ENGLAND EUROPEAN REGIONAL DEVELOPMENT FUND OPERATIONAL PROGRAMME 2014 TO 2020

ELIGIBILITY GUIDANCE

November 2018

Eligibility Guidance

Contents

Note: Separate, self-contained, guidance has been produced on:-

Revenue generating projects;
Priority Axis 4, including energy efficiency and renewable energy in housing;
Document retention;
Output indicator definitions;
Funding agreements (capital and revenue);
Performance management strategy;
State Aid Law;
National Procurement Requirements

1. Purpose and scope of the guidance

This handbook is a source of guidance and information for potential applicants, grant recipients and their delivery partners and also MHCLG. It provides a practical interpretation of the National Eligibility Rules covering the 2014-20 England European Regional Development Fund: https://www.gov.uk/government/publications/european-structural-and-investment-funds-eligibility-documents

The Handbook has been developed and informed by questions raised on the Eligibility Rules by grant applicants and the MHCLG Growth Delivery Teams. It will be updated where appropriate to take account of policy developments and new questions that arise.

However, the information contained within this handbook does not constitute legal advice. The Ministry for Housing, Communities and Local Government does not accept any liability with regard to the use of the contents of this document.

2. Who can apply for ERDF

Undertakings in Difficulty

Undertakings in difficulty as defined under the State Aid rules should not be supported, in accordance with Article 3.3(d) of the ERDF Regulation (EU) No 1301/2013.

The definition under State Aid rules that should be used when assessing whether an undertaking constitutes and undertaking in difficulty is set out in the General Block Exemption Regulation (GBER), No 651/2014 .   Article 2 para 18:

"'undertaking in difficulty' means an undertaking in respect of which at least one of the following circumstances occurs:

> *(a) In the case of a limited liability company (other than an SME that has been in existence for less than three years or, for the purposes of eligibility for risk finance aid, an SME within 7 years from its first commercial sale that qualifies for risk finance investments following due diligence by the selected financial intermediary), where more than half of its subscribed share capital has disappeared as a result of accumulated losses. This is the case when deduction of accumulated losses from reserves (and all other elements generally considered as part of the own funds of the company) leads to a negative cumulative amount that exceeds half of the subscribed share capital. For the purposes of this provision, 'limited liability company' refers in particular to the types of company mentioned in Annex I of Directive 2013/34/EU (1) and 'share capital' includes, where relevant, any share premium.*
>
> *(b) In the case of a company where at least some members have unlimited liability for the debt of the company (other than an SME that has been in existence for less than three years or, for the purposes of eligibility for risk finance aid, an SME within 7 years from its first commercial sale that qualifies for risk finance investments following due diligence by the selected financial intermediary), where more than half of its capital as shown in the company accounts has disappeared as a result of accumulated losses. For the purposes of this provision, 'a company where at least some members have unlimited liability for the debt of the company 'refers in particular to the types of company mentioned in Annex II of Directive 2013/34/EU.*
>
> *(c) Where the undertaking is subject to collective insolvency proceedings or fulfils the criteria under its domestic law for being placed in collective insolvency proceedings at the request of its creditors.*
>
> *(d) Where the undertaking has received rescue aid and has not yet reimbursed the loan or terminated the guarantee, or has received restructuring aid and is still subject to a restructuring plan.*

(e) In the case of an undertaking that is not an SME, where, for the past two years:

(1) the undertaking's book debt to equity ratio has been greater than 7,5 and

(2) the undertaking's EBITDA interest coverage ratio has been below 1,0."

N.B. All parts of the test must be applied (as appropriate) in order to determine whether an organisation is an undertaking in difficulty.

Applicants for ERDF support to the Managing Authority

All non-public sector applicants applying for ERDF funding will be subject to a financial due diligence assessment. This assessment tests that financial health of the applicant organisation, its on-going sustainability, its ability to manage the cash flow requirements of ERDF funding, and its ability to repay ERDF funding if necessary.

The due diligence assessment will include an assessment of whether the undertaking is an undertaking in difficulty.

Organisations identified as being undertakings in difficulty are ineligible for ERDF support and their application will be rejected.

Support provided by ERDF Grant Recipients to Businesses

Organisations delivering ERDF projects (with the exception of those delivering financial instruments, which have specific requirements) that provide assistance to businesses must put in place proportionate systems and controls to mitigate the risk of ERDF support being provided to undertakings in difficulty.

These systems and controls must be applied in all cases where support is provided to undertakings, regardless of the approach being taken to manage State Aid. For example, if ERDF support is provided as de minimis aid, the regulation for which does not prohibit support to undertakings in difficulty, the grant recipient must consider the business's eligibility to receive de minimis aid and whether the business is an undertaking in difficulty and therefore ineligible for ERDF support. Grant recipients must keep evidence of compliance with state aid and ERDF requirements in respect of undertakings in difficulty.

N.B that the provision of state aid to undertakings in difficulty is generally excluded under the General Block Exemption Regulation (GBER), No 651/2014. The approach in respect of ERDF in no way alters the requirements under the General Block Exemption Regulation (GBER). If ERDF support is bring provided under the GBER grant recipients must consider whether beneficiaries of support are undertakings in difficulty regardless of the level or type of support being provided. **If an undertaking is an undertaking in difficulty it cannot be supported by ERDF under GBER.**

The systems and controls put into place must take account of the type of support being provided and the value of that support.

In cases where the ERDF support is revenue based e.g. advice, guidance, workshops, conferences and events, grants for consultancy support, graduate placement schemes, among others, the following process must be used.

If the ERDF support to the undertaking is valued at less than £50,000[1] the ERDF grant recipient must establish a system that:

- Collects a self-declaration from undertakings that they have read the definition of an undertaking in difficulty as set out in the General Block Exemption Regulation (GBER), No 651/2014 and that the undertaking is not an undertaking in difficulty.

  This may be done as a standalone declaration or as part of other routine, pre-support, evidence gathering e.g. demonstrating compliance with the General Block Exemption Regulation (GBER), No 651/2014 or as part of the assessment of prior support and proposed aid under the De Minimis Regulation no 1407/2013.

- Makes this evidence available for scrutiny during verification or audit visits.

- Retains evidence of the self-declaration in line with ERDF document retention requirements.

  Care must be taken to ensure that all of the support provided to an undertaking by the project is taken into account. For example, if support of £25,000 is provided to an undertaking and, subsequently, a further £25,000 is provided the £50,000 threshold has been met and a formal assessment is required (see below). This assessment of the value of support should be undertaken separately from any assessment of whether further aid is permissible under the relevant state aid approach, in particular de minimis aid.

If the ERDF support to the undertakings is valued at £50,000 or more the ERDF grant recipient must establish a system that:

[1] Calculated using the gross grant equivalent value of the support

- Includes a formal financial assessment of the undertaking in line with the definition of undertakings in difficulty set out in Article 2 para 18 of the General Block Exemption Regulation (GBER), No 651/2014

- Makes this evidence available for scrutiny during verification or audit visits.

- Retains evidence of the assessment in line with ERDF document retention requirements.

In cases where the ERDF support is in the form of grants towards eligible capital expenditure (as described on p25 of this document) e.g. *inter alia* construction of or improvements to premises, the purchase of plant and equipment, the ERDF grant recipient must establish a system that:

- Includes a formal financial assessment of the undertaking in line with the definition of undertakings in difficulty set out in Article 2 para 18 of the General Block Exemption Regulation (GBER), No 651/2014

- Makes this evidence available for scrutiny during verification or audit visits.

- Retains evidence of the assessment in line with ERDF document retention requirements.

This must be applied in all cases where a grant is provided towards eligible capital expenditure, regardless of the value of grant or the ERDF element of it and the approach being taken to manage state aid. There is no threshold where support is provided as a grant towards capital expenditure and the managing authority will not accept a self-declaration.

Undertakings that are delivery partners in ERDF projects.

Organisations that are undertakings in difficulty may not receive ERDF funding as a named delivery partner in an ERDF operation. Organisations delivering ERDF projects that involve delivery partners are responsible for ensuring that their delivery partners are not undertakings in difficulty.

The applicant/grant recipient must establish a system that:

- Includes a formal financial assessment of the undertaking in line with the definition of undertakings in difficulty set out in Article 2 paragraph 18 of the General Block Exemption Regulation (GBER), No 651/2014

- Makes this evidence available for scrutiny during verification or audit visits.

