



EUROPEAN
COURT
OF AUDITORS

Audit brief



Fighting fraud in EU spending

October 2017

The European Court of Auditors is currently examining whether the European Commission is following best practice in combating fraud in EU spending.

Fraud and corruption are perceived by many EU citizens as a significant problem for the EU budget and for EU institutions. A recent Eurobarometer survey (2015) about their perception of fraud and corruption affecting the EU budget showed that 71 % of respondents thought that EU budget fraud happened rather frequently and 60 % of all EU respondents considered that corruption is significant in the EU institutions. This shows that the perception of EU fraud has deteriorated significantly as compared to the 2008 survey on the same issue.

Our audit aims to examine whether:

- the Commission has appropriate fraud risk oversight at corporate level,
- the Commission's Directorates-General are well prepared to prevent fraud; and
- a robust response is given in those cases where there is a suspicion of fraud.

By providing recommendations on how to further improve the Commission's fraud risk management, our audit will allow the Commission to demonstrate if it is taking all the necessary steps to properly manage fraud risks in EU spending.

If you wish to contact the team in charge of this audit, please do so through the following e-mail address: ECA-Fraud-Audit@eca.europa.eu.

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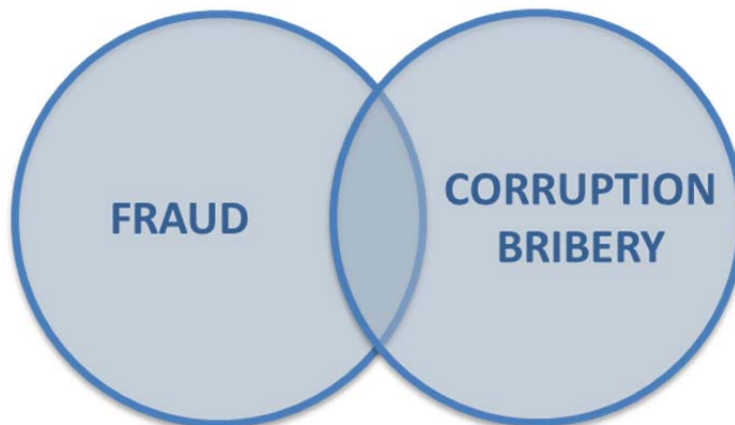
FRAUD AND CORRUPTION

Definition of fraud and corruption

High levels of fraud and corruption reduce the economic performance of countries by adversely affecting long-term economic growth through their impact on investment, taxation, public expenditure and human development:

- fraud generally refers to any intentional act or omission designed to deceive others, resulting in the victim suffering a loss and/or the perpetrator achieving a gain; and
- corruption, on the other hand, is traditionally understood to comprise any act or omission that misuses official authority, or seeks to influence the misuse of official authority, in order to obtain an undue benefit (see **Figure 1**).

