Draft budget – a calculation method of simplified cost options

Fact sheet, April 2020

Legal basis

Article 67(5)(aa) CPR establishes that the amounts of simplified cost units (unit costs, lump sums and flat-rate financing) can be established, among others, using:

a draft budget established on a case-by-case basis and agreed ex-ante by the body selecting the operation, where the total cost of the operation does not exceed EUR 100 000 (EUR 200 000 – Article 48(2)(b) [new CPR]).

Description of the method

It is very important to understand that establishing a SCO using a draft budget is a calculation method and not a SCO itself.

In a nutshell, it means that a programme uses the indicative budget of a project proposal and transforms it into a simplified cost option upon project approval. The SCO(s) is(are) then applied during the project implementation.

The different aspects for the draft budget methodology are elaborated along the different steps of the project life cycle below.

1. Call for project proposals & project application

The MA should clearly define criteria to establish the draft budget (e.g., programme manual, explanatory note, terms of reference for call for proposals). This should include:

- eligibility rules for projects to develop draft budgets (i.e. clearly define which budget lines and costs can be included in the draft budget, what activities are expected and which are not),
- guidance on expected outcome of the project and main tasks to achieve the defined output, deliverables; timeline of activities, especially for small projects,

- examples for triggers for payment with clear definitions (what exactly has to be fulfilled and which evidence documents have to be provided),
- templates meeting the necessary flexibility for this approach.

With a draft budget methodology, the programme can decide to base the simplified cost option(s) entirely on an indicative real cost budget. The programme can also decide to prescribe already at the application stage specific simplified cost options. For example, the programme can limit the real cost to budget categories *external expertise and services* and *equipment* and apply a fixed flat rate of 20% for staff costs on that amount and a 15% flat rate, as well as a 10% flat rate for *travel and accommodation* on the staff costs. In practice, it could look like that:

Budget category	Programme rules	Amounts, EUR	Comment
Staff	Automatically calculated as a flat rate	8 000	20% flat rate on external Expertise & services and Equipment
Office and administration	Automatically calculated as a flat rate	1 200	15% flat rate on Staff costs
Travel and accommodation	Automatically calculated as a flat rate	800	10% flat rate on staff costs
External expertise and services	Indicative real costs	35 000	Proposal by project
Equipment	Indicative real costs	5 000	Proposal by project

It is worth mentioning that pre-defined SCOs prescribed by the programme might be most suited for specific types of projects with specific activities known in advance.

It is also possible that the managing authority in the explanatory note/ terms of reference/ call for proposals specifies in advance which SCOs (i.e. lump sums, flat rates, unit costs) will be established on the basis of the draft budgets provided by the applicants. The specificities of the SCOs have to be then clearly explained to the applicants in advance.

When preparing the draft budget, the applicant should provide:

- a detailed draft budget: detailed information on each budget line and each cost included in the budget,
- the methodology used to measure and calculation of amounts of each cost included in the draft budget,

- the justification (supporting documents) of amounts, quantities, prices (e.g., offers made/ received, pay rolls from previous years, market research, price comparison, expert judgement, etc.).

For the above list, it is helpful if the programme gives guidance on the proportionality of justification required. E.g., how many offers for certain services are needed, how extensive a market research should be and so on. Such information helps to manage expectations and will add to a more efficient use of resources (writing the application, assessing the application).

2. Quality assessment, approval, contracting & documentation

The managing authority assesses (it can also be done by the joint secretariat or external experts, however, the MA bears the overall responsibility) each draft budget on a case-by-case basis. In the assessment, the MA follows the same principles as for “regular” projects:

- to what extent the budget demonstrates *value for money*, i.e., ‘ex-ante’ assessment of value for money (e.g., whether sufficient and reasonable resources are planned to ensure project implementation; if the partner budgets reflect the partners’ involvement, if all activities planned in the project are relevant and needed, if the budget is not excessive, realistic, etc.),
- to what extent the budget is coherent and proportionate (e.g., financial allocations per budget line are in line with the work plan; distribution of the budget per period is in line with the work plan; the budget is clear and realistic; the budget is proportionate to the envisaged work plan and main outputs and results aimed at).

