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ERIC Forum Implementation Project

D3.1 Guidance document on accounting principles for ERICs

WP3 - Operations, Administration, HR and Finance of ERICs

Task 3.1 Budgeting and financial reporting principles

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Executive summary

The study aims to provide a better understanding of financial reporting practices in the ERICs in the framework of the activities of the ERIC FORUM project. In this report we present an overview of some of the methodologies that build on historical and prospective financial information: a first step towards establishing harmonized standards for ERICs financial reporting.

The generally accepted accounting principles are referred as rules that encompass the details, complexities, and legalities of international accounting.

- The ERICs presently rely upon simple accounting metrics though, in future, new focus should be placed on methods that may be driven by key financial performance indicators (KPIs), given the role and the relevance of the ERICs for the deployment of the European Research policies.
- Transparency becomes a matter of vital importance that needs to be made visible: ERICs require internal control mechanisms that allow their stakeholders to assess the destination of resources (the narrative) in accordance with their goals. Transparency and good governance are necessary to achieve the social credibility which allows for the continuity of an organization and the achievement of its goals.
- However, transparency of ERICs is not an end in itself: the creation of effective accounting practices can help to build a better Europe by emphasizing the accomplishments of the goals of the Research Infrastructures.
- Future research could look into the development of appropriate models to empirically measure the performance of the ERICs in an objective, quantifiable way, and matching the efficiency of the cost accounting with the effectiveness of the super-national policy goals which are being accomplished

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1. INTRODUCTION

The document – DEL 3.1 of the ERIC FORUM project- within WP3 (Operations, Administration, HR and Finance of ERICs) Task 3.1 Budgeting and financial reporting principles now in version 7.0 for internal use only - is being elaborated in the framework of the H2020 project ERIC FORUM, in line with the project Task 3.1, focused on the development of a GAAP Guidance document in order to provide a body of evidence to determine whether a need exists to develop European financial reporting standards for ERICs.

The Report Guidance document on GAAP for ERICs (EMSO) 3.3 has been shared on October 23rd, 2020. The feedback on the report has been collected from all ERIC Forum partners in November 2020. The version 7.0 has been delivered for discussion on December 29th, 2020 as a final release for diffusion and concluding feed-back collection by the other ERICs.

Key activities to be carried out during the next months (January 2021-February 2021) :

- Finalisation of the DEL. 3.1
- Provide EC and MSs visibility to the document
- in March 2021 a short webinar is foreseen to present the report and answer questions.

2. SCOPE OF THE WORK

Intangible assets represent an increasingly relevant component of an entity's value. However, the value of intangible assets is not measured on financial statements unless in a combination under both generally accepted accounting principles (GAAP) in the United States and International Financial Reporting Standards (IFRS) internationally.

Nevertheless, the ERICs presently rely upon simple accounting metrics though, in future, new focus should be placed on methods that may be driven by key financial performance indicators (KPIs), given the role and the relevance of the ERICs for the deployment of the European Research policies.

In this report we present an overview of some of the methodologies that build on historical and prospective financial information: a first step towards establishing harmonized standards for ERICs financial reporting. Much more analysis and discussion will be needed between the ERICs interested parties: the findings presented in this report have the potential to inform the debate and move that discussion forward.

The ERICs – though their juridical status is clearly defined by the European Commission - face a multiplicity of varying European fiscal and accounting regimes for the recording of their development activities, which often makes more complex the recording and the accounting phases due to the lack of universally agreed-upon approach to financial planning and reporting.

In fact, shared accounting rules and standard presentation of economic & financial information of the ERIC are very important but are still an important challenge. In fact, (i) the grants tracking procedures (recording, collection) require accurate collection of financial information , (ii) providing long-term sustainability assessment is an exercise based on several assumptions (iii) comparability between the ERICs is not easy since the operational objectives and plans as well as the applied procedure differ from one ERIC/country to another, (iv) effective communication of the financial and economic performance and the spending and of the objectives accomplished of the ERIC to the public to protect the general public interest plays a very important role for the ERICs implementation.

As a general principle – ERICs accomplish scientific excellence goals and impact however are not designed to return profit. Therefore the accounting rules to be applied should be designed to illustrate and measure the execution of its objectives, its impact on society, its sustainability, the transparency of the communication of the results: (i) the success of the scientific research infrastructure joint

initiatives, (ii) the effective sharing of public physical and intellectual resources in an European and international dimension, (iii) the educational activities, (iv) the sharing of knowledge and scientific advancement. These topics deserve more in depth analysis within ERIC FORUM activities.

Generally Accepted Accounting Principles (GAAP) and the International Financial Reporting Standards (IFRS) can improve the clarity of the communication of financial information of the ERICs to the public and ensure an homogenous and comparative analysis of the financial and economic performance of the European Research Infrastructures.

The guidance document –foreseen within the framework of ERIC FORUM project- is expected to:

- Improve the clarity of the communication of financial information of the ERICs to the public.
- Identify a common set of general accounting principles, standards and procedures that ERICs could follow when they compile their financial statements.

The purpose of this Deliverable is also to explore the main principles regarding the disclosure of information and the accountability dimensions of the transparency of information disclosed by the ERICs. It is to be highlighted the need to ensure the application of common rules of transparency, leading ERICs to adopt the appropriate disclosure of information policies for the accountability of the involved institutions.

3. THE GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

GAAP (Generally Accepted Accounting principles) are focused on the accounting and financial reporting of U.S. companies under the responsibility of the Financial Accounting Standards Board (FASB). The alternative to GAAP is the International Financial Reporting Standards (IFRS), set by the International Accounting Standards Board (IASB).

The IASB and the FASB are working on the convergence of IFRS and GAAP and this collaboration removed the requirement for non-U.S. companies registered in America to reconcile their financial reports with GAAP if their accounts already complied with IFRS. This was a big achievement, because prior to the ruling, non-U.S. companies trading on U.S. exchanges had to provide GAAP-compliant financial statements.

Standing for "Generally Accepted Accounting Principles," GAAP is meant to be a standard framework for financial account guidelines in US. In other words, these are accounting standards that should be following to ensure their financial statements are prepared correctly.

The generally accepted accounting principles in this document ,are referred as rules that encompass the details, complexities, and legalities of international accounting and are not referred to GAAP.

