Analysis of the Risk of Fraud in Projects Financed from European Funds

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Abstract: The European funds represent a source of non-refundable financing allocated to the EU member states, in order to reduce the economic and social development gaps between them. Funding from the EU is dedicated especially for the fields that generate the highest added value in the EU economy, and the allocations at the level of each member state are negotiated with the European Commission. Unfortunately, however, a number of irregularities or even frauds also appear in the allocation and implementation of European funds.
This paper aims to analyze the risk of fraud in projects financed from European funds and the measures that can be adopted to reduce the financial corrections applied in the case of irregularities found in the use of European funds.

Key-Words: - European funds, fraud, OLAF, shared management, anti-fraud.

1 Introduction

In order to carry out this paper, a series of reports of institutions with authority in the field of financial and tax fraud investigation which could affect the financial interests of the European Union in Romania, were analyzed. This paper is a presentation and analysis of how the risk of fraud with European funds is managed, both by international institutions and by Romanian institutions.

At the European level, in 1999, on April 28th, the European Anti-Fraud Office (OLAF) was created. Its purpose is to intensify activities to combat fraud, corruption and other illegal activities that adversely affect the Community's financial interests. OLAF's activity consists in investigating serious facts related to professional activities, which could constitute a violation of professional obligations. These violations are sanctioned with disciplinary measures and even criminal actions, when deemed appropriate.

OLAF's work is also regularly monitored by a supervisory committee, whose powers and composition are determined by the European Parliament.

The European Anti-fraud Office (OLAF) carries out administrative investigations in Member States on actions concerning the EU's financial interests and investigations targeting the staff of the European institutions.

2 Financing from European Funds

The EU provides funding for a range of projects and programmes. It applies strict rules, for tight control over how funds are used and to ensure money is spent in a transparent, accountable manner. EU funding comes in many different forms: grants, loans, guarantees and equity, prizes for winners of Horizon Europe contests.

Romania is responsible for the management and control of operational programs financed by EU, establishing eligibility rules for expenses financed from structural instruments, in accordance with Council Regulation no. 1083/2006. Romania became the first country in Europe to establish a structure with competences exclusively in the field of protection of the financial interests of the EU, the Department for the fight anti-fraud. Considering the complexity of the financing system from European funds, the network institution from Romania involved in the verification of the expenditure of these funds, respectively the identification and the sanctioning of irregularities and fraud includes: the Anti-Fraud Department, the management authorities for ongoing programs, the paying authorities, the National Directorate Anticorruption (DNA) and intermediate organisms.

2.1 The risks involved in financing from European funds

European funds are one of the most sought-after sources of funding in the European Union, all the more so as funding programs are increasingly diverse and more and more areas are funded. In recent years, OLAF investigations have become more and more complex, which means that OLAF is faced with transnational cases, across several Member States and even beyond them. For example, one of these cases was analyzed by OLAF in 2018. It was a transnational case developed in two EU member states, Romania and Italy, consisting of buying and reselling the same products between companies from the two states, through an intermediary, without being paid VAT. (See fig. no 1)

Figure 1. Carousel fraud to evade paying VAT

Source: https://anti-fraud.ec.europa.eu/system/files/2021-09/olaf_report_2018_en.pdf

According to an OLAF report, in 2020, Romania had 8 out of the 109 cases of fraud with European funds (the same number of cases as Bulgaria and Hungary), after 2015 – 2017 and 2019, when our country had the highest number of fraud files analyzed annually by OLAF.

Table 1 – Analysis of OLAF's activity in 2015 - 2021 (files analysed)

YEAR	FILES ANALYZED BY OLAF		
	TOTAL	TOTAL FILES OF ROMÂNIA	FILES CONCLUDED WITH RECOMMENDATIONS
2021	115	5	4
2020	109	8	4
2019	100	11 (THE MOST)	9
2018	84	4	2
2017	102	11(THE MOST)	8
2016	141	21 (THE MOST)	11

2015	199	45 (THE MOST)	22

Source: OLAF activity Report, 2015 – 2021

Table 2 - Investigations into the use of EU funds managed or spent in whole or in part at national or regional level concluded in 2020 (OLAF)

