, but we found no indications that better results were achieved with SCO payments compared to reimbursement of costs incurred.

82. The new results-based payments introduced in the Commission's Omnibus proposal open up for the possibility to make payments that are not tied to costs. Their success will depend on the Commission's guidance and on the Member States' willingness to take up this new form of financing.

**Recommendation 4**

The Commission should examine the potential for moving away from reimbursement of costs incurred towards reimbursement based on results. In doing so, the Commission should take on board experience gained from introducing SCOs.

Target implementation date: 2018.

This Special Report was adopted by Chamber I, headed by Mr Phil WYNN OWEN, Member of the Court of Auditors, in Luxembourg at its meeting of 7 March 2018.

*For the Court of Auditors*

Klaus-Heiner LEHNE

*President*

## RURAL DEVELOPMENT MEASURES WHERE SCOs ARE USED FOR 20 RDPs

Measure	Sub-measure	Flanders (Belgium)	Wallonia (Belgium)	Bulgaria	Denmark	Saxony (Germany)	Estonia	Ireland	Greece	Spain	Langue-doc-Roussillon (France)	Provence-Alpes-Côte d'Azur (France)	Croatia	Tuscany (Italy)	Veneto (Italy)	Cyprus	Luxembourg	Netherlands	Austria	Finland	Sweden	
Knowledge transfer and information actions	1.1	X		X			X	X	X	X	X	X	X					X	X	X	X	
	1.2			X		X	X			X	X				X				X	X	X	X
	1.3			X												X				X		
Advisory services, farm management and farm relief services	2.1			X									X									X
	2.2													X								
	2.3												X									X
Quality schemes for agricultural products and foodstuffs	3.1																					
	3.2										X								X	X		
Investments in physical assets	4.1				X					X	X	X		X					X			X
	4.2																		X			
	4.3					X						X							X			
	4.4				X	X	X								X				X		X	X
Restoring agricultural production potential damaged by natural disasters and introduction of appropriate prevention	5.1																					
	5.2																					
Farm and business development	6.4																					
	7.1	X									X									X	X	
	7.2	X																				
	7.3																				X	
	7.4	X																			X	
	7.5	X																				X
	7.6	X				X					X									X	X	
	7.7	X																				
	7.8	X																				
Investments in forest area development and improvement of the viability of forests	8.1	X		X	X											X				X		
	8.2	X																				
	8.3						X					X				X						
	8.4			X			X									X				X		
	8.5	X		X	X	X							X			X				X		X
	8.6						X													X		
Forest environmental, climate services and conservation	15.2																					
	16.1			X		X				X		X		X					X	X	X	X
	16.2	X		X		X				X	X	X		X					X	X	X	X
	16.3	X	X				X			X										X	X	X
	16.4	X		X						X		X								X	X	X
	16.5	X				X				X		X		X						X	X	X
	16.6	X																			X	
	16.7										X											
	16.8																			X		
	16.9	X	X												X					X	X	X
	16.10	X					X													X	X	
Risk management	17.1																					
	17.2																					
	17.3																					
Support for LEADER local development (CLLD)	19.1	X	X	X		X	X													X		X
	19.2	X	X			X	X				X									X	X	X
	19.3	X	X	X		X	X													X	X	X
	19.4	X	X	X		X	X			X	X	X				X				X	X	X
Technical assistance	20.1						X						X									
	20.2						X						X									
<b>No of sub-measures where SCOs are used</b>		21	6	13	4	12	14	1	1	9	10	9	6	1	7	6	0	14	21	18	17	
<b>Total no of non-area/animal related sub-measures in the RDP</b>		30	18	29	21	20	28	14	30	31	23	23	26	36	32	26	8	16	36	25	26	
<b>% of sub-measures using SCOs</b>		70%	33%	45%	19%	60%	50%	7%	3%	29%	43%	39%	23%	3%	22%	23%	0%	88%	58%	72%	65%	

NB: The list includes the 49 rural development sub-measures where SCOs can be used in the 2014-2020 period. There are no sub-measures fully implemented by SCOs. SCOs are only used for specific types of projects or expenditure supported under the respective sub-measures.

Source: ECA based on Member State information and the measures defined in Regulation (EU) No 808/2014.