It should be highlighted that IFRS[1] is a standard-based approach used internationally, while GAAP –formally- is a rule-based system compiled in the U.S. Therefore majority of the countries uses IFRS standards though there are some differences that exist between the two sets of accounting standards:

- Inventory: The first is with the LIFO Inventory. GAAP allows companies to use the Last in, First out (LIFO) as an inventory cost method. But this is prohibited under IFRS.
- Development costs: Under GAAP, these costs are considered expenses. Under IFRS, the costs are capitalized and amortized over multiple periods.
- Write-downs: GAAP specifies the write-down amount of an inventory or fixed asset can't be reversed if the market value of the asset subsequently increases. On the other hand, the IFRS allows the write-down to be reversed

Given the abovementioned differences, the generally accepted accounting principles, as they are referred in this document are intended as a set of generic rules that encompass the details, complexities, and legalities of international accounting and incorporate 10 key concepts:

- Principle of regularity: accountants strictly adhere to established rules and regulations.
- Principle of consistency: consistent standards are applied throughout the financial reporting process.
- Principle of sincerity: accountants are committed to accuracy and impartiality.

[1] IFRS stands for International Financial Reporting Standards, a set of accounting standards set in 1973 by the International Accounting Standards Board(IASB). IFRS is becoming the global standard for the preparation of public company financial statements and it is used in 144 out of 166 jurisdictions. IFRS is becoming more and more adopted around the world, including in certain jurisdictions in the U.S. In addition, the IASB has formalized a set of rules and standards for companies reporting their financial statements such as the balance sheet, income statement, and statement of cash flows.

- Principle of permanence of methods: consistent procedures are used in the preparation of all financial reports.
- Principle of non-compensation: all aspects of an organization's performance, whether positive or negative, are fully reported with no prospect of debt compensation.
- Principle of prudence: speculation does not influence the reporting of financial data.
- Principle of continuity: asset valuations assume the organization's operations will continue.
- Principle of periodicity: reporting of revenues is divided by standard accounting time periods, such as fiscal quarters or fiscal years.
- Principle of materiality: financial reports fully disclose the organization's monetary situation.
- Principle of utmost good faith: all involved parties are assumed to be acting honestly.

6. OBJECTIVES OF FINANCIAL REPORTING

The purpose of accounting is to communicate the organization’s financial position to owners (Assembly of members), managers, investors, and the government. Accounting standards provide a system of rules and principles that prescribe the format and content of financial statements. Through this consistent reporting, it can be assessed the financial health of the ERIC. Accounting standards cover topics such as how to account for inventories, depreciation, research and development costs, income taxes, investments, intangible assets, and employee benefits.

Assembly of members can use these financial statements to determine whether to increase or decrease their support and to identify possible risks.

As countries have different cultures, languages, and social and economic traditions, they developed different accounting practices as well. In an increasingly globalized world, however, these differences are not optimal for the smooth comparisons of the financial reporting in particular for international, cross-border activities by ERIC's.

The International Accounting Standards Board (IASB) is the major entity proposing international standards of accounting. IASB is an independent agency that develops accounting standards known as international financial reporting standards (IFRS). Adherence to the IASB’s standards is voluntary, but

many countries have mandated use of IFRS. For example, companies listed on EU stock exchanges are required to use IFRS. Accounting standards can be complex; and this makes modification of standards difficult. In addition, differing practices among various nations add to the complications of a unified accounting format. For example, in the United States and Great Britain, individual investors provide a substantial source of capital to companies, so accounting rules are designed to help individual investors.

- The purpose of accounting is to communicate an organization's financial position to managers, investors, banks, and the government. Accounting provides a system of rules and principles that prescribe the format and content of financial statements. Through this consistent reporting, managers and stakeholders can assess the financial standing.
- Historically, countries have followed different accounting standards. If different accounting standards are used, however, it's difficult to compare two organisations financial performance. US organisations must prepare financial statements in accordance with the US Financial Accounting Standards Board (FASB) standards, which are known as generally accepted accounting principles (GAAP). On the other hand, entities based in the European Union follow standards adopted by the International Accounting Standards Board (IASB) known as international financial reporting standards (IFRS). Over one hundred nations have adopted or permit entities to use IFRS to report their financial results. The FASB and IASB are working on harmonizing the two accounting standards.
- The three main advantages of a single set of international accounting standards are (1) an increased comparability between organisations, which reduces risk and facilitates cross-border assessments; (2) a reduction in the cost of preparing consolidated financial statements; and (3) the improved reliability and credibility of financial reports.

4. THE RULES OF CONSISTENCY

The consistency principle holds high importance the ERICs for two main reasons.

- By using a consistent accounting method from one accounting period to the next, the financial reports will all hold a similar structure. This makes it easier for the public stakeholders (notably: Member States, European Commission) to compare the performance of the ERICs over different financial years.
- Following the consistency principle, auditors will demand reasons for any changes that could affect the interpretation of the financial statements of the ERIC.

On the other hand, consistency could be described as "the use of the same methods for the same purpose and items". Therefore, consistency is not referred as a qualitative characteristic of financial reporting, but instead as one of the factors that contribute to comparability among the ERICs, which is -on one hand- a key outcome for this exercise, and on the other hand the objective of the abovementioned on-going effort to reach convergence between IFRS and GAAP.

In order to eliminate misleading accounting and financial reporting practices, 4 rules can create consistent accounting and reporting standards, which provide with reliable methods of evaluating an organization's financial standing. ERICS are not legally required to, but being GAAP compliant implies the fulfilment of 4 major rules:

- **Recognizing**: crucial items like liabilities, assets, and expenses destination, revenue recognition, liability tracking, homogeneous financial data communication, In-Kind contributions transactions, funds and physical contributions accounting issues should be easily recognized in ERICs various financial statements
- **Measuring**: the specific amounts need to be reported for each part of ERICs statements including assets ownership of intangible (IP, service design, data, know-how) and tangible assets (inventories, equipment)

- **Presenting**: subtotals and totals need to be properly displayed and line items should be aggregated clearly to facilitate assessment by the member States delegates and the Stakeholders.
- **Disclosing**: the most important information for the Member States should be highlighted in easy to understand terms and make it easier to explain accounting items and supplement the numbers provided.

Accounting compliance can make the financial reporting process transparent and standardizes assumptions, terminology, definitions, and methods. External parties should easily compare financial statements issued ERICs and safely assume consistency, which may allow for quick and accurate cross-ERIC comparisons .