Figure 1 – Fraud and corruption



Source: ECA

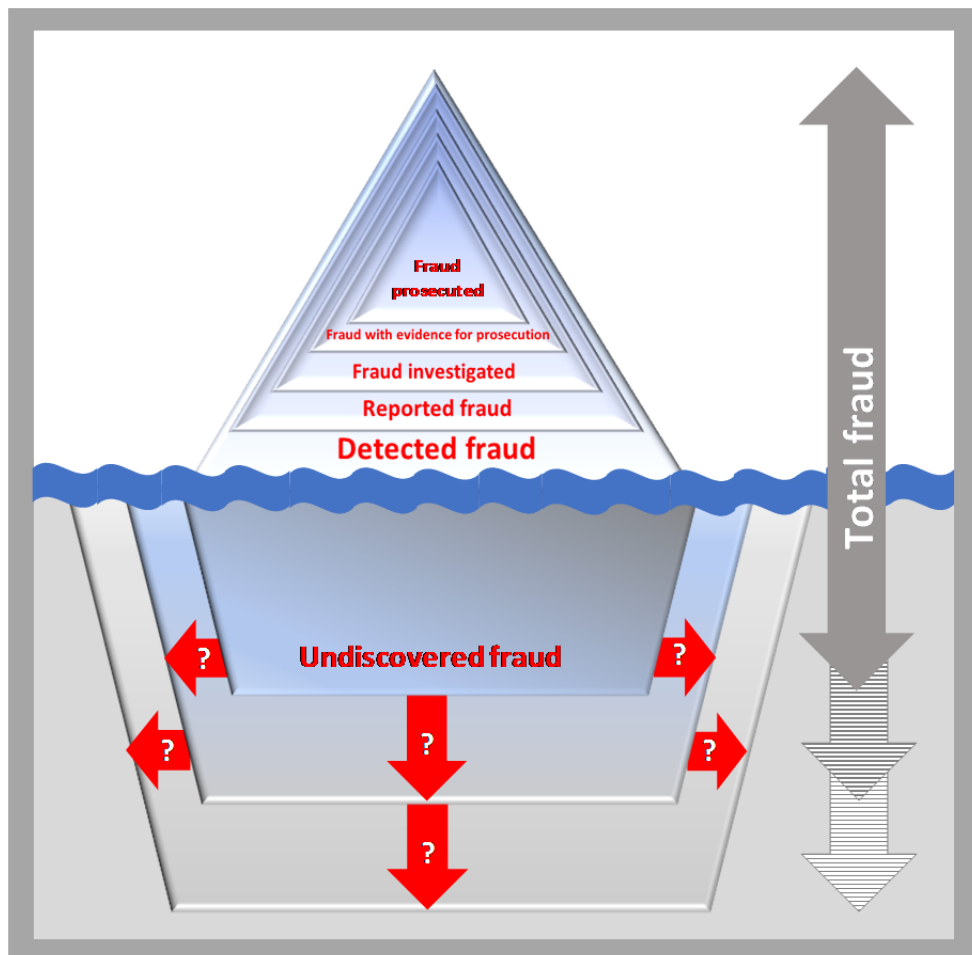
Not all cases of fraud are corruption, and vice versa. **Box 1** contains an example showing how to differentiate between the two.

Box 1: How to differentiate between fraud and corruption¹

If a beneficiary of a grant charges for unjustifiably high expenditure and tries to do this by misleading their principal or the provider of the funds, then that is fraud. If the body providing the grant, or the official authorising it, also participates in reporting and/or accepting unduly high expenditure in exchange for some kind of direct or indirect compensation, then that embodies corruption.

Fraud is a “hidden crime”. There is always a gap between detected and undetected cases where a fraudulent activity is suspected. Because of its nature, it is very difficult to measure the level of fraud (see **Figure 2**). Established fraud describes a case of suspected fraud that has been judged to constitute 'fraud' by a definitive criminal court decision.

Figure 2 – What is the level of fraud?