- Retains evidence of the assessment in line with ERDF document retention requirements.

The applicant/grant recipient must consider whether named delivery partners are undertakings in difficulty regardless of the amount of ERDF the delivery partner will receive or whether the expenditure relates to capital or revenue activity**.**

Retention of Evidence.

ERDF applicants/grant recipients should retain evidence to demonstrate they have fully considered the definition of undertakings in difficulty set out in Article 2 para 18 of the General Block Exemption Regulation (GBER), No 651/2014. As a minimum this includes:

- Evidence that the undertaking's company status was considered – to establish whether paragraph 'a' or 'b' of the definition applies.
- Evidence that the undertaking's accounts were reviewed in line with paragraph 'a' or 'b' of the definition and this established that the organisation is not an undertaking in difficulty.
- Evidence that the undertaking is not in liquidation, drawing on the accounts and companies house records (paragraph 'c' of the test)
- Evidence of a self-declaration from the undertaking in respect of paragraph 'd' of the definition. A self-declaration is acceptable in respect of this paragraph of the test, but only this paragraph.
- Evidence that the undertaking's status against the SME definition was considered and where the undertaking is not an SME applied paragraph 'e' of the definition.
- If an organisation receiving ERDF support as an end beneficiary or a delivery partner is not considered to be an undertaking and therefore not subject to review against the undertakings in difficulty definition, the justification for this decision must be documented and retained.
- All evidence must be retained in line with ERDF document retention requirements.

Effective date for expenditure

The Eligibility Rules advise that expenditure **from the date of the letter inviting a full application** will only be agreed if the following criteria are met (section 7.2 refers) unless there are exceptional circumstances:-

" 7.2. All cases for retrospection must be subject to:-

- *The applicant agreeing, in writing, to accept any financial liabilities should the project subsequently fail to receive full approval;*
- *the applicant and operation meeting any Managing Authority retrospection criteria;*
- *the case for retrospection being supported by strong, clear, written evidence and subsequently fully agreed by the Managing Authority; and*
- *any additional retrospection tests to be carried out by the MA being fully undertaken and passed before payment is made."*

In practice, the term "Retrospection" (or pre grant funding agreement expenditure) applies to expenditure incurred between the date of the letter inviting a full application and the date of the grant funding agreement. Any expenditure prior to the date of the letter inviting a full application will be deemed ineligible.

3. Match funding

Public sector organisations - definition

For an organisation, and consequently, its match funding to be classified as public sector, the organisation should either directly or indirectly receive over 50% of its main funding from central or local government. (This does not include payment for work carried out by private enterprises for the public sector.)

In order to decide if an organisation can supply public match funding, the relevant Growth Delivery Team should work out the organisation's previous financial year's receipts, excluding any ERDF contributions, and the income forecast for the following year, again excluding any ERDF. If over 50% of the net amount (after deductions) comes from central or local government sources, that organisation is able to provide public match funding for ERDF supported projects.

Voluntary organisations

Non-profit making organisations, whether incorporated or unincorporated, that are registered with the Charity Commission can supply public match funding. The registration must be maintained throughout the period of the ERDF project. Public match funding can also be provided by private bodies designated or controlled by the State.

Contributions in Kind

The National ERDF Eligibility Rules state that Contributions in Kind are ineligible as match funding except for the donation of a building or land.

The amount of in kind match funding provided in the form of **land** is restricted to a maximum of 10% of the total eligible costs of the project. Note, the 10% cap does not apply in the case of building valuations as contributions in kind, but the value of the building must be the present value, not the value after completion of the project.

A donation of this kind can be made by a third party to the final beneficiary or the final beneficiary may make a donation to the project. All donations must be evidenced in writing and supported by independent valuations appropriate to the nature and timescale of the donation.

The value of the land or building donated must have been recently (we suggest not more than 12 months before the full application is submitted) certified by an independent, appropriately qualified person/body on the basis of current open market value *(recognising any applicable restrictions, encumbrances or outgoings).* The level of funding to be included in the project will be proportionate to the timescale for which the land/building is donated. It will be necessary to demonstrate that the land or building (or relevant part) will be dedicated exclusively for use for the delivery of the project either:

- For the project lifetime;
- For the economic life of the building; or
- Another appropriate period.

The value of the building or land will need to be apportioned if for example, the building or land has been donated for project use for a limited period of time which could be the project lifetime, for example 5 years and will then be taken back by the owner. In such cases only the value of the asset for that period of time could be included as an eligible cost. The value included would be the rental/lease figure which would be attributed for the relevant period of time. If the land/building is donated on a permanent basis or for the useful economic lifetime of the asset then the full value can be included as match funding, subject to the 10% restriction on donations of land.

In projects where such donations are agreed as part of the project costs it will be necessary to reflect the nature of the donation in the funding agreement. In some cases where the asset is donated for its useful economic lifetime it may be necessary to place a restriction on the title of the asset being donated.

Bank loans

Loans from banks, building societies etc may be used as match funding. The loan should have been secured by the time the ERDF funding agreement has been co-signed by the applicant, so that the project can be delivered.

Capital / Revenue Match Funding

There is nothing in the regulations that prevents beneficiaries from using capital expenditure as match for revenue ERDF, or vice versa, and the European Commission is generally unconcerned over issues relating to capital/revenue. It is therefore potentially permissible where:

- Eligible activities that are wholly and fully integrated as part of a holistic single project/operation that, as a whole, can demonstrate a need for the ERDF grant;
- The capital and revenue activities are mutually dependent on each other in order to deliver against the relevant objectives and targets specified in the Operational Programme, specific Call for Proposals and the project Funding Agreement;
- Profiled expenditure on the combined capital and revenue project gives an overall project intervention up to the maximum Priority intervention rate specified within the Operational Programme;
- All capital and revenue activities are eligible for ERDF funding; and

- Special conditions are included in the Funding Agreement to ensure that the combined project intervention rate is kept below the Operational Programme maxima.

Where it is not possible to present financial tables with ERDF and match split evenly between capital and revenue, different intervention rates for capital and revenue may be used. These need to be balanced when combined to give an overall project intervention rate in line with Operational Programme maxima.

However, this approach carries an increased level of risk, and the further the capital and revenue intervention rates deviate from one another the more pronounced the impacts and therefore the level of risk. The additional risk predominantly relates to:

- The potential impacts of under-spending against capital or revenue on the level of ERDF available and, consequently, potential impacts on project performance / viability; and
- The implications for irregularities / clawback where the capital and revenue intervention rates differ.

The appraisal process should consider the likelihood and impact of these additional risks to inform the selection / approval decision and any supplementary conditions for the funding agreement.

Additional monitoring will be required to ensure that the combined intervention rate is maintained and MA intervention may be required to manage situations where capital / revenue spend deviates from profiles.

<u>Scenario: Broadband project</u>

Capital funding for infrastructure from BDUK used as match for ERDF capital to enhance infrastructure and a relatively small amount of ERDF revenue to fund demand stimulation and maximisation.

The revenue intervention rate of more than 50% is balanced by the capital intervention rate of less than 50% to give an overall project intervention rate of 50%.

Decision taken to proceed based on the fact that:

- The capital programme was considered unlikely to deviate from profile significantly;
- Any shortfall in capital match expenditure could be rebalanced at project level relatively easily by a reduced revenue programme of activity; and
- The grant recipient was prepared to accept the additional risks associated with different capital and revenue intervention rates.

No / Limited business support would have occurred without matching capital with revenue. The business support was an essential element of the project to ensure that businesses were maximising growth and jobs benefits from the infrastructure investment. The project has contributed towards the Businesses Assisted target and delivered significant job and GVA increases which would not otherwise have been possible.

Match Funding - SME Contributions

Background

The purpose of this guidance is to explain how to account for SME contributions in an ERDF funded project. SME contributions to projects supported by ERDF are defined as the financial contribution towards the cost of support made by the beneficiary business (end beneficiary / end user).

These contributions are important both in demonstrating the commitment of SMEs to undertaking and benefiting from the support programmes available, and in reducing the requirement for public sector funds as under certain circumstances, explained further in this guidance note, the SME contributions can be considered as eligible match funding.

