Eu Funded Projects: Management Tools For Preventing Fraud. A comparative analysis of Administrative measures in the Member States

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Abstract: - The purpose of our analysis is to contribute to fighting fraud detrimental to the European Union's financial interests by the dissemination of the knowledge in the field of administrative measures for preventing fraud and irregularities related to the EU Structural funds. In this study we present some theoretical issues as well as the results of a comparative analysis between member states which offer some answers to the question about how much fraud is committed in the EU Structural funds and who are the "champions" of fraud in the last years. Our analysis is structured on 4 parts: a) Romania and the European Funds b) Irregularities and fraud in the management of the EU projects; c) Management tools of Member States to prevent frauds in EU funds- a comparative analysis; d) Conclusions regarding Romanian administrative measures to better prevention of cases of suspected fraud.

Key-Words: - European Funds, irregularities, preventing fraud, Management tools, administrative measures, EU, Romania

Introduction

A variety of EU funds has long been available to improve the development of the EU. The EU funding means that the European Commission awards grants to implement a project in a specific field. The funds are transferred *directly* by the European Commission (calls for tender within FP7, Life Long Learning Programme, and s.o) and *indirectly* through national agencies of Member States (ex. European Regional Development Fund).

There are some funds managed by European Commission for co-operation among the Member States (the project is carried out by consortia which include minimum two or more organisations from the EU Member States). Other funds, as Structural funds, are managed by Member States or regional authorities, and the European Anti-Fraud Office (OLAF) audits how EU funds are spent.

More than a third of the EU budget is devoted to the Structural funds and the cohesion funds. These funds are used for regional development and economic and social cohesion in the EU to improve competitiveness and growth potential at local, regional and national level. The objective of EU funding under regional policy is to promote solidarity and to reduce the gaps in development among the regions and differences among the citizens in terms of wellbeing.

The primary responsibility for rightful spending of the European Funds and for prevention as well as for detection of irregularities rests with the programme management. Although Member States and programme management authorities make efforts to protect that European Funds are used for realisation of projects of general interest, there are still numerous cases of irregular and illegal activities prejudicial to the Community budget. In order to discourage fraud activities, programme manager and auditors must conduct a combination of joint efforts. In particular, they need to be alert with regard to fraud in the procedure of granting the finances to the beneficiaries.

***Methodology*:**

This study represents a qualitative analysis based on some theoretical issues revealed by European and national literature in the field, as well as on a comparative analysis between member states, correlations and synthesis which can offer some answers to the questions about how much fraud is committed in the EU structural funds, who are the "champions" of fraud in the last years and who has the responsibility for rightful spending of the European Funds. Our analysis is structured on 4 parts: a) Romania and the European Funds b) Irregularities and fraud in the management of the EU projects; c) Management tools of Member States to prevent frauds in EU funds- a comparative analysis of administrative measures; d**)** Conclusions regarding Romanian administrative measures to better prevention of cases of suspected fraud

***The Structural Instruments**:*

In the financial cycle 2000-2006 there were 4 structural funds: a) European Regional Development Fund (ERDF) investing in infrastructure, supporting job creation &Entrepreneurship; b) European Social Fund (ESF) investing in people; c) European Agricultural Guidance and Guarantee Fund (EAGGF) and d) Financial Instrument for Fisheries Guidance (FIFG). We can observe some changes for the financial cycle 2007-2013 with a reduced number of structural funds, from 4 to 3: a) European Regional Development Fund (ERDF); b) European Social Fund (ESF) and c) Cohesion Fund. The management of these funds is made jointly by the EU and authorities in the EU countries. No more changes are observed for the financial cycle 2014-2020.

1. Romania and the European Funds

Romania's performances in anti-fraud fight before accession:

- Romania is the first country of the Member/Acceding /Candidate Countries which has an exclusive institution (DLAF) for the protection of Community's financial interests;
- Romania is the first country of the MS/AC/CC which carried out joint on-the-spot controls with OLAF;
- Romania is the second country of the MS/AC/CC which implemented a National Antifraud Strategy.

