Identifying and preventing fraud & corruption in ESI Funds

Model for assessing risk of fraud

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ERDF Audit Authority, Ireland
Assessing risk of fraud

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▪ Annex 1 – Fraud risk assessment tool
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Assessing risk of fraud

EGESIF guidance note 14-0021-00 (2014)

- Assistance and recommendations to MA’s
- How to implement Article 125(4)(c) of CPR – effective and proportionate anti-fraud measures
- Also includes guidance for AA as to how to verify MA compliance
- Approach of MA should be
  - Proactive
  - Structured
  - Targeted
- Adoption of right “tone from the top”
Fraud Risk Self-Assessment

EC recommend MA use the tools described in 4 Annexes:

Annex 1: Risk Assessment Tool
To be carried out by a self-assessment team set up by MA

Annex 2: Recommended mitigating controls
Non-binding further controls in response to any remaining risks.

Annex 3: Template for Anti-Fraud Policy Statement (tone at the top).

Annex 4: Guidance for Audit Authority verification work
Checklists to be used in systems audits of AFM’s
Annex 1 - Fraud risk self-assessment

1. Quantify the likelihood & impact of the specific fraud risk (gross)

2. Assess the effectiveness of the current controls to mitigate the (gross) risk

3. Assess the net risk after taking into account the effectiveness of current controls (residual risk)

4. Assess the effect of planned additional controls on the net (residual) risk

5. Define the target risk i.e. the risk level considered tolerable by the MA
Annex 1 - Fraud risk self-assessment

There are 3 key control processes exposed to fraud:

1. Selection of applicants
2. Implementation and verification of operations
3. Certification and payment

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Annex 1 – Self Assessment Tool

Risk Likelihood

From a drop down menu the risk assessment team should select a risk likelihood score from 1 – 4 based on likelihood of risk occurring in the seven year programming period.

See Criteria below:

<table>
<thead>
<tr>
<th>Score</th>
<th>Likelihood</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Will almost never happen</td>
</tr>
<tr>
<td>2</td>
<td>Will rarely occur</td>
</tr>
<tr>
<td>3</td>
<td>Will sometimes occur</td>
</tr>
<tr>
<td>4</td>
<td>Will often occur</td>
</tr>
</tbody>
</table>
## Annex 1 – Self Assessment Tool

<table>
<thead>
<tr>
<th>LIKELIHOOD</th>
<th>4</th>
<th>3</th>
<th>2</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>HIGH</td>
<td>Will often occur</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MEDIUM</td>
<td>Will sometimes occur</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LOW</td>
<td>Will rarely occur</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Will almost never happen</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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## Annex 1 – Self Assessment Tool

### Risk Impact

<table>
<thead>
<tr>
<th>Reputation</th>
<th>On Objectives</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Limited impact</td>
<td>Additional work delayed other processes</td>
</tr>
<tr>
<td>2 Minor impact</td>
<td>Achievement of operational objective delayed</td>
</tr>
<tr>
<td>3 Major impact e.g. nature of fraud is particularly serious or several beneficiaries are involved.</td>
<td>Achievement of operational objective endangered or strategic objective delayed</td>
</tr>
<tr>
<td>4 Formal enquire from stakeholders, e.g. Parliament and/or negative press</td>
<td>Strategic objective endangered</td>
</tr>
</tbody>
</table>
### Annex 1 – Self Assessment Tool

A self-assessment tool is designed to evaluate the impact of various factors. The tool categorizes these factors into four levels: Limited, Minor, Major, and Formal enquiry, which are then rated on a scale of Low, Medium, and High. The tool helps in identifying areas that may require formal inquiry due to potential high impact.

<table>
<thead>
<tr>
<th></th>
<th>1 Limited impact</th>
<th>2 Minor impact</th>
<th>3 Major impact</th>
<th>4 Formal enquiry</th>
</tr>
</thead>
<tbody>
<tr>
<td>IMPACT</td>
<td>LOW</td>
<td>MEDIUM</td>
<td>HIGH</td>
<td></td>
</tr>
</tbody>
</table>
Annex 1 – Self Assessment Tool

<table>
<thead>
<tr>
<th>LIKELIHOOD</th>
<th>IMPACT</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low LIKENESS</td>
<td>Minor impact</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>Limited impact</td>
</tr>
<tr>
<td>Medium LIKENESS</td>
<td>Major impact</td>
<td>3</td>
<td>4</td>
<td>Formal enquiry</td>
<td></td>
</tr>
<tr>
<td>High LIKENESS</td>
<td>Formal enquiry</td>
<td>4</td>
<td>5</td>
<td>6</td>
<td>High impact</td>
</tr>
</tbody>
</table>

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Annex 1 – Self Assessment Tool

Total Risk Score (Gross)

The inputs into risk impact and risk likelihood will result in a range of scores from 1 (1x1) to 16 (4x4).

The Rankings are outline below.

