INSURANCE OF RISKS SPECIFIC TO NON-REIMBURSABLE FUNDS MANAGEMENT SYSTEM IN ROMANIA

Dumitru BADEA, PhD[*]
Ciprian NICOLAE, PhD Student[**]

Abstract

Non-reimbursable funds in Romania represented a yearly average of about 4 bln. Euro during the financial period 2007-2013 and have the potential to exceed 5 bln. Euro annually during 2014-2020. The field is very complex: governed by many European and national regulations and managed by hundreds of state authorities and institutions, in which thousands of people are working.

Thus, the risk management in this field represents a key element, although is mainly based on theoretical procedures undertaken with limited staff numbers and, in the most cases, with low specific training related to risks and risk management.

Given that risk transfer is mentioned among the risk management measures included in the current methodologies, is to be determined if and how many of the identified risks can be subject to insurance programs and insurance products.

Even if state authorities and institutions have not so far shown interest in the use of insurance products to transfer some of the risks inherent in non-reimbursable funds management, such an approach is both possible and desirable.

Keywords: non-reimbursable funds, risk, insurance, risk management

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About the non-reimbursable funds management system in Romania

As Member State of the European Union, in order to use the development funds available, Romania has put in place complex

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[*] *Faculty of Finance, Insurance, Banking and Stock Exchange, Bucharest University of Economic Studies*
[**] *Doctoral School of Finance, Bucharest University of Economic Studies*

mechanisms of funds management. Its complexity is given by the huge number of regulations applicable, both European and national; the hundreds of state authorities and institutions involved, in which thousands of people are working; the broad range of funding beneficiaries, covering almost all the organizations recognized by Romanian law (public authorities and institutions, companies, NGOs, religious organizations, trade unions, employers, etc.).

Alongside the EU structural and cohesion funds and the EU rural development funds, Romania can use also other international donor funding, such as World Bank, USAID, SEE and Norwegian Funds, etc. This broad range of non-reimbursable funding is completed, for the beneficiary organizations, with the Romanian national grant schemes.

In terms of projects submitted for funding from the EU structural and cohesion funds, on 30/04/2015 there were 45,131 projects with a total of 77,157,081,753.69 Euro requested funding (Romanian European Funds Ministry, 2015); while at the same date the rural development projects numbered 150,259 and accounted for 18,426,374,019 Euro (Romanian Ministry for Agriculture and Rural Development, 2015) requested funding. By the mentioned date only 19,231 projects were approved for funding from EU structural and cohesion funds and 97,264 for funding from EU rural development funds; the available financial allocations from both sources were about 26.3 billion Euro.

In the 2007-2013 financial period, the non-reimbursable funding available in Romania from all the above mentioned sources accounted for almost 4 billion Euro annually, which represents about 3% of Romania's GDP[1] in 2013. For the 2014-2020 financial period, the available EU funding that can be used through projects managed by Romanian authorities will increase up to 30 billion Euro; adding the other funding resources (other international donors, Romanian national funds etc.) the annual average has the potential to exceed 5 billion Euro.

[1] *"Estimated GDP for 2013 was 631,130.1 million lei, current prices" Source: Romanian National Institute of Statistics - http://www.insse.ro/cms/files/statistici/comunicate/pib/a13/pib_trimIVr2013_1.pdf*

Risk management of the non-reimbursable funds management system in Romania

The funds management system in Romania is carried by public bodies (state authorities and institutions at regional and local level) or bodies that state assigned with competencies and responsibilities, such as the regional development agencies, which basically are NGOs. Thus the risk management is subject to regulation.

In Romania, the risk management in the activity of the state authorities and institutions is regulated as a standard of internal control / management within the Order of Ministry of Public Finance no. 946/2005, further amended and supplemented. This Order defines risk management as the *"methodology aimed at providing a comprehensive risk control, allowing the maintaining of an acceptable level of risk exposure for the public entity, with minimal costs".*

Also this regulation states that "the manager is required to create and maintain a health system of internal control/management, mainly by:

- identifying the major risks that may affect the effectiveness and efficiency of operations, rules and regulations, confidence in the financial and internal and external management, protection of property, fraud prevention and detection;
- defining the acceptable level of exposure to these risks;
- evaluating the likelihood that the risk will materialize and the size of its impact;
- monitoring and evaluation of risks and the adequacy of internal controls to manage risks;
- verifying the budget execution reporting, including the one based on programs".

