Guidance on the risk-based management verifications for 2021-2027 and HIT methodology

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Introduction

The nature of management verifications has been significantly changed in the 2021-2027 programming period. This document aims to guide managing authorities on developing the methodology for risk-based management verifications, giving some hints and recommendations. The document also describes the Harmonised Implementation Tools (HIT) methodology for risk-based management verifications that was developed together with several Interreg programmes. The methodology is in line with the regulatory requirements, is ready to use, and can be adapted to specific Interreg programmes' needs and context.

1. Risk-based management verifications in 2021-2027

1.1. Legal framework

The Common Provisions Regulations (CPR) introduced many novelties regarding the management verifications in the 2021-2027 programming period. Aiming to ensure an appropriate balance between the effective and efficient implementation of the Funds and the related administrative costs and burdens in the new period, the management verifications and their purpose, frequency, scope and coverage are based on a risk assessment and are proportionate to the risks identified[1]. "Risk-based" means that controllers should focus their verifications on areas where, according to the risk assessment, the risk of material misstatement is high. In areas where the risk of material misstatement is low, control work should be reduced.

Both administrative and on-the-spot management verifications should focus on risky elements. In practice, this means that not all projects, beneficiaries, payment claims and items within the payment claims must be checked 100%. The risk assessment methodology, along with procedures for the risk-based management verifications, should be part of an Interreg programme's management and control system description.

Having in place appropriate management verifications procedures is one of the key requirements of the programme's management and control system. They are also part of the audit authority's system audit (key requirement 4, management verifications)[2].

Administrative and on-the-spot verifications should be carried out before the submission of the accounts. The results of the management verifications should be reflected in the accounts. The managing authority should also account for the annual updates of the methodology in line with the results of the management verifications and audit findings, where relevant.

1.2. Responsibility of Member States vs managing authorities on management verifications

In general, Member States[3] are responsible for establishing management and control systems for their programmes, and for ensuring that these systems function properly[4]. However, when it comes to Interreg programmes, specific provisions regarding

[1] Article 74 CPR

[2] Article 69 CPR, Annex XI CPR (Key requirements of management and control systems and their classifications Article 69(1))

[3] In the case of the programmes with non-EU countries, the term 'Member States' is understood as all countries participating in the programmes.

[4] Article 69 CPR

management and control and financial management are set. By way of derogations, management verifications can be carried out by controllers appointed by each Member State. To ensure equal treatment, and in consideration of the cooperation goal of Interreg programmes, risk assessments and decisions made by controllers should follow the same principles, regardless of the project/partner in questions or the country of the controller.

Thus, there can be two approaches to organising risk-based management verifications in Interreg programmes:

- the managing authority develops a single methodology for risk-based management verifications, which is applied for the whole programme;
- the managing authority delegates the responsibility for developing the methodology to the Member States[5]. In this case, the managing authority needs to ensure the equal treatment of beneficiaries - any difference in the approaches to management verifications between the Member States should be duly justified. The managing authority can also develop minimum requirements guides for risk-based management verifications, to be used for the controllers in each Member State.

[5] According to Article 46(3) Interreg Regulation

2. Guide on development of a methodology for risk-based management verifications

2.1. How to start?

To develop a methodology for risk-based management verifications, each programme should start with a risk assessment. The risk assessment should be based on the analysis of historical programme data. Such analysis aims to identify risk factors that have previously caused irregularities and errors in the programme. These risks can be considered at different levels: project (e.g., small-scale, regular project, projects with infrastructure, soft projects), beneficiary (e.g., type, legal status, ownership structure, previous experience in implementing cross-border projects, number of partners in the project, capacity to implement projects), payment claim (e.g., first payment claim of the beneficiary, first payment claim containing public procurement expenditure, payment claim exceeding a certain percentage of the partner overall budget), items within the payment claim (e.g., risks identified for a specific cost category, public procurement expenditure, etc.).

When developing a risk assessment methodology, it is recommended that the programme's risk factors are built on solid sources – such as (but not limited to) data from the project monitoring, findings from the audits on the operations, data on financial corrections and irregularities, etc.

For instance, an analysis of the programme data against the evolution of corrections per year will show if a higher risk is associated with the first progress reports and/or if the risk decreases throughout the project's lifetime. An analysis of the number of corrections against the project partnership composition (number of partners in the project, partner's legal status) will show the correlation between certain factors and the risk of error. The amount and number of corrections per cost category will indicate if a certain cost category produces more irregularities and financial corrections than others, thus whether it carries a higher risk. When analysing a programme's data, it is also a good idea to identify the amount and number of errors per type, as this will give information on the most frequent nature of errors.

