

# THE FINANCIAL RELATIONSHIP BETWEEN NGOs AND THE EUROPEAN COMMISSION



European Citizen Action Service  
53 rue de la Concorde  
B-1050 Brussels

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Tel. +32 2 548 04 90 ; fax.. +32 2 548 04 99  
Email. [admin@ecas.org](mailto:admin@ecas.org); website. [www.ecas.org](http://www.ecas.org)

## **THE FINANCIAL RELATIONSHIP BETWEEN NGOS AND THE EUROPEAN COMMISSION**

This policy research paper is one of a series of three prepared by ECAS with support from the Charities Aid Foundation. The other two concern the European Commission's relations with NGOs and citizens' initiatives. The policy research was discussed at a seminar held on 13 September 2004 under the title 3 C's for participatory democracy. As the report of that event points out:

“At the moment concerns about the financial regulation were being expressed in private and behind the scenes because NGOs were concerned about their short-term financial interests. It was probably time however to go public and together with financial institutions and foundations providing guarantees or co-funding for projects, push for revision of the financial regulation.”

ECAS hopes that this paper will contribute to such a public discussion.

A typical European NGO receives roughly half of its income from the public purse. While there are differences between the degree of subsidy accorded to the NGO sector by the different Member States, the proportion of their income that NGOs derive from public sources remains more or less constant across the whole of the EU. The financial relationship that exists between the NGO sector and public funders is thus a vitally important one.

The bulk of the public money that NGOs receive comes, of course, from national governments, regional and local authorities, and quasi-governmental organisations operating at national, regional or local levels.<sup>1</sup> Nonetheless the Commission has, over the years, been an important source of finance for NGOs. The sums involved may not be large in relation to the funding needs of the sector as a whole, or indeed to the EU budget as a whole, but they are still significant<sup>2</sup> and, as will be argued below, have an importance which goes well beyond the actual funds involved.

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<sup>1</sup> A tiny proportion comes from private or philanthropic sources.

<sup>2</sup> The Commission's 2002 discussion paper « The Commission and Non-Governmental Organisations : Building a Stronger Partnership » noted that at that time several hundred NGOs in Europe and worldwide were

The question the sector is now asking is whether the Commission is likely to continue to fund NGOs at the level at which it has done in the past and, by the same token, to continue to develop its partnership with them. There are unfortunately signs that, rhetoric apart, the relationship between the Commission and NGOs will be looser than in the past and the funds available to the sector curtailed. Indeed, it now seems certain that, in practice, financial support for smaller organisations will be drastically reduced.

In "Listening to Civil Society" it was noted that in the light of the Commission's decision to concentrate on its 'core functions' there was a danger that it would be forced to withdraw from much of its direct contact with NGOs and to abandon many smaller grant regimes of great interest to them. The paper added that "This danger is reinforced by an evident lack of staff to deal on a day to day basis with even the present number of grant applications from NGOs and the management and financial accountability problems the Commission has experienced in dealing with intermediary bodies."

Since that time there have been two developments which have reinforced these fears. First, as has been noted, the Commission failed properly to consult NGOs about the future of the Structural Funds or to push the Member States to consult the sector at national level. In the words of a report commissioned by ECAS<sup>3</sup> the result is that "Combined with the end of PHARE and the withdrawal of foreign donors, the financial sustainability of the sector in several countries is in doubt." This finding, that together these factors would threaten "the sustainability of a fast-growing but still relatively deprived sector" was prefigured in an earlier report by ECAS 'NGOs and the Structural funds'.<sup>4</sup>

Confidence in the Commission's future intentions has been further undermined by the advent of the Council Regulations which in 2002 - introduced without the least consultation - new financial rules applicable to the Union's budget and detailed procedures governing their implementation.<sup>5</sup> Together, these two Regulations have posed severe problems for NGOs - to the extent that those without the necessary administrative sophistication or financial means are effectively prevented from applying for grants while others, which might otherwise apply, are reportedly on the verge of withdrawing because the cost, effort, and

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receiving funds from the Commission, and that the sums going to them were considerable - over €1000 million, which represents about 1% of the total EU budget, being allocated to NGO projects directly by the Commission.

