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Journal

**Fraud** *and*  
**Corruption**  
THEME | **Ethics** *and*  
**Integrity**



**...integrity is the biggest  
asset on our balance sheet**



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## Putting ethics and integrity up front

Last month, I got to talk with a friend of mine - with whom I get along increasingly well since we started sharing the same hobby – about the work he is doing. The more I heard, the more I had the feeling that he is - as he put it himself – ‘in the wrong business.’ He works in the Trust business, dealing not with ethics, but with all kinds of financial structures. It’s a business which has become quite an important sector in some Member States. It is also a funny name for a business where for many people the details of its activities often trigger the complete opposite of trust.

Some of the ugly sides to this business were revealed in the book *The Panama Papers*, whose authors, Bastian Obermayer and Frederik Obermaier, we interviewed for this Journal. Reading the book was like stepping into a different world. Quite convincingly, the two investigative journalists explain how the super rich of this world can cloak their wealth, shielding it from taxation anywhere in the world, with no real fiscal or legal checks whatsoever. Their book undoubtedly rings a bell for my friend, and probably several others in his line of business. This is a world in which a house for private use, for example in London, is owned by a trust on Jersey, registered to a company in Delaware, and managed by an ‘entity’ in the Netherlands. The main purpose is to sever the link between the owner and the property, at least in the eye of the law. Does this constitute fraud? It might be correct on paper; so legally you might just get away with it. But your gut feeling, or ‘thinking slow,’ as ECA Member Alex Brenninkmeijer argues in this Journal, tells you otherwise.

When we started work on this Journal’s theme, our initial intention was to zoom in on the issue of fraud and corruption. How much of an issue is it for the EU and its Member States? What action is undertaken to fight it and protect the EU budget against fraudsters? But we soon saw that we could not separate the topic of fraud and corruption from its antithesis, ethics and integrity. That is also one reason why this issue is so voluminous.

The more I read the many articles here, the more it became clear to me that there are two major aspects related to the fight against fraud and corruption. First, there is the repressive/punitive aspect, trying to correct the bad results of fraud and corruption that have been committed and to sanction the fraudulent behaviour and highlighted in this Journal by Michael Levi from Cardiff University. Second, there is the ‘preventive/solving’ aspect, trying to address the root causes of fraud and corruption: highlighting ethics and integrity issues, stressing values and training staff in ‘doing the right thing.’ This linkage is evident in the interviews we present with Commissioner Günther Oettinger, European Commissioner responsible for protecting the EU budget, with Ingeborg Grässle, MEP and Chair of the Budgetary Control Committee, and with Ville Itälä, Director General of the European Anti-Fraud Office.

The first aspect is very important and very necessary. After all, culprits need to be prosecuted and sanctioned to maintain trust in the system. This element of the fight against fraud gets into the public eye the most. Here, numbers are key; big data analytics gets increasingly important and investigators and prosecutors are the main actors, even if judicial procedures can sometimes be slow. The ECA has published a number of reports on this aspect of the fight against fraud, focusing mainly on EU spending but also on the revenue side.

The second aspect, ethics and integrity, receives less attention. Maybe this is because it is not so tangible and visible. What do ethics and integrity actually constitute? No numbers, no big hits against culprits. Instead, there are values, idealistic talk about doing ‘the right thing,’ not only what is legally correct, but also what morally seems good. This more non-digital topic has also attracted the ECA’s attention, not only in terms of our own internal organisation, but also in our assessment of the ethical framework in the EU institutions. That publication comes later in the year and is highlighted in the contribution from ECA Member Mihails Kozlovs.

But surely the second aspect is the solution to the first! Or, as the title of one of our articles starts: 'It's ethics, stupid! - or why legal is not enough.'

Punitive action against fraud and corruption is essential. But it is like pouring water into the ocean if we do not live up to the values that guide our actions in our personal, professional and social lives. It's even more of a waste if such ethical and integrity issues are not even discussed. This last point is difficult. Take the example of (illegal) tax evasion as compared to the (legally permitted) tax avoidance, of which some practices are morally questionable. Most likely, many of us know people who deal with taxation, sometimes on a daily basis: bankers, tax advisors, trust office employees, tax officers in the civil service making tax rulings, etc. Probably, they are nice people to talk with, to hang out with. But do we bring up the moral dimension of whether they are in the 'right' kind of business? Do we risk being labelled as arrogant moralists? Or worse, pathetic idealists...?

Do we actually walk the walk in our daily lives? This is one of the most difficult points: calling on people to live up to the values our society promotes, or at least promotes in public, for example when filling in their tax returns. How we score in the battle between self-interest and the ethical values we feel we have to live up to is an issue examined in this edition by Alexander Wagner from the University of Zürich.

To be sure, doing 'the right thing' is not necessarily easy and requires personal courage. When I try to live up to them, and would ask other people to do so – as I could with my friend in the trust business – I might find myself a rather lonely moral crusader. Even worse, there can be more dangerous consequences, as some brave investigative journalists have experienced. This is addressed in the article by Tom Gibson.

Ethics, and the discussion of them, can serve as a litmus test for the maturity of our society and our commitment to European values when it comes to fraud and corruption. What is positive is that ethical standards, and not living up to them, in business, in taxation, or in politics, are increasingly discussed in the political realm, and the discussion is having tangible consequences. This should not necessarily be seen as an indicator that the problem is getting worse, but rather that we are getting more honest in addressing it.



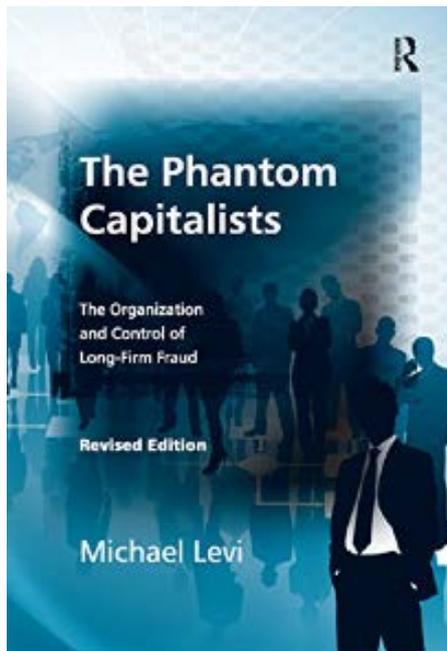
# Fraud and corruption in the EU - the need for a more multi-faceted approach

By Professor Michael Levi, Cardiff University

Do we take fraud as seriously as we should and are all means properly exploited to effectively reduce fraud and corruption? Michael Levi, Professor of Criminology at the School of Social Sciences of Cardiff University, has an international reputation in basic and policy-oriented research on money laundering, corruption, cybercrimes, transnational and white-collar crimes. Below he gives his views on what the focal points in the EU in this policy area are and could be, pleading for a more multi-faceted approach and looking beyond merely criminal investigations.

## Crime prevention and crime reduction

Are there similarities between auditing fraud and the procedures of criminal justice systems? Perhaps an unusual approach to this topic, but let's see in more detail. First, both audits and justice occur at some distance to the commission of crime, if they happen at all. Also, the probability of an audit may be more readily predictable than the interventions of criminal justice, and it tends to occur with more warning (and with different consequences). However, we shall see how useful the analogy is as we go.



In this book, published in 2008, Professor Michael Levi analyzes in detail how and why people become involved in long-firm (planned bankruptcy) fraud, the similarities and differences between long-firm fraud and other crimes, the links between bankruptcy fraudsters and other professional and organized criminals, the techniques that fraudsters use, and the social and commercial relationships that exist within the operational world of the long-firm fraudster, and how these have evolved historically.

Research – including fraud surveys by auditors and professional services firms - shows that external audit is an uncommon way by which corporate fraud is detected. But such observations neglect the counterfactual: what would the level of fraud be if there was no audit at all. We might think about this by conducting a thought experiment about what would happen if the audit function was totally corrupted or absent. Or, by looking around for countries where fraud and corruption are allegedly systemic on a national, regional and/or sectoral basis. Admittedly, this is an extreme way of thinking about the issues, since usually, what we are interested in are issues such as 'more or less audit' or 'more or less policing and prosecution.' The British phrase 'crime reduction' captures the pragmatic spirit of managing crime down better than the more absolutist and binary 'crime prevention:' a corruption or fraud-free society is implausible or would be likely to have far too high a cost in controls.

### **Objectives in fighting corruption and fraud?**

In the particular case of fraud and corruption, it also may matter what type of crime is committed by what status of offender. Looking at recent anti-corruption demonstrations in some EU Member States such as Romania and Slovakia, the perception – true or false – that elites are getting away with it needs to be addressed in its own terms, and is not likely to be mollified easily by official data about the number of frauds prosecuted or the amount of corruption prevented.

Indeed, those of us who believe in a rational world need to confront the ‘fake news’ mindset that resists what we might consider to be ‘authoritative data,’ whether on corruption or on more easily tested phenomena such as violent crime. This ties into a central issue of what our objectives are in the range of control mechanisms. Are they solely about plugging gaps in the control system, about financial savings targets (which tend to be quite complicated to measure but are possible with a basket of indicators), or is there some other objective such as enhancing the legitimacy of the European Union in the eyes of citizens by demonstrating that expenditure is properly controlled and – more difficult to test – is achieving the objects intended.

If it is legitimacy we are aiming for, what evidence are we using or ought to be using to assess the extent of ‘success.’ These lie outside the normal audit processes and are properly in the province of social sciences, including potentially the use of the Eurobarometer to illuminate public and sub-group perspectives, as used in cybercrime research<sup>1</sup>.

### **Perceptions of fraud and organised crime: social stereotypes play a role**

One of the paradoxical issues in how we view fraud and corruption is that they are often seen as separate issues from organised crime or even from each other. Most corruption involves false accounting, yet those who look at crime statistics on corruption seldom consider this overlap (which might require access to detailed case files to test). Since money laundering legislation applies to the proceeds of any crime, how do we differentiate the laundering of organized crime from other criminal activities, which include procurement fraud, tax evasion and grand corruption – all of which can sometimes involve committing ‘organized crime’ offences.

For example, the funnelling of billions of dollars stolen from the Malaysian sovereign wealth fund in the global 1MDB scandal (some of which, ironically, was used to fund the well-received fraud movie *Wolf of Wall Street*) was well organized. It is simply that the principal people involved – allegedly the Malaysian Prime Minister and his entourage, on trial there in April 2019, plus senior former Goldman Sachs staff - would not be viewed (at least then) by many respectable elites or by many police as ‘organized crime actors.’

We might extend this boundary problem to the ‘diesel-gate’ falsification of emissions, by the Volkswagen (VW) Group and other car makers. Arguably, this involved several actors planning how to commit crimes and get away with them over a long period of time for the pursuit of profit and power: criteria that meet the UN Transnational Organized Crime Convention 2000. Yet notwithstanding the criminal aggravated fraud charges in 2019 in Germany against the former chief executive officer and four managers of [VW](#), many readers would balk at the idea of labelling senior executives of major corporations as ‘organized criminals,’ though others might complain if we did *not* so label them for their allegedly intentional deception<sup>2</sup>.

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1 Williams, M. (2016) Guardians Upon High: An Application of Routine Activities Theory to Online Identity Theft in Europe at the Country and Individual Level, *The British Journal of Criminology*, 56(1): Pages 21–48, <https://doi.org/10.1093/bjc/azv011>

2 Levi, M. (Forthcoming). Theoretical Perspectives on White Collar Crime. In *Oxford Research Encyclopedia of Criminology and Criminal Justice*, ed. Henry Pontell. New York and Oxford: Oxford University Press. doi:10.1093/acrefore/9780190264079.013.266

To some extent, the issue is our stereotypes of social class and status. Whether or not the European Central Bank chooses/is allowed to do anything much about it to coordinate supervision (as was done globally after the Bank of Credit and Commerce International collapse in 1991), the investigative media exposure of 'Operation Laundromat' and subsequent scandals such as Danske Bank and Swedbank, shows cross-ties between politicians, organized criminals, professional crime enablers and bankers in Russia, the Baltic States, and other neighbouring countries and international finance centres, including London and New York.

These ties could offer some possible points of intervention after the fact, without necessarily needing to prove what particular crimes - if any - the suspected criminal funds came from. The U.K.'s adoption of Unexplained Wealth Orders in the Criminal Finances Act 2017 is one possible route for intervening against fraud and corruption funds, though it has been used in very few cases so far and there is a risk that it will only be used in sensational overseas cases.

### **Symbolism and effectiveness: criminal and administrative measures**

There is a need for holistic thinking about the prevention of fraud and corruption in which both criminal and administrative mechanisms are merely tactical tools of control alongside others. Of course, one cannot ignore the symbolic meaning of the criminal law – at least to campaigning groups and NGOs - and within the EU and elsewhere, the different formal criteria and administrative paths that criminal and noncriminal routes require. This includes the thorny question of the exchange of administrative data within the EU. If companies and individuals – in their own names or as beneficial owners - have poor track records of performance including cost overruns and insolvency, any rational commercial contractor would want to know that.

Given the global preference for administrative and regulatory measures to deal with possible 'white collar crimes' (even in legality principle countries), most sanctions will not be criminal and the question arises of whether such data can be properly communicated within the EU. We must also bear in mind that some of these sanctions as well as criminal ones can be subject to politics and to resource constraints. Negative stories about companies in the media – which *are* taken into account by banks in the due diligence procedures of anti-money laundering – can be true, but they can also be distorted and planted as 'spoiling tactics' by influential oligarchs who own newspapers in some EU member states.

### **Fighting fraud and corruption requires better data**

In the public procurement or EU grant making process, previous administrative sanctions (including tax violations) in principle have to be declared by the person themselves in the same way as criminal convictions, etc. Persons have to confirm and sign that they have no such impediment. However, there is no central data base for administrative exclusions and penalties, so this cannot be checked other than by a media search, which will not yield all sanctions, and may not be routinely undertaken anyway.

There might be strong lobbying against such a data base. The impact of the administrative penalty/exclusion has to remain proportional, and it could be argued that it may no longer be so if it spreads from one Member State to the whole EU. From Member State to Member State, personal data exchanges are governed by relevant data protection legislation. The EU directive sets out rules for transfers within the EU and outside the EU. An administrative agreement might not be required as long as data protection rules are respected, but regime differences do not make this seamless. It seems likely that the European Court of Justice would not prioritise data protection over fraud prevention – the UK has always had a specific exemption for crime prevention - but there might have to be an appeal to clarify this at an EU level.

Data about fraud and corruption as a whole are difficult to generate, let alone about individuals. And when the EU had embarked to produce a biennial Anti-corruption Report, it was abandoned after its first edition issued in 2014. Moreover, this first and only edition

was a regrettable symbol of the reluctance of EU institutions to evaluate themselves and their Member States.<sup>3</sup>

### **No time for institutional battles over legal competencies**

But so much energy is taken up in fighting institutional battles over legal competency and symbolism that we risk losing sight of the practical differences that criminal and administrative measures generate (or not). In terms of the punishment of offenders, corporations of course cannot be sent to jail; individuals can, but only if they can be tried and convicted which, in politically connected cases, may require independent investigators, prosecutors and judges as well as well-designed criminal legislation. The expertise within the prospective European Public Prosecutor's Office (EPPO) will be welcomed by those bodies motivated to pursue fraud against the European Union. Significantly more difficult is the situation in which the EPPO considers that there are strong grounds for prosecuting but the local/national prosecutors (and perhaps political elites with a personal and/or party financial interest in the proceeds of corruption) do not.

There is also the serious matter of how scarce investigative and prosecutorial resources are going to be allocated between EU fraud, other forms of fraud, and other crimes. There are no parallel audits in other countries to draw on, but recent British studies have emphasised the dire state of online and off-line fraud investigation and prosecution in the UK.<sup>4</sup> By what criteria and mechanisms then can it be decided (and by whom?) that EU frauds should take priority in those jurisdictions over other frauds or non-fraud crimes? Even legality principle countries have to decide on their priorities between different types of case: the question is whether they do so explicitly or not.

### **Prosecution and sanctions vs. administrative measures: what is more effective?**

What evidence is there for considering that prosecution and particular forms of sanctions are more effective than administrative measures? In legitimacy terms, the argument appears to be more strongly in favour of criminal measures because those are the measures that people most commonly associate with harmful wrongdoing. This might be true even if there were evidence - *and this was accepted by the public* - that this leads to longer investigations and less redress of harm to victims, including the EU budget itself.

In practical terms, the arguments are weaker, especially for corporations that anyway cannot be imprisoned. One of the problems is the absence of criminal (and administrative violations) careers data for fraud and corruption offenders compared with other mainstream offender data.<sup>5</sup> So this makes it more difficult to assess the relative impacts of formal interventions. Randomisation of sanctions also would not be politically palatable. The famous regulatory sanctions pyramid, developed by Ayres and Braithwaite,<sup>6</sup> was designed to minimise pointless punitivism and maximise cooperative change, and UK equivalents such as Deferred Prosecution Agreements were not designed for what I termed 'pre-planned fraudsters'<sup>7</sup> who need to be prevented from contracting or closed down rapidly rather

3 Yet it remains politically feasible to produce a supra-national assessment for the EU as a whole, without specifying particular countries, on "the risks of ML and TF affecting the internal market and relating to cross-border activities". See <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017DC0340&qid=1523880011076&from=EN>. The only mention of corruption in all the documentation (SWD(2017) 241 final) refers (at p.270) to the 4MLD relevant risks in *third-party* "countries identified by credible sources as having significant levels of corruption or other criminal activity".

4 HMICFRS (2019) *Fraud: Time to choose - An inspection of the police response to fraud*; Levi, M., Doig, A., Gundur, R. Wall, D. and Williams, M. 'Cyberfraud and the Implications for Effective Risk-Based Responses: Themes from UK Research', *Crime, Law and Social Change*, 67 (1): 77-96.

5 Levi, M. (2010) 'Serious tax fraud and non-compliance: A review of evidence on the differential impact of criminal and non-criminal proceedings', *Criminology and Public Policy*, 9(3): 493-513; 'Hitting the suite spot: sentencing frauds', *Journal of Financial Crime*, 17(1): 116-132.

6 Ayres, I. and Braithwaite, J. (1992). *Responsive regulation: Transcending the deregulation debate*. Oxford University Press.

7 Levi, M. (2008) *The Phantom Capitalists: the Organisation and Control of Long-Firm Fraud*, 2nd edition, Andover: Ashgate

than be given graduated warnings and advice, which they will ignore and lead to greater victimisation. Administrative measures need to be toughened up and those implementing them need to be bolder and more imaginative if they are to be considered a reasonable substitute for criminal proceedings.

### **Fighting fraud and corruption: a perpetual struggle**

A useful way of thinking about organized fraud prevention is to separate out full-time organized criminals; the procurement processes for contracts and their supervision and auditing; the facilitation of their activities via otherwise legitimate or semi-licit legal and accounting professionals; and transport logistics for crime proceeds. Some sophisticated efforts have been made to test the susceptibility of financial services intermediaries to international requests for different types of laundering.<sup>8</sup> But these have examined only the initial responses to contacts from strangers, and not the full laundering cycle or relationships between *repeat* players, which are more difficult and more expensive to investigate.

There has been very little interest within the money-laundering or the corruption evaluation community in such market survey techniques of vulnerability (or greed), and only intermittent interest in using sophisticated datasets to seek out corrupt relationships in construction and other contracting.<sup>9</sup> Note that this is commended as a way of testing *corruptability*. It is a separate question whether this can be translated into evidence or via proactive 'sting operations' which would be unlawful *agent provocateur* methods in many EU Member States. The data leaked in the Panama Papers and Paradise Papers appear to have been exploited variably by different EU and non-EU Member States, and more systematic studies of the effectiveness of this exploitation are required.

Other favoured areas for development are whistle-blower hotlines and protection, but occupational and social stigma effects on whistle-blowers are legion, and Europe has not yet chosen to advance along the US path of high rewards even for conspirators in tax and corruption cases. Protecting economic confidentiality appears still to be seen as a priority over exposing criminality, for example in Luxembourg. The Organized Crime and Corruption Reporting Project is doing a superb job of illuminating many areas of dark behavior, but aggressive shamelessness among the political classes in some EU and non-EU Member States means that sunlight does not automatically disinfect.

The multi-pronged administrative and criminal approaches highlighted above, to be supplemented by the EPPO even in its partially de-fanged state,<sup>10</sup> need to be part of a perpetual struggle to make EU funds cleaner and enhance their legitimacy.

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8 Findley, M. G., Nielson, D. L., & Sharman, J. C. (2014). *Global shell games: Experiments in transnational relations, crime, and terrorism*. Cambridge University Press.

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# European values – we all have to fight for them!

## Interview with Günther Oettinger, Commissioner for Budget & Human Resources

By Gaston Moonen



Commissioner Günther Oettinger (right) being interviewed

Within the European Commission, there is one Commissioner specifically responsible for protecting the EU budget from fraud and corruption: Günther Oettinger. Since early 2017, in his second term as Commissioner, his responsibilities have included managing the budget and reporting to the European Parliament on how the EU budget is spent, but also protecting the EU budget from fraud and corruption. How does he see the Commission's role and what does he consider to be key issues in the fight against fraud and corruption?

### Aiming for European solutions to act on a global playing field

*When you think about fraud in the EU context, what comes to mind immediately?*

**Günther Oettinger:** To preserve and promote trust in the European Union from our citizens and taxpayers, we must all work together to ensure that the EU budget is spent in a regular manner; this is not optional – it is a must! Obviously, this includes fighting fraud and corruption. And we need to be successful in order to gain that trust. I believe we are already doing a lot. We are not yet at the end of our efforts but we are certainly doing a lot to reduce fraud and corruption against our EU budget year by year. Here, several institutions have their own responsibilities. Firstly, the European Commission, since we are the executive arm of the EU. Secondly, the European Parliament, and its Budget and Control Committee. And I can tell you that they are doing a lot, they are highly committed. Thirdly, the ECA, with its own specific powers and expertise as the EU's external auditor. Investigating and analysing the situation on the ground through its on-the-spot checks and presenting its reports not only to the European Parliament, the Council and the Commission, but also to all EU citizens. And sometimes giving us critical comments, sometimes constructive advice, or a mix of both. Finally, the Council monitors us, since a lot of our revenue comes to

“ ... ensure that the EU budget is spent in a regular manner; this is not optional – it is a must!

the EU budget through national contributions from the Member States. So it is a mix of institutions and I think we have been quite successful. But we can do better and are working to do so.

*You have been Commissioner for Digital Economy and Society, and earlier on in your career, you also worked in accounting and tax consultation. So you have seen the power, and perhaps also the limitations, of numbers. Digitalisation nowadays also means being able to deal with Big Data. At the same time, there is a concern about protecting this data: data security. What kind of role do you see data security playing in the fight against fraud and corruption in the EU, and what can institutions do to address the concerns of citizens that they may be increasingly exposed, and thus vulnerable, in an ever more digital society?*

**Günther Oettinger:** Let me first say that not all policies have to be 'Europeanised'. However, seeing the digital revolution and the digital policies we need for that, I believe we urgently need to achieve a digital single market. We have to speak expressly about a digital Union. In our Union, we have to achieve a free flow of data because, on the one hand, we have to use data. On the other hand, we need to protect the data of our citizens and our businesses. And, since 2018, we have had a European General Data Protection Regulation, which applies directly in all Member States. It is about data security in our storage devices, our cloud systems, our computers, and generally in our digital infrastructure.

So data protection and security are two European challenges, and we have to continue to Europeanise these policies, achieving higher standards while looking at how to defend European values. Because data is about our citizens, it is about our economies. Therefore, we have to secure our European data, and we have to arrive at our own European digital sovereignty. Nothing against national sovereignty, but knowing Silicon Valley, knowing global players, knowing what is happening in China, the discussion about Huawei and 5G, we should always be seeking to arrive at European solutions. What we absolutely do not need are 28 different solutions, presented in fragmented silos, across our Union.

“ So data protection and security are two European challenges, and we have to continue [...] achieving higher standards while looking at how to defend European values.

### **Human beings at the heart of European values**

*Taking this image of fragmented silos: when we speak about values, including ethical values, are they fragmented in the EU, is there competition between the Member States in upholding certain values, or perhaps doing the contrary? Is there perhaps competition in values between different regions globally?*

**Günther Oettinger:** I certainly think there are European values, including in relation to ethics. In Europe, after centuries of wars, and certainly with the last World War for which Germany was responsible, we have learnt our lessons. Since then, Europe has been a continent of peace and a community of values. Our human values are in the centre of our actions: democracy, a social market economy and the rule of law. But at the forefront are human values, the well-being of our citizens is our focal point. Looking beyond Europe, we have to accept that there are different developments in other regions of the world, in other countries. Take for example certain countries in Asia, or China, or the US. Some of them are near to us in this regard, some of them rather different. We have to accept this. But we have and will defend our European values. If we think they are good for our next generation, we have to fight for them!

“ ... at the forefront are human values, the well-being of our citizens is our focal point. [...] we have to fight for them!

*You underlined the issue of human values, which are often considered crucial for a democracy to function well. To what extent do these human values have an impact on ethical behaviour and integrity? We have seen, for instance, the Panama Papers, Luxleaks, etc. Here, several European citizens, well known ones in some cases, have been exposed regarding ethics and integrity. What was the core problem and how does this tie in with human values?*

**Günther Oettinger:** We can see here that, on the one hand, ethical values come into play, and on the other hand, financial interests. But you cannot separate them, really. They are actually common to many of the problems we find. If there is corruption, or tax dumping, or if there are other criminal activities: we are acting against each other; in other words: the exact opposite of a Union of solidarity, burden sharing, fair competition and transparency. Such a development risks destroying our values and our ethical foundations – if, in our daily economic life, people are acting in a corrupt manner or benefitting unduly or illegally from our European financial programmes, the European Union as we know it will no longer exist.

### **Commission fighting against unfair practices**

*Corporate corruption can pose a threat to the internal market because it infringes on fair competition. What can the EU do about it?*

**Günther Oettinger:** When it comes to threats to the internal market due to lack of fair competition and due to corruption, it is first and foremost the European Commission which has to fight these. As the Commission, we have a clear responsibility, an obligation to defend our Treaty. As the European Commission, we are standing up as a guarantor of fair competition. That is how the single market can benefit everybody. So it is the Commission that checks whether something is going wrong, whether inside the EU or globally with unfair practices coming from outside the EU.

“ *When it comes to threats to the internal market due to lack of fair competition and due to corruption, it is [...] the European Commission which has to fight these.* ”

Of course, we, as the Commission, have to be objective. If there is a rumour, if there is anything which looks like a threat to fair treatment, we have to investigate it, but in an objective manner. And here I trust OLAF, our Commission service with a specific role in fighting fraud, and its expertise to completely investigate the case. The next stage is the European Public Prosecutor's Office, or EPPO. We are now in the process of setting up the EPPO, which is a huge step, and we hope to be ready by the end of 2020.

A third point is that we have to be transparent: to the European Parliament, the Council, the ECA, and, at the end of the day, to our citizens. I also think that politicians have a particular responsibility in this regard. Politicians are of course citizens. But if you are a Member of the Commission, a Member of the European Parliament, a minister or a mayor, you have an additional obligation. So you have to be extremely vigilant if you hear about corruption or a mafia network; this needs to be looked into. We have to investigate this as thoroughly as possible.

### **Added value of external audit**

*In the fight against corruption, where do you see the ECA's key added value, not least in light of the special report on fighting fraud in EU spending the ECA published earlier this year?*

**Günther Oettinger:** From my former life in Baden-Württemberg, I am familiar with external auditors at regional level in Germany, the Landesrechnungshöfe. I am also familiar with the Bundesrechnungshof at national level. And I know about the ECA and the work of President Lehne, the Members and the auditors. What a Court of Auditors does is give a mix of critical statements and constructive advice. I can tell you, I am not always happy with every report, because sometimes I wonder whether addressing certain things is really a 'must'. But in general – and I'm not just saying this because you are from the ECA, but rather because it is my conviction after a rather long life in politics – I think the expertise of the ECA is excellent. The ECA is a kind of advisory board and my people often say: 'That is a relevant finding with a clear conclusion, and we should use it immediately, because it can make our EU more competitive and better geared towards the interests of our citizens, and build trust and confidence.'

“ *... in general [...] I think the expertise of the ECA is excellent.* ”

As for the report you refer to: I took note of the report and accepted it. Let me put things into perspective. Many of our instruments within the EU framework are quite new, and some of them have their limitations. OLAF is quite new – it has been operational for about 20 years. But year by year, we have strengthened OLAF, step by step. And one has to realise: we have a limited number of officials. It is our budgetary authorities that ultimately decide on the allocation of resources. I could use at least 200 more investigators in OLAF. But there are limits on increasing staff numbers. A second important point is that many of our programmes are realised under shared management. And EU action is managed also at national, regional and local level by bodies and officials in the Member States. So we are dependent on their willingness, readiness and ability to make the best use of our EU money, and to do so efficiently. Shared management means shared responsibility, which requires strong cooperation from both sides.

### **Commission not yet where it wants to be**

*One of the best known types of fraud relates to tax evasion and money laundering. The International Monetary Fund has calculated this type of fraud for members of the Organisation for Economic Cooperation and Development to be in the region of US\$600 billion per year. Is this an area where the Commission can step up its actions?*

**Günther Oettinger:** Although taxation is typically an area where Member States are active, I think it would be in the interests of the Union, our Member States and all our institutions to strengthen our instruments and powers here. And we are doing so. Take, for example, our Directorate General responsible for the Commission's policies on taxation and customs. It is a quiet, yet strong part of the Commission, headed by my colleague Pierre Moscovici. And indeed, when he started more than four years ago, this department was not so strong as it is now. But there is still a long way to go and we have not yet reached the end of the story.

“ [about taxation] ... I think it would be in the interests of the Union [...] to strengthen our instruments and powers here.

# Calling for strategic fraud management

## Interview with Juhan Parts, ECA Member

By Derek Meijers and Gaston Moonen



Juhan Parts, ECA Member

The ECA's special report 1/2019 assessed the state of the fight against fraud in EU spending. Juhan Parts is the reporting Member for this report, which received considerable attention from ECA's institutional stakeholders. He explains his interest in the topic, analyses the current state of the EU's anti-fraud strategy and highlights the report's main recommendations for the Commission and the EU Anti-Fraud Office, OLAF.

### Pay attention to fraud...

ECA Member Juhan Parts has extensive experience with combatting fraud, or in what he calls 'a never-ending fight against it'. Juhan Parts: 'In the 25 years before I came to the ECA, so basically during all my professional career, fraud and corruption have always been somewhere on my agenda. In Estonia in the 1990s, I was directly responsible for setting up a new justice system after the fall of communism. My responsibilities as deputy Secretary General included the development of a new legal framework and the government's anti-corruption strategy. So I always had to deal with the topic in one way or another in my different posts, and in Estonia in the 1990s, fraud and corruption, just as anywhere else, was important to tackle!'

Juhan Parts is a passionate and committed proponent of anti-fraud measures and a fierce opponent of fraudsters, underlining that it is essential to root out all forms of fraud and corruption in society. 'The lower the levels of fraudulent behaviour are in government and public administration, the cleaner the business world is and the better it is for your country's economic development.' He explains: 'Take for example the Transparency International Corruption Perception Index, the CPI. One point there equals one percent point GDP growth. So, in general, when there is less fraud, an economy is better developing.'

“ ... in general, when there is less fraud, an economy is better developing.

Juhan Parts underlines that anywhere you go, the economic situation will profit from anti-fraud measures. 'The research we did in preparation for our special report 1/2019: *Fighting fraud in EU spending: action needed*' showed this as well. Something we need to keep in mind when talking about EU investments and fraud risks. Money can bring

good or bad ethics.' He recalls to have seen this in Estonia as well, where the first wave of foreign investments after the era of communism came from neighbouring Scandinavian countries. 'The important lesson was that these investors did not only bring their money, but also their business ethics, which had a very positive effect on the advancement of the Estonian economy.' In this context, Juhan Parts sees a clear role for the EU. 'If the EU distributes its funds through different programmes, we should aspire to spread good ethics as well. Otherwise we should not distribute EU funds. And the EU should show the necessary vision and leadership to address these issues.'

“ If the EU distributes its funds through different programmes, we should aspire to spread good ethics as well.

### ... because it is a fact of life...

Juhan Parts thinks the ideal of a fraud-free society neglects basic features of human behaviour. 'In all cultures you can encounter different types of behaviour. The EU therefore faces a lot of different challenges when deciding on policies to address the numerous realities it has to deal with in all parts of the world.' He points out that one very difficult question is how to deal with corrupt and fraudulent governments. 'Should we subsidise or support such governments? Should we accept their behaviour is not in accordance with our values, although we do not accept that in our Member States, simply because we want to support development projects for the people there? Can we justify spending EU taxpayers money in such countries, even for good projects, when some of the money might end up in the hands of corrupt politicians?'

For Juhan Parts, the answer to these questions is clear. 'If we want to promote our European values worldwide, we have to take the current geopolitical problems into account.' In this context, he notes the increasing number of authoritarian regimes that are emerging around the world and that such regimes are often kleptocracies in which corruption is widespread. 'These developments create enormous problems and hinder development and the increase of well-being around the world. And I believe the EU should take a firm stance here and, quite literally, put its money where its mouth is. And with this I do not only refer to our aid to third countries. This first and foremost should apply to our actions, financial support and investments within the EU.'

'Fraud cases,' Juhan Parts continues, 'regularly receive a lot of attention in the media, and rightly so. People tend to say fraud is a sensitive topic and they falsely assume that if a fraud case linked to EU funding appears in the news, the public will think the entire EU is fraudulent. But this is not true!' He argues that it is of course sad that some people commit fraud sometimes and that there are many reasons and causes for this behaviour. 'But instead of trying to keep the lid on, I would argue we have to be transparent and react professionally. Show that we have a robust anti-fraud management framework and strategy and that we take the necessary measures to prevent, detect and fight fraud. This is a question of leadership, drive and vision.'

### ... also in the EU

Eurobarometer surveys show that more than 71% of EU citizens believe that in many cases, the spending of EU money involves some form of fraud. Juhan Parts: 'Let's analyse that. I know there are some officials that say these people are wrong, or that these figures are anti-EU propaganda. But I can assure you that the one thing I learned as a politician is that the citizens are never wrong!'

He is not surprised that many EU citizens think this way. 'The EU must ask itself: what causes our citizens to worry? I believe these worries stem from real-life experiences.' He explains: 'In many places, our citizens see projects that are funded with EU money. For example, agricultural subsidies, infrastructural works or research projects. And many of those citizens might also have heard stories about people taking undue advantage of such EU funding.'

“ ... I learned as a politician is that the citizens are never wrong! [...] [their] worries stem from real-life experiences.



Juhan Parts gives the example of fraud in public tendering, which is one of the main fraud risks for the EU. 'This is an obstinate problem. Take for example a public procurement that is rigged by three bidders that are connected to each other. There will be dozens of businesses around them that know about it, and these will say they do not stand a chance in public tenders because the competitions are fake. If we fail to address such problems, if we cannot ensure fair competition and level

playing fields, it will have substantial effects on our economy. Moreover, people will lose trust in the EU and its institutions. And rightly so!'

### Complex rules as a cause of fraud

On the topic of the causes of fraud in EU expenditure, Juhan Parts notes that there are of course many different causes, but that scientific research clearly also points at the complexity of certain EU rules. 'As we mentioned in our fraud report, some of the experts we consulted highlighted the possibility of a causal link between the complexity of rules and fraud. What is really worrying here, is that this complexity does not only provide professional fraudsters with loopholes to circumvent the rules, in some cases it might also force otherwise honest citizens to behave dishonest!'

“ ... possibility of a causal link between the complexity of rules and fraud.

To illustrate this, Juhan Parts gives the example of EU funding for university programmes on a very technical topic, where the subsidy would only be paid in case the course would be attended by a minimum of 15 participants. 'The field of studies is a niche, so in any country, only a handful of academics would be working in that area. So imagine how difficult it would be for a small university in a small country to find enough qualified participants. We have found cases in which the university would add the names of other students in order to become eligible for the subsidy.' Juhan Parts emphasizes that he obviously does not approve such behaviour, but that he can understand what causes it. 'In my opinion, one-size-fits-all legislation does not work in real life as complex conditions can lead to unintentional fraud when people try to adjust their situations to fit the rules. We also hear this message from national authorities, and I think it should be one of the main points the European Commission needs to take into account when redeveloping the EU fraud risk management strategy.'

### The scale of the problem

A recurrent issue in the discussion about fraud risks in EU expenditure is the lack of reliable information about the number of fraud cases and the amounts involved. Juhan Parts, citing the recent ECA report: 'The Commission does not have comprehensive data on the scale, nature and causes of fraud. Its official statistics on detected fraud are not complete and it has so far not carried out any assessment of undetected fraud.' He laments the lack of a detailed analysis to identify what causes some recipients of EU money to behave fraudulently and underlines that this lack of information reduces the practical value of the EU's fraud risk management strategy.

“ The Commission does not have comprehensive data on the scale, nature and causes of fraud.

Juhan Parts: 'You can manage fraud risks if you can measure them and to measure them you need to know where to find them. So to manage the scope of fraud in expenditure, we recommended the Commission to develop a proper fraud risk management strategy and to use tailor made models to define the scope of the fraud.' The ECA Member repeats that the report's recommendations are in line with academic research, in which scientists often propose the use of two types of measurements. Juhan Parts: 'Experts usually advise to use specific surveys that show what fraud could amount to in procurement,

and to apply different methods to research big data, also to estimate the impact of the different risks. Whatever EU programme or legal act is initiated or adopted, if there is a financial consequence, they should be accompanied by a proper fraud risk impact analysis. Sadly, however, this is not the current practice.'

In response to the ECA report, the Commission acknowledged the need for a well-informed fraud risk assessment, and a robust fraud risk management strategy, which it announced to develop in the near future. Juhan Parts explains further: 'Our dialogue with the Commission was interesting. Everyone agreed this is necessary. But we also pointed out it took them a very long time to get to this point. After all, the Commission promised the European Parliament already in 2010 it would come up with a strategy as from 2022. So after quite a long period in which it displayed a lack of drive and serious political will, it is about time that the Commission shows leadership and steps up its fight against fraud in EU spending.'

### Inapt anti-fraud toolbox

In its special report on fraud in EU spending, the ECA also looked at the Commission's anti-fraud strategy and its fraud prevention tools, including EU Anti-Fraud Office (OLAF). Juhan Parts: 'Our conclusion was that OLAF's results are rather poor, to which they replied is that they are actually doing a pretty good job, but that national law enforcement agencies do not take them seriously and that the Commission's Directorates General (DGs) do not recover enough.'

For Juhan Parts these poor results can be partly attributed to OLAF's set-up as well as to its mandate and working methods. 'This is such that it can never be effective. First, for financial recoveries, it sends recommendations to the individual DGs, who may then decide whether or not they will do that. Second, OLAF sends national prosecutors information about fraud cases and recommendations to prosecute people.' He continues: 'But OLAF has no final responsibility. It is only sending recommendations and that is the reason its results are so poor! So our report points out that OLAF lacks the power or responsibility to defend their findings in front of a court of law.'

“ ... our report points out that OLAF lacks the power or responsibility to defend their findings in front of a court of law.

Juhan Parts: 'Another problem is OLAF's mandate. We talk about hidden crime here, and OLAF is an investigative body, not a police force. But it does not have a sufficiently robust mandate. It cannot take documents forcefully, check bank accounts, or carry out intelligence work, etc.' He continues: 'So how could anyone expect OLAF to be able to carry out its investigations effectively and successfully without such powers?' Juhan Parts concludes that OLAF has no responsibility for real outcomes, no real power, and no opportunities to achieve its mission. 'And with real outcomes I mean prosecuted people or recovered money.'

### Filling the gaps at OLAF

When discussing how to address the gaps in OLAF's set-up, Juhan Parts starts from a taxpayer's point of view. 'OLAF is the nucleus of the part of law enforcement that protects the EU's financial interest against fraud. So there is a big expectation gap between what OLAF is doing – or is able to do – and what people think it is or should do.' In this context, Juhan Parts notes the ECA fraud report comes up with a number of options. 'Considering its legal possibilities, OLAF should take on a coordinating role to help Member States' law enforce systems to investigate fraud cases and prosecute fraudsters.'

“ ... there is a big expectation gap between what OLAF is doing – or is able to do – and what people think it is or should do.

Juhan Parts explains that, in practice, this would mean that when OLAF discovers a fraud case, it should not start its own investigation. 'Instead, it should contact the proper law enforcement and prosecution bodies in the Member States and forward the case to those bodies. That would be a logical step, as, also in the current situation, if a fraud case ends up before a judge, the proceedings will always take place in front of a national criminal court, as there is no EU criminal court.'

This approach and a coordinating role would make a lot of sense, also in the light of the newly established European Public Prosecutors' Office (EPPO), which will set up offices in 22 Member States. Given the fact that fraud cases are often cross-border Juhan Parts argues: 'OLAF should coordinate, facilitate, and provide information. And it should do so systematically, not only case-by-case. In addition to this, OLAF should monitor Member States' capacity to investigate and prosecute fraud, assess the independence and effectiveness of national law enforcement bodies, and keep track of how many people are convicted and how much money is recovered.' He gives an example: 'At present we have no idea how many national investigators are investigating suspected fraud cases that involve EU money. So it would be very useful if OLAF were to monitor that.'

Further to this, Juhan Parts explains that the EU Treaty stipulates that Member States are obliged to take effective steps to fight fraud. 'However, currently we do not have a mechanism to check how governments address this Treaty obligation, but OLAF could do that.' He adds: 'In that case, it could inform the Commission which countries do not put in place the necessary capacity to investigate and prosecute fraud. The Commission could then reduce, or stop, its funding to protect the taxpayers' and EU financial interests. If you add this to an increase in prosecuted fraudsters and recovered money, the EU's fight against fraud would become a lot more successful. And, most importantly, having such a robust framework of fraud prevention, detection and prosecution would have a strong deterring effect on potential fraudsters.' He highlights that these fraudster would think twice before attempting to defraud the EU when the chance of being caught would be much higher than in the current situation. 'After all, strategic fraud management is only effective if you have effective law enforcement.'

“ [on effective steps to fight fraud] ... currently we do not have a mechanism to check how governments address this Treaty obligation, but OLAF could do that.

### 'The ECA's role in the fight against fraud'

Auditing the EU's anti-fraud strategy and its tool-box induced the ECA to also consider its own role in the fight against fraud in EU spending. In doing so, Juhan Parts starts from another expectation gap. 'Just as OLAF, we might think we are doing alright, but our stakeholders or the EU citizens might have totally different expectations. Imagine a situation in which they think we are doing tasks A and C. And the public wants us to do A, B and C. While we only do A and B. This quickly leads to an expectation gap.' Juhan Parts: 'Auditors are not a police force or part of the law enforcement branch. So auditors have a different role in the fight against fraud and we have to communicate this clearly.'

“ Auditors are not a police force or part of the law enforcement branch. So auditors have a different role in the fight against fraud...

According to Juhan Parts an external audit body (such as the ECA) will never have the deterring effect necessary to keep people from committing fraud. Apart from this he points out that the goal of an audit is different from that of a fraud investigation. 'However, we still need to address fraud and corruption in our financial, compliance and performance audits, for example through automated data analyses for financial audit. But it will not scare many fraudster. To do so one needs a pro-active policing power to actively and effectively take on fraudsters.'

The ECA Member definitely sees opportunities for the ECA to contribute more to the EU's fight against fraud. 'Through our work, we can provide important information which the Commission could then use to recover funds and to improve its fraud risk management.' He gives the example relating to the ECA's Statement of Assurance. 'Take our annual report. Imagine we would manage to successfully develop our data analytical skills to the point where we would be able to check the entire audit population, so every individual transaction, linking all available databases, also national ones. This would provide us with a complete image of the scope of irregularities and a mine of information about underlying patterns.'

Juhan Parts adds that irregularities may not be the same as fraud, but that performing a comprehensive annual data analytical audit would obviously also benefit the fight against fraud, because it would provide insight in which types of rules, programmes, and management structures are effective. Juhan Parts: 'And although we are not at that point yet, I see a lot of potential and I can imagine the Commission could use the ECA's future audit reports as a continuous benchmark to establish the minimum quality criteria for its fraud risk management strategy.'

### EU and fraud outlook – what needs to be done

Summing up the main actions that need to be taken to improve the fight against fraud in the EU, which were also put forward in the fraud report. Juhan Parts starts recommending that the Commission should put in place a robust system to report on fraud and provide comprehensive information on the scale, nature and causes of fraud. 'Based on that information it can then develop a new fraud risk management strategy.' Secondly, he points out that the Commission needs a system of strategic fraud prevention and that it should clearly place the responsibility with one person. 'Currently, no Commissioner has the final responsibility for strategic fraud management at the Commission. But without leadership and top level engagement there is no hope some serious changes will be made. Therefore we think somebody should have that final responsibility.'

Fraud prevention is the third step towards a more effective anti-fraud system in the EU. Juhan Parts: 'The Commission should do more to prevent fraud from happening in the first place and setting up a system for early detection is one of the possibilities we suggested in our fraud report.' Finally, he sees the reform of OLAF as a major step in the fight against fraud. 'I believe the reform will prove to be the litmus test. Reconsidering OLAF's role and responsibilities is essential for the EU to become more effective in combatting fraud in EU spending on all levels, also in light of the establishment of the EPPO.'

### EU's long term objectives in the fight against fraud

Concluding the interview, Juhan Parts considers there are three achievements the EU should strive for in its fight against fraud. 'The first would be to bring the amount of fraud cases down substantially, for example by establishing new and reinforcing existing fraud fighting bodies. Juhan Parts: 'Our law enforcement structures should be so effective and the risk of being caught so high that fraudsters do not even dare to try to defraud the EU.'

“ Our law enforcement structures should be so effective and the risk of being caught so high that fraudsters do not even dare to try to defraud the EU.”

Secondly, he calls for measures that reduce bureaucratic complexity that could force ordinary people to behave fraudulently. 'Simplifying the rules has many benefits, as the current Commission also recognised when it formulated the objective of better regulation, and reducing fraud is one of the most important reasons to do that.' Finally, Juhan Parts underlines that the different law enforcement structures on EU and Member State level should be set up in accordance with the highest professional standards. 'This would mean the end of empty political debates about whether or not the EU should fund projects in countries that do not want to follow the rules, or where there is not enough capacity to ensure every single euro of EU taxpayer's money is spend according to the rules. The decision to stop funding should be a professional, not a political one. And everyone should respect that decision!'

# ECA Opinions on the Commission's legislative proposals for fighting fraud

By Eva Lindström, ECA Member



Eva Lindström

The ECA regularly provides Opinions on new proposals for EU legislation. In 2018, as requested by the Parliament and the Council, the ECA published two Opinions in the area of fraud: one on the Commission's proposal relating to the new EU Anti-Fraud Programme and another one on cooperation between OLAF and the European Public Prosecutor's Office (EPPO). In this article Eva Lindström, who as ECA Member was closely involved in preparing these two Opinions, explains what they are about and what the ECA considers to be some of the key issues in the EU's fight against fraud and corruption.

## Better internal controls – less errors

Internal control of EU spending has been strengthened significantly in the last ten years. The increasing effectiveness of the European Commission's and the Member States' internal control systems is also illustrated by the year-on-year decrease in the ECA's estimated level of error in payments, which can also be seen as an estimate of the degree to which spending does not comply with the EU's financial rules. For the third year in a row, our audit work in the context of the annual Statement of Assurance (SoA) shows a decreasing level of error in EU spending: for the financial year 2015, the estimated level of error in payments amounted to 3.8 %, in 2016 it was 3.1 % and in 2017 it was 2.4%.

For the 2017 SoA exercise, our auditors examined around 700 transactions. Of these we handed over 13 to the EU Anti-Fraud Office (OLAF) for further investigation due to suspicion of possible fraud. Our special reports 1/2019 on fighting fraud in EU spending and 6/2019 on tackling fraud in EU cohesion expenditure make one thing clear: the fight against fraud and corruption needs to be strengthened, at both EU and Member State level. This is important for the European project, not least in the light of increasing EU scepticism in a number of countries.

### **ECA opinion on the next EU Anti-Fraud Programme**

In our Opinion No 9/2018, published in November 2018, we commented on the proposal for establishing the next EU Anti-Fraud Programme, for which the proposed programme budget amounted to €181 million for the entire period – 2021-2027. This programme - which is directly administered by the Commission - is the only one dedicated to the protection of the financial interests of the European Union. Its three specific objectives are:

- to prevent and combat fraud, corruption and any other illegal activities affecting the EU's financial interests;
- to support the reporting of irregularities, including fraud;
- to provide tools for information exchanges and support for operational activities in the field of mutual administrative assistance in customs and agricultural matters.

