



Recommendation paper on Financing Not Linked to Costs

ESF Transnational Cooperation Platform
Community of Practice on Results-based Management

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What is the European Social Fund (ESF) Transnational Cooperation Platform?

Mutual learning is at the core of the ESF Transnational Cooperation Platform and its four Communities of Practice (CoP): employment, education and skills; social inclusion; results-based management; and social innovation.

The ESF Transnational Cooperation Platform gives CoP members, including managing authorities, intermediate bodies and other ESF stakeholders, the opportunity to participate in mutual learning activities and tackle common challenges together. The CoPs were created as a place for members to share ideas and concerns, deepen knowledge and expertise, and help one another to solve problems with practical approaches.

The mutual learning activities generate hands-on outputs such as toolkits, guides, practice mapping, checklists and recommendation papers that can inspire practitioners and policymakers alike.

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This paper has been prepared by Luca Santin, Lead Thematic Expert of the ESF Community of Practice on Results-based management established under the ESF Transnational Platform.

The paper is based on recommendations and proposals shared by representatives of ESF managing authorities, audit authorities and national coordination bodies from all (27) EU Member States within the ESF Community of Practice on Results-based management (CoP RBM). Key contributions for the preparation of the paper were also provided by members of the CoP RBM's subgroup on 'Results-based Approaches' and by officials of the European Commission DG EMPL – Unit G1 European Social Fund + and REGIO-EMPL Joint Audit Directorate for Cohesion.

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List of abbreviations

AA: Audit Authority

CoP RBM: (ESF) Community of Practice on Results-based Management

CPR: Common Provisions Regulation for the 2021-2027 programming period

ESF+: European Social Fund +

ESI Funds: European Structural and Investment Funds

EU: European Union

FNLC: Financing not linked to costs

IB: Intermediate body

MA: Managing authority

MS: Member State

NCB: National coordination body for Cohesion Policy/EU Funds

OTS: Off-the-shelf options

SCO: Simplified cost options

TN: ESF Thematic Network on Simplification

Introduction

The concept and content of this recommendation paper on financing not linked to costs (FNLC) were designed by the European Social Fund (ESF) Community of Practice on Results-based Management (CoP RBM), which builds on the work of the ESF Thematic Network (TN) on Simplification between 2015 and 2020.

Established under the ESF Transnationality Platform, the TN and CoP RBM carried out work programmes involving ESF managing authorities (MAs), intermediate bodies (IBs) and audit authorities (AA), national coordination bodies of Cohesion Policy or EU funds (NCBs) and ESF stakeholders from all Member States of the European Union (EU), as well as several Directorates-General of the European Commission, coordinated by the Directorate-General for Employment, Social Affairs and Inclusion (DG EMPL), Unit G.1.

Aim of the paper

This paper aims to support ESF+ authorities and stakeholders in designing FNLC schemes. It presents key recommendations from discussions within the CoP RBM and its subgroup on results-based approaches, as well as preliminary experiences of the Member States that have developed draft FNLC schemes.

Target audience

The paper is primarily aimed at representatives of ESF+ authorities and stakeholders with little or no experience in FNLC design, as well as authorities from other EU funds and programmes.

Approach

The paper is based on two key assumptions, validated by CoP RBM members:

- It does not constitute additional requirements or interpretation of legal provisions, and should not be seen as a source of ‘gold-plating’¹.
- It presents both good and not-so-good practices dos and don’ts.

Sources and legal framework

Key sources of information in preparing the paper were:

- Presentations by DG EMPL officials and representatives of Member States experienced in the design of FNLC schemes.

¹ Gold-plating is the process by which a Member State, in transposing EU Directives into national law or implementing EU legislation, imposes additional requirements, obligations or standards that go beyond the requirements or standards foreseen in the transposed legislation (European Commission, 2015). The term is often used in the context of the implementation of the European Structural and Investment Funds (ESI Funds) to describe the administrative supplementary requirements and burdens imposed on beneficiaries by the ESI Funds national and sub-national authorities, both in response to EU-level procedures and stemming from national administrative traditions and customs (High-Level-Group on Simplification, 2016).

- Outcomes of group discussions at CoP RBM plenary and subgroup meetings.