7. THE STANDARD IFRS REQUIREMENTS

Under EU rules, listed companies (those whose securities are traded on a regulated market) must prepare their consolidated financial statements in accordance with IFRS[2].

As above anticipated IFRS[3] is a standard-based approach used internationally, covering a wide range of accounting activities for business and non-for profit entities. However, there are certain aspects of practice for which IFRS set mandatory rules for both categories of entities:

- Statement of Financial Position, also known as a Balance Sheet. IFRS sets the rules to be applied to report the accounting components of a balance sheet.

[2] Regulation (EC)N. 1606/2002 requires all listed companies to prepare their consolidated financial statements in accordance with IFRS , since IFRS provide a common accounting language used by more than 100 countries, making company accounts understandable and comparable across international boundaries. In addition, Regulation (EC) No 1606/2002 lays dow (i) a mandatory rule: all EU listed companies must use IFRS as adopted by the EU for their consolidated financial statements, (ii) discretionary provisions: EU countries can opt to extend the use of IFRS to annual financial statements and non-listed companies as well.

[3] IFRS stands for International Financial Reporting Standards, a set of accounting standards set in 1973 by the International Accounting Standards Board(IASB). IFRS is becoming the global standard for the preparation of public company financial statements and it is used in 144 out of 166 jurisdictions. IFRS is becoming more and more adopted around the world, including in certain jurisdictions in the U.S. In addition, the IASB has formalized a set of rules and standards for companies reporting their financial statements such as the balance sheet, income statement, and statement of cash flows.

- Statement of Income, which can take the form of one statement, or it can be separated into a profit and loss statement and a statement of other income, including the account recording of property and equipment.
- Statement of Changes in Equity or statement of retained earnings, which shows the changes in earnings or profit for the given financial period.
- Statement of Cash Flow, summarizing the in and out financial transactions in the given period.

In addition, the entity must also give a summary of its accounting policies. The full report is often seen side by side with the previous report, to show the changes in profit and loss. The shareholders or the Members must create separate account reports for each of its controlled or participated entities.

8. ABSENCE OF IFRS REFERENCES

According to IAS n.8, in the absence of an IFRS that specifically applies to a transaction or an event , or condition (as for example: IFRSs do not address assets with service potential[4],), management shall use its judgment in developing and applying an accounting policy that results in information that is relevant to the purpose and objectives the economic decision-making needs of users and stakeholders and that is reliable (IASB, 2011a). In developing such accounting policies principles the management should refer to the following criteria:

- Search the requirements in IFRSs dealing with similar and related issues;
- Identify the definitions, recognition criteria and measurement concepts of the Conceptual Framework for assets, liabilities, income and expenses; and

[4] A main characteristic of the assets of non-profit organisations is the fact that their assets may not necessarily be used to generate future economic benefits. A non-profit organisation based on its nature and purpose of existence, may very well use an asset to fulfil its stated objectives rather than to generate economic and financial benefits (i.e. , profits cash flows) (Rossouw, 2008): as "cash consumers" rather than assets expected to generate cash inflows. Despite this, these assets of non-profit organisations may still be regarded as being valuable to the entity and acquired specifically to enable the entity to meets its objectives. This concept is referred to as the asset having "service potential". An asset's service potential may be a substitute for future economic benefits in the recognition and measurement of assets of ERICs.

- Search for recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards[5]. As an example, IAS n.8 requires compliance with any specific IFRS applying to a transaction, event or condition, and provides guidance on developing accounting policies for other items that result in relevant and reliable information. Changes in accounting policies and corrections of errors are generally retrospectively accounted for, whereas changes in accounting estimates are generally accounted for on a prospective basis.

A last remark is to be made regarding the social accounting and its relevance for the ERICs. In fact, the process of communicating the social and environmental effects of organizations' economic actions to particular interest groups within society and to society at large is very important for ERICs. Some ERICs are already engaged in social accounting, intended here as the determination of those to whom the ERIC is accountable for its performance and the development of appropriate reporting techniques implying social impact and economic sustainability assessments.

9. FINANCIAL REPORTING FOR THE ERICS

ERIC are legal entities with legal personality and full legal capacity recognised in all EU Member States. The members are free to define in the statutes, case by case, membership rights and obligations, the bodies of the ERIC and their competences. The liability of the ERIC's members is generally limited to their respective contributions.

An ERIC is recognised by the country hosting its seat as an international body or organisation for the It should be highlighted that IFRS[6] is a principle of the standard-based approach and is used internationally, purposes of the directives on value added tax (VAT) and excise duties. It also qualifies as international organisation for the purpose of the directive on public procurement. An ERIC may

[5] IAS 8 amendment effective for annual reporting periods beginning on or after January 1, 2020.

[6] IFRS stands for International Financial Reporting Standards, a set of accounting standards set in 1973 by the International Accounting Standards Board(IASB). IFRS is becoming the global standard for the preparation of public company financial statements and it is used in 144 out of 166 jurisdictions. IFRS is becoming more and more adopted around the world, including in certain jurisdictions in the U.S. In addition, the IASB has formalized a set of rules and standards for companies reporting their financial statements such as the balance sheet, income statement, and statement of cash flows.

therefore, under certain limits and conditions, benefit from exemptions from VAT and excise duties on its purchases in all EU Member States and it may adopt procurement procedures respecting the principles of transparency, non-discrimination and competition but not subject to the directive on public procurement as implemented in national law.

The ERIC framework has been developed primarily for new research infrastructures. ERIC is a legal entity which has been specifically designed to support the operations of high-profile research infrastructures with a European dimension.

Therefore, the focus throughout the study was on ERICs defined as international entities that are:

- constituted on a not-for-profit basis;
- self-governing;
- established for the European benefit.

A first comparison among the overall differences underlying the accounting rules and the governance systems applied for ERICs, (non-profit), the Business organisations and the Public organisations is shown in Table 1 below.