In particular, it supports mutual assistance between the administrative authorities of the Member States and cooperation between them and the Commission to ensure the correct application of the law on customs and agricultural matters.

The programme would essentially continue its predecessor, the Hercule III programme, while also financing the Anti-Fraud Information System (AFIS) and the Irregularity Information System (IMS). In the opinion, we welcomed the initiative to streamline budgetary management in this way. We also consider that such an approach could contribute to an efficient and effective use of resources in similar areas.

We criticised, however, that the proposal had not been based on a comprehensive impact assessment. Moreover, we questioned the programme's value added and pointed out a risk of overlaps and lack of synergies with other EU actions. Finally, we noted that the monitoring of implementation, the evaluation of results and the effective targeting of funds to actions ensuring value added would be difficult, since the programme's objectives and its performance indicators were not sufficiently clear and specific. In view of the importance given to fighting fraud against the EU budget, the EP increased the programme funding to €321 million.

### **ECA opinion on EPPO and OLAF investigations**

Our other recent opinion - Opinion 8/2018 related to the fight against fraud and corruption, also published in November 2018 - was on the Commission's proposal to amend the OLAF Regulation to adapt the functioning of OLAF to the establishment of the European Public Prosecutor's Office (EPPO).

#### **Box: OLAF and EPPO**

Since its establishment in 1999 OLAF, (Office Européen de Lutte Anti-fraud), the EU Anti-Fraud Office, has been responsible for developing anti-fraud policy and conducting independent administrative investigations into suspicions of fraud, corruption and illegal activities affecting EU financial interests. The purpose of these administrative investigations is to recover money incorrectly spent. OLAF cannot carry out prosecutions on suspicion of fraud, it can only make recommendations. Instead, national authorities must act.

The administrative investigations carried out by OLAF and launched on the basis of suspicion of fraud are often complex and sensitive. If there is a reason to suspect fraud, it is important to secure evidence, and should the suspicions turn out to be wrong the procedure must respect the integrity of the individual or organisation involved. Currently an OLAF investigation takes on average between 17 and 18 months. To this must be added the time needed for judicial procedures in national courts. Time in itself is a crucial factor in order to avoid fraudsters disappearing or covering their tracks.

It is hard to estimate how much of EU spending is lost to fraud. In 2017, OLAF opened 215 investigations on suspected fraud cases and finished 197 investigations. As a result, OLAF recommended recovery of €3 billion.

The European Public Prosecutor's Office - the EPPO - is to be operational from late 2020 or early 2021 onwards. It will be responsible for investigating, prosecuting and bringing to judgement criminal offences affecting the EU's financial interests within the meaning of the PIF-directive (Protection d'intérêts financiers). The EPPO is being set up under the model of enhanced cooperation between - currently - 22 Member States. Given that the EPPO will be empowered to investigate and prosecute crimes against the EU's financial interests in participating Member States, the establishment of the EPPO significantly changes the legal and institutional setting for fighting fraud against the EU's financial interests.

The aim of the proposal was to facilitate future cooperation between the two bodies in the fight against fraud and to enhance the effectiveness of OLAF's investigative function. The issue of OLAF and its work has been a topic of interest during many years for both the European Parliament, and particularly its Budget and Control Committee, and the Council. It is a complex issue involving not only organisational challenges but also addressing subsidiarity and proportionality from a Member State point of view.

We considered that the proposal reflects well the principles that should govern cooperation between OLAF and the EPPO, such as close cooperation, exchange of information, complementarity and non-duplication of work. However, we also found certain weaknesses, such as the need to increase the effectiveness of OLAF's investigations, their timeliness and the recovery of funds. These remain major challenges to be addressed.

The proposal includes a limited number of targeted measures, which we welcomed because they should help improve effectiveness. Amongst others, these measures are: clarification as to when national and European law applies during OLAF on-the-spot checks; access for OLAF to bank account information; strengthened admissibility of evidence collected by OLAF; clarifications in the proposal on OLAF's mandate in Value Added Tax (VAT) matters.

At the same time, we also stated that the proposed changes would not resolve the overall issue of the effectiveness of OLAF's administrative investigations. This is also recognised by the Commission, which plans to propose a more comprehensive modernisation of the OLAF framework at a later stage. However, there is currently neither a time plan for such further reform of OLAF nor a clear identification of which issues would be addressed.

We also stressed the need for further action. In the short term, we proposed that the Commission should address the overall issue of OLAF's effectiveness and reconsider OLAF's role and responsibilities in combating fraud in EU spending. In this regard, OLAF could be given a strategic and oversight role in EU anti-fraud actions. In the medium term, the Commission should evaluate co-operation between OLAF and the EPPO and, where appropriate, propose further legislative actions. Currently, the proposal is still under negotiation between the Council and the European Parliament.

### **Successful cooperation will be key in the fight against fraud**

Member State authorities and EU institutions must give dealing with suspicions of fraud and corruption the highest priority. This is key for maintaining the citizen's trust in the EU. In this respect, the Commission proposal on the EPPO can become a *game changer*, if the EPPO is set up properly with adequate resources. So far, however, not all Member States have chosen to participate in the EPPO. Denmark, Ireland, Hungary, Poland and the UK are not participating. Sweden is expected to join, according to the Swedish Prime Minister's speech in the European Parliament on the 4 April 2019.

For the future, it is important that cooperation between OLAF and the EPPO functions well and increases the effectiveness of OLAF's investigations. When international crime such as fraud knows no borders in the EU but the fight against it does, then there is clearly an unfavourable situation. The possibility to prosecute across borders increases with the creation of the EPPO, and this means there will be greater potential for discouraging fraud and increasing the amount of money recovered.

The mere suspicion that Member States, national authorities or institutions are not treating EU financial interests with the greatest concern is already damaging to the trust of citizens in the EU. As the EU's external auditor, we will continue to be their watchdog and keep track of the effective, efficient and economic use of the EU's finances, and provide an independent assessment of the EU's policies and programmes. In the end, it is all about the taxpayer's money.

# Fraud risk for the EU budget – what the ECA recommends

By Judit Oroszki, Financing and Administering the Union Directorate

Media reports on fraud cases involving EU funds have a high likelihood of catching the interest of the public. The perception that EU spending, but also cross-country fiscal mechanisms like VAT or emissions trading, is particularly prone to fraud schemes and organised crime does not contribute to strengthening the citizen's trust in the Union. This is one of the reasons why the ECA decided to look into how the European Commission fights fraud in EU spending. Judit Oroszki, principal manager, was the head of task for the audit that resulted in special report 1/2019: 'Fighting fraud in EU spending: action needed.' She provides insights into key reflections and challenges when approaching the audit subject and what has happened since the publication of this report in January 2019.



Fraud is cross-cutting by nature, meaning that the risk of fraud may be present within the whole EU budget, although to differing degrees. It is a consensus view by experts in the field that fighting fraud effectively requires a comprehensive fraud management framework, covering the full cycle of anti-fraud activities. This must consist of a series of actions to prevent, detect and respond to/ deter [fraud](#)\*.

\* [Audit brief](#) - Fighting fraud in EU spending

## How did we approach the audit?

The EU fraud management framework consists of several institutions and bodies (involved at different stages of the framework) implementing certain parts of the framework (such as prevention, detection, investigation or sanctioning/prosecution) and working under different jurisdictions. Overall, quite a complex picture.

From the outset, given the amount of resources at our disposal, it was obvious, however, that we would not be able to cover the whole fraud risk management framework, for both the revenue and spending side of the EU budget. This clearly would have been too broad an audit subject.

For this reason, when preparing our audit, the first key step was to map the main bodies involved in the EU's fraud management cycle, together with identifying the key risks to their performance in fighting fraud. This mapping exercise helped us to decide on the focus of the audit (see **Table 1**).

We also considered the areas covered by previous audits: we had already looked into the fraud management framework in the area of own resources<sup>1</sup> and the management of OLAF<sup>2</sup> – the EU's key anti-fraud body. We therefore decided to focus our audit on EU spending (rather than revenue) and on the aspects of prevention and sanctioning of fraud affecting the EU's financial interests<sup>3</sup>.

1 Special report 24/2015 – 'Tackling intra-Community VAT fraud: More action needed'.

2 Special report 1/2005 concerning the management of the European Anti-Fraud Office (OLAF), special report 2/2011 - Follow-up of special report 1/2005 concerning the management of the European Anti-Fraud Office (OLAF); Opinion No 6/2005, Opinion No 7/2006, Opinion No 6/2011.

3 Special Report 1/2019 - 'Fighting fraud in EU spending: action needed'.

**Table 1- Main bodies involved in the EU’s fraud management cycle**

Bodies	Prevention	Detection	Investigation	Response
OLAF	√	√	√	
IDOC			√	√
Commission DGs	√	√		√
Eurojust				√
Europol	√			
National administrative authorities	√	√	√	√
National judicial/ law enforcement authorities		√	√	√
EPPO			√	√

Source: ECA

### Fraud prevention is more cost-effective than detection and correction

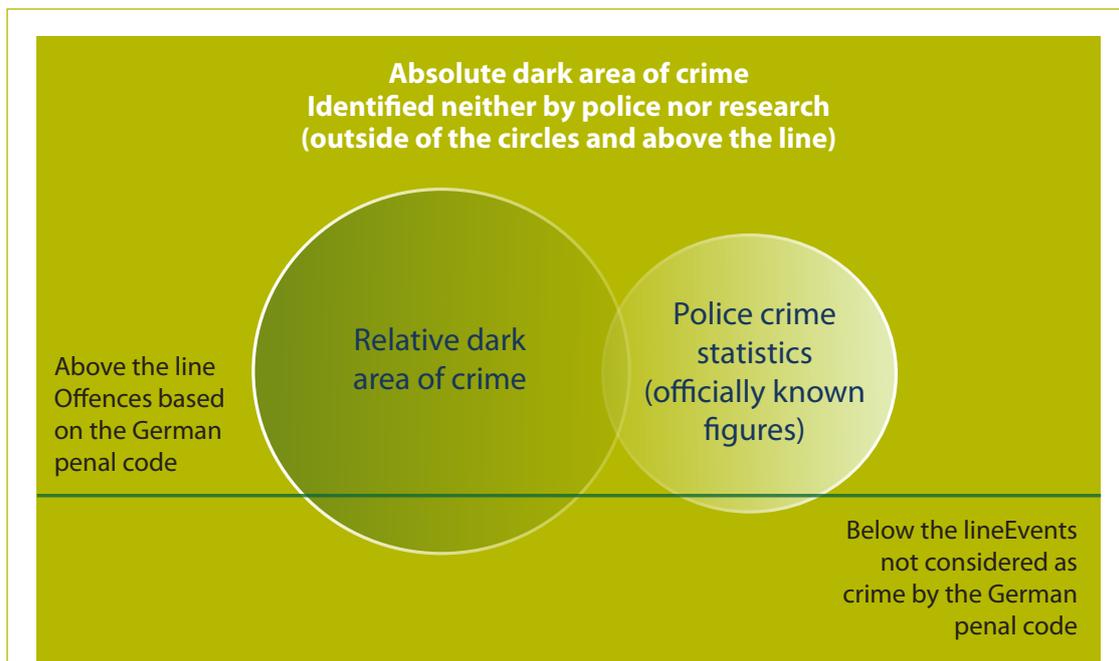
In recent years, several standard setters have highlighted the importance of fraud prevention (i.e. reducing opportunities for fraud to take place). This is because preventing the occurrence of fraud is much more cost-effective than the detection and correction of fraud, which is often followed by lengthy, costly and sometimes unsuccessful administrative procedures to prove and sanction fraudulent acts and recover the financial damages caused by these acts. Also, by the time the fraud is discovered, the money is often unrecoverable (or at least the chance to recover the full amount is very slim). In our report, we also highlight the difficulties of recovering EU funds based on OLAF’s investigative reports.

Not surprisingly, assessing the actual results of fraud preventive actions is actually quite challenging. In an ideal world, one would need to know the overall scale of fraud, how much and what type of fraud can be prevented and at which costs and how much is actually prevented.



Gaining insight into the overall scale of certain traditional crimes (such as vehicle theft or burglary) is a common practice for national enforcement authorities (see **Figure 1** below).

**Figure 1: The dark area of crime – the approach by the German Bundeskriminalamt (BKA) and the the UK Home office**



Source: BKA

The German federal policy authority - the Bundeskriminalamt – has put significant effort into researching the undetected or hidden scale of crime, because crime statistics are mainly based on crimes known or reported to the police. For this, they use methods such as [victim surveys](#) or surveys of those who have actually committed crimes.

Source: UK Home office

The UK Home Office’s annual publication on ‘[Economic and social costs of crime](#)’ calculates a unit cost per crime, regardless of whether it was reported to the police or not, in order to ensure that the cost of each crime committed is estimated, rather than each crime recorded by the police. In this study, case estimates are based on reported rates and adjusted by a multiplier based on the results of the British Crime Survey – a victim-based survey – to estimate the actual number of cases to be used to calculate the unit costs. For certain types of crimes – such as vehicle theft – reported crime rates are more reliable because victims have an interest in reporting the crime, while for others – for example, sexual abuse – victims may actually underreport cases .

For financial crimes, such as fraud, coming up with an estimate for the overall scale or overall cost of crime is more challenging compared to other traditional crimes. This is because, by its very nature, fraud is elusive, i.e. it is conceived in a way which makes detection difficult. In addition, due to the nature of fraud, victims may not always be even aware that a fraud has been committed; or they may not consider that they are directly (or personally) affected.

### **Challenges in fighting fraud against the EU budget**

When we look at fraud against EU spending there is a further aspect to be considered. Around 85 percent of the EU budget is spent through Member State governments and regional or even sub-regional bodies. In other words, the main victim of fraud against EU spending is the EU (rather than the national or regional) budget. This creates an obvious moral hazard, because, instead of protecting the EU budget, the priority of Member States may be rather to spend all earmarked EU funds.

An EU-wide system of fraud prevention, detection and correction can therefore only work effectively if the European Commission can fully rely on the Member States to ensure that the money is spent in accordance with the applicable rules, and that Member State administrations are effective in detecting and reporting cases of suspicion of fraud to the EU. Unfortunately, it is far from certain whether this is always the case.

### **The importance of assessing the risk of fraud**

Generally speaking, the best way to prevent and detect fraud is through effective internal controls. In recent years there has been growing consensus amongst key standard setters, such as the the Committee of Sponsoring Organizations of the Treadway Commission (COSO), the Institute of Internal Auditors (IIA), the Chartered Institute of Public Finance and Accountancy (CIPFA), the Association of Certified Fraud Examiners (ACFE) and SAIs (such as the US GAO or the Australian NAO) that the assessment of fraud risks needs to be incorporated and strengthened in the framework of internal controls.

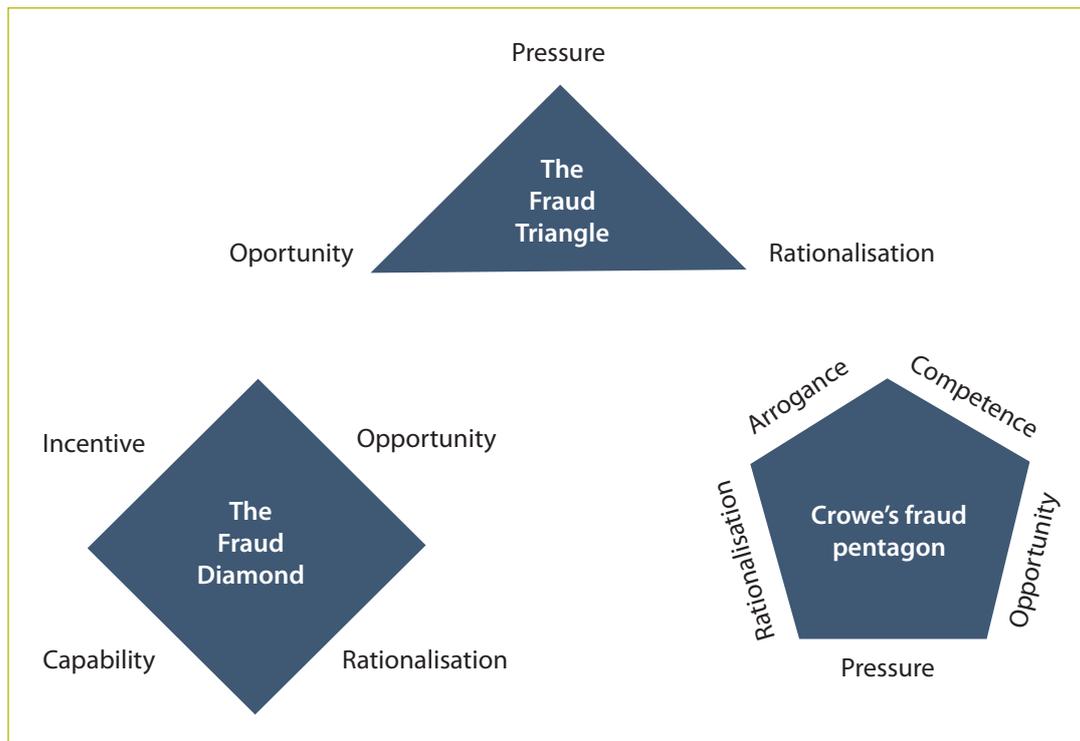
Importantly, the 2016 COSO Fraud Risk Management Guide also underlines that simply adding the fraud risk to the existing internal control assessment is not enough. Conducting a meaningful fraud risk assessment involves looking at what has happened in the past, with the aim of identifying the crucial elements which may have enabled fraud to be committed. Criminology work and a criminology perspective are very relevant to this assessment. Key in fraud prevention is to understand the causes of fraud. Several models have been developed to identify the elements that lead perpetrators to commit fraud. Donald Cressey proposes a fraud triangle framework<sup>4</sup> while other conceptual frameworks have complemented this by also focusing on the individual's capability, i.e. his or her personal traits and abilities<sup>5</sup> (see **Figure 2** below). These models have influenced standards and good practice guides on how fraud risk assessments can be performed by internal controllers.

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4 Cressey, D. R. (1953). *Other People's Money*. Montclair, NJ: Patterson Smith, pp.1-300.

5 Wolfe, D., & Hermanson, D. R. (2004). The fraud diamond: Considering four elements of fraud. *The CPA Journal*, 74 (12), 38-42; Crowe Horwath LLP, *Trust is a Professional Hazard!* (2011)

**Figure 2 – Different theories to explain the causes of fraud**



Some of the factors that enable fraud to occur relate to ineffective control or governance system, which provide an opportunity for fraudsters to act. Other factors (such as incentives and rationalisation) refer to the motivation that leads to unethical behaviour and the way potential fraudsters justify their acts as something that is not to be considered as a criminal activity.

Recently, therefore, [fraud experts](#) have been putting more and more emphasis on the type of person who commits fraud<sup>6</sup>. This requires an analysis of the capabilities of potential fraudsters, i.e. the individual skills and traits needed to exploit opportunities to commit fraud<sup>5</sup>. This type of analysis may be similar to the criminal profiling used by criminologists and law enforcement authorities and is an investigative method that uses behaviours and psychological analysis to generate predictions about the characteristics of the most likely suspects of a crime<sup>7</sup>.

This is why we need to analyse incentives/pressures, opportunities and rationalisations when performing fraud risk assessment. Internal control systems, however, primarily address incentives and opportunities, which in most cases are easier to spot<sup>8</sup>. In other words, internal control systems are necessary - but they may not be sufficient to fight fraud effectively.

### What data is available on potential fraudsters against the EU budget?

All of these above considerations and reflections led us to look closely in our audit at how the Commission and OLAF collect data on fraud affecting the financial interest of the EU and what use they make of this data for fraud prevention purposes. We based our

<sup>6</sup> See also 'Improving fraud risk management with an enhanced Fraud Triangle', by Douglas M. Boyle, DBA, CPA, CMA; F. Todd DeZoort, PhD, CFE; Dana R. Hermanson, PhD; David T. Wolfe, CPA, CFF; Fraud Magazine, March/April 2018

<sup>7</sup> Kocsis, R. "Criminal Profiling: International Theory, Research, and Practice" (2007).

<sup>8</sup> "Rationalizing Fraud - How Thinking Like a Crook Can Help Prevent Fraud", By Natalia Mintchik, PhD, CPA and Jennifer Riley, PhD, CPA, The CPA Journal, March 2019 issue.

criteria on the key elements identified by standard setters such as the COSO and CIPFA guidelines. In essence, these bodies argue that knowledge about previously identified fraud cases is key. Without a good understanding of past fraud schemes and the types of fraudsters committing fraud it is simply not possible to establish well-focused and cost-effective methods to prevent fraud.

However, our audit showed that the Commission does not have comprehensive and comparable information on the detected fraud level in EU spending. This is also due to the fact that the methodologies Member States use to prepare their official statistics on detected fraud differ, and the information reported in the Commission's Irregularity Management System (IMS) is incomplete. The Commission also refrains from complementing official statistics by its own estimates of undetected fraud.

We also found that there is only little qualitative information on the nature and causes of fraud. Some information is available on fraud patterns and schemes used in different sectors, but the information available is neither systematically updated nor actively used by the Commission. So far, the Commission has not attempted to identify what causes some recipients of EU money to commit fraud. In this context, it would also have been interesting to compare how Member States deal with such cases when there is EU funding, and when there is no such funding. However, we found that such a comparison is not possible since most Member States do not collect separate data on crimes against the financial interest of the European Union and those affecting only the national budget.

### **Better insight into fraud against the EU budget needed**

This illustrates that there is a need to gain a better insight into the scale, nature and causes of fraud in EU spending. In particular, we recommended in our report that the Commission should put in place a robust fraud reporting system, providing information to assess the scale, nature and root causes of fraud. In particular, it should:

- enhance the Irregularity Management System (IMS) so that information on criminal investigations related to fraud affecting the EU's financial interests are reported in a timely manner by all competent authorities, and
- build its capacity to collect information from different sources on the risk of fraud and corruption against the EU budget, measure this risk on a recurring basis using different methods (encounter surveys and indexes based on administrative data); and consider establishing risk indicators by spending area, country and sector.

Analysing these data sets will also require new approaches and techniques, where big data and algorithms will play an obvious and increasing role.

Last but not least, we saw an urgent need for the Commission to update its anti-fraud strategy, dating from 2011. This update would then provide an opportunity for the Commission to address the weaknesses in fraud prevention identified by our audit.

### **The Commission's 2019 anti-fraud strategy – a first response to our report**

The Commission took up our recommendation swiftly. In April 2019 (i.e. not even three months after the publication of our special report), it has adopted its new anti-fraud strategy entitled "Commission Anti-Fraud Strategy: enhanced action to protect the EU budget"<sup>9</sup>. Based on a qualitative fraud risk assessment, the Commission defined two key objectives for the coming years :

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<sup>9</sup> European Commission; Communication from the Commission to the European Parliament, The Council, The European Economic and Social Committee, The Committee of the Regions and the Court of Auditors, Commission Anti-Fraud Strategy: enhanced action to protect the EU budget, COM(2019) 196 final.

- data collection and analysis: to further improve the understanding of fraud patterns, fraudsters' profiles and systemic vulnerabilities relating to fraud affecting the EU budget and
- coordination, cooperation and processes: to optimise coordination, cooperation and workflows for the fight against fraud, in particular among Commission departments and executive agencies.

### **Putting the strategy into action**

The Commission must now demonstrate that it will use all available means to fight against fraud which is to the detriment of the EU budget. This cannot be done without having a good knowledge and data about past fraud patterns, the causes of fraud and the motivation for committing fraud. Analysing what causes fraudsters to commit fraud is a method used by criminal sociologists and psychologists. Using theories and practices from other disciplines – such as criminology – and incorporating these into the internal control framework of an organisation allows for a better understanding of the motivations and processes behind these crimes and could help guide the design of controls to prevent and detect fraud.

The 2019 Commission anti-fraud strategy explicitly recognises the need for better data collection and analysis to understand fraud patterns and fraudsters' profiles. This is already a very important step forward. What matters now is that this strategy is put into action swiftly.

# Tackling fraud in EU cohesion policy spending – looking behind and beyond the audit

By Dana Christina Ionita and Jorge Guevara López, investment for Cohesion, Growth and Inclusion Directorate



Source: European Commission

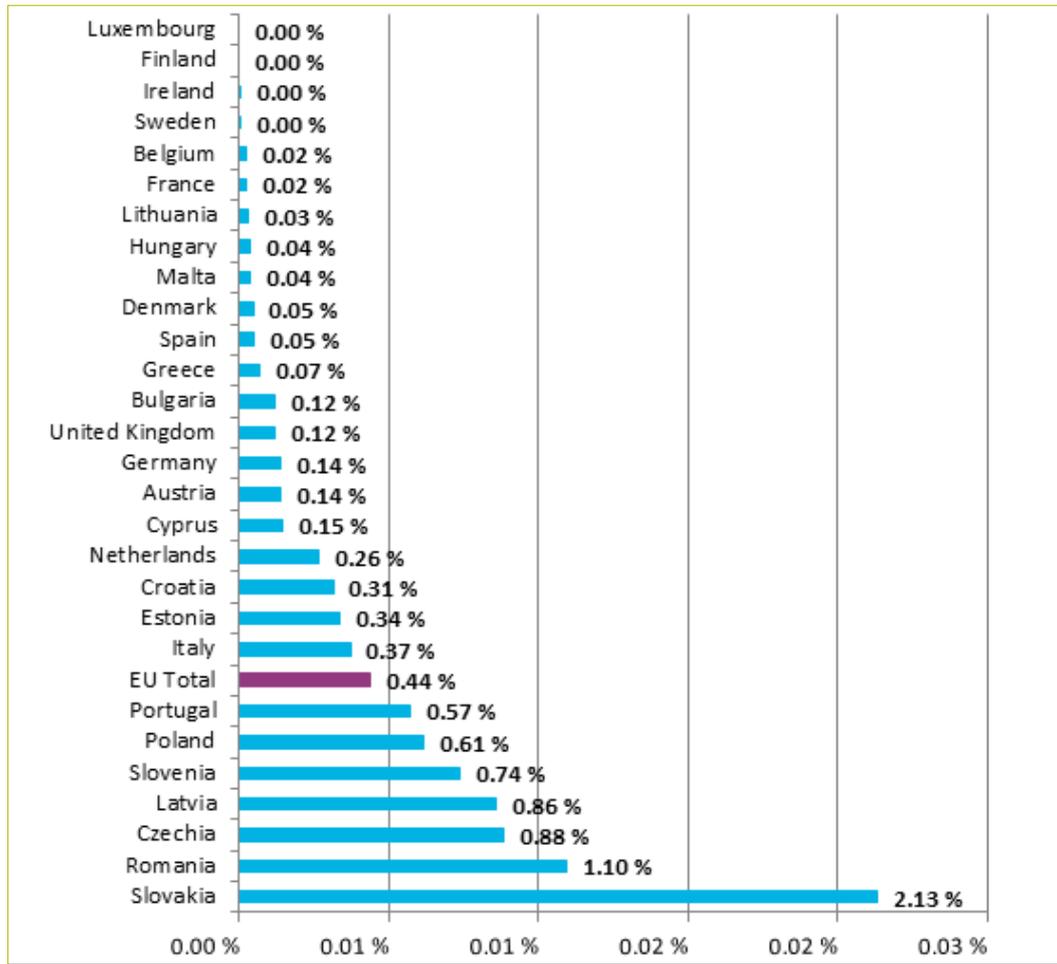
On 16 May 2019, the ECA issued a special report on tackling fraud in EU cohesion policy spending. The head of task for this audit, Jorge Guevara López, and senior auditor Dana Christina Ionita, report on the challenges that arose during this task and what they learned about Member States' efforts to fight fraud issues in EU spending.

## Fraud from a performance perspective

For many years we have both been auditing compliance in the field of EU-funded programmes and projects under the European Structural and Investment Funds (ESIF), and contributing to the ECA's annual audit opinion on the EU's financial statements, the Statement of Assurance (SoA). During this work, inevitably, we were confronted with questions related to fraud. Frequently, we were faced with cases of non-compliance that, at least at first sight, could have indicated fraudulent behaviour. In some cases, an analysis of the information gathered during our audits even resulted in the case being handed over to OLAF. In addition, one of us had also examined the topic of fraud as part of our studies, so we welcomed the opportunity to analyse the issue from a broader audit perspective. The Commission currently estimates the incidence of fraud in EU cohesion spending at 0.44%, with wide variations across Member States (see Figure 1).

The EU operates a zero-tolerance policy towards fraud in the field of cohesion. The implementation of this policy, however, is subject to the principle of proportionality. In other words, not every euro spent from the EU budget is checked down to the final recipient to ensure that there is no improper use. Existing controls in Member States are assumed to be sufficient to address the risk of fraud, and tackling those fraud cases that escape the controls would be too costly. But our audit findings show that such an optimistic view may not always be justified.

**Figure 1 - Fraud detection rate by Member State - EU cohesion policy 2007-2013**



Source: Commission 2017 report on the protection of the financial interests of the EU

The very nature of fraud against the EU is that people committing it have comprehensive knowledge of management and control systems and exploit gaps in their design. They are therefore likely to repeat those schemes that go undetected, so adequate investigation of an individual case of fraud may uncover a wider scheme affecting thousands or millions of euros. We therefore thought an audit on the way anti-fraud measures are being designed and implemented at the level of the Member States would be opportune.

### Our team

We put together a team of eight auditors, and we obtained further support from the compliance audit team in charge of auditing European Regional, Territorial and Social Cohesion Policy. Particularly for our visits to Member States we were also able to draw on valuable support from the ECA's language services. In addition, we coordinated extensively with the audit team who had carried out an audit focused on the Commission's work - published as special report 1/2019 concerning fighting fraud in EU spending. And we participated in the specialised fraud certification course organised by our training department. Henri Grethen was the reporting Member for this task and both his private office staff and our directorate's team provided support. So our audit was the result of a broad 'team' effort across the ECA.

### **Challenges faced by fraud fighters in the field of cohesion policy (and elsewhere)**

Let's start from the beginning. The fight against fraud in the field of EU cohesion, as well as in other policy areas, faces a series of challenges that threaten the effectiveness of any initiatives taken:

- Reliable intelligence on the incidence of fraud in Member States is lacking. Thus, the EU institutions combating fraud are facing difficulties in estimating the magnitude of the problem, understanding the way fraud is perpetrated and designing effective preventive and detective measures to address it;
- The definition of fraud is not harmonised across the Member States (in particular, regarding the manipulation of public procurement, etc.);
- Suspected or even confirmed fraud cases are often not reported at EU level. This tendency exists in all Member States, but is more pronounced in some than in others. The consequences of this practice might have to be borne by all of us.

Against this background, the European Commission has taken action to address these challenges at two levels. At the operational level, the Directorates-General of the Commission in charge of the implementation of EU cohesion policy have issued guidance on the use of fraud risk assessment for the design of anti-fraud measures. Moreover, the European Anti-Fraud Office (OLAF) has drawn up instructions on the reporting of fraudulent cases. As regards the legal framework, the recently adopted [Directive](#) on the protection of the financial interests of the EU by means of criminal law will play a key harmonisation role in the years to come.

In our audit we assessed the extent to which Member States' managing authorities have put in place effective and proportionate anti-fraud measures in response to the risks identified. To start with the good news: we found several cases of good practice that are already being applied. Our findings also indicate that technological advances provide a huge potential for more effective measures: how we make use of data analytics and the possibilities offered by new digital technologies will determine the future of anti-fraud policies in Europe.

#### **Special report 6/2019: Tackling fraud in EU cohesion spending: managing authorities need to strengthen detection, response and coordination**

The audit focused on the way managing authorities had set up and implemented their anti-fraud measures and responded to fraud. We noted that their fraud risk assessment is more systematic now, and that fraud prevention has improved even though anti-fraud strategies or policies are generally lacking. As regards fraud detection, however, managing authorities have made insufficient progress towards proactive detection and lack procedures for monitoring and evaluating how anti-fraud measures are working. We also found problems in the way programme authorities coordinate with investigation and prosecution bodies.

As regards the Commission's estimate of the incidence of fraud, in a number of concrete instances we found that managing authorities had failed to report fraud cases. We confirmed once again that the reliability of the Commission's estimate is limited.

At a time when the Parliament and the Council are discussing the new rules for the 2021-2027 programming period, we recommended that Member States adopt formal anti-fraud strategies and policies, involve all relevant actors in the fraud risk assessment process and strengthen fraud detection by introducing proactive measures and data analytics tools. In turn, the Commission should expand the role of the national anti-fraud coordination services, the AFCOSs.

### **What we learned beyond the findings in the report**

Overall, the audit covered seven Member States: Bulgaria, France, Hungary, Greece, Latvia, Romania and Spain. And for each of them, the set-up and functioning of their national and regional bodies involved in combating fraud differed at least in part from

those in the other Member States. Another interesting aspect we observed was that cultural differences also play a role and influence the functioning of systems that are meant to provide a harmonised approach across the Union, based on similar sets of rules and regulations. For example, there are Member States where, before reporting a suspicion of fraud, the person or body investigating the case has to have a clear indication of the fraudulent aspects, otherwise there is a risk of being accused of calumnious denunciation. In these Member States, it is less likely that those aware of fraudulent behaviour take a step forward and report it to the competent authorities. This could partly explain apparent differences in tolerance of fraud across Member States.

Performing the audit work was a challenging task, not so much for the audit procedures as such, but rather for the environment in which our audit visits took place. Our audit teams met representatives of the authorities in charge of the operational programmes but also representatives of the investigative and prosecution bodies in order to obtain a comprehensive picture of the Member State's anti-fraud system. At the same time, our assessment in special report 6/2019 is limited to the authorities directly involved in the programmes' implementation: the managing authorities.

In some of the countries visited, the topics of fraud and corruption were considered as 'hot' in the social and political context, receiving a lot of public attention – within the Member State but also at EU level. It also happened that, despite the fact that we randomly selected cases for a more detailed examination, some of them concerned well-known public persons. Our auditors needed to be very careful in communicating the scope of our audit visits and dissociating our examination from recent events and discussions related to these persons.

Altogether, the audit gave us a unique insight into the way Member States implement anti-fraud measures in practice. It allowed us not only to apply the knowledge gained through several years of experience in auditing cohesion expenditure, but also to develop our understanding of the occurrence of fraud affecting EU cohesion policy, and of how to protect the EU's budget (and national budgets) against this fraud.

# How criminals evade VAT and how we use new techniques to detect it

By Carlos Soler Ruiz, Regulation of Markets and Competitive Economy Directorate

Fraudulent activities regarding the EU budget may relate to EU subsidies but also to EU revenue. Every year, the EU loses billions of its VAT revenues through the activities of organised crime. Because exports of goods and services from one EU Member State to another are exempt from VAT, criminals can fraudulently evade VAT in the Member State of destination, and the result is lost revenue for the countries concerned as well as for the EU. Carlos Soler Ruiz is an ECA specialist when it comes to VAT and customs issues and was head of task for the special report the ECA published on VAT fraud in 2015. Below he explains some of the main threads of fraudulent activities and modern techniques currently used in the fight against fraud relating to EU revenue.

## VAT fraud is a criminal activity

Criminals can exploit the weaknesses of the current EU VAT system for cross-border trade and earn money illicitly, depriving Member State and EU budgets of resources, and reinvest the proceeds to finance other criminal activities. In addition, they undercut honest traders and distort the level playing field in the internal market. So there are enough reasons to improve the VAT management and collection schemes to prevent this. Fortunately, there are more and more data analysis tools to help us do so.

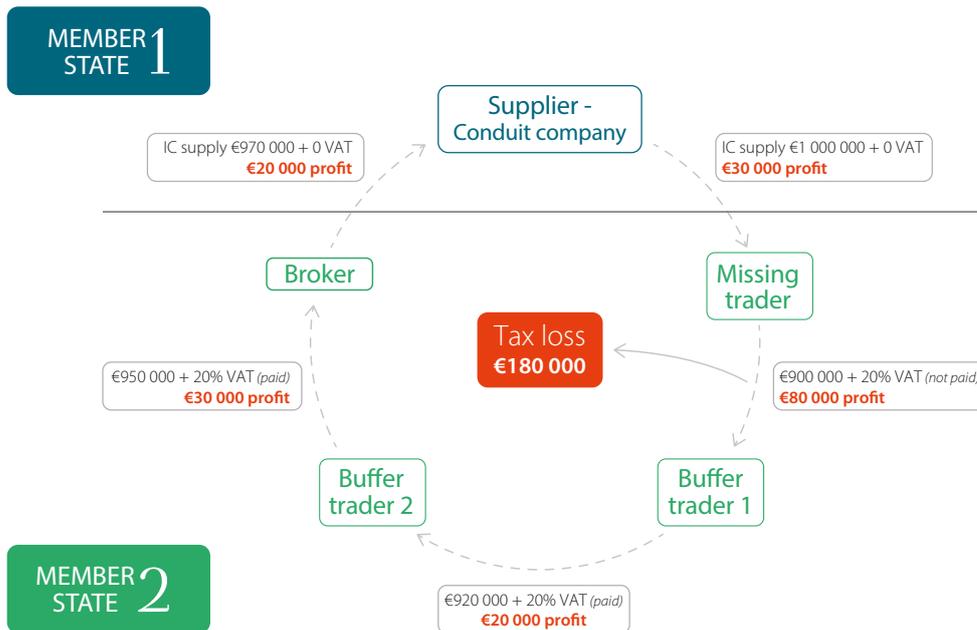
## Missing traders and carousels

Criminals can abuse the VAT system because intra-EU cross-border supplies of goods and services are VAT-exempt. The purchasers do not pay VAT on these purchases but charge VAT when they sell them to their customers. If the purchasers disappear without remitting the VAT charged to their customers to the tax authorities, they are known as *missing traders*.

The missing traders can sell the goods below cost and gain a competitive advantage in the market because the unpaid VAT increases their operating margin. Their customers offset the VAT paid to the missing traders from the VAT charged on their outputs or get this VAT reimbursed by the tax authorities when they export the goods purchased to missing traders. In any case, the tax authorities suffer a loss equal to the VAT not remitted by the missing traders.

When the goods exported by the customer of the missing trader are reimported by the missing trader, this is known as carousel fraud. There may be several intermediaries, called "buffers", between the exporter or broker and the missing trader, which make it difficult for tax authorities to follow the transaction chain. Some of the buffers may be involved in the fraud scheme while others are innocent traders. The supplier of the missing trader is often known as the conduit company. Sometimes the same goods can be reimported several times by the missing trader or they exist only on paper. The missing trader is often a shell company created or taken over by organised crime groups with the sole purpose of making illicit money. **Figure 1** and **Table 1** show a basic carousel fraud scheme assuming a VAT rate of 20 %. More information can also be found in ECA special report 24/2015 'Tackling intra-Community VAT fraud: More action needed.'

Figure 1: A carousel fraud scheme



Source: ECA Special Report No 24/2015

Table 1: How a carousel scheme damages the budget

CAROUSEL	MEMBER STATE 2					MEMBER STATE 1	Carousel profit
	Missing trader	Buffer trader 1	Buffer trader 2	Broker	VAT collection/ losses	Conduit company	
Output VAT (VAT on sales)	180 000	184 000	190 000	0		0	
Input VAT (VAT on purchases)	0	180 000	184 000	190 000		0	
VAT paid/ refunded	0	4 000	6 000	-190 000	-180 000	0	
Purchase price	1 000 000	900 000	920 000	950 000		970 000	
Sale price	900 000	920 000	950 000	970 000		1 000 000	
<b>Profit/loss</b>	<b>80 000</b>	<b>20 000</b>	<b>30 000</b>	<b>20 000</b>		<b>30 000</b>	<b>180 000</b>

The missing trader makes a profit of €80 000, even though the purchase price is €1 000 000, and the sale price is only €900 000, because it keeps for himself €180 000 of unpaid VAT, i.e.  $900\,000 + 180\,000 - 1\,000\,000 = 80\,000$ .

Source: Carlos Soler Ruiz, based on the example in Figure 1

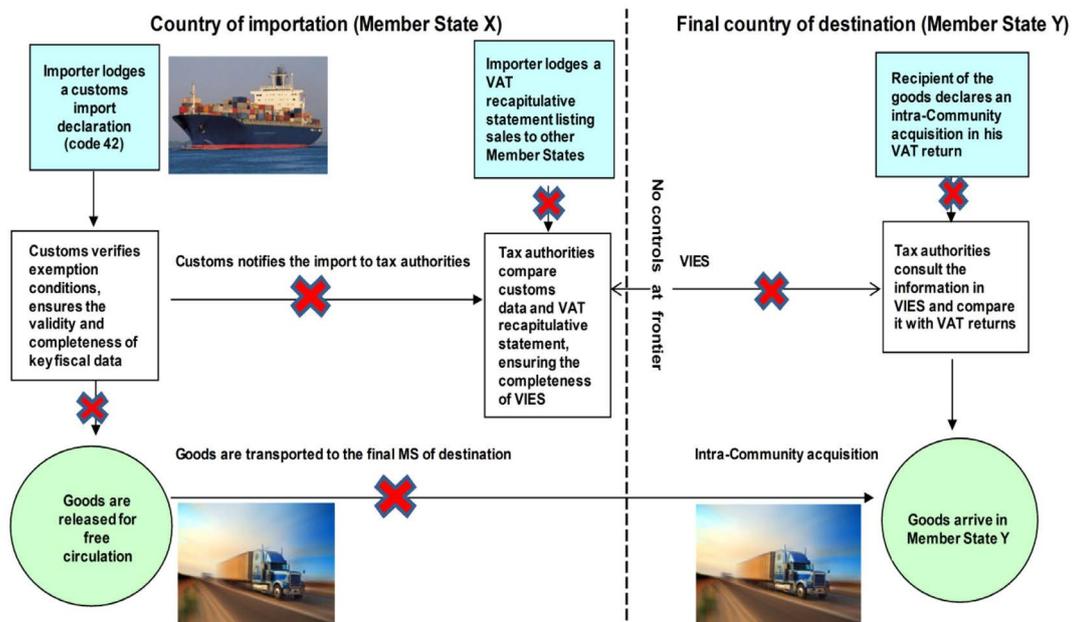
### Abuse of customs procedure 42 (CP 42), the weakest link in the chain

When the circular flow includes a third country, customs procedure 42 (CP 42) can also be used to hamper the traceability of transactions. CP 42 is the procedure an importer uses in order to obtain a VAT exemption when the imported goods are to be transported to another Member State. Goods imported using CP 42 are VAT exempt in Member State X because they will be immediately transported to Member State Y and VAT should be accounted for in Y. The risk is that goods are sold either on the domestic market of Member State X or Y without payment of VAT.

If Member State X does not inform Member State Y about these consignments using the 'VAT Information Exchange System' (VIES), there is a high probability that the VAT will never be accounted for in Y. This is possible because customs authorities in Member State X do not check the validity of the VAT information shown in the import document or do not send information on these imports to the tax authorities.

Even when tax authorities receive this information they must perform effective cross-checks between the information recorded in VIES by the importer and the information received from customs. **Figure 2** shows an import transaction under CP 42. The blue squares show the tax obligations of the traders, the white ones show the expected key controls by customs and tax authorities, and the green bubbles show the physical flow of goods. The different crosses show the weaknesses of the system.

**Figure 2: Flowchart of imports under CP 42**



Source: ECA

Concerning CP 42 we found that cross-checks between imports under CP 42 and VAT recapitulative statements are not possible because customs authorities do not send this data to tax authorities, and traders are not obliged to report the intra-Community supplies separately in the VAT recapitulative statements following these imports. In addition, not all Member States exchange data on risky imports under CP 42 through 'EUROFISC'<sup>1</sup> working field 3. We recommended that Member States' customs authorities should send data on imports under customs procedure 42 to tax authorities, and the Commission should propose legislative amendments enabling effective cross-checks between customs and tax data. The Commission originally rejected this recommendation on legislative amendments, but eventually included the recommended measures in its latest proposal on administrative cooperation<sup>2</sup>. The Council approved the Commission's proposal on 2 October 2018 in Council Regulation (EU) 2018/1541<sup>3</sup>.

**How fraud can be detected: transaction network analysis and visual data analysis**

From the example shown in **Figure 1**, it is self-evident that typical conduit companies have a big turnover, low VAT payments (as goods are not consumed in the territory of Member State 1), and often only few employees. If the tax authorities of Member State 1 have suspicions that a company, which has these features, is operating as a conduit, they can send information about the current or intended customers of the conduit company, which potentially can be missing traders, to the tax authorities of Member State 2, through Eurofisc. A good risk management system should be able to quickly spot companies matching the profile of a conduit.

1 Eurofisc is a decentralised network of officials from the Member States' tax and customs administrations, who swiftly exchange and jointly process and analyse targeted information about possible fraudulent companies and transactions.

2 COM(2017) 706 final.

3 For more details see also the Public Hearing on VAT fraud before the European Parliament's TAX3 Committee on 28.06.2018 in <http://www.europarl.europa.eu/committees/en/tax3/events-hearings.html?id=20180622CHE04441>

In order to detect fraud, tax authorities of Member State 2 can pay a visit to the customer of the conduit in order to verify whether this customer carries out a real commercial activity or is just a shell company created for purposes of defrauding VAT

### **Transaction Network Analysis (TNA)**

To date each Member State has been running its own risk management system based on the information available in its national VIES database. In order to improve the operation of Eurofisc, the Council has introduced several changes<sup>4</sup> to extend to other Member States the 'Transaction Network Analysis' (TNA) used by the Benelux countries since the beginning of 2019. TNA performs an automated selection of information already available in the VIES system according to risk indicators. The system allows an automated, faster and more precise detection of fraudulent chains. It also allows chains of transactions and companies that may be involved in fraud to be identified. This is in line with what the ECA recommended in special report 24/2015.

### **Visual Data Analysis (VDA)**

Concerning imports under CP 42, textiles and footwear from China are usually sold without VAT on the domestic market of either Member State X or Y. In addition to that, in order to avoid payment of customs duties, false invoices are used at the moment of importation to declare a value which is less than the price actually paid for the imported goods<sup>5</sup>, because customs duties are usually set as a percentage of the value of the goods (*ad valorem*).

In order to identify transactions matching these profiles we used *Visual Data Analysis* (VDA) techniques. The VDA (see **Figure 3** below) provided by *Tableau*<sup>6</sup> allowed us to spot undervalued imports of textiles products, e.g. trousers from China, by using a scatter plot of data extracted from the Surveillance 2 database<sup>7</sup>. The scatter plots in **Figure 3** show clearly that goods imported from China (red-colored crosses) have a declared value at import that is lower than the value declared for goods imported from other eastern countries.

VDA allowed the audit team to detect that 18 out of the 150 risky transactions selected using visual data analysis had not been reported in VIES and to identify substantial losses amounting to £81 million, as specified in ECA special report 24/2015.

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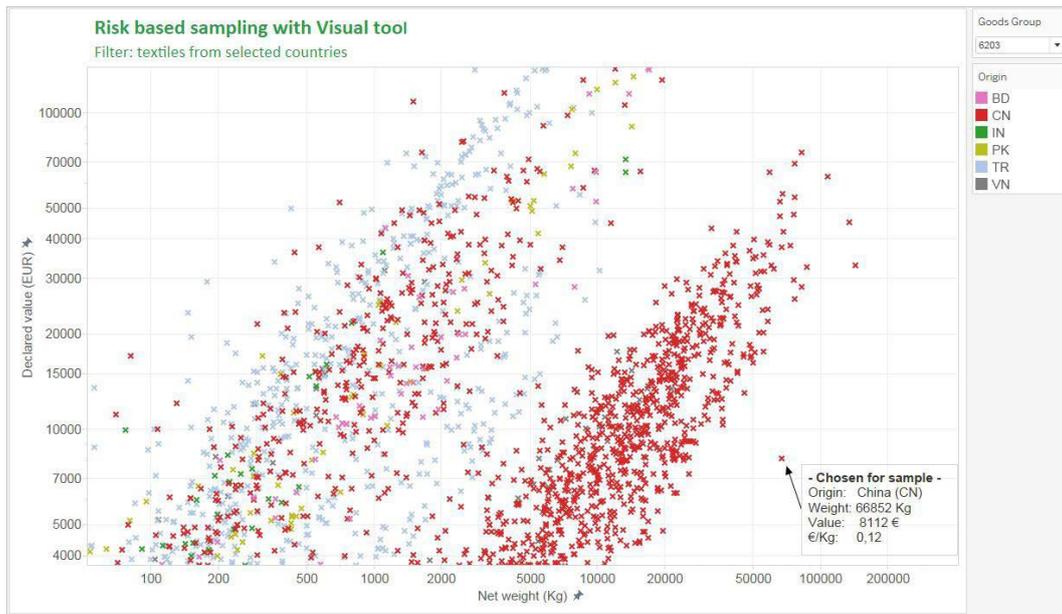
4 Council Regulation (EU) 2018/1541 of 2 October 2018, amended Articles 33 to 36 of Regulation (EU) No 904/2010 and Regulation (EU) 2017/2454

5 See for example the results of Joint Customs Operation 'Octopus' in <http://www.douane.gouv.fr/articles/a12973-la-douane-et-l-olaf-presentent-les-resultats-de-l-operation-octopus>.