When assessing the draft budget, the MA will:

- verify if the costs included in the draft budget follow the eligibility rules,
- check if supporting documents justifying the amounts are provided and are sufficient,
- if all calculations are correct,
- assess each activity against project outcome, each budget line against the task (relevance of all costs), value for money of each amount; compare amounts with the cost benchmarks, if existing, with other similar projects, etc.

How to 'formalise' assessment of value for money?

The MA has to demonstrate that a sound and solid system for the assessment of the value for money has been established when assessing draft budgets.

One way to do so is to develop a catalogue of cost benchmarks (reference costs) to be used by applicants when drawing up their draft budgets. A solid stock of cost references is required to prepare a draft budget as justifications have to be provided for all costs. Also, the MA has to provide evidence that the method is correctly applied. For that reason, a catalogue of cost benchmarks of frequently used items and recurrent costs (e.g., costs for organisation of a meeting, study visits, feasibility study, communication activities, etc.) should be developed by the MA based on the programme historic data, market research, expertise of national controllers. This costs catalogue could considerably reduce the workload for the applicants when developing their draft budgets; i.e., the applicant does not need to provide justifications for the costs below or equal to the reference costs.

Along with cost benchmarking, a programme might use some sort of 'performance benchmarking' – comparing of costs and expected outcomes of one project application against similar activities of different application. The focus of this benchmarking rests on the results and outcomes wherever possible.

Another way to formalise assessment of value for money is to develop SCOs for frequently recurring items and/ or indirect costs to be used inside draft budgets. When assessing draft budgets or budgets based on real costs, the MA can spot items, which are common for many projects. Based on the programme historic data, the MA can develop unit costs and/ or lump sums for these recurring items. This will ease the workload for both applicants (when preparing their draft budgets) and for programmes when assessing the value for money. For indirect costs, the MA can offer flat rate to be used inside the draft budgets (either off-the-shelf or programme-specific). This will allow focusing on the assessment of direct costs.

During the assessment, the MA might notice mistakes or areas for improvement or requires further clarifications and after a positive decision of the monitoring committee (or body approving projects) and prior to contracting, the draft budget can be discussed/revised with the project and "transformed" into a simplified cost option.

When it comes to documenting the methodology, the MA has to ensure a proper documentation of the projects drawn up using the draft budget method, supporting documents provided by the applicants justifying the amounts, the SCOs established based on the draft budget, assessment methodology, assessment results of each application, communication with projects before contracting, the subsidy contract, the approved application and any changes during the implementation. These can be stored electronically, using the monitoring system (e.g., eMS).

Given the individual approach, an extensive documentation on MA side is very important for verification and audit purposes (see further information under audit).

For contracting, it is recommended to design a “standard” subsidy contract in a way that it will also cover the requirements for SCOs following a draft budget methodology. Following the good practice to establish a “static” subsidy contract and only referencing “dynamic” elements as annexes (e.g. latest approved application form), the description of the SCOs applied, including payment triggers should be an annex to the subsidy contract. This approach helps to avoid additional administrative work in case of project changes. In any case, the MA has to ensure that all relevant SCOs and their application with the payment triggers are part of the contractual agreement.

3. Monitoring, management verifications & audit

The monitoring of the project implementation follows its usual principles: activities are matched against the approved application form with its related costs. However, some adjustments are needed:

- The programme has to ensure that deliverables or outputs defined for the payment trigger can be reported accordingly. For instance, if it has been agreed that a unit costs is applied for participants, that the number of participants can be reported. Or if a lump sum for an event is agreed that the project can specifically provide information on the event. For this, it might be necessary to design/adjust templates.
- The programme has to ensure that the rules for SCOs are respected. In case of lump sums the pre-defined output/ deliverable has to be provided in full (100%) before any payment can be made (binary approach of a lump sum).
- Depending on the SCOs established and the payment triggers agreed, the MA should keep in mind how this could affect the cash flow on the programme side and on the project side. Moreover, if and how the reporting cycle should be adjusted. To use a very much simplified example: Does it make sense for a project with a budget of less than EUR 100,000 and a duration of 1 year to ask for more than one report?