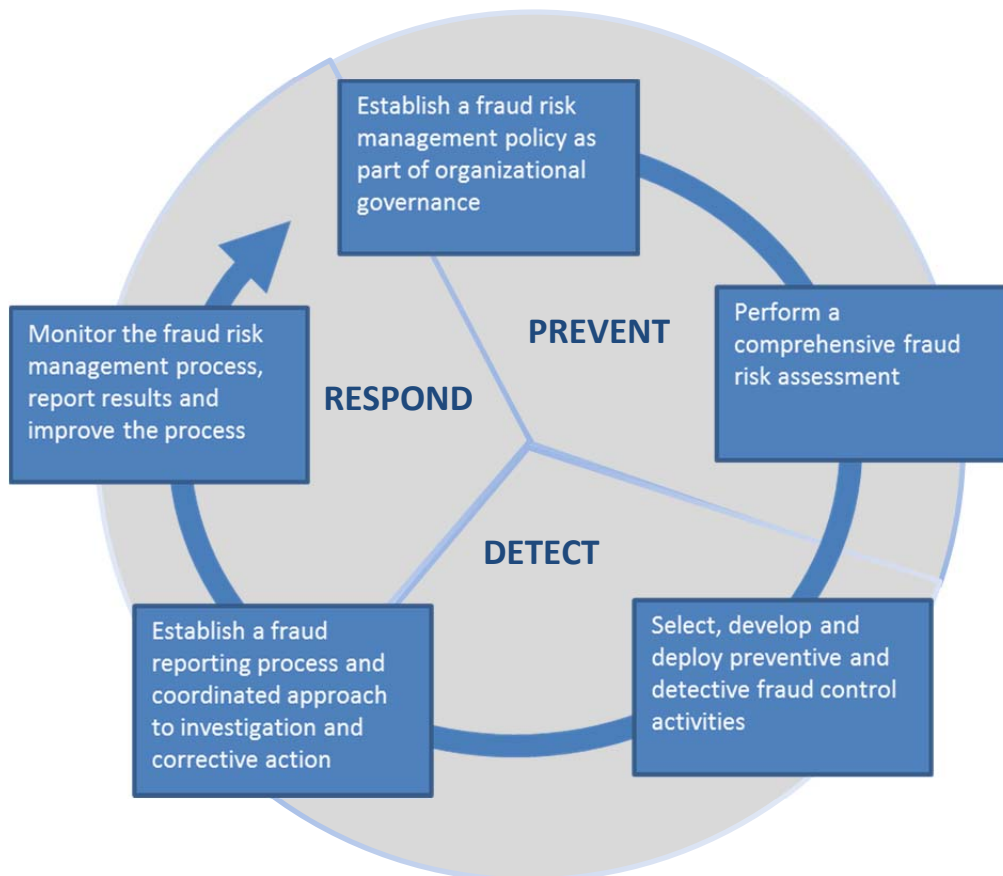
Source: ECA

¹ Transparency International Hungary, [The corruption risks of EU funds in Hungary](#), 2015, page 8.

Fraud risk management

An effective fraud risk management framework covers the full cycle of anti-fraud activities comprising fraud prevention, detection and response (see **Figure 3**).

Figure 3 – Fraud risk management cycle



Source: ECA (based on COSO framework)

Fraud prevention and deterrence are much less costly and time-consuming than the lengthy process of fraud detection, investigation and prosecution.

Robust fraud risk assessment is key to effective fraud prevention. It involves analysing the profile and motivation of potential fraudsters, and estimating the total risk of fraud relating to the organisation. This proactive identification of the causes and enabling factors for fraud and their removal is also essential to make fraud deterrence more effective.

Many bodies have developed guidelines for managing fraud risk: the Committee of Sponsoring Organisations of the Treadway Committee (COSO), the Organisation for Economic Cooperation and Development (OECD), the Institute of Internal Auditors (IIA), the Chartered Institute of Public finance and Accountancy (CIPFA) or the Association of Certified

Fraud Examiners (ACFE). Guidelines have also been developed by Supreme Audit Institutions such as the US General Audit Office (GAO), the UK National Audit Office (NAO) or the Australian National Audit Office (ANAO).

REGULATORY ENVIRONMENT

Protecting the EU's financial interests against fraud

The European Commission is responsible for protecting the EU's financial interests. It must take the necessary measures to provide reasonable assurance that irregularities and fraud in the use of the EU budget are prevented, detected and corrected. This responsibility is shared with Member States in the areas of EU budget shared management and of Traditional Own Resources (TOR).

An irregularity is an action or omission which leads to non-compliance with EU or other relevant rules, and has a potentially negative impact on the EU's financial interests. Irregularities may be the result of genuine mistakes made by beneficiaries or by the authorities responsible for making payments.