6 Tableau is a software application for visual analytics that allows ad hoc analysis to be performed in an intuitive way. See more on <https://www.tableau.com/>

7 Surveillance 2 is the database of imports managed by the European Commission's Directorate-General for Taxation and Customs Union (DG TAXUD), to which the ECA has direct access.

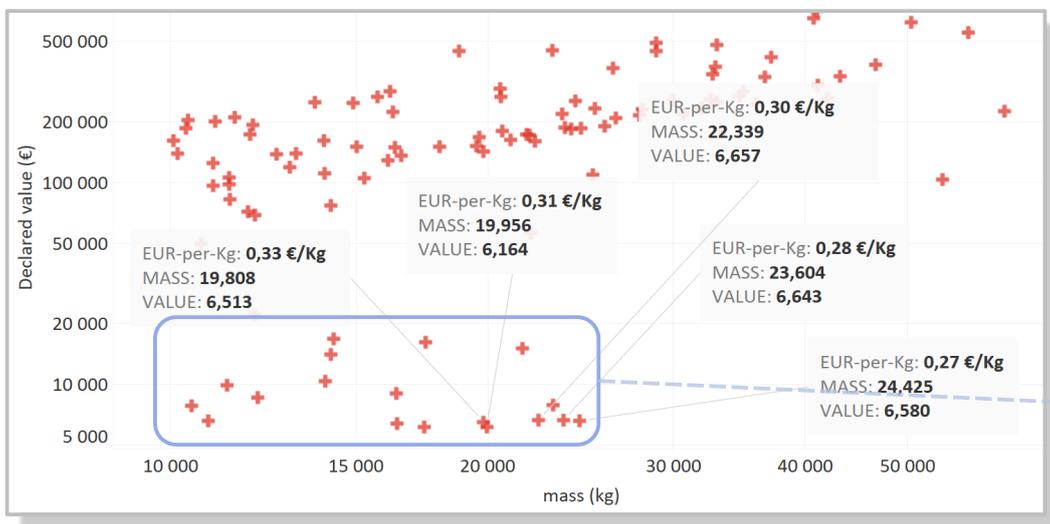
**Figure 3: Risk-based sampling using visual data analysis (2015 data)**



Source: ECA

We explored further the possibilities of VDA to detect potentially undervalued import transactions evading both customs duties and VAT in our special report 19/2017: *Import procedures: shortcomings in the legal framework and an ineffective implementation impact the financial interests of the EU*. The scatter plot allowed us to spot highly undervalued imports of Chinese textile goods in the UK and select them for examination of the underlying evidence. (See **Figure 5**)

**Figure 5: Risk-based selection of highly undervalued imports (2015) using VDA**



Source: ECA

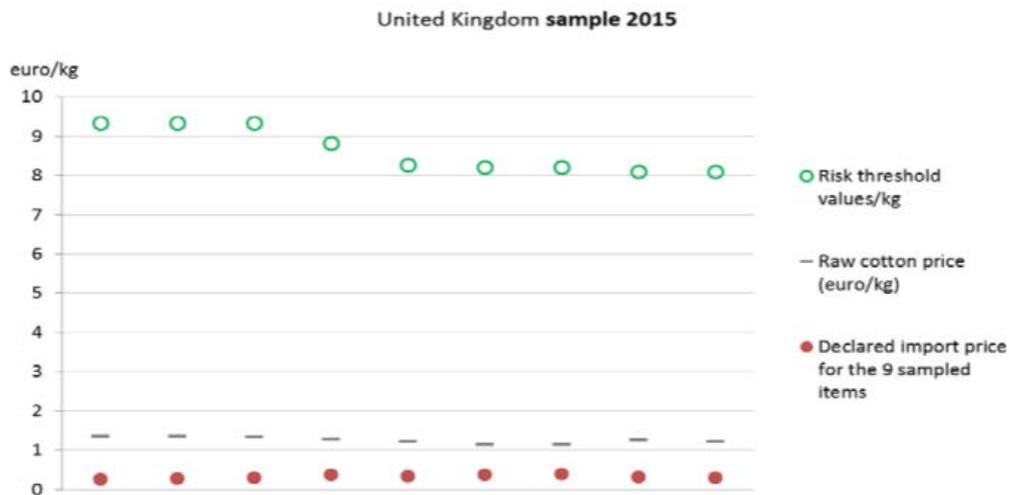
Then we benchmarked the price of the selected items declared at import with both the risk threshold values and the price of the raw cotton to see whether the declared price was potentially undervalued. The risk threshold value has been set up as a percentage of the fair price<sup>1</sup> determined by the European Commission's Joint Research Center on the basis of COMEXT<sup>2</sup> data. Indeed, the value declared at import in these cases for processed

<sup>1</sup> Fair price is a statistical estimate calculated for the prices of traded products on the basis of outlier-free data.

<sup>2</sup> COMEXT is Eurostat's database for detailed statistics on international trade in goods.

cotton goods was not only far below the risk threshold value but also below the price of the raw cotton (see **Figure 6**).

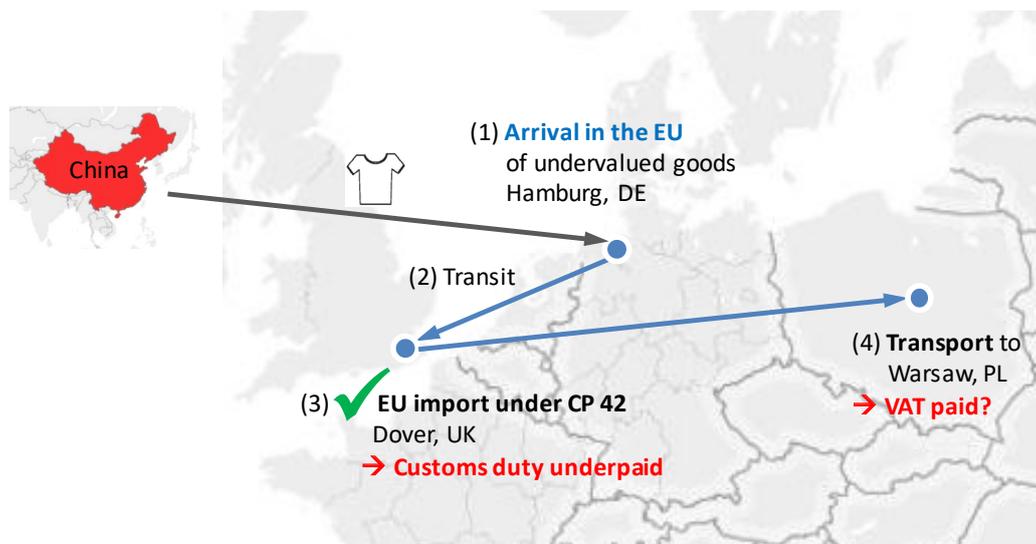
**Figure 6: Prices of imported processed cotton goods from a sample in the UK and comparison with risk threshold values and raw cotton price**



Source: ECA

An examination of the underlying evidence showed that the imported processed cotton goods from China followed routings that were not economically justified. The import point was chosen specifically to evade payment of customs duties and VAT, under what is known as “import point shopping” (See **Figure 7**). Fraudsters chose the UK as the import point because it did not apply the risk threshold values to request at import a guarantee - in order to cover the potential duty loss - for the release of goods declared with a potentially undervalued customs value.

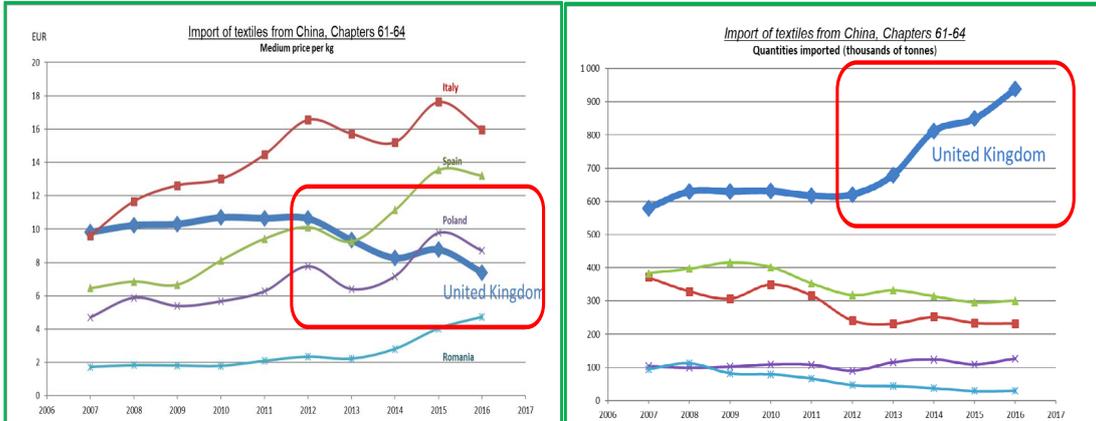
**Figure 7: A case of ‘import point shopping’ using customs procedure 42 (2015)**



Source: ECA

In fact, Eurostat statistics in **Figure 8** suggested the trade diversion effect of ‘import point shopping’, but only VDA allowed us to identify concrete imports which provided evidence of this practice.

**Figure 8: Medium prices and volumes imported of textiles and footwear in 2007-2016**

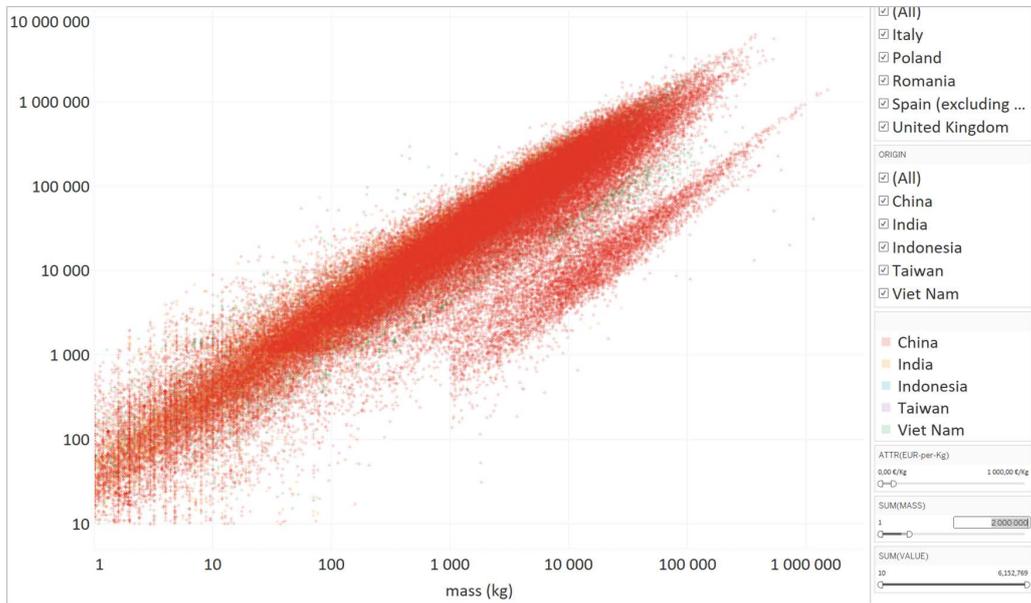


Source: Eurostat

**Using transaction network and visual data analysis in the fight against fraud**

Transaction network analysis and visual data analysis are key digital tools that tax authorities have to explore in order to identify a fraudulent chain created with the purposes of defrauding VAT. VDA can also be used to discover VAT and customs duties evasion and trade-based money laundering<sup>1</sup>.

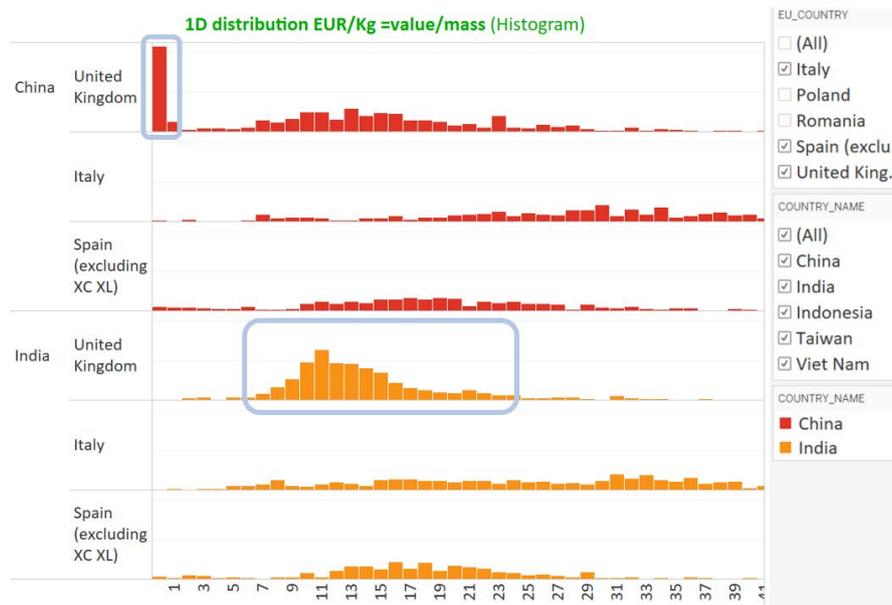
**Figure 9: Scatter plot with the population of textiles and shoes imported from Far East countries (2015 data)**



Source: ECA

<sup>1</sup> See for example Financial Action Task Force (FATF), "Trade Based Money Laundering" of in <http://www.fatf-gafi.org/media/fatf/documents/reports/Trade%20Based%20Money%20Laundering.pdf>

**Figure 10: Detection of abnormal price distributions using VDA (2015 data)**



Source: ECA

For auditors, VDA represents a change in the paradigm as we can analyse the whole population and observe anomalies at a glance. For example, the empty square in the bottom left hand corner of the scatter plot that contains the whole population in **Figure 9** (see ECA special report 19/2017 on import procedures) shows that one Member State does not report imports under a certain threshold in the Surveillance 2 database. Finally, apart from scatter plot analysis, VDA using *Tableau* allows the auditor to easily detect abnormal price distributions, which are an indicator of undervaluation fraud. See for example **Figure 10**.

The audit work we have done on import controls and VAT fraud shows that the systems are not yet effective enough and contain weaknesses and loopholes. Our audit work has served as an important source for the last European Parliament study entitled the 'Protection of EU financial interest on customs and VAT: Cooperation of national tax and customs authorities to prevent fraud' of March 2019. Many of the ECA recommendations in this area are reflected in this study.

With the aid of digital data analytical techniques tax authorities can step up their efforts to close these loopholes and prevent revenue losses for Member States and the EU budget. If we, as auditors, can do it, so can tax authorities. Hopefully, the changes introduced in the regulations in October 2018 will bear fruit and show a substantial decrease in the loss of billions of euros which the Member State and the EU budget have suffered during the last decade and lead to a better functioning EU Single Market.

# The ECA Statement of Assurance - separating errors from alleged fraud

By Nikolaos Kilonis, Financing and administering the Union Directorate

Each year the ECA publishes the results of its financial and compliance audit work in the form of a Statement of Assurance. For most of the areas of the EU budget, the ECA provides an estimated level of error. Each year the ECA goes to great pains to explain that these error estimates are not measures of fraud, or of inefficiency or waste. Nikolaos Kilonis, a senior auditor who coordinates work related to the ECA's annual financial and compliance audit, explains the differences between errors and suspicions of fraud and how the ECA identifies and treats each of these two findings.

## Common perceptions on ECA's work

Dialogue between an **ECA auditor** and his **mother**:

*I can't say I was looking forward to this, but what is this about?*

*Ahh that means 2,4% of the EU money was fraud and corruption!*

*Aren't you?*

*Hello Mom, here is our annual audit report.*

*It is the result of our audit, where we found an error rate of 2,4% in EU spending.*

*But I've told you several times Mom, I am not a detective!*

### **Questions after a published scandal:**

*Where were the auditors?  
Why didn't they do their job?  
How did it happen?  
Why didn't the controls work?*

### **Replies of auditors**

*An audit of financial statements is not a fraud audit!*

Dialogues as reflected above occur in real life situations quite often and illustrate what the general view and public expectation can be regarding our work as EU auditors. But how does the ECA consider the element of fraud in its financial and compliance audits, also called Statement of Assurance (SoA) audits, and how do the error rates we find relate to fraud?

## What is fraud and what is a Statement of Assurance error?

Under the Treaty, as the EU's external auditor, we have as mandatory tasks to examine the regularity of all EU revenue and expenditure as well as the soundness of financial management by the EU. In doing so, we report in particular on any case of irregularity, mostly within the framework of our audit work done for our SoA.



ECA's annual 'EU audit in brief' publication reflecting the main audit findings on its financial and compliance audit work

What is an error as opposed to an irregularity? An error is an unintentional misstatement in financial statements and an irregularity is any breach of EU law due to an act or omission, which harms or could harm the EU budget. A SoA error shows our estimate of the money that should not have been paid out because it was not used in accordance with the applicable rules and regulations.

By contrast, we regard (in line with EU regulation) as fraud any intentional act or omission relating to the use or presentation of false, incorrect or incomplete statements or documents, the non-disclosure of information (although required) and the improper use of EU funds. Fraud usually harms the EU budget, or at least the national budgets.

The notion of intentionality is pivotal in fraud. Fraud may consist of acts designed intentionally to conceal its existence. There may be collusion between management, employees or third parties, or falsification of documents and thus, it exceeds the duties and powers of the auditor. As auditors we do not have investigative powers and thus we cannot be expected to identify forged documentation in support of claims for grants and benefits, unless there are obvious forgeries. A court of law has the jurisdiction to determine if a particular transaction is fraudulent. This is why we report such instances as suspicions of fraud.

So irregularity is a broader concept than fraud. It is defined as any infringement of the law, which has, or would have, the effect of prejudicing the EU budget. If such breach of law has been committed intentionally, then it is fraud. Hence malicious intent on the part of the perpetrator is the differentiating element .

### What do we do at audit phase?

Although auditors do not legally determine if fraud has occurred, they do have a responsibility to assess whether the EU transactions concerned comply with relevant rules. Fraudulent transactions are, by their nature, not in compliance with relevant rules. Thus, the auditor may suggest that fraud is suspected in certain transactions.

According to audit standards, the primary responsibility for the prevention and detection of fraud rests with those charged with governance of the entity and management. However, before launching the audit procedures we always take account of the fraud risk (as part of the general risk assessment). We discuss internally where spending and revenue may be susceptible to material misstatement due to fraud, including how fraud might occur.



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We consider all information available resulting from our audits or coming from other sources (such as cases reported by the European Commission and Member States to the European Anti-Fraud Office (OLAF), OLAF investigations, and other external sources such as reports from Non Governmental Organisations (NGOs) and research institutes, corruption indexes etc.). We document the conclusions of this fraud

risk analysis and accordingly develop audit procedures designed to mitigate fraud risks. Professional skepticism is always present when carrying out the audit.

### **When do the errors found constitute cases of fraud ?**

Fraud may go unnoticed in audit procedures carried out in accordance with generally accepted auditing standards due to both the nature of fraud and the inherent limitations of an audit. Therefore, we do not give an assurance that cases of fraud do not exist. Actively searching and investigating fraud is not within the boundaries of a SoA audit. However new digital techniques (big data analysis) may help to identify common patterns of irregularities.

If the audit evidence needed for our audit has been seized as part of fraud investigation (by OLAF or national authorities), we then try to find alternative evidence and if not we carefully decide whether an error occurred or not. The errors found by the auditors are classified into a list of reasons, which may appear individually, or in any combination. In this list of reasons, the option of deliberate-intentional implies suspected fraud. In these cases, auditors consider that they have indications or even proof that a suspected fraudulent activity took place.

Therefore, our general estimate of the level of error in the EU budget is neither a measure of fraud nor of inefficiency or waste. Rather, it is an estimate of the money that should not have been paid out because it was not used in accordance with the applicable rules and regulations. To put it succinctly, fraud is always an error but an error is not necessarily fraud.

### **How do we report fraud?**

Despite the opacity of fraud, we find a number of suspected fraud cases each year in our SoA audits. However, we classify the overwhelming majority of irregularities as errors rather than suspicions of fraud. In 2018, for example, we found 13 such cases of over 700 audited transactions related to financial year 2017.

In cases of suspected fraud, we notify – where appropriate, unless they are implicated - the appropriate levels of management, those charged with governance such as the Commission, other EU institutions and bodies, national and regional authorities, and our superior within the ECA for appropriate follow-up and response. We then report them via the ECA's Legal Service to OLAF. It is then up to OLAF to investigate and follow up these cases, where appropriate in cooperation with national judicial authorities.

For example, in 2015 we reported a case where an EU agency granted an amount of €16 500 to promote European cooperation in the youth area. The audit procedure revealed that there was actually no beneficiary. Following our reporting of the error we found, the Commission applied the relevant rules and procedures and informed OLAF. The Commission also took the necessary actions to recover the paid funds.

Another example concern a huge infrastructure project related to a metro network. The ECA findings and reporting to OLAF was important material for OLAF investigations, resulting in a correction of several million euros some years after the initial finding. See for more information also page 49 of this Journal .

In the last three years, we reported to OLAF, over 50 cases of suspected fraud, either identified during our audit (including our work on performance) or based on information provided directly to us by third parties.

**Table 1: Overview of the suspected fraud cases the ECA reported to OLAF**

	2017	2016	2015
Transactions audited	703 (and 28 special reports)	1000 (and 36 special reports)	1200 (and 25 special reports)
Cases found during our audits	13	11	27
Cases based on information provided by third parties	6	5	15

Most of these cases concerned the artificial creation of the necessary conditions for EU financing, the declaration of costs not meeting the eligibility criteria and procurement irregularities. Thanks to our reported cases, between 2010 and 2017, OLAF recommended recoveries totaling €294,7 million. There were, however, cases that OLAF closed without recommending further action, due to the absence of evidence affecting the EU budget.

### Explaining the external auditor's role to the EU citizens when it comes to fraud

While it might be easier to present and digest auditor's findings as wrong doings, waste and even fraud (with media headlines saying *EU auditors found billions of euros wasted*) reality is often much more complex. Different roles and likewise different players exist for the different concepts of errors and fraud, the more since the latter most often can have criminal implications, triggering actions that go far beyond an auditor's realm.

The above analysis on the distinction between error and fraud and the different actions related to them is part of a continuous dialogue the ECA seeks with its stakeholders, whether it is an EU citizen (such as the auditor's mother) or a Member of the European Parliament. A dialogue in which we point out what we do in our annual financial and compliance audit work, and the specific role the ECA takes up to identify which actions our auditees need to focus on in fighting fraud in EU spending, as pointed out in special report 01/2019, which looks at the different roles the Commission, OLAF and Member States have to protect the EU's financial interests against fraud and corruption. With this last report the ECA shows that it does not shy away from its tasks in the fight against fraud and corruption, while keeping a clear eye on the respective responsibilities of the different actors, including its own as the EU's external auditor.

# Finding and rectifying a fraud case while auditing EU funds

By Orsolya Szarka, Investment for Cohesion, Growth and Inclusion Directorate



Source: Pixabay

How to start to put a stop to fraud?

How does an auditor find out about an error or possibly a fraud case? When does he or she realise that a finding concerns a case of suspected fraud rather than an error? And what does he or she then do to start the clock against the alleged perpetrator? Orsolya Szarka has audited many projects financed with EU funds. In this article, she zooms in on a particular audit experience from several years ago, which contributed to a multi-million euro recovery of EU funds.

## When you doubt it find more about it

Auditing can be full of surprises. One thing I have learnt over the years while auditing cohesion projects is not to judge a case based on first impressions. Several times I have experienced that things are not black and white. It is safer to have another look at an issue before drawing a final conclusion. And this is not only due to the multi-level EU and national rules we need to deal with. Sometimes you might find disastrous-looking documentation at the beneficiary's premises but end up finding no serious problems. In other cases, you might 'dig' deeper into a perfectly documented file just to find out that the carefully compiled papers are concealing some severe issues.

Judging why an irregularity has occurred is not an easy task. Was it an unintentional mistake? Ignorance of the applicable rules? Maybe the national authorities overlooked the problem while conducting their checks? Or was it committed intentionally by stepping beyond the bounds of legality and regularity to maximise the use of available funds – not from an EU budget point of view, of course, but rather for the benefit of those receiving the grants. We do not necessarily need to understand the underlying reasons, but if we suspect that EU money has been used illegally or for a fraudulent

activity, we are responsible for reporting this to the European anti-fraud office (OLAF), which can follow up on such cases.

I believe that each of us, within certain boundaries, has his or her own approach to doing our job. I came across a definition of a jigsaw puzzle recently. It said: "Each piece usually has a small part of the picture on it; when complete, a jigsaw puzzle produces a complete picture." For me, auditing is like putting together a puzzle. I work my way through the documents, piece by piece, to build up the complete picture, i.e. to find the audit trail for the expenditure I am auditing. However, the puzzle pieces do not always fit, which means there is a problem with the picture. Most often, I can conclude that this is due to an unintentional error. But not always...

### **On-the-spot visit to a big infrastructure project**

The case, which I recall very vividly, goes back a few years to when I was assigned to a compliance audit to contribute to our Statement of Assurance. The sample covered big projects with extensive documentation. We were already prepared, prior to the on-the-spot-visit, for the fact that one of our projects already had a certain 'reputation'. National authorities and the European Commission had already identified several problematic contracts and excluded these from eligible expenditure.

By their nature, our compliance audits cover expenditure from a well-defined period. It is possible, therefore, that the scope of our audit will include only a small part of the cost of a given project, particularly when we are auditing a large project with a long implementation period. This was the case in audit in question. Even though our project was huge, involving countless contracts, our sample covered only a short period and we needed to review only a limited number of expenditure items.

As always, after some preparations, our audit work started with the on-the-spot visit. We were able to identify and obtain the necessary documents, we understood the procedures and, overall, we could trace – what seemed like – a proper audit trail. However, the work was far from over at this point – we still had a lot of work ahead of us in the office.

### **Identifying contradictory puzzle pieces**

When we started the in-depth analysis of the documents, it turned out that the different 'puzzle pieces' for one of the consultancy invoices contradicted each other. This cost type usually requires some extra attention due to its immaterial nature. In this case, we were able to trace an hourly fee back to the contract, but somehow the value of the single invoice exceeded the amount budgeted for several years. It was only a periodic invoice, which did not cover the entire lifetime of the contract. And we neither found nor were presented with any contract modification.

In such a situation, we inevitably need to go back to the beneficiary and ask for clarifications. As a result of our enquiry, we received further pieces of the puzzle which answered one question, but raised several others. We were unable to obtain convincing arguments showing that the expenditure was regular, instead, we grew more confident that we had a serious finding.

We also discovered additional elements that made the situation even more suspicious. Many more and different people had worked for the project than those originally planned; significant modifications had been made at the contractor's request within a very short timeframe; the audit evidence called into question the project manager's independence from the contractor.

A contract with an intangible output but without a well-defined scope (in terms of both subject matter and budget) may be seen as an opportunity to gain money in bad faith.

By the time we had finished auditing the project, my colleagues and I all agreed it was highly likely that our beneficiary had been deliberately flexible when conducting the public procurement procedure and signing the contract. We therefore decided to refer the case to OLAF as a case of suspected fraud.

### **Out of our hands, up for fraud investigation**

Shortly after our notification OLAF launched its investigation of the project. Our report to OLAF with our findings was not its only source, but it definitely played a part in triggering a long and detailed procedure. The contract we had reported in our notification formed part of the examination. The investigators confirmed our finding, but, as the scope of their investigation was broader, they also found that the service rendered had not even been necessary. Another contract had already been signed earlier to cover this kind of consultancy work.

It took almost five years until OLAF closed the investigation and sent a report with a massive finding to the national authorities. In the meantime, the project was also subject to audits and investigations by several administrative and judicial authorities. As far as I know, the recovery procedure is not yet complete.

The contract in question represented a tiny part, less than one percent, of the financial impact on the EU budget estimated by OLAF: . But we can safely say that the decision to report it as a case of suspected fraud got the ball rolling on the recovery several million euros of EU funds, contributing to an investigation that shed light on a case of serious misuse of EU funds. Hopefully it will not only lead to the recovery of the public funds involved, but also prevent similar types of infringements on other major infrastructure projects.

# Private sector auditors in the fight against fraud: from audit to forensic investigation

By Lilian Grooten and Gérard Zolt, EY Luxembourg



Public opinion is keen to see fraud and corruption tackled, and legislation and measures by private companies have been stepped up in response. However, data obtained through surveys and from current findings on wrongdoing show that fraud and corruption have not decreased. What can auditors do about this and where does an audit stop and a forensic investigation start? Lilian Grooten works in the Forensic & Integrity Services of EY in Luxembourg and Gérard Zolt is the Country Practice Leader in the same division. They provide a perspective from the private audit world on the specific features of a forensic investigation compared to a more conventional audit.

## Actions stepped up but no results visible yet

In recent years, several large-scale scandals have taken place affecting big companies globally. Private and public organisations are increasingly exposed to fraud. Fraudsters are becoming smarter and more creative in hiding their fraudulent activities in reaction to the introduction of basic fraud prevention processes inside companies. One would have thought that this strengthening of internal controls, as well as numerous new laws being introduced - such as the French anti-corruption *Sapin II* law or the transposition of the EU Fourth Anti-Money Laundering Directive - would have had a serious impact on business ethics. However, in the EY annual Global Fraud Survey<sup>1</sup>, in which 2550 executives from 55 countries and territories around the world were interviewed, the responses received clearly demonstrated that fraud and corruption have not decreased globally in the last two years. The fact that fighting unethical behaviour is a big concern does not appear to radically change the mentality of many professionals. In view of this, besides all these new regulations a critical eye is required in all sectors to fight fraud and corruption, and auditors can play a substantial role in this struggle.

Below we will present some of the specific features of a forensic investigation compared to the more conventional audit. We also provide some concrete examples where internal and external auditors reached their limit and a forensic investigation provided the insights needed. These examples show the difference in approach, technology and means between a forensic investigator and an auditor.

## Financial audit vs. forensic investigation

A financial statement audit performed by an experienced auditor might come to mind first as the way to discover fraud - but might not discover



Source: EY Luxembourg

<sup>1</sup> 15th Global Fraud Survey 2018, EY

certain types, such as asset theft fraud. The main reason being that the objective of the financial statement audit is to determine whether the financial statements fairly present the company's financial position. If, for instance, a manager of the company audited has setup a fictitious vendor to transfer money into his own personal account, the transaction in itself will appear in the financial statement and might seem in line with procedures and business. However, if one looks deeper into this transaction, one would probably have some doubts about the real nature of the transaction and may conclude that it is fraudulent.

FOR AN AUDITOR, THE RISK OF NOT DETECTING A MATERIAL MISSTATEMENT RESULTING FROM FRAUD IS HIGHER THAN THE RISK OF NOT DETECTING ONE RESULTING FROM ERROR  
ISA 240

An auditor would issue an unqualified opinion, which would be justified, as this auditor cannot examine every transaction and is not tasked with doing so. A financial audit gives assurance to companies but a forensic investigation is performed on the basis of an issue defined by the client. A forensic investigator will not express an opinion on a company's financial statements. He applies very different methods which require specific knowledge and it can cost time to perform a full and accurate investigation. As described in Example 2, auditors may be the first ones to handle complaints but at a certain point more expert knowledge might be required.

### When to launch a forensic investigation?

A company or an institution can decide to request a forensic investigation in case it suspects unethical or illegal undertakings of the company or entity audited and needs confirmation of the suspicions if possible. An aspect which often comes into play when deciding to launch the forensic investigation, is whether there is a likelihood that the results of the work might be used in front of a court and/or in relation of a dismissal procedure and/or a company debarment as service provider or recipient of financial aid.

While an auditor will focus on the current fiscal year figures, information and documents, the forensic investigator is not limited to a defined period in time. If amongst the scope agreed is to determine for how long the fraud took place or for instance to quantify the potential damage suffered, the forensic investigation will seek and review all relevant information, regardless of when it was produced. During an investigation, a forensic investigator can become aware of other frauds that were not part of his scope. With discretion, this can result in a new investigation and solve previously uncovered frauds like the case described in Example 1.

#### Example 1 - a case in the industry sector

- Issue resulting in request for forensic intervention: at a major production site, the supply of a critical fluid was interrupted by a series of explosions. The client had already sent his internal audit team as well as external lawyers to examine the incidents, but none of them was able to determine whether these explosions were the result of fraud, mismanagement or sabotage. In addition, as the fluid was produced by a major supplier to the industrial plant, might there have been an error on their side?
- Approach applied: we undertook the following main steps
  1. Examined all relevant documentation, memos, email exchanges, meeting notes and other information relating to the decision to set up this critical fluid delivery.
  2. Examined all stages of the tender process in order to verify that all third parties were selected based on objective elements and not due to collusion with the client's purchase department.
  3. Analysed the tasks and actions of all persons involved in the building of the facility as well as its day-to-day operations.
  4. Interviewed all key persons involved.
  5. Analysed the incident reports and remediation steps undertaken by personnel on site.
- Results: we were able to demonstrate that the series of explosions did not have any illicit origin but was due to a combination of factors: non-respect of the internal tender process - companies and staff involved in the building process were not familiar with very specific norms to be complied with when handling the fluid – cost-cutting steps taken by the plant manager in order to meet financial goals imposed by HQ.
- Other points: while the explosions were not caused by any illicit actions, we found that certain pipelines, produced and supplied by another company of the group, did not correspond to the norms indicated in the ordering documents. An internal investigation was launched in this other company, where serious cases of fraud were discovered.

## **Interview techniques**

A forensic interview can be very challenging as the interviewee might have a hostile attitude, either because he has something to hide or, on the other hand, he has a high stress level because he must defend his innocence. The related parties interviewed might feel uncomfortable as well, because they are afraid to speak unfavourably about the suspect or they might even be protecting the suspect. Both circumstances could put them in unpleasant or even dangerous situations. This interview needs to be designed carefully beforehand to get the right information out of the person. A forensic investigator needs to be well trained to have the right approach during this interview, which will result in valuable evidence. Whatever the objective that one wants to achieve through such interviews, there are two aspects that always need to be respected:

- the fundamental rights of all person being interviewed;
- objectivity: the forensic investigator is not on a witch hunt but bases all his work on objective elements.

During a financial statement audit, an auditor also needs to interview his auditees, and it is not uncommon for the auditor to encounter a certain hostility or lack of cooperation. Naturally, training auditors in basic forensic interview techniques will not transform the auditor into a forensic investigator, which is also not the objective. However, it will improve the interviewing skills of the auditor and allow him to cope better with an uncooperative auditee. This could not only make the normal audit process more efficient, but a side-effect would also be to increase the possibility of eventually receiving information that might indicate a red flag or even a fraudulent situation.

### **Example 2 - a case in the financial sector**

- Issue resulting in request for forensic intervention: the management of a bank received a complaint by an external person, in which serious allegations of embezzlement and other fraudulent activity involving a senior staff member were made. As this very senior person was heading one of the most important desks of the bank, internal and external auditors directly reviewed the elements of the complaint, but could not find anything. As it was likely that the regulator might ask for clarification, the management of the bank decided to call us in.
- Approach applied: we undertook following main steps
  1. The suspected banker being a very discreet person, he had not kept all the information in the CRM system, as required by internal procedures. In order to proceed, we identified all direct and indirect sources of information and documentation held in the bank that could allow us to clarify which, if any, of the allegations had some basis in reality.
  2. After having received confirmation from external counsel that the laptop, credit card and mobile phone used by the suspect were the exclusive property of the bank, we proceeded to forensic technology extraction and analysis of the information held in these devices, including deleted and archived data sets.
  3. As the professional credit card used was directly debited to the bank, we combined all credit usage information with other data sets.
  4. We undertook a full mapping of email correspondence, internet usage as well as phone logs, in order to identify unusual numbers, addresses or patterns.
  5. We examined all accounts managed by the suspect, including transactional flows.
  6. We carried out forensic interviews with a limited number of colleagues.
- Results: not only were we able to confirm the allegations in the complaint received, but we were able to identify other fraudulent activity undertaken by the suspected person: mismanagement of a number of accounts, creation of a 'bank within a bank,' close involvement with some clients, non-authorized transfers and so forth. Our forensic report was shared immediately by the bank with the competent regulators and police forces.

## Chain of Custody and Chain of Evidence

The *Chain of Custody* is a principle used in many forensic fields, not only financial. It is a method of guaranteeing integrity while handling evidence. Basically, in the chain of custody you keep a record of certain details regarding the evidence; the location of the evidence, who has been in charge of this evidence, and who has accessed it, with the relevant dates. With the *Chain of Evidence*, you document whatever changes have been made to the evidence and by who. For example, an excel file obtained has been adjusted to make the retrieved data easier to read.



Source: Shutterstock

Both chains are measures taken to keep track of the location of and any alterations in the materials. If any non-registered alterations are found, the person in charge of the material at the time of the alteration can be found by consulting the Chain of Custody. Having a Chain of Custody and a Chain of Evidence in place allows you to demonstrate that you proceeded with integrity during an investigation and, more importantly, will allow any third party to retrace all the major steps in the investigation. In court, any investigation undertaken without having properly applied these two chains will be challenged by the defending parties.

From an auditor's perspective, the principle of the Chain of Custody and the Chain of Evidence could in certain cases be considered to provide added value, even in the course of a traditional audit. If, for instance, the auditor suspects that the company or entity about to be audited might have performed some non-compliant or illegal acts, then the use of these two chains will be of great value. Once the first red flags have been detected by the auditors, the forensic investigative team can rapidly go into action, as some work performed by the auditors can be integrated into the investigation without any risk of being challenged in court or by a defending party.

### Example 3 – a case in the public sector

- Issue resulting in request for forensic intervention: various government projects linked to education needed continuous additional major financing. Due to a lack of adequate resources and other considerations, the government internal controlling body proposed to the competent ministers that they should hire external forensic investigators.
- Approach applied: we undertook the following main steps
  1. As the education sector has specific rules and a limited number of specialised service providers, we set up a task force with trusted employees of the ministries involved. The main objective of the task force was, after thorough examination, to classify all parties involved internally and externally. This classification was needed in order to plan a structured approach, as we wanted to delay as much as possible their realisation that an investigation had been launched.
  2. We reviewed all the contracts relating to the various projects.
  3. We reviewed all the HR files of the relevant public servants involved and cross-checked them with the owner and management set-up of each commercial company mandated for these projects.
  4. We analysed all payments undertaken as well as all supporting documentation for all projects.
  5. We downloaded and undertook a forensic review of all emails exchanged between the various public servants and these companies.
  6. We undertook a large number of forensic interviews.
  7. We checked other data sets available.
- Results: we were able to identify a certain number of conflict-of-interest situations, as well as two cases of serious fraud. In one of the fraud cases, the ministry paid for the presence of a large number of employees of a service provider, and we were able to prove that over half of these employees never existed and/or were never present on site. Criminal complaints were filed by the ministries involved, while for other cases identified, reimbursement of the unduly paid funds was requested.
- Other points: as a result of our investigative work, we were asked by the ministries to assist them in improving their fraud prevention process.

## **Court**

A forensic investigator will conclude his investigation with a report to the client drawn up in such a way that the client always has the option of filing a legal case in court, wherever this court might be located. All work undertaken by forensic specialists must therefore fulfil the highest standards in terms of thoroughness, completeness, accuracy and documentation, as one can never know for sure where the report might be presented. Take Example 3, for instance, where a major investigation into government projects led to criminal complaints being filed by the ministries involved.

Another important element is that the report must be written in clear language, understandable by all parties involved, thereby negating any possibility of interpretation by these parties. It is the 'black and white' standard, and speculation or hypothesis should never appear in a forensic report.

## **In the end creative minds are key**

Obviously, a forensic investigator needs to have a good understanding of all the types of fraud that can be perpetrated and how. That being said, fraudsters are becoming very creative and are finding new ways to hide their activities. A forensic investigator must therefore be able to think out of the box and consider all options as possibilities. Companies hire forensic specialists for specific questions or situations for which no standardised questionnaires or audit reporting formats exist.

In the end, an open and creative mind is a must in this field. The traditional way of training auditors is slowly showing certain limitations. While it is absolutely necessary for auditors to follow the defined audit programme and processes, they must be very careful not to become victims of 'tunnel vision,' i.e. so focused on the audit objectives that all information not directly linked to them is automatically ignored.

There are many possibilities to train out of the box and creative thinking - through courses, for example. Training this creative mind, while wearing the 'forensic glasses', can be done by practising with real life or simulated forensic cases.

<b>Recap of the main differences between an audit and a forensic investigation</b>	
<i>Audit</i>	<i>Forensic investigation</i>
<ul style="list-style-type: none"> <li>• Pre-defined audit program</li> </ul>	<ul style="list-style-type: none"> <li>• Scope defined for each intervention and adaptable during the course of the work</li> </ul>
<ul style="list-style-type: none"> <li>• On-site for a limited amount of time</li> </ul>	<ul style="list-style-type: none"> <li>• Time on-site is determined by decision of the client and cooperation of the third-parties involved (if not part of the same company)</li> </ul>
<ul style="list-style-type: none"> <li>• Pre-defined team size</li> </ul>	<ul style="list-style-type: none"> <li>• Will depend on the scope of work to be performed and budget allocated</li> </ul>
<ul style="list-style-type: none"> <li>• Potential resource constraints</li> </ul>	<ul style="list-style-type: none"> <li>• Possibility of very rapidly increasing the size and/or composition of the forensic team</li> </ul>
<ul style="list-style-type: none"> <li>• Use of standard IT Audit tools</li> </ul>	<ul style="list-style-type: none"> <li>• Use of forensic technology tools that offer more flexibility and/or processing power than standard tools</li> </ul>
<ul style="list-style-type: none"> <li>• Limitations to admissibility in front of certain criminal courts</li> </ul>	<ul style="list-style-type: none"> <li>• No such limitations</li> </ul>
<ul style="list-style-type: none"> <li>• Blocked if the standard documents and/or information is not available</li> </ul>	<ul style="list-style-type: none"> <li>• Trained to find alternatives to missing information/documentation</li> </ul>
<ul style="list-style-type: none"> <li>• Standard audit report structure</li> </ul>	<ul style="list-style-type: none"> <li>• Report structure adapted to the needs of the client and final utilisation.</li> </ul>
<ul style="list-style-type: none"> <li>• Standard professional secrecy processes</li> </ul>	<ul style="list-style-type: none"> <li>• Specific security and confidentiality measures applied</li> </ul>

Source: Pixabay



In the end, an open and creative mind is a must in this field. The traditional way of training auditors is slowly showing some limits. While it's absolutely necessary for auditors to follow the defined audit program and processes, they must be very careful to not become victim of the so-called 'tunnel vision,' i.e. so focused on the audit objectives that all not directly linked information is automatically ignored.

There are many possibilities to train out of the box and creative thinking, through courses for example. Training this creative mind, while wearing the 'forensic glasses' can be done by practicing with real life or simulated forensic cases.

# Cooperation is key to make the fight against fraud successful

## Interview with Ville Itälä, Director-General of the EU Anti-Fraud Office - OLAF

By Gaston Moonen



Source: OLAF

Ville Itälä

The EU Anti-Fraud Office – OLAF – investigates a wide variety of wrongdoings, from embezzlement to customs fraud, and even food fraud. OLAF investigates and detects fraud, but it also carries out activities aimed at fraud prevention. Ville Itälä, OLAF’s Director-General since August 2018, shares his views on OLAF’s mandate, its core activities and its outlook.

*Before you became Director-General of OLAF you were an ECA Member, so you know the audit profession from the inside. And as a Member of the European Parliament and former minister in Finland, you know the political dimension. In Finland, you worked both in audit and in investigations and prosecution. Which aspect of your previous professional experience do you think is most beneficial to you in your current job?*

**Ville Itälä:** I have had different jobs in different organisations and environments, and I feel that the experience I gained in all of them is highly useful in my job here at OLAF. What was common across all of them was a strong belief in our European values, especially in human rights. And the need to maintain the trust of citizens: that is also an important aspect. In the Finnish Parliament, I was Chairman of the Constitutional Committee in the period when we first put human rights into the Finnish Constitution; the Committee was dealing with human rights issues on a daily basis. So I feel that human rights are an important part of my background, and that they are also very important for my current job.

*Can you give a specific example of such cooperation which clearly paid off?*

**Ville Itälä:** It was 35 years ago when I was working as a police chief and a prosecutor. In this case, there was a company which breached all the possible provisions of Finnish criminal law. What we found was just a small cardboard box with some invoices. They had no accounts, no registration: nothing. They were stealing things and selling them

on, among other things. What surprised me at the time was that all the evidence fitted inside a small box. In those days, the dimensions were different from now, and it was quite easy to recognise the structure of the fraud. Fraud schemes are more complex now, and much more systemic. And since fraud is now often cross-border, it is more difficult to detect and investigate. And in that sense I am quite happy to be here, because our added value comes from this cross-border investigation and cooperation. Our work requires knowledge about the legislation and the language of different countries. National police authorities have generally neither the capacity nor the resources to do that. In this regard, OLAF clearly adds value.

“ ... our added value comes from this cross-border investigation and cooperation.

### Key input in cross-border investigations

Can you give a specific example of such cooperation which clearly paid off?

**Ville Itälä:** An example that comes to my mind is a VAT case in Romania. It involved cooperation between the Italian and Romanian authorities, and OLAF coordinated it. It was really a success story: it involved “big money”. A national authority acting alone could not have cracked the case. With the help of OLAF’s knowledge, the team was able to put the pieces of the puzzle together, and we tracked the fraudsters down in Romania. Basically, it was a joint operation with the Guardia di Finanza in Italy and the Romanian authorities, and there have already been arrests and seizures of assets. But it seems that the same gang copied its actions elsewhere. So that will keep on going in terms of case work.

We present the different types of cases we deal with, and the trends we see, in [our annual report](#). And under each trend you can see a lot of real-life examples. For the VAT case, we also had a press release: you can find it on our website.

*OLAF cannot bring prosecutions, because it cannot undertake legal action. So what is exactly OLAF’s role? Does it involve following up on leads where national police authorities are also involved?*

**Ville Itälä:** We usually start off with information from our leads. Then we sometimes notice that our partners actually possess identical information about a case which has come to OLAF: for example, in the case I just mentioned, the Romanians were already working on it, and we knew that in Italy they were following related leads...so by putting the case together, we managed to catch the bad guys.

Another success story is called ‘Operation Bonifica.’ Together with the Italian authorities we found thousands of instances of what we call ‘false farmers:’ people who are deceased or who own pieces of land that are not cultivated. But claims for EU funding have been submitted by these people, and for these unused plots of land. So grants were being paid out by the Italian authorities, but it was actually a whole scam managed by the mafia. The Italian authorities came to us because we possess expert knowledge on how these funds are supposed to be managed. They concluded the national level investigations, we concluded the EU-level investigations, and we recommended that about €30 million be recovered. This brings me to another significant role played by OLAF: our prerogative to recommend recoveries via the financial route, so that the money claimed by fraudsters is returned to the EU budget. In the “false farmers” case, our recommendation meant that the European Commission was able to recover the money without any additional proceedings.