**1. ASSURANCE ON SCOs**

**Introduction: We discussed these key requirements with the Commission services responsible for the European Structural and Investment Funds; they are relevant for all bodies using and checking SCOs. The extent to which these requirements will be covered in a particular audit depends both on the scope of the work performed and on the extent of the use of SCOs in expenditure examined.**

<b>Requirement</b>		<b>Approach</b>
<b>Design (methodology and calculations of SCOs)</b>	The MS uses only SCOs that are allowed under EU and national rules.	Analyse the EU and national rules: <ul style="list-style-type: none"> <li>• ensure that the type of SCOs used are compatible with these; and</li> <li>• identify any limitations to the types of operations for which SCOs can be used and verify that SCOs are being used for types of operations and cost categories that are allowed.</li> </ul>
	The SCO is established based on one of the methods allowed in the legislation.	Analyse the EU and national rules and identify the methods allowed for establishing SCOs.  Verify that the SCO is established using one of the methods identified in the legislation (e.g. a fair, equitable and verifiable calculation method, use of existing EU or national schemes, use of specific rates or methods from the regulations).  If specific rates or methods specified in the regulations are used, there is no need to check the design.
	The SCO covers only eligible costs.	Ensure that the methodology for defining the SCO includes only costs that are eligible based on EU and national rules.
	If a combination of SCOs or different reimbursement mechanisms is used for the same operation, double declaration of costs is avoided.	Verify that a single type of expenditure for an individual beneficiary can only be financed once.  If an operation is partially reimbursed based on real costs actually incurred, verify that these costs are not also paid as part of the SCO.  If a lump sum and unit costs are used for the same type of operation, verify that the calculation of the lump sum does not cover the elements reimbursed based on unit costs.  For flat rates, ensure that there is a comprehensive definition of, and a clear distinction between, the cost categories to which the rate is applied and the cost category reimbursed by the flat rate.

Requirement	Approach
<p>If SCOs are based on existing EU or national schemes, these schemes should address similar types of beneficiaries and operations.</p> <p>The calculation of the SCO is fair: reasonable and based on reality, not excessive or extreme.</p> <p>The SCO calculation is equitable: it does not favour some beneficiaries or operations over others.</p> <p>The SCO calculation is verifiable: based on documentary evidence that can be verified as long as the SCO is in use.</p>	<p>Assess whether the types of beneficiaries and operations supported by the SCO are similar. Check this on a case-by-case basis, for instance by assessing whether the type of beneficiary would have been eligible under the EU/national scheme used as a basis for the SCO.</p> <p>Verify that the parameters used from the existing methodology (for example the geographical scope) are also valid for the types of operations for which it will be used.</p> <p>Verify that the MS authorities have justified their assumptions and data used for the methodology and SCO calculation.</p> <p>Analyse the SCO amounts or rates and verify that the assumptions and data used to establish them are based on average operations/beneficiaries or, alternatively, that amounts or rates are diversified based on objective justifications.</p> <p>Verify that the body determining the SCO has kept adequate records of:</p> <ul style="list-style-type: none"> <li>• the description of the methodology (including key steps of the calculation);</li> <li>• the sources of the data used, including an assessment of the relevance and quality of the data; and</li> <li>• the calculation itself.</li> </ul> <p>Verify the data used for the SCO calculation on a sample basis and ensure that there is an adequate audit trail.</p>
<p>Design - Management and control system (only insofar as it concerns SCOs)</p> <p>The management and control system includes relevant checks related to the design of SCOs.</p>	<p>Check the MS procedures and assess whether they include provisions for a functionally independent review of the methodology and calculations of SCOs.</p> <p>Check that the review is carried out when relevant and that it covers the applicable above key requirements.</p>
<p>Implementation (payments based)</p> <p>SCOs used in practice are established in advance.</p>	<p>Examine the call for proposals and ensure that it includes a reference to the use of SCOs.</p> <p>By examination of the document setting out the conditions for support, verify that the SCO amount or rate used was communicated at the latest in the aid decision.</p>