Fraud is the severest form of an irregularity. The term fraud is defined within the "Convention on the protection of the European Communities' financial interests", the so-called PIF convention². The definition of fraud affecting the EU budget is quite lengthy (see **Box 2**). The core is that it needs an intentional act or omission to have an irregularity defined as a fraud and therefore for it to be punishable by judicial proceedings.

² Council Act of 26 July 1995 drawing up the Convention on the protection of the European Communities' financial interests ([95/C 316/03](#)), Article 1(1).

Box 2: Definition of fraud affecting the EU's financial interests

Fraud affecting the EU's financial interests consist of:

(a) in respect of expenditure, any intentional act or omission relating to:

- the use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the misappropriation or wrongful retention of funds from the EU budget or budgets managed by, or on behalf of, the EU;
- non-disclosure of information in violation of a specific obligation, with the same effect;
- the misapplication of such funds for purposes other than those for which they were originally granted.

(b) in respect of revenue, any intentional act or omission relating to:

- the use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the illegal diminution of the resources of the EU budget or budgets managed by, or on behalf of, the EU;
- non-disclosure of information in violation of a specific obligation, with the same effect;
- misapplication of a legally obtained benefit, with the same effect.

In 2012, the Commission proposed a Directive on the fight against fraud to the Union's financial interests by means of criminal law (PIF directive) to improve the success of criminal investigations and the prosecution of crimes against the EU's financial interests. This Directive was adopted by the Council in April 2017³ and by the European Parliament in July 2017⁴. Member States have 24 months to implement the PIF directive in their national law.

ROLES AND RESPONSIBILITIES

A large number of actors are involved in managing the risk of fraud against the EU budget at the different stages of the “anti-fraud cycle” both at EU and Member State level (see ***Figure 4***).

³ <http://www.consilium.europa.eu/en/press/press-releases/2017/04/25-new-rules-to-protect-eu-finances/>.

⁴ [Directive \(EU\) 2017/1371](#) of the European Parliament and of the Council of 5 July 2017 on the fight against fraud to the Union's financial interests by means of criminal law.

Figure 4 - EU and Member State bodies involved in managing the risk of fraud

Bodies	Prevention (anti-fraud governance and leadership, fraud risk assessment, anti-fraud strategies, preventive controls, intelligence)	Detection (detective fraud control, fraud complaint mechanisms)	Investigation (administrative and criminal)	Response (sanctions, recoveries, prosecution, performance measurement and reporting)
OLAF	✓	✓	✓	
IDOC			✓	✓
Commission DGs	✓	✓		✓
Eurojust				✓
Europol	✓			
National administrative authorities	✓	✓	✓	✓
National judicial and law enforcement authorities			✓	✓
EPPO			✓	✓

Source: ECA

'Office pour la lutte anti-fraude' (OLAF)

Within the Commission, the main horizontal actor for anti-fraud measures is the 'Office pour la lutte anti-fraude' (OLAF). OLAF is governed by a specific EU regulation⁵.

OLAF leads the design and implementation of the Commission's anti-fraud policy. It is the only body with independent investigative powers at EU level, and it carries out administrative investigations in internal (within EU institutions) and external (EU revenue and expenditure) cases of fraud, corruption and any other illegal activities affecting the EU's financial interest. However, OLAF does not have sanctioning powers.

⁵ [Regulation \(EC, Euratom\) No 883/2013](#) of the European Parliament and of the Council concerning investigations conducted by the European Anti-Fraud Office (OLAF).

Based on its investigations, OLAF may issue the following type of recommendations (see **Box 3**):

- **Judicial recommendations** to the competent national judicial authorities. It is then up to these authorities to decide on opening a judicial proceeding or dismissing the case.
- **Financial and administrative recommendations** to the competent Directorates-General of the Commission which are responsible for ensuring that the EU funds concerned are recovered and system weaknesses are remedied.
- **Disciplinary recommendations** to the specific authorities with disciplinary powers in the EU institution or body concerned.