Based on this regulation at the level of the public authorities and institutions responsible for managing grants were adopted and are in place risk management procedures.

Main provisions of the risk management procedures

The analysis of these risk procedures[2] showed that it represents in fact only reproductions more or less complete of the

[2] *The analysis of the risk procedures was carried on during January and May 2015, using the provisions of the Law no. 544/2001 on access to public information. It implied preparing and submitting formal requests to 50 major authorities/institutions involved in non-reimbursable funds management.*

Methodology of implementation of internal control standard "Risk Management"[3]. Also, the procedures used by different state authorities and institutions are for the most part similar.

Thus, the procedures contain the following:

- risk definition
- risk identification
- risk evaluation
- risk control/management
- action plan for reducing risks
- models of documents to be used

As for the present analysis regarding the insurance of risks specific to non-reimbursable funds management system in Romania important are the definition of risk and the inclusion of insurance as management measure.

Risk definition

Despite the fact these procedures flow from the same regulation, risk definitions varies depending on the state authority or institution. Thus, within the procedures applicable to Sectorial Operational Program Human Resources Development (SOP HRD) the risk is defined as *"potential danger, for a system or entity, that, by producing some events/actions or by lack of action, the goods and/or reputation or objectives fulfillment for all the system/entity components is affected"*.

Within the procedures applicable to Regional Operational Program (ROP) and Fishing Operational Program the risk is defined as *"problem (situation, event, etc.) which didn't occur but that can occur in the future, in which case reaching the planned results is threatened or boosted. In the first case the risk represents a threat, while in the second risk is seen as opportunity. The risk represents the uncertainty in reaching the envisaged results and has to be treated as a combination of probability and impact"*.

Within the procedures applicable to Romanian national funds for SMEs, the risk is defined as *"the possibility to produce an event which might have an impact on objectives fulfillment"*.

These definitions are in line with the provisions of the ISO 31000:2009[4] standard and with the PMBOK Guide[5], which defines it

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(3) *Methodology for implementation of the internal control standard "Risk management" developed in 2007 by the Ministry of Finance - Central Harmonization Unit of Financial Management and Control Systems.*

as an event or uncertain condition, which, if appears, has a positive or negative effect on one or more of the project objectives.

A slightly different approach has the European Commission which, in the PCM Guidelines[6], defines it as “the probability that an event or action may adversely affect the achievement of project objectives or activities. Risks are composed of factors internal and external to the project, although focus is generally given to those factors outside project management’s direct control”. We can see that, for its aid programs the European Commission treats risk only as a problem, not as an opportunity.

In the economic theory there are many definitions of risk, some of it depicting only the negative aspects: potential loss, loss caused by the evolution of risk factors to the contrary of the expected results (Bârsan-Pipu, 2003). Other definitions (Mehr and Forbes, 1973) focus on the financial negative aspects involved by risks.

Comparing the definitions in the procedures adopted in Romania by the public authorities and institutions responsible for managing grants with those from different international bodies or those in the economic theory, we note that the first refer to positive aspects and opportunity although the state has the mission the efficiently use the public resources. We consider that the state authorities should use risk management as tool for minimizing negative effects and increase the degree of objectives fulfillment.