"The model implemented by Romania in 2005 for the protection of European funds, through the creation of the Fight against Fraud Department – DLAF, is an example for all Member States and candidate countries."[Brüner, F.H, Director General of the European Anti-Fraud Office – OLAF, 2006]

Romania and the European Funds after accession [Excerpt KPMG, 2013]***:***

- Romania's European Funds allocation for 2007-2013:
  23.53 billion euro (17.9% GDP).
- Payments to Romania from European Funds in 2007-2012:
  2.78 billion euro
- Romania: very weak absorption rate in 2007-2012 :
  12% payments /projects (av. 44% in the New Member States)
- Romania: lowest contracting rate:
  70% (av. 83% in the New Member States)
- Romania: the biggest difference between contracted amount and payments:
  70% vs. 12%

2. Irregularities and fraud in the management of the EU projects

2.1 Management rules for cost reporting

The costs of the EU funded projects must be reported to the European Commission [Romano, V, 2013] and the following management rules for cost reporting must be respected:

- Ensure that all activities are implemented according to EU and national rules
- Hold documents related to the implemented activities for at least 5 years after the end of the project
- Keep a separate account or an appropriate accounting system for all accounting related to the project
- Inform the EC about the technical and administrative implementation of the project

- Provide all the documentation and be available for the control boards of the EU.

2.2 Fraud vs. irregularity

An irregularity is the result of the errors committed both by beneficiaries claiming funds and by the authorities responsible for making payments. The official definition of *"irregularity*" is *any infringement of a provision of Community law resulting from an act or omission by an economic operator, which has, or would have, the effect of prejudicing the general budget of the Communities or budgets managed by them.* [Art.1 (2) of Regulation (EC) No 2988/955]

An 'irregularity' in Structural Funds terms includes any administrative or financial mismanagement that comes by act or omission by an economic operator which has or would have the effect of prejudicing the general budget of the Communities or budgets managed by them, by charging an unjustified item of expenditure to the Community Budget.

Irregularities can arise due to human error, due to serious failings in management and control systems designed to ensure correct accounting and compliance with rules and regulations. All error amounts over €10,000 must be reported to the Commission in an irregularity report.

Some examples of Irregularities based on evidence collected at a monitoring, verification or audit visits:

- An *incorrectly calculated grant claim*;
- *Ineligible expenditure have been included* in the calculation of grant previously claimed and paid (for example, Banks fees included in error; VAT is recoverable by the beneficiary and should not therefore have been included in expenditure returns; Pensions not paid into a managed fund; Funds for travel and subsistence found in Capital expenditure returns);
- *Insufficient documentation* to support expenditure declared;
- *Inflated progress* against targets/objectives included in previous progress reports;
- Failure of requirements in *publicity or procurement implementation.*

2.3 EU-expenditure fraud in the management of EU projects

An irregularity may or may not be a fraud. If an irregularity is committed intentionally it's *fraud*, it's a criminal offence, is a deliberate act of trickery intended for personal gain or to cause a loss to another party.

Fraud can be defined as "*Deceit, trickery or sharp practice or breach of confidence perpetrated for profit to gain some unfair or dishonest advantage'* [Collins English Dictionary 10th edition]

The question is what constitutes EU-expenditure fraud? The European literature in this field considers the following most common frauds:

- The use of false or falsified documentation or declarations is the most frequently used method leading to wrongful payment of funds from the EU budget or budgets managed by the EU
- Nondisclosure of required information with the same effect
- Use of resources in a different way than foreseen in the project
- Falsification of administrative, financial and legal documents during project submission and reporting

An example is given by a criminal syndicate have been charged with fraud for fake research projects. They created a cross border network of fictitious companies and subcontractors. To make the companies seem legitimate grant applications included names of real scientists and established research institutes and companies without their knowledge [Nature News, 2011].