Box 3 provides some information on the outcome of the judicial and financial recommendations, based on data reported in the OLAF report for 2016⁶.

Box 3 – Outcome of OLAF investigations

Between 2009 and 2016 OLAF sent **541 judicial recommendations** to Member States. Only 44 % of cases submitted by OLAF (for which a decision was taken at national level) resulted in an indictment by the judicial authority. The indictment rate differs significantly between Member States.

In 2016, **OLAF recommended an amount of 631.1 million euro** (2015: 888 million euro) for financial recovery. The amount recovered as a result of OLAF investigations finalised in previous years was not published within the OLAF Annual Report for year 2016. The funds recovered in 2015 amounted to 187.3 million euro.

The Investigation and Disciplinary Office of the Commission (IDOC) may investigate internal cases which cannot be dealt with by OLAF (such as minor offences against the EU Staff Regulations), and it is entitled to initiate disciplinary procedures.

OLAF's legal framework is currently being examined by the Commission within the larger context of an evolving anti-fraud landscape. This examination is expected to be completed by the end of 2017.

⁶ [The OLAF report 2016](#), pages 12 and 33.

Directorates-General of the Commission

The Commission's Directorates-General (DGs) and Executive Agencies have operational responsibility for setting up effective fraud risk management systems in the different areas of the EU budget.

DG Budget is responsible for establishing an internal control framework within the Commission to prevent and detect fraud effectively. It provides support to services, disseminates best practices and oversees the reporting on the implementation of the internal control framework.

DG Growth has a particular role in charge of establishing the Commission's public procurement strategy to produce transparent, fair, and competitive public procurement across the EU's Single Market.

Under shared management, the Member States are primarily responsible for establishing a control system to manage fraud risks effectively. The Commission DGs in charge of the different funds (in particular DG REGIO, EMPL, AGRI and MARE) must, however, make sure that the management and control systems set up by the Member States appropriately address the key fraud risks.

The DGs are also responsible for recovering funds and implementing financial and administrative recommendations resulting from OLAF investigations. They must report to OLAF on the follow-up given to these recommendations.

In addition, all EU institutions are obliged to introduce appropriate procedures to protect whistle-blowers. It is mandatory for all EU staff to report on suspected fraud.

Eurojust and Europol

Eurojust and Europol are law enforcement agencies which function on an inter-governmental basis. Neither of them have the power to start and/or to conduct criminal investigations (or prosecutions) in Member States:

- **Eurojust** is an EU agency set up in 2001 by the European Council to stimulate and improve the coordination of investigations and prosecutions between the competent authorities in the Member States, to improve the cooperation between these authorities and to provide support for investigations and prosecutions of

cross-border crimes. It may also ask Member State authorities to investigate or prosecute specific acts⁷;

- **Europol** was established in 1997. In 2009, it formally became an EU agency. Its main task is to assist national law enforcement authorities in their fight against serious crimes through its analysis tools and information exchange networks⁸.

National authorities

Criminal investigation and prosecution is the sole competence of the national judicial authorities. Investigation and conviction rates for fraud against the EU's financial interests vary greatly across the EU. This is due to the differing legal frameworks and law enforcement systems, different definitions of what constitutes fraud against the EU budget, and variations in sanctions and periods within which it is possible to investigate and prosecute offences⁹.

In shared management, Member State authorities establish national anti-fraud strategies and carry out fraud risk assessments. They are also obliged to report to the Commission on any irregularities or suspicions of fraud of over 10 000 euro they may encounter.

European Public Prosecutor's Office

In 2013, the Commission proposed setting-up a European Public Prosecutor's Office (EPPO). On 8 June 2017, 20 Member States agreed to establish the EPPO. The European Parliament gave its consent on 5 October and on 12 October, at a meeting of the Council of the European Union, the regulation¹⁰ establishing the EPPO was adopted by those Member States which are part of the EPPO enhanced cooperation.

