



Internal Note 01/2013

14th January 2013

To: ERDF IBs
Cc: Line Ministries
Certifying Authority
Audit Authority
Treasury

Internal Note to ERDF Intermediate Bodies:

Issues arising from past calls for projects in the procurement of works, services and supplies by Private Bodies

This internal note ought to be seen in conjunction with Internal Note 01/2012 issued by the Managing Authority (MA) on 23rd January 2012 on the Procurement of Works, Services and Supplies by Private Bodies.

It is being issued in view of the difficulties identified by the MA itself and the ERDF Intermediate Bodies (IBs) in the processing of claims presented by private enterprises¹ (from past calls for projects) in relation to works, services and supplies under aid-schemes co-financed by Structural and private funds, the procurement of which was not based on the cheapest quotation obtained (from a minimum of three) and/or acquired from suppliers/service providers who are either related between them and/or to the Beneficiary enterprise.

As a general rule, the MA has always reiterated that even though private enterprises are not governed by the Public Procurement Regulations, since they are benefitting from public funds, they have to abide by the spirit of these regulations. EU Treaty principles and the General Financial Regulation oblige Member

¹ 'An enterprise is considered to be any entity engaged in an economic activity, irrespective of its legal form. This includes, in particular, self-employed persons and family businesses engaged in craft or other activities, and partnerships or associations regularly engaged in an economic activity.' As defined in the Commission Recommendation (2003/361/EC) of 6 May 2003 concerning the definition of micro, small and medium sized enterprises.

States to ensure that public funds (irrespective of whether they are being used by public or private bodies) are used in a manner that ensures best value for money, good governance, and compliance with the main principles of non-discrimination, equal treatment, transparency and proportionality.

It is pertinent to note that in the IB Network meeting of 03rd February 2010, DG (PPCD) emphasised the importance of transparency, competition and good governance in the implementation of aid schemes and reiterated that although there is no EU rule stating that three quotations should be received prior to procurement, this is the best procedure to ensure a good snapshot of the market and also conducive to good governance. It was also emphasised that in those instances where the Beneficiary selects a more expensive quotation, this can be allowed as far as the IB reimburses the equivalent of the cheapest quotation. At this point, the MA was already arguing against procurement from related companies knowing that this raises issues of transparency and the possibility of unfair competition. It also brings into question the need for the grant in the first place. It was recommended that IBs should start including declarations - endorsed by the Beneficiary - stating that the three quotations submitted do not include quotations from any of the company's subsidiaries. In conjunction to this, IBs were also advised to double check relationships with MFSAs records. Failure to abide by the aforementioned practices will leave IB's susceptible to defend this during future audits. *(From minutes of IB Network Meeting, 3rd February 2010).*

This stance was reiterated over and over again in most of the IB Networks and bilateral meetings held between the MA and the IBs.

IBs carry out functions similar to those of the MA. They have been entrusted in fact with two separate and distinct functions – one of the project selection and monitoring, and the other of control. The payment process is in the hands of the IB together with the Line Ministry (LM) and Treasury.

Despite this, as MA we are aware of a number of instances from the earlier calls for projects wherein IBs are finding it difficult to process claims for payments by Beneficiaries (or the MA not recommending paid claims for certification), either because the procurement was not made on the cheapest quotation (usually the IB would have accepted a justification presented by the Beneficiary for not selecting the cheapest quotation), or the quotations were not obtained from three independent suppliers/service providers (either related between them, or with the Beneficiary), or else the procurement was made from a company related to the Beneficiary.

In such circumstances, while the MA reiterates strict adherence to the "three-quotations", the "cheapest" and the "non-related" principles, IBs need to obtain further assurance that expenditure was correctly incurred, that the grant did not lead to profits within the same enterprise, that the procurement, even though not based on the cheapest quotation and/or done from a related company, still produced the best

value for money, and that the principles of good governance, transparency, equal treatment, non-discrimination and proportionality, still prevailed.

Following internal discussions and taking into account international accounting standards, as well as taking into consideration the specificities of the local market, in order not to leave claims laying idle in the system, the MA has sought to recommend a balanced guidance which is not totally exclusive but at the same time seeks to preserve the main principles of good governance.

In cases where procurement was not based on the cheapest quotation:

1. IBs can undertake a detailed cost-comparison exercise between all quotations submitted to demonstrate that even though the selected quotation was *prima facie* not the cheapest, if one is to include and compare all items, it would still be the cheapest of the three, and that likewise, one can have a true and realistic snapshot of the market²;

OR

2. IBs can produce a cost/savings exercise to determine that the selected option, even though not the cheapest, was the most viable over the first five years of operation from a return on investment perspective. Such exercise can be conducted by the contracted Quality Assessors if it falls within the contract's terms of reference.

It is important to note that if these exercises are either not undertaken or the outcome does not justify the IB's decision to reimburse on the non-cheapest quotations, the IB / MA will have to apply a minimum suggested correction of 5% on the amount claimed for that activity.

In cases where beneficiaries failed to produce a minimum of three quotations obtained from three independent suppliers / service providers:

3. If still in time (and if it still makes sense), Beneficiaries may be given the chance to rectify the situation and asked to re-submit all three quotations anew to ensure equal treatment between all suppliers;
4. If the project has been already implemented, it does not make sense to ask for revised quotations. It is therefore to be considered that procurement was done without obtaining a fair and realistic snapshot of the market, and in such cases, a 5% financial correction on the claimed amount is being recommended;

² This may not be applicable in case of equipment which is time sensitive

In cases where procurement was made from a related enterprise:

5. IBs should obtain assurance that the grant did not lead to profit within the same enterprise. Reasonable assurance on this can be obtained by asking for a declaration from the supplier / service provider's accountant / auditor stating that the sale did not involve intra-enterprise profits (i.e. was based solely on the cost, without a mark-up);
6. Further assurance can be obtained by asking for a copy of the invoices and receipts related to the investment in question directly from the related supplier / service provider to determine the cost incurred by the latter for the purchase / undertaking of this investment, prior to the sale to the Beneficiary.³

These recommendations are being presented to help IBs deal with those cases wherein the MA's instructions to reimburse on the cheapest and to procure from non-related companies, were not fully adhered to. It is to be made clear that such recommendations are only meant for "partial mitigation" to strengthen the reasonable assurances needed on such "dubious" cases, and do not offer a guarantee against any future financial recoveries. Additionally, they should not be regarded as alternative methods to those reiterated by the MA in the implementation of these schemes, i.e.:

- Beneficiaries submitting a minimum of three comparable quotations;
- Quotations should be obtained from independent suppliers / service providers;
- Procurement cannot be made from a company which is related to the Beneficiary;
- IBs should always reimburse the equivalent of the cheapest quotation.

The MA stresses that it is ultimately the IBs who should be making recommendations to solve such implementation issues (in light of the guidance provided). It is important that any decisions taken by the IB are guided by the principles of sound financial management and good governance. Each case has to be looked at on its own merits and discussed in depth to ensure that any decision taken is sound. In this regard, the MA remains at the IB's disposal for discussion and support where additional guidance is necessary. LMs are also encouraged to support IBs in their efforts to implement the schemes in an efficient and effective manner.



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³ Further proof can be obtained by asking for a copy of the Bill of Lading of the machinery/equipment to determine the timing when the item was purchased.