Public sector funding is intended to encourage and increase private sector investment; this is particularly significant in the context of an ongoing reduction in public sector resources. In addition, the commitment of the SME in contributing to the cost of the support marks one of the steps in addressing the imperfect information market failure on the benefit of business advice / support in helping SMEs to set up, sustain and/or grow their business. They do not initially see the benefit of such support, resulting in individuals not starting a business or SMEs either not taking up any support or making sub-optimal choices on the individual support they require.

Eligibility Rules

The ERDF National Eligibility Rules for 14-20 provides the following:

"*6. Match Funding*

The contribution from European Regional Development Fund finances only a specified percentage of the total eligible costs of a project. The percentage is based on different factors:-

(i) The categorisation of the region (as 'less developed', 'more developed' or 'transitional');

(ii) State Aid, either General Block Exemption Regulation or any other notified scheme, together with the size of the enterprise where they are a grant applicant

(whether Small, Medium or Large) will also have an effect on the (total) level of permissible funding; and applicants should be fully aware of the effect of accumulation of aid, particularly if one undertaking is conducting a number of related projects.

The funding for the remaining balance of eligible costs (known as match funding) must be available from the outset. It may come from the applicants themselves (and any delivery partners' resources), or from other organisations in the public or private sector. Match funding from small and medium sized enterprises is allowed, provided it does not count as revenue to the grant recipient under Article 61."

Guiding Principles

1. Contributions from SMEs (end beneficiaries) can be included in the funding package, provided these will contribute towards the total eligible costs of the project. Where SME contributions form part of the funding package it is accepted that written evidence/letters of intent will not be in place at the time the project is approved, but the Full Application will need to demonstrate that the level of demand for the service stacks up in terms of expected SME contributions. In addition, the SME contributions must be accounted for within the project's proposed State Aid approach and must be compliant with State Aid.

2. During the assessment and appraisal, consideration of Article 61 and Article 65.8 of Regulation (EU) No 1303/2013 will need to be taken into account. Articles 61 and 65(8) or Regulation 1303/2013 sets out the definition for revenues generated by projects and how they must be treated. There is a separate guidance note on this which should be considered together with this note. Cash in-flows directly paid by users of the goods/services provided by the project i.e. charges borne by users for the use of infrastructure, buildings or services are considered to be revenues to a project and cannot also be considered as match funding. That is to say any payments made directly to the project applicant by the end beneficiaries (SMEs) for services delivered by the project would be revenues to the project and treated as such – they cannot also be categorised as match funding. Clarification from the European Commission confirms that revenues generated reduce the eligible direct costs and cannot be used to co-finance the costs of delivering the project.

3. SME contributions will have to be monitored closely. At Full Application stage, a project cash flow forecast should be submitted to support this and there should be an on-going contract management requirement to monitor this. The ERDF Grant Applicant will be required to provide a quarterly update on the cash flow projection and SME contributions received through the progress monitoring reports. As the SME contributions are estimated it is possible that the contributions actually generated by the project will vary from original forecasts.

The situation could arise where contributions generated are in excess of the forecast figures. In this case the finance package of the project must be reviewed – if the contributions plus the confirmed match funding (if any) and ERDF are in excess of the total project costs the ERDF will be reduced accordingly. . Grant applicants cannot use additional SME contributions to offset or reduce their own or other match funding contributions. The ERDF intervention rate will subsequently be reduced which will be undertaken through change control.

4. As the contributions are not secured in advance of the project the applicant must be able to demonstrate that it has the financial capacity to cash flow the project until contributions begin to materialise. In the case of the private sector this would be evidenced through the due diligence checks required. In the case of the public sector confirmation that the project can be suitably cash flowed will be required. There is a risk that enough SME contributions will not be generated – projects with this type of match funding will therefore be closely monitored to ensure the level of SME engagement is sufficient. Suitable break clauses will be included in funding agreements enabling the early closure of a project if forecast deliverables are not achieved.

5. At the end of the project, the ERDF Project Applicant will be required to show that the amount of ERDF passed through to the end beneficiaries (SMEs) is equal to the amount received (taking into account reasonable costs incurred in delivering the support). Any monies received into the project (including ERDF and match funding) in excess of the agreed total project costs (i.e. the residual sum) would be subject to clawback.

6. Match funding is treated the same as ERDF regardless of source, this means that the total expenditure (including match funding/SME contribution) must be used for the agreed purposes and defrayed on eligible expenditure. All expenditure must be evidenced, auditable and defrayed prior to the inclusion in any claim and follow all other ERDF compliance rules. Procurement rules apply to project expenditure in its entirety this includes the model where an SME may procure services directly and is therefore defraying project costs.

7. Match funding must come from a ‘clean’ i.e. non-European source i.e. an SME cannot obtain a European grant and use that to match fund another project.

8. The activity and source of the match funding must form an integral part of the project and not be artificially ‘bolted-on’ in order to draw upon ERDF monies (e.g. an ERDF Grant Applicant cannot use capital equipment which an SME had already purchased in order to draw down ERDF revenue to deliver additional business support activity). In doing so, the ERDF Project Applicant must demonstrate the following:

a) Operate the Project on a not for profit basis with no risk of cross subsidy to any of the ERDF Project Applicant's (and/or their delivery partners') economic activities (where applicable);

b) Obtain an independent market assessment or provide evidence to demonstrate in relation to any salary costs or other compensation being paid to the ERDF Project Applicant's/Delivery Partners' for carrying out the Project Activities, that there is no over-compensation to the Grant Recipient/Delivery Partners;

(c) Maintain complete and accurate records and provide full details on the cost of delivery of the Project, including internal wage costs, and where required, bench mark the same against market prices; and

(d) Ensure that the benefit of the Project is directed to SMEs

Audit Requirements & Evidence Retention

To ensure SME contributions can be verified as eligible ERDF match, the ERDF Project Applicant and the beneficiary SME must maintain a clear audit trail and provide evidence of defrayed expenditure.

The beneficiary SME must retain and be able to provide appropriate evidence of the total eligible spend and their contribution to this spend to:

- The ERDF Project Applicant, as they will be responsible for verifying expenditure included in any claim for ERDF;
- An auditor in the event that an auditor may wish to check original records/documentation held by the beneficiary SME; and
- Evidence of procurement.

Although the beneficiary SME will be required to provide the ERDF Project Applicant with evidence in relation to eligible spend and procurement (certified copies of invoices and bank statements) they will also be responsible for retaining evidence for audit purposes as this evidence will include originals of certain documents which the beneficiary SME may require for other purposes.

The Grant Funding Agreement between MHCLG and the ERDF Project Applicant must clearly explain ERDF audit requirements, and the project applicant must ensure that all SME's in receipt of grant support / making a financial contribution are aware of, and comply with these requirements.

ERDF projects which include SME contributions as part of the eligible costs should have a special condition included in their GFA which allows ERDF Project Applicants to claim expenditure defrayed by the beneficiary SMEs regarding Eligible Expenditure:

"The Grant Recipient is advised that the Managing Authority will accept as eligible expenditure, only that expenditure which is:

- *Supported by evidence of defrayal by the eligible beneficiary SMEs on agreed eligible project costs/activity*
- *Reimbursed to the SME at the agreed rate as set out in the Grant Funding Agreement*

Any expenditure not meeting these requirements will not be eligible, and should not be included in any claim for ERDF reimbursement.

The Grant Recipient is required to ensure that all SME beneficiaries are fully aware of this requirement (including the requirement that costs are incurred and paid in an ERDF compliant manner) and that a robust evidence retention process is in place for both SME beneficiary and Grant Recipient."

Responsibilities of the ERDF Project Applicant

The ERDF Project Applicant will be responsible for ensuring the project complies with ERDF audit requirements, specifically:

- 1-2-1 support (consultancy, equipment etc) has been procured compliantly. SMEs, as end beneficiaries, who provide match funding to the project will be subject to the procurement rules/treaty principles and the audit trail evidence is retained;
- Claims will only include actual defrayed expenditure.
- The project applicant retains overall financial responsibility for the project.
- The expenditure declared by the SME must be supported by receipted invoices, or documents of equivalent probative value.
- The eligibility of the expenditure claimed by the SME, the SME contribution, and the completion of the product/service, is verified by the proposer before including it in the ERDF grant claim; and
- An audit trail is maintained which includes details of the beneficiary SMEs and their contributions.