- Potential conflict of interest (undeclared)

An example is given by an EU-funded highway construction project, near Salerno (Italy's Calabria region). OLAF and the Italian investigators, found evidence of €388 million lost in EU funds by transport authorities. The investigators uncovered *conflicts of interests* where Italian officials were awarding contracts to companies they also worked for. OLAF investigators recovered €388 million of EU funds but the money returned to the EU budget invariably came from the Italian taxpayer [EUobserver, 2012].

- Subcontracting of activities against national law and/or "best value for money" principle
- Misuse of funds for purposes other than those for which they were originally granted.

In this latest category, EU Funds are being spent on the completely different way than they should be, according to the project (and priority axis). There are projects spread all over Europe that claim one goal and serve another one, which is considered as fraud. Some examples for misuse of funds:

The European Court of Auditors (ECA) audited 24 investment projects for public buildings in the Czech Republic, Italy and Lithuania, since these were the countries that received the most Cohesion and Regional Development funds for energy efficiency measures between 2007 and 2013. "*Only 10% of EU cohesion funds earmarked for energy efficiency - in total worth €5 billion - are being used correctly. Member states were essentially using this money to refurbish public buildings while energy efficiency was, at best, a secondary concern*." [Wögerbauer, *H.*, 2013].

In Poland, the project **„***Building a retention basin Niewiadoma, main Basin object",* co financed from European Regional Development Fund: there are some companies that plan to launch restaurants, recreational and leisure services like kayaking" [Romaniuk, 2013]. In Latvia, a factory for production that was built in less developed region (the costs were 1.9 million EUR), never started working, even if it received final payment from EU funds in August of 2008. The project implementer exists only on paper without any turnover or money in bank account.

Some authors consider all errors as irregularities divided in fraudulent and non fraudulent. Liberatore, U [2013] presented case studies of irregularities/fraud in European Funds terms grouped by the following macro-areas:

- Failure to fulfill obligations undertaken 18%
- Other false documentation 16%
- Incomplete and/ or incorrect documentation 15%
- Unlawful expenditure 14%
- Fraudulent Behaviors 8%
- False invoices 7%
- Violations of public procurement procedures 6%
- Errors in the form 4%
- Lack/loss of requirements 3%
- Violation of the industry related regulations 3%
- Others 6%

We can see more than 60% of the irregularities /fraud grouped in the first four macro-areas.

2.4 The dimension of fraud committed in the European Funds

As a result of the 3 500 investigations OLAF has completed since it was set up in 1999 by 2012, over €1.1 billion of EU money has been recovered (excluding financial penalties), 335 individuals have received prison sentences totalling 900 years and OLAF has recovered on average €100 million a year [Fraud in figures, EC]. In 2013, 15779 (fraudulent and non-fraudulent) irregularities were reported to the Commission, involving an overall amount of about EUR 2.14billion, of which about EUR 1.76 billion concern the expenditure sectors of the EU budget. In the same time, 1609 irregularities were reported as fraudulent (this includes both suspected and established fraud), involving EUR 309 million in EU funds [Fight against fraud 2013, EC].