<sup>3</sup> "Access by NGOs to the structural funds in the new member states of eastern and central Europe. A report for the Euro Citizen action Service. Brian Harvey, June 2004

<sup>4</sup> See the ECS website

<sup>5</sup> Council Regulation No 1605/2002 is the basic Financial Regulation. Regulations 2342/2002, 2343/2002, and 2344/2002 covers the implementation of the Financial Regulation. (The latter are contained in one document) It is important to understand that all these texts need to read together.

frustration involved in applying is not proportionate to the results achieved. The result is that significant numbers of NGOs are now convinced that the Commission has the covert intention of withdrawing altogether from grant-aiding the sector. Calm reflection might suggest that this is unlikely, but the reaction of many NGOs is, in the circumstances, understandable, and the impression hard to avoid. Given the sector's reaction it is all the more unfortunate that it was not consulted at the time that the Regulations were being developed. Indeed, it was stressed at the seminar on 15 September that although consultation is time consuming and expensive, the financial regulation is a example of the costs and loss of goodwill which occur as a result of non-consultation.

### **The Financial Regulation**

It is not difficult, given the problems which the Commission has had in preventing fraud, and its loss of self-confidence following the resignation of the Sauter Commission, to see why it was felt necessary to introduce new financial rules. And in any event, the prevention of fraud, the enforcement of accountability, and the introduction of greater transparency, are all admirable objectives.

There is, indeed, much to welcome in the new rules. The introduction of activity based budgeting – that money should be tied to purposes - and the evaluation of the results of expenditure<sup>6</sup> are clearly welcome, if not overdue. Similarly welcome in principle is the new split between the functions of budgeting, auditing and financial management, involving as it does the devolution of responsibility for expenditure and detailed financial management to officials in the DG dealing with the relevant subject matter.<sup>7</sup> As concerns grants, that their award “shall be subject to the principles of transparency and equal treatment” and that they “may not have the purpose or effect of producing a profit for the beneficiary”, seems only right. The new annual programme for grants as well as the naming of beneficiaries will also introduce a usefully more regular and transparent grants cycle.<sup>8</sup> Indeed at the seminar on 13 September, many participants did point out that the financial regulation had brought more clarity.

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<sup>6</sup> Chapter 7, Article 27(3) & (4)

<sup>7</sup> As any bureaucrat knows, the experience of dealing with financial officials with little or no interest in policy but a great deal of power, can be difficult and time-consuming.

<sup>8</sup> The Financial Regulation (1605/2002), Article 110.

Taken as a whole however, there is no doubt that the Regulations are posing severe, and in some cases insuperable problems for NGOs. In the words of a recent paper by CONCORD<sup>9</sup>, they confront NGOs with “rigid financial and managerial rules which put at stake the efficiency and effectiveness of cooperation between NGOs and the European Commission”. Leaving aside the additional problems caused by the Standard Contract for Grant Management to which aid organisations are subject, this is a judgement with which many NGOs would agree.

Indeed, it was a judgement supported by the speakers and most of the participants at the seminar. There is a strong feeling that the financial regulation is not working well. NGOs even have allies in the Institutions who are well aware that its application is simply far too burdensome. Controls and paper work must be kept in proportion.

The problem for NGOs, especially smaller ones is, in short, that the Regulations take little or no account of their specific characteristics, or their typical capacities and means. Many NGOs do not have the time or the resources to devote to the heavyweight administration and grant management demanded by the Regulations or the means to pay for sometimes repeated audits or to qualify for the bank guarantee that may be required.<sup>10</sup> Those that have the time and expertise necessary to apply for grants and are successful can find themselves spending an inordinate amount of their resources – especially in terms of the time of senior management - on complying with the Commission’s demands. This a great pity, since had there been consultation, the problems could easily have been foreseen and a sub-set of rules devised which would have at once been suitable for NGOs and have respected all the important *principles* – for example, of transparency and accountability - on which the Regulations are rightly based.<sup>11</sup> As a first step towards the development of such rules research could be carried out into a sample of procedures used by major public and private donors and a judgement made of their effectiveness and adaptability. In any event it is, in this context, important not to mistake bureaucracy for control: simple rules applied in good faith can work perfectly well and, as recent commercial scandals have amply demonstrated,

