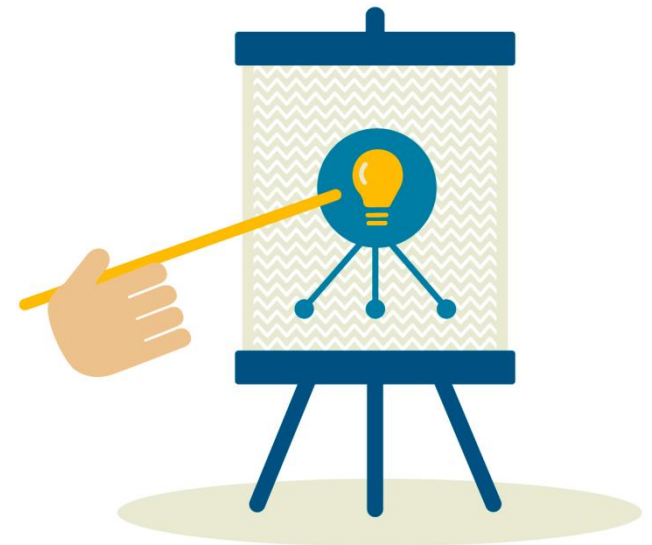# Risk-based verifications and sampling

National Control (FLC) workshop
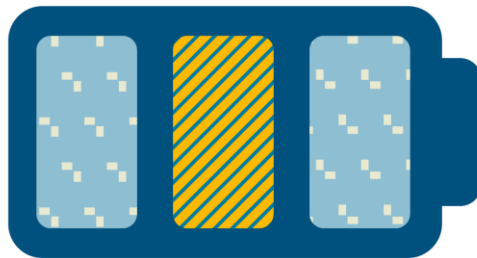
08-09 May 2018 I Dubrovnik, Croatia

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Content

1. Terminology

2. Regulatory framework and guidance 2014-2020

3. HIT risk assessment and sampling

Terminology

Sampling

- Sampling involves the <u>application of control procedures to less than 100 % of items within a class of transactions or budget lines</u>, such that all sampling units have a chance of selection (Definition based on ISA 530 No. 5)

- Routinely applied by certified auditors, Second Level Control, EC Auditors, ECA, etc.

- Was used in some ETC FLC systems (on-the-spot, administrative).

- Usually done if it is impossible, unnecessary or not practical to control all expenditure items.

Risk

- Potential error source

Risk assessment

- Aimed at obtaining a better understanding of potential error sources related to the project, the beneficiary, the type of expenditure, etc.

- Sampling methodologies often include risk assessments as a basis for planning the sampling methodology.

Risk-based approach to control (1)

Pick the riskiest!

- **Decrease control work** for low-risk control areas, where certainty is high that more controls will not result in the discovery of material errors, such as:

    ✓ Items of low value (e.g. bus tickets, pens, paper, etc.);

    ✓ Standard internal processes for which it is already known that they function well (e.g. payment processes, deduction of VAT, staff cost budget line, etc.)

Risk-based approach to control (2)

- **Increase control work** for control areas where the risk of material errors is high, even if difficult to control.

- **More thorough controls:** Spend more time, pay more attention to details, etc.

  - ✓ Infringement of public procurement rules,
  - ✓ Double funding,
  - ✓ Lack of existence and reality,
  - ✓ Fraudulent external expertise arrangements,
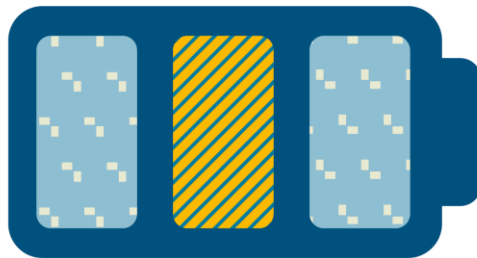 - ✓ etc.

Risk-based approach is not new to controllers

Controllers …

- Are very aware of potential risks (especially experienced controllers)

- Have good feelings about the quality of the reports they control

- Many adapt their work programmes over time to the quality of reports (although not always explicitly so)

Regulatory framework and guidance 2014-2020

Intensity

On the spot verifications

Art 125.5, Reg. 1303/2013: on-the-spot verifications may be carried out on a sample basis

Administrative verifications

Guidance on management verifications: where justified, verification of a sample of expenditure items is allowed.

Methodology – Recommendations (1)

On-the-spot verifications (p. 13)

- MA keeps records of the operations selected; description of the sampling method and reviews the sampling method annually

- Risk-based selection is complemented by a random sample

- Risks e.g.: complexity of operation, amount of public support, risks discovered during management verifications, etc.