With regard to the management verifications, projects implemented entirely though SCOs based on the draft budget methodology, require almost no work (compared to regular projects and in terms of the regulatory verification requirements). Checks will be limited to the agreed deliverables/outputs, hence the project content and activities.

Programmes should consider the concrete management verification requirements for such projects and what is the most resource efficient way to comply with them (on both sides, programme and project).

Audit of the draft budget method

When it comes to auditing the draft budget methodology, the key is a complete and exhaustive documentation of the approach by the MA.

The EC has developed a checklist[1] for audit authorities on the review of SCOs. Section 2 of this document explicitly refers to the assessment of the SCO methodology. Since a draft budget is one of the methods to establish calculation methodology (Article 67(5) CPR), point 2.3 of it specifies the guiding questions for the assessment:

- In the case of a SCO based on the draft budget established on a case-by-case basis (Article 67(5aa) CPR, the AA has to verify that:

a) the budget was reviewed and agreed ex-ante by the MA;
b) the public support does not exceed EUR 100,000[2];
c) have changes in budget/scope of the operation been introduced after project approval?
d) if yes, is it acceptable in view of the initial conditions agreed?

The checklist further specifies that the documentation supporting the amounts established by the draft budget has to be reviewed. In order to assess that the overall budget is reasonable taking into account the planned activities/outputs and the project duration, different documentation/ information could be helpful, such as:

- documents demonstrating that the MA assessed the budget/the sources of the data used by the MA for analysis of the draft budget (e.g., cost benchmarks if existing),
- the historical data of the beneficiary,
- the amounts obtained by application of its usual cost accounting practices,
- any available data on market research, etc.

[1] The checklist – Review of the SCOs – can be accessed here: https://ec.europa.eu/regional_policy/en/policy/how/improving-investment/simplified-cost-options/ under the 5th ERDF/CF SCOs network of practitioners, 'Presentations' folder.
[2] The checklist refers to the amounts draft budget established on a case-by-case basis and agreed ex-ante by the body selecting the operation, where the total cost of the operation does not exceed EUR 100 000 – Article 67(5aa) CPR (EUR 200 000 – Article 48(2)(b) [new CPR]).

Other considerations

The following information provides further information for the draft budget methodology, including some examples.

Draft budgets and SPF

According to the draft ETC Regulation, the use of SCOs in small projects (where the public contribution does not exceed EUR 100 000) might be compulsory in the 2021-2027 programming period (Article 24(6) [new ETC]). This means that SCOs in small projects can be established either by using a fair, equitable and verifiable method or SCOs from other Union policies for similar types of projects and beneficiaries or by using a draft budget method[3].

In practical terms, in case the programme decides to establish a small project fund (SPF), the draft budget method allows to comply with the compulsory use of SCOs for small projects from the start. It might be taken as a complementary element to off-the-shelf SCOs in case the nature of projects in the SPF is quite diverse.

Draft budget method vs real costs

The draft budget calculation method shifts significant part of the workload for both applicants and the MA to the design of the method and application stage. The MA has to ensure that specific elements are in place when introducing a draft budget calculation method (e.g. cost benchmarks for recurring items, description of the specific eligibility rules for draft budget), whereas the applicant needs to provide justifications and supporting documents for all cost items included in the budget (together with calculation methods used, etc.). The MA has to define expected outcomes of the project, qualitative (fair, objective and transparent) and, if needed, quantitative requirements triggering the payment (which are recommended to be replaced with unit costs), supporting documents to easily verify the fulfillment of the conditions. It is adviced to go through all these elements together with the applicants to avoid misunderstandings and misinterpretations. The MA also assesses each draft budget on a case-by-case basis.