The paper refers to provisions under the legal framework of the European Structural and Investment (ESI) Funds for the 2021-2027 programming period - in particular, to the Common Provisions Regulation (CPR) adopted for this period².

Structure of the paper

The paper is structured around several key points (questions) on FNLC design and implementation identified by CoP RBM members:

- *What is FNLC*: section 2 presents the main aspects defining FNLC, as well as a short comparative analysis of FNLC and simplified cost options (SCOs).
- *Why FNLC should be used*: section 3 illustrates the main advantages of using FNLC.
- *When and where to use FNLC*: section 4 presents recommendations on the scope of FNLC schemes, particularly suitable types of operation.
- *Who should be involved in FNLC design*: section 5 presents the authorities involved in the design and assessment of FNLC and provides recommendations on the collaboration needed between authorities.
- *How*: section 6 includes preliminary recommendations on the design of FNLC proposals.

Finally, section 7 summarises the key recommendations identified by CoP RBM members.

1. Defining FNLC

Article 51 of the CPR defines FNLC as a form of Union contribution based on:

- (i) the fulfilment of conditions; or
- (ii) the achievement of results.

Where FNLC is used, the amounts to be reimbursed are linked to the fulfilment of the conditions or the achievement of results. They are determined *ex ante* (i.e. prior to implementation of the FNLC scheme) in one of two ways:

- By Member States submitting FNLC proposals to the Commission, under Article 95(1) CPR, together with the ESF+ programme (or a request for programme amendment). The proposals are submitted in accordance with the specific template

² Regulation (EU) 2021/1060 of the European Parliament and of the Council of 24 June 2021 laying down common provisions on the European Regional Development Fund, the European Social Fund Plus, the Cohesion Fund, the Just Transition Fund and the European Maritime, Fisheries and Aquaculture Fund and financial rules for those and for the Asylum, Migration and Integration Fund, the Internal Security Fund and the Instrument for Financial Support for Border Management and Visa Policy.

set out in Annex V, Appendix 2 to the CPR. Following a positive assessment by the Commission, the FNLC scheme is approved, together with the programme or the request for its amendment; or

- European Commission adopts a delegated act under Article 95(4) of the CPR, establishing amounts for Union-level financing by type of operation (EU-level FNLC).

Pursuant to the provisions of the Financial Regulation³, the methods to establish FNLC shall ensure:

- Respect for the principle of sound financial management. With respect to the appropriateness of the amounts linked to the fulfilment of the respective conditions or the achievement of results, the Commission and the Member State should ensure that the resources employed are adequate for the investments undertaken.
- Reasonable compliance⁴ with the principles of co-financing and no double funding.

Other than these guiding principles, the CPR does not make reference to methods that could be applied to determine the amounts within FNLC schemes.

Compared to other simplification measures (e.g. SCOs), FNLC is relatively new, having been introduced for the first time in the 2014-2020 programming period.

ESF+ practitioners within the ESF CoP RBM often deal with the question of the difference between FNLC and SCOs. Table 1 presents a preliminary comparative analysis of the differences (and similarities) between these two simplification measures.

³ Regulation (EU, Euratom) 2018/1046 on the financial rules applicable to the general budget of the Union.

⁴ CPR uses the wording 'reasonable compliance', with CoP RBM members noting that this could lead to subjective decisions. It is important to ensure, *ex ante*, that the method to establish FNLC complies with the principles of co-financing and no double funding.