2.2. Mitigation measures and simplification of programme's procedures to reduce risks

An analysis of programme data – for example - on the most common irregularities, their nature, sources, and problematic areas should give a good indication as to which areas are risky. In line with the simplification and harmonisation efforts across the European Structural Funds, the programme should consider different mitigation measures to make programme procedures simpler and reduce the risk of errors as much as possible. Here are a few examples of such mitigation measures:

- Reducing the number of options that a programme offers to reimburse certain cost categories, such as staff costs. According to audit reports, staff costs have always been the most "problematic" cost category in Interreg projects due to the variety of options used to report staff costs, different national procedures, extensive reporting obligations and audit trail, etc. Thus, reducing the number of

options allowed by the programme to reimburse staff costs could effectively reduce the number of errors.

- Extensive use of simplified cost options - implementing off-the-shelf flat rates offered in the Regulations and using own programme-specific SCOs. Some cost categories are typically composed of a high amount of items of low value; e.g., office and administration, travel and accommodation. This gives plenty of space for errors. Using simplified cost options to reimburse such cost categories instead of real costs can reduce the risk of irregularities and errors, since flat rates do not require providing justification and documentation of the underlying expenditure covered by the flat rates.
- A single electronic centralised IT system where all invoices and supporting documentation for the audit trail can be stored. The system should be easily accessed by the different bodies involved in the programme implementation, on the one hand, and beneficiaries, on the other hand. Elimination of paper versions, using e-signatures and digital documents as much as possible, is also an effective way of eliminating errors.

2.3. When to do the risk assessment?

There can be different approaches as to who does the risk assessment and when it is done - at the project selection or appraisal stage, when performing verifications of a partner project report, etc. It is also possible for a programme (e.g., staff of the joint secretariats/ managing authorities[6]) to do risk assessment assigning a certain level of risk when assessing project applications, or the controller himself when verifying reports according to the methodology provided by the JS/MA. The level of risk assigned at the project selection stage to a project or certain project partner (e.g., low-, medium- or high risk) can determine the "heaviness" of the controls and checks during the project implementation. For example, if at the project assessment stage, a certain partner's risk level was determined as "low", then verifications of that partner would be less extensive than a partner with a "medium" or "high" risk level.

If the JS/MA initially assigns a risk level to a particular project/ project partner (at the project selection or appraisal stage), that risk level can later be re-visited and re-assessed during the project implementation, to determine the required extent of controls and verifications.

Another approach can be that the controller will determine the level of risk based on the nature of the expenditure items in the list of expenditure and control risks, looking at the quality of reported expenditure from previous reports and experience with the beneficiary (according to the methodology for the risk-based management verifications developed by the JS/MA). The controller will then perform verifications according to the risk level - more extensive verifications for reports with higher risk levels, and less extensive verifications for reports with lower risk levels.

[6] The final responsibility for the methodology for the risk-based management verifications remains with the managing authority.

2.4. Scope of management verifications

Both administrative and on-the-spot verifications should be proportionate to the risks identified. This means that not necessarily all projects, all project partners, all project reports and all items within the payment claims should be verified. The rationale is to focus management verifications on the risky items or areas in the payment claims, and risky operations and beneficiaries.

Based on the risk factors identified from the analysis of the historical programme data, the JS/MA should decide on the level of management verifications. For example, it can be project level, project partner level, payment claims, specific items inside the payment claim, etc. However, the decision should be based on the thorough analysis and not on the programme's assumptions.

On the basis of risk assessment, the JS/MA can decide that the management verifications are done at the project partner level. This means that all projects are to go through risk-based verifications (however, checks are not 100%). Such a decision can be justified, for instance, by the fact that all project partners are using the staff costs cost category if the analysis of programme data on irregularities shows that the staff cost category is a risk factor.

If the management verifications are done at the project partner level, criteria for the selection of payment claims and items within the payment claims for verifications should be established. For instance, if the analysis of programme data suggests that there is a higher risk associated with the first progress report, the JS/MA can decide that the first reports of all partners are fully checked. Another justification for full verification of the first progress report can be to establish a certain level of assurance to see if the project partner understands the programme's eligibility rules, audit trail requirements, etc. On the other hand, if the results of risk assessment and programme data analysis do not reveal increased risk related to the first reports, full verification of those reports might not be needed, and they can be addressed as all other reports via regular risk-based verifications.

The JS/MA can also decide that not all project partner reports are subject to verifications if the JS/MA identifies no risky elements.