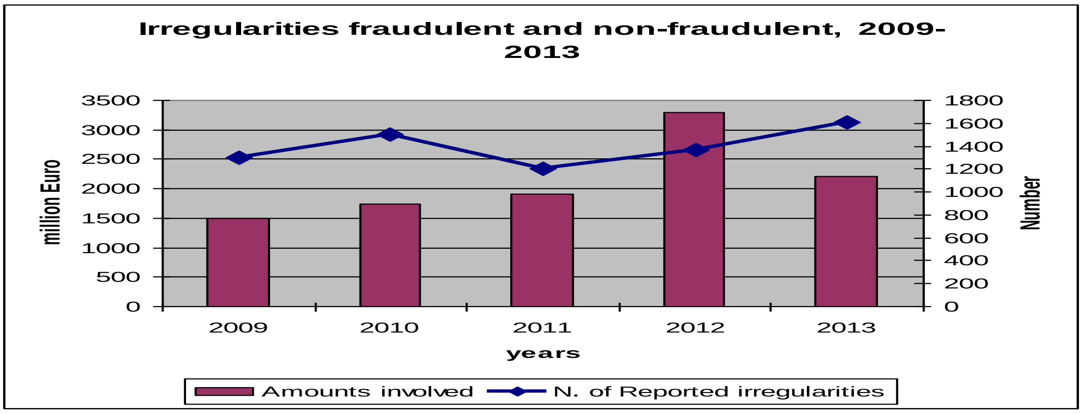

Figure 5: Number of reported irregularities (fraudulent and non-fraudulent) and amounts involved
Source: author, based on Fight against fraud 2013 Annual Report, EC 2014 and The Structural Funds in 2011, EC COM/2012/0633 final

Two-thirds of the EU fraud concerns just six countries

An analysis of the Structural Funds in 2011 made by European Commission [COM/2012/0633] reveals **"*the champions*"** of fraud in the management of the EU projects. "*About two-thirds of alleged EU fraud concerns just six countries: Bulgaria, Romania, Greece, Italy, Poland and Spain*"**.** Some changes were registered in 2013 [EC, SWD (2014)] when the Member States who detected and reported the highest number of fraudulent irregularities *by budget sector (expenditure)* are: Italy, Romania, Bulgaria, Poland, Denmark and Greece (between 302 and 55). In terms of the amounts involved, the highest figures were reported by Italy, Poland, Romania, Greece and Germany (between EUR 68 and 24 million). *For agriculture*, the irregularities notified [EC, SWD(2014)] by four Member States (Bulgaria, Denmark, Italy and Romania) represent about 75% of the total number of irregularities reported as fraudulent, but the number of irregularities reported as fraudulent also increased for five other countries (Czech Republic, Greece, Spain, France and Poland). As typical fraud found for these countries it is noted: false declarations; false invoicing; false or exaggerated (double/triple) cost claims for inputs or services; tendering through false or exaggerated bids, cartel bids, illegal or irregular sub-contracting; fraud and irregularities resulting from undisclosed conflict of interest.

Member States with a higher irregularity rate can perform far better than others

There are different opinions regarding "*the champions*" of irregularities and fraud in the management of the EU projects.

A Report from the Commission to the European Parliament and the Council [EC, COM (2011)] presented some arguments why a higher number of cases reported *does not necessarily mean* that more irregularities are committed or that a Member State is more vulnerable for irregularities. For a country with "*a more developed audit strategy, tailor made audits, higher number of performed audits, better trained or instructed auditors and so forth will normally lead to a higher number of detected irregularities".* The conclusion could be: ***"****It is possible that Member States with a higher irregularity rate perform far better than Member States with a lower irregularity rate".*

But in the case of Romania, Buggenoms S, Head, Audit Unit of the Directorate for Regional Policy in the EC considers "*Romania has difficulties in identifying and preventing fraud in the European funds absorption process*" [Buggenoms S., 2012]

3. Management tools of Member States to prevent frauds in EU funds- a comparative analysis

Art.53 b (2) of Regulation 1605/2002 states that Member States are responsible to prevent and deal with irregularities and fraud in the area of shared of the Structural Funds management in order to protect the financial interests of the Community. The Member States are also responsible for setting up management system and control system but primary responsibility for fraud prevention- detecting and investigating fraud - rests with management.

3.1 "Breaking the fraud triangle"

Breaking the fraud triangle is considered the key to fraud prevention in Member States. In the *Handbook of Fraud Deterrence* (2007) three elements are responsible for fraud:

a. *Opportunity*: relaxed internal control systems may give rise to an opportunity for fraud (e.g. deficiencies related to: supervision and review, separation of duties, management approval or system controls);
b. *Rationalization*: a person can develop a justification for himself by rationalizing their acts;
c. *Financial pressure*: personal financial problems or personal vices such as gambling, drug addiction etc

The principal mechanism for reducing opportunity is *strong internal control*, covering in particular adequate supervision and review.

The Managing Authorities in the Member States (MSs) have the responsibilities of strong internal control as the principal mechanism for reducing "opportunity" of fraud; they also have to identify fraud indicators and report irregularities and suspected fraud to OLAF.