TABLE 1. Comparison of common key factors and differences in financial reporting

Common key factors	**Different impacts on financial reporting**		
	ERICS	**BUSINESS**	**PUBLIC SECTOR**
Constitutional form	**Established by EC**	Limited by shares or guarantee (companies with a for-profit motive), limited liability partnership	Established by Constitution or national Legislation
Ownership	Classic non-owned entities with **no property rights** held by Member States	Equity providers of risk capital	The State (government and the people)

Shares transferability and redemption	**No transferability**. Transfer to non for-profit entities.	Typically transferable. On dissolution, residual funds to shareholders	On dissolution, residual assets returns to public funds
Management and Control	• As per governing (Statutes) document. • Accountable to Member States. • Audits are required by constitution.	As per governing document. Accountable to shareholders. Employed governors elected by shareholders. Audits or similar required for 'publicly accountable' entities	Organisations/individuals exercise control under statutory remit. Accountable to parliament. Employed governors appointed. Audits required by statute
Common key factors	**Different impacts on financial reporting**		
Voting rights	**Membership/participation**	Linked to number and type of shares	Democratic rights/ Spoil system
Control rules	**Control is ruled by common goals accomplishment** (service delivery, public interest aims). No equity control.	Law defined boundaries, Control in order to gain economic advantage or benefits (but not limited to)	Government-defined boundaries. Control for purposes of probity and services provided
Liability	The financial liability for the debts of the ERIC is be limited to the contributions provided to the ERIC.	In general, he financial liability for the debts of the company should not exceed the capital .	Public authorities respond to liability in a variety of ways,
Constitutional form	**Established by EC**	Limited by shares or guarantee (companies with a for-profit motive), limited liability partnership	Established by Constitution or national Legislation

Ownership	Classic non-owned entities with **no property rights** held by Member States	Equity providers of risk capital	The State (government and the people)
Shares transferability and redemption	**No transferability**. Transfer to other non for-profit entities .Only for full worth?	Typically transferable. Generally, dissolution residual funds to shareholders	On dissolution, residual assets returns to public funds
Management and Control	• As per governing (Statutes) document. • **Accountable to Member States.** • Audits are required by constitution.	As per governing document. Accountable to shareholders. Employed governors elected by shareholders. Audits or similar required for 'publicly accountable' entities	Organisations/individuals exercise control under statutory remit. Accountable to parliament. Employed governors appointed. Audits required by statute
Common key factors	**Different impacts on financial reporting**		
Voting rights	**Membership/participation**	Linked to number and type of shares	Democratic rights/ Spoil system
Control rules	**Control is ruled by common goals accomplishment** (service delivery, public interest aims). No equity control.	Control in order to gain economic advantage or protection or legitimate interests	Government-defined boundaries. Control for purposes of probity and services provided

According to comparative summary of Table 1, ERICs financial statements of ERICs should provide relevant information to meet the common interest of Member States, and the stakeholders who provide resources in most of the criteria thereby listed. However, Accounting communication can affect readers of financial statements by changing the presentation of statements for ERICs. The most important use of ERICs accounting data is to communicate meaningful information, with allows management and Member Countries to make good decisions. To be effective, accounting information

must make sense and be understood, otherwise it is just a list of numbers with no real significance. ERICs should use templates for internal reports to communicate information in a matter that is familiar and easy to use by the stakeholders.,

Therefore, ERICs accounting data should include :

- Income statements should reflect the income is to be replaced by cash-carryover
- Statements of cash-flows
- Accounting data referred to goals: L/T society, scientific, environment and also economic sustainability
- This is all confirmed by the COUNCIL REGULATION No 723/2009[7] whereas in art. 13(Budgetary principles, accounts and audit)it is stated that "*All items of revenue and expenditure of an ERIC shall be included in estimates to be drawn up for each financial year and shall be shown in the budget*. *The revenue and expenditure shown in the budget shall be in balance."*
- It is necessary for an ERIC to carry out its activities according to sound budgetary principles for the exercise of its financial responsibility.

10. THE REVENUES/ EXPENSES RECORDING PROCESS

10.1 Revenues recording

ERICs are positioned as non-profit organizations set up by the European Commission (EC): in order to accomplish their mission they have as main sources of revenues (i) membership fees, (ii) grants from government , (iii) EC funding, (iv) in-kind contributions provides by Member States or donors , (v) in some cases , in limited amount ,they could provide their services upon the payment on fees.
Many of these items are non-exchange revenue, that is, funds received where the provider of funds does not expect to personally receive goods or services of equal value in return.

[7] COUNCIL REGULATION (EC) No 723/2009 of 25 June 2009 on the Community legal framework for a European Research Infrastructure Consortium (ERIC)

The distinction between exchange and non-exchange revenue is not simple. A significant difficulty is in the area of valuing and recognizing in-kind contribution items/services.

Two critical aspects in Revenue recording are :

- given that all changes in assets and liabilities must pass through the revenue and expenditure statements, when non-exchange revenue is received, the recognition of revenue in one year may not provide information to a user as to the likely revenue for the following year, thus reducing the decision-usefulness.
- Also, when incomes are received in one period for use in another, an obligation to repay or allocate those funds or assets is required before these funds can be recognised as a liability and in effect, carried forward to the next year. Often such an communicating obligation is overlooked , : as a consequence income statement may show swings from a large surplus one year to a large deficit in another, which can cause difficulties when communicating with resource providers .

Therefore, when ERICs prepare a Statement of Cash Flows, they can show to the stakeholders the cash received for operating purposes separately from the non-cash in-kind contributions received.

On a related issue, even assuming that revenue variability can be overcome, there is insufficient advice on the appropriate way for entities to report the receipt of restricted or conditional grants/contracts. Issues include the allocation across funded or partly-funded programmes, and the liabilities imposed from endowments and constructive obligations(see Liabilities) .

10.2 Expenses recording

There are wide variances in what expenses legitimately form part of the cost of programme-spending ratio. The cost of the management structure (Central management organization, Overhead of fixed operational cost) is an issue for most of the ERICs: this cost item is difficult to be calculated effectively and it is sometimes hard for Member States to know just how much of their contributions are being directly spent on ERIC purposes and how much to cover fixed costs (e.g. overheads).

10.3 Assets

IFRS defines an asset as “cash generating unit and the economic benefit to be derived from assets”. Therefore, assets held by ERICs are “a resource, with the ability to provide an inflow of service potential

or economic benefits that an entity presently controls, and which arises from a past event". This would allow preparers to value an asset at a 'value in use' rather than an 'open market' value when assets are used for a purpose other than their best purpose.

