The 2014-2020 Interreg Programme Management Handbook is composed of fact sheets. Each theme is covered by one fact sheet so that the reader can easily and quickly choose the relevant fact sheet.

Fact Sheet; Risk Assessment

1. What is it? What is the definition of the term / theme of this fact sheet?

Risk in the context of Interreg programmes means a potential source of errors or irregularities. Risks are usually quantified or described in qualitative terms. They can be ranked in relation to each other, for example as low, medium or high risks to the programme.

Risk assessment refers to the estimation of quantitative or qualitative risk related to a concrete situation. For example, it could be an analysis of potential error sources for the project’s financial report. Quantitative risk assessments normally require the calculation of 1) the probability that a harmful situation occurs, and 2) the magnitude of potential loss should the situation occur.

Risk = Probability x Magnitude of Potential Loss

This means that a risk is high if either the probability of occurring or the magnitude of loss, or both, are high compared to other risks.

Risk management is the identification, assessment and prioritization of risks, followed by targeted action to address the risk. This means risk management in Interreg programmes includes not only the assessment and prioritization of the risk as low, medium or high, but also a set of actions to minimise, monitor and control the risk. In many cases in Interreg, addressing a risk means installing more targeted controls.

One obstacle to Interreg risk management is the objective measurement of both probability and magnitude of potential loss, as these can be very difficult to measure. In the absence of reliable quantitative data, these assessments are usually based on professional judgment.

Professional judgment: The application of relevant training, knowledge and experience within the context provided by control, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate.

Acceptable risk is a risk that is understood and tolerated, usually because the cost of implementing effective measures exceeds the expected potential error. For example, controlling eligibility of small expenditure items such as bus tickets can take a substantial amount of time, although - at the same time - the control is unlikely to address a significant risk due to the small value at stake. Interreg programmes can decide to target controls towards those transactions that are high risk.

Materiality threshold: In ERDF, materiality is usually defined as an error larger than 2% of the population value (i.e., the sum controlled).

Risks of Material Misstatement: The risk that the financial report (of the beneficiary or of the programme, for example) is materially misstated. The risks of material misstatement at the level of the expenditure declared by a beneficiary consist of two components: inherent risk and control risk.

Inherent risk and control risk: Are both risks associated with the beneficiary.

- Inherent risk is inherent to the nature of the partner (e.g., ‘private’, ‘inexperienced’, ‘history of fraud’), the project (e.g., ‘large number of partners’, ‘intangible outputs’) or types of transactions (e.g., ‘public procurement’). Inherent risks assessed based on experience. It can be high for some projects, partners, transactions, etc., and low for others. It can also vary from programme to programme.
• **Control risk** is a function of the effectiveness of the design, implementation and maintenance of internal control by the beneficiary (through the accounting department, for example). Internal control, no matter how well designed and operated, can only reduce, but not eliminate, risks of material misstatement. There is always the possibility of human errors or mistakes, or of internal controls being circumvented.

• **Irregularities and fraud** According to Article 59(2) of the Financial Regulation, Member States must take all necessary measures, including legislative, regulatory and administrative measures, to protect the EU’s financial interests, namely by preventing, detecting and correcting irregularities and fraud. For more information on errors and irregularities, please consult the fact sheet on ‘Financial Corrections’.

Fraud always involves an intentional act, while errors or irregularities are unintentional misstatements.

2. **Why we are discussing it?**

Risk assessments in one way or another exist in most programmes at different levels. For example, programmes might have checklists at the project selection stage that highlight the presence of risks inherent to a project type, or type of partner or activity (e.g., economic activities might implicate the presence of State Aid). Management verifications might use risk assessments to identify risky transactions based on the experience (professional judgment) of the JS and/or national controllers (e.g., ‘private partners often have public procurement errors’). Management verifications and audits also use risk assessments as a basis for sampling controls or audits.

In Interreg, risk assessments have become more important over time as they are recognised as a useful tool to better target controls towards those areas where high risks of material misstatement exist. They also become more important as a basis for sampling at the level of management verifications, and they are also used as a basis for addressing potential fraud risks.