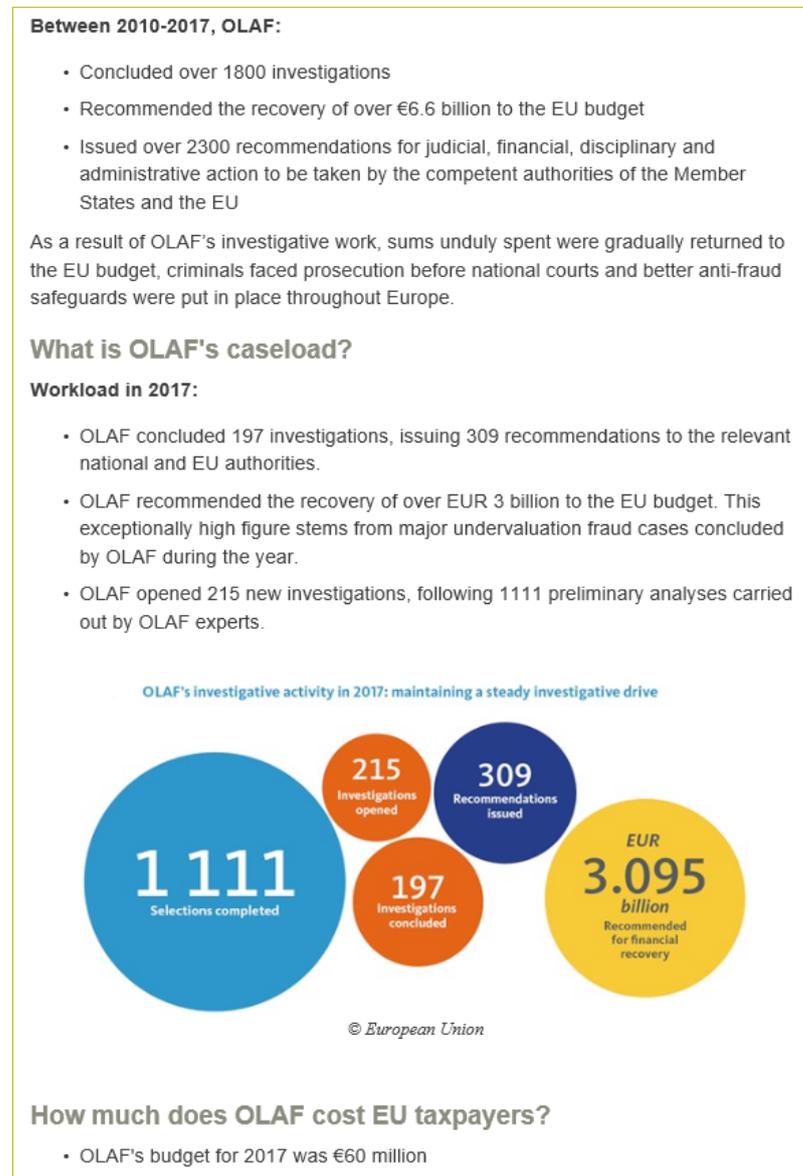
“ ... our prerogative [is] to recommend recoveries via the financial route, so that the money claimed by fraudsters is returned to the EU budget.

### Significant recovery recommendations

Speaking about money: your 2017 report mentions recovery recommendations of over €3 billion?

**Ville Itälä:** Yes, but mostly because of one case. It concerned big shipments of Chinese food and textiles to Hamburg (Germany). Then the fraudsters put the textiles on to

trucks, which then went to the UK where they formally entered the Single Market. The UK customs authorities however undervalued the textiles. On the basis of our investigation covering three to four years, we calculated that €1.9 billion in customs duties had been lost. In fact, the Commission sent an even bigger bill because it looked further back, and realised that the issue dated back far longer. Finally, they concluded that an amount of €2.5 billion has to be paid back by the UK. As you probably know, this case is currently at the European Court of Justice. This example shows that criminals are looking for the weakest links in the customs control chain. And this requires cooperation within the EU.



Source: OLAF

**Figure 1 – Some figures related to OLAF's activities**

*When you find such a case you normally cannot extrapolate from it, correct?*

**Ville Itälä:** Yes, that is correct. Everything is case-specific. That is also what we say in our annual report. We do not want to ring the alarm bells and suggest that there is more fraud in Europe than there actually is. When we say that fraud is "systemic", we do not mean that fraud is embedded in all the EU does. Instead, we mean that the fraudsters have created a whole system, which at first sight may not necessarily seem to be fraudulent, even when you audit it. For example, in some Member States we identified an issue of conflict of interest in public procurement. We made recommendations on this and the Commission is working on the recovery.

*The judicial process takes time to recover funds. To what extent is it capable and equipped to deal with such cases?*

**Ville Itälä:** This is why it is so important the European Public Prosecutor's Office (EPPO) is being created. There are too many criminal laws and different practices, and it is too fragmented. Currently, the judicial procedures take too long. This needs to be addressed and we believe that the EPPO will be very helpful in this regard.

### **More instruments to fight fraud than rules and controls**

*Tender procedures and customs duties have long been associated with voluminous rules and procedures. To what extent does complex regulation lead to opportunities for fraud and corruption? According to some experts, regulation can also have the reverse effect from a trust point of view. How do you see that?*

**Ville Itälä:** I think it is not about how simple or complex the rules are. The issue is that fraudsters are doing what they are doing. There are different motivations for that. But it always has the same consequence: fraudsters take the money away, with as a consequence that there is less funds getting to people who really need it. And, as the ECA has often pointed out, procurement rules can be very complex and difficult. That can make such proceedings more vulnerable to irregularities and fraud. But the core problem is that fraudsters are exploiting the possibilities of our single market. Capital can move freely, people can move freely...and the criminals can move freely too. That is why we need a system to follow that, and here OLAF's added value of is evident. You need somebody to keep an eye on what the fraudsters are doing.

“ ... the core problem is that fraudsters are exploiting the possibilities of our single market.

So when it comes to the single market, law enforcement is not agile enough. But criminals exploit the systems immediately. So we are always a little bit behind. We have to develop our systems however in a sensible way and we should not put in place too many controls, either. This would only push costs up, and would be an obstacle to the main overall objective of the single market: free trade. That is why we are developing our information systems. The exchange of information is so important. That is one of our priorities. If we have better information, fraudsters will find it harder to act.

*Is one of the instruments for exchange of information also blacklisting? In the past, Member States did not use this tool very often, not least because it might hurt some of their own companies. Is that changing? In the sense that the overall interests of the EU will suit Member States' own interests now too?*

**Ville Itälä:** Yes, we have seen this change, and it has happened quite rapidly now. Even on the borders of the EU, so not only inside the EU but also from an international point of view. So far, at conferences, everyone has said: 'Yes, we have to cooperate.' But in reality, cooperation was lagging behind. Now I think the situation has changed a lot: people are going further than just talking.

As I said before: exchanging information is crucial, but there are also many legal limits on that. A big one relates to data protection, which clearly is an important issue. Sometimes data protection rules limit the exchange of information which is really necessary to go after fraudsters. Often, however, we can find a way to exchange such information and still comply with these rules. For OLAF, this is important because preventing the sharing of data makes cross-border investigations more difficult.

#### **Box 1 - ECA – OLAF workshop on 21 May 2019**

After mutual updates on recent trends and plans for near future, representatives of OLAF and ECA provided some insights on procedures and criteria shaping each institution's daily work. Close cooperation of both institutions was tested in practice by solving case studies in four thematic areas:

- Agriculture;
- Structural funds;
- Cases in 3<sup>rd</sup> countries; and
- Parallel OLAF investigations and ECA audits.

Results of the case studies were discussed in groups and presented to all participants. The importance of exchange of information and use of IT tools in audit work was stressed by several speakers both from ECA and OLAF.

## Fear of reputational impact

*One of the issues often linked to fraud is the reputational risk: speaking about fraud as such can already trigger some reluctance because of reputational impact. The fear is that mentioning fraud will make people think that a lot of EU funds is tainted. So let's not speak too much about it. OLAF is often associated with fraud, with costs for the EU budget, and not necessarily benefits. How do you plan to turn around this image? What is your strategy?*

**Ville Itälä:** We are not reluctant to discuss fraud. But when we carry out an investigation, we cannot publicly state what we are doing. Then we conclude the case and issue a recommendation: for example, a judicial recommendation. If we inform the public too early, we may jeopardise the national prosecutor's investigations. So we need to be careful when informing the public since we do not want to jeopardise ongoing investigations.

We are currently trying to find a way of being more transparent. As I said, people do not know, or know enough, about what we are doing. That is why we have this annual report, which describes to people non-technically what we have done and explains our cases.

The latest case we had is also quite telling: it was about counterfeited shampoo being shipped to Mexico and Colombia. We detected it and passed on the information to the Mexican and Colombian authorities. Then they seized them and arrested the perpetrators. That case also shows our mandate regarding revenue fraud. Basically, it is the same thing as in the undervaluation case I mentioned before: the fight against counterfeiting is in the same family of cases, because it is revenue fraud. It was shampoo made in Asia, so it was fake branded. Through our information we knew that the criminals were targeting the EU market. They were sailing around the world...they reshipped the counterfeit goods so many times so that the authorities lost track of the containers containing them. Together with law enforcement in Mexico and Colombia, we caught them, by cooperating internationally. So we prevented this kind of product from flooding the EU market. Preventing such products from entering the EU is one of our objectives: if they reach the EU market, it leads to loss of revenue, customs duties and so on. But even more importantly, such products are potentially dangerous to the health of our citizens.

*Do you feel that, as Director-General of OLAF, you have to present contrasting perspectives: you have to indicate the severity of situations – a negative story – while on the other hand you have to present the success stories?*

**Ville Itälä:** I think fraud in a way is indeed negative, but from the citizen's point of view, what matters more is that there is a European body defending their interests. My communications specialists and I are always discussing how we can be more transparent. We have tried to find solutions, but we are in a different position from most other EU bodies. And it is important to stress this: we provide information where we can, and we certainly do not brush fraud under the carpet: quite the opposite, we expose it. Thanks to us, fraudulently acquired money is returned to the EU budget, where it will be used to finance useful projects and promote the creation of jobs. Another element we have to take into account is the deterrent effect of investigation. Fraudsters know that we are here and working to prevent them from doing what they are up to.

“...we certainly do not brush fraud under the carpet: quite the opposite, we expose it.”

## OLAF's mandate only goes so far

*One of the issues increasingly related to fraud is tax evasion, including money-laundering. The latter often involves banks. We have seen fines levied on ING in the Netherlands, Danske Bank and Nordea, big cases. The Panama Papers were published. What is the role of OLAF on these issues, if any?*

**Ville Itälä:** Tax evasion as such does not fall within our mandate. That is for sure. But the Panama Papers are part of another OLAF success story that I am happy to share. Our investigators and analysts used very innovative methods and they collected this huge amount of data, with around 420,000 documents, all downloaded from publicly available data. And then our analysts cross-referenced these with the names and information of about 45,000 EU staff and Members of the institutions. Commissioners, MEPs and EU officials, mostly those who are in charge of managing funds. These can be project managers, but we also included auditors.

So we cross-referenced these to see if the names of EU staff and Members appeared in the Panama Papers. Out of these, we actually had only 17 matches. But they were not all real matches. Out of these we opened investigations and then we got some information through our regular channels and opened two more. Overall, in connection with the Panama Papers we ended up with six cases, four from our analysis and two through our regular channels.

That is the technological capacity we nowadays have at OLAF. With a very reassuring outcome for the EU institutions: as I said, only six cases out of 45,000 staff. But on tax evasion issues as such, that is dealt with primarily at national level. However, regarding big data analytics, one of our concerns is that each Member State has developed its own databases and systems, and they do not communicate with each other enough, or even at all. We are trying to find a way to relay this information; we are also discussing it with the European Commission to negotiate a way for us to gain access. This is also very important for the customs-related aspects of e-commerce where OLAF does have a stake.

*A few years ago, the ECA published a report on VAT fraud; on 16 May 2019, we published one on fraud in cohesion expenditure, special report No 6/2019. In 2018, the ECA presented two Opinions on fraud-related issues, and of course we have special report No 1/2019 on fighting fraud in EU spending. What is your take on these publications, and what do you think are the main issues to focus on?*

**Ville Itälä:** I agree with many of the critical remarks made in these opinions, particularly those aimed at improving the system. Once our investigations are finalised, the judicial and financial follow-up by national prosecutors, other Commission departments or national bodies is out of our hands. Our mandate stops when we have issued our recommendation. There were some interpretations that it was OLAF's fault. Well, absolutely not! There is something wrong with the system. We need to find better ways to recover the money.

“ Our mandate stops when we have issued our recommendation.

I was happy to read that the ECA noted in its Special Report No 1/2019 that we need to take action, because that is now on the table for a new regulation, which should give us the possibility to access information on bank accounts, carry out more on-the-spot investigations, and make our evidence admissible in national courts. These will be important tools for us to become more effective. These new tools will help us a lot. In fact, the ECA report helped us in making progress; and the European Parliament also strongly supports this. The Council is however much more reluctant.

“ ... the ECA report helped us in making progress; and the European Parliament also strongly supports this.

What I do not agree with is saying that we are not effective. We are quite effective, and that can be measured in many ways. Instead of criticising OLAF for not being effective, you have to criticise the system, which needs to be changed to allow us to become more effective. We can become more effective if we are given the right tools, that I fully admit. This is why I was very happy with the proposal in special report No 1/2019 that we should focus more on developing the Commission's anti-fraud strategy. That is now on a wholly new level; I have personally started meeting all of my colleagues in the Commission to discuss this, for example with DG SANTE.

I was in Italy some weeks ago, and the Guardia Finanza has one division dedicated entirely to food fraud. They have very interesting cases, often also involving food stuff coming from non-EU countries. This field has been expanding enormously in recent years. And the citizen are thinking: why is the EU there? The answer is: to provide security, also regarding food. Cooperation is also necessary here, exchange of information between authorities, including to and from OLAF.

*Fraud and integrity are two opposite, but interlinked issues. As an MEP, you have also seen sensitive situations in the Parliament. Is integrity something to be concerned about in the EU institutions?*

**Ville Itälä:** First, I must say that even one case is too much if it concerns the EU institutions. Most of the time, not so much money is involved in such cases, but the reputational impact for the EU is huge. But I must also say that in 2017, there were 17 cases, and we issued 12

recommendations. And if you consider that there are around 45,000 people working for the EU, it puts things into perspective. What I am trying to say is that, although people are quick to presume that there is substantial fraud happening inside the EU institutions, there is no evidence to support that! The ECA's 2017 annual report indicates the same thing. Administrative expenditure for many years has been for many years now below the ECA's materiality level of 2% of the expenditure, actually close to zero. In reality, fraud and corruption is quite a small issue inside the EU institutions. However, as I said, even one case is too many, and may attract huge headlines. But citizens really should not worry: there is a zero tolerance level for fraud and corruption within the EU institutions and bodies.

“ In reality, fraud and corruption is quite a small issue inside the EU institutions. However, as I said, even one case is too many...

### OLAF as a knowledge centre

What do you think is a key accomplishment to have been achieved by the end of the next Multiannual Financial Framework, so in about seven years from now? Also from a strategic point of view?

**Ville Itälä:** We should really start building the bridges I mentioned, including improving our cooperation with the ECA. On 22 May this year, I will sign an administrative arrangement with your Secretary-General, Eduardo Ruiz-Garcia, which will help the ECA auditors in their handling of cases of suspicion of fraud in the areas they audit. The other thing I want to improve is that we as OLAF are even closer to EU citizens, especially when we deal with issues such as food fraud and e-commerce. Finally, there will always be new areas where fraud may be committed, and we have to follow that, or better, pre-empt that. Cooperation and the exchange of information are essential in this respect. I want OLAF to follow these developments, and use artificial intelligence and other tools to become a knowledge centre for fraud. We need to build trust and cooperation with other parties to get there. And we also need to contribute to trust in the institutions, and in the EU generally. These are my priorities. And I really hope to continue the good cooperation OLAF has with the ECA, and to create new possibilities for working together, such as joint training measures or the follow-up of cases reported by ECA. Together, OLAF and the ECA, we share a purpose: to protect the EU's financial interest.

#### Box 2 - Administrative arrangements between OLAF and the ECA

On 22 May 2019 the OLAF, represented by its Director-General Ville Itälä, and the ECA, represented by its Secretary General Eduardo Ruiz Garcia, signed a so-called 'Administrative Arrangement' at the ECA in Luxembourg. With this arrangement, OLAF and the ECA contribute to a structured framework for cooperation between the two organisations which in principle aims at facilitating their timely exchange of information. The arrangement provides further details on contact persons, case selection and information provision relating to possible cases of fraud and corruption detrimental to the financial interests of the EU, opening and closing of certain types of cases by OLAF, and also regarding non-operational cooperation issues, such as training, workshops and exchange of staff. The arrangement takes immediate effect.



From left to right: Ville Itälä, OLAF Director-General, Klaus-Heiner Lehne, ECA President, Eduardo Ruiz Garcia, ECA Secretary General

# New kid on the block: the European Public Prosecutor's Office

By Oliver Salles, European Public Prosecutor's Office



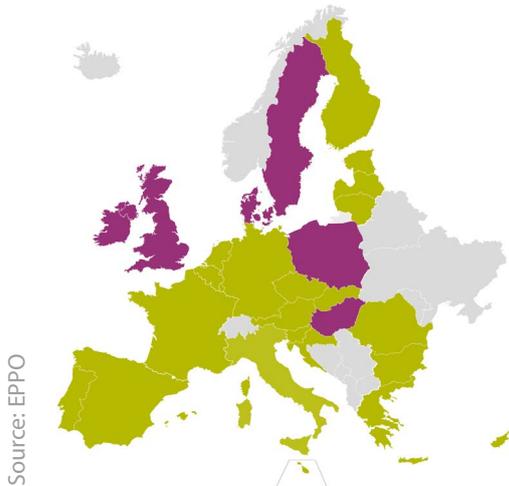
Source: European Parliament

Several EU bodies are involved in the fight against fraud and corruption, with acronyms such as OLAF, Eurojust, Europol, the CJEU and ECA. Another one has only recently been created: The EPPO, the European Public Prosecutor's Office. Many experts consider this office to be the missing link in stepping up action against fraud and corruption in the EU. Oliver Salles, as the interim Administrative Director of the EPPO, presents some key issues related to the process of setting up the EPPO and where they stand from an operational point of view.

## 22 Member States pushed the start button

On 12 October 2017, after four years of negotiations on the proposal of the European Commission, the Council adopted the Regulation implementing enhanced cooperation on the establishment of the European Public Prosecutor's Office (EPPO) as an independent EU prosecution body competent to investigate and prosecute fraud, corruption and other crimes affecting the Union's financial interests. At the time, twenty Member States agreed to start a paradigm shift in the way the European Union protects its financial interests by setting up this new office. Two more Member States (the Netherlands and Malta) have since joined them, and the Swedish Prime minister has recently announced his government's intention to submit the decision to join the EPPO to the Riksdagen, the Swedish parliament. Only the United Kingdom, Ireland, Hungary and Poland are not participating in the EPPO, for the time being, and nor is Denmark, which has a Treaty opt-out on judicial cooperation.

**Figure 1: 22 EU Member States participating in the EPPO**



### EPPO challenges and added value

Fraud affecting the financial interests of the EU is complex, often involving criminals in several Member States. National authorities have to deal with criminal law systems which differ from one state to the next, lengthy procedures for judicial cooperation, language barriers, a lack of resources and the different priorities of public prosecutors. In order to be successful in such investigations, the relevant national authorities would need to have a robust understanding of the judicial and administrative frameworks in all of the Member States involved and the ability to act swiftly. In practice, this is not always the case.

It has become obvious that the previous EU framework comprising Eurojust, Europol and OLAF - the EU's anti-fraud office – could not overcome these difficulties effectively. Currently, only national authorities can conduct criminal investigations and also prosecute cases of fraud affecting the financial interests of the EU. However, their competence stops at their respective borders.

Eurojust and Europol, as judicial and police cooperation bodies, mainly support the Member States in their actions against serious cross-border crime and terrorism. However, they cannot carry out investigations or prosecutions themselves. OLAF carries out administrative investigations and sends recommendations to the competent authorities at EU or Member State level to recover any defrauded funds or to prevent money from being unduly spent, as well as to national judicial authorities, which can decide to open criminal proceedings on this basis (or not). Currently, only 50% of the recommendations issued by OLAF to national judicial authorities result in indictments. This is an average, hiding considerable national disparities. The lack of a consistent level of judicial oversight across the EU creates loopholes: cross-border VAT fraud being a case in point.

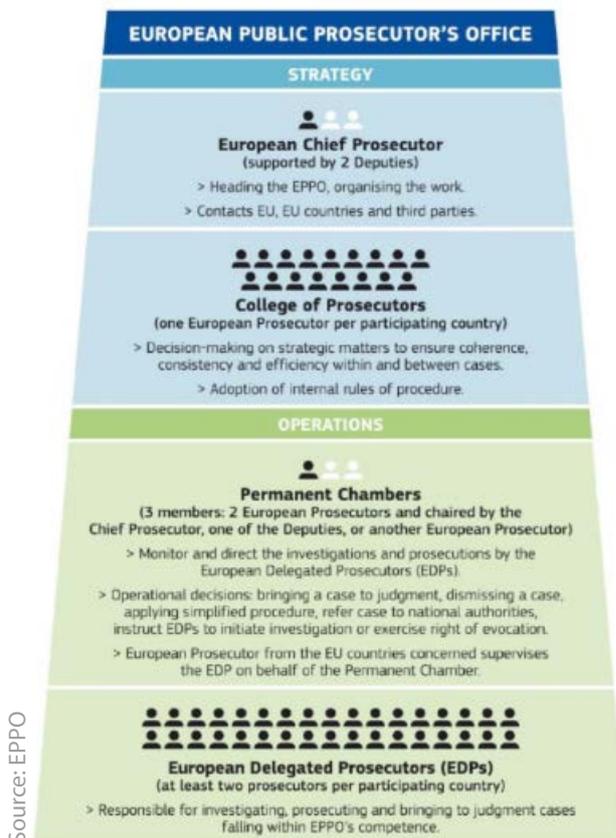
This is where the EPPO will make a difference. It will operate as a single office with a decentralised structure across the participating Member States. Its Central Office will be in Luxembourg but it will work together with European Delegated Prosecutors embedded in the judicial systems of all the participating Member States. The Central Office will consist of a European Chief Prosecutor and one European Prosecutor from each participating Member State, as well as support staff. By 2023, when it has reached cruising speed, it is planned that the EPPO will have a total of 117 staff at its Central Office.

In addition, there will be European Delegated Prosecutors – national prosecutors working for the EPPO under the supervision and guidance of the Central Office - who will carry out the bulk of the EPPO's investigative work. Member States will provide both the legal and material means for the European Delegated Prosecutors to be able to act effectively within their national systems. The Central Office will provide the information and legal tools for the European Delegated Prosecutors to be able to cooperate effectively across borders.

Where necessary, criminal procedural systems will have to be adapted to allow the EPPO to carry out its investigation and prosecution work properly. Furthermore, the European Prosecutors in the EPPO's Central Office will act as prosecuting authorities in each national system, with the power to supervise investigations in their Member State of origin and, in exceptional cases, to conduct them personally.

The EPPO is meant to become the depository of unique expertise and a provider of strategic data in the fight against fraud and corruption at EU level, and hence will have both the ability and the means to lead complex, cross-border criminal investigations, allowing it to overcome the current fragmented national approach. To do so, the EPPO will define its own European investigation and prosecution policy, and work closely with national judicial and law enforcement agencies (e.g. police, tax and finance authorities, customs, etc.). It will also need to establish close cooperative relationships with its

**Figure 2: Overview of the EPPO**



Source: EPPO

Union partners; in the area of PIF investigations (protection of financial interests), synergies between the EPPO and OLAF will enable them to protect the budget through a combination of criminal and administrative investigations. Comprehensive reporting requirements imposed upon national authorities as well as EU institutions, bodies, offices and agencies will ensure that the EPPO can exercise its competence effectively.

### Competence

The EPPO will have powers to deal with criminal offences affecting the financial interests of the Union, as defined in the PIF Directive<sup>1</sup>. In accordance with Articles 22 and 25 of its founding regulation, the EPPO will in principle<sup>2</sup> only deal with cases where the damage to the EU's financial interests is more than 10 000 euros. In addition, the EPPO will be competent for serious cross-border VAT fraud involving total damage of at least 10 million euros.

Moreover, the EPPO's competence will cover offences relating to participation

in a criminal organisation as defined in the EU's Framework Decision 2008/841/JHA, if the focus of the criminal activity of such a criminal organisation is committing the offences defined in the PIF Directive. In addition, the EPPO will also be competent for any other criminal offence that is inextricably linked to an offence affecting the Union's financial interests.

The EPPO may, under certain circumstances, investigate and prosecute cases even if they were committed outside the territory of the participating Member States, i.e. in the territory of non-participating Member States or third states.

The EPPO's actions will be guided by high standards with regard to the protection of the rights of the persons involved in its investigations through the guarantees provided in national procedural law systems and in the relevant EU instruments (directives on procedural rights of persons suspected or accused in criminal proceedings). The EPPO's action will be guided by high standards of protection of the rights of the persons involved in its investigations, through the guarantees provided for in national procedural law

<sup>1</sup> 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.

<sup>2</sup> The EPPO will be able to deal with cases below the threshold of 10 000 euros under the conditions set out in Article 25(2) of the EPPO Regulation if the case has repercussions at Union level or if officials or other servants of the Union or members of the institutions of the Union could be suspected of having committed the offence.

systems and in the relevant EU instruments (Directives on procedural rights of persons suspected or accused in criminal proceedings).

### **Organisation**

The Commission is responsible for the establishment and initial administrative operation of the EPPO, with the objective of the EPPO starting to work on actual cases as from November 2020. As interim Administrative Director, I am in charge of coordinating several lines of work to that effect. Allow me to mention a few of them.

The general public has focused its attention mainly on the negotiations between the Council and the European Parliament concerning the first European Chief Prosecutor. Unfortunately, the Council and Parliament have not been able to come to a 'common accord' so far, so the appointment of the first European Chief Prosecutor has been delayed.

In the meantime, the Member States have started to nominate their three respective candidates for European Prosecutor positions. At least 66 candidates will be interviewed in the coming months by the selection panel, so that 22 of them can be appointed around the summer and possibly take up their duties towards the end of this year.

A dozen posts have or will be published this year to start recruiting EPPO staff. This first wave will fill key central support functions, such as HR, the legal service, IT, security and administration.

Another main focus of work is the preparation of the EPPO headquarters in Luxembourg. All the preparatory and technical specification work is well underway, in close cooperation with the Luxembourg authorities, so that work on the selected building can start in January 2020 at the very latest. In the meantime, transitional accommodation solutions are being arranged.

The EPPO is also designing and building its future IT infrastructure, which includes the development of an unprecedented Case Management System, connected to the case management systems in each of the participating Member States - the backbone of the EPPO's future operations.

### **Cooperation with the ECA.**

Apart from cooperation with Eurojust, Europol and OLAF, as defined in its founding Regulation, the EPPO will also have a natural interest in developing strong and fruitful relations with the ECA. After all, though acting from different angles and with different tools, they share a common objective - protecting the financial interests of the EU, in particular through fighting fraud.

The ECA's focus on sound financial management and the efficiency and effectiveness of EU spending could inform the EPPO's strategic policy orientation. The ECA's reports and findings will be extremely useful in this context. In addition, the ECA will be able to transmit its relevant findings and cases of suspected fraud to the EPPO, as it currently does to OLAF.

From a practical point of view, the challenge will be to find the right ways to make good use of the ECA's expertise and knowledge: we could explore information exchange modalities, share best practices, organise joint or reciprocal training. Such cooperation would probably have to be embedded in a Memorandum of Understanding or administrative agreement at some point, designing an approach which will be mutually beneficial.

We welcome the prospect of further reflection and discussions in this regard. There is no doubt that this will be among the priorities of the first European Chief Prosecutor and that the ECA will contribute to making the EPPO a great success. This being said, each body will keep its power to exercise its respective legal and institutional role. The ECA will be able to audit the EPPO, and theoretically the EPPO might lead investigations involving the ECA.

### **Getting into gear**

In the years to come, the challenge for the EPPO will be to demonstrate its added-value by solving conflicts of jurisdiction, stepping up prosecution rates and achieving tangible results. In other words, by bringing cases to judgement in a swift and conclusive way. This is quite a task in the area of criminal law where national jurisdictions have set the tone and pace for centuries. A crucial element for the success of the EPPO will be support and input from the Member States who have to prove they are serious about protecting the financial interests of the EU.

# EPPO, OLAF and CJEU - a brief look at their interplay

By Jan Inghelram, Court of Justice of the European Union

The creation of the European Public Prosecutor's Office (EPPO) undoubtedly has a large bearing on the activities and proceedings of the European Anti-Fraud Office (OLAF). And both OLAF's and EPPO's activities have been and will be affected by judgments of the European Court of Justice (CJEU). Jan Inghelram is well-placed to give his insights on how three crucial actors in the EU's legal realm interact in the fight against fraud and corruption related to EU funds. Not only is he currently Director and Legal Adviser on Administrative Matters of the CJEU, but he also the author of several publications on EU finances, the ECA and the CJEU. Before joining the CJEU, Jan worked for several years in the ECA's Legal Service. Below he gives his personal views on some legal challenges the three EU bodies face, particularly when it comes to the protection of some fundamental rights, and the role of the CJEU in a changing institutional context.

## Developing the protection of the EU's financial interests

Thirty years ago, the European Court of Justice (CJEU, hereinafter referring to all EU courts) rendered its famous judgment in the Greek maize case (68/88, Commission v Greece). It obliged Member States to give the protection of the EU's financial interests the same weight as their own financial interests and to provide for effective proportionate and dissuasive penalties to protect the EU's financial interests.

This judgment was the direct cause for important developments in the area of the protection of the EU's financial interests. It was 'codified' in the Treaty of Maastricht in order to become what is now Article 325 TFEU. This Article was first implemented in 1999 when it became the legal basis for the regulation governing the investigative competences of the newly created European Anti-Fraud Office (OLAF, Regulations 1073/1999 and 1074/1999, now Reg. 883/2013).

At the time when OLAF became operational in 1999, a European Public Officer's Office (EPPO) was no more than an academic proposal, tabled in the 'Corpus Juris introducing penal provisions for the purpose of the financial interests of the European Union'.<sup>1</sup> Ten years later, however, the possibility of establishing an EPPO was already provided for at Treaty level by the Treaty of Lisbon, and another ten years later we are witnessing the setting up of the EPPO, the creation of which was decided in 2017 (Reg. 2017/1939). So far 22 Member States are participating in this project.

## CJEU and OLAF

Indirectly involved in OLAF's inception, the CJEU also contributed to shaping OLAF during the twenty years of its existence. The first OLAF-related cases were submitted in 2002 and, in the meantime, OLAF's investigative competences have been dealt with in some 60 cases, resulting in case law with a sometimes decisive impact on OLAF investigations in practice.

Many OLAF-related cases raise the issue of fundamental rights, leading to judgements in which the importance of those rights are stressed, such as



Jan Inghelram speaking during an OLAF conference

Source: David Plas

<sup>1</sup> Under the responsibility of Delmas-Marty, M., "Corpus Juris introducing penal provisions for the purpose of the financial interests of the European Union", Paris: Economica, 1997.

the right to an impartial investigation (T-309/03 *Camós Grau v Commission*) as well as the right to be heard, the presumption of innocence and the reasonable time requirement (T-48/15 *Franchet and Byk v Commission*). General principles of EU law and the Charter of Fundamental Rights of the EU are a particular source of inspiration in this respect. The importance of this case law on fundamental rights is confirmed by the fact that, when revising the OLAF Regulation in 2013, the EU legislator literally copied case law into the regulation on the existence of a right to be heard before information is sent to national judicial authorities. Core fundamental rights were directly incorporated in EU rules pertaining to the fight against fraud and corruption relating to EU funds.

Case law is more reserved on the existence of a right of access to the file at the stage of OLAF investigations (T-381/15 *International Management Group (IMG) v Commission*) as well as on the admissibility of actions for annulment against OLAF investigative acts (T-261/09 P *Commission v Violetti and Others*). This inadmissibility deprives, in practice, the applicant of the possibility to ask for interim measures in the context of such an action, and, thus, of an effective remedy in urgent matters.

There is also case law on the important issue of the law (EU and/or national) applicable to OLAF investigations. It has been ruled that OLAF has an autonomous right, based on EU law, to carry out on-the-spot checks and inspections on the premises of economic operators. National law only applies if national authorities are required to give assistance to OLAF because the economic operator opposes on-the-spot checks and inspections (T-48/16, *Sigma Orionis v Commission*). As a general rule, therefore, there is no duplication of applicable laws, which greatly improves legal certainty.

### OLAF and EPPO

The EPPO will most likely also have an important impact on the further shaping of OLAF. OLAF will remain independent from the EPPO and it will have a larger territory of operation than the EPPO, since it is competent for the entire EU, whereas the EPPO will only be competent within the participating Member States. The fields of operation of the EPPO and OLAF are, however, closely linked. Therefore, a division of tasks will most likely develop in practice, affecting also OLAF's current functioning.

Furthermore, OLAF may be asked by the EPPO to conduct administrative investigations to support or complement the EPPO's activity (Art. 101 Reg. 2017/1939, further developed in COM(2018) 338). This, at first glance, purely operational link hides a more fundamental discussion on adequate control of OLAF.

Whereas EPPO investigative measures will be subject to the control mechanisms of national law, which may include, for instance, prior judicial authorisation before such measures can be implemented, no such control mechanisms exist for OLAF's investigative competences. What is more, a sufficient and immediate remedy to redress potential violations of rights and procedural guarantees of persons under investigation is currently not provided for by the OLAF legal framework (European Court of Auditors' Opinion 6/2011 and OLAF Supervisory Committee's Opinion 2/2013).

Well aware of this discrepancy between OLAF and the EPPO in relation to control mechanisms, the Commission proposed in 2014 the creation of a Controller of procedural guarantees for OLAF (COM(2014) 340). Until today, this proposal has not been adopted by the EU legislator, leaving the control gap between those two entities intact.

This may have implications on the usability by the EPPO, for the sake of its own investigations, of information gathered through OLAF investigations. The question may indeed arise to what extent the EPPO can use information gathered through investigations not subject to the same standards of control, in view of the protection of fundamental rights, as those applicable to its own investigations. Moreover, similar considerations could apply to the usability by the EPPO, for the sake of its own investigations, of information gathered through OLAF investigations in Member States in which the EPPO has no competence.

## EPPO and CJEU

The Commission's 2013 proposal (COM(2013) 534) was based on a legal fiction of the EPPO being a national authority for the purpose of judicial review when adopting procedural and investigation measures in the performance of its functions, notwithstanding the fact that the EPPO is an EU entity. As a practical consequence, this would have excluded all CJEU competence to review the validity of EPPO measures.

The final text adopted by the EU legislator (Art. 42 Reg. 2017/1939) is a compromise in this respect. Procedural acts of the EPPO that are intended to produce legal effects vis-à-vis third parties will be subject to review by the competent national courts in accordance with the requirements and procedures laid down by national law. In consequence, actions for annulment, brought before the EU General Court (Art. 263 TFEU), will not be possible, with one exception, i.e. when directed against decisions by the EPPO to dismiss a case, contested directly on the basis of EU law. Requests for preliminary rulings brought before the European Court of Justice (Art. 267 TFEU) on the validity of the procedural acts of the EPPO will be possible, although some conditions will apply.



Source: F. Jimenez Meca/schutterstock.com

It is true that Art. 86(3) TFEU states that the regulation establishing the EPPO must determine the rules applicable to the judicial review of procedural measures taken by the EPPO in the performance of its functions. However, it is equally true that the CJEU alone has jurisdiction to determine whether the act of an EU entity is invalid and that, by Art. 263 TFEU and Art. 267 TFEU, the Treaty established a complete system of legal remedies and procedures designed to ensure review of the

legality of acts of EU entities, and entrusted such review to the CJEU (C-461/03, *Gaston Schul Douane-expediteur*). The underlying idea is that differences between courts of the Member States as to the validity of acts of EU entities would be liable to jeopardise the essential unity of the EU legal order and undermine the fundamental requirement of legal certainty. The way in which judicial review of procedural acts of the EPPO is organised therefore derogates from this fundamental rule on the system of judicial protection instituted by the TFEU.

Furthermore, a practical consequence of this compromise is that cases involving judicial review of procedural acts of the EPPO will - at EU level - almost exclusively be dealt with by the European Court of Justice through the preliminary ruling procedure, whereas the EU General Court, which is in fact the primary court to hear cases brought by individuals through actions for annulment, will be left out, so to speak.

### Thirty years after: several legal challenges on the horizon

OLAF, EPPO and CJEU have interacted and/or will interact, in search of effective protection of the EU's financial interests. Thirty years after the Greek maize case, there is no lack of challenges in this respect. It will be most interesting to see how, for example, the control gap as well as the territorial discrepancy between OLAF and the EPPO will be addressed when it comes to the EPPO using information gathered through OLAF's own investigations. Moreover, it will be interesting to see how judicial review of procedural acts of the EPPO will work out in practice.

# Upholding the rule of law to preserve the EU's key values

## Interview with Inge Gräßle, Member of the European Parliament and Chair of its Budgetary Control Committee

By Gaston Moonen



Source: European Commission

Inge Gräßle during a session at the European Parliament

In her almost 15 years of experience as Member of the European Parliament (EP) Inge Gräßle has built up a reputation as a persistent MEP who does not shy away from calling a spade a spade. As Chair of the Budgetary Control Committee (CONT) she is also the heading the EP committee with which the ECA has a privileged relation. Moreover, Inge Gräßle has developed a particular interest, expertise and a track record when it comes to fighting fraud and corruption with EU funds. In her usual open and upfront way, she shares in this interview her views on this topic ... and a few others, including looking back at her work in CONT.

### Scrutinising the implementation of legislation - not always the most popular task

Inge Gräßle has been a Member of the European Parliament (MEP) since 2004. Since her early days in the EP she has built a reputation as a committed MEP with a particular interest in accountability issues, including those relating to irregularities affecting the EU budget. It turns out that she took up this task, not only because she wanted to do so but also, at least according to her, because someone had to do it. 'In my early days as an MEP, I got interested in the topic of the implementation of the EU budget. It turned out that not many people wanted to deal with it, and I really believed that this issue, the proper implementation of the EU budget and accountability for it, was very important for the EU. And since nobody wanted to do it, I did it.' Experience has taught her that it is not the most popular topic in many committees. 'Not all of my colleagues are really keen on carrying out checks on what we decided to do. Sometimes you can also see this in the rather limited interest other committees have in working with the Budgetary Control Committee and the European Court of Auditors.'

The German politician, who has been chairing the Budgetary Control Committee (CONT) for almost five years now, has an explanation for what she calls a lack of interest in accountability issues. 'The European Parliament is a multicultural and multi-country organisation. A lot of MEPs focus mainly on issues relevant to their own country. The consequence is that too few Members are willing to look into issues that concern other Member States, particularly when it comes to budgetary issues.' In her view, this is however not the right approach. She points out that the EP by its very nature as a European institution has to look at the overall picture for the EU and the reputational risks for the Union as such. 'And this is what I am trying to do.'



Inge Gräßle, the No 1 of the Budgetary Control Committee during the last five years

This also has consequences for finding MEPs willing to be active in CONT. Inge Gräßle explains that in CONT MEPs have a full seat or a substitute seat. Then, smiling, she explains how this differs from other committees: 'Unlike other EP committees, CONT allows MEPs to have one more full seat at another committee. We do this in order to make sure that we get enough Members from spending committees.' She points out that in general MEPs are more interested in 'spending committees' than in 'checking committees.'

The interests of the 'spending committees' are also reflected sometimes in the way these committees relate to CONT. Inge Gräßle, sighing: 'Over the past years I have tried to encourage other committees to cooperate, and they often did so. CONT is one of the committees which have the highest number of joint meetings with other committees.'

“CONT is one of the committees which have the highest number of joint meetings with other committees.”

She underlines her committee's interest in sharing experiences with other committees, inviting them, exchanging information with them. 'For example, when we get somebody from the ECA, we always invite Members of other committees to participate, listen and discuss with us.'

### Building up experience takes time, also when fighting fraud

If there's one thing that characterises the relatively small office of Inge Gräßle, it is the abundance of documents: stacks of reports, papers, and files. Laughing she explains that this comes with the job. 'What I learnt in journalism is to ask questions, to compare documents over the years and to bring to light contradictory information.'

“What I learnt in journalism...”

All this would not be possible without her staff. 'Another thing is that you need to attract brilliant staff who really want to contribute to the job.' Inge Gräßle cherishes her assistants as her main 'asset'. Then she confides: 'And I never change my team. I like to keep them as long as possible. Our collaboration is based on mutual trust. Their knowledge is as good as mine.' The CONT Chair explains that it takes at least two years to get a staff member trained for this kind of job, and her assistants are specialising in different topics. 'One of my assistants works on staff regulations, another one on discharge, and another one works on the fight against fraud. This means they are all highly specialised, and their experience is of real added value. They like it and I like it.' She underlines that they need an interest in the job, but they also need success stories, successes in what she and her team are trying to achieve. 'Success stories in their daily work are important, because results are very motivating!'

When it comes to experience with fraud and corruption, Inge Gräßle can draw on her early days as a journalist. 'In Germany I worked as a journalist at district courts in Baden-Württemberg and Bavaria. I was there every day, to listen and to write about those cases - murder, theft, and also fraudsters.' She adds that the latter group were mostly clumsy,

often not too intelligent fraudsters. Jokingly she says: 'Maybe this was because the justice system only deals with fraud cases which were discovered.'

This quickly takes us to special report 1/2019 issued by the ECA earlier this year. The CONT Chair is rather outspoken on this, and the topic this special report covered. 'The ECA report is a very important one because it also examined the PIF report – the European Commission's annual report on the protection of the EU's financial interests.'

She points out that the PIF report is voluminous but very important. 'In its special report 1/2019 the ECA rightly observes, in a forceful and convincing way, that there are big loopholes.' She underlines that she has read many of the PIF reports, showing the most recent issue. 'If you look into the report you have the impression: something is going wrong! And when you read the ECA special report, you realise what is missing. The usefulness of the ECA report is to name the problems and to suggest remedies.' She explains that more than once she has criticised the ECA for its recommendations not being sufficiently precise and detailed, not practical enough. 'But in this ECA report we have rather detailed recommendations, setting out a number of problems related to these PIF reports. And you realise that there is still a lot to be improved in the reporting on irregularities and fraud concerning the EU budget. The ECA clearly has built up knowledge and expertise on this and I can only encourage the ECA to continue with this. I am keen to see, when we assess the next Commission PIF report, what kind of improvements will have been made.'



Inge Gräßle, showing the most recent PIF report

### **Getting the basics right**

'I compared the information we received from OLAF, the European Anti-Fraud Office, over the last ten years, and I am not satisfied.' Inge Gräßle explains why: 'Over time we received less and less harmonised data. OLAF changed the terminology, they changed what they report on, they changed their statistics. All this makes it difficult to make comparisons over several years, and sometimes it makes me doubt the reliability of these statistics. So I am quite tired of the way the PIF report is prepared.' She raises another concern she has. 'Sometimes I think that our institutions – the Commission, but also the Parliament or the ECA - are reluctant to be forthcoming on reporting on fraud because that would give the impression that fraud is quite common in the EU. But this is not the case, and we can only show that by reporting on it. This is why we need to make an effort in providing comprehensive and robust figures on fraud cases and in improving the databases on which these figures are based. Otherwise, the EU's reporting on fraud will not be taken seriously.'

“*... our institutions [...] are reluctant to be forthcoming on reporting on fraud because that would give the impression that fraud is quite common in the EU. But this is not the case...*”

She points out that she had many discussions with several directors-general of OLAF on these Commission's statistics on fraud. 'But the result was meagre: there is no real willingness to improve the reporting.' As regards the figures provided in the 2017 OLAF Report – according to which fraud levels are supposed to amount to 0.3 percent of EU spending - Inge Gräßle is sceptical. 'They presented these figures to deflect criticism because they believe that the reputation of the EU is at risk, they do not use it as a starting point for action.'

## Fraud and corruption: from case-based to systemic characteristics

When discussing whether fraud and corruption will be a big issue in the upcoming elections for the European Parliament, Inge Gräßle thinks it will differ a lot by country. 'In some Member States, particularly the older ones, and perhaps more in the North, this will not be a big issue. But in some other Member States, particularly in Central and Eastern Europe, I think the systemic risk of semi-legal systems enabling fraud is more and more present, and we need to do something about it.'

“ ... in some other Member States, [...] I think the systemic risk of semi-legal systems enabling fraud is more and more present, and we need to do something about it.

For her, the fraud risks of today are rather different from ten or twenty years ago. 'When I started working at the CONT, organised crime tried to file invoices for old machines and pretended that they were new, trying to get paid for new ones. But now we have cases where politicians systematically use their power and the influence they have over EU projects and/or national projects to enrich themselves, their companies, or their friends or family. This is something which was unheard of ten years ago!'

Inge Gräßle expresses her great concern about this development. 'The EU is now finally giving itself the instruments to face this development, such as the European Public Prosecutor's Office and the regulation on the protection of the EU budget in case of deficiencies as regards the rule of law in the Member States. The EU is basically under pressure because of non-action on national problems for which the EU does not have the competence, the power to act. But at the same time people expect us to do something.'

She does not refrain from naming and shaming. 'Slovakia, Czech Republic, Hungary, Romania, Poland: in these Member States we see cases of single bidding in public procurement, companies building up monopolies because other companies are thrown out of the competition.' Regarding information on this development the CONT Chair sees a big role for the ECA: 'No organisation is as close to getting to these bidding practices as the ECA is, and I would like to see the ECA ringing the alarm bells louder on these issues.'

She points out that, in its regular audit work, the ECA has to look at the number of bidders, to look at whether the public procurement process took place in a fair and orderly fashion. 'These processes can be tarnished because of these issues, something which I learnt for example from studying the TED database, the EU database which publishes the calls for public procurement. Every year 175 000 calls for tender proposals are launched in which EU funds are involved.' She refers to a study by the European Commission's Directorate-General for Regional Policy on single bidders, underlining that this question of fair competition is a matter of major concern to her. 'This directly undermines the single market idea, but it is also a political problem for the EU. If we make the rich ones richer with EU money, then citizens will lose faith in our system.'

This is what I mean with the semi-legal and systemic fraud issues which have arisen. We are now facing problems which are beyond project level, so you need to go above this level to tackle them. I think the ECA can play an important role in doing so, assessing and informing us on how the procurement process was done. On paper, everything may look perfect. But fraud does not necessarily start at project level, it may originate further upstream. If the ECA suspects fraud, then of course the case has to be sent to OLAF. But looking into the systemic issue is at least as important.'

“ ... fraud does not necessarily start at project level, it may originate further upstream. [...] looking into the systemic issue is at least as important.

She also links such systemic issues to the functioning of Member States in the Union. 'When we look at what is happening, for example in Hungary, perhaps we should ask: do we really have the right accession criteria and right procedures to ensure that all Member States continue upholding what we agreed upon together when countries join the EU?'

### More information exchange on taxation issues

Another issue, though less related to EU funds, but relating to fraud, is tax evasion and money laundering. Discussing recent scandals related to banks such as the ING and Danske Bank, Inge Gräßle sees little opportunities for the EU to take up a major role in this area. 'As long as the Commission has no rights regarding taxation issues, there is no point in discussing this. If you want the EU to acquire more powers in this area – and I am not against it – you will need a Treaty change. And this is a difficult enterprise in the current political situation!'

At the same time, she agrees that changes are necessary also in this area. 'If we do nothing, we will have Member States that will carry on arranging their taxation issues on their own, thereby harming their EU neighbours. And this gives a very bad impression.' She refers to Member States like Luxembourg, the Netherlands and Ireland, where companies may pay lower taxes than others because they have tax agreements with the respective governments. 'If companies are not treated in the same way, and do not pay the same taxes in a single market, this harms the reputation of the EU. If I tell people that we, as their MEPs, cannot do anything, and that unanimity – meaning approval by all 28 Member States' governments in the Council – is required for the EU to act, then people understandably are dissatisfied.'

“... If companies are not treated in the same way, and do not pay the same taxes in a single market, this harms the reputation of the EU.”

Inge Gräßle is keen for measures to be taken as soon as possible without a Treaty change, pleading for more cooperation between Member States. 'For example, when you open a bank account in another Member State, the competent authority in your home country will be informed about this. However, when you buy an apartment, your national fiscal administration gets nothing. There simply needs to be more information exchange between Member States when you buy for example real estate, so that they can deal with any potential tax issues.' She recalls that the financial crisis after 2009 triggered some discussions. 'At the time we saw a lot of Greek money flowing out of the country. And now we see a lot of money flowing out of Italy. I met a local banker who told me that recently two Italians bought two companies in Germany. Obviously, there is nothing wrong with this as such. But these transactions make an information exchange between the local tax authorities necessary, so there can be cross-checking on how clean the funds used for these transactions are.'