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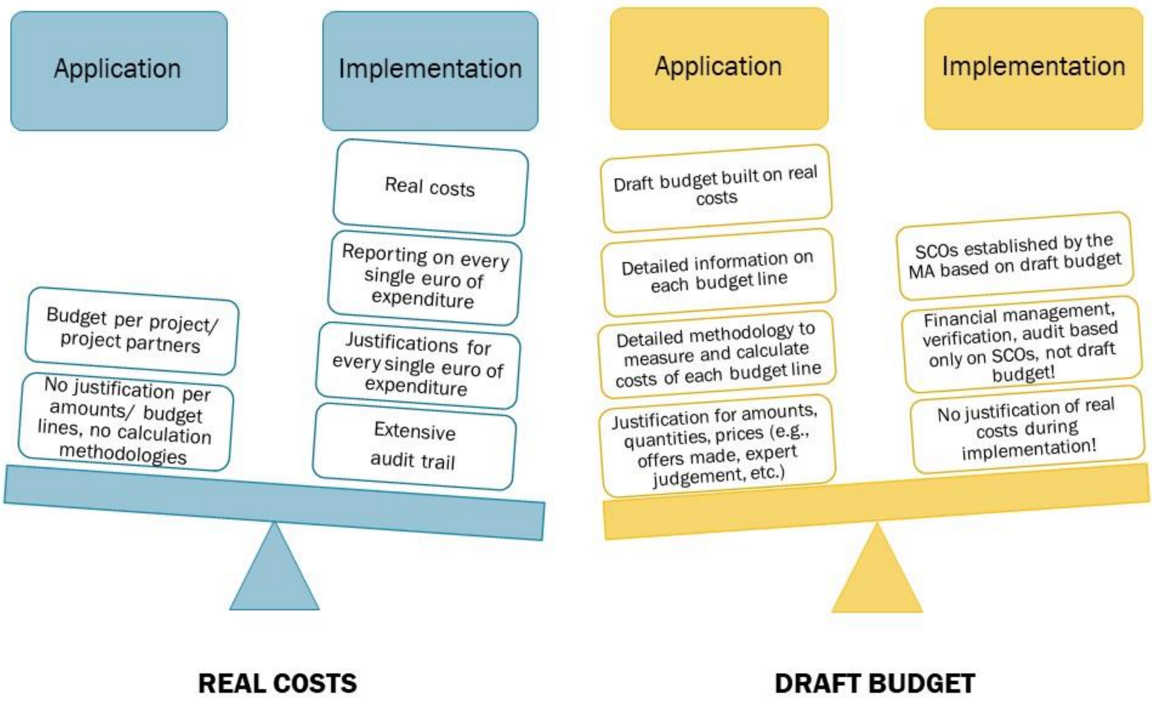
[3] At the moment of publication of this factsheet (April 2020), a provisional common understanding has been reached in the negotiations of the text of Article 24 [new CPR], which explicitly allows the draft budget method to be used in small project funds:
'Where the total costs of each project do not exceed EUR 100 000, the amount of support for one or more small projects may be set out on the basis of a draft budget which is established on a case-by-case basis and agreed ex ante by the body managing the small project fund.'



Even though a draft budget is based on real costs, once the SCOs are established, during the implementation of the project it is only the correct application of SCOs that has to be verified, and not the real costs from the draft budget. The work load in the implementation phase of the projects is then considerably reduced, because the financial management, verifications and audits are based only on SCOs.