Relevant documents to be collated and retained by the ERDF Project Applicant should include:

- Agreement between the project applicant and the beneficiary SME;
- A certified copy of the SME's bank statement identifying payment of (a) the full cost of the service (1-2-1 support) or (b) salary for graduate placements;
- The agreement between an SME and the service provider (1-2-1 support) detailing the type of support being provided, the timescale for delivery and the total cost OR;
- The agreement between an SME and graduate placement staff including start and finish dates, salary and other contractual costs for placement projects; and publicity/recognition of the contribution of EU funds where applicable; and
- Procurement evidence.

Agreement between the ERDF Project Applicant and the Beneficiary SME

The ERDF Project Applicant must ensure that an agreement is in place between the ERDF Project Applicant and the beneficiary SMEs. Such agreements must explain the detailed ERDF audit requirements and the process for claiming ERDF grant. The beneficiary SME should sign the agreement to demonstrate that the terms and conditions of grant have been understood and will be followed.

Each beneficiary SME will be required to retain documentary evidence of the support received, and to provide copies of this evidence to the ERDF Project Applicant to claim the ERDF grant and to retain originals which must be made available for inspection by an auditor.

Each SME must retain the documentation about their grant as per the 14-20 ERDF Document Retention Requirements. In the event that an SME ceases trading, the documentation must be passed to the ERDF Project Applicant to retain as per the 14-20 ERDF Document Retention Requirements.

The evidence to be retained / provided by the beneficiary SME includes:

- The agreement / offer of grant between the ERDF Project Applicant and the SME;
- The original invoice / claim submitted by an SME to receive grant payment;
- The agreement between an SME and the service provider detailing the type of support being provided, the timescale for delivery and the total cost, including VAT;
- The original invoice from the service provider to the SME;
- The SME's bank statement showing payment of the total cost of the service to the provider;

- Agreements between an SME and placement staff including start and finish dates, salary and other contractual costs for placement projects; and
- Procurement evidence.

Worked Examples

Each project will be considered and appraised on its own merits. However a project should be able to use SME contributions as match funding and remain compliant with ERDF rules if grant applicants and SMEs maintain a detailed adequate audit trail; meet all ERDF regulations (e.g. state aid, procurement, document retention); and the SME contributions do not pass through the grant recipient's bank account.

Illustrative examples are given below to demonstrate when SME contributions can and cannot be included in an ERDF project:

<u>Example 1</u>

A project is established to provide a range of subsidised business support measures to SMEs. The project engages with SMEs and identifies a business need which could be met through a third party (not the applicant organisation)

This could be through a diagnostic service or via an application process. The ERDF Project Applicant considers the SMEs request for support and with the permission of the project applicant the SME sources and compliantly procures consultancy services to help improve their production processes. The procured third party delivers the service to the SME. The consultant invoices the SME for the full amount and the SME pays the full invoice. The SME then makes a claim to the ERDF Project Applicant with all the supporting evidence which as a minimum is:

- A certified copy of the original invoice from the consultant to the SME for the full cost of the service and a statement to say that the original is available on request;
- A copy of the SME's bank statement identifying the payment made by the SME to the consultant; and
- Procurement evidence

The ERDF Project Applicant then pays the agreed percentage of the full invoice to the SME. The total eligible expenditure does not pass through the ERDF Project Applicant's bank account. However, the evidence provided by the SME and the audit trail allows for the full cost of the invoice to be included in the claim and the SME contribution can therefore be counted as match funding. Both the SME contribution and the reimbursed amount to the SME would need to be recorded on the transaction list on one line showing:

- The SME contribution (showing the amount being paid by the SME and the apportionment of SME contribution being claimed by the project); and
- The agreed subsidy being paid to the SME by the project applicant.

This is to ensure that the ERDF Project Applicant has received the appropriate documentation from the SME and also that they have reimbursed the SME.

<u>Example 2</u>

The ERDF Project Applicant works with an SME to place a graduate into employment within the SME and agrees to pay a contribution towards their salary costs for a defined period. The graduate is employed by the SME and the graduate's salary is paid in full each month by the SME. Each month or quarter, the SME invoices or submits a claim, with supporting evidence, to the Grant Recipient for the agreed financial contribution. The ERDF Project Applicant pays the SME's claim and the graduate's total salary cost is recorded as eligible expenditure. The supporting evidence must include:

- Certified copy of the contract of employment detailing start date, salary and end date if applicable;
- Certified copies of pay slips, showing salary and on-costs e.g. NI and pension payments; and
- Certified copies of the SME's bank statements identifying the monthly salary payment to the graduate.

As with example 1, the total expenditure does not pass through the ERDF Project Applicant's bank account. However, the evidence provided by the SME and the audit trail allow the total costs to be included in the claim and the SME contribution to be included as match funding.

Both the SME contribution and the reimbursed amount to the SME would need to be recorded on the transaction list on one line showing:

- The SME contribution (showing the amount being paid by the SME and the apportionment of SME contribution being claimed by the project); and

- The agreed subsidy being paid to the SME by the project applicant.

Exclusions

Scenario 1 – A project is established to provide subsidised consultancy/business support to SMEs. The project applicant either delivers this service directly or procures services from a third party contractor. The service is delivered to the SME. If this is delivered by a third party, the consultant (supplier) invoices the ERDF Project Applicant for the full cost of the work and the ERDF grant applicant pays the consultant. The ERDF Project Applicant invoices the SME for the net value (i.e. the total cost less the subsidy agreed). The SMEs benefitting from the service makes a contribution towards the cost of the service and this contribution is paid directly to the project applicant. In this case the contribution paid by the SME would constitute revenues generated by the project as it would be paid directly to the project applicant in return for a service.   This would be defined as income generation and would therefore be subject to Article 61 or article 65(8). Sums paid in this way cannot also be counted as match funding. Contributions are either income/revenues or match funding but cannot be both.

Scenario 2 - the Grant Recipient charges the SMEs a fee for their services and or a fee for attendance at an event which is paid directly to the Grant Recipient. This is defined as income generation rather than SME match contribution and would therefore be subject to Article 61 or Article 65(8).

Scenario 3 – A project is established to provide specialist expertise/knowledge to SME beneficiaries in order to achieve an agreed business objective or to undertake a specific business related task. The support to the SME may be in the form of consultancy support or it may be through the provision of specialist/knowledge expertise that the SME does not currently have or does not have access too. This support may be delivered in the form of a temporary post created within the employment of the SME with the Grant Recipient providing a proportion of the salary via a grant. The supported post cannot be filled by an existing employee within the SME, because the SME already has access to this individual. This is ineligible because the SME is not using ERDF to bring in new/additional expertise. ERDF support should be directed at creating additional capacity within the SME not to subsidise the salaries of existing employees.

4. Capital Expenditure

Contingencies

Inclusion of contingencies in capital projects is standard practice in project development and planning to allow for cost fluctuations and unforeseen costs. The Programme will therefore allow a contingency budget, within the total ERDF eligible costs, to be identified at application stage for capital projects only under the following circumstances:

- A risk analysis should have been undertaken to establish all significant risks to a project, identifying uncertainties around the actual budget estimate to ensure the proposed figure for contingency is reasonable;
- The value of a contingency budget can be used to determine the total eligible costs. This should be clearly identified and quantified within a granular breakdown and should be included within the relevant budget heading i.e. the building & construction line, or other appropriate cost category within the finance tables.
- There will be no reimbursement of costs against the heading 'contingency' as such costs will be defrayed and claimed within the relevant cost category under which they are agreed and contracted. Submitted claims cannot include contingency as an eligible item; only actual costs relating to the agreed budget headings should feature in any breakdown of expenditure.

Mobile Assets

The purchase of mobile assets such as mobile phones, computers, laptops, tablets and motor vehicles can be included as an eligible project cost. This is on the basis that they are used exclusively in delivering an approved project.

The costs of mobile assets not used exclusively within the approved project would be seen as an indirect cost and therefore covered in the appropriate flat rate applied.

Guidance:

Mobile assets with an individual purchase value of £1000 need to be listed on the project asset/ inventory register

Disposal of mobile assets, with a purchase value of £1000 or more requires, approval by the Managing Authority.