2.5. Timing

Administrative and on-the-spot verifications should be carried out before submitting the accounts[7]. The first accounting year in the new programming covers the period from 1 January 2021 to 30 June 2022, and the deadline for the submission of accounts is 15 February 2023. This deadline applies if a programme submits payment applications to the EC in the first accounting year. If it does not, then the deadline of "before the submission of the accounts" applies from the year in which the programme has submitted payment applications to the EC. In addition, the risk-based management

[7] No expenditure should be included in the certified accounts submitted to the EC if the planned management verifications are not fully completed and the expenditure is not confirmed as legal and regular.

verifications methodology is part of an Interreg programme's management and control system description. At the latest, the management and control system description should be ready by the time of submission of the final payment application for the first accounting year - and no later than 30 June 2023[8]. This means that the programme's methodology for risk-based management verifications should be in place at the latest together with the management and control system description if no expenditures are included in the certified accounts submitted to the EC before this point.

2.6. Principles of risk-based management verifications

Once the programme has implemented mitigation measures to reduce the risk environment and has identified risky and non-risky elements, the next step is to define the risk-based management verification principles.

Suppose an analysis of programme data shows that specific cost categories or expenditure items are more prone to errors than others. In this case, verifications should focus on these error-prone items, whereas non-risky items should not be verified (or verified to a limited extent, for example, through random sampling). For example, if the programme analysis shows that irregularities and financial corrections are often associated with public procurement (e.g., restrictive selection/award criteria, failure to observe the principles of equal treatment, problems with contract implementation), the programme might decide to fully verify public procurement items in all partner reports or fully verify public procurement items above a certain threshold.

If a programme makes extensive use of simplified cost options, and several cost categories in the project are reimbursed using, for example, flat rates (e.g., office and administration, travel and accommodation, staff costs are three cost categories reimbursed as flat rates), the list of expenditures of such project partners will be much shorter compared to one where real costs are used. In practical terms, it means that a programme has reduced the risk of error via the use of simplified cost options. A programme might decide not to perform verifications of items reimbursed as real costs if there are no risky elements. On the other hand, a programme might decide to use random sampling on the remaining items in the list of expenditures, to reduce the risk of potential errors.

If a programme does not use simplified cost items extensively, and most items are reported using real costs, the programme might decide to supplement full verification of risky items with random sampling. Different approaches to random sampling can be used; e.g., fixing a minimum number of items per cost category to be verified (e.g., two items per cost category), verification of a minimum of 10% of all items, random sampling of expenditure items with the same risk within a cost category or type of expenditure, etc.

In addition, the programme can decide to allow the controller to use his/her professional judgement when performing verifications. On top of mandatory items for verification, controllers can select additional items for verifications, in order to obtain

[8] Article 69(11) CPR

the necessary level of quality assurance of reported items. These could be suspicious items, unusual items, items that exceed a certain amount or percentage of the total costs reported for a certain cost category, items with reported errors in previous periods, etc. It is up to a programme to decide if verifications of additional items by the controller require any justification from the controller.

2.7. Extension of sample for verifications

A programme should establish principles to extend a sample if mistakes and errors are found in that sample. For example:

- if there are errors in the main sample, the controller should verify items of a similar nature - expanding the sample size per strata (e.g., if a mistake is found in staff costs, the controller should check other staff costs items);
- if for the random sampling a certain number of items was checked (e.g., 10 items), an extension of sample to verifying another 10 items can be done;
- if there are errors in the main sample and there are no items of similar nature (e.g., all staff costs were included in the main sample), random sampling can be used (e.g., a random percentage of the remaining items);
- if there are further errors in the random sample, full progress report verification can be done.

If there are still errors found after the extension of a sample, 100% verification of items in the payment claim can be justified.

In general, extending the sample up to 100% of the expenditure items should be possible in cases of uncertainty, errors and other problems. 100% verifications are, thus, possible, provided it is justified based on the risk assessment. The purpose of the risk-based management verifications is that the JS/MA obtains a 100% assurance by not verifying 100% of expenditure submitted by projects. The verification work should sufficiently cover risks and the verifications can be extended to obtain reasonable assurance.

2.8. Update of the methodology

Methodology for the risk-based management verifications can be revised and updated periodically, using the results and findings of previous administrative and on-the-spot verifications. Furthermore, external factors that can impact the implementation of operations (e.g., potential conflicts of interest and concerns reported in media, other findings, etc.) can form a basis for the revision of the methodology. The risk assessment methodology is also subject to the audit authorities' system audits[9], where the adequacy

[9] The MA's methodology for risk-based management verifications is subject to the AA's system audits of the key requirement 4 (KR4, management verifications) when such audits are carried out. The adequacy and quality of the management verifications will be examined by an AA's system audits based on a sample selected from the management verifications already carried out.

and quality of verifications are checked. The managing authority might consider updating its methodology based on the recommendations and findings arising from the system audits and audits of operations.