Requirement	Approach
	<p>Verify in the document setting out the conditions for support for a sample of operations that the pre-defined terms of agreement clearly specify the deliverable required in order to receive the SCO-based payment.</p>
	<p>Verify that the pre-defined deliverables are completed and that the conditions for receiving support are met (through physical inspection or by obtaining other concluding evidence).</p> <p>For lump sums and unit costs: verify that the pre-defined conditions have been fulfilled. For unit costs, verify the number of actual eligible units.</p> <p>For flat-rate financing, verify that the amount established is based on categories of eligible costs defined in the methodology. Verify the actual costs incurred and paid to which the rate is applied and ensure that these are in accordance with the document setting out the conditions for support.</p>
	<p>Check that the calculation of the payment is based on the SCO established in accordance with the applicable rules at the time of granting the support (if the rate or amount of the SCO has been revised, check that the correct rates are used).</p> <p>Test the calculation of the payment mathematically for a sample of operations (unit costs: number of implemented units multiplied with the unit cost, lump sum: equals aid decision, flat-rates: % of the defined categories of costs).</p> <p>In the event that the value of the costs to which the flat rate is applied was modified, verify that the amount calculated based on the flat rate was also proportionally adjusted.</p>
<p>Implementation - Management and control system (only insofar as it concerns SCOs)</p>	<p>Review the MS procedures and assess whether they include administrative checks on the realisation of the operation, fulfilment of the pre-defined terms, and verification of the units (for unit costs) and the categories of eligible costs (for flat-rate financing).</p>
	<p>For a sample of payments, examine the administrative checks and verify that they were carried out in accordance with the checks defined in the management and control system.</p>

**2. PERFORMANCE OF SCOs**

**Introduction: This section provides examples of principles which may be relevant for auditing performance; other may be developed depending on the scope of the audit. In addition, audit criteria will need to be developed for each of the principles.**

<b>Principle</b>		<b>Approach</b>
Economy	The SCOs are set at the right level.	Check that, for a given level of outputs or results, the SCOs could not have been designed or implemented in a way which would have resulted in significantly lower costs.
	The need for indexation or updating the methodology and data used for the calculation is evaluated periodically.	Verify (through examination of procedures, previous updates or inquiry) that the MS authorities periodically evaluate the need for updating the assumptions used for the SCO methodology and the data used for the calculation. Check that the calculations have been updated if relevant.  If SCOs are based on existing EU or national schemes, check whether the methodology used for the original scheme was modified during the period, and if this was the case, verify that the SCO has been modified accordingly.
Efficiency	The time spent on and cost of preparing the SCO methodology and calculations is proportionate to the savings during implementation throughout the period.	Enquire about the resources needed for establishing the methodology as compared to the time savings during implementation. Analyse whether using SCOs for this particular type of operation, beneficiary and/or cost category is efficient.
	The administrative checks are simplified to reflect the use of SCOs.	Examine the MS procedure and checklists for administrative checks to ensure that: <ul style="list-style-type: none"> <li>• the costs actually incurred are not checked for categories of expenditure reimbursed by SCOs;</li> <li>• expenditure certified to the Commission is calculated on the basis of certified quantities;</li> <li>• for unit costs and lump sums the checks are focused on output and outcome; and</li> <li>• for flat rates, the verification focuses on the eligible costs to which the rate is applied.</li> </ul>
Effectiveness	SCOs are focused on achieving output and results.	Check that the deliverables expected from the beneficiary in order to receive an SCO-based payment are clearly linked to achieving policy objectives.

## **REPLIES OF THE COMMISSION TO THE SPECIAL REPORT OF THE EUROPEAN COURT OF AUDITORS**

### **"NEW OPTIONS FOR FINANCING RURAL DEVELOPMENT PROJECTS: SIMPLER BUT NOT FOCUSED ON RESULTS"**

#### **EXECUTIVE SUMMARY**

I. The Commission enhanced the Simplified Cost Options in 2014 with the aim to further simplify the delivery of certain rural development measures. It was clear on the outset that this alternative method of cost reimbursement was unlikely to significantly increase the focus on results. As such, the approach of SCO should lead to the same results as conventional reimbursement systems, though in a simpler and quicker way.

IV. The Commission considers that SCOs alleviate significantly the administrative burden, and the human resources and administrative effort involved in the management of the Fund can be focused more on the achievement of policy objectives instead of being concentrated on collecting and verifying financial documents.

V. The Commission has clarified and plans to further clarify the role of Certification Bodies as to the audit of the SCO methodology in the Expert Group Meetings for Certification Bodies.

VI. The Commission considers that SCO is a novelty for non-area and non-animal-related expenditure. It needs some time to be taken up by Member States. However, some SCOs are currently being introduced through RDP amendments.