Retail

The general principle is that support to build or refurbish retail facilities will not assist economic development and that improved performance for one facility is regarded as displacing similar activity elsewhere. Nevertheless, ERDF can be used to support the business growth and low carbon needs of retail businesses as part of projects that are not exclusively targeted at the retail sector.

Revenue support for the retail sector is eligible where all the following are met by a project:

- the business supported is an SME; and
- the support is not exclusively or predominately targeted at retail businesses.

Capital investment in land buildings or infrastructure of any nature for use and/or occupation by retail businesses and/or services such as restaurants is not eligible, except for the installation of low carbon technology, or via a financial instrument, as indicated below.

Financial instruments – investment capital (equity or loan investment) for SME retail sector businesses is eligible provided that:

- The support is not exclusively or predominantly targeted at retail businesses;
- The investment is predominantly used to support business growth. It shall not be used exclusively or predominantly to purchase land, build or refurbish buildings or other infrastructure for investee retail business use; and
- The financial instrument addresses market failures identified by an ex-ante assessment.

For the avoidance of doubt, the use of financial instruments for land, buildings or infrastructure of any nature for use and/or occupation by third party retail businesses is not permitted.

Where there is no question of displacement, for example, a specialist consultant is offering advice to a range of retail organisations on reducing their carbon emissions, this should be allowed.

Banking and insurance companies should not be supported, as their activities are non productive and support to one institution is likely to lead to displacement of jobs, except as a deliverer of services or match funding, for example as members of a VCLF consortium. This would include insurance brokers who act as intermediaries and 'sell' insurance policies to businesses or individuals.

Nuclear related activity

ERDF Regulation (1301/2013), Article 3 (3)(a) prohibits ERDF being used for the decommissioning or construction of nuclear power stations. This means that ERDF cannot be applied in relation to activity that directly or indirectly is related to the building and decommissioning of nuclear power stations

Eligible Capital Expenditure

Capital expenditure is eligible where the activity fits within the scope of the ERDF Regulation and the Operational Programme and relates to a specific Call for proposals. Eligible capital costs should fit within the following expenditure headings:-

Land acquisition

The cost of purchasing land which is not built upon may not exceed the limit of 10% of the total eligible project costs. A higher percentage may be permitted by the managing authority for operations concerning environmental conservation.

Building acquisition

The cost of acquiring a building if there is a direct link between the purchase and the objectives of the project.

Building & construction

This should include external/internal refurbishment and conversion of existing buildings, new build premises, provision of services, and landscaping.

Plant & machinery

This should include tangible fixed assets used for the purpose of providing a service for the project. If plant and machinery is subject to hire/lease purchase agreements, instalments towards the capitalised value of leasing and hire purchase can be included provided they are required for the project and are defrayed within the project period.

Other Equipment

Equipment required for operational and research purposes should be included where it is directly related to the project. The purchase costs of second-hand equipment are eligible provided they meet the needs of the projects and have not been purchased with the aid of national or community grants.

Fees

This should include fees and salaries for design and supervision but professional fees should not normally exceed 12.5% of the total eligible works costs. Fees include legal consultancy fees, notarial fees, and the cost of technical and financial experts if they are directly linked to the ERDF operation and are necessary for its preparation or implementation.

Other Capital

Any eligible capital expenditure not covered by the categories above provided it can be clearly demonstrated that these are directly related to the delivery of the project. This may include site investigation and preparation where it can be demonstrated that it is necessary for the development and implementation of the project.

Apportionment of capital costs

Where the project involves the construction of premises and infrastructure or the creation/purchase of assets and it is deemed that the asset will be used for non ERDF eligible purposes during its economic lifetime the associated eligible costs will be apportioned on the basis of the forecast eligible usage. The method of apportionment must be clear and transparent and agreed by the managing authority. **Note:** this is different to the apportionment of running costs or the cost of shared assets which is covered in the section on flat rates.

Ineligible capital expenditure

The following are **ineligible** for ERDF support:

- Provision of local social welfare facilities e.g. hospitals, nursing homes, fire stations, child-minding facilities, sports facilities, parks, public libraries when these are not directly related to the objectives of the Operational Programme;
- Coastal protection, soil conservation and infrastructures; all with an exclusively agricultural bias, reforestation and prevention of forest fires, insofar as such infrastructures can be financed under EAFRD. This does not include green infrastructure which is eligible under ERDF;
- That proportion of public expenditure incurred in land acquisition not directly linked to productive investment or investment in infrastructure;
- Building and renovation of housing, except for energy efficiency improvements and renewable energy operations which comply with Priority Axis 4 of the Operational Programme; and
- Major infrastructure in private sector ports, on the grounds that port developments and port operations should not need public subsidy. Furthermore, it could distort competition between ports. Subsidy tends to spread the problems caused by excess capacity and can be damaging to otherwise healthy neighbouring ports.

NB This list is not exhaustive and any queries about the eligibility of costs not included in the list above should be addressed to MHCLG.

5. Revenue expenditure

Simplified Cost Options: 15% Flat Rate for Indirect Costs

Background

The European Commission initially introduced simplification measures during the 2007-13 programming period – the 2014-20 programming period sees the introduction of a range of new possibilities (simplified cost options) giving more legal certainty and reduced audit risk for Managing Authorities and Grant Recipients. The Common Provisions Regulation (CPR — Regulation 1303/2013) includes options for the ESI Funds to calculate eligible expenditure of grants and repayable assistance on the basis of flat rate financing.

Purpose of the Guide

To explain the rationale for, and proposed implementation of, the 15% flat rate for indirect costs.

Why Use Simplified Costs?

Where simplified costs are used, the eligible costs are calculated according to a predefined method. The use of flat rates is considered by the European Commission and European Court of Auditors as a better way of calculating eligible project costs because, when compared to the traditional 'real costs' reimbursement method, it reduces the likelihood of financial corrections due to errors and the corresponding administrative and audit burden on both the managing authority and grant recipients.

The tracing/auditing of all costs to individual supporting documents is no longer required - this is the key point of simplified costs as it significantly alleviates the administrative burden.

The 15% flat rate enables the calculation of **all indirect costs** attributable to a project without the need for complex apportionment or overhead methodologies or checking of evidence/audit trail associated with indirect costs.

Flat Rate Financing for Indirect Costs

In the 07-13 ERDF programme various methods were used to calculate indirect (including shared) costs. Methods were generally complex with significant administrative resource required to calculate, verify and monitor detailed calculations and apportionment methodologies. The flat rates will replace these options and all applicants wishing to include an element of indirect costs must use one of the flat rates available.

Note: Some specifically defined research and innovation activity may attract a higher rate if they meet some of the objectives of the Horizon 2020 scheme. See pages 38 and 39 for more details.

Definitions of Costs

It is important to define the types of costs within a project and ensure that there is no overlap between the types of costs meaning costs would potentially be double funded i.e. wrongly classified as direct (and included as such) when in fact they are indirect and already covered by the flat rate. To avoid the risk of double funding the following three definitions apply;

Direct Costs

All eligible costs ***other than direct staff costs*** (a separate category defined below) which are essential for the delivery of the project. This includes (but is not an exhaustive list):

- Premises costs and associated running costs which are **exclusively** used for the **project** – that is to say costs which are **not** shared or apportioned across multiple projects, including multiple ERDF projects;
- Equipment used exclusively for project purposes;
- Other costs such as marketing, publicity and evaluation where these can be clearly identified and directly attributable to the project;
- Stipends, as these are not salaries associated with a contract of employment but a living allowance – these could be agreed as an eligible direct cost where the payment relates to a period of time within the project lifetime and the student is required to carry out a piece of work which directly relates to project activity. There must be a written agreement setting out what is expected of the student and that the stipend is conditional upon this being completed. If the student does not meet the terms of the agreement the grant recipient must repay the appropriate amount of grant to the managing authority associated with the stipend.
- Procured goods/services/works (used exclusively by the project) essential for the delivery of project activity; and
- Cost of business trips, other travel and subsistence.

Exclusions

- **Shared/apportioned costs**.

This includes shared/apportioned premises and running costs and assets/equipment/services used for purposes other than the project. This is to avoid the use of apportionment methodologies. A general rule of thumb is that if a methodology is required to calculate the cost to the project it would be classed as indirect. **This does not mean that project costs need to be separately invoiced to constitute a direct cost**, they just need to be specifically and clearly attributable to a project. The examples below provide some clarity on this. Note this is different to cases where the building or asset *is* the project rather than being used *by* the project (e.g. the construction of SME space) where costs may be considered direct but might be apportioned on the basis of eligible/non eligible usage – see the capital expenditure section of the guidance for further detail.

