



A joint initiative of the OECD and the European Union,
principally financed by the EU

Risk Assessment in Practice: European Court of Auditors

Arjen Lok

Tirana
28 January 2013



Risk Assessment in Practice

European Court of Auditors

Risk Assessment:

1. Of the organisation of the ECA itself
2. The audit work
3.
 - a. In our Special Reports
 - b. Of our main auditee, the European Commission





Risk Assessment of the organisation of the ECA itself

COSO defines risk assessment as “the identification and analysis of relevant risks to the achievement of objectives, forming a basis for determining how the risks should be managed”.



ECA is organisation set out to achieve certain objectives. The management practice of ECA therefore also includes a risk assessment of the own activities.

For example this month we started the periodic assessment of Business Continuity.





Audit Risk Model

A particular aspect of risk assessment in financial and compliance audit is the application of the audit risk model:

$$\text{Audit Risk} = \text{Inherent Risk}_{\text{EU}} * \text{Control Risk} * \text{Detection Risk}$$

The audit risk is related to the level of assurance that the auditor wants to provide:

- Reasonable assurance
(in practice between 90%-99%)
- Limited assurance
(in practice above 50% but never more than 90%)





Assurance Model

At the heart of the ECA's approach concerning legality and regularity is the Assurance Model:

- Preliminary assessment of inherent and control risk (combined risk assessment) to determine:
 - Reasonable expectations concerning level of confidence (controls assurance)
 - Extent and scope of substantive testing to be carried out aiming to reach an overall level of confidence of 95%

Table and decision tree as tools





Assurance Model

Assessment of inherent risk	Control risk	Minimum degree of confidence to be derived from substantive testing (%)	Minimum sample size
Not high	Low	45	30
	Medium	67	55
	High	92	125
High	Low	67	55
	Medium	80	80
	High	95	150



Assurance Model

Area	Expenditure (mio euro)	Sample size	Assessed risk	Control systems
AGRI EAGF	43 801	180	high	poor(*)
AGRI+SANCO ENV. MARE	13 310	178	high	poor
COHESION ENERGY & TRANSPORT	33 373	180	high	poor
EMPLOYMENT & SOCIAL AFFAIRS	10 171	180	high	poor
EXT.AID DEVELOP. & ENLARGEMENT	6 201	150	high	poor
RESEARCH & OTHER INTERNAL POLICIES	10 591	150	high	poor
ADMIN	9 777	56	not high	good
Total	127 224	1 074		

(*) good where IACS works, poor otherwise





Why 'poor'

'Poor' means that the internal control systems do not prevent errors to the extent that ECA can rely on it.

'Poor' does not mean that the systems do not function at all.

The assessment is the input for the assurance to be obtained.





Performance Audit Risk Assessment

The set up of this workshop closely relates to the risk assessment by ECA in performance audit, as:

- The performance audits are selected to
 - Best fit with the audit strategy
 - Assure delivery of timely and relevant report to the European Parliament
- Risk assessment is essential in selecting the most relevant audit questions to be audited on the topic selected





Selection

ECA is divided in four Chamber, each having the responsibility of auditing defined policy areas

CEAD Chamber is responsible for cross-cutting topics

Each Chamber:

- analyses the activities in the policy areas concerned;
- assesses risks to particular policy fields
- scores risks according to
 - interest
 - financial importance
 - coverage





Risk assessment in the performance audit itself

One of the first steps in the audit process is the preliminary study. In this phase a risk assessment on the topic is made.

Step 1: Present the audited area in a diagram & list the expected key controls.



Step 2: Identify the risks



Step 3: Analyse the risks to assess the risk level



Step 4: Focus on the key risks to define the audit questions and scope.





Risk assessment by the European Commission

Risk assessment got a firm basis with the reform in 2005, see SEC(2005)1327

Internal Control and Risk Assessment are key elements in the management by the European Commission.

“Risk Management is part of an effective internal control. Risk management can generate important information for the planning of the DG's activities and objectives, and helps management focus the internal control activities on areas representing the highest risks.”



Internal Control Standards

16 Internal Control Standard

ICS 6

Risk Management Process

A risk management process that is in line with applicable provisions and guidelines is integrated into the annual activity planning.