VII.

First bullet: The Commission accepts this recommendation and has already started to update the guidance document mainly to include the changes that will be introduced by the Omnibus CPR regulation.

Second bullet: The Commission accepts this recommendation.

The Commission accepts the need to clarify some aspects concerning the verification of the methodology and calculation for SCOs in the updated guidance. The Certification Bodies currently provide an opinion on the internal control systems, as well as of the legality and regularity of expenditure, including compliance with applicable law as regards SCOs. However, their role in auditing SCO could be further clarified.

Third bullet: The Commission accepts this recommendation and will update the list of key and ancillary controls to reflect the use of SCOs. The Commission has included more off-the-shelf SCOs in the Omnibus CPR.

Fourth bullet: The Commission accepts the recommendation. The Commission is reflecting, as set out in the Communication on the Future of Food and Farming, on ways to move to systems which base Member State reimbursement on policy delivery.

#### **OBSERVATIONS**

##### **Box 3 – Flat rate for social charges in Sweden**

The example from Sweden very appropriately demonstrates the potential administrative benefits from using SCO instead of actual costs incurred.

28. The Commission considers that the investment needed to develop the SCO methodology is later on compensated by the time saving of the competent authorities during the submission and processing of the applications for support and the payment claims.

#### **Box 7 – Reasonableness of costs when grants are paid based on costs incurred**

Second indent: The assessment of reasonableness of costs is the responsibility of the Member States. Moreover, the offers or the reference prices are just two of the options on how this assessment is to be carried out (Article 48(2)(e) of Regulation (EU) No 809/2014 refers to them as 'such as' options). The Commission protects the EU budget when weaknesses are identified through conformity procedures and issues guidance on how to improve the systems in place (see Guidance on rural development controls and sanctions, including a checklist presented by ECA in Special Report 22/2014 for the assessment of reasonableness of costs).

30. The Commission notes that according to the applicable legal framework (Articles 67 and 68 Regulation No (EU) 1303/2013), when SCO amounts are developed on the basis of the methodology, they do not necessarily need to be updated nor reviewed during the programming period. However, even though there is no legal basis to require updating calculations, a SCO might need to be updated if proven that it is not fair (i.e. it does not reflect average market costs) anymore.

34. The Commission fully shares the view that the underlying data for calculating the SCOs should be available for possible verification. This is also mentioned in the ESIF Guidance document for SCOs published in 2014.

#### **Box 10 – Member State authorities could not always explain their selection of data for the SCO calculations**

As outlined before, the Commission fully shares the view that the underlying data for calculating the SCOs should be available for possible verification and Managing Authorities should be capable to explain their decisions regarding the underlying data used.

However, it should also be taken into account that, for certain specialised materials and services, it is difficult to obtain even three offers from providers/manufacturers, all the more if they are to be provided in Outermost Regions and in limited quantities (for example, small tractors to be used in steep landscapes, materials resistant to tropical conditions, special machinery, etc.).

#### **Box 11 – Lump sum based on incomparable offers that did not lead to any savings**

The Commission considers that this observation cannot be generalised as it does not cover all cases: attendance to fairs can involve various categories of eligible expenditure which all summed up could indeed lead to additional burden to administration and beneficiary. SCOs are especially recommended for small grants and, for other ESI Funds, they are even compulsory.

40. The Commission notes the recent change in the legislation has streamlined the approach with other ESI Funds, for which the independent statement is not necessary. In practice, there were SCOs that Member States could not use because of the need to submit an independent statement via a programme modification. As ECA notes, Member States may still choose to involve an independent body to review the methodology and calculations. Therefore the Commission considers that this abolition brings simplification and should rather be seen as an opportunity than a challenge.

42. The Commission's conformity audits are not solely targeted to SCOs. In order to obtain reasonable assurance that the expenditure financed by the EAFRD on the selected measures has been applied for and spent in conformity with EU rules, the assessment of the SCOs is done on a sample basis as part of the systems audit carried out. Otherwise, the SCOs would be the only scope of the audit and no other issues could be audited.

43. The Commission considers that financial corrections are not barriers, but rectifications in case of non-compliance with the rules (infringement of EU law, breach of the contract) and they do not depend on the methodology of calculating costs.