Example 1

Indirect:

An organisation has one contract in place for 20 mobile phones with 5 of these being used part of the time for the ERDF project and the rest not used for ERDF purposes at all. The invoice stipulates one overall amount with no itemisation of cost. These would be classed as an indirect cost as the specific actual cost per phone cannot be identified – and they are not used 100% of the time for the project.

Direct:

An organisation has a contract in place for 20 mobile phones and 5 of these are used 100% of the time on the project and the bill/invoice states the cost per phone. A specific actual cost for each phone is identifiable and therefore attributable as a direct cost.

Example 2

Indirect:

An applicant/grant recipient procures a company to carry out some marketing and publicity activity in respect of a number of ERDF projects. The tender identifies one overall cost for all of the work undertaken and the invoice presents one overall figure. In this case the actual cost per project is not specified – the overall cost would need to be shared across the projects using an apportionment methodology. This would be classed as an indirect cost as a clearly identified itemised cost for the project is not available.

Direct:

An applicant/grant recipient procures a company to carry out some marketing and publicity activity in respect of a number of ERDF projects. The tender identifies separate work packages with a cost attributed to each. The invoice specifies itemised costs in respect of each work package. These can be accepted as direct costs as a specific clearly attributable cost is evident within the invoice. Separate invoices are not required – the key point here is that a specific actual project cost can be identified and evidenced.

- **Internal recharges**

Internal recharges from other parts of an organisation for goods and or services e.g. internal charges from HR, legal, planning or other specialist departments as these do not involve the external defrayal of expenditure

- Any other costs which in the opinion of the managing authority are not directly related to delivery of the project and for which a clear audit trail linking costs to project activity does not exist.
- Any costs claimed under direct staff costs.

Direct Staff costs

This includes salaries and on-costs of staff engaged in activity directly related to the implementation and management of the project. It can also include pension deficit contributions. Staff could work 100% of their time on project activity, or part of their time with all hours, including the time spent working on the project, recorded on suitable timesheets.

However, although an individual has been accepted by the Managing Authority as having a 'Direct' role on a project it does not necessarily mean that all of their time or activity related to that project can be claimed as 'Direct'.

Some individuals whilst undertaking 'Direct' activity on the management and implementation of a project, may also complete 'Indirect' activity on that project and/or complete activity completely separate to the project all together.

Time sheets must therefore provide sufficient detail to clearly demonstrate that any time identified as 'Direct' was spent on tasks specifically related to the direct management and implementation of the project – the level of detail must be sufficient to provide the Managing Authority with assurance that the work undertaken and associated hours claimed are related to a 'Direct' role within the project.

Lack of detail within the timesheets may lead to claw back or non-payment of grant if sufficient evidence is not provided.

Costs associated with staff employed by named delivery partners within the project can be included provided they perform a direct role. The costs of secondees from other organisations can be included as direct staff costs provided they are on the payroll of either the grant recipient or a named delivery partner. Consultants/those secured as contractors through a procurement exercise would be a direct cost (included as a fee) not a direct staff cost.

Exclusions

- All staff who do not perform a role engaged in activity directly related to the implementation and management of the project;
- Cost of business trips and travel and subsistence (this would be a direct cost, not a direct staff cost); and
- Procured services (this would be a direct cost, not a direct staff cost).
- Stipends as these are not salaries associated with a contract of employment, but a living allowance – these would be a direct cost.

It is expected that all organisations who submit an application for ERDF are in a position to deliver the approved activities. Staff training costs can only therefore be included where it is identified that an individual has specific training needs necessary for the delivery of the ERDF project that could not be identified before the project commenced.

Indirect Costs

Any costs which do not fall within the direct staff costs category or the direct costs category are *de facto* indirect costs and will be claimed using the flat rate. Such costs do not have to be individually identified/listed within an application.

Indirect costs, often referred to as 'overheads' are those costs which are linked to activity that supports the delivery of a project but cannot be easily attributed to the project in terms of the actual specific cost and cannot be evidenced by invoices or other transactions[2].

Such costs include:

- Support/back office staff, not engaged in activity directly related to the implementation and management of the project; and
- Other costs which are not ***solely*** associated with the delivery of the project, such as the Apprenticeship Levy or shared premises costs such as rent, utilities, insurance, cleaning, IT maintenance or insurance. This means that unless a premises is used for only that project the costs would be derived from the 15% flat rate. There is no apportionment methodology to share the cost of premises and running costs amongst projects as a direct cost.

[2] Internal transfers used to charge 'costs' to ERDF projects using a standard corporate methodology do not constitute direct costs, Such costs would be covered by the 15% flat rate. .

- costs of services/equipment or assets not exclusively used by the project where an actual specific cost cannot be identified.

External costs (such as procured services, or grants for enterprises), premises or equipment solely used for ERDF purposes which can be directly attributed to project activity in a clear and auditable way would be direct costs.

Indirect costs can apply to capital and revenue projects. If delivery of a capital project involves direct staff costs as a revenue cost (e.g. engaged in activity directly related to the implementation and management of the project) then the rate can be applied but would be included as a revenue element to the project in the finance tables.

Calculating Indirect Costs

Indirect costs are calculated by applying a simple flat rate of 15% to **direct eligible staff costs**. As stated above a project will essentially contain 3 types of costs:

- **Direct costs:** costs which are directly related to the delivery of the project activity. These costs are not calculated with the flat rate and the rate is not applied to them. They will be subject to audit and must be capable of being traced back to original actual cost based transaction;

- **Direct Staff costs:** the salaries and on costs for those staff engaged in activity directly related to the implementation and management of the project. This is the cost driver for the flat rate – i.e. the rate is applied to these costs to calculate the eligible indirect costs; and

- **Indirect costs:** a figure arrived at by applying the flat rate to the direct staff costs, this figure will then be used to cover those costs which are not or cannot be connected directly to the project activity and an exact actual cost cannot be attributed to the project.

Using the flat rate applicants ***only*** need list direct staff costs and other direct costs. ***There would be no need to identify, cost out or list indirect costs.*** They would be included in a cost schedule as;

Indirect costs (direct staff costs x 15%) £ xxxx

In such cases the actual indirect costs are not auditable at all – only the direct staff costs (used to calculate the indirect costs) and the other direct costs would be checked/verified.

Other useful guides

Please refer to the guidance note on the hourly rate unit cost. The hourly rate calculation is used for staff who work part of their time on a project and complete time sheets.

Simplified Cost Options: Hourly Rate

Where simplified costs are used, the eligible costs are calculated according to a predefined method.

Using simplified costs means that the human resources and administrative effort involved in management of the ESI Funds from an MA perspective can be reduced as is the administrative burden on grant recipients.

The simplified hourly rate is a method to enable the use of a unit cost approach to calculate the cost of direct staff costs. The calculation must be used in all cases where staff costs are based on an hourly rate.

What is an Hourly Rate and When is it Used?

The hourly rate is the cost per hour of a project staff member whose time needs to be time sheeted because they either:

- Do not spend 100% of their time working on the approved project i.e. the activity covered by the relevant Funding Agreement and do not work a fixed percentage of their time on the project;
- are funded through more than one ESI fund (e.g. ERDF and ESF);
- work on more than one ERDF funded project; or
- do not spend 100% of their time working on the project and work across more than one category of region.

Note: Staff working all of their time on the project but across more than one Category of Region, Priority Axis or Investment Priority are not required to use the hourly rate. Staff working part of their time on the project but working a fixed percentage of their time on the project (with evidence available as described in the section below) are not required to use an hourly rate and do not need to complete time sheets.

The underlying principle is that the project pays for the hours of work it receives – no more, no less. It allows an organisation to make use of existing staff as well as newly appointed staff on a temporary or ad hoc basis whilst being appropriately compensated. If a member of staff is absent from work for whatever reason (including sick leave, maternity/paternity leave) the assumption is that hours of work required by the project would be covered by an alternative member of staff and thus paid at an agreed rate. Projects cannot claim for notional hours that *might* have been worked should an individual be absent from work.