- Sample, e.g.: high value operations, <u>problems/irregularities or unusual transactions have been previously been identified</u>
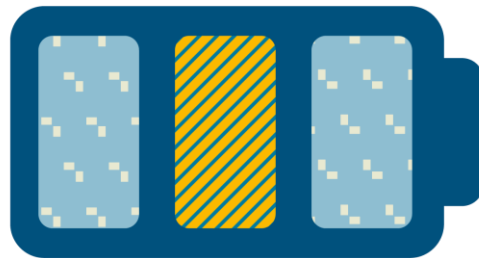
Methodology – Recommendations (2)

Administrative verifications (p. 12)

- Methodology established ex-ante (by the MA)

- Sampling based on risk factors (e.g. value of items, type of beneficiary, past experience)

- Risk-based selection is complemented by a random sample

HIT risk assessment and sampling methodology

Risk (inherent + control risk)

Inherent Risk

Control Risk

- **Inherent Risk -** Typical for this type of beneficiary, project or report

- **Control Risk** - Related to the quality of internal accounting and controls of the beneficiary.

    Assessment requires experience with the quality of the expenditure reported by the beneficiary.

    -> No sampling of the first report!

Inherent risk

- Inexperienced beneficiary

- Beneficiary with poor track record, known issues

- Beneficiary with other EU or non-EU grants

- Large partnership

- Large partner budget

- Private partner

- Person responsible for preparation of the financial report has changed recently

- Large public procurements

- Few tangible outputs (based on networking, meetings, etc.)

- Others (e.g. programme- or country-specific risks)

Control Risk

Assess the quality of the partner report:

1. Quality of expenditure when originally reported (e.g. good, medium, bad)

2. Number of clarification rounds with beneficiary

3. Quality of expenditure after clarifications

Recommended to do this per budget line!

Draw conclusions for the <u>next report.</u>

Sampling (Example)

A combination of:

- **Simple random sampling:** The suggested minimum sample size per budget line is **at least 10%** of the total value of declared expenditure for the budget line AND **at least 2 items.**

- **Key-item sampling:** In addition included are:

    All items that exceed 25% of the total value of the budget line.

    Any risky item (e.g. based on type of beneficiary) and unusual or suspicious items.

It can be necessary to expand this sample until controllers have a good feeling about the reliability of information!

Example – Travel and Accommodation

Project:
DivTe

Project Partner:
Tennis Center Supernova

CONCLUSIONS:

In total EUR 127.50 is found not eligible and should be deducted.

	Flights	Trains	Hotels	Municipal Public Transport (Metro and airport bus tickets)	Entire Report (Budget line travel and accommodation)
Total Sum claimed by beneficiary	1.870,00 + 721,10 = **2.591,10**	420,00	732,50 + 720,00 + 570,00 = **2.022,50**	48,00 + 30,80 + 32,00 + 22,00 + 14,00 = **146,80**	5.180,40
Total Sum deducted	**90,00**		12,50 + 22 = **34,50**	3,00	127,50
% of item category	3,47%	0%	1,71%	2,04%	2,46%
% of Budget Line	1,74%	0%	0,67%	0,06%	2,46%

Extending controls after the initial sample

Management verifications

- In case that material errors are found in the sample tested -> extend the testing **to determine whether the errors have a common feature** (i.e. type of transaction, location, product, period of time)

- Either:

  - No common feature(s): extend the verifications to 100% of the application for reimbursement, or

  - Common feature(s): project the error in the sample to the unchecked population.

- The total error is calculated by adding the errors from the risk based sample to the projected error from the random sample.

HIT Sampling methodology for administrative verifications

✓ In line with EC Guidance on Management Verifications

✓ Sampling based on risk assessments and done per budget line

✓ Sampling items, e.g.:

- Staff costs: monthly payments to employees

- Office and administration: monthly electricity costs

- Travel and accommodation: business trip reports

HIT Sampling methodology for administrative verifications
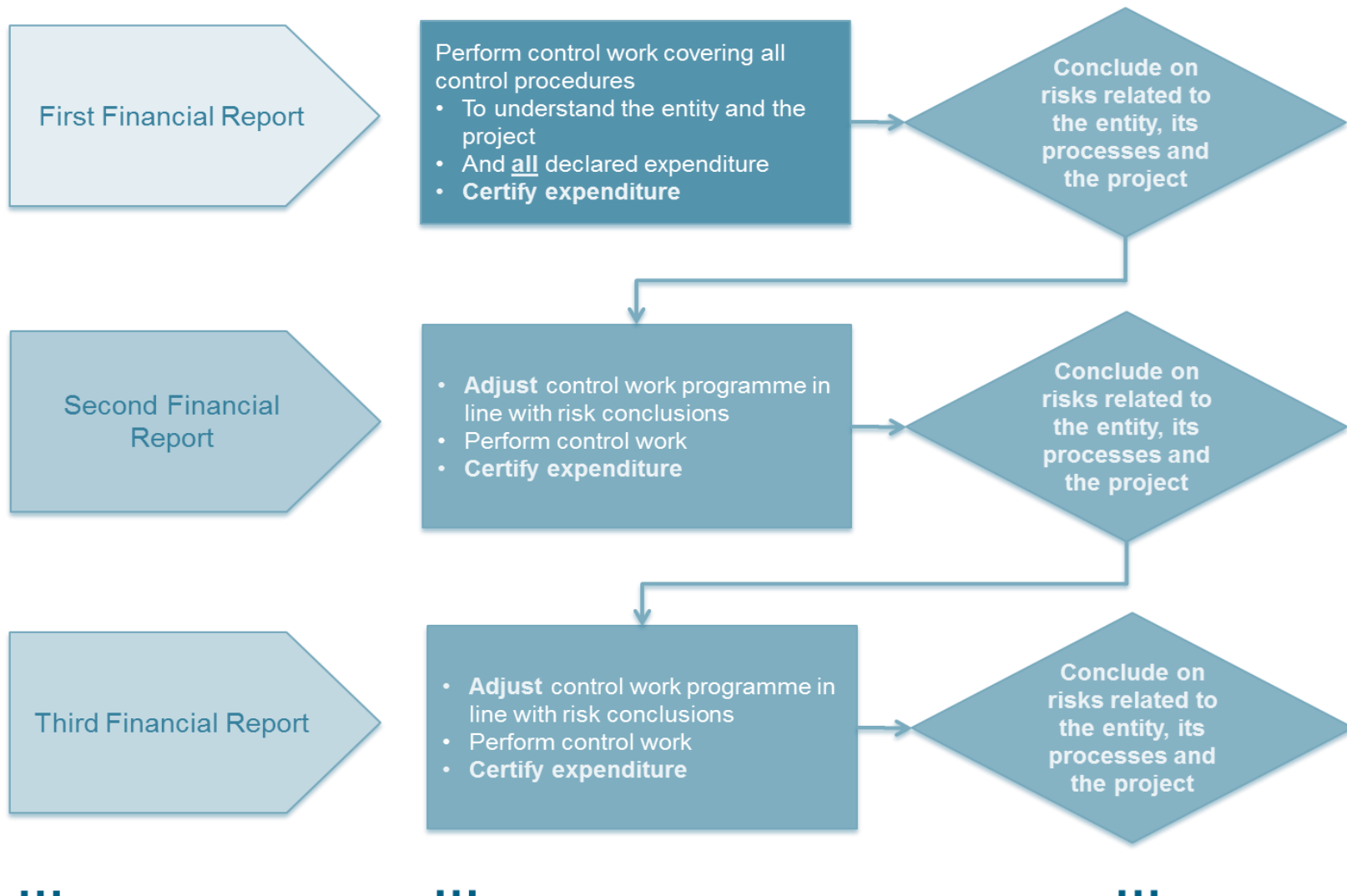
Sampling <u>not</u> recommended for:

1. The first partner report

2. Public procurements

3. General controls of the checklist (audit trail checklist)

4. Budget lines where quality of previous report was not sufficient

5. Simplified cost options

6. Unusual or suspicious items

Developing own sampling method

- Define risk factors for inherent risk

- Define 'quality of partner reports' for control risk (good, medium, bad reports)

- Develop sampling methodology consisting e.g. random sample minimum size (e.g. 10%) plus key item sample (e.g. all risky and suspicious items)

- Determine what should never be sampled

- Review methodology a very year and adapt if necessary

Adapting control work over time

First Financial Report

Perform control work covering all control procedures
- To understand the entity and the project
- And **all** declared expenditure
- **Certify expenditure**

Conclude on risks related to the entity, its processes and the project

Second Financial Report

- **Adjust** control work programme in line with risk conclusions
- Perform control work
- **Certify expenditure**

Conclude on risks related to the entity, its processes and the project

Third Financial Report

- **Adjust** control work programme in line with risk conclusions
- Perform control work
- **Certify expenditure**

Conclude on risks related to the entity, its processes and the project

…   …   …

Cooperation works

All materials will be available on:

www.interact-eu.net