<table>
<thead>
<tr>
<th>Score</th>
<th>Ranking</th>
<th>Colour</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 - 3</td>
<td>Tolerable</td>
<td>Green</td>
</tr>
<tr>
<td>4 - 6</td>
<td>Significant</td>
<td>Yellow</td>
</tr>
<tr>
<td>8 - 16</td>
<td>Critical</td>
<td>Red</td>
</tr>
</tbody>
</table>
## Annex 1 – Self Assessment Tool

<table>
<thead>
<tr>
<th>Likelihood</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>High</strong></td>
<td></td>
</tr>
<tr>
<td>Tolerable  3</td>
<td>Significant 6</td>
</tr>
<tr>
<td>Significant 4</td>
<td>Critical 9</td>
</tr>
<tr>
<td>Critical 12</td>
<td>Critical 12</td>
</tr>
<tr>
<td><strong>Medium</strong></td>
<td></td>
</tr>
<tr>
<td>Tolerable 2</td>
<td>Significant 4</td>
</tr>
<tr>
<td>Tolerable 2</td>
<td>Significant 6</td>
</tr>
<tr>
<td>Tolerable 3</td>
<td>Significant 4</td>
</tr>
<tr>
<td><strong>Low</strong></td>
<td></td>
</tr>
<tr>
<td>Tolerable 1</td>
<td>Tolerable 2</td>
</tr>
<tr>
<td>Tolerable 3</td>
<td>Tolerable 3</td>
</tr>
<tr>
<td>Tolerable 4</td>
<td>Significant 4</td>
</tr>
</tbody>
</table>
Annex 2

Annex 2 to Guidance suggest controls under the following headings:

- Selection of applicants
- Implementation and verification of operations
- Certification and payments
- Direct procurement by MA (if applicable)
If MA ... ...

- Demonstrates a clear commitment to combat fraud and corruption
- Raises awareness about its preventative and detective controls
- Is determined to transmit cases to competent authorities for investigation and sanctions

It will send a clear message to potential perpetrators

May change behaviours and attitudes towards fraud
Fraud prevention

1. Ethical Culture
Ethical Culture

- **Mission Statement**
  Clear expression (internal and external) that MA striving to achieve highest ethical standards

- **Tone from the Top**
  Oral and/or written communication from highest level of MA that highest ethical standard expected from staff and beneficiaries

- **Code of Conduct**
  Unambiguous code of ethics that all staff must routinely declare adherence to:
  - Conflicts of Interest – procedures to declare them
  - Gifts and hospitality policy – explain responsibilities to staff
  - Confidential information – explain responsibilities &
  - Requirement to report fraud.

- **Anti-fraud Policy – Annex 3** provides a Template for MA's
Fraud prevention

1. Ethical Culture
2. Policy, Responsibilities, Training, Reporting
Allocation of Responsibilities

- MA must have clear allocation of responsibilities for setting up MCS
- That comply with EU requirements
- Verify that these systems effectively prevent, detect and correct fraud.

Training & awareness raising

- Both theoretical and practical
- Anti-fraud culture
- How to identify and respond to suspected cases of fraud
- Put clear reporting mechanisms in place
- Informally by way of newsletters, posters, group meetings
Fraud prevention

1. Ethical Culture
2. Policy, Responsibilities, Training, Reporting
3. Internal Control System
Internal control systems

- Controls focused at mitigating the identified risks
- Management verifications and on-the-spot controls
- Thorough management verifications will increase likelihood of detection
- Ensure awareness of fraud indicators
- Data analytics – ARACHNE
- Reporting mechanisms – Audit Authority, MS investigative authorities, OLAF
- Investigation, correction and prosecution by competent authority
Fraud prevention

1. Ethical Culture
2. Policy, Responsibilities, Training, Reporting
3. Internal Control System

1, 2, 3 Help to reduce Fraud Risks
Annex 4 – AA verification of MA compliance with Article 125(4)

1. Review the process for fraud risk assessment
   - Composition of assessment team
   - Time and resources spent on exercise
   - Sources of information were adequate (audit reports, fraud reports, other self assessments)
   - Exercised clearly documented
   - Adequate oversight by senior management

2. Gross risks
   - Review selection of the scores for IMPACT (explanations & supporting evidence)
   - Review selection of the scores for LIKELIHOOD (explanations & supporting evidence)
   - Has the GROSS risk been calculated and graded (T,S,C) correctly?
Annex 4 – Audit Authority Audit

Annex 4 – AA verification of MA compliance with Article 125(4)

3. **Existing controls and Net Risk**
   - Select a sample of controls and verify
   - Do the controls actually exist?
   - Are they adequately documented?
   - Review scores for effect of controls on the Gross Risk (Impact & Likelihood)
   - Has net risk been calculated and graded (T, S, C) correctly?

4. **Action Plan and Target Risk**
   - Select a sample of risks from fraud risk assessment (cover all processes)
   - Review score given for effect of new controls (on Impact and Likelihood)
   - Is score consistent with AA knowledge of effectiveness of control?
   - Has Target Risk be calculated and graded correctly?
   - Do additional controls appear to be optimal and well-considered?
## Sampling techniques

<table>
<thead>
<tr>
<th>Risk-based sampling</th>
<th>Random/Statistical sampling</th>
</tr>
</thead>
<tbody>
<tr>
<td>If you want to find &amp; fix a problem ...</td>
<td>If you want to give an objective, unbiased and representative opinion/error rate</td>
</tr>
<tr>
<td>Will point you in direction of ‘bad’ projects</td>
<td>Will select good and bad projects – every unit in population has chance of selection</td>
</tr>
<tr>
<td>Will skew the audit result / error rate</td>
<td>It will give a fair/accurate error rate because based on representative sample</td>
</tr>
<tr>
<td>More suited to control than audit</td>
<td>More suited to audit than control</td>
</tr>
<tr>
<td>Is subjective and reliant on professional judgement and risk tolerance</td>
<td>Is objective/logical and not overly reliant on professional judgement</td>
</tr>
<tr>
<td>Requires information about the nature of the project/operation, history, risks.</td>
<td>Can be applied to project financial data by means of Excel / IDEA</td>
</tr>
</tbody>
</table>
Sampling techniques

Audit Authority Sampling:

12+ Months (1/1/N until 15/2/N+1) audit of operations should start immediately

• Consider sampling techniques to reduce workload and spread over time
  • stratification,
  • grouping,
  • confidence levels,
  • two semester sampling
• Consider potential impact of techniques chosen (e.g. grouping)
Questions?

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