Staff on fixed hours per month

Staff costs related to individuals who work part of their time on a project may be calculated as a fixed percentage of the gross employment costs, in line with a fixed percentage of time working on the project per month, with no requirement to complete time sheets.

The employer **must** issue a document for employees setting out the fixed percentage of time for working on the project. This could be, for example, in the form of a job description. The key requirement is that it must be formally documented. Personnel working flexibly across a number of ERDF projects where hours fluctuate would not be able to use this methodology. They would need to keep time sheets and use the 1720 hours calculation.

What about Periods of Absence?

Staff included in a project on an hourly rate basis are those who only spend part of their time working on the project and do not have documented fixed hours on the project.

This could be because they are only required on a temporary basis for time limited activity; there may be an ad-hoc requirement for their involvement or they may be shared across various projects. Hours are charged to the project on the basis of time sheets – and the time sheets are the critical piece of evidence required to justify the costs claimed. If a particular individual is absent from work due to sick leave/maternity leave/paternity leave (or any other reason) then that individual *does not contribute* working hours to the project therefore *costs cannot be claimed*. It cannot be justified that costs are eligible based on what ***might*** have been worked as this would be a notional cost to the project and notional costs are not eligible. If other individuals are required to backfill and undertake work on the project as a result of someone's absence then that individual's hours (if evidenced by time sheets) *can be charged to the project.*

Periods of annual leave are not charged to the project as the hourly rate calculation provides an element of compensation for annual leave.

Maternity/sick/paternity pay in respect of staff who work all of their time on a project (whether full time or part time) are eligible as this is an actual cost to the project as that individual is employed solely for project purposes.

How is the hourly rate calculated, agreed and checked ?

The calculation

There is one calculation used to work out hourly rates:

$$\text{Hourly staff cost} = \frac{\text{latest documented annual gross employment costs}}{1720}$$

Use of the 1720 hours is mandatory, except for staff on fixed hours per month (see above) and set out in the ESIF Regulation. 1720 hours assumes a working week of 33 hours – it therefore overcompensates by between 4 and 9 hours depending on an organisations standard working week to take account of annual leave costs.

It is understood and accepted that a unit cost may benefit one organisation more than another – however that is the very nature of a unit cost – it is an average standard.

The total number of hours declared for an individual, even if they are working on more than one ERDF project, should not exceed the hours used for calculating the hourly rate, i.e. 1720. If they work on ERDF and another Fund they should ensure that they comply with any applicable Rules for that Fund.

If individuals work part time their hourly rate must be calculated by using a corresponding pro-rata of 1720 hours. This means that if an individual is 0.5 FTE the gross employment costs would be calculated as follows: 1720 x 0.5 = 860 and so on. Where a pro rata is used, the total number of hours declared must not exceed the number of hours used for the calculation.

When an average hourly rate (see below) is calculated for a group(s) the hourly rate unit cost will, in some cases will be higher than that person's actual hourly rate – in some cases it will be lower. This is accepted and is the intended consequence of this flexibility.

Once agreed with the Managing Authority the hourly rates are fixed and cannot be changed other than with the agreement of the Managing Authority. In the case of a project implemented over several years, the managing authority will update the hourly staff cost annually at agreed review points. This means the rates will be agreed in principle during appraisal with initial verification of the rates taking place prior to payment of the first claim. The managing authority will agree the future review points with the applicant/grant recipient. The first review point can be within

12 months of the initial agreement/verification of the rates but would not normally be conducted any more than annually from the date of the first review. A key principle of the simplified method is to reduce the administrative time required to update and check the hourly rates so multiple review points during a single year would not be agreed.

Hours claimed must be evidenced by appropriate timesheets.

The same calculation can be used in different ways:

(i) **individuals** – this means if 10 people are used in a project they would each have their own hourly rate i.e. 10 individual hourly rates agreed and claimed.

(ii) **group rates:** there is no prescribed way to calculate group rates however all methods of calculation must be agreed by the managing authority and must be based on a reasonable and fair rationale. Calculations should not be deliberately structured in a way that the rate is artificially inflated. For example an individual on a high salary working a small percentage of their time on the project must not be included in the same calculation as a number of individuals on significantly lower salaries as this would result in an artificially higher rate for the larger proportion of staff. If an applicant/grant recipient wishes to make use of a group calculation they need to demonstrate that a fair approach has been taken. Options include:

> **(a) an average hourly rate for groups of staff in similar posts or with similar salaries** – this means if a project uses 20 employees and 10 of them earn between £20-30k p.a. and 10 earn £31-50k p.a. then 2 average hourly rates can be calculated for the 2 groups of staff. The average would be calculated by adding up the gross employment costs of the individuals included in the calculation then dividing this by the number of people included. The rates would then be used to claim the cost of all hours worked on the project by all staff included in the calculation regardless of what their actual hourly rate would be. To determine the number of rates to be calculated it is recommended that the salary bands for the groups encompass a variance of no more than £10k, for example £25-35k p.a.;
>
> **(b) a single group of employees on varying salaries –** this means one average hourly rate is calculated and used for all employees included in the calculation. This option is only suitable when the individuals included are on similar salaries ie within a £10k band. Where this option is used care should be taken not to artificially inflate the hourly rate by including those on a significantly higher salary then

the majority. Any outliers must be considered separately and have an individual hourly rate calculated.

(c) an average hourly rate per grade – where an organisation has a grade structure with a defined salary band it would be possible to agree an hourly rate per grade. This could either be an average calculation of all staff within the relevant band with an average calculated, or the hourly rate could be simply calculated using the mid salary range point, for example if a salary minimum is £20k and the salary maximum is £26k then the figure used to calculate the hourly rate would be £23k

(iii) an aggregate hourly rate covering a group where individuals cannot be identified in advance of delivery – this can be used for example where the grant recipient may draw upon a number of mentors/researchers etc in assisting SMEs but do not know at outset who these individuals might be as this would be informed by the needs of the beneficiary SME, a University for example may draw from a number of academics. In this case an average hourly rate of all the salaries – or groups of salaries if these vary widely could be agreed then used as and when individuals are needed to work on the project, alternatively individual rates can be agreed as and when the individuals concerned are identified.

Points to note are:

- The latest annual gross employment cost has to be documented through accounts, payroll reports, etc. This information does not have to be audited ex-ante but has to be auditable;
- Latest documented annual gross employment costs may be derived from the available documented gross employment costs or from the contract for employment, duly adjusted for a 12-month period. This means the actual gross annual salary of the individual should be used at the point at which costs are included in the project;
- Only the hours actually worked should be used for calculating the eligible staff costs. Annual leave for instance is already included in the calculation of the hourly staff costs;
- The added value of this methodology is that the 1720 hours cannot be questioned;
- Staff costs calculated using the hourly rate can then be used to calculate the indirect costs through the use of the flat rates for indirect costs;
- As this is a unit cost the rate does not have to be justified with each claim. Evidence is through time sheets;

- This method can only be used for **direct** staff costs. Indirect staff costs are calculated and claimed using the flat rates for indirect costs;
- Added value is reduced calculation and checking requirements at full application stage, appraisal, claims and audit stages; and
- When used for groups of employees the unit cost will in some cases exceed the actual and will in some cases be less than the actual hourly rate – this is however a characteristic of any unit cost and is completely acceptable.
- Changes in guidance pertaining to the calculation of the hourly rate can be implemented at the agreed hourly rate review point or at any other point agreed by the managing authority. Projects are not required to adhere to the guidance in place at the point of approval for the project lifetime. Changes in guidance can be adopted with the agreement of the managing authority.

Agreeing the Hourly Rate – what should be checked and when

The rates would ideally be agreed in principle as part of the appraisal but can be agreed in principle via pre or post contract conditions but in any case prior to claims being submitted which include related expenditure.

Agreement in principle means that an applicant will provide an estimate of the overall salary budget – this should be further detailed within a granular breakdown specifying each post included in the project together with gross salary costs and an hourly rate calculation. The appraisal will test that the salary budget is sufficient to cover the salary costs proposed and will refer to the hourly rates proposed although will not specify these within the appraisal document nor confirm that they are verified. The focus is on ensuring these estimate costs at the point of appraisal are based on the correct methodology to ensure the budget is sufficient.