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<sup>9</sup> European NGO Confederation for Relief and Development: “Major concerns raised by NGOs on the Financial Regulation respective the Standard Contract for Grant Management”

<sup>10</sup> See Article 118 of Regulation 1605/2002 under which “the authorising officer *may* require (our italics) the beneficiary to lodge a guarantee in advance in order to limit the financial risks connected with the payment of pre-financing”.

<sup>11</sup> For example, the UK Charities Acts impose graduated reporting and accounting requirements on charities according to their assets and turnover. All charities, however, have to produce reports and accounts which have to be either professionally audited or independently examined, to provide full information about themselves and are subject, if necessary, to investigation by the Charity Commission. Grant conditions are, of course, a matter for the donors.

even professional auditing is not always capable of uncovering sophisticated fraud - of a kind which, incidentally, the vast majority of NGOs would hardly be able to carry out.

It is clear then that changes are urgently required. Indeed the Commission has already recognised this in the relation to the Erasmus programme. In a Communication issued on 14 July this year<sup>12</sup> the Commission acknowledged that pressure "for a simpler and more flexible programme" has come not merely from public consultation, Member States and National Agencies, but also from the "Commission in its budgetary Communication".<sup>13</sup> It adds that simplification "requires more than good intentions: it requires that the legislative environment be appropriate; and that where it is not appropriate the necessary legislative derogations should be introduced. In specific terms, this implies focussed derogations to the Implementing Rules for the Financial Regulations." Among the derogations mentioned are those enabling "simpler application forms and contracts" and "simplified documentation on the financial and operational capacity of beneficiaries". All in all the case for change could hardly be put more strongly.

If the Regulations are to be made more user-friendly derogations like those the Commission is proposing in respect of the Erasmus Programme will be necessary for all grant regimes involving NGOs. Change is, however, likely to take some time and the question arises what NGOs should do in the meantime.

In its annual funding guide, ECAS is beginning to advise NGOs to weigh up very carefully the pros and cons of access to European funding before they apply. The advantages of accessing the funds include the wide range of projects available, the professionalism that can be gained in project and financial management, and the working together with partners from different countries and different sectors.

But particularly smaller NGOs have to be aware of the disadvantages:

- The financial requirements are too high. Finding a guarantee for the project in a climate where banks, even social economy and mutual banks close to the sector, require assets or full cash backup may prove impossible. Had financial institutions been consulted on the financial regulation and been made aware of the low risks involved, they might now be more favourable and have devised solutions. For

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<sup>12</sup> COM(2004) 474 final "Proposal for a decision of the European Parliament and of the Council establishing an integrated action programme in the field of lifelong learning".

<sup>13</sup> This is an important confirmation of the fact that the present rules are a cause of real difficulties and additional work for the Commission as well as NGOs.

smaller or even medium-sized organizations, finding a guarantee *and* matching funding is not easy. It would be useful if the Commission, NGOs and financial institutions could organize a seminar to look into possible solutions.