Country	Cases concluded	
	Total number per country	of which closed with recommendations
Italy	13	9
Bulgaria	8	7
Hungary	8	4
Poland	7	2
Romania	8	4
France	7	3
Serbia	6	3
Slovakia	6	5
Spain	4	2
Syria	4	2
Uganda	4	3
Croatia	3	3
Greece	3	3
United Kingdom	3	2
Ethiopia	2	1
Mauritania	2	2
Armenia, Bangladesh, Bosnia & Herzegovina, Burkina Faso, Czechia, Denmark, Egypt, El Salvador, Estonia, Iraq, Moldova, Nigeria, North Macedonia, Portugal, Somalia, South Africa, Sweden, Turkey, Tanzania, West Africa*, Yemen	21 (1 per country)	13
Total	**109**	**68**

* Single investigation covered several West African countries (Côte d'Ivoire, Guinea, Liberia, Mali, Nigeria, Senegal, Sierra Leone)

Source: OLAF activity Report, 2020

Many countries face challenges in managing fraud and corruption risks related to European funds. Although the European Commission has issued guidelines (e.g. on fraud risk assessments), the documents are general and not country-specific. As a result, Romania has set out to develop its own specific strategy for managing fraud and corruption risks related to European funds. It was developed in a new form for the period 2021-2025. The vision of this strategy is to strengthen the national system for preventing and combating corruption by strengthening mechanisms for identifying and managing risks, threats and vulnerabilities related to this phenomenon, in order to guarantee professionalism and efficiency in the public sector, the safety of citizens and support a developed social and economic environment.

The Council of the EU adopted on 17 December 2020 the regulation on the new Multiannual Financial Framework (MFF) 2021-2027 and the Next Generation EU Economic Recovery Package (NGEU), which provides for a long-term budget of EUR 1 074.3 billion (in 2018 prices) for the 27 Member States of the European Union, Including the integration of the European Development Fund. Together with the 750 billion EUR of Next Generation package, it will allow the EU to provide unprecedented 1.8 billion EUR in funding in the coming years to support the recovery from the COVID-19 pandemic and the EU's long-term priorities in different policies/areas (EU Budget of the Future).

The need for a detailed analysis of fraud risk and the development of fraud prevention and detection measures has become increasingly greater, especially after the launch of the National Recovery and resilience Plan (NRRP).

Romania’s National Recovery and resilience Plan is part of the RRF (Recovery and Resilience Facility), being designed to support Romania’s development by implementing programs and projects funded by European

Funds made available by the European Union through the NextGenerationEU program. Romania's National Recovery and resilience Plan is structured on 15 components, covering all 6 pillars provided by the Regulation: 1. The green transition; 2. Digital transformation; 3. Smart, sustainable and inclusive growth; 4. Social and territorial cohesion; 5. Health, as well as economic, social and institutional resilience; 6. Policies for the next generation.

Programs financed from the European Union budget can be classified, depending on the type of management, in: 1. Direct management programs (EU funds are managed directly by the European Commission); 2. Programs under shared management (EU funds are jointly managed by the European Commission and national authorities); 3. Indirect management programs (the funds are managed by EU or non-EU authorities or even partner organizations in those programs). Of these EU funding programs, shared management funds account for around 70%.

The 5 EU funds under shared management are:
1. European Regional Development Fund (ERDF)
2. European Social Fund (ESF)
3. Cohesion Fund (CF)
4. European Agricultural Fund for Rural Development
5. European Maritime and Fisheries Fund

2.2 Fraud against the financial interests of the European Union

An **irregularity** is an act that does not comply with EU rules, and which may affect the financial interests of the EU, but which may arise as a result of errors, committed unintentionally, both by beneficiaries who have requested funds and by the authorities responsible for making payments.

When irregularities are committed with the obvious intention of benefiting from undue benefits, they are cases of fraud.

Fraud is an "act of cheating committed to obtain personal gain or to cause a loss to a third party." (EU Directive 2017/1371).

In Romania, the main institution with responsibilities in the field of protection of the financial interests of the European union is the Department for Combating fraud. This is the institution that initiated and implemented the National Anti-fraud Strategy (SNLA).

The elaboration of the National Anti-fraud Strategy for the Protection of the European Union's financial interests in Romania had as a starting point the need to streamline the financial control and fiscal control that is exercised in relation to European funds. The strategy strictly concerns fraud against the EU's financial interests, with a delimitation between this type of fraud and corruption.