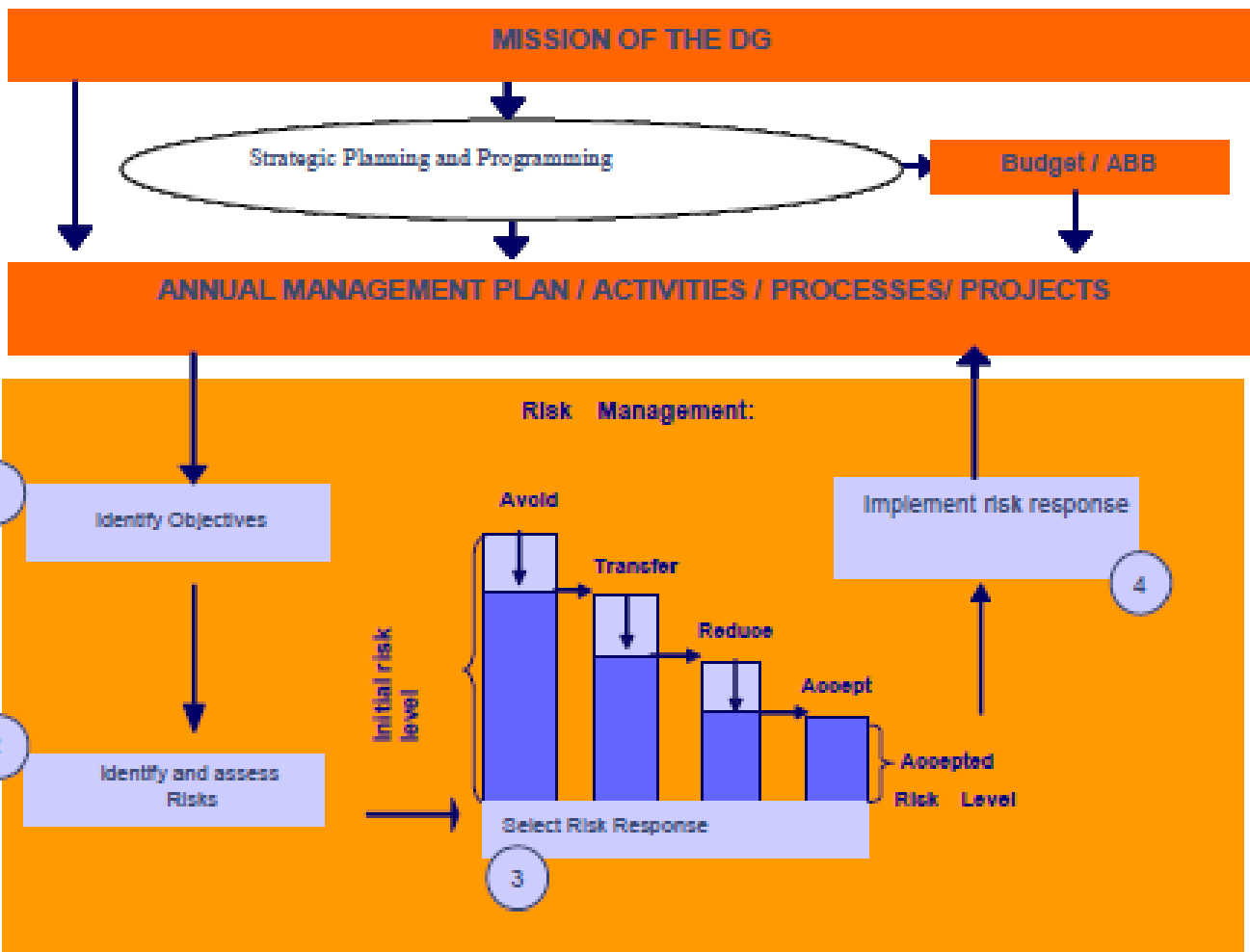
Risk assessment by the European Commission

- A risk management exercise at DG level is conducted at least once a year as part of the AMP process and whenever management considers it necessary (typically in the event of major modifications to the DG's activities occurring during the year). Risk management is performed in line with applicable provisions and guidelines;
- Risk management action plans are realistic and take into account cost/benefit aspects in order to avoid disproportionate control measures. Processes are in place to ensure that actions are implemented according to plan and continue to be relevant;
- Risks considered "critical" from an overall DG perspective (see SEC(2005)1327, §2.4) are indicated in the DG's Annual Management Plan and followed-up in the Annual Activity Report.





Risk assessment by the European Commission



MONITORING AND REPORTING

5

A joint initiative of the OECD and the European Union, principally financed by the EU





Risk assessment by the Internal Audit Service of the European Commission

However the best example in relation to this workshop is the risk assessment by the Internal Audit Service of the European Commission itself.

The Internal Audit Service follows the Standards of the Institute of Internal Auditors

The Internal Audit service has a three year risk based audit planning.





Risk assessment by the Internal Audit Service of the European Commission

Risk is assessed in 5 steps

- Categorisation of risks
- Definition risk factors
- Definition risk criteria
- Risk scoring
- Definition of risk-ranked audit universe

The 3 year audit work period provides the Internal Auditor with the audit evidence needed for the ‘Overall Opinion’ provided to the Audit Progress Committee of the European Commission in May of each year.





Risk assessment by the Internal Audit Service of the European Commission

Risk is assessed in 5 steps

- Categorisation of risks
- Definition risk factors
- Definition risk criteria
- Risk scoring
- Definition of risk-ranked audit universe

The 3 year audit work period provides the Internal Auditor with the audit evidence needed for the 'Overall Opinion' provided to the Audit Progress Committee of the European Commission in May of each year.