The Commission (ESI funds DGs) continues providing guidance to the Member States on SCOs. Several information sessions were organized for the Member States, where also the auditors were involved. Clarifications were provided whenever Member States had questions related to SCO methodology.

44. Such option for all ESI Funds could be burdensome for the Commission, while the use of SCOs is precisely to reduce administrative burden for authorities.

46. The Commission's guidelines for Certification Bodies are general and cannot cater to specific processes such as SCOs, which may or may not be applicable to each Paying Agency.

47. The independent check does not necessarily ensure that the system is error proof. The Commission notes that even when this audit was carried out the obligation to have an independent body to certify the methodology was still applicable, and as ECA demonstrated this has not mitigated the risk of errors in the calculations. On the contrary, SCOs payments under other ESI Funds, where no independent check is necessarily carried out, seem to be less prone to errors.

48. On the basis of a recent study on "Use and intended use of simplified cost options in European Social Fund (ESF), European Regional Development Fund (ERDF), Cohesion Fund (CF) and European Agricultural Fund for Rural Development (EAFRD)" the Commission has an overview on the use and intended use of SCO.

56. The Commission considers that SCO payments can be used in principle for all types of operations even if the diversity of projects supported under the EAFRD may require initial investment in the designing of the methodology.

58. See Commission reply to paragraph 56.

61. The Commission auditors indeed check the design and implementation (correct application) of SCOs whenever they are used in the implementation of the measure(s) within the scope of the audit. The Commission is considering making SCOs more explicit in the key and ancillary controls in a future revision of the document.

62. The Commission stresses that the Certification Bodies should not follow the performance principles set in Annex II.2. In the current legal framework, these principles go beyond the scope of the Certification Bodies' audit work which is clearly laid down in Article 9 of Regulation EU 1306/2013.

63. The Commission considers that this observation proves the relevance of the decision to remove the certificate taken by the legislator.

67. The Guidance suggests that the use of SCOs is to reduce administrative burden for authorities and beneficiaries, enabling the administrative effort involved in the management of the Fund to focus more on the achievement of policy objectives instead of being concentrated on collecting and verifying financial documents.

68. There is no indication that the use of SCOs will help in achieving *better* results compared to real costs. SCO reimbursement system should lead to the same results as conventional reimbursement systems, though in a simpler and quicker way. See Commission reply to paragraph 67.

69. While the definition of selection criteria and aid intensity are means to increase the targeting of the interventions (e.g. towards certain beneficiaries or areas), the application of SCO leads to administrative simplification compared to the standard ways of reimbursing beneficiaires

(invoices). The former methods help to increase policy performance, the latter lead to administrative efficiency gains.

Common Commission reply to paragraph 70 and 71.

Policy performance is based on the effective interaction of supported interventions in view of policy objectives. CMES indicators are means to assess policy performance. Therefore, they are based on the activities carried out, and not on how those activities are paid out. According to the intervention logic there cannot be a direct link between policy objectives and payments to beneficiaries.

Operations supported by rural development are clearly linked to the objectives of the policy through the focus areas under which they are placed.

72. This option of "payments on fulfilling conditions" to be introduced by the Omnibus CPR regulation is not considered as an SCO (payment to beneficiaries) but a new form of financing based on which the Commission could reimburse Member States. The new provision in the CPR, stemming from a similar proposal introduced in the amendments to the Financial Regulation (Article 121), provides for the possibility to reimburse Member States based on the fulfilment of conditions related to the realisation of progress in implementation or the achievements of objectives of programmes as laid down in the delegated acts (to be adopted).

## **CONCLUSIONS AND RECOMMENDATIONS**

74. The Commission does not agree with the direct linkage between payment at project level and results, as explained in Commission replies to paragraphs 69-72.

75. Managing Authorities need to invest time in the methodology only when SCOs are established in line with Article 67(5)(a) of Regulation (EU) No 1303/2013. However, there are other possibilities provided for in Article 67(5)(b) to (e) and 68 which do not require developing a methodology.

77. In the absence of legal requirements for regular updating, it is within the responsibility of the Member States to assess whether SCO might need to be updated if proven that it is not fair (i.e. it does not reflect average market costs) anymore. See also Commission reply to paragraph 30.

### **Recommendation 1**

The Commission accepts this recommendation. The Commission will revise the guidelines by providing some examples of best practices and further information.