It is very important to note that risk assessments should not simply lead to MORE controls. Instead, they should keep in mind the principle of proportionality and lead to BETTER TARGETED controls and the identification of areas where the programme might so far have had a potential ‘blind spot’.

3. **Reference to the regulations and what is new in the the 2014-2020 programming period compared with the the 2007-2013 programming period**

Legislative framework:

- EC Regulation 1303/2013 (CPR),
  - Article 2 (36-38), Definitions
  - Article 23 (11), Measures linking effectiveness of ESI Funds to sound economic governance
  - Article 72 (h), General principles of Management and Control Systems
  - Articles 74 & 122, Responsibilities of the Member States
  - Article 125 (4), management verifications and effective and proportionate anti-fraud measures
  - Article 143, Financial corrections by Member States
  - Article 144, Financial corrections by the Commission
  - ANNEX XIII; Designation Criteria for the MA and the CA; especially ‘Internal Control environment’, ‘Risk management’ and ‘Management and Control activities’

1 Fact sheet – Errors, financial corrections, irregularities, recoveries and withdrawals
EGESIF_14_0012_02, Guidance for Member States on Management Verifications, e.g. Chapter 1.7, ‘Intensity of management verifications’
EGESIF_14_0021_00, Fraud Risk Assessment and Effective and Proportionate Anti-Fraud Measures

4. Challenges and frequently-asked questions

• What are typical inherent risks in Interreg?
• How to assess control risks?
• How do we react in case a risk is identified?
• How do we address fraud risks using the guidance on fraud risk by the European Commission?

5. How they are addressed and how does it work in practise?

Inherent risks are usually identified based on professional judgement in combination with additional information sources such as the INTERACT list of typical inherent risks. Since inherent risks can differ from programme to programme, list of potential inherent risks need to be developed individually.

Control risks (e.g., the risk that internal controls of beneficiaries do not properly work) can be assessed based on experience with the quality of the reports submitted to national controls or the JS. It provides information on the quality of the documents submitted and the reliability of the expenditure reported by cost category. The assessment of control risks can be used to justify sampling (e.g., if the quality was good in this reporting period for a certain cost category, sampling can be applied in the next reporting period, provided no major changes have occurred). An assessment of control risk is usually updated for each reporting period after the verification has been completed.

Risk assessments need to result in appropriate actions to address the identified risks. For example, they may be reflected in the controller’s planning of the control work (e.g., what to do on-the-spot). A risk assessment without a good idea what to do in case of identified risks is usually not effective. This means that all risk assessments must be accompanied by considerations about potential actions to address the risk identified.

Fraud risks can be addressed using the EC guidance on Fraud Risk Assessment and effective and proportionate anti-fraud measures. Annexes to the EC guidance on Fraud Risk Assessment and effective and proportionate anti-fraud measures provide a very useful list of potential fraud risks. Interreg programmes need to identify and rank risks relevant to their programme area. They also need to identify a set of measures to address these risks.

6. Good practice examples

Familiarity with the notion of risks and risk assessments can help programmes better target controls and effectively reduce the administrative burden, while -at the same time- reduce errors, irregularities and fraud. Administrative resources spent on 100% controls (i.e., controlling every expenditure item for every potential error) are not necessarily more effective in reducing programme error rates than systems that apply risk assessments and sampling. The key is to spend administrative resources wisely and to target efforts more towards those areas that cause real risks.

Risk assessments usually evolve over time as more experience becomes available. It is important to note that inherent risks are programme-specific, as they depend on the programme area as well as programme rules and professional judgement applied by the people developing the risk assessment. In order to identify
risks and develop appropriate measures to address these risks, programmes can find it useful to consult with different level of controls, including national controllers, MA/JS and audit authorities.

7. Reference to other, more-detailed papers

- International Standards on Auditing (ISA) are professional standards for the performance of financial audit of financial information. These standards are issued by International Federation of Accountants (IFAC) through the International Auditing and Assurance Standards Board (IAASB). They contain useful information about risks and risk assessments.
- Fact sheet: Audit and Control bodies
- Fact sheet: First Level Control
- Fact Sheet: Financial Corrections