Table 1 – Differences between FNLC and SCOs

Key aspects	SCOs ⁵	FNLC
Definition	'SCO are <u>amounts or percentages</u> that represent the <u>best possible approximation of actual (real) eligible costs</u> incurred in practice when implementing an action'.	FNLC is a form of reimbursement based on conditions or results. The amounts set out in FNLC schemes are not defined as approximation of actual (real) eligible cost (i.e. reimbursement is not linked to costs).
Timing	Both SCOs and FNLC should be defined <i>ex ante</i> (i.e. before the actions covered by the simplification measures are implemented).	
Approach	SCOs are based on 'processes', 'outcomes' or 'results'.	FNLC is only based on 'conditions' or 'results'.
Methods	CPR provides several methods to calculate SCOs.	No specific method envisaged. The principle of sound financial management shall be respected.
Off-the-shelf options	Several off-the-shelf options are included in the CPR. EU-level SCOs can be established by the Commission under Article 94(4) CPR.	Possibility of EU-level FNLC adopted by the Commission under Article 95(4) CPR.
Mandatory use	In principle, the use of SCOs is optional. Exception: where the total cost of an operation does not exceed EUR 200 000, the use of SCO is mandatory, except for operations for which the support constitutes State aid.	Use of FNLC is always optional.
Adoption assessment by Member States	SCOs can be adopted by Member States under Article 53 or Article 94 CPR. Under Article 94, ex ante assessment by the Audit Authority is mandatory prior to Commission approval (highly recommended under Article 53).	FNLC are adopted by MS under article 95 CPR. The proposals are assessed by the Commission (as for SCOs under article 94), but ex ante assessment by the Audit Authority is not mandatory (still consulting the AA is highly recommended).
Verifications and audit	Where SCOs and FNLC are used, verifications and audits are limited to checking that the conditions (or results) triggering the reimbursement are fulfilled. The underlying costs of the operations covered by SCOs or FNLC shall not be subject to verifications or audits. It is also important to note that methodologies establishing FNLC and SCOs (where adopted under article 94 CPR) shall not be subject to audits.	
Reimbursement bases	Both SCOs and FNLC can be used for reimbursements from the Commission to Member States and from the Member States to the final beneficiaries (in the case of FNLC, grants provided by Member States to beneficiaries may take the form of FNLC only if such grants are covered by a reimbursement of the Union Contribution pursuant to Article 95 CPR).	

⁵ ESF CoP RBM, *Manual on Simplified Cost Options*, 2021, available at: <https://ec.europa.eu/european-social-fund-plus/en/publications>

2. Why FNLC should be used

The use of FNLC has several advantages for ESF+ authorities and stakeholders, some of which are common to SCOs:

- **Reduced administrative costs and burdens.** Recital (34) CPR states that ‘where a financing scheme not linked to costs is used in a programme, the underlying costs linked to the implementation of that scheme should not be subject to any verifications or audits’. This would significantly alleviate administrative costs (for the authorities) and burden (for final beneficiaries).
- **Enhanced focus on policy objectives and results.** Setting up an FNLC scheme requires the MA to clearly define what will be financed, for what objectives, and under which specific conditions.
- **More effective policy development and implementation.** Final beneficiaries can fully focus on fulfilling the conditions and achieving the results relevant to realising policy objectives.
- **Lower error rate,** compared to real costs. Similar to what has been reported for SCOs by the European Court of Auditors⁶, projects whose costs are declared using simplified rules are less error-prone, suggesting that more extensive use of FNLC will have a positive impact on error rates.

FNLC has several additional advantages compared to SCOs:

- **Calculation method is not required.** Given that FNLC should not lead to the *best possible approximation of actual (real) costs* (as in the case of SCOs), the MA is not required to develop a calculation method to establish the amounts linked to conditions and results. Rather, the only requirement is to justify the amounts in compliance with the principle of sound financial management.
- **FNLC allows greater flexibility** in determining the amounts linked to conditions and results. For example, the amounts could be established on the basis of savings in public expenditure through achieving the results envisaged by the scheme. Being “not linked to costs”, FNLC could be also considered for financing innovative policy schemes, for which no historical data are available to calculate SCOs.
- **Enhanced possibilities to achieve challenging results.** The achievement of more challenging results could be incentivised by establishing higher amounts, unlike SCOs, where amounts cannot exceed the actual costs incurred by beneficiaries.
- **Paradigm shift in approach to ESF+.** FNLC is not solely an instrument to finance projects, but also further enhances possibilities for approaching ESF+ as a ‘policy instrument’.

⁶ European Court of Auditors, *Annual report of the Court of Auditors on the implementation of the budget concerning the financial year 2018, 2019*.