### Pleading for clear information on what the EU stands for

With the European Parliament elections coming up, Inge Gräßle considers it more important than ever to inform the EU citizens what Europe is and what Europe does. For her such information is a condition for trust in the EU project. 'We need to have a permanent information campaign on what Europe does, because people are not well informed about the EU. What was very striking to me, during the Brexit debate, was how little knowledge the British government had on what it means to be a Member State of the EU, and how closely the UK is actually linked to the continent. They did not comprehend, which resulted in a campaign based on non-information and even lies.'

She realises that people are not always interested in having a better understanding, but she still thinks more work is needed here. 'I am sure that citizens would like to know at least some key facts about the EU.' She gives an example where a lack of information can easily create the wrong picture. 'Did you know that the EU allows more agricultural goods from the less developed countries into the common market than the US, Canada, Japan, Russia, Korea and China combined? EU agricultural funds are heavily criticised, supposedly being responsible for the bad situation of farmers in developing countries. But there are some basic facts which tell a different story, and they need to be communicated to the public.'

For a politician from Germany, Inge Gräßle presents a striking slogan. 'We need to be clear that our main EU export product is not cars. It is human rights!' She explains that for many people in the developing countries the key

“We need to be clear that our main EU export product is not cars. It is human rights!”

issue is human rights. 'They are fighting for their human rights. And if they did not have the EU, they would have no support at all.' She argues that there are plenty of things EU citizens can be very proud of. 'The European integration is a process of progress for humanity, a process which reaches beyond Europe.'

She clarifies that one perhaps has to change perspective to see the key value of human rights. 'I also have a tendency to speak a lot about the economy, the financial side of things, about what is relevant to people's own situation, their own material interests.' The CONT Chair pleads for a closer look at the immaterial values of the EU. 'Of course, there is peace, which many people nowadays take for granted. But besides peace there are many other benefits brought by the EU, by our community of countries. Despite our occasional quarrels we should never forget that we share the same values. You can see these values in the actions taken by the EU. I really regret that we speak far too little about what unites us and far too often about what separates us.'

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... we speak far too little  
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separates us.

When speaking about trust and particularly about trust in politicians and the upcoming elections, Inge Gräßle observes that people are generally sceptical about politicians. 'But never about the politician who is in front of them. Knowing people only from the newspapers or from TV is different.' Of key importance for her is that you practice what you preach. 'What you say should match what you do, and vice versa. If that is not the case, it is only a matter of time before, as far as trust is concerned, disaster strikes.'

### **Bringing issues back on the agenda, including unpopular ones**

Having been the CONT Chair for almost five years, and a member of CONT for ten years longer, Inge Gräßle has not lost her energy to pursue issues. 'We are among the four committees which hold the highest number of meetings. I believe that putting issues on the agenda regularly contributes to solving them.' She refers to how CONT regularly called upon the Commission to follow-up on the systemic problems identified with EU spending in the Czech Republic, Hungary and other Member States. 'If you do not do that, things will be forgotten. And yes, we do naming and shaming - as well in the discharge resolution - much more than before. Because if we do not clearly point to the specific problems in some countries, we treat each of them in the same way, and that's not helpful.' She underlines that naming Member States is not done just to point a finger at them. 'We do this to help them overcome the problems identified, and also to help the Commission officials who work on these dossiers.'

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I believe that putting issues  
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contributes to solving them.

She mentions a few examples of success in putting things back on the agenda. 'I tried to have more and better digitalised information on third country projects, so we developed our own monitoring system. The outcome was that the Commission devoted more care to those 2 000 projects because they knew that the issue would rear its head again. It may be boring but it was rather successful.' Another example relates to putting the issue of conflict of interest into the EU's Financial Regulation. 'Politicians are now forbidden to interfere in bidding processes in which EU money is involved. This is also applicable to politicians who own companies. I believe this to be important for building trust, for equal treatment.'

However, she also remains self-critical. 'I think we can never do enough, also in the fight against fraud and corruption. Of course we now have the European Public Prosecutor's Office – the EPPO – which is a big step forward towards a more harmonised penal law, also one of the reasons why it was blocked that long by the Council. Just imagine - the EPPO now finally has powers to fight VAT fraud!'

One of the areas she considers clearly needs more work is the rule of law. 'We now have a rule of law proposal on the table. In the last five years we saw awareness-raising on this. And we now see that the criticism we have levelled is shared by the Commission as well.' She realises that it is a difficult topic for the Member States. 'But we will overcome that. Otherwise people will get the feeling that in this Union you can enrich yourself with taxpayers' money and that nobody will do anything about it.'

### **CONT and the ECA: pursuing mutual interests and cooperation**

For the CONT members the ECA reports and opinions are an essential tool in keeping the Commission and other executive bodies accountable for the implementation of EU policies. The CONT Chair is very positive about the way in which the ECA and the CONT cooperate. 'The ECA Members are open to listening to us, to our concerns, to our needs. It is not just listening, it is really a feeling of interest and cooperation. They pick up our proposals.'

“ *The ECA Members are open to listening to us, [...] it is really a feeling of interest and cooperation.* ”

But Inge Gräßle also has a wish list for the ECA. 'I would like to see reports which are more specific and hard-hitting, which call things by their name, and present less an avalanche of words but focus more on the main issues found. Let's be precise and practical, also in the recommendations.'

Inge Gräßle is standing again as a candidate for the new parliamentary period. Whether she, if elected, will come back as CONT Chair remains to be seen. 'We will have to see who will get what, always a complex process the outcome of which is difficult to predict. But I hope to support the ECA in its work also in the future.' She is not in favour of having a newly elected MEP becoming the chair of a committee. 'We have seen this before in CONT and it weakens the influence of the committee, with repercussions for all its stakeholders, including the ECA. Now we really have built up something together, also thanks to President Lehne – an experienced former MEP himself – and we will see how we can maintain that.'

# GRECO – States responding to the global threat of corruption

By Agnès Maïtrepierre, Ministry of Europe and Foreign Affairs of France



The image shows the GRECO logo at the top left, which includes the text 'GRECO Group of States against Corruption' and 'THE COUNCIL OF EUROPE ANTI-CORRUPTION BODY'. Below the logo is a silhouette of a person's head in profile, blowing a stream of small black seeds or particles into the air. At the bottom of the image are the logos for GRECO and the Council of Europe.

No country is immune to corruption. Government action to prevent and fight this corruption does, however, not always work as foreseen, may be not far reaching enough or not well implemented. Moreover, corruption is a global threat, so states cannot act alone. The Council of Europe (CoE) has created the Group of States against Corruption (GRECO), which monitors its members' compliance with CoE standards and calls out non-compliance countries, as we saw in recent months regarding Belarus, Albania and Malta. Agnès Maïtrepierre is magistrate, seconded to the Legal Department of the Ministry of Europe and Foreign Affairs of France. She is also heading the French delegation of GRECO and acts as its GRECO's Vice-President. Below she provides some of the key aspects of GRECO and its work, just in time for its 20<sup>th</sup> anniversary in 2019.

Source: GRECO

The Group of States against Corruption (GRECO), which was set up in 1999, is the Council of Europe's anti-corruption body. It is one of many international forums concerned with the fight against corruption, such as the Organisation for Economic Cooperation and Development (OECD), the United Nations Office on Drugs and Crime (UNODC), the Organisation for Security and Cooperation in Europe (OSCE), the EU, the G7, the G20 and the Organisation of American States (OAS). The plethora of such forums testifies not only to the international dimension of corruption, from which no state is completely immune, but also to the need for a common response to the global threat it poses, as states cannot act alone.

As a result, several international conventions on the subject were adopted about 20 years ago, not only by the Council of Europe<sup>1</sup> but also by the OECD, UNODC, the OAS and the African Union<sup>2</sup>. Their adoption was accompanied by the setting up, in the various forums, of bodies designed to ensure that the signatory States comply with

<sup>1</sup> Criminal Law Convention on Corruption (ETS No 173) of 21 January 1999, and its Additional Protocol (ETS No 191) of 15 May 2003; Civil Law Convention on Corruption (ETS No 174), of 4 November 1999. These Council of Europe instruments, together with the Enlarged Partial Agreement establishing GRECO, are a follow-up to Resolution (97)24 of 6 November 1997 by the Committee of Ministers of the Council of Europe, which lists 20 guiding principles for the fight against corruption.

<sup>2</sup> The Inter-American Convention against Corruption of 29 March 1996; the OECD Convention of 11 July 2003 on Combating Bribery of Foreign Public Officials in International Business Transactions; the African Union Convention of 11 July 2003 on Preventing and Combating Corruption, and the United Nations Convention against Corruption of 31 October 2003 (the "Merida Convention").

their international commitments. These bodies also play a leading role in the development of existing international standards by making recommendations to individual States with a view to increasing their capacity to fight corruption. The recommendations, which form a body of doctrine ('soft law'), do not have the same binding force as a freely made international commitment ('hard law'), but act as a powerful lever that encourages States to step up their anti-corruption measures.

### Using a peer-based approach

This incentive effect owes much to the existence, in most of these forums, of peer-based procedures. These involve each State not only being evaluated and then examined as regards the extent to which it has implemented the resulting recommendations, but also participating in the evaluation and follow-up of other States.

The effect is all the more significant as the procedure for monitoring recommendations takes place over several years. Through a series of mutual incentives, these evaluation and monitoring procedures create a common dynamic of progress in the fight against corruption. In addition to this method, which is common to the various anti-corruption bodies, GRECO has a number of unique features.

### Essentially a European geographical coverage and increasing

GRECO's first unique feature is its number of member states and geographical coverage. GRECO currently has 49 member states, meaning that its scope of evaluation and monitoring is slightly broader than the OECD's (44 States), but narrower than UNODC's (185 States).

Unlike the OECD and UNODC, GRECO's geographical coverage is essentially European. Almost all GRECO member states are members of the Council of Europe, and the latter's 47 member states have been members of GRECO since 2010; all the Member States of the European Union are also members. Another member state, Belarus, is a member neither of the Council of Europe nor of the European Union.

At present, GRECO has only one non-European member: the United States. The fact that the US participated in drafting the agreement that established GRECO was the basis for its being admitted as a member. The US still contributes actively to GRECO's work, even if it remains the only GRECO member state that is not yet a party to the Criminal Law Convention against Corruption. However, it does allow recommendations to be addressed to it by virtue of the Convention being an international standard.

### What is GRECO

GRECO was established by a Resolution of the Committee of Ministers of the Council of Europe: Resolution (99) 5, which was adopted on 1 May 1999. This Resolution established GRECO in the form of a so-called 'enlarged and partial agreement,' which involves the participation not only of a number of Council of Europe member states (at least one third) but also of states outside the Council of Europe.

GRECO's objective is to improve the capacity of its members to fight corruption by monitoring their compliance with Council of Europe anti-corruption standards through a dynamic process of mutual evaluation and peer pressure. It helps to identify deficiencies in national anti-corruption policies, promoting the necessary legislative, institutional and practical reforms. To this end, GRECO is assisted by a secretariat in Strasbourg.

GRECO works in cycles, called evaluation rounds, each covering specific themes. The first evaluation rounds started in 2000 and since then themes like independence, specialisation and means of national bodies engaged in the prevention and fight against corruption, or the identification, seizure and confiscations of corruption proceeds have been covered. The current evaluation round, launched in 2017, aims at preventing corruption and promoting integrity in central governments and law enforcement agencies. GRECO follows a two-step procedure comprising a mutual evaluation and a compliance program, which is applied to all members for each evaluation round.

Other non-European States are likely to join GRECO, as membership is open not only to those who took part in drafting the founding agreement or who have ratified the Criminal Law Convention on Corruption, but also to those who are invited to join by the Committee of Ministers of the Council of Europe, subject to their commitment to observe the guiding principles of the fight against corruption, as defined by Resolution (97)/24.

GRECO's Statute (Article 5) and Rules of Procedure (Article 2) expressly provide for European Union participation in its work. On 16 May 2017, the European Parliament adopted a resolution encouraging the European Union to submit an application for [membership](#). The arrangements for the European Union's participation in GRECO's work – whether as a member or just as an observer – are still the subject of debate at the Council in Brussels.

### **Fight against corruption based on the rule of law, democracy and fundamental rights**

GRECO's second unique feature is its approach to the fight against corruption. As a Council of Europe body, GRECO is naturally inclined to favour an approach based on the values the Council defends, i.e. the rule of law, democracy and human rights. This approach differs from that of the OECD, which essentially aims to promote economic development and growth by ensuring that foreign trade is secure.

This difference of approach reflects the multifaceted nature of corruption and the type of relationships it affects. This is true not only of horizontal relations between businesses (corruption distorts competition), but also of vertical relations (corruption undermines citizens' trust in public institutions, thereby threatening the stability of democracies to the detriment of good governance and the common good). While the OECD focuses on the horizontal aspect, GRECO focuses on the vertical, which explains the particular attention paid to the institutional systems of the individual States that are evaluated.

To fight corruption, the Council of Europe adopted a number of multifaceted standard setting instruments, aimed at improving the capacity of States to fight corruption domestically as well as at international level. GRECO is entrusted with monitoring compliance with these standards. Some examples of these standards are:

- The Criminal Law Convention on Corruption
- The Civil Law Convention on Corruption
- The Twenty Guiding Principles against Corruption
- The Recommendations on Codes of Conduct for Public Officials; and
- The Recommendations on Common Rules against Corruption in the Funding of Political Parties and Electoral Campaigns.



For GRECO, the fight against corruption is key to understanding each institutional system. This analytical focus makes it possible to identify shortcomings and vulnerabilities in each country, which could encourage corruption to develop. This approach is essentially preventive, as repressive measures in the fight against corruption – although necessary – are insufficient.

For this reason, after assessing the tools that are available to States for prosecuting and sanctioning corruption, GRECO is currently focusing on measures to prevent corruption and to promote the integrity of public officials - Members of Parliament, judges, senior civil servants (including top executive functions) and the police.

### **New emergency procedure to respond to exceptional circumstances**

GRECO's third unique feature is its recent emergency ad hoc evaluation procedure. This was introduced in June 2017 by amending GRECO's Rules of Procedure to respond to exceptional circumstances, where a state appears to be undergoing a worrying structural change that could lead to a reversal in the fight against corruption. GRECO is now in a position to act promptly, without having to wait for the next step in the standard procedure for following up recommendations.

GRECO's intervention, which is based on an accelerated procedure, involves requesting additional information from the state concerned and, where appropriate, carrying out an ad hoc assessment, if necessary by means of an on-the-spot visit. As under the standard evaluation procedure, a draft report is drawn up and discussed at a plenary meeting on the first available date. This new procedure enables the international community to bring an additional source of pressure to bear on the state concerned.

To date, this procedure has been used twice for two EU Member States (Poland and Romania) in response to their reforms in the fields of justice and criminal legislation.

### **Looking at 20 years of GRECO action against corruption**

The Council of Europe views corruption as a serious threat to its core values: pluralist democracy, human rights and the rule of law in Europe. In its fight against corruption the Council of Europe takes a multidisciplinary approach and has adopted multi-faceted instruments to address it. Until now GRECO has completed four thematic evaluation rounds, and is currently implementing its fifth round, through which it aims to act as a catalyst for major policy and legislative changes and anti-corruption reforms in both the public and private sectors of its Member States.

This year GRECO will celebrate its 20th anniversary. The French Presidency of the Committee of Ministers of the Council of Europe will organise a high-level conference in Strasbourg on 17 June 2019. This conference provides an opportunity to report on GRECO's achievements so far, to take stock of its current work and to reflect on the new challenges it faces to work as a pan-European centre of anti-corruption monitoring and expertise.

# The fight against tax fraud: an EU action priority

By Cécile Remeur, European Parliament



Source: Shutterstock

Business jumping from spring / © Zenzen / Shutterstock.com

Over the past five years fiscal policy has come to the forefront of European politics, also as a result of repeated journalistic investigations into large-scale tax fraud, for example the Panama papers, or national tax schemes for large corporations in several member States, such as 'Luxleaks'. In January 2019, the European Parliamentary Research Service (EPRS) published a briefing 'The fight against tax fraud', which was co-authored by Cécile Remeur. Cécile works as a policy analyst in the EPRS and has researched tax policy in the EU for several years. She homes in on some key issues presented in the recent EPRS briefing on tax fraud and some key actions taken within the EU framework to tackle it.

## Support for the fight against tax fraud

Over the past years, there has been a growing consensus on the need to tackle tax fraud. This is among EU citizens' main expectations of public authorities and of the EU in particular. The [2016](#) and [2018](#) Eurobarometer surveys show a very large and stable share of EU citizens who would like the EU to intervene more in this area (75 % in 2016 and 74 % in 2018), and similar results can be found in the Member States.

## How broad is the concept of tax fraud? A simple question...

Put simply, tax fraud refers to the illegal practice of not paying taxes. In some cases, the establishment of the illegality is rather straightforward; in others, it requires a careful assessment of the facts. That is the task of the tax authorities and, ultimately, the courts. They judge the specific situation, unravelling its complexities and determining whether it is legal or not (tax evasion and fraud are both illegal, with fraud involving the addition of an intentional element – hereafter both are referred to as 'fraud'). The distinction between what at first sight may appear to be legal avoidance and what is illegal fraud can only be determined after a case-by-case analysis of the facts and provisions at stake.

**... covering a wide variety of situations...**

The [fight against tax fraud](#) has at its core the fight against the breach of tax law by taxpayers, be they natural or legal persons, in their personal or professional capacities regarding taxes (direct, indirect and social contributions). Such breaches cover failure to report income, reporting expenses that are not legally allowed, or not paying taxes owed.

Yet there are other situations that at first sight may appear legal, but on closer examination may potentially be illegal because they are not in accordance with the letter and spirit of the law. Such cases include aggressive tax planning schemes involving large taxpayers, not only multinational companies operating on a global scale, but also individuals, involving numerous legal entities and stakeholders.

Money involved in tax fraud can be hidden in a variety of ways, from keeping it in cash to complex schemes shielding the beneficiary, which may involve transit via several countries (tax jurisdictions) and entities - this is where letterbox companies and trusts, among others, come in.

**... resulting in large scale unpaid taxes**

Tax fraud results in unpaid, lost or missing revenues for individual countries. It generates assets that cannot appear in accounts related to the taxpayer concerned if they are to avoid detection and prosecution. The proceeds of tax fraud therefore enter the black economy, also referred to as the 'non-observed economy'.

There is no direct, objective way of quantifying tax fraud. Various estimates have been made, each calculated by taking just one aspect of the phenomenon, based on different sets of data covering more or less large samples that are used as a basis for making larger estimates. Comparisons of global flows provide rough estimates of the magnitude of the illicit flows and lost resources. Assessments of tax gaps - per tax, per country or on a larger scale, such as the [EU VAT tax gap](#) provide more precise indications of the difference between the estimated amount of tax theoretically to be collected and the taxes actually paid, but this includes situations other than tax fraud.

To give some idea of the magnitude of taxes lost: a 2016 International Monetary Fund (IMF) working paper estimated worldwide losses due to base erosion and profit shifting (BEPS) and relating to tax havens to be approximately USD 600 billion per year. The IMF's long run approximate estimates are USD 400 billion for OECD countries (1% of their GDP).<sup>1</sup>

**The fight against tax fraud - from tackling illegal tax practices...**

The fight against tax fraud chiefly aims to recuperate unpaid taxes. It also serves another function: to ensure that fraudsters do not have an advantage compared to compliant taxpayers.

Typically, auditing taxpayers catches fraud. Even if this only identifies a limited proportion of tax fraud, it ensures that tax fraud is seen as a risk that can impact an individual's finances, personal situation and reputation (deterrence effect). It can also be seen as a tool to ensure fairness between taxpayers (also referred to as a level playing field) and serves as a tax compliance incentive, demonstrating that failing to be tax compliant is not without financial, legal and even criminal consequences.

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<sup>1</sup> See for the IMF study: <https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Base-Erosion-Profit-Shifting-and-Developing-Countries-42973>

Tracing money is another way of addressing the problem. Anti-money laundering measures can be seen as the other side of the fight against tax fraud - although it should be noted that they also address other illegal activities. This is because the proceeds of tax fraud pertain to the black economy and need to undergo a money laundering process in order to be used in the real economy. Hence the importance of identifying the ultimate beneficiary of assets, so as to link them to the taxpayer.

### **... to addressing loopholes, mismatches and conduits used in tax fraud...**

Fraud practices are adapted to specific taxes (such as Value Added Tax carousel fraud), to specific taxpayers (such as aggressive tax-planning schemes) or specific locations (income routed to and from tax havens and through non-transparent entities).

The fight against tax fraud also has to be adapted to the latest ways of doing business and the corresponding new ways of escaping taxes. It involves addressing mismatches and loopholes, and keeping pace with the latest schemes and technologies

### **...requiring widened cooperation**

Pooling enforcement capacities and cooperating with other Member States and third countries are key to tackling tax fraud. Tools and policies need to match the scale of the fraud, which is often cross-border and global. Consequently, the fight against tax fraud is not a matter that can be solved by the national tax authorities alone without receiving information from and sharing information with other authorities.

To uncover complex schemes it is essential to link available data (in particular measures on anti-money laundering, customs, company reporting, bank reporting) and to allow authorities to gather information from different countries. In this regard, using the potential of digitalisation and big data also opens up possible new ways forward – for instance, to trace fully digital transactions from the provision of the service through to payment (showing that the impact of digitalisation is not limited to the risk of creating new mismatches and loopholes).

### **What actions are proposed?**

Fighting tax fraud has become an EU action priority. And tax matters have been included in the Treaties since the Union's beginnings, as one of the policies of the Economic European Community. Nevertheless, tax policy is a shared competence of the EU and its Member States, as part of the internal market, with tax matters enjoying a specific status closely linked to the Member States, and a number of specific elements remaining within their remit.

Tax policy has been kept outside the evolution most EU policies have undergone, since it remains the subject of decisions with limited involvement of the European Parliament and taken unanimously within the Council. The close link between tax and national sovereignty is the standard explanation for what is now an exception compared to the general use of the ordinary legislative procedure and adoption of decisions by qualified majority within the Council. The situation has not, however, completely blocked the adoption of legislation, as has been apparent in particular since 2014.

What is equally evident is that the current situation does not allow going beyond what can be seen as the minimum agreeable, and does not allow any strong move towards ending tax competition within the EU, since unanimity means that any one Member State can block (veto) the adoption of a piece of legislation. Such stalemates have recently led to the withdrawal of the 2011 common consolidated corporate tax base (CCCTB) proposal, relaunched in two phases, and the change from a legislative proposal on the financial transaction tax (FTT) for the whole EU into an enhanced cooperation proposal (for a smaller number of Member States). The latter has not yet proved to be more successful, since one concern is precisely that, by its very nature, the measure would not apply evenly across the EU.

On 15 January 2019, the Commission adopted a communication with the aim of moving towards more efficient and democratic decision-making in EU tax policy, focused on the adaptation of the decision-making process. The communication reviews the obstacles resulting from decision by unanimity in the Council and lists possible options to overcome them.

The communication proposes a way forward in the form of a roadmap for a progressive and targeted step-by-step transition towards qualified majority voting under the ordinary legislative procedure for EU tax policy. Four steps are defined:

1. measures that have no direct impact on Member States' taxing rights, bases or rates;
2. measures primarily of a fiscal nature designed to support other policy goals;
3. areas that are largely harmonised and need to keep pace with new circumstances;
4. other initiatives in the taxation area which are necessary for the single market and for fair and competitive taxation in Europe.

### **How far have we come?**

Since 2014 the European Commission has put forward a number of action plans and other proposals related to EU tax policy. They include the Tax Transparency Package (March 2015), Action Plan on Corporate Taxation (June 2015), Anti-Tax Avoidance Package (January 2016), Corporate Tax Reform Package (October 2016), single VAT area (November 2017), and Fair Taxation of the digital Economy (March 2018).

Since September 2014, nearly 30 legislative proposals relating to tax matters have been put forward. More than half of them have been adopted by the Council to date. In a nutshell, over the past five years, legislative and non-legislative EU measures have:

- upgraded tax administrations' cooperation mechanisms;
- addressed specific challenges of corporate tax and ensured proper EU implementation of the OECD BEPS action plan (including an obligation for intermediaries to communicate to tax authorities prior to their application schemes likely to constitute aggressive tax planning);
- equipped the EU with a list of non-cooperative jurisdictions;
- reformed the VAT framework to modernise it and make it more fraud-proof.

The Commission has proposed a new Fiscalis programme for the 2021-2027 period, as part of the package on the next multiannual financial framework it adopted on 2 May 2018.

### **Identifying results and impact**

While several tax proposals have been adopted, results will not be seen until these proposals have been implemented. Assessment of the results depends on where the focus is placed, looking at what has been achieved or considering what remains ahead.

The main salient issues relate to providing enough transparency to tax authorities in order to enable them to fight against tax fraud. This can be complemented by broader transparency, given the fact that significant tax fraud has been uncovered by individuals (whistle-blowers) or journalistic investigations. Substantial progress in the field has been achieved.

The corporate tax framework is also under pressure, with a need to address the changes that flow from regulatory and technological evolution. In order to better fight against tax fraud and money laundering, there is a need to improve measures and ensure effective

implementation as well as strengthening provisions to fight against money laundering. Similarly, specific attention must be paid to certain stakeholders which play a particular role in tax fraud and the laundering of its proceeds, namely a number of intermediaries and financial institutions through which money resulting from such practices can be routed.

### **Versatility needed to keep pace with digital evolution**



Source: Pixabay

Finally, action needs to be global as tax fraud is global, implying an active and consistent international approach. All of these measures need to be monitored and updated on the basis of regulatory and technological evolution, which is rapidly taken into account and taken advantage of in tax frauds. Yet in spite of the notable deliveries under the current parliamentary term, there remains work ahead, since all provisions need to be implemented, enforced, monitored and, if need be, updated, given the versatility of those carrying out tax fraud and the need to keep pace with global digital evolution.

# Corporate bribery – EU needs to step up to the plate

By Branislav Hock, University of Portsmouth



Source Shutterstock

From an institutional perspective, the EU looks strong on protecting the EU budget from fraud and corruption. But is enough done to protect the internal market from international corruption? To what extent is corporate bribery seen as a practice that undermines competition? And how come the European Commission can sanction firms for competition-related violations but has only limited means to act against market distortions by firms that bribe their way into business? Branislav Hock is a Lecturer in Counter Fraud Studies at the University of Portsmouth's Institute of Criminal Justice Studies. In this article, he looks at who takes action – internationally – against corporate bribery, and who does not, and likewise who takes the lead on anti-corruption compliance. He argues that there is still a world to be gained for the EU.

## Hidden progress and hope for credibility

Corruption continues to be a challenge for Europe – a phenomenon that costs the European economy an estimated € 120 billion per year. This was the key conclusion of the [EU Anti-Corruption Report](#) more than five years ago. Yet, hopes for a more focused and robust EU role in fighting international corruption have not been fulfilled since then. Things did indeed start well, as the [ECA](#) pointed out, but the EU's effort lacked the necessary detail, determination, and creativity to substantiate its anti-corruption policy.

According to [Transparency International](#) at first sight, an EU citizen may see the EU's anti-corruption effort as a failure. For example, the promises of bi-annual monitoring of the Member States' efforts have not been met. Furthermore, the EU institutions have not been monitored by an external body, with the exception of [the European Union](#)

[Integrity Study](#) by Transparency International in 2014 and the recent [ECA special report 1/2019](#). Even for a person genuinely interested in EU anti-corruption matters, it is hard to understand why the European Commission is still negotiating participation with the Group of States against Corruption (GRECO), the Council of Europe's anti-corruption monitoring body, without much progress. Similarly, the Commission still has not completed the self-assessment mandated by the United Nations Convention Against Corruption ([UNCAC](#)). These rather disappointing developments do not help the EU institutions gain the credibility they so badly need.

EU citizens need more explanation about the role the Union plays in the global anti-corruption arena. The EU institutions should explain to its citizens what the EU has done to make Europe less corrupt than five years ago. While a more global EU anti-corruption effort has somehow evaporated, EU institutions and agencies such as Eurojust, Europol, OLAF (the EU's anti-fraud office) and the ECA are traditionally strong on protecting EU-related funding. Moreover, the establishment of a new European Public Prosecutor's Office (EPPO) with powers to investigate, prosecute and bring offenders to justice for crimes such as fraud, corruption or serious cross-border VAT fraud has potential to strengthen the system even further. These measures, however, are limited in their focus on the EU budget.

### **International bribery as part of internal market distortions**

More ambitious are measures aimed at enhancing the resilience of the internal market against fraud and corruption. Corporate bribery of foreign government officials can be seen as a practice that undermines competition. Corporations that give money to government officials in order to obtain business have a competitive advantage over corporations who do not have a policy of bribery. If corruption and bribery have negative effects on the internal market, the EU should claim more regulatory power in this field.

Having said that, some first initiatives have been taken. The EU has engaged significantly in protecting the internal market from distortions caused by transnational economic crimes. Consider the Commission's ongoing effort to incentivise financial institutions to prevent money laundering and terrorist financing ([European Commission](#)) and improve transparency regarding the real owners of corporations, and the European Parliament's recent proposals in the area of tax evasion ([European Parliament](#)). The Commission's supervision, including through its supervisory agencies such as the European Banking Authority (EBA), in the fight against money laundering has become stronger and more integrated ([EU Commission](#)).

### **EU-based companies and Member States' legal systems are becoming increasingly Americanised**

Yet, measures to protect the EU's internal market are not sufficiently corruption-specific. Unlike the regime of the Organisation for Economic Cooperation and Development (OECD) and the US regime, which regulate against international corruption and bribery to protect market competition from corrupt businesses, the EU looks at the problem largely from the perspective of criminal liability on the part of corrupt government officials. This is somehow paralysing because criminal law enforcement is under the responsibility of the Member States. Until recently, however, the Member States have not been very active in enforcing their own anti-corruption laws.

In the US, corporate crimes such as money laundering and international bribery are being investigated and prosecuted on an unprecedented scale. According to [Moody's](#), for example, European banks such as ING, Deutsche Bank and BNP Paribas were fined over \$16 billion from 2012 to 2018 in connection with money laundering and trade sanction

breaches. Yet, the vast majority of these sanctions were imposed by US authorities, as reported by [the NY Times](#). Similar trends can also be seen in other areas of economic crime. My own research shows that from 2008 to 2018, US authorities imposed over \$13.6 billion in sanctions on non-US corporations that engaged in international bribery. The majority of these non-US corporations were European firms such as Siemens, Alstom, VimpelCom, Telia and Rolls-Royce.

European corporations are sanctioned by US authorities because they fall under their jurisdiction, but also because EU and Member State authorities have not been active enough. Many European corporations are listed on the NY stock exchange, use US dollars, have subsidiaries in the US and do business with US corporations. The US enforcement authorities have been very creative in assigning their jurisdiction to [European corporations](#). In effect, we see an extensive Americanisation of anti-corruption approaches in Europe. The US statutes, such as the Foreign Corrupt Practices Act (FCPA), have become a model that has inspired the OECD Anti-Bribery Convention, national anti-bribery laws and the enforcement practices of national enforcement authorities in Europe and beyond.

The Member States have only recently become active in fighting international corruption, and to a large extent are following US practices in this area. Countries such as France and the UK, for example, have adopted legislation that allows prosecutors to negotiate out-of-court resolutions with corporations. In exchange for cooperation with prosecutors, corporations might avoid a criminal conviction and receive lower penalties. While buying a good ethical standing is not part of the European legal tradition, and controversial as far as the rule of law is concerned, the system is better than the one in which the Member States did not sanction corrupt corporations at all.

Also, thanks to the possibility of reaching an out-of-court settlement, Member States' enforcement authorities have started enforcing their own anti-corruption laws. Consider [SBM Offshore](#), [Telia Company](#), [Société Générale](#) and [Rolls-Royce](#), which all entered into global foreign bribery settlements and agreed to pay fortunes to US, UK, French, Dutch and other authorities. In the vast majority of global settlements, the US authorities led negotiations and 'allowed' the Member States to take a piece of the pie when collecting penalties. The enforcement landscape is undeniably becoming global in an American way.

### **Who will standardise global anti-corruption compliance?**

The EU is losing a lot by not being more ambitious in the field of international anti-corruption law. Besides, the possibility of US enforcement protectionism, the aggressive enforcement of the FCPA and other US anti-corruption laws has changed businesses. Businesses are expected to design effective compliance programmes to prevent economic crimes, and to self-report detected violations to US authorities. This system of enforcement has created a global market, led by US consultations, audit firms and law firms.

Compliance industries need standards and ethical codes for guidance on applying the right norms and practices (see [Brenninkmeijer et al 2018](#)). In the anti-corruption field, such standards are emerging, as illustrated by the [ISO anti-bribery standards](#). The current regime, however, relies on the authority of US prosecutors, who enjoy wide discretion in negotiating settlements with corporations. The power of US prosecutors somehow counter-balances the power of the private sector to self-regulate in this area. After all, under the US system, prosecutors rely heavily on results of internal investigation by consultancy/audit firms. In the European context, prosecutors are not so powerful and it is not clear whether, or how, additional public guarantees should be provided.

### 'Slap these fines' - Europe should be more ambitious

Besides the evolution of a – largely American – anti-corruption industry, the EU also seems to underestimate the huge disruptions that international corruption and bribery cause to the EU internal market. The EU simply needs to do more, because international corruption has impact on EU citizens, corporations, and its internal market. Bringing in the EU rationale would create a balance between a business-driven American system of enforcement and the need for the rule of law, while also encouraging cooperation and coordination on enforcement between multiple enforcement authorities.

The European Commission already has good experience with 'balancing out' the American model of good market competition through the enforcement of EU anti-trust rules. The US is not particularly happy that the European Commission has repeatedly fined US hi-tech champions billions of euros for abusing dominant positions and hurting consumers, as illustrated by a recent tweet by [President Donald Trump](#).



Some experts and colleagues think big: they propose establishing an international anti-corruption court. I am not so ambitious. Thinking disruptively, I want to see a much stronger anti-corruption initiative at the EU level. International corruption and bribery are problems of economic governance and market competition. The EU should act accordingly by really addressing the problems at EU level. Unfortunately, looking at the problem predominantly from the perspective of criminal liability on the part of individuals has left Europeans frozen theorising about corporate corruption and bribery rather than doing something about it.

While the American system may be controversial, the EU and its Member States can still learn a lot from the US approach. In any case, it is certainly better than the system in which corporations such as [Siemens](#) had special bribery departments and bribery-cash machines. The other alternative is for the EU to leave hegemonic enforcers such as the US to set their own standard. This is not ultimately a bad thing, but the EU should aim higher and address the rather striking contrast between the Commission sanctioning US firms for competition-related violations, but having no powers in relation to similarly dangerous distortions of competition by firms that bribe all around the world.

# AFCE International Fraud Conference Zurich

By Derek Meijers and Gaston Moonen



Plenary session of the 2019 ACFE European Fraud Conference organised in Zurich

From 27 – 29 March 2019, the Association of Certified Fraud Examiners (ACFE) held its European fraud conference in Zurich. Spread over two and a half days, this event hosted speakers on a range of topics, varying from fraud risk assessments to financial crime and cyber security. The ECA Journal was invited to cover this conference, where it had the opportunity to attend several presentations, and to speak with Bruce Dorris, President and CEO of the ACFE, as well as with some of its key speakers.

## Let's talk about fraud

From 27 – 29 March 2019 participants from across the globe met at the Association of Certified Fraud



*Together, Reducing  
Fraud Worldwide*

Examiners' (ACFE) European fraud conference in Zurich to discuss tools and methods for anti-fraud investigations, including topics related to data security, challenges of human behaviour, cyber-related attacks, business ethics and fraud investigation techniques.

The ACFE is active worldwide and provides training and certification to a global network of fraud examiners. In addition, it organises conferences on five continents, offering participants from its regional chapters a discussion platform and a valuable opportunity to exchange best practices and to share their knowledge — thus creating awareness and promoting the fight against fraud. Bruce Dorris, J.D., CFE, CPA, President and CEO of the ACFE, explained that the association was founded in the United States, but that its membership has now become very international: 'Over 40% of our new members come from outside the U.S. and we see an increasing interest in fraud examination, also in Europe.'

A quick look at the conference's attendance list clearly revealed that the need to fight fraud is on the agenda of governments, institutions and businesses alike. The majority of the conference's participants were corporate members, and only a limited number work for public organisations. That said, law enforcement bodies, which are joined in a special ACFE network, the Law Enforcement and Government Alliance, were represented well. Another striking feature was that many of the attending fraud examiners were relatively young and female.

### Association of Certified Fraud Examiners (ACFE)

Based in Austin, Texas (US), the non-profit organisation ACFE is the world's largest anti-fraud organization, providing anti-fraud training and education to more than 85 000 members worldwide. Its mission is to reduce business fraud worldwide and to inspire public confidence in the integrity and objectivity within the profession.

Last year, the ACFE provided a training for over 30 ECA auditors to become certified fraud examiners.

## Fraud is international

After several big fraud cases surfaced in recent years, and with many of them initiated by whistle-blowers, the spotlight of public attention has turned to fraud. This in turn led to enhanced anti-fraud measures and anti-bribery and anti-corruption legislation in more and more countries. The business world also recognised the risks of fraud, which has led to an increased interest in the topic, and more education and training in this vast and multi-faceted area. The ACFE operates in this context and its conferences are an important tool to promote professionalism and knowledge sharing within the sector.

Source: ACFE



Bruce Dorris, J.D., CFE, CPA, President and CEO of ACFE

Bruce explained that, currently, there is a lot of interest in ways to tackle challenges in the area of cross-border and cyber-crime. 'Whether from Europe, the Middle East, or the US, fraud examiners typically face multi-jurisdictional issues, and technological developments most certainly increase the risks as they offer fraudsters new ways to commit fraud.' He noted that the difficulty here is that solutions that work in the US might not necessarily work in the EU or anywhere else. 'International crime does not stop at the border, but crime fighting often does.'

Therefore, it is important for fraud examiners to maintain an international network and to exchange best practices with colleagues from other regions or organisations. And our association aims to offer them this opportunity by bringing all these people together in one room where they can discuss the problems they face in their country.'

## Fraud risk assessments - the mind of a fraudster

During the conference, many presenters noted that the human aspect is key where it comes to tackling fraud and video interviews of convicted fraudsters were shown, providing highly interesting and telling insights into the reasons behind the crimes they committed. All of which fit the pattern of the theory of the fraud triangle, according to which anyone could be susceptible to dishonest behaviour if the three conditions of pressure, rationalisation, and opportunity are met.

Bethmara Kessler, CFE, consultant, advisor, ACFE Faculty Member, and Member of the ACFE Board of Regents, explained this and the concept of the fraud triangle during her address on the opening day of the conference: 'During a fraud risk assessment, it is essential to be aware of what a fraudster is thinking about when he is trying to defraud your organisation or seeking out a bribe. In addition, you must keep in mind that any person can come to commit fraud under the "right" circumstances.' She explained that such situations occur if an individual experiences enough pressure, for example because of financial problems, if there is an opportunity to misappropriate funds, and if he can convince himself he has good reasons to commit fraud. 'For example because he thinks he should receive a promotion.'

Source: Piotr Piwowarski



Bethmara Kessler

## Fighting fraud – an organisation's prerogative

During her presentations, Bethmara repeatedly pointed out that the behaviour of the top-level management of an organisation has a big influence on that of its ordinary staff members. 'The ACFE regularly interviews convicted fraudsters to learn about the reasons behind their crimes, and many of them, especially from the financial sector, have indicated that

they felt entitled to misappropriate funds as they had seen their companies' leadership behave dishonestly.' Bethmara, as well as others during the conference, emphasized that the top management of every organisation needs to display honest behaviour and promote ethics. But that in itself will not be enough to mitigate fraud risks.

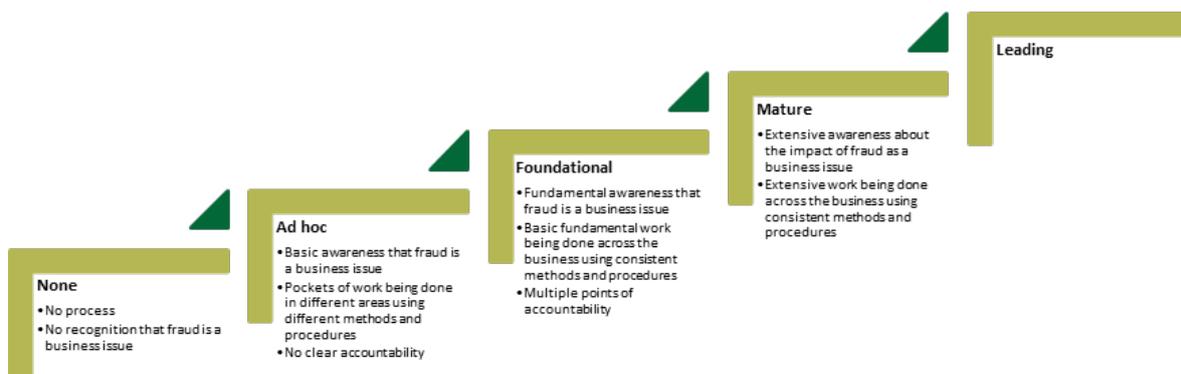
In this context, one of the key messages of the conference was that the human factor plays a decisive role as well. As individuals are less likely to steal from people they have a personal relationship with, it is important the leadership of an organisation develops such a relationship with its staff. Being visible for ordinary staff members, showing an interest in daily affairs and the personal circumstances of employees can make the difference when it comes to potential fraud.

In her talk, Bethmara explained that this is also imperative to create an atmosphere in which people feel free to flag potential risks. Bethmara: 'People need to believe that coming forward helps and that their concerns are taken seriously. If staff fear the response by the leadership is negative, that it is not willing to take action together with the right people from the organisation, they will not have the necessary faith to flag risks.' She pointed out that it is a common response from organisations to keep people in the dark when it comes to fraud risks, or even – suspected - fraud cases, as a first reaction often is that being open about these things could harm the company's reputation. Bethmara: 'But if a fraud case comes up, that is actually a good moment to learn about fraud and the risks thereof. It is the perfect moment to discuss fraud within the organisation and to make people aware, giving them examples of good and bad behaviour, drawing lessons from past cases.'

She particularly encouraged managers to take the opportunity when it arises to create an environment in which staff members become vigilant when it comes to fraud risks and potential fraudsters. 'Strengthen your staff's professional judgement and promote scepticism, openness and intellectual curiosity in your organisation,' she said, and, laughing: 'And not just with your fraud examiners or auditors!'

Bethmara presented the fraud maturity curve (see **Figure 1**) to measure how developed an organisation is when it comes to fraud risk awareness and management. Ranging from no process at all to a leading stance in the fight against fraud. It shows that organisations need to be aware that fraud is a business issue, and that uniform and consistent methods and processes are necessary across all levels of the organisation to remain vigilant and to ensure both the leadership and ordinary staff members feel responsible and accountable for the mitigation of fraud risks. 'This is basic business ethics, but such moral aspects are essential to keep the organisation on the right track and to promote honest behaviour.'

**Figure 1: The fraud maturity steps**



Source: ECA, based on ACFE material

## Public organisations and fraud

Public organisations encounter fraud just as much as businesses. However, the defrauding methods and financial risks are often of a different type and scale. When asked about these differences between the governmental and the corporate world, Bruce indicated that, in general, companies face bigger risk of being defrauded by their own staff or by criminals sending fake invoices, whereas public organisations are more vulnerable to bribery and are corruption. Bruce: 'Of course, fraudsters can strike anywhere, but the biggest risks can be found there where people actually have direct access to money. So, to give an example, a corporate fraud case will more often involve someone from the inside that is authorized to pay invoices, for example. As can also be seen in the interview with Nathan Mueller, who was convicted embezzling \$8.5 million while working at ING.'

'Now, in public organisations,' Bruce continued, 'there are generally less people with direct access to money, so for that reason the risks often come from the outside.' As an example, Bruce mentioned international development aid programmes where subsidies are paid and where fraudulent behaviour can often be found in the supply chain, where money or goods could be misappropriated. Bruce: 'Now the problem in these situations often is that people and organisations dealing with the aid are very much aware of the risks, but also see it as a necessary evil. Take the example of disaster related aid.'

By definition, this type of intervention takes place under difficult circumstances and under extreme time pressure, and in areas where you have to work with individuals and organisations that could



not be vetted as much as one would do under normal circumstances.' He explained that: 'The tendency in such situations is to think: "we know there is corruption and that a part of the aid will end up at the wrong place, but, if only 60 out of every 100 euro reaches the people that actually need it, at least we can make a difference." But the problem of this way of thinking is that it harms the public trust, which might discourage donors to provide the necessary means in the first place.'

Bruce pointed out that there is a lot of attention for this type of issues in the trainings the ACFE provides. 'If we go back to the example of 60 euro, the purpose is to increase that "impactful" amount from 60 to 70, and from 70 to 80, and so on. We try to make fraud examiners and investigators from law enforcement bodies, especially also from impoverished nations where these disaster relief and aid programmes are active, aware of the risks and teaching them how to look for them, how they can be recognised, avoided, and, where necessary, combatted. We have seen good results and we as ACFE hope this contributes to the positive impact development aid has around the world.'

## Break-out sessions

Apart from the plenary sessions, the conference offered its participants a number of parallel sessions (also see **Figure 2**) on specific issues such as data security and compliance with the General Data-Protection Regulation (GDPR), challenges of human behaviour, cyber-related attacks, social engineering, business ethics and fraud investigation techniques.

### *Business Ethics in Action*

One of the breakout sessions focused on how straightforward and normal a high level of ethics should be in a corporate environment. Starting point was common sense and concerning behaviour aligning what you feel with what you do. Issues discussed were dilemma's and scenario sketching, to make people more common with 'unfamiliar' situations. Other elements related to leading by example: if leaders expect staff to 'live' the ethics formally laid out they need to be leaders in that themselves; and know engaging people in ethics will make a difference in profitability. Several case studies were presented, including the analogy between aerospace and more 'normal' corporate

Figure 2 - Agenda of the 2019 Fraud Conference Europe

activities. In aerospace no one will hesitate to bring up 'errors' because of the huge safety consequences. Any organisation should encourage an atmosphere of speaking up without fear of retaliation in case the making of a mistake is spotted. The idea here is that making a mistake is not a mistake. Not reporting it is a criminal act. Interesting was also the reference to a so-called 'TGIF' (Thank God It's Friday) mentality, meaning that research had shown that 24% of staff is disengaged, 62% of staff gives less of themselves than they could. And only 14% of the staff is highly engaged with their work.

*Demystifying the Dark Web: Tactics, Techniques and Procedures*

Another parallel session dived into the fascinating, yet disturbing world of the so-called dark web — an area of the internet that is not accessible via normal search engines such as google or yahoo. The presentation started with some basic facts, for example that the dark web, actually is just one area of the deep web, which is the part of the world wide web that just is not freely accessible to anyone, and where companies intranet pages, peoples bank accounts and your personal email account live. This was followed by an introduction into the online tools an investigator can use to access the deep web. The deep web is built on the Tor network, which is an open source project developed and supported by the U.S. government.

The presentation then turned to the darker parts of this deep web, Tor browsers allow you to roam through the fully anonymous slums of the internet, which is actually not illegal in itself. There, criminals offer any type of service or product, ranging from hacked log-in codes and drugs, to weapons and child pornography. To their – relative – relief, the presenter ensured the audience that a number of morbid urban legends linked to the dark web, such as livestreamed murders, have never been proven. In fact, many of the services offered by criminals and scamsters on the dark web are nothing but ... scams.