Fraud is defined as "any intentional act or omission in relation to:

- use or presentation of false, incorrect or incomplete statements or documents, which have the effect of allocating / acquiring, respectively inappropriate or incorrect use of Community funds from the general budget of the European Community and / or the corresponding co-financing amounts from the state budget;
- failure to communicate information in breach of a specific obligation;
-"diverting funds from the purposes for which they were originally granted." (O.G. 79/2003 (updated in 23 august 2008).

Although fraud is a broad legal concept, the external public auditor is interested in fraud that produces significant distortions. There are two types of intentional distortions that are relevant to the external public auditor:

- distortions resulting from the misappropriation of assets and
- distortions resulting from fraudulent financial reporting.

O.G. 79/2003 (updated) defines, in addition to fraud, the irregularity as "any deviation from legality, regularity and compliance, as well as any non-compliance with the provisions of the financing memoranda, memoranda of understanding, financing agreements – supporting the non-reimbursable financial assistance granted to Romania by the European Community –, as well as the provisions of the contracts concluded under these memoranda/agreements, resulting from an action or omission by the economic operator, which, through a non-eligible expense, has the effect of prejudicing the general budget of the European Community and/or local budgets."

For example, the fact that a bidder, even if it has no intention to do so, can influence the conditions of a tender in a way that is favorable to it, constitutes a situation of conflict of interest. When a conflict of interest is detected, Member State authorities should take into account possible implications for other operations or contracts for the operation(s) concerned and act accordingly to prevent new situations of conflict of interest.

So, the thing that distinguishes fraud from irregularity is **the intention**, the good will with which the deed is done.

2.3 Specific elements for shared management

The overall responsibility for the implementation of the EU budget rest with the Commission. However, around 75% of the EU budget is implemented by Member States under shared management, in accordance with the rules of FR 2018, applicable EU sectoral law and national rules. Close cooperation between the Commission and national authorities is therefore necessary to ensure that the EU budget is used in accordance with the principles of sound financial management and that the EU's financial interests are protected by an appropriate accountability model.

Shared management means that Member States (and their regions, too), taking into account their institutional and legal framework, are responsible for the implementation of programs and actions funded under shared management. This role also includes defining the scope of support from the Funds and developing specific tools for support and the allocation of funds to beneficiaries (e.g. businesses, farmers, municipalities, etc.), as well as audits and controls on the implementation of the programs. Under shared management, the Commission is responsible for proposing EU legislation, adopting programs, performing certain advisory functions and supervising the implementation of programs, including monitoring and auditing, without intervening directly at operational level.

For the assessment of the main fraud models related to EU funds under shared management, the distinction must be made between: detected irregularities and fraudulent irregularities (as fraud cases are difficult to be detected).

2.3.1 Risks to fraud of European funds

The main risks of fraud are:

the falsification of documentation – this may consist of:

- the falsification of documents, which give the impression that the applicants fulfill the conditions necessary for obtaining the funds;
- the artificially split of the project and submit multiple applications for funding.

the breach of contract terms:

- the falsification of documents by which the non-compliance with the contractual conditions can be masked;
- the reception and the payment of non-executed works, through false supporting documents (attesting compliance with contractual clauses);

fraud related to the fulfillment of eligibility criteria:

- falsification of the documents necessary to obtain an additional score in the selection of the funded projects;
- submission of false statements regarding the fulfillment of the eligibility conditions;

fraud related to breach of public procurement rules:

- simulating by the beneficiary the procedures for awarding contracts for works or equipment;
- subcontracting the works to another company after winning the contract;
- overloading the financier through requests for reimbursement of costs for goods or services purchased at lower prices;
- "plagiarism" means that a project which receiving funding has been copied;
- "double funding" – which involves financing a project from several sources, without the financiers knowing that there are other sources of funding.

fraudulent financial reporting

- manipulation, falsification (including the production of false documents) or modification of the accounting records or supporting documentation on the basis of which the financial statements are prepared;

- intentionally misrepresenting or omitting from the financial statements of the operations, transactions or other important information;
- international misapplication of accounting principles in terms of values, classification, presentation or description. Fraudulent financial reporting often involves to avert the controls by the management, that, in fact, seem to work effectively.