Defining risk as opportunity in the public sector seems inappropriate, especially in the context in which none of the risks

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[4] *The standard ISO 31000:2009 was developed by the International Organization for Standardization. ISO 31000:2009, Risk management – Principles and guidelines, provides principles, framework and a process for managing risk. It can be used by any organization regardless of its size, activity or sector. Using ISO 31000 can help organizations increase the likelihood of achieving objectives, improve the identification of opportunities and threats and effectively allocate and use resources for risk treatment.*

[5] *The PMBOK Guide, 5th edition, revision 3, 2014, page 338. The PMBOK Guide (A guide to the Project Management body of knowledge) was developed by the Project Management Institute, the world's leading not-for-profit professional membership association for the project, program and portfolio management profession, founded in 1969.*

[6] *Project Cycle Management Guidelines, vol. 1, 2004, page. 145, published by the European Commission and available at https://ec.europa.eu/europeaid/sites/devco/files/methodology-aid-delivery-methods-project-cycle-management-200403_en_2.pdf*

identified by the above mentioned authorities refer to a positive situation of opportunity in terms of delivering the public services in a better manner.

Insurance as risk management measure

Each of the risk methodologies used by the state authorities and institutions include provisions related to risk control measures. The following were identified:

- acceptance (tolerance) of risks
- ongoing monitoring of risks
- avoiding risks
- transfer (outsourcing) of risks
- treat (alleviate) of risks

With regards to **transferring risks** the procedures stipulate that *"this risk response strategy is to entrust a third party with risk management expertise to manage that risk, ending a contract for this purpose. This aims, on the one hand, reducing the exposure of the organization, and on the other hand, effective risk management by a specialized third party. This option is especially beneficial if the financial and economic risks"; "It is important to note that some risks are not (fully) transferable. In particular, it is not possible to transfer risks related to the credibility of the organization. The organization remains accountable to beneficiaries, even if some services is contracted with third parties"*.

None of the analyzed procedures present insurance as the possibility of risk transfer. This is only mentioned within the *Methodology of implementation of internal control standard "Risk Management"*.

Nevertheless **the Romanian insurance market offers some products related to non-reimbursable funds, but primarily aimed at recipients of funding:**

- liability insurance of the professionals working within projects (accountants, financial auditors, legal advisers, architects, engineers etc.)
- advanced payment bonds
- performance bonds

Also, some of the financing programs require beneficiaries to insure the equipment bought within projects, for the implementation period plus 3 to 5 years after the implementation.

The insurance liability of the professionals working within projects offers financial protection needed for paying damages to the beneficiary of the services rendered by the professionals, for damages caused to it as a result of the failure to the fault (negligence, carelessness, omission) the due diligence work undertaken under the agreement concluded with the beneficiary and for which the professional becomes liable under the laws and the profession.

The advanced payment bonds guarantees repayment by the beneficiary of financing of the amounts which the state authority or institution managing the non-reimbursable funds has paid in advance for the project implementation.

The performance bonds is a guarantee instrument requested to the companies that sign a public procurement contract (including the ones within projects). The beneficiary organization of non-reimbursable financing has a warranty that protects it against the risk of failure or improper fulfillment of the contractual obligations assumed by the company executing a contract part of a project.

Analysis of the risks identified for the non-reimbursable funds management activities

Within the analysis of the current procedures of risk management an inventory of the risks was structured. It comprises over 500 individual risks, as they were defined by the state authorities and institutions within the risk registers in force. Sorting these risks in order to eliminate duplicates it is conditional to the provision within the risk methodologies that, in order to establish if a situation represents a risk, it should be linked to objectives. Considering that only one of the risk registers received from the state authorities and institutions links some of the identified risks to the objectives of financing or specific activities, a correct sorting of all the risks is very difficult. It should be done by the risk officers representing all the state authorities and institutions involved in non-reimbursable funds management.

The first finding of the analysis is that ***not all the state authorities and institutions have risks registers***, either because an authority higher in hierarchy is expected to fulfill such a register, either because no risks have yet been identified.

The second finding within risk registers analysis is that ***most of the risks in the inventory are operational risks***, such as:

- risks of delay/overdue (ex: delay of administrative compliance and eligibility assessment of project applications; delay in the

submission of documents on irregularities management to Certification and Payment Authority; delays in financing contract signing; delays in projects implementation).

- risks of omission/error detection (ex: identification of errors in documents; not detecting errors because of lack of accuracy in checks).
- risks of financing quality (ex: errors in the technical and economic assessment of funding applications; closing underperforming contracts within the projects; promoting bad quality projects).