Agenda	
<b>Wednesday, 27 March</b>	
13:00-17:00	<b>Pre-Conference: Taking Fraud Risk Assessment to the Next Level</b> Bethmara Kessler, CFE, CISA Consultant, Advisor and ACFE Faculty Member ACFE Regent
<b>Thursday, 28 March</b>	
09:00-10:15	<b>Welcome and Opening General Session</b> Gretta Fenner Managing Director, Basel Institute on Governance
	<b>Track A</b>   <b>Track B</b>
10:35-11:50	<b>2A The Data Dilemma</b>   <b>2B Social Engineering and Phishing: Future Cybercrime Challenges</b>
11:50-13:30	<b>Luncheon Session</b>
13:40-14:55	<b>4A Improving Your Data Security and GDPR Compliance</b>   <b>4B Challenges of Human Behaviour in Interviews</b>
15:15-16:30	<b>5A Financial Crime Involving PEPs: How to Detect Money Laundering, Sanctions Violations and Corruption</b>   <b>5B Business Ethics in Action</b>
16:30-18:00	<b>Networking Reception</b>
<b>Friday, 29 March</b>	
09:00-10:15	<b>General Session</b> Sir Rob Wainwright, Former Executive Director, Europol Senior Cyber Partner, Deloitte
10:35-11:50	<b>7A Cross-Border Asset Tracing</b>   <b>7B Demystifying the Dark Web: Tactics, Techniques and Procedures</b>
11:50-13:30	<b>Working Lunch</b> Xavier Justo, IMDB Whistleblower  Dr. Lukas Straumann, Executive Director, Bruno Manser Fund
13:40-14:55	<b>9A How to Create a Coordinated GDPR and Fraud Strategy</b>   <b>9B Dos and Don'ts in Investigations</b>
15:15-16:30	<b>Closing Session</b> Dr. Alexander F. Wagner Associate Professor of Finance, University of Zurich

Source: ACFE

### Root causes and key lessons

From the discussions during the conference, it appears that, to make their fraud risk management plans stronger, fraud examiners need to continuously develop their skills and methodologies and stay informed about new fraud schemes. Utilising tools such as data analytics, control systems, and cyber security will make fraud risk management plans more robust. In addition, technological developments and advanced data sciences offer fraud investigators more and more tools to detect, manage and mitigate fraud risks. Artificial intelligence, for example, can take us a long way in assessing possible risks and in performing recurrent checks.



However, organisations cannot rely on technology alone when it comes to preventing and fighting fraud, as the root causes of fraudulent behaviour lie in human nature. Moreover, technology can never replace an individual's intellectual curiosity, scepticism and professional judgement. Without acknowledging the importance of the human element, the fight against fraud cannot move forward. Therefore, any organisation must primarily ask the question what drives people to behave dishonest, taking into account the three elements of the fraud triangle, as well as business ethics. Investigators must always factor in the capricious characteristics of human behaviour. Creating awareness, an open and transparent working environment that encourages people to flag possible risks will make an organisation more resilient.

# Fraud fighters: anti-fraud training for ECA auditors

By Robert Lamers, Head of European Partnership development,  
Association of Certified Fraud Examiners



The ECA offers its auditors in-house training on fraud and compliance, and also on ethics and integrity. Since 2018, this coursework includes a training provided by the Association of Certified Fraud Examiners (ACFE), aiming at fraud prevention and detection and leading to the CFE exam. After passing, a participant becomes certified fraud examiner. Robert Lamers is Head of European Partnership Development in ACFE and was the trainer for the first course in the ECA. He explains the need for training in the area of fraud and reflects on the ACFE training provided to the ECA.

## Fraud is everywhere

Open a random newspaper or watch the news on television and there is a good chance you will be confronted with stories about fraud, compliance and ethics. New cases of fraud and corruption are exposed almost on a daily basis. And they occur at any level of our society. On the one hand, this is quite alarming, but the upside is that the public opinion about fraud and corruption is changing rapidly. Where lacking knowledge and limited persecution led to a certain acceptance of fraud and corruption in the past, nowadays, fraudulent acts and corruption are deemed unacceptable. Even more interesting is the change of opinions, also on the political level, in the way people think about actions that used to be a grey area between right and wrong, such as tax avoidance.

Officially tax avoidance, which entails various methods used by private individuals as well as companies to minimize the amount of tax they have to pay, might not be an illegal action. And in the past it was even pretty normal and accepted to avoid paying too much tax, for example by using tax havens. However, the public opinion on such schemes has turned 180 degrees following several scandals, such as those that were uncovered with the publication of the Panama Papers in 2015. Many people all over the world were shocked and disgusted to find out on what scale tax was being avoided worldwide, and the publication put severe pressure on companies and especially VIP's, such royals and politicians from across the globe.

### Box 1 -the Association of Certified Fraud Examiners (ACFE)

In 1988, Joseph T. Wells, an accountant-turned FBI agent, founded the Association of Certified Fraud Examiners (ACFE). The mission of the ACFE is to reduce the incidence of fraud and white-collar crime and to assist its members in fraud detection and deterrence. With 85 000 members in 160 countries the ACFE is the world's largest anti-fraud organization and premier provider of anti-fraud training and education.

The Panama Papers exposed a hidden world where dodgy law firms and trust funds created complicated financial and fiscal constructions to help their rich clients to hide large sums of money from tax authorities on all continents. And although such constructions are not always illegal, the public opinion is clear: such behaviour is morally wrong.

## But what exactly is fraud?

Fraud is an umbrella term that includes any intentional or deliberate act to deprive another of property or money by guile, deception, or other unfair means. It causes tremendous damage to the global economy and undermines the trust of citizens in governments, institutions, and – especially – in the financial sector. The important question is how this risk can be reduced significantly, and what the best ways are to detect and fight fraud.

An important challenge here is that fraudulent schemes and fraudsters come in all sorts of shapes and sizes. The amount of modus operandi is virtually unlimited and fraudsters come from all walks of life. In addition, the overlapping conditions that can be found in all fraud cases are quite general. Any person can come to commit fraud if there is enough pressure, e.g. because of financial problems, to commit fraud, if there is an opportunity to misappropriate funds, and if the individual can convince himself he has good reasons to commit fraud.

## Anti-fraud training at the ECA

The variety and frequency of fraud obviously means that, for an organisation to be successful in fraud prevention, detection and investigations, it will need to train its staff in order to gain sufficient knowledge about the characteristics of fraudsters and fraud schemes. The ECA is no exception here, and although its main mission is not to detect and report fraud, its auditors do encounter – suspected – fraud cases during their work, in which case they are required to inform OLAF, the EU's Anti-Fraud Office.

To enhance its auditors' knowledge and skills in the area of fraud, the ECA set up a training programme, which includes the Certified Fraud Examiner (CFE) review course offered by the Association of Certified Fraud Examiners (ACFE). The first group of ECA auditors took, and successfully completed, this course in October 2018. The participants discussed topics such as the difference between assumptions and fact finding, and how to deal with suspected fraud. Participants got information showing that it can be tough to move from a suspicion of fraud to a proven fraud case.

## Added value for teachers and participants alike

The ultimate goal of the course we provide is to make participants CFE in five days. This means getting familiar and digesting a lot of material, plus four exams consisting of 100 questions each. During the week at the ECA nearly everybody was able to pass the exams, resulting a several new CFEs at the end of the week. Teaching this ECA class was not only very pleasant but also gave real added value to my colleague Kurt and me. We learned a lot about the specific issues the ECA auditors face when assessing EU expenditure and policies. Enriching our work for future groups.

### Box 2 - Certified Fraud Examiner (CFE) credentia



In order to improve the general and specific knowledge and to set high standards for continuing professional education, the ACFE developed the Certified Fraud Examiner (CFE) credential. People with the right combination of academic skills and a minimum of two years professional experience in a fraud related field can apply for this international CFE credential.

This credential can be acquired through a 4 or 5-day classroom CFE Exam review course, which teaches participants about fraud investigations, law, financial transactions, fraud schemes, and fraud prevention and deterrence. To maintain the credential every CFE must follow at least 20 hours of continuing professional education per year.

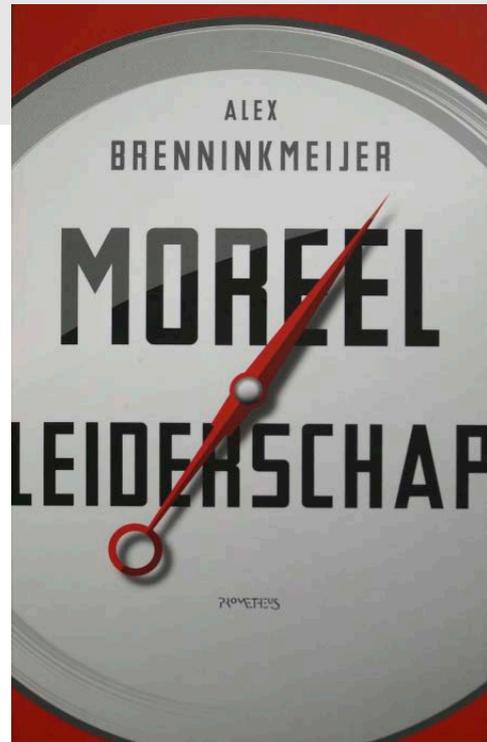


Source: ACFE

# Moral leadership as an answer to corruption and fraud

By Alex Brenninkmeijer, ECA Member

As a former judge and National Ombudsman in the Netherlands, as an academic and currently as an ECA Member, Alex Brenninkmeijer has dealt extensively with the procedures and decisions of government institutions. Early in 2019 he published a book on moral leadership, which he considers to be a key element in determining in which direction a person, a business, an institution, or even a society is heading. In this article, he argues that moral leadership can be an answer to counter corruption and to prevent fraud. And points out some key steps that can help us become moral leaders...



## Moral reflection to restrain fraud and corruption

No imagination is required to link fraud and corruption to a lack of integrity and moral leadership. Real life, however, shows us that in many places fraud and corruption can flourish in the absence of moral reflection or restrictions. Former US President Barak Obama, in his speech on the occasion of Nelson Mandela's 100th birthday, argued that so-called 'strongmen' have the potential to threaten our democratic states and the rule of law. Our well-ordered, rule-based and liberal world may well revert to 'an older, more dangerous and more brutal way of doing business.' There is also a risk that those strongmen may 'undermine institutions on which democracy is grounded.'<sup>1</sup> In contrast, European cooperation is based, by its very nature, on the respect of multi-laterally agreed rules, a balancing of interests within our society and between countries, and cooperation in good faith.

Fraud and corruption can weaken the fundament of this cooperation and erode the faith of citizens in our societies. For example, most EU programmes are managed by the European Commission, together with Member States. This shared management requires trust and, above all, loyal cooperation. In this system, we at the European Court of Auditors provide assurance to EU citizens that EU money is spent in accordance with the applicable rules and delivers value for money. Because EU spending is not meant to enrich a happy few who try to mask their fraudulent intentions.

## Human dignity versus authoritarianism

Democracy and the rule of law are centrepieces of moral leadership. History teaches that important moral leaders such as Mahatma Gandhi, Martin Luther King, Václav Havel and Nelson Mandela all fought for human dignity as an expression of human rights, as part of combating authoritarian or colonial regimes. The essence of their moral conviction could be the recognition of every human being as equal. People may be different, but they are all humans.

<sup>1</sup> The Guardian, 17 July 2018.

Democracy – ‘one man one vote’- and the rule of law, together with equality before the law, are the most fundamental principles in protecting men as humans. Both are directly threatened if our leaders, our judges, our auditors and everybody serving the public administration are not seen to adhere to the principles of integrity and honesty, and instead are perceived to be prone to fraud and corruption. So, the key question is: how can we as individuals support integrity and honesty? How can we identify and show moral leadership?

### Thinking, fast and slow

In my analysis of ‘the pursuit of moral leadership,’ I argue that two aspects are fundamental: thinking slow, if needed, and striking a fair balance between the three fundamental aspects of our daily life: logos, pathos and ethos.

In our daily life, we are used to applying many shortcuts in our brain and their use is often very effective, allowing us to act swiftly and on the bases of long-accumulated knowledge and experience. They are the result of our individual learning process and our ‘copy-pasting’ of that of others. Stopping at a red light is an automatism which supports traffic safety. Many decisions in our daily life are based on these shortcuts. However, Nobel prize winner Daniel Kahneman introduced the difference between ‘thinking fast and thinking slow,’ indicating two different systems in our thinking<sup>2</sup>. If we enter a ‘cognitive minefield,’ we should firstly identify the risks linked with this specific situation in our social life. In other words, Kahneman warns that not every decision, not every situation can be dealt with by ‘thinking fast.’ In some situations we should step back, collect as much relevant information as possible, and we should conduct a more thorough reflection.

Moreover, we are rational beings, with feelings, but first and foremost, we should find our orientation according to values. Reading Nelson Mandela’s ‘Long walk to freedom’ I was really impressed by the manner in which he balanced logos, pathos and ethos through his actions. But logos, pathos and ethos are not only key in the toolbox of a rhetor, balancing those three aspects of our own life is key in finding our way towards moral leadership.

### Can I explain what I do to outsiders

Imagine that you start working in a public organisation which is tasked with certifying that costs that will be financed by the EU have been incurred for a project agreed with the Commission. This organisation will certainly have a routine for making cost declarations. Thinking fast you just follow ‘the tradition’ and modus operandi of the organisation. But somehow, you get the feeling that these cost declarations are not properly done and result in overcharging and profits for the receiving party. You feel that it is not just, as money has been gained, and questions arise, such as: ‘Whose pockets are being filled?’ and ‘Is this lawful?’. Similar examples can be found regarding public procurement procedures.

In the case of cost declarations, thinking slow might be helpful: What are the rules? What are the expenses? What is reasonable? What would the outside world think of this cost declaration and the subsequent payments? If a webcam were to follow this transaction, would the outside world be comfortable with it? Indeed, transparency can generate

#### Logos, pathos and ethos

In his book *Rhetorica*, Aristotle provides his analysis of the modes of persuasion. The elements he provides for persuasion by the spoken word are logos, pathos and ethos. Logos relates to the mind, to reasoning, and is normally used to describe facts and figures, presenting a factual substantiation. It makes the speaker look knowledgeable. Pathos relates to the feeling that the speaker may transfer to his or her public and appeals to the audience’s emotions. So it can refer to the speaker’s own feelings, or anticipate (perceived) emotions in the audience. Finally, ethos relates to the moral aspect, in the form of a judgement or an appeal, and also shows something of the personal character of the speaker.

2 Daniel Kahneman, *Thinking, Fast and Slow*, Penguin Books Ltd, January 2012.

valuable feedback. Feeling confident that 'I can explain my actions to the outside world' is a good start for applying the method of thinking slow.

However, Kahneman warns that we, as human beings, have only limited brain capacity and we risk inserting many biases when processing relevant data and the consequences of our decisions. We always try to mould and fit our view of reality into the shape of our comfort zone. Moreover, it may be risky to discuss a standing practice in your own organisation, or discuss a certain routine which is favourable for another or many in that same organisation. The ancient Greeks referred to this situation as *parrhesia*, which can be translated as being frank and open, speaking truth for the common good, for a just world, also called 'speaking truth to power.'

In my view, speaking truth to power can start early in the morning when I look in the mirror, and ask myself a frank question: 'Why am I doing this?' - and 'Can I explain the answer to this question to the people who are the nearest to me? It is not only important to know what we do and how we do it. The most important question is the 'why'. This 'why' question may lead us out of the cognitive minefield Kahneman mentions in his study on 'Thinking, Fast and Slow.'

### **Going for the intrinsic justification**

Our world is complex and our professional life is part of this complexity. I presume that is why gardening, walking or cycling become so attractive: it might be much simpler than practising our profession. But that is what we are paid for and chose to do. In this complex world, we often find a safe haven in rules, procedures, habits, protocols and budgets. However, these are only a part of what is relevant to making the right decisions. To be convincing for others we cannot only refer to rules and procedures. There is always a need for a more intrinsic rightness or justification. If I explain what I am doing to my 13-year-old niece, she should think: 'This is right!' And 13-year-old nieces always have a perfect compass for rightness.

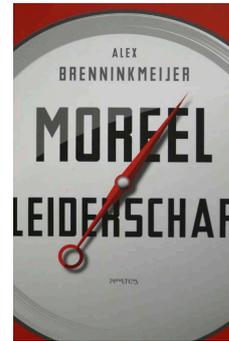
Finding this rightness or justification asks for a reflection on the three fundamental aspects of our existence as human beings: we are not only 'rational' but we also have our feelings and convictions. In the world of ratio, 'feelings' are often perceived as 'weak' or 'feminine'. This implies that in our dominant culture there is a hierarchy where ratio and logos sit above pathos. However, psychology tells us that we only think we are rational, but our actions are dictated by emotions. Knowing this, it might be helpful to reflect on our concerns, fears and pride, and that of others involved in the case. If a decision is taken according to rules and procedures that do not feel right, maybe we are entering into the cognitive minefield that Kahneman has identified. If it comes to our convictions – and those of others – a third part of our cognitive existence comes into play: the ethical norms we and others adhere to.

These ethical norms may correspond with rules and regulations that are in force, but are often broader. Not all that fits into the rules is ethically justified. Ethical norms can be fundamental, such as the fundamental rights of every human being as enshrined in international treaties and the EU's Charter of Fundamental Rights. However, many ethical rules are based on the intrinsic convictions within all of us. Setting a good example and inspiring people to act 'justly' is the core of moral leadership.

### **Thinking slow, moral leadership and fraud and corruption**

What is a good example to set? What is 'just?' These are fundamental – I would say existential – questions in our daily, professional and personal lives. The answer to these questions can be found in balancing logos, pathos and ethos. For example, if I get a 'bad feeling' about a certain cost declaration or a certain 'standing practice' in my organisation, I should switch to thinking slow. In doing so I can reflect on the data and the rules, the concerns and the feelings connected with the issue and the ethical principles I and eventually others would like to support. This cognitive exercise demonstrates how moral leadership can be an answer to counter corruption and to prevent fraud. The quintessence of leadership is not 'How should they behave?', but 'How do I behave?'

This contribution is based on the book Alex Brenninkmeijer published in January 2019 in the Netherlands. He analyses moral leadership and applies this analysis to politics, the judiciary, the executive and the media. His book is not about moral leaders as such but about developing moral leadership as a professional and in your personal life. His central thesis is that everybody can develop moral leadership by switching from fast to slow thinking and balancing the three fundamental aspects of our cognitive existence: logos, pathos and ethos; the ratio, emotions and ethical principles.



# Auditing the ethical framework of EU institutions: easier said than done

By Mihails Kozlovs, ECA Member



Source: EP/EP/EC/Council

Buildings clockwise from top left to bottom left: European Parliament, European Council, European Commission, Council

When it comes to their role in fighting fraud and corruption, most EU institutions and bodies go at length to explain their efforts and intentions to lead by example. But how do these claims stand up to a reality check? An assessment of their ethical standards and the framework to uphold them provides a compelling litmus test and interesting insights. Mihail Kozlovs works as reporting Member on the currently on-going audit covering the European Commission, the European Parliament, the European Council and the Council. Below he zooms in on some key aspects regarding ethics, their relevance for the EU's public administration, and the approach taken by the ECA auditors in assessing EU institutions' ethical frameworks. The report is scheduled to be published later this year.

## Meaning of ethics – a variety of perspectives

'What makes ethics so important to public service is that it goes beyond thought and talk to performance and action.'

The above quote effectively encapsulates the essence of the debate about ethics in (public) management. The principles of ethics are as ancient as humanity. They are rooted in the basic philosophical ideas, especially in a discourse about individuals' actions and thoughts in pursuit of the individual and common good.

These ideas have been developing constantly throughout the evolution of our society and its behavioural norms. Indeed, it appears that public servants of the earliest civilisations thousands of years ago considered ethical actions as vital as the thoughts or words of such actions. Justice and fairness were the cardinal principles in public office; and ethical behaviour was the cornerstone of administrative conduct. How does one achieve the state of being ethical? For Aristotle, who associated ethics with moral and intellectual excellence, the ideal person 'practiced behaving reasonably and properly until he or she

could do so naturally, by habit, and without effort.' Aristotle believed that moral virtue was a matter of avoiding extreme behaviour and finding instead the mean between the extremes.<sup>1</sup>

In the second half of the 20<sup>th</sup> century, a lot of research went into the concept of ethics in public administration. As George L- Hanbury put it: '...the academic work 'supports the need of good ethical administration to carry out the social, political and economic needs of good government in a democratic society.'

Ethics is closely connected to an individual and individual's behaviour in the context of perception or expectations of others. Needless to say that these vary greatly: indeed, the perception and expectations about the individual's behaviour may be extremely different because of his/her place in society and the potential influence upon other individuals and society.

**Ethics, as defined in the Cambridge Dictionary of Philosophy (1995)**

'Commonly used interchangeably with 'morality' ... and sometimes it is used more narrowly to mean the moral principles of a particular tradition, group or individual.'

Over time, the concept of ethics has evolved into a set of well based, understandable and commonly accepted minimum standards of what is right versus what is wrong, often prescribing what individuals ought to do. However, overall the opinion seems to be that '... although the future favours more regulations, standards, and codified procedures, no law, ancient code, or religious edict, replaces an individual's basic honour and good moral character.'<sup>2</sup>

Organisational theories regarding ethics seem to surface in much greater detail in the late nineties. This was triggered by ethical issues appearing more and more frequently in the public debate, and organisations themselves reacting by introducing elements of ethical infrastructure to protect themselves against reputational risks. Ethical infrastructure means here the existence of, awareness about, and implementation of the ethical rules in organisations.

Various approaches have been developed during the recent years in both private and public sector. However, there is still no consensus about the best applicable framework to address the ethical matters in organisations. The concept of New Public Management - whereby the public administration increasingly adopts working methods that are characteristic to private sector organisations - seems to further complicate the matter from an ethical point of view. However, one may argue that 'the effect of introducing business-like methods in the public sector depends more on the establishment of practical principles to ensure that these methods are exercised in an effective and ethical manner, than the introduction of business-like methods as such.'<sup>3</sup>

### Conceptual approaches to address ethics

The above considerations represent general theoretical foundations. Yet, what is optimal for the European public administration in order to gain, maintain and enhance the trust of the European citizens in the European institutions? Hence, what criteria should the external auditors and other stakeholders use to scrutinise the ethical systems established in the EU institutions?

Currently, two conceptually different frameworks are being discussed, compared, examined and applied. First, the *integrity management approach*, and, second the so-called *pluralistic framework*. The choice of one of them, or a combination of both, depends on the type of organisation in question and its needs (e.g. reputation risk level).

1 See for example George L. Hanbury, A 'Pracademic's' Perspective of Ethics and Honor: Imperatives for Public Service in the 21<sup>st</sup> Century, Public Organization Review: A Global Journal 4, p. 287-204 (2004)

2 GEORGE L. HANBURY, A "Pracademic's" Perspective of Ethics and Honor: Imperatives for Public Service in the 21st Century, Public Organization Review: A Global Journal 4: 187-204 (2004)

3 EMILE KOLTHOFF, LEO HUBERTS, HANS VAN DEN HEUVEL, THE ETHICS OF NEW PUBLIC MANAGEMENT: IS INTEGRITY AT STAKE?, Public Administration Quarterly, Winter 2007

*The integrity management framework* introduced by the Organisation for Economic Co-operation and Development (OECD) in 2009 brings together instruments, processes, and structures for fostering integrity and preventing corruption in public organisations<sup>4</sup>. According to the OECD, public officials need to know, or at least be aware of, the fundamental values of the public service and the standards of conduct that they are expected to apply in their work, including where the boundaries for acceptable behaviour lie.<sup>5</sup>

*The pluralistic framework* is relatively new. It refers to the concept of 'ethics' practices' instead of the one of 'controls.' Ethics practices operate in a complementary fashion at the individual, collective, and strategic levels and target very specific elements of the organisation's ethics' context and activities. Individual ethics' practices aim to foster and encourage individual ethical reflection and behaviour. Collective-level practices target working groups, departments, levels, or the organization as a whole by focusing on, for example, ethical culture and context, ethical leadership, the working environment, or group unity. Strategic ethics practices focus on the governance of the organization and its positions and actions toward external stakeholders as well as social, environmental, and political issues.<sup>6</sup>

Since 2009, and partly in response to the above, the OECD has been refining the *integrity management concept* further. One of the main question was about the effectiveness of framing the ethical matters in the form of legal acts. In 2017, the OECD adopted its *Recommendations on public integrity*<sup>7</sup> that define the public integrity as '... the consistent alignment of, and adherence to, shared ethical values, principles and norms for upholding and prioritising the public interest over private interests in the public sector.'

Interestingly, the OECD Recommendations put much more emphasis on soft and cultural aspects, rather than on the creation of more rules only, stricter compliance and tougher enforcement. There is, however, still significant focus on the legislative and institutional frameworks, internal control and management, enforcement, oversight and control. Thus, a well-balanced mix of the rules based and awareness raising approaches seems to be the mainstream approach.

Overall, the integrity management approach emphasises the rules-based ethical infrastructure supported by awareness raising activities and enforcement. The pluralistic framework though, has a lot to do with the notion of culture in an institution to enable making ethical judgements.

### **Growing awareness of ethical issues within the EU public administration**

Within the EU institutions, there is a growing awareness of the positive leverage of having in place robust ethical frameworks. This is also triggered by the substantial and long-lasting potential damage of failures to engrain the key principles of ethical behaviour in everyday performance. Ethical conduct in public affairs means that civil servants should serve the public interest, manage public resources properly, and make fair decisions. It contributes to sounder financial management and increased public trust, which is indispensable if public policies are to succeed. Any unethical behaviour by staff and members of EU institutions and bodies readily attracts high levels of public interest and reduces trust in the EU. These elements make it only more important for the institutions to put in place adequate ethical frameworks to ensure that the risks of unethical behaviours are reduced to a minimum. Indeed, according to Carol Lewis, '...nothing is more important to public administrators than the public's opinion about their honesty, truthfulness, and personal integrity.'

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4 INTEGRITY FRAMEWORK, OECD

5 Public sector integrity: Providing services efficiently, JULY 2012, OECD

6 Maryse Tremblay, Jo   T. Martineau & Thierry C. Pauchant (2017) Managing Organizational Ethics in the Public Sector: A Pluralist Contingency Approach as an Alternative to the Integrity Management Framework, *Public Integrity*, 19:3, 219-233, DOI: 10.1080/10999922.2016.1230688

7 The OECD Recommendation on Public Integrity, 26 January 2017-C(2017)5

### Audit approach needs to take account of the specifics of EU institutions

In 2017 the ECA adopted its current 2018-2020 Strategy which aims at fostering trust in the EU. In line with this strategic orientation, the ECA's 2018 Annual Work Programme provided for an audit of the ethical frameworks in EU institutions, focussing on the European Parliament, the European Commission, the European Council and the Council.

Carrying out such an assessment of ethical matters is however far from straightforward, mainly for the following reasons:

1. Scrutinising ethics poses a number of methodological and practical questions. For example, how does this relate to other elements of the internal governance framework, what are appropriate audit criteria, which benchmark can be used? These aspects need to be discussed with the auditees at an early stage;
2. All EU institutions are independent from each other; they have different roles and responsibilities, but they are also operating under the same or at least very similar sets of rules. This needs to be reflected in the audit approach;
3. Since the ECA itself is an EU institution, it is legitimate for its stakeholders to expect that someone looks into the ECA's ethical framework, applying the same criteria as the ECA does towards other institutions;

For the purposes of ECA's ongoing assessment, the term 'ethical framework' refers, firstly, to ethical legal requirements, and secondly, to procedures, enforcement tools, guidance and communication that help to ensure that legal requirements are being adhered to. The EU legislation as such, however, does not provide for a statutory definition of an ethical framework. At the same time, many provisions of both primary and secondary law can be construed as ethical obligations. The right to good administration is proclaimed in the EU Charter of Fundamental Rights as a fundamental right of EU citizens. Article 41 thereof stipulates that 'every person has the right to have his/her affairs handled impartially, fairly and within a reasonable time by the institutions, bodies, offices and agencies of the Union.' This is an important reason for establishing a well-established and functioning ethics infrastructure.<sup>8</sup>

Moreover, the founding Treaties laying down the aspirational values for EU administration represent the starting point: the administration should be open, efficient and independent. These values should be part and parcel of the daily work of the EU administration; they should be at the foundation of ethical frameworks.

**Article 298 (1) of the Treaty on the Functioning of the EU (TFEU)**

*In carrying out their missions, the institutions, bodies, offices and agencies of the Union shall have the support of an open, efficient and independent European administration.*

**Article 11 of the Staff Regulations**

specifies that civil servants shall carry out their duties 'objectively, impartially and in keeping with [their] duty of loyalty to the Union.'

There are two sets of provisions: rules for elected, appointed or nominated members of the EU institutions (such as Commissioners or Members of the European

Parliament) and rules for staff. Because at certain levels the concept of ethics is universal, the rules rightly bear a certain degree of similarity in the language employed and in the spirit of the norm. However, since the roles of members and staff are quite different, there is a need to address each of these groups specifically. Indeed, as Carol Lewis points out, '...the leader sets the tone and conveys the public image...'

Some aspects of the conduct of members of the EU institutions are regulated at the level of the Treaties and others at the level of internal self-regulatory acts. For staff, the 'Staff Regulations of Officials and the Conditions of Employment of Other Servants of the European Communities' (hereafter Staff Regulations) provide a framework which is generally applicable. Staff Regulations contain a number of broad requirements relating to the ethical principles that should be observed by public officials: *independence, integrity, objectivity,*

<sup>8</sup> "1998 Recommendation of the OECD Council on Improving Ethical Conducting the Public Service, including Principles for Managing Ethics in the Public Service", in OECD, Trust in Government. Ethics measures in OECD Countries, Paris, 2000, p. 74.

*impartiality and loyalty.* To enforce these requirements, Staff Regulations set principles like – declaration of conflict of interests, information about outside activities, information about employment of the spouse, information about post-employment activities.

In addition to ethical requirements for staff and members, the ECA has also examined the applicable procedures for enforcing ethical requirements.

The main audit criteria we used for this work were internationally recognised standards developed by the OECD, EU legislation, and the ethical requirements and procedures set out by the audited institutions – in the form of codes of conducts, decisions, guidelines etc. This was complemented by a comparative analysis of the audited institutions' ethical frameworks to identify 'good practices.' We also organised an expert panel to discuss characteristics of a coherent and comprehensive ethical framework in public organisations. Thus, the audit team had to deal with a complex and multi-dimensional task: four EU institutions, at least two major levels (Members and Staff) and a range of ethical principles (conflict of interest, whistleblowing, etc.).

In addition, to get insights into staff awareness of the ethical framework and perception of the institution's ethical culture - that represents a key building block of the ethical infrastructure - we conducted a staff survey. In doing so we made a major effort to ensure that the legitimate concerns of the audited institutions about data protection were reconciled with the need for the survey to be as objective as possible. The results of the survey also helped to gain insights into the implementation of the ethical frameworks in the institutions.

### **What counts is what happens in practice**

At a glance, the principles of ethics may seem simple and understandable, yet they are much more complex in practice. Ultimately, however, what counts and makes a difference is not what is on paper but what happens in practice.

The 'practice-what-you-preach principle' is a key principle that guides the work of the ECA. Parallel to the assessment we made of EU institutions' ethical frameworks, two Supreme Audit Institutions have been conducting a peer review of the ECA's ethical framework. As a result, by mid 2019, and prior to the start of a new legislative period, the ECA will have provided an independent assessment of the ethical frameworks of three major EU institutions as well as have a comparable peer review – accessible to the public - of its own ethical framework. This represents an opportunity for improvements, also for the ECA.

### **Ethics as integral part of good governance**

During the recent years, the ECA has ventured into the matter of governance in the EU institutions assessing, among other topics, governance in the EU Commission, the EU Anti-fraud Strategy, and implementation of the EU law, i.e. the rule of law. Reviewing and benchmarking the ethical frameworks is a logical continuation in these series.

Although it is not impossible that the feedback of the auditee may range 'from co-operative acquiescence and co-operation to confrontational defiance,'<sup>9</sup> the efficiency of management, also when it concerns ethical issues and integrity, is an integral part of sound financial management and essential in the fight against fraud and corruption. It should not therefore escape the independent external scrutiny based on open cooperation between the parties involved. A major difference of the ECA's work compared to other stakeholders' assessments is our full independence and unrestricted access to all necessary information. Ultimately, it is for the benefit of the audited institutions themselves and, from a much broader perspective, for the transparency and the image the EU institutions create in the eyes of citizens.

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<sup>9</sup> Warwick Funnella, , Margaret Wadeb, Negotiating the credibility of performance auditing, *Critical Perspectives on Accounting* 23 (2012) 434– 450

# We need people with moral courage

## Interview with Anton Colella, Global CEO of Moore Stephens International

By Gaston Moonen



Source: Moore Stephens International

Anton Colella

For over a year now Anton Colella has been working as the Global CEO of Moore Stephens International, belonging to the top 10 accountancy firms in the world with offices in over 100 countries, employing over 30 000 people worldwide. Having worked before as the CEO of the Institute of Chartered Accountants Scotland, Anton Colella has built up a reputation of presenting and 'living' audit as a value-driven service to society. He shares some of his views regarding the role of values, particularly when it comes to fraud and corruption and how audit firms should deal with this.

### **Different, yet familiar, aiming for the human relationship**

Waking up in different time zones is not new for Anton Colella. 'But it just happens more now than in my previous job.' He had a timeslot for the interview early in the morning, just before giving presentations to 50 leaders of Moore Stephens International who had gathered at Harvard University in Boston. 'On the one hand my work is quite different from before, in the sense that the discussions are more macro, dealing with issues coming from different parts of the world. On the other hand, from a leadership point of view there are also many similar demands to previous positions I held. And I started in a good learning school, being a high school teacher a long time ago.'

Anton explains that in the very busy market of accountancy firms there is a lot of competition. 'The challenge is how to differentiate yourself. Pricing? Pricing as such is a wrong strategy, because the client can see through that. I think there is an opportunity today to differentiate in the quality of care that we have for our clients. And that means changing sometimes the fundamental DNA of a firm. From a transactional relationship with clients to a companionship relationship with them.' He points out that at a time when technology is driving so much - personal life, corporate lives, operation of businesses - there is a potential for a significant dehumanizing in organisations. 'I believe there is

an opportunity today to disrupt and bizarrely the new disruption will not be technology. The new disruption in the market place will be the businesses that embrace a renewed and profound humanity.'

“ *The new disruption in the market place will be the businesses that embrace a renewed and profound humanity*

The Global CEO explains that technology is perceived by several people as a threat in accountancy, or a disrupter.' But I believe that it in fact provides us with a liberty allowing us to disrupt the market significantly by bringing a new humanity to our work. If we think we can attempt to demonstrate a profound humanity in the relationship with our clients, while we do not sufficiently do it in our own work places, in the small things in the way we run our businesses and work with colleagues, our clients will know, and they can smell our insincerity.' For Anton the challenge for Moore Stephens will be to build a reputation as a profoundly human organisation.' It will make us attractive as an employer, but will also generate significant loyalty from our clients.

### Moore and Stephens International addressing fraud and corruption

For Anton Colella the question on how a company like Moore Stephens International should deal with fraud and corruption issues all has to do with this human factor. 'We are an organisation that provides services in audit: internal audit, forensic audit, statutory audit. And we are the ones hired by clients to...seek the truth!' As to fraud and corruption, he identifies human behaviour, human desire, human weakness as the biggest factor. 'The ultimate key to our support to clients of preventing fraud is not just that formal process. It is developing a relationship with them that allows us to look at culture, and values, the quality of leadership. What type of behaviour goes on in an organisation. Because in reality fraud does not start as a massive fraud.' He argues that fraud starts with small weaknesses. 'Great sins start with small ones. Our role in working with clients to eliminate fraud is to identify a culture, or a set of behaviours, when they are weak to small things, and allow them to flourish.'

“ *... we are the ones hired by clients to...seek the truth!*

When it comes to finding the right balance of the self-interest of making profits and the values to be upheld by a company, whether active in audit or another area, Anton Colella is rather outspoken. 'We do not seek profits at the expense of truth. Truth must prevail over self-interests, even the self-interest of an entire organisation. Because ultimately, what do we want? We want respect. And respect is earned not just in the call of your work, but in the decisions and statements you make. So part of the development of the leaders in your organisation is to develop them to be confident to take that position. Not be fearful of loss, but appreciate that courageous position, and provide a longer-term success for the business.'

“ *Truth must prevail over self-interests, even the self-interest of an entire organisation.*

“ *... respect is earned not just in the call of your work, but in the decisions and statements you make.*

As a risky area - when it comes to possible fraud - Anton Colella identifies expenses. 'That is where fraud is most often encountered and I think organisations pay a lot of attention to the management of expenses. Because that is where things begin. Some may consider expenses as a relatively minor part of the leadership role. But scrutiny, discipline and tight controls over there protect an organisation, and sometimes protect individuals from themselves, from their own behaviour.'

### Trust as the key output of accountancy and audit

Anton Colella is very clear what should be the main output of his company and of the profession in general. 'We are in the business of trust, which is a consequence of the quality of our work. People are looking for trust. And they are looking for someone who will indicate whether something is trustworthy or is to be trusted. That is part of our role.' He explains that it is tragic if those who are in the business of establishing trust

are unable to fulfil that purpose. 'And it is sad when we hear of accountancy firms being discredited in public, because of the perceived outcome of their work. Because people, and now increasingly politicians, are placing a lot of faith in the work we do. We have built our house, our company, on being able to be given trust by our clients. But not just our clients anymore, it is the whole of society.'

As to how the Global CEO of Moore Stephens International would deal with a major fraud case related to one of the leaders in his organisation, he explains that this is when leaders are really tested: 'How do leaders deal with crisis and matters of integrity? And their reputation - as leaders - depends on exactly this. Therefore such cases must be dealt with firmly, speedily, and with justice. It needs to be investigated properly because it needs to be just. And the CEO should take a big interest in it.'

He explains that moral leadership is key, for a reputation is lost in a second. 'And we need to guard our reputation. Our Integrity is the biggest asset on our global balance sheet. Therefore we need to guard this with everything we have.' So as to the choice whether to give a negative opinion and lose the client or give a less conclusive opinion while the accounts say otherwise, Anton Colella says without any hesitation: 'A negative opinion, without question. Because if we look at the maintaining of short-term profit for the loss of long-term reputation, that is bad arithmetic, quite simple.'

“ ... Integrity is the biggest asset on our global balance sheet.

### Leaders' responsibilities for upholding values

On the topic of the importance of values in the society of today, also in view of well-respected people appearing in the Panama Papers, the Paradise Papers, etc., Anton Colella refers to the quality of leadership. 'Today we have an issue about the quality of leadership in society. Political, civic, business, religious leadership. People have lost confidence because the media today are able to expose where leaders are weak, or they made bad decisions, historically or presently. So people have become more and more used to leaders who are weak and who do not live their values. The reality is: there is no perfect leader.'

Anton Colella underlines that those in positions of responsibility need to realise that what they do echoes through nations, businesses, economies. 'And that with the bigger responsibility, they also have a higher accountability. We need leaders today who have the courage to do the right thing and to seek the truth.' He points out that courage sounds like a cliché, a kind of sound bite. 'But living a life of moral courage is a very, very difficult thing. If you look at the history of people who have exercised moral courage, they have often been in prison, persecuted, rejected, or ridiculed. And sometimes the truth of their actions is only manifest long time after they are gone.'

Speaking about courage brings him to the issue of whistleblowing. 'I actually think this is an unfortunate term. The term whistleblowing does not do justice to what someone is doing when he or she reveals or exposes something that is wrong. They are doing much more than whistleblowing: they are exercising with great integrity and moral courage, and they should be honoured, not ridiculed. Today we need men and women who will speak out and exercise moral courage in the face of what they consider to be societal values or best corporate values. As CEO I will do my utmost best to promote such courage.'

“ They are doing much more than whistleblowing: they are exercising with great integrity and moral courage, and they should be honoured...

# Honesty as a value that matters for business

## Interview with Alexander F. Wagner, Associate Professor at the University of Zurich

By Derek Meijers and Gaston Moonen



Alexander F. Wagner

Several theories exist to explain the causes for fraud. A well-known one is the fraud triangle. But there is a deeper question underlying that: what motivates people to be honest, and remain honest? This may shed light on why some companies encounter more fraud than others. Alexander Wagner, Associate Professor at the Swiss Finance Institute (SFI), University of Zurich, looks into why people are honest or dishonest in business.

### Interdisciplinary approach giving new insights

As SFI Professor at the University of Zurich Alexander Wagner has built up a research portfolio on the topics of honesty, deception, and financial market communication. Some people would associate this topic more with psychology. But he relates this behavioural issue to business and explains the origins of this interest. 'In the summer of 2002, when I was working at Lehman in London a number of scandals erupted, including accounting fraud scandals. This sent shocks through the market and suddenly fraud was a topic at even the largest corporations. Although you might think "Well, there are lots of controls in place..." it still happened.'

He says that he did not spend much thought about it at first. 'But years later I ran into a colleague and now friend, Carmen Tanner, who is a psychologist. She happened to be working on the topic of taboo values, also called sacred values in people's decision-making. We and another financial economics colleague and friend, Rajna Gibson, ended up talking what certain values might mean in economics. And these different inputs of observing the emergence of fraud became an interesting mix of how to understand what goes on in organisations.'

Regarding the research question of why some organisations succeed and why some fail as far as fraud is concerned Alexander Wagner points out that there is a lot of research

on psychological observations but that economics also has something to add. 'Take for example a notion economists emphasize, namely, that you need to conduct an experiment with real incentives to find out what is going on, instead of asking people 'What do you think?' That is a distinct economic paradigm.' Another dimension he brings up is the linkage to market data – not just looking at individual choices but that you can see quickly how the market responds to certain actions by companies. 'The market offers a great laboratory for measuring how much it matters.'

### One out of seven companies committing fraud...

In his [TED](#) talk he certainly quickly gets the viewer's attention by pointing out that research done in the US shows that one out of seven companies we deal with on a daily basis, commits frauds, costing shareholders and therefore society US\$ 380 billion per year. More and more fraud seems to become a feature and not an bug of the financial services industry, according to the president of the American Finance Association. But Alexander Wagner also underlines the other side of the coin: six companies out of seven act honestly. Why such difference?

To approach this question, Alexander Wagner looks more at the broad statistical samples than at specific cases. 'I look at how people respond to different situations, often in an experimental, fairly controlled setting. I would love to do a field experiment with a company or public institution that wants to know more about which incentives or other interventions to reduce fraud or corruption work in their specific setting.'

### Controls can work...but also backfire

Alexander Wagner was one of the speakers at the 2019 ACFE Fraud Conference Europe – also covered in the Journal - and spoke about the experiments he did in a controlled setting, as he did in his TED talk. An illustrative example is where people toss a coin secretly and then have to report the number of times tails came up – where people get paid more if they announce a higher number of tails throws. One natural question that comes up is how to motivate people to give an honest reply, going against their own financial interests. 'In practice, many companies ask people to sign a conduct of conduct. We did an experiment where one group of participants had to sign an honour code at the beginning. It turned out that it did not work at all and increases in fact the extent of extreme lies.'

Thoughtfully he explains that if you impose too stringent requirements on people to be truthful, people may resist. 'That is a well-known phenomenon. It turns out that controls can backfire, especially if you have people who are inclined to be truthful – they might be insulted. People think: "Well, they do not trust me, so I will do the thing they expect me to do." Perhaps this

#### Box 1 - self-interest and other values

In his [TED](#) talk, Alexander Wagner brings out different interests that motivate people's actions. In general, he distinguishes the norm of self-interest versus certain intrinsic values. He



argues that research shows that people are motivated by self-interest and by certain intrinsic, or so-called 'protected values.' These can be protected values for love, for live, the environment, and he has focused on the protected values for honesty. People driven by such values will not only respond to the consequences of their behaviour, but will take into account what they feel is right or wrong as such. This may even lead to actions clearly against their direct owninterest. For organisations, it is important to know how different people respond to incentives and that not everybody responds the same to incentives. While the standard economic approach is for organisations to appeal to benefits and costs to try to get people to behave according to them, organisations can select people who have values that are in line with the ones the organisation wants to pursue.

“ It turns out that controls can backfire, especially if you have people who are inclined to be truthful... ”

is not a conscious decision but sometimes rules and controls can result in the very thing they are trying to avoid.' Wagner also emphasizes, however, that codes of conduct can work. 'When the message is: "If you are behaving according to this code, then you are part of the group," that is a signal of inclusion, and then it can be very positive.'

The professor indicates that sometimes very subtle things can make quite a difference. 'In the experiment, when we just asked people to think how others might behave in that particular situation, this already changed things and seemed to shift the distribution of behaviour towards integrity. This is still the subject of ongoing research but very exciting. It is this sort of soft intervention which I want to pursue in the context of a real organisation.'

### Incentives matter, but some resist

When it comes to direct, more personal encounters with fraud, Alexander Wagner has none. 'Fortunately not, neither in the private sector nor in the academic world.' However, he points out that it is a topical issue, also in research institutions. He thinks that the sources for that are rather similar to what is happening in corporations. 'There are incentives. They do not come in the form of multimillion-dollar bonuses. They come in the form of opportunities of rising through the ranks and becoming famous. We like to have impact and there is an incentive to tilt the numbers in a certain way, to massage the data. And then some people actually end up manipulating data in a direct way.'

This also makes clear to him that incentives matter. 'There is the economic theory of crime, which says people trade off benefits and costs and think about the probability of being caught. There is probably a lot to that. But our research confirms that while there are a lot of incentives to lie most people actually stay honest. There seems to be a level of intrinsic motivation to try to discover and report the truth that makes systems still survive.'

“ ... our research confirms that while there are a lot of incentives to lie most people actually stay honest.

When asked whether his research is more about ensuring that the number of honest people prevails to make sure that they do not become fraudulent, or more to stop fraudulent people from being dishonest Alexander Wagner thinks for a while. 'That is a very valid question. First and foremost, I want to know what's going on. I am trying to understand human nature. The second element is that I think we cannot hope to change people's preferences but we can hope to address the drivers. For example, recent research we have done shows that honesty is fragile when expectations are violated (see **Box 2**). Overall, I think my research touches more on how to ensure that the number of honest people prevails and prevent they become fraudulent.'

#### **Box 2 - example given by Alexander Wagner of an experiment showing that honesty is fragile**

Say we have a group of people who do not know each other. Person A is sending a message to person B. A knows the truth of something and B does not know if it is true or false and has to decide whether to trust A. And suppose A has an incentive to lie to B. Then B finds out whether A has lied or not. Immediately afterwards B will send a message to person C. If A lied to B, we find that B is much more likely to lie to C. Especially if B had initially expected A to tell the truth.

If we live in an environment where B knows that A tells the truth with only 60% probability, then you do not mind being lied to. It's expected. But in another situation where 90 %, i.e. 9 out of 10, actually, tells you the truth and you happen to meet the 10<sup>th</sup> guy who lies to you that induces you very strongly to lie as well.

This experiment tells us is that honesty is fragile. We may never attain 100 %. Even generally honest people may in a certain situation behave dishonestly.

Based on experiments (see **Box 2**) Alexander Wagner argues - referring back to this concept of protected values - that someone with strong protected values will be less inclined to pass forward lies received from others. He concludes: 'So values can protect

against these ripple effect of deception. An organisation needs to build in safeguards on various fronts. It needs to select the right people and to make sure that the right social norms are in place. These are all failure points.'

### Absolute values...are also relative

When it comes to the protected values mentioned earlier, the question arises whether they belong to an absolute value, as argued by Immanuel Kant. 'It seems that there are no absolute values for most people. When we increase the incentives and the costs of being truthful more people start lying. The good news is that not everybody starts lying at the first euro or dollar they can earn. Some sustain their truthfulness even in the face of quite steep incentives to lie. But one should really think of the protected values as measuring not some absolute value, but the extent to which somebody is willing to resist temptations.'

“ ... not everybody starts lying at the first euro or dollar they can earn.

One of the characteristics of Alexander Wagner's research is that it is very interdisciplinary. As to whether there is a lot of interest from the business world in the topic the answer is affirmative. 'There is great interest in how to select the right people. But that is not my greatest area of expertise. My co-author, Carmen Tanner, who is a psychologist, is probably more into that. There is also great interest in how can we tell as investors on which CEOs are truthful or not. I have not yet exactly worked on that topic but I have used textual analysis tools to screen what managers say and how. That is something investors are very interested in.'

#### Box 3 – Checking on inconsistencies

Alexander Wagner recalls a story of when he presented research on the analysis of corporate conference calls:

'One gentleman came up to me and told me about his background. He used to be the chief homicide officer of a major English city and is now working for a hedge fund. They recruited him because he is very good at finding inconsistencies in what people say. They hired him specifically to just go through spoken statements of CEOs and companies they are investing in. He is doing that manually but there is a lot of interest in using modern technology like text analysis, big data analytics, etc.'

### Public sector different from the private sector?

When asked whether he sees a significant difference in behaviour of employees employed in a business environment and those in the public sector he points to some differences but also some similarities. 'One of the first pieces of independent research I did was about how in public agencies managers hire people to insure that these people remain loyal to them and do not become too ambitious themselves. It turns out that this model also has an analogy in the corporate world. Of course, monetary incentives prevail in the corporate world but non-monetary incentives can be just as important. For example the reward that comes from following social norms.' He observes that from an abstract point of view the challenges are quite similar. 'However, the public sector does not have the financial market as a disciplining device. It has the electoral market as a disciplining device. But that one is sometimes more indirect.'