Further difficulties occur with the recognition and valuation of provided assets by third parties to ERICs:

- control of assets may be shared (as for example, if the ERIC must care for an infrastructure provided by a member State which is readily accessible to the public) and the control criterion may not be met;
- costs of obtaining a fair value (including impairment) may outweigh the benefits
- valuation may not meet the underlying concepts of financial reporting (for example, to be understandable , reliable, relevant).

In relation to liabilities in general, and specific issues already raised in the revenue and assets sub-sections, fair presentation is a challenge for ERICs, particularly how long a potential liability needs to be tracked and the ability to identify when an item ceases to be a liability. Guidance on liability definition is required, specifically in relation to unearned revenue.

An example is concessionary loans provided by, for example, members to the ERIC. These may be liabilities in one period, but if the member decides to forgive the debt, they would become Cash Carry-over.

10.4 Cash Carry-over

Residual Cash carry-over typically does not return to members of an ERIC. In case of liquidation, ERIC assets should transferred to another ERIC, so neither the Member States, nor the current beneficiaries may be the residual holders. So far no cases of this nature occurred yet within the ERICs community.

However, it is often the case that the equity of an ERIC comprises a number of funds subject to different conditions as a consequence of grants or fees received for specific purposes.

For instance, European Commission projects funds account contains money that can only be used for specific purposes (a grant, an investment). These funds provide reassurance to stakeholders that the received contributions are used in a manner they have chosen and should be highlighted in the financial statements. Therefore, European Projects accounting assists the objective of financial reporting, as it allows members to track their inputs.

Nevertheless, fund accounting is not consistent with the generally accounting principles as specified on page 6. Possible options that could be used by ERICs include:

- Preparation of separate financial statements for each fund/source of grant.
- Provision of a separate income statement for each fund/source of grant, but with all funds of the entity brought together on a single balance sheet.
- Presentation only of unrestricted fund movements through financial statements with movements on restricted funds not regarded as part of the reporting entity for either the income statement or balance sheet but disclosed as 'funds held on trust' through notes to the accounts.
- Provision of a balance sheet showing restricted funds as current liabilities (creditors) but with no recognition in the income statement.
- Showing different classes of funds in columns with a total
- *Amalgamation of funds* in a single income statement and balance sheet, with no distinction between restricted and unrestricted revenue except by way of notes to the accounts.

10.5 In-Kind contributions recording

All contributions received by an ERIC should be recorded as revenue upon receipt, including in-kind contributions. The standard for recording in-kind contributions implies that contributed services/items are recognized in financial statements if :

- Are non-financial assets, or
- Are specialised skills, provided by Entities possessing those skills/ capacities/ infrastructures, and would need to be purchased if not provided through In-Kind contributions.

In-Kind Contribution can include Materials and Supplies, Services, Property. Recording the in-kind contribution as an expense and income does not change the bottom line (Cash carry over/ income) on the ERICs financial statements. However, by recording the in-kind contribution, what an ERIC has done in this process is accurately recorded and reflected what it takes to operate.

The requirements related to in-kind contributions, and the required accounting treatment of in-kind contributions as match in the general ledger are:

- Grantees should record in-kind contribution as they do cash expenses in their accounting

systems.

- If this is not the practice of the ERIC, there should be a written policy in place that describes the system to record the transactions.

11. VAT AND EXCISE DUTY: THE LEGAL FRAMEWORK

ERICs qualify to VAT and excise duties exemptions (Art.5 (1-d of the ERIC Regulation) being an international body in as of Article 143 (1)(g) and Art. 151 (1) (b) of the VAT Directive 2006/112/EC and being an international organization as of the Directive N.2008/118/EC Article 12(1) (b) related to excise duties.

The implications are that VAT and Excise exemptions are granted for the purchase of goods and services under the following conditions):

a) Subjective status - the purchase is made by the ERIC or by a Member (options: directly or indirectly)

b) Objective situation – the purchase is for the sole (exclusive) use of the ERIC (options: only for institutional or partly for commercial purpose, but with proportional tax payments).

Application of the norm

Until 2020 the exemption has been used only for the VAT. The use for Excise (i.e. for utilities) has not been used by ERICs yet and will be probably used only for energy intensive facilities. There are not known

cases of purchase from a provider outside the EU area. Import duties are to be treated separately and in some cases are exempted for research related purchase.

There are two major Tax exemption application cases:

- **Tax exemption in case of purchase in the same country**

  The simplest and most linear case of this principles is the case which foresees the ERIC purchase of goods or services directly from a provider for the use in the same Country of the provider (no cross-border transfer). The ERIC declares to the purchaser that the purchase is tax exempt according to the legal framework as reported above, and the payment from the ERIC to the provider is tax exempt. This may apply for purchases in the Country hosting the Statutory Seat and, whenever the (multi-sited-distributed) ERIC has declared to run directly its facilities in another Country (hubs, nodes, or Facilities in general) for purchase in that Country (in this case the facility can be defined as an "establishment", "outstation" or "office" of the ERIC, terms used in international law and Entities).

2. **Tax exemption in case of purchase from an EU provider**

   The next (linear & direct) case: the ERIC can directly purchase from a provider (within the EU) for transfer and use in another EU Country. The declaration must be made on the template provided by the EU and attached to the VAT Directive 2006/112/EC (form 15.10) subject to visa (or exemption from visa, as provided for in the same Directive) by the tax authority of the ERIC host Country. This requires preliminary contacts with the local tax authorities to define who is the validator (see tips below).

There are more complex cases, whereas the indirect option is required: most of these cases have been encountered when one Member (Country) wants to contribute in-kind to an ERIC by purchasing -in tax exemption allowance as a Member of an ERIC - goods/services to be transferred to the ERIC. Government administrations cannot purchase directly, but normally purchase through a " third Party" (Research Council, University, etc.).

The transfer (delegation) of the right to apply the tax exemption from the Member to a party is possible but there is an ongoing discussion (at EU and some Country's level) whether this can be made by the selected party only "on behalf" or should be "in the name and on behalf". While the first option may allow the selected Institution to procure and transfer goods/service in its name (and then transfer either the availability or the property to the "sole use" of the ERIC) the second one would force the State to become the owner (which is not practical). Some Countries (and their national tax authorities) accept to apply the second option, others do not: this is one of the issues to be defined with the local tax authorities.

When this is possible, the Party can be delegated by the Member on a specific case basis and only for a specific procurement, or can be delegated to act on behalf of the Member within a broader scope, e.g. when the party is nominated as a "Representing Entity" (Article 9 (4) of the ERIC Regulation). In this case it is important that the letter of nomination includes explicitly the delegation of the right to apply tax exemption.