3.2. Management Tools for Preventing Fraud: Comparative Administrative measures in Romania and Member States

Administrative measures:

a. National strategies

Romania and 16 other MSs established National strategies using new control and investigation strategies in order to reduce the risk of fraud and to better detect cases of fraud in the spending of the European funds. [COM (2012) 408]

b. General and /or specific fraud indicators

Romania and *18 MSs* make use of specific fraud indicators:

- Categories of irregularities;
- Categories of economic operators;
- Categories of operations;
- Categories of modus operandi;
- Economic sectors;
- Geographical areas of projects;
- Transactions.

Romania as well as *Bulgaria*, *Hungary and Portugal* make use of general fraud indicators identified in a Manual or Guide for the Audit Authority employees.

c. Cost benefit analysis in anti-fraud investigations

Romania and 5 other MSs apply cost benefit analysis when conducting anti-fraud investigations. 15 other MSs (Romania not included) investigate fraud irrespective of the amount involved, and all incidences of irregularities and fraud detected are pursued.

The results of Administrative measures -A Comparative analysis in Romania and MSs

Improvements of the detection record

- Human aspects – enhancing administrative capacity, training of competent staff: 16MSs

- Increase of financial resources, as to reduce the risk of corrupt attitudes and practices, competitive wage: Romania and 15 MSs
- Technical - the drawing up of a handbook and compilation of best practices: Romania and 9 MSs

Better prevention of Fraud

- the strong proactive approach with more irregularities detected before payment : in *Romania* and *24 MSs*
- the higher ratio of accepted eligible amounts by the beneficiary to the managing authorities: in *Romania* and *14 MSs*
- the preventive impact of the *Commission Guidelines on public procurement*: in *Romania* and *15 MSs*
- the preventive impact of the *Commission Note on fraud indicators*: in *Romania* and *15 MSs*
- There are some other outcomes not reported by Romania, but other MSs

Romania adopted in 2011 some *measures at his own initiative* [Implementation of Art. 325 TFEU, 2011] for the protection of the EU's financial interests and the fight against fraud:

1. *Consolidation of the anti fraud regulatory framework*: the new institutional framework (2011) ensures independent decision making institutional stability, has extended and consolidated the control powers and has endowed Anti Fraud Department (DLAF) with legal personality.
2. *Improving the public procurement system* through organization and functioning of the National Regulatory and Monitoring Authority for Public Procurement (ANRMAP)
3. *Other Measures:* The National Tax Administration Agency (ANAF) has developed the software application '*Traffic Control*' for managing information concerning transports of goods representing intra Community acquisitions, enabling the monitoring and risk analysis of suspect intra Community acquisitions.

Some Romanian observers consider there is a tendency to '*over-interpret*' EU requirements in Romania by introducing excessively complicated and burdensome rules for management and control systems. They paid attention to the negative impact of this trend on the Romanian absorption rate of the European funds and ask for *simplification*.

4. Conclusions regarding Romanian administrative measures to better prevention of cases of suspected fraud

Measures taken within the Romanian administrative procedures after accession to the EU have contributed to better prevention of cases of suspected fraud in the area of the Cohesion Policy and improvements in the risk management system.

1. The Anti Fraud Department (AFCOS Romania) has access to *the Single Management Information System* (SMIS) 2007-2013. The information extracted from that database is used to justify control policies and carry out risk analysis to respond immediately to OLAF's requests concerning the existence of certain projects, the source of financing, the stage of implementation and other project details.
2. The Anti Fraud Department (DLAF) gained access to the *public records database* and other national and European databases (e.g. the central exclusion database); the information extracted from those databases has contributed to improving the risk management system.
3. Some managing authorities have established administrative procedures that cover risk management, management of irregularities and anti fraud control. *The Code of Conduct* adopted on December 2011 is a guide for preventing and avoiding situations involving *conflicts of interest* and/or incompatibilities that may affect the personnel administering non-reimbursable European funds.

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