The EPPO central office will be based in Luxembourg. The date on which the EPPO will assume its investigative and prosecutorial tasks will be set by the Commission on the basis of a proposal from the European Chief Prosecutor once the EPPO has been set up. This date will not be earlier than three years after the entry into force of the regulation.

⁷ [Eurojust Annual Report 2016](#).

⁸ <https://www.europol.europa.eu/about-europol>.

⁹ Impact assessment accompanying the Proposal for a Council Regulation on the establishment of the European Public Prosecutor's Office (page 18).

¹⁰ <http://www.consilium.europa.eu/en/press/press-releases/2017/10/12-epo-20-ms-confirms/>.

The EPPO will investigate and prosecute serious crimes affecting the EU's financial interests and VAT fraud. It will work as a collegial structure composed of two levels:

- European Delegated Prosecutors located in the Member States, who will be in charge of the day-to-day conduct of criminal investigations and prosecutions in line with national criminal law, working on a decentralised basis.
- a centralised European Chief Prosecutor who will have overall responsibility for the office. It will monitor, direct and supervise all investigations and prosecutions undertaken by European Delegated Prosecutors, thereby ensuring a consistent investigation and prosecution policy across Europe¹¹.

SPECIFIC ANTI-FRAUD MEASURES AT COMMISSION LEVEL

The Commission adopted its most recent Anti-Fraud Strategy (CAFS) in 2011¹². It covers the whole “anti-fraud cycle” from the prevention and detection of fraud to investigations, sanctions and the recovery of misused funds. The CAFS also includes an action plan composed of 51 actions (such as establishing DG-level anti-fraud strategies, using IT tools to better prevent or detect fraud, or the revision of the public procurement directives). OLAF presents an annual report to the Commission on the implementation of the CAFS and its action plan¹³.

In 2007, the Commission updated its previous Communication on fraud-proofing legislation and contract management dating from 2001. Since then OLAF has also been responsible for fraud-proofing new EU legislation, based on “lessons-learnt” from its operational activity¹⁴.

¹¹ http://europa.eu/rapid/press-release_IP-17-1550_en.htm.

¹² ec.europa.eu/anti-fraud/sites/antifraud/files/docs/body/ec_antifraud_strategy_en.pdf

¹³ Commission, Staff working document ‘Implementation of the Commission Anti-Fraud Strategy (CAFS)’, [SWD\(2016\) 239 final](#).

¹⁴ Commission, Prevention of fraud by building on operational results: a dynamic approach to fraud-proofing, [SEC\(2007\) 1676](#).

COMMISSION ESTIMATES FOR FRAUD AGAINST THE EU BUDGET

Member States and candidate countries are requested to report to OLAF all major cases of irregularities that they have detected in the areas of EU revenue (TOR) and expenditure (cohesion, agriculture and pre-accession funds). Reporting by the Member States and candidate countries must also specifically identify cases of suspected and detected fraud.

To calculate its estimates of the level of fraud detected, the Commission uses its own data in cases where it manages the expenditure directly, and uses data forwarded to OLAF by Member States and candidate countries in cases concerning EU revenue and expenditure under shared management. These estimates are published in the annual PIF report¹⁵.

Table 1 provides information on the value of fraud cases detected in EU revenue and expenditure in 2016. Fraud detected within the EU budget amounted to 391 million euro.

Table 1: EU budget – Detected fraud per area (2016)

EU budget area	From Commission data, MS and candidate country reporting (amount million euro)
Cohesion and fisheries	236.9
Traditional own resources (customs and trade)	83
Natural resources	61.8
Direct expenditure	6.3
Pre-accession	3
Total	391

Source: European Commission, Protection of the European Union's financial interests – Fight against Fraud 2016 Annual Report; COM(2017) 383 final, page 15.

¹⁵ https://ec.europa.eu/anti-fraud/reports_en.