One other complex case (but apparently acknowledged only in few cases), is the delegation of the right to purchase tax-exempt given from the ERIC to a "Party". In this case, the only viable option seems that the party acts "in the name and on behalf" of the ERIC (i.e. the purchase becomes property of the ERIC). This option could help to overcome the difficulty of implementing in-kind contributions by a Member when the Member has financed a Party for this purpose and there is agreement to transfer the property to the ERIC. In this case, the Party can be delegated by the ERIC to act in its name and on its behalf and pay with the funding given by the Member and available to the Party.

In those cases when a Party acts "on behalf" purchasing from another EU Country, there is the additional question of filling the 15.10 form: under which ownership is it filled? A solution is to fill it in the name of the Party, but with reference to whom is entitled to the exemption (the ERIC or the Member). Also this has to be cleared with the local tax authority, to avoid misunderstandings.

The other option listed in b) above: in principle it may happen that one instrument purchased under tax exemption allowance is used (within the institutional activities of the ERIC) for commercial purposes within the allowed limited commercial activity of the ERIC. If the amount of commercial use is known in advance, the tax exemption can be required only for the remaining part (and the tax is paid for the commercial part already at the moment of purchase). If this amount is known only afterwards (and

there is a track record of this use) the amount of due tax must be calculated and paid when the yearly accounting is made, and, again, it is advisable to detail the methodology and the procedure to keep the track record and to effect the payment with the local tax authority.
Concluding, all complex VAT exemption cases need to be clarified in advance with the relevant tax authorities: in some Countries these authorities are structured in National and Regional levels: it is very important that all levels are informed and aligned (but in particular the entry and executive, local/regional level).

Practical tips

When planning for the use of the tax exemptions, it is important that a detailed track-record is kept in the ERIC accounts. If the tax-exempt goods and services are not transferred in the property of the ERIC, but made available by a Party on behalf of a Member, it is important that this track record is kept in the accounts of the Party and reflected in the accounting/reporting of the ERIC. The auditing of the ERIC accounts should take note of all the items which are acquired within the tax-exemption area for the sole use of the ERIC.
The staff (either directly employed or seconded/detached from partners to the ERIC) who is responsible of the operation/use of the goods/services purchased in tax exemption should know the conditions to which the use is subjected, both to track the eventual commercial use and to avoid "promiscuous" usage outside the remit of the ERIC (i.e. ensure that the use is within the "sole use of the ERIC"). When the ERIC activities are hosted within a larger research institution, this may require some careful definition of operation frameworks. Therefore it could be recommended to record all VAT related transactions in the annual reporting and auditing as a separate information for the stakeholders

The local/national tax authority will need to be informed of the start of activities of an ERIC. Being the ERIC Regulation relatively unknown, and its activities very different from those of a Firm and its tax exemptions different from those granted to an Embassy or a Consulate (the most common examples of tax exempt “international Entities”) this will require a direct person-to person involvement to explain the “rationale” of the ERIC and what is a Research activity. It is suggested to take this as a part of the “stakeholders outreach activities” including possibly an invitation for a site visit and/or a presentation of the activities of the ERIC.

The meetings with the tax authorities and the competent Ministry of Finance aim at defining correct procedures to follow, possibly defining a “framework agreement” where correct procedures and ways of reporting are outlined.

Check the statute of the ERIC and integrated with internal regulations detailing correct procedures for tax exemptions. Most Statues have limits in the amounts allowed or in the extent of application.

12. LIABILITIES

The most common liabilities for the ERICs include the following items :

- Accounts Payable: amounts owed to vendors or creditors for goods or services rendered;
- Unpaid bills;
- Unpaid wages, taxes or grants can be included reported separately if significantly large;
- Deferred revenue: as for instance grants received from the EC that have not been recognized as revenue because the conditions of the grant have not been met yet;
- Due to Third Parties: certain ERICs collect contributions from one Member State and transfer them to another Service or Public Agency. When these ERICs are operating as a transfer agent with no variance power to change the recipient, then the associated cash receipts are not recorded as revenues by the ERIC, rather they are carried as liabilities;
- Long Term Debt: the principal and interest owed to a creditor. These debts can be in the form of bank loans, publicly traded bonds, or privately arranged debt financing: these debts are not common among the ERICs .

An ERIC shall be liable for its debts. However, the financial liability of the Members for the debts of the ERIC is normally limited to the respective contributions provided to the ERIC. The Members may specify

in the Statutes that they will assume a fixed liability above their respective contributions or unlimited liability.

It is recognised that some endowments represent a net liability to ERICs[8] as stated in the ERICs Regulation whereas " *an ERIC shall be liable for its debts*" -not the Community -and that "*the financial (see Liability) of the members for the debts of the ERIC shall be limited to their respective contributions provided to the ERIC*" though "*the Members may specify in the Statutes that they will assume a fixed liability above their respective contributions or unlimited liability."*. However, "*if the financial liability of the members is not unlimited, the ERIC shall take appropriate insurance to cover the risks specific to the construction, operation and governance of the infrastructure."*

On the other hand, since an ERIC is liable for its debts, it has no immunity from seizures of its assets in case of forced recovery of debts. It also is not immune from insolvency proceedings, which will in general be governed by the law of the statutory seat applicable insolvency law.

The liability of the members for the ERIC's debts is limited to each member's contribution provided to the ERIC. Contributions may be financial or "in kind" which has been paid or promised in a legally binding way.