Of course, the effects of all these operational risks will most probably have a financial quantification, but only in conjunction situations (ex: financial corrections established by the European Commission for repeated errors in project documents).

The third finding of the analysis is that a ***few of the risks*** included in the risks registers ***have direct financial effects***:

- certification of ineligible expenditure
- authorization of expenditure that can subsequently be declared ineligible by entities entrusted with audit / control
- repeated payment for the same invoice included in several refund requests
- payment made to a bank account other than that the one specified in the refund requests
- not finishing projects

The fourth finding of the analysis is related to ***global risks***. Thus we identified the following two, which should be carefully and continuously monitored by all the state authorities and institutions:

1) automatic decommitment of funds (low absorption rate).
2) financial corrections established by the international donors.
3) quality of financing (results, effects and impact of projects).

The fifth finding of the analysis is that ***some risks are not included in the risk registers***. For example, there are no risks related to projects impact assessment or effects quantification, neither to use of current results for the next programming periods. Also, the only risks related to external audit phase is that on not ensuring an adequate audit trail. No risks related to feasibility of projects were reported, although for all the infrastructure projects (pre)-feasibility studies are required by regulations in force.

Most of the identified risks are related to implementation of projects and some to evaluation and contracting phases.

The sixth finding of the analysis is that risks don't follow the Project Cycle Management phases[7]; ***risks are identified and organized at department level***. During to discussions to officials of the Ministry of the European Funds, it come up the fact that each department proposed risks to be included in the risk registers and only that specific department is following it.

This approach has consequences on quality of the identified risks, as these are mostly related to current activities and not to objectives of the financing (ex: "non-unitary replies", "risk of losing documents", "poor quality of the fulfillment of duties").

The seventh finding of the analysis is that ***the human resources involved are few and in most part unprepared on risk management***. For example, Ministry of the European Funds, which is coordinating 5 operational programs (transport, environment, human resources, economic competitiveness and technical assistance) has no personnel trained on risk management and the person responsible for the current risk management activities is responsible for all the 25 procedures required by Order 946/2005 issued by Ministry of Finance. Also the Ministry of the European Funds does not have a risk register or action plan for reducing risks.

The state authorities and institution that responded at the requests the analysis is based on reported 4.699 employees, out of which only 380 are responsible on risk activities or work related to it and 321 participated in a training course on risk management. 4 institutions out of the 50 reported that do not have a risk officer (risk management responsible) and a 17 reported their employees did not attend a course in the field.

The eight finding of the analysis is that, although the risk management procedures define risk also as opportunity, which enhances objectives achieving, ***all the risks included in the registers have negative connotations*** (their effects are negative).

Can the identified risks be subject to insurance programs and insurance products?

As we already mentioned above, none of the analyzed procedures present insurance as the possibility of risk transfer.

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[7] *According to European Commission the 5 major phases of the project management are: programming, identification, formulation, implementation (including monitoring and reporting) and evaluation and audit (see Project Cycle Management Guidelines – available at http://ec.europa.eu/europeaid/aid-delivery-methods-project-cycle-management-guidelines-vol-1_en).*

Nevertheless a discussion about the possibility of creating insurance programs and insurance products should be made for the risks identified by the state authorities and institutions managing non-reimbursable funds. In this respect, the following questions have to be asked:

1) Which risks are insurable and which are not?

For an insurance company, at least at theoretical level, any risk can be insured. But this has a cost. Which is the cost the public administration can afford to pay and for which risks?

For example, we consider that some of the risks identified within the current registers must not be insured because of their nature or their subjectivity. For example, the risk of losing documents has a broad covering, from the situation in which the public servants do not do their jobs correctly (ex: an officer carries some documents in a file out of the office building and forgets it on a public bench) to the situation in which a disaster is happening (ex: some documents disappear in a fire).

Other risks must not be insured because of the difficulty in establishing correct financial effects. For example the risk "the emergence of legislative changes related to the management of non-reimbursable funds" is very difficult to quantify and the insurance company would probably establish a prohibitive insurance premium in order to have covered all possible situations.