- The application procedures are too heavy. A typical response to a call for proposals, the writing up of the application, producing the budget in a special format, obtaining letters of commitments from co-funders, and meeting all the formal requirements such as declarations from banks and auditors, is about one month's work. It is necessary to block off one full day simply to put together all the documents in the right way in the sealed envelopes, before the deadline. It is necessary to invest heavily in making the application because they can be rejected on purely formal grounds: the statutes were in the wrong language; the accounts were missing, and so on. It would be better to have a system which is sometimes used by the Commission - an invitation for a preliminary assessment and a short four page proposal for shortlisting, so that only successful candidates need embark on the compilation of a 30-70 page dossier.
- A predetermined and over-rigid approach can stifle creativity. On the one hand, it is true that the Commission looks for innovation at least at one level. Those grant seekers who offer something extra, like an original approach to communicating the results of the project or propose an interesting type of partnership will be noticed. And it is certain that not all projects should be innovative: the aim may simply be to "reach the unreachable" on issues connected to EU policies. On the other hand, too much has to be established in advance about the contents and results of a training programme, seminar or research project, thus excluding genuinely creative or risk-taking proposals. Applications stand or fall on fitting in to pre-existing objectives, reflecting programmes already adopted by the Institutions, rather than on their chances of pushing at the boundaries of policies. Moreover, variations allowed in the budget or changes in the timescale are very restrictive, making it difficult for NGOs to experiment with a different ways of doing things in the course of a project. And yet, such flexibility and achieving sometimes huge results on very limited resources, is one of the strengths of the NGO community. Too often the conclusion is "don't look towards EU funding to do anything new".

In the experience of many NGOs, the problems posed by the Financial Regulation itself are exacerbated by the way that it is implemented. The complaint here is essentially of

confusingly different practice between different DGs and sometimes even between different holders of the same post.

It is difficult to say quite what the reasons are for these differences in approach. They may simply reflect the fact that bureaucracies often appear to find it easier to enforce uniform rules on others than on themselves. There is, however, another more worrying possibility.

As has been said, the responsibility for the day-to-day financial management of Commission funded projects now lies with officials in the DGs – the so-called ‘authorising officers’. In effect the Financial Regulation makes the authorising officer personally responsible for ensuring that his actions conform in all respects with its provisions. This is as it should be. The difficulty is that, as in all legislation, it is not always entirely clear what is required (must there be a bank guarantee or is a guarantee simply advisable?) while at the same time the consequences of being judged to have fallen short are potentially draconian. Chapter 4, Section 2, Article 66, makes the authorising officer liable to repayment of compensation (i.e. to make good losses in whole or in part) of any damage suffered by the Commission as a result of “serious misconduct” or if she or he carries out his or her financial responsibilities “without complying with this Financial Regulation and its accompanying implementing rules”. Article 67 gives examples of the sort of conduct which might lead to disciplinary action and payment of compensation one of which is: (a) “he/she loses or damages monies, assets and documents in his/her keeping”.

Easy enough, one might suppose, and it may well be true that the ‘financial irregularities panel’ which, under the Regulation, would examine individual cases, would take an humane and reasonable view of the matter in the light of all the facts. Nonetheless, it is not difficult to see that different officers might well react differently to the perceived threat of disciplinary action. Thus what an individual officer might require by way of guarantees, audits and information, might well differ according to his or her experience, the size of the grant and its public profile, how well the organisation is known to him or her, and a host of other factors not to mention his or her interpretation of the Regulation itself.

If the above analysis has any force, what might provide some reassurance for officials is something like the doctrine of ‘good faith’ established by the English courts in respect of charity trustees - who are in most circumstances technically personally liable for any loss incurred by their charities as a result of ‘mismanagement or abuse’. The courts have in effect said that trustees will not be pursued if they act in ‘good faith’ – that is if they think that they are doing the right thing however foolish or misguided they might be and even

though the results might well be serious. *Intentional* 'mismanagement' or 'abuse' is another matter entirely, and here the courts can (and sometimes do) come down very severely on miscreants, particularly if personal interests are involved. The doctrine would not, of course, translate wholesale – for one thing it will no doubt sometimes be appropriate to take disciplinary action against officials - but a degree of necessary reassurance might nevertheless be provided by a code embodying much the same principles. The essential point is that a distinction needs to be drawn between actions carried out in good faith and those which are not. There is a presumption in Community law from the jurisprudence of the court that Union Institutions and their officials operate in good faith.

### Funds for Smaller NGOs

It is in the nature of the NGO sector continually to renew itself from below, and such renewal is essential to its health. In this sense, the sustainability of the sector does not depend simply on continued funding to enable existing NGOs to continue their work, but also on providing small sums, particularly at local level, to enable the formation of new bodies. It is a matter of real regret that such small sums have been seriously lacking from public sources.