13. THE EFFECTIVE REPORTING TO ERICs STAKEHOLDERS

13.1 The generally accepted accounting principles in ERICs financial reporting

The business-like terminology can present issues for ERICs. Terms such as profit, and loss, which permeate the business accounting standards, are not suitable for the ERICs. In particular, the concentration indicator of performance confuses the meaning behind ERICs financial reporting which should be focused on the European Research and development cohesion objectives. Therefore, narrative reporting is "absolutely essential" in ERICs reporting. Information types identified include a statement of goals, objectives and measures of outputs and outcomes which are suited to the users of the reports: analysis of performance against service performance as well as financial sustainability can

[8] COUNCIL REGULATION (EC) No 723/2009 of 25 June 2009 on the Community legal framework for a European Research Infrastructure Consortium (ERIC), art 14.

answer a number of questions that stakeholders will have about how the ERICs has achieved their objectives. ERICs report to a wide range of stakeholders with whom the ERICs interact and which have differing needs for accountability. Although Members States are seen as the primary users of ERICs activities and financial information, the stakeholder list is much wider and includes:

- The European Commission
- The Host Organisation
- Employees
- Other European Research Institutions
- Partner Organisations
- Regulators
- Other investors
- Suppliers

In order to execute effective accountability between the ERICs and its stakeholders, the stakeholders accountability needs have to be fully understood and the overall information provided by the ERICs should address these needs. Whilst recognizing that the ERICs performance is important, the purpose of accountability is to make sure that the ERICs managers act in a relationship with the providers of funds: the relationship should be based on trust, shared collective goals and relational reciprocity. The IASB's Conceptual Framework states “the primary objective of financial reporting is to provide financial information about the reporting entity that is useful to users in making decisions about providing resources to the entity”. Therefore, users of ERICs accounts - primarily the Assembly members- require to make decisions about future resources and to assess accountability of the management. Therefore, the financial reporting should provide information that would allow them to assess whether:

- The current levels of charges are sufficient to maintain the volume and quality of services provided and the accomplishment of the statutory goals
- The ERIC is achieving the objectives established as the justification for the resources raised during the reporting period
- The ERIC is using resources economically, efficiently, effectively and whether such use is in their interest: users are likely to make decisions about more than economic resources, but also social and scientific impact aims.

13.2 Mandatory auditing process

An independent audit is an examination of the accounting records and financial statements by an independent auditor—normally, a certified professional accountant (CPA). The auditor carries out an independent analysis to test the accuracy of the accounting records and internal controls. At the conclusion of the audit, the auditor issues a report in the form of a letter stating whether, in the auditor's professional judgment, the examined accounting records and year-end financial statements are fairly represented according to generally accepted accounting principles (GAAP) or to the IFRS . The auditor's letter should be attached to the front of the financial statements.

All ERICs are required to obtain audits, to obtain what is termed a "single audit" to test for compliance with European grants management standards. In addition, Member States require ERICs to be audited if they solicit funds and will not provide funding unless they receive audited financial statements. This is confirmed by the COUNCIL REGULATION No 723/2009[9] whereas in art. 13 (Budgetary principles, accounts and audit)it is stated that "*an ERIC shall be subject to the requirements of the applicable law as regards preparation, filing, auditing and publication of accounts*".

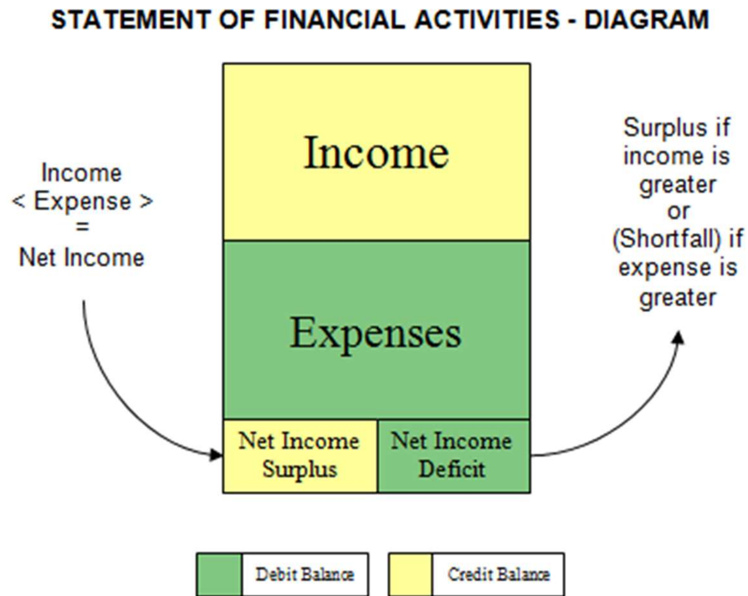
[9] COUNCIL REGULATION (EC) No 723/2009 of 25 June 2009 on the Community legal framework for a European Research Infrastructure Consortium (ERIC)

13.3 Narrative Reporting

Narrative reporting describes the non-financial information included in annual reports to provide a broad and meaningful picture of activities, performance, impact and future prospects. This includes the strategic areas / services being developed (Narrative Notes, see Figure 3), the directors' report, the chairman's statement, the directors' remuneration report and corporate governance disclosures.

The income statement – though many ERICS produce a variety of versions of this report calling it various names such as budget report, profit & loss, income and expense - shows the ERICs income and expenses for a specific period of time. The statement reflects the changes to an ERICS net assets resulting from income and expenses that occur during the current fiscal year(Figure 1) .

Figure 2. Comparison of Common key factors and differences in financial reporting



The results of the year's activities result in a change to the ERICs net assets. Net results (Cash-carry over) for each year are accumulated and show as changes--increases or decreases--in those net assets categories. Net assets beginning balances in each expenses category are increased by each year's surplus and decreased by each year's deficit. However, it should be highlighted that some ERICS (eg ESS ERIC) do not generate a surplus according to their accounting policy.

A well-formatted reporting provides accurate and relevant information with enough context for the board to thoroughly understand what's going on with your organization financially. To be strategically useful, the reports should show numbers in context so a ERIC Assembly Members could answer the following questions:

- What was the total revenue/expenses of last year?
- What is the annual budget for this year and what are the variances with respect to the budget?
- How do we expect to end the year and how does that compare to the approved budget? What are the reasons for the significant variances?

Below (Figure 2) is a general format for an Income Statement recommended for ERICs internal reporting purposes. The report for an ERIC should include detailed line items in each category, but the objective

would be to keep the report at one page in length, although narrative explanations may flow to a second page.

In this report design, income is shown by source (membership fees, in-kind contributions, R&D Projects) and subtotaled separately as earned and contributed. Within earned and contributed categories, you may include additional line items to show more detail such as earned income by program, or each contributed income by source such as member Countries, and special events.

Expenses can be shown as aggregate figure or by major program activity. Showing expenses by activity (function) clearly demonstrates how the ERIC spends its resources toward accomplishing mission activities.

The prior-year total provides context for comparison. The annual budget as approved by the Assembly is shown as well as a year-end forecast in lieu of frequent budget revisions. The forecast column is equal to the budget column at the beginning of the year to reflect anticipated changes from the original budget. Variances between the approved budget and the year-end forecast are to be shown both in Euro amounts and in percentages, and significant variances should be noted and explained.