In 2016, OLAF financial recommendations amounted to 631.1 million euro¹⁶ of which 353 million euro (56 %) was in the cohesion area¹⁷. There is, however, no specific analysis of the amount of OLAF financial recommendations relating to fraud (as opposed to irregularities).

There are several factors which may cause the estimates for detected fraud to be understated:

- Member States are only obliged to report irregularities, including suspicions of fraud, worth more than 10 000 euro;
- to estimate the amount of fraud affecting the EU budget, the Commission relies to a large extent on data provided by Member State authorities. While Member States are legally obliged to indicate if there is a suspicion of fraud, this is not always a self-evident classification; and
- Member States have no incentive to report on a greater number of fraudulent cases since these cases are more likely to result in financial corrections¹⁸.

The Commission itself considers that the number of irregularities reported as fraudulent (and the related amounts) may not be correlated to the actual level of fraud affecting the EU budget¹⁹. Some alternative figures are, for example, provided in a preparatory study for the European Commission's impact assessment for the establishment of the EPPO²⁰. In this study, cigarette smuggling has been estimated to cost to the EU budget some 1 billion euro per year. The same study also estimates that in a "low-risk" scenario, damages in the area of agricultural and cohesion support could amount to 4.1 billion euro each year.

¹⁶ [The OLAF report 2016, page 12.](#)

¹⁷ Commission, Protection of the European Union's financial interests – Fight against fraud 2016 Annual Report; [COM\(2017\) 383 final](#), page 25.

¹⁸ [Special Report 4/2017](#) "Protecting the EU budget from irregular spending: The Commission made increasing use of preventive measures and financial corrections in Cohesion during the 2007-2013 period".

¹⁹ Commission, 2016 [Report on the protection of the EU's financial interests – fight against fraud report](#), page 14.

²⁰ Commission, STAFF WORKING DOCUMENT IMPACT ASSESSMENT Accompanying the Proposal for a Council Regulation on the establishment of the European Public Prosecutor's Office; [SWD\(2013\) 274 final](#); pages 87-90.

MAIN RISKS IDENTIFIED WHEN PREPARING THE AUDIT

When preparing our audits, we carry out a risk analysis of the policy area or programmes that we intend to examine. For our audit of how the Commission manages fraud risks in EU spending, we identified the following risks related to the area of fraud prevention:

- In the shared management area, the figures reported by Member States (and candidate countries) to the Commission on irregularities and fraud detected may not be comparable between Member States due to divergences in interpreting what information should be reported, and when.
- In addition, the Commission may not gather adequate and comparable estimates of undetected levels of fraud in Member States. This would affect the reliability of the Commission's calculation of the amount of fraud affecting the EU budget.
- The Commission may not dispose of and/or use all available operational intelligence to obtain a sufficiently detailed analysis of the profiles and motivation of potential fraudsters and the main methods of defrauding the EU budget.

Moreover, an effective response to fraud requires timely and proportionate sanctions. Unduly spent funds have to be recovered and criminal offences should be punished. The low level of implementation of OLAF's financial and judicial recommendations by DGs and/or Member State authorities points to a risk that.

- the EU's current model of collaboration between judicial authorities in different Member States may not provide the most effective action against cross-border crimes.
- OLAF investigations may not act as effective deterrents.

Finally, in a recent special report we have already highlighted the need for the college of Commissioners to take overall political responsibility for the execution of the budget²¹. This also includes responsibility for ensuring that the prevention of fraud in EU spending, and the response to it, are effective.

²¹ ECA [Special Report No 27/2016](#): Governance at the European Commission — best practice?

ABOUT ECA SPECIAL REPORTS AND AUDIT BRIEFS

The ECA's special reports set out the results of its audits of EU policies and programmes or management topics related to specific budgetary areas.

Audit briefs provide some background information in relation to on-going audit tasks. They are based on preparatory work undertaken before the start of the audit and are intended as a source of information for those interested in the policy and/or programme concerned.

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