As regards internal fraud committed by EU staff and staff of the EU institutions, 60% of the sections mentioned undeclared conflicts of interest, 57% confidential information leaks and fraudulent payment claims of 21%. Indeed, illegal or false subcontracting, the use of offshore bank accounts and corruption are the types of public procurement fraud that are often the subject of OLAF investigations (Official Journal of the European Union, 2021/C 121/01).

2.4 Combating fraud against the EU budget

The Financial Regulation requires EU Member State authorities to put in place effective internal control systems to prevent or detect and correct fraud and irregularities, but it does not require them to maintain a blacklist and apply exclusion situations and procedures similar to those used for EDES, which only cover expenditure under direct or indirect management. The Financial Regulation and sectoral legislation (Article 144 of the Financial Regulation, Article 5 of Commission Delegated Regulation (EU) 2015/1971 and Article 5 of Commission Delegated Regulation (EU) 2015/1970), also provide for Member States to use the IMS (irregularity Management System) to report fraud and irregularities related to EU funds under shared management (Article 122(2) of Regulation (EU) No 1303/2013, Article 50(1) of Regulation (EU) No 1306/2013, Article 30(2) of Regulation (EU) No 223/2014, Article 5(5) of Regulation (EU) No 514/2014, Article 21(1)(d) of Regulation (EU) No 1309/2013). However, the Commission should consult the Member States before using the reported data in this way (Article 144 of the Financial Regulation) and may use those data only to exclude counterparties from receiving funds under direct or indirect management.

The EU public Procurement Directive (Article 57) requires Member State authorities to exclude counterparties in certain situations. The requirement applies to all public procurement in the Member States, including those involving EU funds. The Directive lists the mandatory and optional exclusion situations that Member States must transpose into national law. Optional exclusion situations include those that are mandatory under the EDES (bankruptcy, insolvency and other similar situations), but in practice, Member State authorities may exercise considerable discretion as regards exclusion situations that apply in certain public procurement procedures. Thus, there is a different classification from one country to another of the criteria for excluding counterparties from financing and thus the protection of EU financial interests under shared management is less than under direct management.

3 Conclusion

The protection of the EU’s financial interests in Romania is carried out through the DLAF (Anti-fraud Department). It is the contact institution for OLAF in Romania and ensures, supports and coordinates the fulfillment of Romania’s obligations regarding the protection of the EU’s financial interests, in accordance with the provisions of Article 325 TFEU.

From 1st of January 2016, in order to protect the EU's financial interests more effectively and to ensure fairer financial management, the European Commission has established the EDES – the early detection and exclusion system, which has brought a number of improvements in:

- Early detection of persons or entities which present risks to the financial interests of the Union
- Exclusion of persons or entities from participation in award procedures or selection for the implementation of Union funds, where they fall under the following circumstances: bankruptcy or insolvency, non-payment of taxes or social security contributions, serious professional misconduct, involvement in criminal activities (fraud and corruption or participation in a criminal organization), serious breach of a contract, entities created with the intention of circumventing tax, social or other obligations (Creation of letter box companies, in accordance with Article 136(1) of the Financial Regulation;
- Imposing a financial penalty on a person or entity (Article 138 of the Financial Regulation);
- Information on early detection, exclusion or financial penalty may come from:
- final judicial decisions or final administrative decisions;

- concrete data and findings of the Commission's Anti-fraud Office (OLAF), the European public Prosecutor's Office (EPPO), the Court of Auditors, audits or any other checks or controls carried out under the responsibility of the authorizing officer responsible;
- non-final decisions or administrative decisions that are not final;
- decisions of the European Central Bank (ECB), the European Investment Bank (EIB), the European Investment Fund or international organizations;
- cases of fraud and/or irregularities reported by national authorities managing the budget under shared management;
- cases of fraud and/or irregularities reported by the entities implementing the budget under indirect management.

In view of the situations created until the new financial protection system was established, we consider it is opportune to apply the main elements of the EDES to all types of European financing (including shared financing), so that there is no longer discrimination or exclusion of counterparties from financing, depending on national laws.

The practical work also notes the need for an extensive database on activities financed by European funds in the Member States of the European Union.

As so far, in the coming period, both the European institutions (OLAF, ECA, EPPO) and the national institutions need to continue and expand their actions to prevent and combat fraud and corruption, including frauds generated by shared management of European funds.

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