Draft budget – challenges and opportunities

Challenge	Opportunity
Draft budget requires significant resources from the MA (e.g., to assess each draft budget individually, to establish SCOs based on draft budgets). The balance between the resources spent on the assessment of draft budgets and the size of projects (if applied for small projects only) has to be considered.	Draft budget gives room for projects to use their individual approaches and to innovate; it does not restrict projects to only certain types of activities and costs.
A solid stock of cost benchmarks for draft budgets needs to be developed by the MA (e.g., based on market research, programme historic data, public authorities/ national controllers expertise, web search, payment requests, from other draft budgets, etc.).	Applying cost benchmarks could significantly reduce the MA's workload during the assessment of draft budgets.
The MA needs to ensure consistency across different SCOs established based on different draft budgets.	SCOs developed based on the draft budgets can later on be extended to the programme level and applied by other projects.
If a single lump sum is established based on the draft budget (where a realistic and achievable output can be easily defined), there is a significant risk of a binary approach (yes/no payment) of the lump sum for a beneficiary.	In case a lump sum is established based on a draft budget, where more than 1 output/ activity with its 'own value' can be identified, it is possible to establish a lump sum with several stages. Like this, a binary approach will be avoided, as delivery of each output/ activity will trigger the payment of certain amount. This will reduce beneficiary's risks.
	Draft budget allows programmes to establish 'bottom-up' cost benchmarks; i.e., based on the real data from project applicants. This data pool can be used for future references and establishing SCOs (e.g., unit costs) for recurring items.
	Beneficiaries normally have sufficient information to back up costs that they include in their budgets.
	It is a method which allows for a 'rolling' process of learning and the later replacement of cost items which frequently appear in draft budgets by unit costs or lump sums (cost benchmarks might be used as ceilings – e.g., in AT such benchmarks are used to free applicants from the obligation to provide comparison offers for a range of widely used cost items).

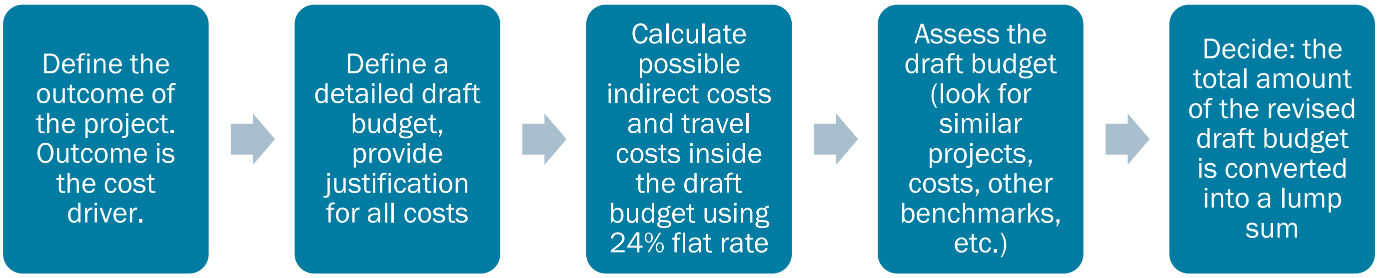
Example of a draft budget

Budget item	Cost, EUR	SCO	Approach
Kick-off workshop	15 000	Lump sum 1 = EUR 60 000	
Feasibility study	45 000		Milestone 1 (trigger Payment 1, EUR 60 000)
3 consultation workshops	12 000	Lump sum 2 = EUR 28 000	
Final conference and agreement on technical solutions	7 000		Milestone 2 (trigger Payment 2, EUR 28 000)
Staff costs	8 000		
Translation	1 000		
Total	88 000	EUR 88 000	

Case study from Finland: Lump sums based on draft budget

In the 2014-2020 programming period, Finland has used lump sums based on draft budgets in around 240 projects (co-financed from ERDF).

Calculation method of lump sums



Few points of attention:

- In this case, according to national eligibility rules, it is possible to use a flat rate to calculate indirect costs and travel costs inside a draft budget. Such specificities (e.g., SCOs to be used inside a draft budget, which costs fall under the SCOs, which are other eligible costs and budget lines) have to be clearly communicated to the applicants in advance.
- The flat rate for indirect costs and travel costs was established based on a fair, equitable and verifiable method (using programme historic data) based on Article 67(5)(a) CPR.
- The payment trigger is the outcome defined in the project financing decision. The payment is made only if the outcome has been achieved and the beneficiary has provided the evidence documents as specified in the funding decision.
- Lump sum project can be divided into several phases (if intermediate milestones can be defined). For each phase, a separate outcome must be specified in the project financing decision in which the payment is based. This approach allows to decrease a risk for the beneficiary significantly (as several payments are done, instead of one).
- Definition of the project outcome for the lump sum has to be specified in collaboration with the beneficiary to avoid any misinterpretations and misunderstandings (as delivery of that outcome triggers the payment – if no outcome delivered, no payment is done).