3. When and where to use FNLC

Although FNLC is theoretically applicable to any ESF+ intervention, several aspects should be considered when assessing whether an operation is suitable for this form of financing:

- **‘Size’ (percentage of budget covered) of the operation.** The CPR does not provide for a minimum amount to be covered by FNLC proposals under article 95. However, setting up FNLC schemes implies some work for the MA (design the scheme and prepare the proposal), the Commission (assess the proposal) and, possibly, the AA (whose assessment is highly recommended). It is recommended that FNLC proposals submitted for approval by the Commission cover a considerable percentage of programme contribution.
- **Policy-based approach.** Members of the CoP RBM have noted that FNLC should be seen as a form of ‘policy-based financing’, whereas SCOs are better viewed as a measure to simplify the financing of ‘projects’. The scope of FNLC (types of operations covered) should include interventions that could have a considerable impact on the achievement of key policy objectives.
- **Possibility to identify clear and measurable conditions or results.** Defining an FNLC proposal implies a clear, *ex ante* definition of the technical standards⁷ of the types of operation covered and conditions to be fulfilled or the results to be achieved in order to trigger the payments. Similar to SCOs, the target group and conditions and/or results triggering payment should be clearly defined for all types of operations covered by the FNLC scheme. Selecting recurrent and stable operations (i.e. financed in the past under conditions that would not change significantly over time) could facilitate the standard-setting process and the identification of relevant conditions or results. FNLC could also be viewed as an effective solution to finance innovative policy schemes (see section 2).

4. Who should be involved in FNLC design?

According to the CPR, it is the sole responsibility of the MA to prepare and submit the FNLC proposal to the Commission, in view of its adoption under Article 95.

However, the preliminary experiences of early adopters of FNLC indicate that such schemes should be designed as a collaboration between authorities and include dialogue with relevant stakeholders:

- **Relevant policymakers, IBs and line ministries.** Taking into account the need to clearly define the technical standards of the types of operation and indicators, as well as the potential impact of decisions on the design of the FNLC schemes at policy level, it is recommended that relevant policymakers, IBs and line ministries be involved in the decision-making process. Defining FNLC is not merely an administrative process.

⁷ The description of the type of operations covered by the FNLC scheme is one of the key aspects to be covered by proposals under article 95 CPR. The description should be clear and sufficiently comprehensive to allow the assessment of the proposal, but MAs should avoid including technical specifications that may hinder flexibility or generate unnecessary constraints - beneficiaries should focus on what to achieve, rather than how to achieve it.

- **AA.** The *ex ante* assessment of FNLC proposals by the AA is not mandatory, but consultation is recommended by members of the CoP RBM, much like with SCOs⁸. Under Article 95 CPR, the Commission's adoption of the proposal ensures legal certainty on the compliance of the FNLC scheme with EU rules. However, consulting the AA facilitates better proposal design and prevents misunderstandings (e.g. on the audit approach and audit trail) or potential errors in the implementation phase.
- **ESF+ stakeholders, social partner final beneficiaries.** FNLC implies a paradigm shift and change in mindset for authorities and stakeholders, particularly for programmes with little or no experience in implementing results-based approaches. Learning from more experienced MAs, it is recommended that, during proposal design, ESF+ stakeholders and beneficiaries are kept informed of the key aspects of the scheme and practical implications (pros and potential cons) of its implementation. Consulting stakeholders early on paves the way to better (and more sustainable) implementation of FNLC schemes. In addition, social partners have important contributions to make to the design of the policy approach and the FNLC scheme.
- **European Commission.** Early – ideally informal – consultation with the European Commission is strongly recommended in order to facilitate smooth and swift adoption of the scheme.

5. How to design FNLC proposals

This section presents preliminary recommendations on how to design FNLC proposals under Article 95 CPR. These recommendations and insights were identified by members of the CoP RBM and the CoP's subgroup on results-based approaches.

Table 2 presents these recommendations in line with the template for submitting FNLC proposals to the Commission. It refers to items included in section B of Annex V, Appendix 2, to the CPR.