- Calculation details (i.e. individual/group/average) and agreed rates should be agreed and documented. Documentation (appraisal/PIV report/file note) should specify the posts included as direct costs together with the agreed hourly rate – the rate cannot be changed without the agreement of the Managing Authority once set;
- JDs should be provided for all posts included unless this is not possible in which case letters advising post holders that their post is supported by ERDF should be issued and retained for audit;
- Latest annual gross employment costs include the annual salary, contractual benefits, national insurance and superannuation contributions. Overtime, although an eligible project cost (as hours can be included on the time sheet if related to the project activity), should be excluded from the hourly rate calculation as this would artificially inflate the hourly rate;

- Bonuses cannot be included as the numerator is based on gross salary costs relevant to project activity;
- The numerator used to establish the hourly rate does *not* have to be tracked back to defrayal during appraisal but should be tracked to defrayal prior to payment of the first claim (at the PIV if possible). During appraisal the numerator should however be justified – for all posts included, confirmation in the application (or the supporting granular budget) of the gross annual salary and on costs for each post is sufficient. These will be tested/verified prior to payment of grant.
- If a consolidated/average group rate is to be agreed it should be ensured that the inclusion of a significantly higher salaried individual is not included in order to artificially inflate the rate. It would be more appropriate to calculate a separate rate should this be the case. It should be checked that all posts included in a calculation are then included in the claims; and
- If a project draws on a number of staff which cannot be identified in advance – for example using Academics within a university for SME support this should be noted – reflected in the GFA with a requirement for rates to be agreed as individuals are identified, alternatively an aggregate rate could be agreed in advance or a number of aggregate rates if salaries vary widely.

Checking and Validation of the Hourly Rate

As the numerator used to calculate the hourly rate is *justified* during appraisal it is necessary that the figures be evidenced periodically as follows either by contract managers or through OTSV:

- Numerator should be evidenced back to defrayal as part of initial checks either during the PIV or with the first claim – this would involve a full defrayal check to evidence that the gross salary costs used to calculate the hourly rate are in fact correct. No further defrayal checks are then needed either during desk based checks or OTSV during the following 12 month period – only evidence required being the time sheets;
- Further defrayal checks will be made on an annual basis when the rates would be re-checked and agreed for the next 12 month period enabling any annual increases to be taken into account – unless the project lasts for less than 2 years in which case checks are only required once at the outset;
- For projects involving large numbers of staff a sample verification check can be undertaken – this should be a minimum of 10 individuals or 10% of the total of the number of staff included (whichever is the highest figure). If errors are found the sample to be checked can be widened as considered appropriate by the verification officer; and

- Contract managers should also ensure that where a group or aggregate rate is agreed that claims include hours relating to all relevant posts as anticipated during appraisal (this means not all posts will be included in all claims).

Simplified cost options – the Horizon 2020 programme

Background

Article 64 (c) of the Common Provision Regulation (EU) No 1303/2013 allows indirect costs to calculated using existing methods and rates applied in other EU programmes for similar types of projects.

ERDF research and Innovation projects delivered under the intervention codes and investment priorities set out below may use the flat rate available under the Horizon 2020 (H2020) programme.

Simplified Costs – Regulatory Position

Article 29 of EU Regulation 1290/2013, laying down the rules for participating in H2020 states that indirect eligible costs shall be determined by applying a flat rate of 25% of the total direct eligible costs, excluding direct eligible costs for subcontracting and the cost of resources made available by third parties which are not used on the premises of the beneficiary, as well as financial support to third parties.

In order to ensure that procured services do not distort the indirect costs paid to grant recipients when using the Horizon 2020 approach, it is compulsory to deduct subcontracting costs. If an ERDF grant recipient delivering a project that can use the Horizon 2020 method sub-contracts (that is to say procures) a third party to deliver all or some of the project activity, for instance consultants providing services to end beneficiaries, these costs must be excluded from the calculation of indirect costs. Other eligible ERDF direct costs such as *inter alia* equipment, materials and intangible assets such as IT software licences that grant recipients purchase to use in the delivery of the project are not considered to be sub-contracted and may be included in the calculation to establish the amount of eligible indirect costs.

For example

a) Direct staff costs	£1,000,000
b) Equipment and materials	£500,000
c) Costs of consultants	£2,000,000
d) Total ERDF eligible direct costs	£3,500,000
e) Indirect costs (a+b)*25%	£375,000
f) Total ERDF eligible costs d+e	£3,875,000

Article 20 of EU Regulation 480/2014 states that indirect costs may be calculated by applying a flat rate established in accordance with Art 29 of 1290/2013 for ERDF operations which are innovative in nature, in line with the requirements for participating in H2020, and are eligible for support under the following intervention codes and investment priorities:-

<u>Intervention field codes</u>

056 Investment in infrastructure, capacities and equipment in SMEs directly linked to research and innovation activities

057 Investment in infrastructure, capacities and equipment in large companies directly linked to research and innovation activities

060 Research and innovation activities in public research centres and centres of competence including networking

061 Research and innovation activities in private research centres including networking

062 Technology transfer and university-enterprise cooperation primarily benefiting SMEs

063 Cluster support and business networks primarily benefiting SMEs

064 Research and innovation processes in SMEs (including voucher schemes, process, design, service and social innovation)

065 Research and innovation infrastructure, processes, technology transfer and cooperation in enterprises focusing on the low carbon economy and on resilience to climate change.

<u>Investment priorities – ERDF Regulation 1301/2013</u>

Art (5)(1), strengthening research, technological development and innovation by:

(a) Enhancing research and innovation infrastructure and capacities to develop R&I excellence, and promoting centres of competence, in particular those of European interest;
(b) Promoting business investment in R&I, developing links and synergies between enterprises, research and development centres and the HE sector, smart specialisation, advanced manufacturing capabilities etc

Art (5)(2)(b), enhancing access to , and use and quality of, ICT, by:

Developing ICT products and services, e-commerce, and enhancing demand for ICT

Art (5)(3), enhancing the competitiveness of SMEs by:

(a) Promoting entrepreneurship, in particular by facilitating the economic exploitation of new ideas and fostering the creation of new firms, including through business incubators

(b) Supporting the creation and the extension of advanced capacities for product and service development

Art (5)(4)(f), supporting the shift towards a low carbon economy in all sectors by:

Promoting research and innovation in, and adoption of, low carbon technologies.

Direct staff costs on Broadband projects (Investment Priority IP2a)

Section 2.A.6.1 of the England ERDF OP, describing the type and examples of actions to be supported under vIP2A, states that ***''The Local Authorities are also required to provide resourcing for project management costs.''*** It then states that ***''Superfast broadband projects seeking to use Government funding (including those using ERDF as a source of funding) are assessed against the following requirements before funding is confirmed;***

- ***Contract management capability and capacity is available and funded''***

It should be clarified that the resourcing for project management costs provided by the local authorities does not necessarily need to come entirely from their own budget. Direct costs of staff that perform a role engaged in activity directly relating to the implementation and management of an ERDF project under IP2a may be supported. However, the project will need to demonstrate that the costs are reasonable and ERDF is not simply funding all contract management costs.

Ineligible revenue expenditure

The following individual revenue costs are not eligible for ERDF support:

- Notional costs, for example, where an item usually retails at £x, but the applicant buys it cheaper but claims the difference between the price paid and £x
- Payments for activity of a political nature
- Provisions – i.e. money set aside to pay for future events e.g. sink funds
- Contingencies and contingent liabilities
- Dividends
- Interest or service charges arising on debt incurred including finance leases, hire purchase and credit arrangements

- Costs resulting from the deferral of payments to creditors
- Costs involved in winding up a company
- Payments for unfair dismissal
- Compensation for loss of office
- Bad debts arising from loans to employees, proprietors, partners directors, guarantors or shareholders
- Payments for gifts and donations
- Entertainments apart from food and non-alcoholic drink provided as part of a meeting
- Statutory fines and penalties
- Criminal fines and damages
- Legal expenses in respect of litigation
- Costs incurred by individuals in setting up and contributing towards private pension schemes, or the setting up of such schemes by organisations in receipt of ERDF
- Costs incurred by organisations in relocating personnel displaced by the refurbishment or conversion of a building for ERDF use.

NB This list is not exclusive and any queries about the eligibility of costs not included in the list above should be addressed to MHCLG.