3. HIT methodology for risk-based management verifications

3.1. Rationale

The HIT risk-based sampling methodology has been developed as part of the HIT Controllers package for the 2021-2027 programming period. Along with other documents (i.e., Control Certificate, Control Report and Checklist) aiming to harmonise controllers' work across Europe, the HIT methodology for risk-based management verifications can be used by Interreg programmes as a basis for their risk-based controls and verifications. The HIT methodology is a simple and customisable methodology that fulfils the regulatory requirements for risk-based management verifications in the 2021-2027 period. It can also be used to emphasise typical issues in an Interreg programme and raise controllers' awareness of these issues.

In addition, the methodology could help if an Interreg programme decides to delegate the responsibility of the management verifications to its Member States. It can serve as minimum requirements to be followed by all controllers in their verifications.

The methodology and its elements were jointly developed and agreed upon within the Risk-based sampling subgroup, comprised of members of the HIT Core group programmes and Interact. The work was started from scratch. HIT methodology and programmes' experiences with risk-based management verifications in the 2014-2020 period were analysed and used as inspiration. The group agreed on the methodology elements after extensive discussions on the control and inherent risks that formed the basis of the initial HIT methodology. The survey on historical programme data regarding the most common errors and irregularities found in partner reports by controllers was organised to help justify or eliminate certain assumptions regarding risk elements. Every aspect or element of the methodology can be customised to fit each specific programme's context, especially when the analysis of the individual programme suggests that the relevant risks are different from the ones used as the inspiration for this document.

3.2. Approach and general principles

According to the HIT risk-based methodology, management verifications are done by controllers at the level of **each project partner** and **its partner progress report.**

Verification of each partner progress report is composed of a full verification of risky items ("key-item verification"), and items picked up for verification based on the professional judgement of the controller. Apart from the key-items verification and items picked up by the controller based on his professional judgement, a programme can decide to apply a random sampling of the remaining items to supplement verifications.

Full verification of the partner progress report could be justified if the analysis of the programme data suggests that some specific progress reports are riskier (e.g., first progress report, reports with investment items, etc.) than others. Full verification of a report could also result from the errors found by a controller in the verified items if the controller needs to obtain a necessary quality assurance level of the reported expenditure.

3.3. Administrative verifications

3.3.1. Key-items verification

According to the HIT risk-based methodology, the controller performs full verification of key items for each progress partner report.

Within this context, the following items are risky (key items) and should be fully (100%) verified:

1. Public procurement for contracting amounts above EUR 10.000[10] (excl. VAT - unless the threshold set by the applicable programme/national rules is stricter).
2. Staff costs of the first two progress reports where staff costs occur. Furthermore, staff costs of a new staff member included for the first time in the progress partner report, and if significant changes in the staff costs occur (e.g. > 20%) in the time allocation of staff members (if the fixed percentage method is used), or if there are changes in the staff costs methodology (e.g., a change from fixed percentage method to an hourly rate).
3. VAT (for projects with total costs above EUR 5m, including VAT).

These items are considered risky, based on the analysis of the most common irregularities and errors data in 2014-2020, as provided by several Interreg programmes[11].

Items that are not considered risky are indicated in Annex 1.

Actions to take

1. The controller reviews the list of expenditures submitted by the beneficiary to understand the type and nature of the expenditure (cost categories) claimed.
2. Expenditure items that correspond to the aforementioned characteristics have to be fully verified. "Fully verified" means that the controller should perform full verification of the item, ensuring expenditure is in line with European-, programme- and national eligibility rules, and complies with the conditions for support of the project and payment, as outlined in the subsidy contract.

3.3.2. Professional judgement

On top of the full verification of key items, the controller, based on his/her professional judgement (decision-making, analyses, or evaluation based on knowledge, skills,

[10] The threshold of EUR 10.000 is used in line with the HIT public procurement templates. The programme can customise the threshold according to its context.

[11] If a programme follows the approach of key-items verification, the parameters (like the ones provided above) for the key items in the risk-based verification methodology should stem from the risk analysis and should be specified in the methodology document.

training, or experience that the controller possesses) can select additional items from the list of expenditures to perform verifications on - provided this is needed to obtain the necessary quality assurance of the partner progress report.