One of the areas he highlights is corruption, in many parts of the world linked also to the public sector. Alexander Wagner points out that particularly public procurement is prone to corruption. 'I think the evidence that corruption brings a huge social cost is rather strong. But hopefully institutions like the ECA can put a stop to the most egregious cases here.'

“ I think the evidence that corruption brings a huge social cost is rather strong.

As to the issue whether the reputational damage to an organisation – the breach of trust - is bigger in the public sector than in the private sector in the case of dishonesty Alexander Wagner gives some nuances. 'It all depends. If you are a financial advisor and

you breached the trust of your client, in most areas there is a regulator and you go on record that you were caught in a scandal.' He refers to a recent paper that shows that a financial advisor's career will be hampered by this. 'There are some negative labor market effects. But these people tend to work for firms that sometimes seem to specialise in having previously fraudulent financial advisors.'

Alexander Wagner adds: 'The real problem is that the individual does not pay the full price. So if an advisor is caught in a fraud, her or his career might be damaged to a certain extent but it's nowhere near the damage the institutions has to deal with. Her or his incentives to be careful are much lower than they should be.' He believes the same applies in top management. 'If you are the CEO of a company you are never going to lose as much as the company. You may lose the equity and your reputation, but that is often a tiny part of the damage that has been done. In short, there is a classic agency problem. And that also applies in the public sector.'

“ [if caught in a fraud] The real problem is that the individual does not pay the full price.

He doubts whether one can address that issue in a fully satisfactory way with an appropriate incentive scheme. 'Of course you could create an incentive scheme for the president of the ECA that says: 'If the public opinion of the ECA goes down by 5% we will take your house. But I am not sure it would achieve the goal. This gives rise to incentives for manipulating a specific issue – in this case, trying to create favourable public opinion – instead of focusing on what the organisation really should be doing. Incentives may work out in different ways than foreseen.'

### Gaining trust as a constant challenge

The general thinking is that trust is easily shattered and difficult to get back. Alexander Wagner agrees with this observation. 'Trust is constant labour, it is never done. This is clearly visible in the corporate world, for example. A company needs not only to report what is absolutely required by law but, for trust building purposes, also talk about the non-financials, talk about how they actually create value and how they do business.' One of the issues in

“ Trust is constant labour, it is never done.

#### Box 4 - maximising profits and trust

In his research, Alexander Wagner found that firms that do not manage earning as much as they legally could turn out to receive higher levels of trust from the financial market. The market responds more to news that these companies have. 'So suppose I have some corporate news, I am announcing earnings and you need to figure out: 'Okay can we trust CEO Alex and how much should we respond to this news.' If you do not trust me, you will discount the news I have and say: "Yes he is exaggerating, let's just not move the price so much." If you think: "Hey, this is a straight shooter,' then you will take what I said at face value and incorporate that into prices more quickly and in a stronger way. So how do you tell if I am a straight shooter or not? You look at my history, my previous behaviour and you find that in the past I might have had an incentive to massage earnings little bit in order to increase my bonus. If I in fact did that, then you know I am very much motivated by my own incentives and not a man of principles; so you would not trust me too much. If, however, I consistently did not follow those temptations in the past, then you can say: 'Aha, he is reliable, and his announcements can be trusted.'

such reporting, this value reporting, is that it needs to have substance. 'But is not an easy task to explain how you are adding value.'

When it comes to CEOs and other decision-makers in the financial world, what drives their behaviour? Are they embracing an integrity-driven approach? Alexander Wagner: 'I would say that the financial services industry by and large is still often driven by a compliance-oriented approach, saying: "What is it that we minimally have to do?" I think few firms go beyond that and establish practices that go beyond the necessary legal minimums.' However, he sees some change happening: 'The notion that if you are perceived as a financial services provider with a particular integrity level, you can create value for your company is gaining some traction.' He indicates that some players really like to position themselves like that, perhaps more even relatively newcomers.



Alexander Wagner

that the investors are more inclined to trust those companies and stay with them. This would be the positive signal you can send. And would indicate that having trust in the longer run pays off.

Alexander Wagner also points out that there is financial market evidence that firms who engage in Corporate Social Responsibility Practices (CSR) that go beyond the minimum are more resilient in times of crises. 'Looking at the 2007/2008 crisis we see that for companies which had been engaging in CSR - and not just banks - that they came back much more quickly and also did not even decline as much. It may be that the customers are not running away as much but it may also simply be

## Directors' Cut

# Making sure fraud risks are on our radar

## Interview with Mariusz Pomienski and Zac Kolas, ECA directors

By Derek Meijers and Gaston Moonen



Mariusz Pomienski and Zac Kolas, ECA directors

What is the role of the ECA regarding fraud when auditing EU funds? And to what extent is the ECA itself vulnerable to fraud and corruption? The two ECA directors mostly affected by these questions are Mariusz Pomienski, who as director of the Financing and administering the Union Directorate is in charge of the financial and compliance audit work that underpins the ECA's annual Statement of Assurance, but also comes across the cases of suspicion of fraud the ECA reports to the European Anti-Fraud Office (OLAF). As ECA director for Human Resources, Finance and General Services, Zac Kolas is responsible for making and keeping the ECA organisation as fraud proof as possible. The two ECA directors share with us their experience with fraud, the ECA's recent work in this area, and the framework the ECA created to protect itself from fraudulent activities.

### Own experiences encountering fraud

When asked about when they first encountered suspected fraud in their professional lives as auditors, both Mariusz Pomienski and Zac Kolas do not have to think long. Mariusz: 'I immediately have to think of fraud with public procurement. I relatively frequently encountered cases of collusion between the contractor and the managing authority, especially during my years as an auditor at the Polish Supreme Audit Institution, the NIK.' He explains that in many of those cases one would see the creation of artificially restrictive selection criteria for participating in a tender or unusual contract award criteria, pointing at an alleged collusion between the contracting authority and the bidder. 'This is bid rigging.'

Zac recalls two cases of serious fraud and a number of smaller ones during his years as an auditor in Greece and at the ECA. 'One of these actually led to the uncovering of a large scheme of fraudulent agricultural projects that induced the European Commission to stop the direct financing of projects under a specific budget line. The frustrating element was to see how cumbersome the process of punishment could be.' For one particular case, he recalls he had to attend a court hearing which took place eleven years after the fraudulent acts were uncovered. 'Another worrying aspect of many of the fraud cases I have seen is their scale and the perceived impunity with which the fraudsters operated. Fortunately, I have never seen that at EU level.'

### Fraud is on the agenda

In the last few years, the ECA has published a number of reports related to fraud, covering topics such as VAT fraud, the fight against fraud in EU spending (published early this year as special report 1/2019), and most recently fraud in cohesion policy spending (published on 16 May 2019 as special report 6/19). Mariusz explains this increased attention for fraud: 'The ECA might not be well equipped to hunt down individual fraudsters, but we are good at assessing the governance structure of those who should chase them. Thanks to this helicopter view, we are able to offer them advice on how to improve their organisations and work to achieve better results.' He believes the ECA can add value by offering an independent outsider's perspective. 'And given the success of our recent activities, I definitely expect more work in this field in future years.'

“*The ECA might not be well equipped to hunt down individual fraudsters, but we are good at assessing the governance structure of those who should chase them.*”

According to Zac, one significant cause for an increase in fraud cases is a lack of personal and professional morality and ethical values. He adds: 'Also surrounding circumstances play an important role. Some factors facilitating fraud and corruption include inadequate controls, lack of or insufficient sanctions, and an atmosphere of keeping silent, so the unwillingness of individuals to bring to light cases of fraudulent behaviour that they have witnessed.' Zac considers it a duty of everyone to play an active role and take a stance in the fight against fraud and corruption.

Zac thinks that the ECA focus on auditing the EU governance structure set up to fight against fraud is a logical choice. 'There clearly is an increased attention, and I think this a good development, especially if you consider the positive reception, both by the Commission and the European Parliament, of our recent reports on fraud.' He refers to the words of Ingeborg Gräßle, Member of the European Parliament and Chair of the European Parliament's Budgetary Control Committee: 'She called the four recommendations in our special report on the Commission's anti-fraud body, OLAF "Spot on!" He also believes that the frequency with which fraud cases occur, are uncovered and reported upon in the media can play an important role in putting fraud in the spotlight of the public debate. 'Media coverage certainly raises interest, but may also contribute to the public perception that fraud and corruption are more widespread than they really are.'

“*Media coverage... may also contribute to the public perception that fraud and corruption are more widespread than they really are.*”

### Fraud as a by-catch

When discussing the relation between fraud and ECA audits, Mariusz underlines that the ECA's audits are not designed to detect fraud. 'This is not the objective of the audit work. We are not a fraud-fighting organisation, that is not our prime objective and we do not have a specific mandate to do that. I believe the Treaty, in article 287(2), is clear here as it instructs the ECA to report in particular on any cases of irregularity. Our work on the Statement of Assurance is not risk based, and therefore we randomly select a sample that covers the entire EU budget. In general, we do not come across too many fraud cases. To illustrate this: our auditors detected nine cases of suspected fraud in 2018, which we all forwarded to OLAF.' He adds that the ECA sometimes zooms in on areas where it is more likely to detect fraud cases, reviewing the systems set up to prevent



Mariusz Pomiński

and detect fraud. 'An example of this is our recent special report on fraud in cohesion expenditure. But this is not the objective of our compliance audits.'

When asked if this means the ECA does not do enough to detect fraud, both directors disagree. Mariusz: 'Although it is not the auditor's objective to look for fraud, it is our professional obligation to make sure our methodology is designed in such a way that we can be sure not to overlook fraud if we would come across it. And I think the

results over the past few years clearly show that we do detect and report fraud whenever a case is part of our audit sample.' He adds that, when designing the audit, the ECA has to identify potential risk factors, both in financial and compliance audits, so up front. 'Take for example our Statement of Assurance financial audit, for which our team sits together every year to discuss all areas that are to be covered to flag where the potential risk of fraud is higher. Our audit standards require this exercise, which is necessary to make sure potential fraud risks are on our radar when we conduct the audit.'

Zac points out that, in order to be able to detect fraud, it is essential that auditors are sufficiently sceptical when they are presented with documents and other audit evidence. 'We should never take anything for its face value. Something that looks legitimate might simply be forged in a very professional way.' Both directors think that the best weapon against this is to make sure the applicable rules are clear and simple, and easy to follow. Mariusz: 'The more layers there are, the more complex rules and regulations become. This in turn can create grey areas that offer fraudsters loopholes to take advantage of the system.'

“ We should never take anything for its face value. Something that looks legitimate might simply be forged in a very professional way.

Both directors underline that for auditors this means that they have to continuously develop their skills to be able to detect possible fraud. Mariusz: 'We are putting a lot of effort into that. One reason is the fact that, due to its atypical nature, only using random sampling will not be enough to detect fraud cases. If you want to be sure to catch them all, you would need to check every single transaction.' Smiling he remarks that this is something an auditor simply cannot, irrespective of the available resources. 'However, we are currently reflecting on how to make best use of the opportunities provided by new technologies, and big data auditing.'

“ ... only using random sampling will not be enough to detect fraud cases.

### Expectation gap, institutional and individual responsibility

When discussing expectations from citizens the two directors concur that people sometimes think that the ECA should play a more active role in the fight against fraud. Zac: 'There is a certain expectation among the public that auditors have more power than they actually do. We are sometimes viewed as "saviours" who would right all wrongs, but we do not have that kind of power. However, we do see it as our obligation to report and signal every reasonable suspicion of fraud or corruption that we encounter in our work.' Mariusz adds: 'In the eyes of some, there is a clear relation between Supreme Audit Institutions (SAIs) and law enforcement. And although in some countries this might be true, as certain SAIs have jurisdictional powers as well, this is not the case for us.' He believes it is important that citizens and other stakeholders are made aware of the respective roles institutions have. 'Including of those which are specifically set up to detect and fight fraud, and which are much better equipped to do so. Such as OLAF, and in the future the European Public Prosecutors' Office, the EPPO. As the EU's external auditor, we are expected to be vigilant and to report suspected fraud cases to OLAF, which we do meticulously, but there our responsibility ends.'

For Mariusz, as far as the EU budget is concerned, it is clear that the fight against fraud must be fought by the European Commission itself, together with the other competent EU bodies such as OLAF or the EPPO. 'That is also why I am so happy with our recent special report which looked beyond OLAF and recalled that this fight must start at the highest corporate level. To counter fraud, anti-fraud measures need to be coherent, well organised and properly funded, and supported at all levels in the organisation.' For Mariusz OLAF is just one – though important – wheel in this machinery. 'To counter fraud, we need more than the operational investigative activities of OLAF. Coordination and vision are key elements in the fight against fraud, which is a responsibility that is shared by all Directorates General, but also by the College of Commissioners. Everybody has a role.'

Zac notes that, although the onus is on the organisations involved, and especially their top management - which should display and promote ethical behaviour and follow-up on possible fraud identified - each staff member also has a personal responsibility in fighting fraud. 'Most important is to lead by example and to promote organisational culture based on ethics and integrity. Management should set a standard, and provide guidance and supervision when it comes to ethical issues.' Then, making it more personal: 'I am acutely aware that my own actions, and how I behave myself, send strong signals to the staff at my directorate and beyond. In addition, we need to educate our staff what is at stake if we do not perform our jobs in an ethical manner.' He finds that setting such an example will help staff members to be more vigilant when it comes to fighting fraud, whether encountered during audits or in the office.

“ ... we need to educate our staff what is at stake if we do not perform our jobs in an ethical manner.”

### Contributing to the fight against fraud to foster trust

As external auditor, the ECA is in the business of trust, and according to its 2018-2020 strategy, it fosters trust through its independent audit work and its reports. Through its work, it also contributes to the protection of the EU financial interests, including the fight against fraud. But how can you gear your organisation to be able to take on this task? Mariusz: 'As mentioned before, it is not the auditors' objective to detect or report on fraud. But we do of course train our people to be vigilant and to be sceptical, and by following audit standards we try to ensure that we will detect fraud whenever we encounter it.' He adds: 'By definition, fraud is a form of non-compliance. It is intentional non-compliance where someone breaks the rules that normally should prevent him from wrongdoing. So in our audits, we should be aware, ready and capable to detect this. We must make sure our knowledge and understanding of the rules is close to perfect. This will enable our staff to flag any situation they think could be suspicious.'

In all this Mariusz believes it is important to create an open culture in which people feel confident to report even their slightest doubt. 'Because, due to the "professionalization" and shrewdness of fraudsters and their schemes, we must rely heavily on the professional judgment of our staff – and I am very confident we can!' He adds that, although some people might consider fraud to be a sensitive issue, the ECA should frequently and openly discuss how to prevent and fight it. 'Both in our audit work, but especially also in the office. We should make sure that staff members have a clear idea on what are the ways to report fraud, and what is the support, that they can receive from the institution in such cases.'

### Fraud risks for the ECA organisation

When discussing how fraud-proof the ECA is as organisation two aspects surface: firstly, to what extent an opportunity risk for auditors arises to commit fraud in their audit work itself? And how fraud proof the organisation is against fraud, for example when claiming the reimbursement of travel expenses? Zac: 'The risk of embezzlement of funds is not that high at the ECA, simply because we do not deal with a lot of money.'

He argues that the risk is low, also because of the way the ECA carries out its audits.

‘Normally we operate in teams, plus with our system of supervision and quality control, such a situation will not easily occur. I think chances are very slim that for example in the framework of the Statement of Assurance a colleague checks a public procurement procedure, identifies a possible fraud and does not report because of counter services offered by the auditee.’ In addition, he brings up the extensive training ECA auditors receive to raise awareness about ethical and integrity issues, but also on how to practically deal with sensitive situations. ‘This is compulsory for all staff members, also aimed to stimulate and build up this capability of professional judgement mentioned by Mariusz.’



Zac Koliás

Zac explains that the ECA tries to recruit people of the highest standard of ability, efficiency and integrity. ‘The staff members we recruit usually have passed rigorous selection procedures, either organised by the EU’s recruitment office, the European Personnel Selection Office (EPSO), by the ECA, or another EU institution.’ He continues: ‘These procedures do not only test knowledge and competences, but also aim at evaluating how a person would behave at work and how they would work with others. Personal assessments and interview questions are often designed to imitate real-life situations representing complex cases or ethical dilemmas.’ He points out that, in addition, there is the formal requirement for the candidate to provide proof of a clean record, the so-called ‘vetting.’

Regarding the second issue, committing fraud against the ECA itself, Zac separates two issues. ‘The first thing here can be fraud committed against the ECA by an external party. Some years ago, we suspected fraud with a provider of security services. Here the ECA was a victim, and we raised the issue with other EU institutions, listing the company and sending the case to the appropriate national authorities and to OLAF.’ The other issue he brings up are the key risks concerning declarations made by Members or our own staff, related to travel expenses, working hours, family conditions, etc. ‘These issues are rather common for any public or private organisation, and the EU institutions including the ECA are no exception to this rule. But we have several mechanisms in place to minimise the risks.’

When asked about recent examples of cases of suspected fraud, Zac remarks: ‘Over the last ten years we had two cases of suspected internal fraud. One case related to a colleague who had tried to cheat with family allowances. When this was detected several years ago, the staff member resigned. Another case concerned a former ECA Member and related particularly to the declaration of travel expenses. We referred both cases to OLAF and subsequently to the relevant judicial authorities.’

“ Over the last ten years we had two cases of suspected internal fraud.

Whatever measures are taken to prevent, detect and sanction fraud, Zac believes that in the end it comes down to the individual people: ‘Any organisation can become a subject of fraud, there is no such thing as a waterproof system. You need to have systems that entail these three aspects regarding fraud, and particularly systems that are actually used, and not only exist on paper.’ He argues that despite all this it will be difficult to make a system totally fraud proof. ‘The cost of control would be enormous. But you need to react in an appropriate and expedient manner.’

“ Any organisation can become a subject of fraud, there is no such thing as a waterproof system.

### **Reaching for high integrity standards**

In this context, Zac refers to the 2014 report by Transparency International (TI) on the European Union integrity system (see also page 129). In this report TI identified as strengths for the ECA the comprehensive infrastructure of basic integrity rules, the good level of transparency regarding the outputs of audit work, well-working oversight of the ECA by other institutions, and the extensive access to information on EU financial management for audit purposes.

Zac: 'However, there were also some critical remarks and we followed up on them: we improved our Ethics Committee, created ethical advisors, and we opened the transparency portal, following TI's recommendation on this.' He points out that another important shortcoming identified was the absence of internal whistleblowing provisions. 'This was a very helpful recommendation which we fully took on board. It led to the publication of the ECA's own rules on whistleblowing in October 2014, and was commended by the European Ombudsman in 2015 for being one of the first two institutions, together with the Commission, to introduce such rules.'

In the end, Zac sees also a limit to what rules can do. 'Complex rules can also increase the risk of fraud, and are certainly not the panacea. The main thing is to implement the rules with common sense and to apply them consistently. In the end, even the best rules will never cover all the cases. Transparency is probably more effective than stricter rules. Because if you know that things may get into the public domain, you will always think at least twice ...'

# Standards of public life, and attitudes to ethical behaviour

By Amita Patel, Audit Quality Control Committee Directorate



Source: Pixabay

Many public organisations have adopted integrity frameworks and explanations about the values they pursue in their work and work attitude. But what determines these ethical values and duties they commit themselves to? Amita Patel, who works as principal auditor at the ECA, looks at possible sources for such values, including the United Kingdom's 'Seven principles of public life' as a skeleton for underpinning many institutions' ethical values and duties. She also draws on her experiences to illustrate cross-cultural attitudes to ethical behaviour in development aid.

## Searching for theory and matching practice of ethical values

When I joined the ECA in 1992, I faced questions and moral dilemmas that had not even occurred to me when I was working as a private sector auditor in Luxembourg. As a chartered accountant I had signed up to the code of ethics of the Institute of Chartered Accountants in England and Wales. But this seemed to me to be more about maintaining professional standards and behaviour aiming to avoid conflict of interest in order to maintain public trust in the audit profession, rather than dealing with societal issues.

To illustrate how attitudes to ethics and moral behaviour can change over time: Luxembourg at the time had banking secrecy and was implementing anti-money laundering legislation. My private sector audit firm required me to follow 'deontology' courses (on normative ethical theory). However, the business climate was such that no one was questioning practices that helped people and companies avoid paying taxes in their home countries, or looking too closely at the provenance of their funds. This situation has evolved, especially with the events of the last ten years that have called for greater transparency, accountability and paying taxes where they are due.

Working for a European organisation (the ECA was not yet an institution) was a steady job with good prospects, but what was I required to do in order to be a good civil servant? What does public interest mean? How does one carry out the role of a public sector auditor, how does the stewardship role function when taxpayers' money is everyone's money and no-one's money? The staff regulations for EU civil servants make dry reading for answers to these questions, and in the early 1990s, there was no dedicated induction training on ethics for newcomers, nor any mention of the global standards and guidelines of the International Organisation of Supreme Audit Institutions (INTOSAI).

### **Seven principles of public life**

Our ethical values and obligations are spelled out in a number of documents: the EU Treaty, staff regulations, financial regulations, the ECA ethical guidelines, code of conduct for ECA Members, audit standards and employment laws, and we have training on public ethics. But we need a short, everyday manifesto of what is expected of us as EU civil servants. I have therefore taken the liberty to restate the Nolan Committee's seven principles of public life with reference of what is required in our behaviour rather than that required of some faceless, invisible bureaucrat.

The UK government's Committee on standards in public life (the Nolan Committee) was set up to establish a code of conduct for those in public life, including civil servants, after political scandals related to cash for access to politicians.

#### **Box 1 - Seven principles of public life - the Nolan Committee**

##### **As holders of public service, we will act with:**

- **Selflessness:** we will act solely in terms of the public interest;
- **Integrity:** we will avoid placing ourselves under any obligation to people or organisations that might try inappropriately to influence us in our work. We will not act or take decisions to gain financial or other material benefits for ourselves, our family or our friends. We will declare and resolve any interests and relationships;
- **Objectivity:** we will act and take decisions impartially, fairly and on merit, using the best evidence and without discrimination or bias;
- **Accountability:** we are accountable to the public for our decisions and actions and will submit ourselves to the scrutiny necessary to ensure this;
- **Openness:** we will take decisions in an open and transparent manner. We will not withhold information from the public unless there are clear and lawful reasons for doing so;
- **Honesty:** we will be truthful;
- **Leadership:** we will exhibit these principles in our own behaviour. We will actively promote and robustly support these seven principles, and will challenge poor behaviour wherever it occurs.

Source: based on UK Committee on standards in public life annual report 2017-2018

### **Cultural context?**

Nobody can object to these values per se, but the problems begin when we differ in what they mean to us and how we put them in place in our everyday life. For example, there was a noticeable change in attitudes to 'how we do things around here' when the EU with 12 Member States, the EU-12, became the EU-15, with pressure to move away from the more formal, hierarchical culture that existed at the time, with more questioning and less tolerance of practices that were not considered acceptable. This is not to say that nationals of some Member States are perceived to have better values and behaviours than those of others – just that they are expressed differently. This has not gone away with the 2004 enlargement – except that instead of explaining things away as 'that is just the French/British/German/Belgian etc. ' way of doing things, I more often hear 'that is just the way things were done in the former eastern bloc/ that is just the way some people behaved in the former communist countries.'

The meaning we attribute to the words selflessness, integrity, objectivity, accountability, openness, honesty and leadership can be determined by our cultural context. For example, the definition of integrity above from the UK Committee on standards of public life rules out nepotism and using position to help family and friends.

But in another culture where the norm is that a good member of society will take care of their tribe, say by making reciprocal arrangements that benefit its members, for example by ensuring that they have good jobs, the outcome of acting with integrity would result in the opposite outcome!

### **Ethical dilemma's appearing while auditing on the spot**

Auditing development aid and humanitarian aid in the early 1990s was eye opening about attitudes to public service in Africa and stereotypes about Africans getting into public service in order to line their pockets, about how they could not be trusted to handle projects or money without using it for themselves.

During my first mission to the Ivory Coast for checking the STABEX system (stabilisation of export earnings), we saw plenty of poverty and subsistence farming. We also saw many vanity projects built by President Houphouët-Boigny in his natal village, which he made the political and administrative capital of the country. They included a Basilica to rival St Paul's in Rome, gifted to the Catholic Church to prevent the building from being dismantled by subsequent governments. Roads wider than the Champs Elysee, a palace surrounded by a moat with crocodiles to which his political rivals were reportedly fed, and an enormous hotel where the only guests were the ECA auditors and the EU delegation.

This and subsequent missions to other countries generated plenty of internal discussions about immoral behaviour from government leaders and civil servants lacking a public service ethos, but no one questioned the role of European and other foreign nationals and companies in aiding and abetting the construction of vanity projects or facilitating corrupt behaviours. Was it good enough to say that this was just the business model with bribery, corruption and dishonesty that was required to buy influence?

### **Cross-cultural perspectives**

Attitudes to fraud and corruption are determined by cross-cultural perspectives, and are based on different conceptions of human nature. What may be considered legitimate in one culture may be considered corruption in another, and it all starts with the intention behind a given behaviour. For example, gift giving and hospitality in many eastern cultures is used to build and cement relationships and to build trust with future business partners, but may be construed by western cultures as bribery and attempts to influence.

If you are interested in learning more, I would highly recommend Fons Trompenaars' book *Riding the waves of culture*, and the eye opening questions that he asks the reader to consider as a way of finding out what their cultural perceptions are. For example, would you lie for a friend who has committed a crime? And if yes, why?

#### **Box 2 - Dimensions of human relationships**

Fons Trompenaars identified five dimensions of human relationships that influence how people do business and how they respond to moral dilemmas:

1. Relationships versus particularism (rules versus relationships)
2. Individualism versus communitarianism (individual versus the group)
3. Neutral versus affective (the degree to which feelings are expressed)
4. Diffuse versus specific (the degree of involvement)
5. Achievement versus ascription (how status is accorded).

Source: based on Fons Trompenaars, *Riding the waves of culture*

### **Discussing how to put theory into practice**

As European civil servants, we should shy away from easy, trite explanations of behaviours by attributing them to national stereotypes. Some people may claim that stereotypes help them navigate and make sense of their environment, but they do disservice by focusing on a narrow view of people's behaviour in a certain environment, by exaggerating and caricaturing the culture being observed. By looking at differences, there's a danger that we equate something different with something wrong, and look at individuals as 'other' rather than a person with whom we have more in common than appears outwardly.

In the EU institutions we are in an ideal position to create a shared culture and shared meaning for the values that are listed above. But this requires honest conversations, time and energy to think and discuss about what these values mean and how we would put them into practice in our behaviours and decisions.

Awareness about integrity does not come by itself, integrity issues have to be lived, shared and practiced. Examples of real life situations, either from our own organisation or from others, both good and bad practices, can make the 'seven principles of public life' alive and an integral [inherent] part of an ethical culture that staff members seek for themselves and others in public life. Ethical values and principles can be learned by doing. In conclusion, a good starting point when doing something should be 'would this stand up to public scrutiny?'

# Integrity risks and remedies in the EU institutions

By Carl Dolan, Open Society European Policy Institute



Cover of the Transparency International study on the European Union Integrity System

When it comes to fighting fraud and corruption Transparency International (TI) is a well-known NGO. Each year, it publishes an International Corruption Perception Index, measuring the perceived levels of public sector corruption in almost 180 countries. It also issues many studies, including a report looking at the integrity risks in EU institutions. The first issue of this report was published in 2014 and TI is currently updating this study, focusing on the European Parliament and the European Commission. Carl Dolan, currently Deputy Director of the Open Society European Policy Institute, was, until May 2019, the Director of the TI's EU Office in Brussels. He gives his perspectives of corruption and how it is perceived in the EU and some insights on the integrity risks that TI identified in relation to EU institutions and what has been done to address them.

## Integrity risks well under control?

Before the 2016 US presidential elections, many observers were confident that the institutional checks and balances in the U.S. system, together with the decades old norms and values that imbued them, would be more than enough to constrain a man like Donald Trump if he ever were to be elected. More than half-way through his mandate, this seems a rather optimistic picture as Mr Trump has trampled over conflicts of interest norms, undermined the independence of the judiciary and law enforcement, used executive powers in an unprecedented fashion to bypass the legislature, and even threatened to ignore subpoenas and to pardon himself of alleged crimes.

It couldn't happen here of course - or could it? The European Parliament elections in May 2019 are predicted to return a wave of populist-nationalists whose disregard for traditional ethical norms is the equal of Mr Trump's. Many of them, such as Le Pen's National Rally, are already embroiled in illegal party financing scandals, and Transparency International's research shows that Members of the European Parliament (MEPs) from outside the political mainstream tend to have greater risks of conflicts of interest through outside sources of income. So how robust are the checks and balances - the integrity system - of European Union institutions? How would the system fare under the sustained political stress-testing we have seen in the USA?

Fraud and corruption are a persistent threat to the integrity of public decision-making across the EU. The public sees this as a growing threat and does not believe that political institutions are sufficiently protected or able to tackle these risks. [The special Eurobarometer 470](#) published in December 2017, revealed that over two thirds of Europeans think that corruption is widespread in their country (68%). Almost three quarters (72%) believe corruption is present in the local, regional, and national public institutions of their countries. 43% of Europeans think that the level of corruption in their country has increased over the past three years. Worryingly, only a minority of respondents believe that various measures to discourage, tackle and punish corruption are effective (only one-third think there is enough successful prosecution).

### **Own interests over public interests**

The view of the public is not without reason. The last years have seen many scandals involving undue influence by wealthy corporations or political leaders that are seemingly more interested in their own fortunes than that of citizens. Examples include the 'cash for amendments' scandal, in which MEPs were recorded by journalists accepting promises of payments to submit amendments to legislative proposals, the ongoing *Dieselgate* scandal, where European carmakers established a pervasive system for accessing and influencing lawmakers, or the many revolving door cases, with EU politicians moving into lucrative private sector jobs. This includes former Commission President Barroso joining the investment bank Goldman Sachs or the way in which Jean-Claude Juncker's Head of Cabinet Martin Selmayr has been appointed as the European Commission's Secretary General, described by both the European Parliament and the European Ombudsman as a 'coup-like action which stretched and possibly even overstretched the limits of the law.'

Transparency and accountability shortcomings were clearly confirmed in the only EU anti-corruption report published by the European Commission in 2014. This analysis details the extent of corruption across EU Member States and points to high-risk areas such as political party financing, the allocation of government contracts, as well as parliamentarians' conflicts of interest and political accountability. These conclusions echo the findings of a [series of national studies](#) carried out by Transparency International, which also identified corruption risks in the close links between politics and business, poor protection for whistleblowers, and barriers to accessing information on public bodies.

What the EU anti-corruption report failed to evaluate however, were the EU institutions themselves, something which was also clearly noted by the ECA in its review of the Commission's anti-corruption report . Why was this the case? Perhaps there is a belief that the EU institutions are free from the corruption risks present at national level. However, can we be sure that this is indeed the reality? Past corruption scandals answer this question with a resounding no and these, together with other factors, have led to the integrity of the EU institutions being questioned. According to the [standard Eurobarometer of Autumn 2018](#), the trust of citizens in the European Union has decreased significantly since 2008 and it is now almost as low as the trust in their own national governments.

### **TI's European Union Integrity Study 2014: rules in place but practice rather different**

To fill the missing chapter in the Commission's anti-corruption report, the one that looks at the institutions themselves, Transparency International EU launched the European Union Integrity Study in 2014. This was the first ever comprehensive review of corruption and integrity risks in the EU institutions , with the goal of separating myth from reality and putting forward recommendations for reform. This study – which also covered the ECA - looked at how EU institutions promote integrity, how they deal with corruption risks and how their policies help the fight against it. It looked at both the rules in place and the practice in ten EU institutions and bodies.

Following nine months of research, the study came to some striking conclusions. It found that there is a good foundation in the EU system to support integrity and ethics; a foundation provided by the general policies and rules adopted to prevent fraud and corruption. There is a wide range of provisions already in place to protect EU institutions and those working for them from undue influence; to give the public a right of access to EU information; and to enable suspected maladministration, fraud and corruption to be investigated. Citizens and businesses also have the opportunity to submit complaints or request judicial review of EU decisions affecting them. All these channels are being actively used in practice and have proven to function well on the whole, albeit with some variation between institutions.

However, this foundation is often undermined by poor practice, lack of political leadership, failure to allocate sufficient staff and funding, and lack of clarity on to whom

the rules apply. The result is that despite improvements to the overall framework, corruption risks persist at EU level. The most urgent of these include opacity in EU law-making and in EU lobbying, poorly managed conflicts of interest, weak protection for EU whistleblowers, and weak sanctions for corrupt companies.

The report noted, for example, that existing EU transparency rules were rendered meaningless in practice by complex decision-making procedures and opaque negotiations within and between EU institutions that fall outside the formal rules. In an attempt to speed up the pace of EU law-making, there had been a trend towards decision-making being increasingly done outside of the processes foreseen in the Treaties. The consequence of this is that critical parts of the legislative process did not receive proper scrutiny and important negotiations were shrouded in secrecy. Similarly, no mandatory rules on lobbying were applied at the EU level, and the public remained largely in the dark about how outside interests are influencing EU legislation. Since the publication of the report, it is necessary to highlight that both the Commission and Parliament have introduced or are in the process of introducing lobby transparency measures.

In addition, no evidence could be found that the financial information declared by European Commissioners and MEPs was being systematically verified by the institutions themselves, undermining the effectiveness of this essential safeguard against conflicts of interest and illicit enrichment. Meanwhile, committees monitoring compliance with ethics rules were usually made up of current or former members of the institutions, and therefore lack independence or real teeth. At the same time, the absence of provisions to protect internal whistleblowers at almost all institutions meant that there was little incentive for staff to come forward and report unethical and illegal activity, despite legal obligations to do so. This poor implementation of existing rules could also be seen in the reluctance of the European Commission to use all the powers it has to prevent corrupt companies from taking part in public EU contracting. In late 2013, only one company was prohibited from tendering for EU contracts on the basis of the Commission's powers to debar (or 'blacklist') companies where there is evidence that they have engaged in fraud or corruption.

More generally, the study concluded that failure to make full and proper use of existing controls would not reassure a public that is sceptical of the commitment of politicians and bureaucrats to a more open and ethical style of government. Moving beyond the existing mechanisms, it recommended ways to address the identified shortcomings and drew attention to the need to take action. Only by implementing these changes will the institutions demonstrate that they are serious about tackling weaknesses and fulfilling the spirit as well as the letter of the law. After all, it is not simply about changing perceptions but also about bolstering institutional legitimacy, contributing to better governance across the region, and ensuring the highest possible standards of public service among EU officials.

### **Change to the better in EU institutions**

Since the publication of the first report half a decade ago, much has changed in the EU institutions. This mandate saw new systems and new rules coming into place, and existing mechanisms were revised. Many of the recommendations set in the first set of studies have been adopted by the institutions in the last years. Examples of this are new or reformed Codes of Conduct for the European Commission and the Parliament, longer cooling-off periods for Commissioners, greater lobby transparency through the publication of meetings by the Commission, whistleblower protection guidelines in all EU institutions, reforms in the EU financial institutions such as the European Central Bank (ECB) and European Investment Bank (EIB), and some improvements to the transparency of 'trilogue' negotiations between the Commission, the Council and the Parliament.

Yet, many inadequacies in the integrity mechanisms of the EU institutions still exist. The upcoming European Parliament elections are an ideal opportunity to renew the political impetus to address these. Although the chance is there for the taking, we are faced with

a challenge, as there is no up-to-date holistic assessment of the corruption risks in the different EU institutions and how to mitigate them. Which mechanisms are in place that effectively increase corruption resilience and the good governance of the EU? Are there weaknesses? If so, what are they? How can these be addressed? Which best practices can be adopted? These, and many other questions, need to be answered if we want to ensure that the EU is able to seize future opportunities for reform and improvement.

### **European Integrity Study 2.0**

The difficulties and obstacles described above highlight the need for strong advocacy efforts by civil society, based on unbiased analysis and deliberation. It was thus with the overall objective of contributing to the maturing of the EU as a polity that is an effective champion of good governance, transparent democratic processes and accountable institutions, that TI EU decided to conduct an updated evaluation of the integrity risks currently threatening the EU institutions, the European Union Integrity Study 2.0 .

We will carry out a practical research assessment of the three main EU institutions – the European Parliament, Commission and Council – using an already widely tested integrity systems methodology. This study will be done in a review card format and is intended to be a practical tool to both assess the work done by the EU institutions in the last legislature, as well as guide future advocacy efforts to strengthen the different EU ethics and integrity systems. We will supplement the qualitative methodology employed in 2014 with quantitative data analysis. For purposes of research and analysis, data will be collected through desk research, especially review of audit reports, media monitoring, and analysis of databases and registries. This will be supplemented by interviews with policy-makers, EU officials and experts. Where necessary, we will file access to information requests.

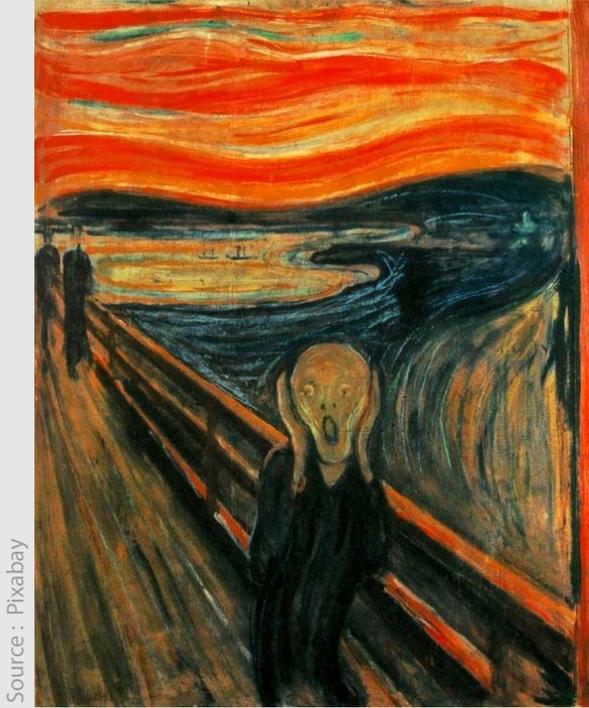
The analysis for each of the three EU institutions will be published in a separate report. Each of the reports will focus on the areas identified as having the greatest integrity risks. The first report to be published will be on the integrity system of the European Parliament, projected to be released in mid-July of this year. This report will look into potential integrity issues in the areas of access to documents, internal rules and functioning of parliamentary bodies, trilogues, lobby transparency, allowances of Members of the European Parliament (MEPs), conflicts of interests, revolving doors, declarations of financial interests, outside incomes of MEPs, whistleblowing procedures, recruitment processes, as well as ethics trainings.

### **Ultimate goal: accountability towards EU citizens**

Together, the analysis done by all three reports will help to provide us with new information, allowing us to refocus and guide our advocacy efforts in the coming years. The ultimate goal of the project will thus be to improve the EU's accountability towards its citizens, a goal which TI shares with the European Court of Auditors, as well as improve the protection of EU institutions against fraud and corruption risks.

# Whistleblowing- a key issue for all EU institutions and bodies

By Christophe Lesauvage, ECA Legal Service



Source : Pixabay

The Scream , painting of Edvard Munch

At the starting point of many fraud and corruption cases that have been exposed are most often...whistle-blowers. In the EU institutions and bodies, men and women who have the courage to speak up when they find something suspicious that most likely is an illegal act against the organisation they work for are protected by law. Nevertheless, becoming a whistle-blower requires courage and there are also certain rules and procedure that must be complied with by the whistle-blower. Christophe Lesauvage, principal manager in the Legal Service of the ECA, covers such questions, explaining why these rules are essential to enable whistle-blowers to speak up when needed and what specific arrangements are at the ECA.

At the starting point of many fraud and corruption cases that have been exposed are most often...whistleblowers. In the EU institutions and bodies, men and women who have the courage to speak up when they find something suspicious that most likely is an illegal act against the organisation they work for are protected by law. Nevertheless, becoming a whistleblower requires courage and there are also certain rules and procedures that must be followed. Christophe Lesauvage, Head of the ECA's Legal Service, looks at these issues, explains why the rules are essential to enable whistle-blowers to speak up and describes the specific arrangements in place at the ECA.

## What is whistleblowing?

For the EU institutions and bodies, the possibility of whistleblowing is covered by the Staff Regulations of Officials of the EU and Conditions of Employment of Other Servants (referred to below as the 'Staff Regulations'). EU organisations falling under the Staff Regulations can provide further details on whistleblowing through their internal rules. Alongside Article 22a of the Staff Regulations, therefore, whistleblowing at the ECA is governed by our internal rules on the forwarding of information in the event of serious irregularities. The mechanism was set up with the 2004 reform of the Staff Regulations to prevent and detect breaches of EU law that may adversely affect the interests of the European Union.

The ECA's internal rules define 'serious irregularity' as any illegal activity, including suspected fraud or active or passive corruption, to the detriment of the EU's interests, or any serious professional misconduct by a Member or a staff member, a seconded national expert, a trainee of an institution, an economic operator participating in an ECA public procurement procedure or a member of the staff of that economic operator, or a contractor of the ECA or a member of its staff.

Whistleblowing must be information about someone or something. This therefore excludes the reporting of rumour or hearsay, the origin of which is unknown or uncertain and the veracity of which is doubtful. Harassment, bullying and sexual harassment do not lend themselves to whistleblowing because they should be reported in the first instance by the person who experiences them and through specially established formal or informal procedures.

Irregularities which auditors find in the course of their audit must be reported via a specific internal channel. This is not considered whistleblowing but is an audit task carried out in accordance with the audit methodology defined by the Court.

### **Available whistleblowing channels**

Whistleblowing channels follow the line of command and allow communication exclusively within the institution or institutions. In the case of the ECA, whistleblowers are required to send information concerning a serious irregularity to their immediate superior, who must in turn forward it to the Secretary-General. If there is a conflict of interest, the information should be sent directly to the Secretary-General or the President.

This purely internal reporting channel is preferred by the Staff Regulations and by the internal rules on the basis that the top management of the institution is best placed to rapidly investigate and remedy the problems encountered. The internal channel makes it possible to avoid making public suspicions of irregularity within the institution. This is a way of protecting the institution's image. It also contributes to the general objective of protecting the EU's interests.

### **Not an option but a duty**

Certain channels outside the institution are also intended to receive information from whistleblowers. They include OLAF, the EU Ombudsman, the Presidents of the EU institutions and the inter-institutional panel specialising in financial irregularities referred to in Article 143 of the Financial Regulation. Reporting to journalists or the judicial authorities of a Member State is not in line with the rules in force at the ECA.

The whistleblowing system was established as an obligation for officials and other staff. In other words, whistleblowing is not an option but a duty. Persons who are aware of a serious irregularity and do not report it would normally be liable for failing to comply with their obligations under the Staff Regulations.

While making whistleblowing compulsory may be seen as a way of encouraging denunciations, it is also possible to see things from a different perspective. Being witness to serious irregularities or part of a system which is malfunctioning because of the behaviour of some individuals, but doing nothing about it, could amount to non-assistance to an institution in danger and in some cases even to complicity in wrongdoing.

Since the system was designed to prevent the institution from suffering any human, material or reputational damage, reporting should be done in accordance with the principle of proportionality: is whistleblowing the best way to protect the interests involved? In some cases, rather than raising the alert, it is advisable to speak to the alleged offender with a view to asking them to correct their attitude or repair any damage resulting from the irregularity. If the person stops their behaviour, the whistleblowing system has met its objective. The purpose is not to punish the person, but to stop the conduct. Any further consequences (sanctions, disciplinary procedures, etc.) are the responsibility of the institution or competent authorities.

Thus whistleblowing is ethical only if it is aimed at safeguarding the public interest and done selflessly with a view to making a positive contribution to the rule of law. Reporting should be done not only in good faith - the person doing the reporting should believe that the information they give is accurate - but it must also be free from any personal

motivation of gain, harm or revenge. Informants who supply incorrect information — when they knew or should have known that it was incorrect — may be called to account under disciplinary, civil or criminal law for defamation.

In addition to the obligation to follow internal transmission channels, whistleblowing is subject to several formal requirements. Reports must be made in writing, using a form available on the ECA's internal network and website.

### **Protecting the whistleblower**

Can an alert be anonymous? In principle, the answer is no. Any person submitting information on the appropriate form must be identified at the time of transmission. That person then becomes an 'informant' within the meaning of the internal rules. This requirement is justified in terms of system efficiency and ethics. On the one hand, it affords whistleblowers the protection which is the keystone of the system. Without protection, there would be very little reporting since whistleblowers would fear professional or personal retaliation. However, if informants do not identify themselves, the institution will be unable to discharge its duty to protect them. Moreover, the ethical nature of anonymous submissions is far from clear. An informant who wants to remain hidden when they have no reason to fear reprisals may not be acting solely in the interests of the institution and with the conviction that their allegations are justified.

The informant's identity must, however, be kept strictly confidential unless they personally authorise disclosure or if that is a requirement in the context of criminal proceedings that may result from a report of serious irregularities. In principle, neither OLAF nor the Court of Justice of the EU can require that an informant's identity be disclosed.

The European Data Protection Supervisor (EDPS) has drafted guidelines on the protection of personal data when processing an alert in an ethical alert procedure. Provided that the conditions for forwarding the information laid down in the ECA's internal rules have been complied with, and in particular that the informant has acted in good faith, protection of the whistleblower is guaranteed even if the information subsequently proves to be inaccurate.

### **EU Directive on the protection of whistleblowers**

Within the EU, diverging approaches among Member States are about to be harmonised thanks to a Commission proposal for a Directive on the protection of whistleblowers reporting irregularities in certain areas of the law which are considered to be crucial for the health and safety of citizens, the stability of the financial system, the EU's financial interests, etc. The Directive provides for the setting-up of early warning systems in companies with more than 50 employees or communities with more than 10 000 inhabitants. The text introduces important safeguards, such as an exemption from liability for breaches of contractual or legal restrictions on the disclosure of information. The Directive also contains a list of support measures to be put in place for whistleblowers.

Whistleblowing is not an obligation. Internal alerts are encouraged, but public whistleblowing, in particular by investigative journalists or via social networks, may also qualify for protection. Particularly in the event of a failure to act by the recipients of an alert or if the whistleblower has reasonable grounds to fear a manifest or imminent threat to a public interest, collusion between the authorities and their institution, or reprisals. The Directive establishes an obligation for authorities and undertakings to provide feedback within three to six months, as appropriate.

Since the Directive also covers infringements affecting the EU's financial interests, staff members who are also EU citizens will be able to invoke the protection arising from the transposition of the Directive into national law if they report illegal conduct detrimental to those interests, as required by national law. It is therefore important that the Staff

Regulations be aligned with the Directive on a number of fronts. It will also need to be adapted to the establishment of the European Public Prosecutor's Office, which will be one possible transmission channel.

The European Parliament adopted a draft of the Directive in April 2019. It still needs to be approved by the Member States, but they are expected to adopt it by the end of the year.

### **Some views on the current system of internal whistleblowing**

The system currently in place for the EU institutions has certain shortcomings which are likely to affect its effectiveness. For example, whistleblowers are not sufficiently informed about the follow-up to an alert and cannot therefore assess the utility of their approach in relation to the objective of protecting the EU's interests. The response time of authorities following an alert could be shortened in such a way that whistleblowing could reasonably have the effect of ending the reported irregularity. More speed and feedback in the follow-up of reports would enhance the credibility of the system and users' trust that it will contribute to more ethical governance.