⁸ CoP RBM, *Ex ante assessment of Simplified Cost Options and partnerships between managing authorities and audit authorities - How to do it?*, 2021, available at: <https://ec.europa.eu/european-social-fund-plus/en/publications>

Table 2 – Preliminary recommendations on FNLC design

Items in section B of Annex V, Appendix 2	Preliminary recommendations
1. Description of operation type	<ul style="list-style-type: none"> ▪ It is essential to clearly describe the types of operation and specific objectives covered by the FNLC scheme (i.e. what does the MA want to finance and for what specific objectives). Unclear or incomplete descriptions make it difficult for the Commission to start the assessment and make it impossible for final beneficiaries and stakeholders to understand the conditions or results to be achieved.
2. Specific objective(s)	<ul style="list-style-type: none"> ▪ Keep the description simple and to the point, omitting information that is unnecessary to defining the scope of the FNLC scheme and assessing the proposal. Such information could hamper flexibility in the implementation phase (Annex V, Appendix 2, is part of the ESF+ programme). Cross-references to the programme could be included in the description. ▪ Keeping the description simple is also essential to avoid unnecessary constraints for final beneficiaries, who should concentrate on achieving particular results or conditions ('what'), rather than meeting (unnecessary) technical standards ('how') (see section 3). ▪ Where relevant, the scheme can be linked to more than one specific objective. In section 2 of the template, the MA should indicate the specific objective(s) of the fund-specific regulation to which the FNLC scheme refers.
3. Conditions to be fulfilled or results to be achieved	<p>Conditions or results should be:</p> <ul style="list-style-type: none"> ▪ Relevant, closely linked to the policy objectives to be reached. ▪ Consistent with the types of operation covered by the scheme (section 1) ▪ Clear and unequivocal, to avoid any risk of misunderstanding/misinterpretation (e.g. whether or not a specific result is achieved). ▪ Feasible/sustainable in relation to the technical specifications and the amounts paid upon fulfilment/achievement. ▪ Measurable and easy to verify.

Items in section B of Annex V, Appendix 2	Preliminary recommendations
4. Deadline for the fulfilment of conditions or results to be achieved	<ul style="list-style-type: none"> Set realistic deadlines, as any condition fulfilled or any result achieved after the deadline set out in this section cannot be considered (unless the scheme is amended).
5. Indicator definition	<ul style="list-style-type: none"> Indicators and units of measurement should reflect the criteria described in the recommendations for section 3 (definition of conditions and results).
6. Unit of measurement for conditions to be fulfilled/results to be achieved to trigger reimbursement by the Commission	
7. Intermediate deliverables (if applicable) triggering reimbursement by the Commission with a schedule for reimbursements	<ul style="list-style-type: none"> Setting intermediate deliverables (milestones) is highly recommended, particularly where the FNLC scheme is also used for reimbursements from the Member States to the final beneficiaries. This mitigates the risk of financial disequilibrium due to their binary approach⁹. Setting interdependent or cumulative milestones¹⁰ could hinder the flexibility of the FNLC scheme. In particular, situations where the achievement of all/most milestones is conditioned to achieving a subsequent (final) result or condition should be avoided, as this would clearly nullify the aforementioned positive effect of setting milestones in terms of mitigating the risk of financial disequilibrium. Some flexibility can be allowed in the 'envisaged date' to be indicated for each intermediate deliverable (unlike the deadline indicated in section 4). For example, the Commission could accept slight misalignments. Nonetheless, it would be important to respect the logical sequence of the intermediate steps/deliverables. Particular attention should be paid in this regard where cumulative milestones are set.

⁹ Amounts set out in the FNLC scheme are reimbursed only if predefined conditions are fulfilled or results are achieved. If those conditions or results are not (entirely) achieved, no reimbursement is possible. In practice, this could lead to a binary situation of payment/no payment, depending on full achievement. Establishing milestones that trigger partial payments related to the achievement of specific intermediate conditions clearly defined upfront (within the FNLC proposal) is an effective mitigation measure.

¹⁰ Where the achievement of one or more milestones is conditioned to achieving other (previous or even subsequent) milestones established within the FNLC scheme.