78. As part of the review of the internal control system, the Certification Bodies are expected to check the procedures for SCOs in order to review the design of the process. In addition, they test some transactions against the list of key and ancillary controls to see if the Paying Agency's checks are properly designed and implemented. This is developed in the guidelines to the Certification Bodies to be applied mandatorily from Financial Year 2019 onwards, and voluntarily in Financial Year 2018.

Moreover, during the statistical substantive testing of files, the Certification Bodies should check in detail the payment claim, the Paying Agencies' controls (administrative and/or on-the-spot) and the payment calculation. In case the Certification Body has already reviewed the procedure, only the arithmetical accuracy of the payment calculation may need to be verified.

In respect of the SCO methodology, in some cases, the Certification Bodies reviewed it.

The Certification Bodies role in auditing SCO was clarified in the workshop on SCOs during the November Expert Group for Certification Bodies and will be further clarified in Expert Group Meetings.

### **Recommendation 2**

The Commission accepts the recommendation.

The Certification Bodies currently provide an opinion on the internal control systems, as well as of the legality and regularity of expenditure, including compliance with applicable law as regards SCOs. The role of the Certification Bodies should be further clarified and the Commission considers that this part of the recommendation is currently being implemented. The guidelines are clear as to the audit work to be performed by Certification Bodies for SCOs at Paying Agency level.

The Commission has clarified and plans to further clarify their role as to the audit of the SCO methodology in the Expert Group Meetings for Certification Bodies. See Commission reply to paragraph 78.

79. The Commission considers that SCO is a novelty for non-area and non-animal-related expenditure. It needs some time to be taken up by Member States. However, some SCOs are currently being introduced through RDP amendments.

### **Recommendation 3**

The Commission accepts this recommendation as follows:

First bullet: The Commission considers this sub-recommendation as implemented since new off-the-shelf SCOs have been included in the Omnibus CPR regulation. The Commission will continue exploring the options to develop more off-the-shelf SCOs to be included in future legislation but it is not in a position at this stage to make specific commitments.

Second bullet: The Commission will update the definition of key and ancillary controls to reflect the use of SCOs.

81. The use of SCOs is to reduce administrative burden for authorities and beneficiaries, enabling the administrative effort involved in the management of the Fund to focus more on the achievement of policy objectives instead of being concentrated on collecting and verifying financial documents. There is no indication that the use of SCOs will help in achieving better results compared to real costs. SCO reimbursement system should lead to the same results as conventional reimbursement systems, though in a simpler and quicker way.

82. The new provision in the CPR provides for the possibility to reimburse Member States based on the fulfilment of conditions related to the realisation of progress in implementation or the achievements of objectives of programmes and will be laid down in delegated acts (to be adopted).

### **Recommendation 4**

The Commission accepts this recommendation.

While the Commission is not in a position at this stage to make specific commitments in relation to legislative proposals for the post 2020 period, the Commission is reflecting, as set out in the Communication on the Future of Food and Farming, on ways to move to systems which base Member State reimbursement on policy delivery. At the same time, the Commission will continue to encourage Member States to use SCOs to facilitate reimbursement of beneficiaries.

<b>Event</b>	<b>Date</b>
Adoption of Audit Planning Memorandum (APM) / Start of audit	8.3.2017
Official sending of draft report to Commission (or other auditee)	23.1.2018
Adoption of the final report after the adversarial procedure	7.3.2018
Commission's (or other auditee's) official replies received in all languages	9.4.2018

Simplified cost options (SCOs) can bring simplification and may decrease the administrative burden for both beneficiaries and Member State authorities. However, they only constitute a small part of rural development spending during the 2014-2020 period. By basing payments on output, SCOs shift the focus away from invoices but do not increase the focus on results. We found that SCOs can keep the costs of rural development projects under control, but only if set at the right level and based on a fair, equitable and verifiable methodology.



EUROPEAN  
COURT  
OF AUDITORS



Publications Office

EUROPEAN COURT OF AUDITORS  
12, rue Alcide De Gasperi  
1615 Luxembourg  
LUXEMBOURG

Tel. +352 4398-1

Enquiries: [eca.europa.eu/en/Pages/ContactForm.aspx](https://eca.europa.eu/en/Pages/ContactForm.aspx)

Website: [eca.europa.eu](https://eca.europa.eu)

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