They are most urgently needed in Eastern and Central Europe, where, with few exceptions funders, whether private or public, have concentrated on establishing infrastructure - information centres and other bodies designed to serve the sector or a part of it – and training organisations aimed at helping build the sector's capacity. Furthermore funding has been heavily concentrated on capital and other large cities to the virtual exclusion of rural areas. The situation is not as bad in the rest of Europe, but the problems are, in essence, not dissimilar.

There is no doubt that information centres and the like have played an essential role in informing governments and other public authorities about the sector and in raising its profile in the public mind. The services they offer are, however, of little use to small and for the most part unsophisticated organisations with limited local ambitions. Their need is not for information or for the sort of training typically offered – for example, in fundraising, in management or in advocacy – but simply for small, often very small, sums of money. As local actors those struggling to take action know their territories better than anyone and very often have no need of outside help or technical assistance of any kind. They simply lack the necessary money to get their projects off the ground.

The impoverished and neglected state of smaller NGOs can hardly be laid at the Commission's door, but it is something of which the Commission ought to be aware and it could help by setting an example. It would not, of course, be able to run a small or 'micro' grant regime itself, but it could take up the suggestion made in "Listening to Civil Society" of conferring the role of intermediary grantmaker on foundations, or consortia of foundations operating at European level.<sup>14</sup> Initially, such a scheme could count as a pilot "of an experimental nature designed to test the feasibility of an action and its usefulness" under Article 49 of the Financial Regulation, and as such could run for an initial two years without a legal basis. Under Articles 53(2) and 54(2)(c) of the Financial Regulation the scheme could be entrusted to foundations as "bodies governed by private law with a public-service mission".

Initially the scheme could, for example, be used to fund start-up funds for small projects embodying new ideas which are more risky than would normally be acceptable under EU programmes; for international contacts designed to encourage mutual learning or to create partnerships; and for modest individual travel bursaries to enable attendance at relevant seminars. For rather larger organisations it could pay for training in accessing EU funds or the creation of partnerships sufficiently substantial to enable the partners to access the Structural Funds. The fund would cover all Member States but with a bias to assisting organisations in rural areas, especially in the new Member States and in existing and likely future accession countries.

The fact that the Commission might lack the resources or the necessary expertise to run a small grants regime targeted at rural areas in the new Member States and the applicant countries does not, of course mean that it should withdraw altogether from direct grantmaking. On the contrary. As "Listening to Civil Society" put it: "the danger (of withdrawal) is not simply loss of funds for the sector and a lessening of its capacity to operate at European level in some fields, but loss of official expertise in dealing with NGOs". Certainly, without the knowledge and expertise that the Commission has built up over many years – largely in the context of grantmaking – it is difficult to see how it could credibly take a strategic interest in the development of civil society in Europe.

In any event, a failure on the Commission's part actively to engage in the strategic development of civil society in Europe would be serious indeed. In that sense the importance of continued and direct funding lies less in the resources accruing to the sector, important though these might be, than in the earnest it gives of the Commission's recognition of the

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<sup>14</sup> The participating foundations would be expected to co-fund the scheme.

sector as essential to the future development of the Union and of its determination to see that development proceed in an equitable, balanced, and democratic manner.

### **Recommendations**

Given that the Financial Regulation is unlikely to be amended quickly, there should be established a working party composed of representatives of the Commission and NGOs to examine what flexibility there might be in favour of NGOs and to ensure uniformity of treatment.

In the longer term there should be derogations similar to those proposed for the Erasmus Programme on lifelong learning.

A doctrine of 'good faith' should be established designed to reassure officials that honest mistakes will not be followed by disproportionate measures.

That there should be a small/micro grants scheme funded by the Commission but managed by a consortium of foundations who would be expected to co-fund the scheme.

That the Commission should issue a statement that it remains committed to strategic direct grant-making.

Any future financial regulation should be subject to full and wide consultation.