



Overhead costs

Background

The purpose of this note is to assist all project beneficiaries with the reporting of overhead costs under the Interreg IVB North Sea Region Programme. The note restates the key principles governing eligible overhead costs and should therefore be considered as a clarification of already existing rules and procedures.

Main points

When reporting or controlling overhead costs, a number of principles must be kept in mind. If the costs reported do not comply with these basic conditions, the costs are not eligible and must be removed from the claim.

1. **Only real costs** are allowed. No flat rates, which are not based on real costs, or estimates are acceptable; only the real actually incurred and defrayed expenditure can be included in your claim.
2. It must always be possible to trace every element of the overhead cost calculation back to a paid invoice for the organisation.
3. The project share of the organisation's overhead costs must be charged to the project using a fair, transparent and documented calculation key. This *pro rata* calculation must provide a verifiable basis for the inclusion of costs (e.g. number of fulltime equivalent employees working for the project vs. total number of fulltime equivalent employees in the organisation).
4. Only necessary overhead costs are acceptable: This means costs for running the premises (building) without which the project would not be able to operate (e.g. IT service, electricity, rent, heating, cleaning) This means that all non-essential costs (e.g. general management, general supplementary training, academic and administrative staff un-related to the project) must be removed when making the pro rata calculation, cf. point 3.
5. Only eligible overhead costs can be included. Ineligible costs such as e.g. interest costs derived from a mortgage cannot be reported.
6. Knowing how time consuming it sometimes can be to fulfil the strict requirements for the documentation of overhead costs, you should consider carefully whether it is worth including overhead costs in your project costs
7. The First Level Controller must for every claim verify that points 1-5 have all been carefully checked.

Definition

Overheads, or indirect costs, are those costs essential to the operation of the project, for which it is not possible to attribute and demonstrate the cost directly (e.g. the project's share of the organisation's overall heating bill). The rules for claiming such costs and the documentation requirements are strict because of past abuses. Therefore, wherever possible the costs should be claimed directly, e.g. the working time of support staff from the accounts department should be claimed directly as staff costs. Only those costs which are impossible to document and include as direct costs under other budget lines should be claimed under overheads. Indirect costs may include building costs such as rent, heating, utilities and other office costs, central services, and other costs such as insurance. Again, anything which can be directly attributed in an auditable way to the project, should be declared as a direct eligible cost. This may include costs which the organisation would normally include in its overheads. Therefore, the components of what is being treated as an overhead or indirect cost should be examined before the pro rata calculation takes place. It is of course essential that when costs are claimed directly they are not also included in the overhead calculation.

Important principles

Indirect costs declared for ERDF co-financing must be actual (real) and not estimated costs, which can be demonstrated to be essential for project operations rather than simply relevant to the organisation delivering the project. It is important to stress again that the support for the project only covers the costs strictly necessary for its implementation and should not be used to fund the wider operating costs of the organisation. Consequently, the acceptable indirect costs to be included should be detailed in cost pools which may differ significantly from the costs included in the general overhead calculation for the organisation.

Estimated, out of period, or opportunity costs are not eligible. All costs must have been paid (i.e. there must be evidence to show that the relevant cost has been defrayed and paid) and the costs must relate to the approved project period, i.e. the eligibility period. Importantly, in common with all other types of expenditure, a full audit trail all the way back to the payment to external bodies is required for overheads and can at any time be demanded by the relevant authorities and the controllers on 1st and 2nd level as well as controllers from the European Commission. It is the duty of the 1st level controller to satisfy themselves that the requirements are complied with before completing the relevant section of the checklist for every claim.

Only real indirect costs can be claimed, i.e. no use of flat rates (which are not based on real costs) are allowed under this programme.¹

The identification and calculation principles can be illustrated in two simple steps as follows:

- Step 1. Identification of those eligible costs that can be charged directly to the project.
- Step 2. Identification of eligible indirect costs which are actual costs eligible for ERDF support, arising from the delivery of an ERDF project but which cannot be captured directly. This is because that even though the nature of the resource consumed by the project is clear the exact amount cannot be distinguished and must be derived by apportionment, i.e. using a pro rata principle. For the purposes of this note such indirect costs are referred to as 'overheads' and the fair, transparent and documented apportionment should use simple proxies for actual consumption (e.g. cost per square metre or total hours for the organisation against project hours).

It is not possible to provide exact definitions of the costs that may be included (the cost pool) for calculating the pro rata share of the overhead costs to the project as these will vary significantly between organisations². Nevertheless, every organisation must ensure that the method selected complies with this guidance and it is the duty of the First Level Controller to ensure this compliance before verifying the overhead costs.

Overhead costs for complex organisations:

For some organisations it can be quite a challenge not to say impossible to calculate the overhead costs for the individual unit or department. When this is the case the organisation may decide to calculate the overhead cost per staff member for the whole organisation and then use this as the basis for the pro rata calculation of the overhead costs. However, it should be noted that the fundamental principles mentioned under “the main points (page 1)” still must be complied with. Again, it is the responsibility of the First Level Controller to verify the compliance with these essential principles.

¹ Earlier versions of the current regulations and subsequent programme guidance referred to the possibility of using a fixed percentage for the overhead costs (up to 25% of the direct costs) for projects approved before 1 September 2009. It is important to note, however, that only those projects where this option is explicitly mentioned in the subsidy contract can make use of the option.

² If you are in doubt about the eligibility of a certain cost item or if you cannot provide the full documentation of the questionable cost item(s) leave this/them out before making the pro rata calculation.

Possible consequences of non-compliance

If overhead costs are included but the real costs behind them cannot be documented or the pro rata calculation is not verifiable, it must be expected that all overhead costs will be excluded until reliable evidence has been provided. If this is not possible, the costs will have to be excluded.

It is important to recall that controllers must not complete the first level control checklist until they have obtained reasonable assurance of the correctness of all costs including overheads. In the event of an audit, controllers will be expected to document these basic requirements. Where it is clear that checks have not been carried out, all related expenditure will be regarded as ineligible until proper control verifying the overhead costs has been completed by a qualified controller to demonstrate the correctness of the costs.

Please be aware that if your organisation is claiming disproportionate overhead costs, you will be the subject of particular scrutiny and can expect later audit of these costs. Deliberate non-compliance with eligibility rules will put the whole or part of the grant at risk.

If at any time you are in doubt about the application of these rules, it is essential that you contact the first level controller and/or the Joint Technical Secretariat to obtain clarification before claiming costs. If practices by your organisation or controller for previous claims may not comply with this guidance, it is essential that you contact the programme immediately for guidance on correcting the situation.