2) Which would be the key insurable risks?

As mentioned above, three global risks should be considered:

- automatic decommitment of funds (low absorption rate)
- financial corrections established by the international donors
- quality of financing (results, effects and impact of projects)

If we consider that at the level of May 2015 the absorption rate of the Structural and Cohesions Funds is 54.22%[8] out of 19,21 billion Euro, it means that the decommitment of funds amounts almost 8.8 billion Euro. If at the end of 2015, the absorption rate will be 80%, the decommitment will be at 20% (almost 4 billion Euro). In this case, what insurance premium should be established by an insurance company?

If we take the risk of financial corrections applied to Romania by the European Commission, the former minister of European funds

[8] *www.fonduri-ue.ro.*

in Romania, Mr. Eugen Teodorovici declared in March 2015 that *"The financial corrections on the current financial framework today we estimate to one billion euros. These are financial corrections coming on the particular system, the public procurement the most of it. That is the price paid by Romania for having put people in key positions, which, unfortunately, were not to be there. And especially in the area of public procurement"*[9].

Ensuring the risks related to quality of financing will probably be easier to accept by the state authorities and institutions, as it can be established as an obligation of the beneficiaries. But this could be accepted by the private beneficiaries, as the public ones having trouble in finding the financial resources for it.

Having in mind only the private beneficiaries, we can state that the funds it will be available for it will surely be more than 1 billion Euro per year. Adding to it their co-financing, it results an yearly insurable "market" of 2 billion Euro or more.

Key issues influencing insurability of the risks related to the management of the non-reimbursable funds

The following key issues have a decisive influence in insuring the risks identified by the state authorities and institutions managing the non-reimbursable funds:

1) the risks relate to the activity of these authorities and institutions, of the will and competencies of its personnel, as the regulation of the field is done also by the state. It might happen that further regulation influence in a bad manner present insurance contracts, so that insurance companies be negatively affected and state pay less. On the other hand regulation might be used to favor some insurance companies in a broad corruption situation.
2) in this moment there is no database recording the situations related to the identified risks (frequency, impact, specific conditions etc.). Thus an effective insurance program/product cannot be created.

[9] *See the article "Romania will pay one billion Euro financial corrections for the past budgetary framework" available at http://www.agerpres.ro/economie/2015/03/19/teodorovici-romania-va-plati-un-miliard-de-euro-corectii-pentru-cadrul-financiar-trecut-15-09-31*

Conclusions and proposals

In this moment, the risk management in the field of non-reimbursable funds is one of “another” activities of the state authorities and institutions managing the non-reimbursable funds. The risk registers contain vague expressions considered risk and do not cover all the project cycle management phases. Furthermore, the major risks are not present in the risk registers of all the state authorities and institutions involved.

Although the insurance market provides some insurance products related to accessing non-reimbursable funds, these products does not cover the risks currently identified by the state authorities and institutions managing non-reimbursable funds.

The risk management is not use as a decision-making instrument. Currently the risks are identified and treated at department level and in some cases at institutional level. It is not used as basis for legislative modifications or improvement measures for the financing programs.

Currently the personnel involved in the risk management is in short number and underprepared on specific issues.

The following measures have to be undertaken in order for the risk management of the non-reimbursable funds be more effective:

- an exhaustive inventory should be done by the state authorities coordinating the main non-reimbursable funding (Ministry of European Funds, Ministry of Regional Development and Public Administration, Ministry of Agriculture and Rural Development, Ministry of Finance);
- all the risks should be organized on Project Cycle Management phases and should be effectively covering all these phases;
- each state authority and institution that manages funds should permanently monitor all the risks, establish which is active or not, counting frequency, impact and specific conditions of happening. These should be placed in a public database;
- quarterly and annually risks analysis of all the system should be done in order to prepare decisions for the overall system;
- encouraging insurance companies to prepare insurance programs and products to cover some of the identified risks;
- create a coherent risk management system covering all the financing programs and train the personnel assigned in the position of risk officers.

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