The major source of revenues are the “Membership fees”. The item “Other revenue” item may include the EC grants and the funding provided by other third parties.

Figure 3. Internal Report format[10]

[10] Some ERICs apply different nomenclatures (eg Cash-carry-over vs Cash surplus)

	ERIC NAME- Income Statement- Statement of Activities	Prior Year Actual	Current Year to Date	Current Year Budget	% Year Budget	Year End Forecast	Notes
Income by source	*Revenue (fees)*						A
	In-kind Contribution						B
	Other Revenue						
	TOTAL REVENUE						
Expenses by function/activity	*Program Expense*						
	Development Expense						C
	Admin Expense						
	TOTAL OPERATING EXPENSE						
	NET CASH CARRY-OVER						
Narrative Notes	Note A						
	Note B						
	Note C						

The report format (Figure 2) is designed to promote maximum understanding by the Assembly of Members Countries by showing the year-to-date but focusing on the expected year-end results. Management updates the year-end forecast to reflect expected changes to line items, focusing on what can be done to mitigate changes that might cause a deficit.

14. CONCLUDING REMARKS

The purpose of this report was to provide highlights on the need for specific accounting principles for

ERICs. Financial reporting standards and principles such as the IFRSs have not been designed to be specifically applicable to non-profit organizations. However, legislation does require compliance with IFRSs.

In order to meet these objectives a literature review was conducted and the requirements of the generally accepted accounting standards issued specifically for non-profit organizations were analyzed. The views of ERICS Financial Officers were gathered using ERIC FORUM -administered questionnaire circulated in November 2019.

In conclusion, accounting for an ERIC is imperative as ERICs play a vital role in ensuring an enduring European cohesion framework in Research and Development in the European Research Area. The accounting field for an ERIC is varied with different approaches as compared to accounting for-companies. Although the field is challenging, the development of shared and agreed accounting practices for the ERICs is a significant milestone for the future of Research Infrastructures.

ERICs accounting is faced with challenges of convincing European Stakeholders and Citizens that they efficiently manage the funds they receive and that they are dedicated to achieving the missions for which the ERICs were created. On the other hand, an important limitation of the financial statements is their limited ability to assess whether an ERIC is efficiently accomplishing its mission.

Therefore, transparency becomes a matter of vital importance that needs to be made visible: ERICs require internal control mechanisms that allow their stakeholders to assess the destination of resources (the narrative) in accordance with their goals. Transparency and good governance are necessary to achieve the social credibility which allows for the continuity of an organization and the achievement of its goals.

This is confirmed by the COUNCIL REGULATION No 723/2009[11] whereas in art. 13(Budgetary principles, accounts and audit) it is stated that "*The budget shall be established and implemented and the accounts presented in compliance with the principle of transparency*."

The requirement for high levels of transparency in ERICs rests on one fundamental pillar: Member Countries and the EC -the main stakeholders of ERICs- are to promote the effort to homogenize the format of the disclosure of information when providing financial support from public funds. This fact

[11] COUNCIL REGULATION (EC) No 723/2009 of 25 June 2009 on the Community legal framework for a European Research Infrastructure Consortium (ERIC)

is even more important considering that ERICs also compete for public funds.

This implies that ERICs need to adopt common and shared policies of disclosure of information, which cannot be merely transferred from the Non-Profit sector accounting practices .

Concluding, the transparency of ERICs is not an end in itself: the creation of effective accounting practices can help to build a better Europe by emphasizing the accomplishments of the goals of the Research Infrastructures. Future research could look into the development of appropriate models to empirically measure the performance of the ERICs in an objective, quantifiable way, and matching the efficiency of the cost accounting with the effectiveness of the super-national policy goals which are being accomplished.

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16. ANNEX 1

The Results of the ERIC FORUM Survey and of the SEMINAR held in Brussels (February 2020)

THE RESULTS OF THE ERIC FORUM SURVEY (DECEMBER 2019-JANUARY 2020)

The ERICs survey results and participation (online questionnaires were collected by ERIC FORUM during the winter 2019-2020) demonstrated a high level of interest and engagement with the issues, attracting over 15 responses representing experience of ERICs financial reporting in many European countries.
The Survey was very important: it was a reliable method to get real feedback from the ERICs As we found in the survey, ERIC FORUM has a unique opportunity to educate the ERICs about the importance of sharing experience about the applied accounting and financial rules. At the moment, ERICs are not generally concerned about the importance of general accounting, and we find the interviewees possesses only a very basic understanding of the management accounting rules to be applied, and their connections to the ERICs sustainability .
Respondents had direct involvement in ERICs financial reporting. The number and the quality of the responses – particularly as judged by the narrative comments – were very useful for the present exercise.
Nevertheless, it is important to note that the survey did not seek to explain what form ERICs accounting standard might take, but it allowed respondents to interpret this as they saw fit. It is therefore likely the different respondents will have interpreted the term in different ways, and narrative comments indicate that respondents envisaged a voluntary guidance to be followed. Also, one of the limitations of the survey was that the survey may have attracted only some of potential respondents who were receptive to the idea of creating standards for ERICs reporting.
The Survey was based on the distribution of Questionnaires to the ERICs. The results are the following:

- 15 duly redacted forms were collected which is a relevant amount
- 5 Questionnaires contained incomplete responses (33%)

However, the Survey showed a number of interesting results with respect to the goal of this document.

- Depreciation: the majority of respondents of the 10 completed questionnaires provided correct responses

- Income tax. Some confusion was detected: 5 answers indicated NA
- Balance sheet. Some answers state that is the accountant to approve the Balance Sheet
- Budget. The majority of survey respondents (12) indicated that to have a budget approval policy and 3 responded NA
- Regarding non- disclosure agreements, the majority shared the information that there are no standard policies
- In-Kind contributions: the majority of survey respondents (12) indicated it as key outcome, while 3 ERICs do not consider this topic as a key issue.
- What IKC is employed. All respondents mentioned the Personnel (all), 5 mentioned physical office availability, and 3 ERICs mentioned equipment
- IKC definition was somewhat confused. The variety of remarks (some mentioned the IKC as “stock injection”) shows that an accounting and financial terminology homogenization is also a key task.