When exercising this option, the programme should identify in the methodology scope of the items to be selected (minimum of items / minimum of value). In addition, the programme can decide if the controller should briefly justify why a certain expenditure item has been checked (this does not apply to the mandatory key items for verification).

Actions to take

1. After performing full verification of key items, the controller reviews the remaining list of expenditures to identify cost items that, for example, seem unusual or give rise to suspicion of fraud.
2. Evaluate if additional items should be included for the verification, based on the quality of the expenditure originally reported and the quality of key-items verification:
   i) items similar to those where errors or ineligible expenditures were identified in the current/previous reports;
   ii) where repeated mistakes/errors, such as re-inclusion of ineligible expenditure (projects/reports), were noted in the previous reports.

3.3.3. Random sampling

The composition (key-items verification and professional judgement) can be supplemented with random sampling of the remaining (non-risky) items, based on the following sampling principles:

1. sampling is done per cost category based on the total remaining population of items under that cost category;
2. a minimum of 2 items per cost category is selected, a minimum of 10% of the remaining items.

When can random sampling be part of the methodology?

1. When errors/irregularities are found in key-item verification or verification of items based on professional judgement.
2. When a programme does not use many simplified cost items; i.e., many cost categories are reimbursed as real costs.

3.3.4. Extension of sample

If the initial sample shows that the quality of the information provided is not sufficient, the sample size should be extended. The purpose of extending the sample is to determine whether errors have a common feature (e.g., type of transaction, location, period, product/output, etc.) or whether they are simply random errors.

If no common features are determined, the sample can be extended to a 100% verification of the payment claim.

If errors are found to have common features, the total error can be determined by verifying all relevant items (i.e., those likely to be affected by the same/similar error). Alternatively, controllers can project the error in the sample to the unchecked population, based on a fair and transparent method.

3.4. On-the-spot verifications

The managing authority is responsible for establishing the approach to the on-the-spot verifications (i.e., when they are done, how often, etc.).

On-the-spot verifications should be carried out when the project is well under implementation (i.e., not at the very early stages, but rather after 2-3 progress reports). It is suggested to have at least one on-the-spot check at the project partner level that implements productive investments or infrastructure. Otherwise, an on-the-spot check for a low-risk project partners might not be needed.

If a project has been audited on the spot by the audit authority, the managing authority may decide not to cover such a project with an on-the-spot check, and instead use the results of the audits.

3.5. Review of the methodology

The managing authority should periodically review the risk elements and sampling methodology for management verifications. The managing authority might need to amend the methodology for risk-based verifications, based on the findings from the system audits (on the functioning of the management verifications) and the results of the audit of operations carried out by the audit authorities.

Results of previous administrative and on-the-spot checks and external factors that could have an impact on the implementation of projects should also be considered when reviewing the methodology.

3.5.1. Annex 1 – Non-risky elements

Risk element	Definition
Simplified cost options (SCOs)	Analysis of historical programme data did not provide evidence that SCOs are risky elements – instead, errors that occur are connected with miscalculations (e.g., incorrect unit cost, incorrect rate is applied).
Public procurement for contracting amounts below the programme/ national thresholds (excl. VAT - unless the threshold set by the applicable national rules is stricter)	Only contracts above the relevant thresholds are considered a risk.
Inexperienced beneficiary/ newcomer to the programme	Being new is not considered a risk by default. After the first report, the results of the verifications should be considered to conclude if reporting is poor due to lack of experience.
Type/ legal status of the beneficiary (e.g., private/ public/ NGO/ association)	Data assessment did not suggest any particular risk associated with partners based on their status.
Partner budget size	Data assessment did not suggest any particular risk associated with the size of project partners.
Multiple involvements in the several projects/ programmes	It is a horizontal issue, not an individual risk, which is addressed with the general question in the control checklist.
Durability requirements	It is a horizontal issue, not an individual risk, which is addressed with the general question in the control checklist.
VAT (below EUR 5 m)	Not considered a risk due to simplified provisions on VAT handling in the 2021-2027 period (VAT is eligible, no matter if recoverable or not for all projects with total costs below EUR 5m, including VAT – Article 64 CPR).
Revenues	No provisions in the regulations on the treatment of revenues at the EU level (the issue can be seen as a programme or national affair).
State Aid	Data assessment did not suggest any particular risk associated with the partner's State Aid relevance.
Partner role (lead partner/ project partner)	Data assessment did not suggest any particular risk associated with partners based on their role in the project. Thus, the partner role is not considered.