Items in section B of Annex V, Appendix 2	Preliminary recommendations
8. Total amount (including EU and national funding)	<ul style="list-style-type: none"> ▪ Where necessary, conversion between the euro and another currency shall be made according to the provisions of the Financial Regulation and the CPR.
9. Adjustment(s) method	<ul style="list-style-type: none"> ▪ Adjustment refers to the amounts and not the conditions, results or milestones set out in the FNLC scheme. ▪ The same principles and recommendations should be observed as for adjustment methods for SCOs¹¹.
<p>10. Verification of the achievement of the result or condition (and where relevant, the intermediate deliverables):</p> <ul style="list-style-type: none"> - describe what document(s)/system will be used to verify the achievement of the result or condition (and where relevant, each of the intermediate deliverables) - describe how management verifications (including on-the-spot) will be carried out, and by whom. - describe what arrangements will be made to collect and store relevant data/documents 	<ul style="list-style-type: none"> ▪ The audit trail shall include all obligatory elements for reimbursement of the Union Contribution by the Commission under Article 95, indicated in Annex XIII, Section IV CPR. ▪ The audit trail should be <u>exhaustive</u> (i.e. include all information/documents that should be provided to demonstrate that results or conditions and, where established, milestones have been achieved) <u>but not excessive</u> (it should not include unnecessary information not required by EU rules). ▪ Gold-plating practices should be avoided when establishing the procedures for management verification (administrative and on-the-spot). Integrated IT systems/tools should be used where possible to enhance efficiency and reduce errors in management verification.
<p>11. Use of grants in the form of financing not linked to costs.</p> <p>Does the grant provided by Member State to beneficiaries take the form of financing not linked to costs? [Y/N]</p>	<ul style="list-style-type: none"> ▪ FNLC should also be used for the grants provided by Member State to beneficiaries in order to take full advantage of this simplification measure.
<p>12. Arrangements to ensure the audit trail</p> <p>Please list the body(ies) responsible for these arrangements</p>	<ul style="list-style-type: none"> ▪ Possible changes in the audit trail can be proposed by the Member State based on objective reasons. These should be assessed and agreed by the Commission on a case-by-case basis.

¹¹ European Commission, *Guidance on Simplified Cost Options (SCOs), Flat rate financing, Standard scale of unit costs, Lump sums* (revised edition following the entry into force of Regulation (EU, Euratom) 2018/1046), 2021; CoP RBM, *Guidance on Simplified Cost Options (SCOs) and Manual on Simplified Cost Options*, 2021, available at: <https://ec.europa.eu/european-social-fund-plus/en/publications/simplified-cost-options-practitioners-manual>

6. Conclusions and key recommendations

Preliminary recommendations on the design and use of FNLC are presented below, as identified by members of the CoP RBM.

- I. The MA should look first at what (results or conditions) should be achieved through ESF+ programmes. Reflections on the most suitable form of financing (e.g. FNLC) can be developed only when clear, relevant and measurable results or conditions are identified. Results and conditions should steer the choice of form of financing, not the other way around.
- II. Willingness to change paradigms and mindset is a key precondition for the use of FNLC. Shifting from more traditional forms of financing projects based on (or linked to) costs to approaches based on results or conditions requires a cultural leap by authorities and stakeholders.
- III. FNLC has certain advantages over SCOs in that it allows greater flexibility in determining the amounts linked to conditions and results, and enhances the likelihood of achieving challenging results within ESF+ programmes. As the MA is not required to develop a calculation method, using FNLC could be more feasible in the absence of sufficient data to support calculations, for example, in innovative projects.
- IV. FNLC is relatively new and the level of practical knowledge is inevitably lower. This means that some aspects relevant to the design and implementation of FNLC schemes will still require case-by-case assessment by the European Commission when assessing proposals submitted under Article 95 CPR. Early, informal consultation with the European Commission is strongly recommended as a means of facilitating swift and smooth adoption of the FNLC scheme.
- V. Setting up an FNLC scheme should be seen as an investment. It requires time and resources, but has a positive impact on the effectiveness and efficiency of ESF+ programmes. To enhance the return on investment, FNLC proposals should cover a considerable percentage of programme contribution and include interventions with significant impact on the achievement of key policy objectives.
- VI. The MA is responsible for designing FNLC schemes. However, all relevant parties should be involved in their design and implementation: policymakers, IBs and line ministries, AAs, ESF+ stakeholders, social partners, final beneficiaries, and the European Commission.
- VII. FNLC proposals under Article 95 CPR should balance accuracy, completeness and clarity of information with flexibility and sustainability of the scheme. Gold-plating practices that impose unnecessary rules or procedures not required by EU regulation should be avoided. This recommendation applies to all items in Annex V, Appendix 2 (see Table 2 above).

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