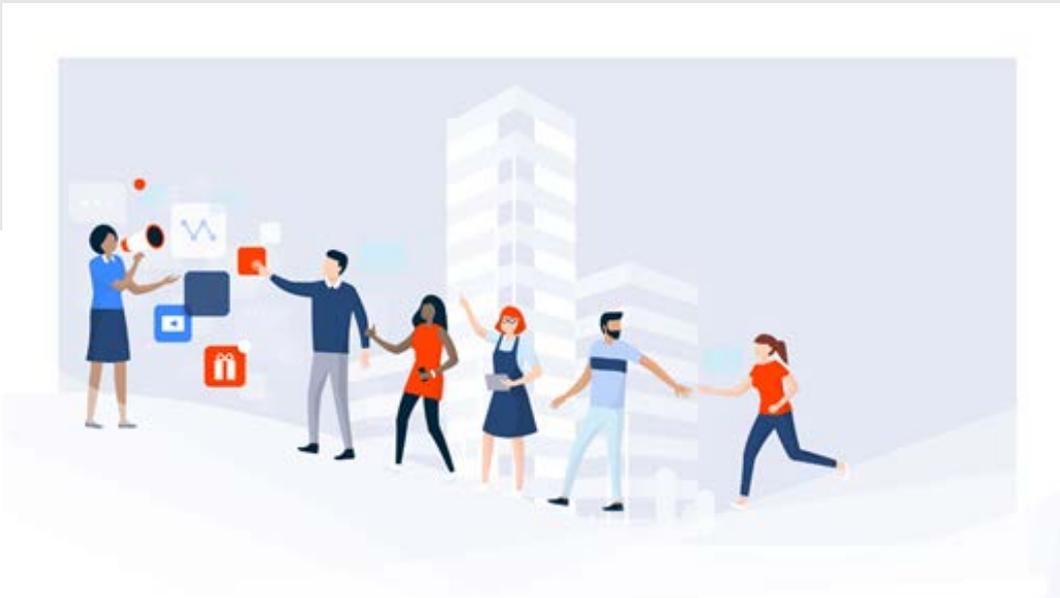
Does the possibility of whistleblowing genuinely help to establish ethical governance within an institution? While whistleblowing certainly works as a deterrent and an incentive to abide by the rules, there is no certainty that this will be sufficient to ensure ethical governance. On the one hand, directing behaviour under the threat of repression is not strictly ethical and, on the other hand, ethical alerts will have no effect if the coercive system in general is not, or barely, applied to certain situations or persons.

The threat of an ethical alert allows irregularities to be stopped in certain cases; it also helps to ensure that the staff of the institution is more likely to comply with the rules, whatever the field (mission expenses, working time, conflicts of interest, outside activities, etc.). Fear of whistleblowing by a colleague, and therefore of being charged in disciplinary or criminal proceedings, has a deterrent effect.

Conversely, there is concern at the level of the EU institutions that, when the threat of sanctions is low, there is proportionally more inappropriate or irregular behaviour. In any event, a form of governance in which certain behaviour is motivated by the deterrent effect cannot be regarded as ethical. Compliance with the rules must be inspired by the duty of public officeholders to lead by example. And to act selflessly — a fortiori when they are part of the governance structure rather than because of the fear of being identified and punished. Ethical governance is the culmination of a long process. In this sense, whistleblowing is a prerequisite for compliance with the rules of the institutions, and will remain so as long as the ethical values of integrity, selflessness and exemplarity have not been sufficiently mainstreamed to drive the highest standards of behaviour.

# Whistleblowing in the private sector: the how matters

By Moritz Homann, EQS Group AG



Some of the most well-known scandals, from LuxLeaks to the Panama Papers or Cambridge Analytica, surfaced because whistleblowers brought them to the attention of the authorities or the media. On 16 April 2019, the European Parliament adopted a new EU Directive on the protection of whistleblowers, aimed at both the public and the private sector. What action have private-sector companies taken to enhance reporting on suspected misconduct? And to what extent is such reporting needed and used? Moritz Homann is Managing Director Corporate Compliance at EQS Group AG, a company providing regulatory technology for corporate compliance with national and international disclosure obligations. Below, he presents some of the key findings of a recent study on internal whistleblowing in several European countries.

## Whistleblowing Report 2019 identifies frequent violations

Legal regulations or internal guidelines were violated at almost every second company in Europe's core economies in 2018. This is just one of the findings of the Whistleblowing Report 2019 undertaken by the University of Applied Sciences HTW Chur, in cooperation with the EQS Group, which examines the state of internal whistleblowing in Germany, France, Switzerland and the UK. It also shows that while many organisations in the private sector have already implemented reporting channels, there is often room for improvement.

Whistleblowers help companies identify internal misconduct, minimise risk, and avoid fines and sanctions. Despite this, only ten EU Member States have passed laws to protect whistleblowers to date. The others now have until 2021 to transpose the new EU Directive<sup>1</sup> on the protection of whistleblowers into national law. From an organisational perspective, many in these jurisdictions are being proactive and taking action ahead of the legal requirement to do so.

The Whistleblowing Report 2019 is based on almost 1 400 interviews with companies in Germany, France, the UK and Switzerland. Across all countries and company sizes

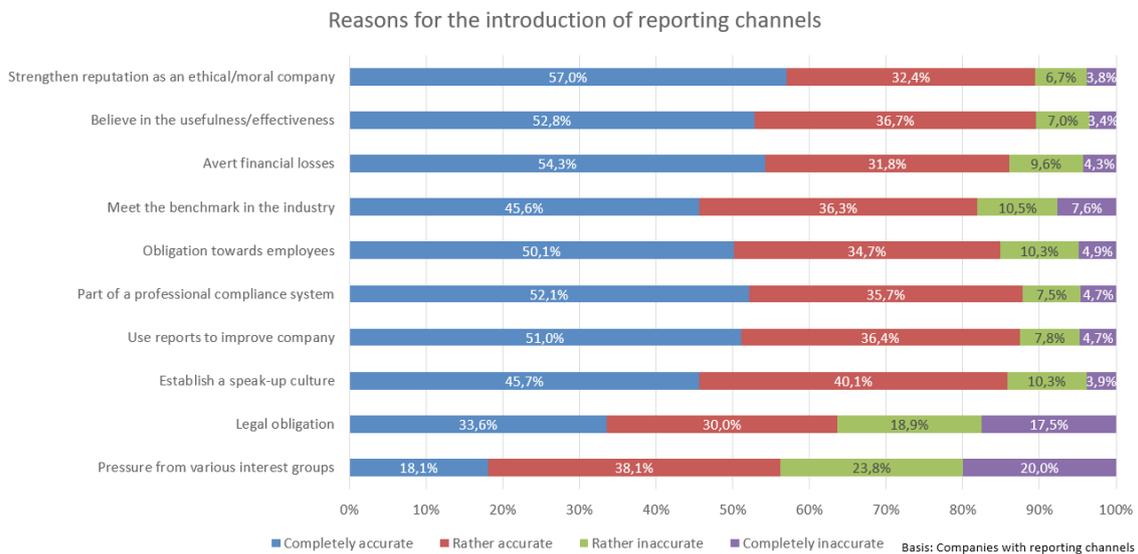
<sup>1</sup> COM /2018) 218

surveyed, almost 60% of companies have implemented a whistleblowing channel through which employees and other stakeholders can report suspected misconduct. Across the jurisdictions, large companies, as well as banks and insurance companies, are more likely to have a whistleblowing system in place.

### Damage prevention and promoting an ethical image are the main motivations

As for why these companies have proactively implemented whistleblowing systems, there are several reasons (see **Figure 1**). In addition to avoiding financial loss and promoting the company as being ethical and honest, one of the most important motives is that companies are convinced of the benefits and effectiveness of whistleblowing channels. These reasons also resonate with the third of other companies surveyed who currently do not have a whistleblowing system, because they are planning to implement one. The remaining companies, most of which are Small Medium Enterprises, do not yet deem it an important topic as it is not yet required by law.

**Figure 1 - Reasons for the introduction of reporting channels**



Source: EQS Group AG

### Implementing internal reporting channels: talk to your stakeholders

Implementing a whistleblowing system affects the whole company. In our experience, it is important to include relevant stakeholders at an early stage. For example, the company's management will ensure the right 'tone from the top'. Ideally, they will openly support the reporting channel, explain its purpose and the benefits of having it in place for the company's integrity and long-term health. In addition to management, other stakeholders include the labour union (where relevant) or employee representatives to make sure the channel(s) is/are designed according to their requirements, and the Data Protection Officer, to make sure personal data is handled in compliance with the General Data Protection Regulation. For internal communications, the communications department and/or Human Resources will also be important stakeholders.

### Communication and clear responsibilities

This latter point is an important one. From our experience implementing internal whistleblowing channels within numerous organisations, one key topic often lacks prominence on the agenda: communication. Clearly, internal reporting channels can only be fully effective if all potential reporters are aware of the channel, how to use it and what to report, and are reminded on a regular basis. The study shows that the most common channels through which the whistleblowing system is communicated to

employees and other stakeholders are line management, top management, the intranet and the Code of Conduct. The majority of organisations also have a separate policy or guidelines relating to whistleblowing, to which employees can refer.

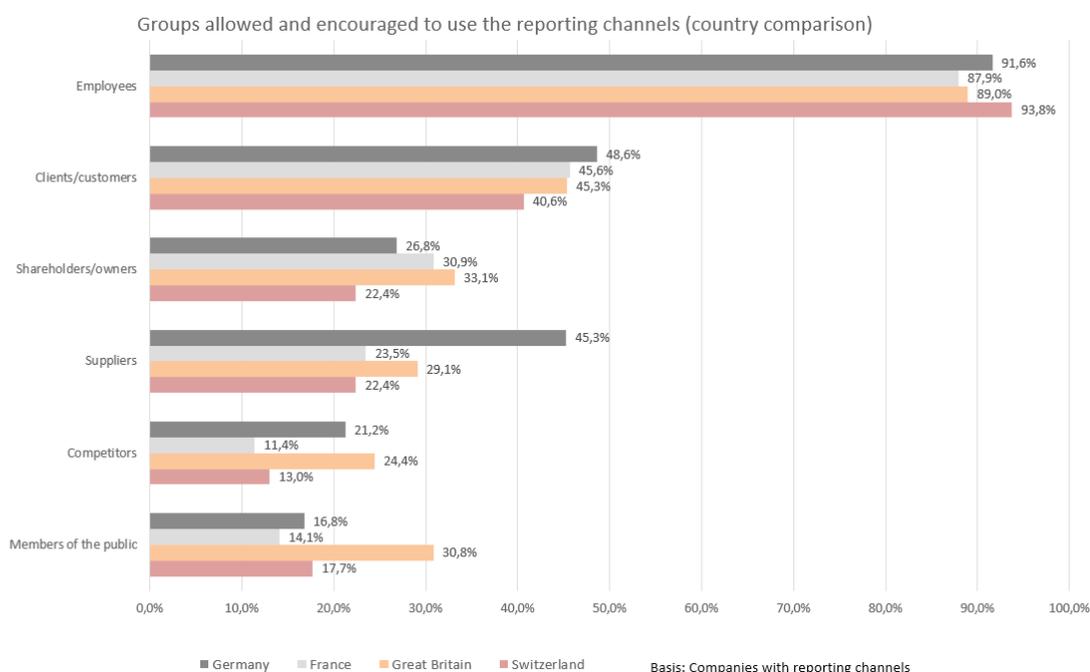
Having clear responsibilities for case managers ensures that cases are dealt with quickly and efficiently, ensuring that reporters know their concerns are being taken seriously. The study reveals that the most common departments responsible for report handling are: compliance, management, human resources, legal or the Board of Directors. The relevant department depends largely on the company size: large, international corporations usually have a compliance department, whereas smaller companies will often rely on a shared function like legal or even the management team.

### The more reporting channels, the more reports

The Whistleblowing Report 2019 shows that companies provide employees with an average of three whistleblowing channels. Companies with specialized reporting channels like a web-based reporting system receive more reports. In addition, the majority of companies make the reporting channels available to employees and at least one other stakeholder group (see **Figure 2**). The statistical analysis shows that the more stakeholder groups are allowed to report information, the higher the potential financial loss revealed by the reporting channels – thereby making the channels much more effective.

Only a fifth of organisations open their channels to the broader public. We would always recommend making the reporting channels as widely accessible as possible, e.g. public on the corporate website. In our connected economies, valid reports on misconduct can come from a plethora of sources. Excluding potential sources of information means that risk is not being identified.

**Figure 2 – Groups allowed and encouraged to use reporting channels (country comparison)**



Source: EQS Group AG

The results also show the importance of providing anonymous whistleblowing channels, e.g. via a specialised web-based system. For companies that provide the option of reporting anonymously, 58% of initial reports are anonymous. This clearly shows that barriers still exist to people coming forward if anonymity is not guaranteed. Specialised web-based reporting systems enable dialogue between the company

and the whistleblower, even if the individual decides to remain anonymous. In fact, experience shows that once whistleblowers have gained the necessary trust during this communication, they sometimes provide their identity so that they can better support the investigation.

### **Every second report points to misconduct**

Providing an anonymous channel sometimes makes companies nervous that it will be open to abusive reports – the data shows that this is not the case. In general, more than 50% of incoming reports point to illegal or unethical behaviour in the organisation. By contrast, less than 10% can be categorised as ‘abusive’. The other reports normally point to other problems within the organisation which are important but not compliance-related.

When we look at aggregate figures, companies receive an average of 52 reports per year; this is across all company sizes and jurisdictions. Clearly, the number of incoming reports largely depends on the size of the company, the industry and the level of business activities abroad.

### **Talk about the outcomes**

We are often asked what companies should do once a report is investigated and closed. Our advice is to let employees know what happened and what the consequences were – anonymously of course. The study shows that more than half of organisations do this already. This helps employees to better understand the types of issues that are relevant, and what the consequences are – more concrete than abstract examples in training sessions. Only a third of the companies also communicate back to the whistleblower about the consequences and around 10% communicate cases publicly. Our view is: the more transparency the better, as it creates trust.

### **Whistleblower reports identify financial misconduct**

‘If you think compliance is expensive, try non-compliance’, goes one of the most famous sayings in the field. This is also reflected in the study. Of the companies who had cases of misconduct in 2018, 16% faced financial losses of more than €100 000. For another 26%, the financial losses ranged between €10 000 and €100 000. Fortunately, reporting channels helped uncover these damages before they ran into the millions and resulted in reputational damage. All companies with reporting channels in place confirmed that these channels had helped them identify at least part of the loss, and more than a third of the German and French companies identified over 60% of the total loss thanks to the whistleblowing system.

The results show: whistleblowing helps companies to identify and remedy misconduct with associated financial loss. For this reason, many companies have already set up whistleblowing systems without being under any legal obligation to do so. While only a minority of companies already offer specialised reporting channels, it is clear from the statistics that providing such channels increases the number of reports and therefore the ability to identify and manage risk. Furthermore, companies that have not yet set up any reporting channels would do well to address this at an early stage in the context of the EU Directive.

# Flipping the narrative: from fighting corruption to building integrity

By Ina de Haan, Netherlands Court of Audit



As good as fighting corruption may be, the term itself also often creates a negative connotation: there is something bad that needs to be eradicated, or at least kept as small as possible. The public expects external auditors to play an important role in keeping the government clean – but can SAls deliver? And do SAls live up to their own expectations in terms of being a model organisation, leading by example. Ina de Haan, senior auditor at the Algemene Rekenkamer (Netherlands Court of Audit), has been actively contributing to developing a self-assessment tool for SAls' institutional integrity, named IntoSAINT. She gives her insights into what IntoSAINT is, and a number of impressions from audit institutions which have worked with IntoSAINT.

## Corruption in the eye of the citizen: a complicated story

Public trust in government is a fickle commodity. According to the Organisation for Economic Cooperation and Development (OECD) public trust has been declining all over the globe. However, there are exceptions, i.e. some [countries](#) where it has been growing. Over time there have been huge [fluctuations in trust](#), showing that trust can be lost and regained.

Corruption is a major cause of erosion of trust and no society is free of corruption. Fighting corruption is definitely on the radar of the International Organisation of Supreme Audit Institutions (INTOSAI) and other international organisations and it is a growing business for Non-Governmental Organisations (NGOs), donor agencies and consultants. However, the past 25 years of concerted and mounting efforts to fight corruption have not eradicated the phenomenon. There are many reasons why this is the case. One reason is that 'grand' corruption is driven by political power and feeds on the existence of complex international constructions used for [illicit money transfers](#). Another reason is that 'petty' corruption is usually deeply rooted in local social norms and circumstances and sometimes even makes perfect sense in a context of [fragile states](#). Whatever the reason, the question is whether 'fighting corruption' is an effective narrative that helps to keep corruption in government at bay and to restore trust in government.

This question is especially relevant when we look at the role of Supreme Audit Institutions (SAIs). The public expects external public auditors to play an important role in keeping the government clean, but can we deliver? Every time we fail to unearth cases of corruption that are brought to light by other entities or the media, we may fail in the eye of citizens. Most SAIs are powerless when it comes to detecting and punishing cases of corruption, be they grand or petty. It does not really fit their role, which is to keep government transparent and accountable. This is a complicated story to get across to the public.

### Need for another narrative

To be effective, and to contribute to trust in government, we need another narrative: a narrative of building integrity, of good examples, of inspirational leadership and hope. This need has been recognised by INTOSAI, and International Standard of Supreme Audit Institutions (ISSAI) 12 gives us guidance on how this can be done: SAIs making a difference to the lives of citizens by strengthening the integrity of government and public sector entities and being a model organisation, [leading by example](#). This is flipping the narrative: from fighting corruption to building integrity.

### Raising awareness of integrity

Since its introduction in 2010 **IntoSAINT**, the INTOSAI tool for Self-Assessment of Integrity, has been an important driver in this paradigm shift.

IntoSAINT is a two-day structured workshop where a relevant cross-section of SAI staff, facilitated by two external moderators, analyses the strengths and weaknesses of the integrity of the organisation. The result is a report with recommendations from the SAI's own staff to strengthen the institutional integrity policy. IntoSAINT is designed to have a double impact, when applied:

- the backbone of the tool is a set of two questionnaires that provides the basis for a thorough integrity risk assessment, complemented by a questionnaire that provides insight into the maturity of integrity controls. This allows the organisation to think in terms of integrity risks and strengthen the internal controls;
- applying the tool through a workshop with employees raises awareness of integrity risks and ethical dilemmas in their work, and, most importantly, employees start to realise that integrity is not only a personal characteristic, but a responsibility shared by the whole organisation.

### Two key IntoSAINT objectives

The aim of rolling-out IntoSAINT in the INTOSAI community is to achieve two objectives. By the application of IntoSAINT within the SAI, the SAI starts implementing ISSAI 30 and at the same time becomes acquainted with the integrity approach. This makes the SAI ready to lead by example in the second step: implementing the integrity approach in the public sector and its audit work.

IntoSAINT implementation and support are coordinated by a workstream within the [INTOSAI Capacity Building Committee](#). Since IntoSAINT was launched in 2010, more than 300 auditors from over 80 countries have been trained in this methodology. More than 50 SAIs have since applied the tool to their own organisation, some of which have taken the next step to bring this approach to their public sector.



Participants in an IntoSAINT workshop

### SAI reactions to the IntoSAINT experience

Several SAIs have shared some impressions of what the IntoSAINT workshop has meant to them and some first results; see the text boxes below.

Source: [Rekenkamer Curacao](#)

*Integrity within the SAI*

**SAI of Mexico (ASF)**

*At the SAI of Mexico, the IntoSAINT workshop led to the establishment of an Integrity Policy, which comprises a Code of Ethics, a Code of Conduct and a Guideline to Prevent Conflicts of Interests. Additionally, an integrity committee and an official mechanism to deal with integrity breaches were created. An integrity coordinator was appointed as well, who is in charge of looking after the implementation of the Integrity Policy.*

*'The most visible impact of IntoSAINT is awareness on integrity matters by the staff. Once the tool was applied at the SAI of Mexico in 2012 for the very first time, the personnel started thinking on the new approach of integrity fostered by the IntoSAINT methodology. The staff knew about ethical dilemmas faced in their daily work, but this mental exercise had never been conscious. This conscious analysis on integrity issues and how to act properly is an immediate change in the staff behaviour caused by the IntoSAINT tool.'*

**SAI of Iraq (FBSA)**

*In 2012 and 2017, two workshops were held at the FBSA in collaboration with the Netherlands Court of Audit. The purpose was to identify strengths in FBSA work and points that needed support and improvement when carrying out audit tasks in a way that enhances the relation with stakeholders.*

*FBSA's top management has a clear vision of the importance of applying the tool and implementing the recommendations of the final report concerning the results of the workshops and of the application of the tool.*

**SAI of Morocco (CdC)**

*IntoSAINT is valued as a strategic development tool that supports the integrity of the CDC and its staff. It is regarded as a means by which the standards of conduct and proceedings can be generalised among the CDC structures and entities. Debate over integrity matters revealed the necessity of setting up a permanent integrity monitoring system at the level of the Cour des Comptes to successfully meet these objectives. Efforts to implement the recommendations included appointing an ethics commission of six members and entrusting it with the mission of advising the First President on concerns regarding ethics. The commission also has the duty to promote integrity awareness-raising and conduct outreach and training activities for the benefit of the Cour des Comptes magistrates and administrative staff.*

*Integrity in the public sector*

**SAI of Iraq (FBSA)**

*The idea is to benefit from this effective tool for enhancing institutional integrity in the public sector by a preventive approach based on understanding the activity and analysing integrity violation risks, as well as establishing the necessary procedures to manage these risks. In line with the above, FBSA has included a strategic goal in its strategic plan (2018-2022) that focuses on 'Enhancement of Transparency and Integrity Principles' and develops projects, standards and tools to implement this goal and measure progress.*

**SAI of Hungary (SAO)**

*Inspired by an EU Twinning project on corruption risk mapping with the Netherlands Court of Audit in 2008, the Hungarian SAI's vision was to develop its Integrity Project: Integrity against Corruption. Since 2009 the SAO has conducted an annual integrity survey among public sector entities, modelled on the questionnaires used in IntoSAINT. The survey aims to serve as an effective tool to give feedback to public institutions on their exposure to risks associated with corruption and assess the control measures required to manage corruption risks.*

**SAI of Morocco (CDC)**

*A series of seminars will be held at national and sub-national levels on the theme 'Promoting Public Service Integrity.'*

*Inspire each other*

**SAI of Hungary (SAO)**

The SAO organises regular Integriy Seminars for SAIs all around the world, to familiarize them with the SAO's Integrity Project and the use of the Integrity Survey.

**SAI of Morocco (CDC)**

*We had the opportunity to have two staff from the CDC trained in moderating the IntoSAINT tool. These two moderators in their turn facilitated integrity self-assessments for the Supreme Audit Institutions of Lebanon and Tunisia.*

*We are planning to invite partner institutions for cooperation on integrity. The aim of this cooperation is to widen the scope of experience sharing and best practices exchange on promoting integrity among SAIs and hence contribute to the further dissemination and strengthening of IntoSAINT and the integrity approach.*

**Flip the narrative**

Crucial to the success of IntoSAINT is that it provides common ground and a common framework for SAIs in respect of integrity in many different contexts and cultures. This allows them to support each other, to learn from each other's experiences, both in training and lessons-learned meetings and through the valuable experience of being an IntoSAINT moderator in another SAI. Within the European Organisation of Supreme Audit Organisations (EUROSAI) the Taskforce on Audit & Ethics has included this into its working plan.

This is how SAIs can start and actually are starting to flip the narrative: from fighting corruption to building integrity. IntoSAINT helps them to inspire each other with good examples, inspirational leadership and hope, thus making a difference to the lives of citizens by strengthening the integrity of government and public sector entities and being a model organisation leading by example.

# It's ethics, stupid! - or why legal is not enough

## 1<sup>st</sup> Prize on Integrity in Public Management awarded to EUROSAI Task Force on Audit & Ethics

By Luis Alvarez Arderius, Canary Island Regional Audit Institution, and Julio García Muñoz, University of Castilla-La Mancha



Source: University of Castilla-La Mancha/World Compliance Organisation

Helena Abreu Lopes (left), Member of the Court of Auditors of Portugal, receives the 1<sup>st</sup> Prize on Integrity in Public Management, on behalf EUROSAI Task Force on Audit & Ethics, handed over by María José de La Fuente, Secretary General of EUROSAI and President of the Court of Audit of Spain.

To highlight the meaning of ethics as a control tool in the public sector, the University of Castilla and the World Compliance Organisation have awarded the Task Force on Audit & Ethics of the European Organisation of Supreme Audit Institutions (EUROSAI) the first prize as the most distinguished initiative with a positive impact in the promotion of ethics and integrity in the public sector. Luis Alvarez Arderius, Technical Auditor of the Canary Island Regional [Audit Institute](#), and Julio García Muñoz, Internal Control Executive Director of the [University of Castilla-La Mancha](#), explain why public bodies must acknowledge and embrace ethical behavior as a key tool and why the EUROSAI Task Force received this 1<sup>st</sup> Prize on Integrity in Public Management.

### **Ethics – more than legislation**

Around the globe public sector arrangements show an abundance of legislation. Administrative law is considered a guarantee of making things right in public sector. Every policy, every single decision needs to go through a legal or administrative procedure before it enters into force. The rule of (hard) law adage seems to be that 'if you follow the rules, decisions and policies will be made up within the legal framework, avoiding private or personal interest interfering with the general one.'

However, no matter how tough your technical or legal framework is built, in the end -and sometimes not even that far towards the end - each and every system show control bugs and loopholes. Holes where procedures do not apply, moments in the process where a person can and sometimes must intervene, have a choice, can choose a direction to an end. There, that right moment when the human factor appears, is where ethics appears, the ethical dilemma pops up.

### **Public procurement – a key example where the ethical dilemma arises**

Raphael is the CEO of a Small and Medium Enterprise (SME) of 15 employees. In the past years, his company has made a tremendous effort to learn and comprehend the new EU Directive on Public Procurement and its national derivative act. A new expert employee hired, a good amount of money spent on training, hours of administrative time preparing bids. Despite all that, results are not coming. He is especially frustrated with the last tender procedure in the Industry and Commerce Chamber, a regional public body. Last month, he found out that his enterprise got zero points in a bid. He knows his business sector perfectly, he knows his competitors and he is sure his bid was by far the best value for money offer on the market. Then, his frustration turns into anger when, during a national business fair, he meets some professional colleagues and finds out - in an informal context - that a person inside the selection committee had private interests at stake. That committee member used a not specifically defined legal provision (in Raphael's view not clearly defined in legal terms) to assign a top score to one bid and not a single point to Raphael's one. The terms were perhaps not directly illegal, but he feels that from the beginning, they were intentionally *cooked* from the inside in order to remain with the traditional provider. And what is more, no one else in the selection committee raised his/her voice because the decision seemed to match the legal basis.

Sadly, Raphael's case is not a single issue. Small and Medium Enterprises (SMEs) constitute 90% of Europe's pie chart, the core of EU employment and its productivity. Jointly, in terms of public procurement, over 250 000 public authorities in the Union spend around 14 % of GDP, or nearly €2 000 billion, each year on the purchase of services, works and supplies. Citizens deserve public services delivered in an ethical manner, with transparency and integrity, and in the most efficient way.

Public procurement, grants and personnel selection/promotion are major examples where the ethical dilemma arises. The other one, the big one, is the policy making process. No single political system is free of private interference. So the headline is crystal clear: public governance and management must be aligned with ethical principles. It's not only a matter of values. Jobs, growth, efficiency and justice are at stake.

### **How to restore integrity**

Spotting unethical behavior was and remains a risk activity. Whistleblowers face retaliations in a vast array of costs, from economic or working conditions to even physical damages. Integrity has a high price, and surely, something needs to be done to restore it as a core public value. Realising this objective in the EU was greatly bolstered by the European Commission's adoption of the EU Directive on the protection of persons reporting on breaches of Union law (Directive Protection of Whistleblowers).

*It's ethics, stupid! - or why legal isn't enough*

But we also find best practices at national level. In Spain, March 2019, the University of Castilla-La Mancha and the [World Compliance Organisation](#) have arranged the *1<sup>st</sup> Prize on Integrity in Public Management* within the *II Compliance in Public Sector Congress*. Aware of the meaning of Ethics as a control tool in public sector, both institutions reached a conclusion: all the effort done, all the risks taken in becoming a model to inspire others, should be recognized.

In its first edition, the Prize held two different categories. A personal category addressed to public servants awarded [Antonio Arias Rodriguez](#) (Asturias Regional Audit Institution) with the first prize and Carlos Balmisa García Serrano with a distinction, or so-called *accessit* ([Spanish National Commission on Markets & Competition](#)). Secondly, the institutional category awarded the 'Task Force on Audit & Ethics' of the European Organisation of Supreme Audit Institutions (hereinafter, TFA & E), as the most distinguished initiative with a positive impact in promotion of ethics and integrity in public sector. The Spanish Local Entities Federation was also conceded an acknowledgement by becoming second.



Source: University of Castilla-La Mancha/World Compliance Organisation

All the awarded candidates: (from left to right) Concepción Campos Acuña and Judit Florez Paredes, representing the Spanish Local Entities Federation, Antonio Aras Rodriguez, Helena Abreu Lopes, representing the TFA & E and Carlos Balmisa Garcia Serrano

The jury of the Awards in Public Management Integrity highlighted the initiatives of TFA & E within EUROSAI, its institutional leadership in public audit and its work addressing ethical conduct and integrity promotion in the deliverance of public value to the Supreme Audit Institutions (SAIs) around Europe, as well as the citizens (see **Box**). The members of the jury have also valued the pedagogical and cooperative approach, as well as 'the ongoing efforts of the working group to promote inter-institutional and inter-professional cooperation in Europe.'

**Box: EUROSAI Task Force delivering good public governance**

Being conscious of the high ethical demands public auditors always need to meet, EUROSAI established, in 2011, the TFA & E. Aim was to create an instrument to strengthen ethical conduct and integrity at the core of Supreme Audit Institutions' mission (hereinafter, SAIs), as well as to promoting them in the rest of public organizations in Europe.



Source: EUROSAI Task Force on Audit & Ethics

Besides SAIs, other public sector entities have also profited from the methodological approach supported by the technical papers published by the TFA & E. Since its foundation the TFA & E has encouraged an unremitting inter-professional cooperation all along Europe's public sector. The guidelines the TFA & E drafted to implement International Standard of Supreme Audit Institutions 30 (ISSAI 30) *Code of Ethics for Public Sector Auditors* is a clear result which is supporting SAIs to enhance their ethical infrastructure.

The TFA & E has collaborated with public and private organisations across Europe, giving weight to the compliance with values, principles and ethical standards in any field of public management activity. All this effort has reached a substantial improvement for SAIs and, therefore, the public sector in a significant number of countries. Specifically in Spain, TFA & E has proactively attended several congresses, conferences and meetings promoting ethics and integrity as key elements in public sector, both in control institutions and in other public entities.

Helena Abreu Lopes, Member of the Court of Auditors of Portugal and representing its President, Vítor Caldeira, as Chair of the TFA & E, collected the prize on behalf of all the Members of the Task Force. María José de La Fuente, Secretary General of EUROSAI and President of the Court of Audit of Spain, was in charge handing over the award. Helena Abreu Lopes commented: 'This prize is a significant recognition of all the work done by the TFA & E and by its members, promoting an ethical culture in public sector organizations and a solid indicator of its impact.'

**Auditors and deliverance of good public governance**

Summing up: auditors have always had a special say in the deliverance of good public governance. Nowadays, this meaningful work stands out even more due to phenomena that undermine public sector effectiveness. On the one hand, we can identify big systemic cancers such as fraud and corruption, sometimes to be at or close to the very heart of democracies. But we also must firmly face and call out the policy making process or legal bugs leading to unethical behavior, weakening trust in public institutions or unduly affecting the position and competitiveness of businesses such as Raphael's SME, whose experience is, unfortunately, not that atypical.

In all these situations, we should not consider ethics as a side element. Ethics set the tone and have direct impact. Auditors are playing their part to make this clear and apparent. Because citizens deserve better.

# Why, why, why? Analysing the root causes of fraud and corruption

By James C Paterson, Director of Risk & Assurance Insights Ltd (RiskAI)

In fighting fraud and corruption, it is very useful to have insights on a broad spectrum of elements to explain why it occurs in your organisation or is related, for example, to a specific programme. Root cause analysis (RCA), a technique applied to uncover the fundamental causes of problems such as fraud and corruption, can help. James C Paterson has been running courses on RCA for over five years for a number of the Institute of Internal Audit (IIA) organisations in Europe. He regularly presents his insights to public and private-sector organisations and has written about lean and agile auditing. So what, in his view, are the essential ingredients of an effective RCA? In this article, James provides a brief overview and applies RCA principles to fraud and corruption.

## What is root cause analysis and how did it start?

Root cause analysis (RCA) is about analysing the underlying reasons why things have not gone as they should. The idea is that by fixing the fundamental causes of a problem, you will also address similar problems, not just the specific cause of the event in question.<sup>1</sup>

### Take the Titanic as an example...

RCA has varied origins, but two of the most famous RCA techniques – the ‘5 whys’ and the ‘Ishikawa’ (fishbone) diagram – stem from the growth of ‘lean’ ways of working, and particularly the associated need to get things done ‘right the first time’.

RCA requires us to be *clearer about what caused a fraudulent act or other incident, or a process weakness*. It distinguishes between three different types of cause:

- **the immediate cause** – the thing(s) that obviously led to the problem: e.g. the iceberg that struck the Titanic;
- **the contributing causes** – these “set the stage” for the problem to occur; in the case of the Titanic: the northerly route taken, close to the icepack; the speed of the ship; and then;
- **the root cause(s)** – the underlying factors that caused the problem and might lead to similar problems in future - in the case of the Titanic, there were multiple root causes, including underestimating the risks the ship faced, insufficient lifeboats, and flaws in the bulkhead design.

I would strongly encourage any reader to start using these terms to discuss fraud, corruption and other incidents, to help their organisation be clearer about what type of cause has been identified.

### Shifting the blame away from the individual

A rigorous approach to RCA means that, even if a single person carries out an act of fraud or corruption, the root cause will not just be that person. Instead, RCA will often reveal deeper problems in the relevant processes, systems, training or oversight that failed to identify and stop what happened.

A tendency to blame individuals for things that go wrong reflects a defensive culture, which will inhibit the ability to find root causes. Instead, one should think about the occurrence of problems in a way that is less likely to scapegoat individuals. The ‘Just culture’ framework, developed for ‘high reliability’ organisations and situations (see **Table 1**), can help.

<sup>1</sup> See for more information on root cause analysis also [www.RiskAI.co.uk](http://www.RiskAI.co.uk)

**Table 1: 'Just culture' – a stepped approach**

**“Just culture” – a stepped approach**

Human Error	At-Risk Behaviour	Reckless Behaviour
<b>An inadvertent action:</b> <i>Slip, lapse, mistake</i>	<b>A choice;</b> e.g. a risk not recognized, or believed justified	<b>Conscious disregard</b> of expectations (including fraud and/or corruption)
Manage through changes in: <ul style="list-style-type: none"> <li>Processes</li> <li>Procedures</li> <li>Training</li> <li>Design</li> <li>Environment</li> </ul>	Manage through: <ul style="list-style-type: none"> <li>Removal of incentives for at-risk behaviours</li> <li>Create incentives for healthy behaviours</li> <li>Penalties for increased risk factors</li> <li>Increase situational awareness</li> </ul>	Manage through: <ul style="list-style-type: none"> <li>Remedial measures</li> <li>Punitive action, including dismissal/prosecution as appropriate.</li> </ul>
<b>Console individual</b>	<b>Coach individual</b>	<b>Discipline/Sanction individual</b>

**Why, why, why?**

There will always be more than one root cause for a problem in an organisation; as a minimum, there will normally be:

- flaws with preventative controls; and
- problems with detective controls.

*5 whys/2 legs framework*

This is nicely summarised in the '5 whys, 2 legs' framework, illustrated below (see **Figure 1**):

**Figure 1: 5 whys/2 legs**



There are also more sophisticated approaches for effective root cause analysis, such as the logic tree (fault tree) and bow-tie (barrier) analysis, which we will not discuss in detail here. However, even these techniques must still be complemented by the ‘why, why, why’ approach of the 5 whys. Using these techniques will often reveal the multiple ‘hairline cracks’ that led or at least contributed to a risk event. For example, in the BP Deepwater Horizon disaster (the largest ever marine oil spill, which happened in the Gulf of Mexico in 2010), around eight different processes failed simultaneously.

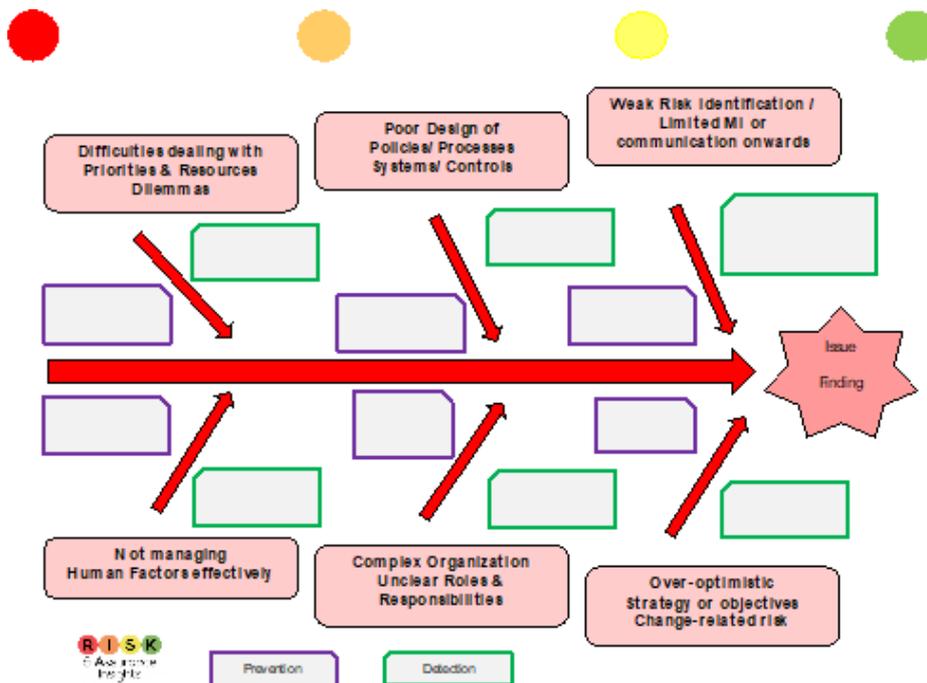
*The fishbone (Ishikawa) technique*

In practical terms, the fishbone (Ishikawa) technique is a useful ‘halfway house’ between the 5 whys 2 legs approach and the more rigorous fault tree and barrier analysis methods. As with all RCA techniques, the fishbone technique explicitly recognises that problems will have multiple root causes, but provides greater structure concerning key areas to examine systematically. This technique is especially useful as a way of:

- cross-checking whether key lines of enquiry have been exhausted, and
- allowing causal categories to be analysed.

The traditional causal categories for the fishbone technique, originating from the early days of lean methods as used on production lines, include People, Process and Equipment. However, working with clients over the years, I have developed a modified fishbone approach that uses another set of root cause categories, illustrated in the **Figure 2**.

**Figure 2: Modified fishbone approach**



Although the root cause categories chosen may point to the root causes of an issue in general terms, the actual root causes for a specific issue will be particular, depending on the detailed facts and circumstances of the situation. In other words, you cannot assume that every root cause category will apply to every problem that arises.

With all types of root cause analysis, care must be taken to:

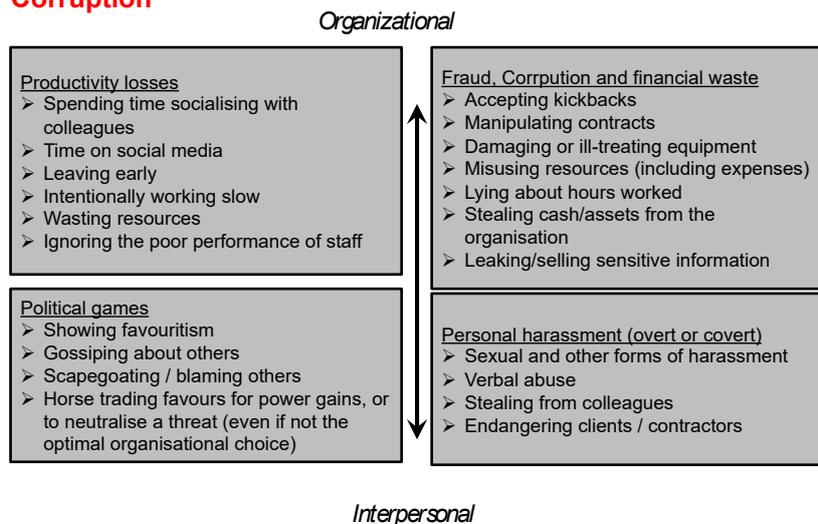
- gather robust evidence,
- be clear about causality (rather than just correlation), and
- consider the impact of any weaknesses (e.g. by using the Pareto (80/20) method – 80% of the results will come from just 20% of the action) in order to remedy these as a matter of priority.

### Fraud and corruption – taking a broader view

It is easy to think of fraud and corruption in a rather narrow, legalistic, manner, rather than see it as part of a broader spectrum of deviant workplace behaviour (see **Figure 3** below). This is because it allows us to think about fraud and corruption as something that wrong-doers do, that has nothing to do with ourselves. A wider interpretation, however, may raise questions about the overall context (or culture) in which fraud and corruption sits. In particular, a bad example set in one domain risks giving the impression that similar or other forms of deviant behaviour (such as fraud or corruption) are justifiable in some way.

**Figure 3: Deviant workplace behaviours**

#### Overview of deviant workplace behaviours, including Fraud & Corruption



Adapted from: Robinson and Bennett

Below are some of the most significant and common root cause factors relating to fraud and corruption issues:

#### Control activities e.g. ABAC controls

Recently, many organisations have put a lot of effort into anti-bribery and anti-corruption (ABAC) programmes, due to increasing penalties for failure to have such programmes in place. However, it is easy for these to simply become a ‘tick-box’ exercise (to comply with laws and regulations), where the letter, but not the spirit, of the rules is followed, and so seen as separate from other organisational processes. In a nutshell, we must be very vigilant to the risk of governance, risk and compliance (GRC) ‘theatre’.

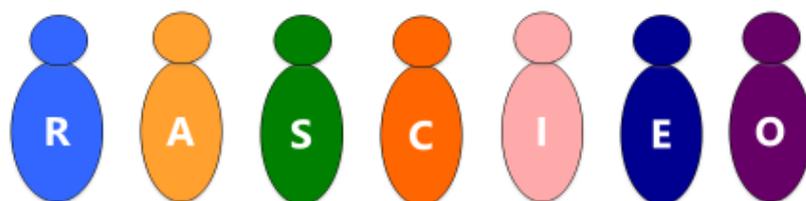
In addition, the time and effort devoted to compliance programmes can easily divert attention away from – for example – anti-fraud activities or efforts to reduce financial waste (which may also be important and in fact contribute to potential corruption risks). Ask yourself: when was last time fraud risk-assessment workshops were carried out with key finance, procurement and operational staff, and how rigorous are efforts to work on efficiency and effectiveness-related issues?

#### Understanding and managing roles and accountabilities

Although everyone has a responsibility to call out potential instances of fraud and corruption, there is a risk that making it ‘everyone’s job’ will in practice make it ‘no one’s job’! In my experience, large organisations need to become much better at understanding and managing the complexities of roles and accountabilities for anti-fraud and anti-corruption issues (as well as many other areas). This can be done with tools such as a modified McKinsey RASCI framework, set out in **Figure 4** below. This allows the organisation to be more precise and joined up when considering who does what, and who oversees this.

Figure 4: Modified McKinsey RASCI framework

**RASCEIO<sup>(i)</sup>: Accountability framework optimised for GRC**



- **Responsible** (exactly one required for the relevant span of activity)
- **Accountable** (exactly one required for the relevant span of supervision)
- **Support**
- **Consult**
- **Inform**
- **Execute\*** (for Service centres and 3<sup>rd</sup> parties)
- **Oversight\*\*** (for Risk & Policy ownership, and governance oversight)

*i) Adapted/expanded from McKinsey's RASCI framework  
\*E developed in Scandinavia with a RiskAI client  
\*\*O developed in AstraZeneca*

For example, when was the last time a line manager or procurement team member received guidance about the sort of fraudulent or corrupt acts that might be going on 'under their noses', and precisely what their role was? When was the last time a senior manager (not a member of finance), talked about this issue to their staff? Anti-fraud and anti-corruption efforts will only really have an impact when they are seen to be a specific part of everyone's job; not in just a generic way, but rather with specific tasks and behaviours required of different roles.

Other important issues to consider relate to accountability for governance, and the quality of oversight and of anti-fraud and anti-corruption activities, which invariably need to encompass finance, legal, compliance, risk management, executive management and any oversight board.

### Allowing for human error and other human factors

How can our processes, procedures and systems allow for human error and human failings as 'a fact of life' that therefore needs to be proactively thought about and managed? As discussed, 'high reliability' organisations that are intent on driving down the number of issues, incidents and near misses use the 'Just culture' framework (see **Table 1**). They pay close attention to both the breadth and depth of training needed.

Rather than simply rolling out e-learning as a blanket exercise for all, some organisations deploy specific e-learning tests with pass marks (even 100% in some organisations, with only one chance to re-sit the test!); others use face-to-face training and workshops for higher-risk areas (i.e. they believe e-learning is not good enough for some roles). They may also use other simulation activities in the workplace to check that people are applying what they learn in practice (as you may have seen with test phishing attacks in relation to IM/IT security, but applied to fraud and corruption-related risk areas).

'Human factors' is also the arena where the existence of deviant workplace behaviour (e.g. senior managers who appear to be overly rewarded with benefits; or seem to ignore poor performance by staff; or show favouritism) may lead some staff to become disgruntled and/or demotivated. Some members of staff may cite 'deviant activities' (but not corrupt or fraudulent ones, according to the letter of the law) as justification for their own deviant activities, which may include fraud or corruption (i.e. 'If they are getting away with X, why shouldn't I be entitled to Y?').

Ask yourself: what deviant behaviour does your organisation tolerate that might be encouraging employees (or contractors) to become demotivated, or disgruntled? Ask yourself: when was the last time this risk was explored with staff on an anonymous basis?

Note that disgruntled staff may 'test' control activities in small ways, to see what they can get away with, before moving on to more serious fraud, etc.

**Management information, resource questions and other dilemmas: Cost/Trust vs. Control**

I understand why some managers feel they have and should have a 'zero tolerance' approach to fraud and corruption, and particularly their insistence that anyone found committing an act of fraud or corruption would need to leave the organisation. However, when I ask them how much effort and what resources they plan to invest to calculate all losses resulting from fraud, and to recover missing funds (perhaps involving the police), they typically explain that they need to be 'realistic and practical'.

Ask yourself: how often does your organisation publicise the removal of wrong-doers? All too often, fraud and corruption issues are kept low-key for fear of embarrassment and, consequently, reputation risks. I appreciate that there are sensitivities here, but the counter-argument to keeping things quiet, is that it means that even when acts of fraud or corruption are discovered, and staff are removed, there is no visible deterrent to others who might be contemplating such acts.

When you look at the resourcing for anti-fraud and ABAC programmes, it is clear that potential action (e.g. more extensive training and awareness in higher-risk areas) is limited by budget and resource constraints. So, managers may say they have a 'zero tolerance' to fraud and corruption after it has occurred, but – in practice – they do not make '100% effort, no expense spared' to identify, manage and stop fraud and corruption in advance! This reflects a broader dilemma facing all organisations. We want to be trusting and empowering, lean and agile, and to be sensible and proportionate how we manage resources; but if we are too trusting and empowering, without enough checks and balances, this can be seriously abused by some of the people who (all too often) most seemed to deserve our trust! The cost, and reputational damage, of a single act of fraud or corruption can still far outweigh the costs of even the most extensive control and monitoring activities.

Whilst it is always important to talk about whistleblowing initiatives, the effective management of fraud and corruption risk requires us to think beyond whistleblowing to other 'weak-signal' information sources that may provide an early warning system to a bigger event. As a minimum (and in addition to robust whistleblowing mechanisms), organisations should collect loss and incident information and not be content if nothing is reported!

Best practice would suggest that organisations should encourage the reporting of near misses (not just actual losses/incidents) and of gaps in expected control activities, as well as carrying out in depth 'spot' checks – in real time, or as close as possible – on the activities of senior managers and finance/procurement managers. Just the mere presence of these spot checks at all levels will drastically deter staff and managers from trying to test the system and its processes. Finally, the most progressive organisations are starting to collect and use cultural and behavioural information (e.g. staff motivation, attitudes and engagement) as a leading indicator of potential fraud and corruption risks.

**To address contextual and systemic causes, you need to be able to see them**

Whilst the specific causes of a fraud or corrupt act will always be particular, root cause analysis, with the aid of '5 whys, 2 legs' framework or the fishbone tool, can allow us to 'see' contextual and systemic causes of potential frauds and corrupt acts. This can help us be more mindful of changes that need to be made to reduce the frequency or impact of such events.

Finally, organisations that are serious about managing the risk of fraud and corruption need to significantly upskill their training, and ways of working, in relation to effective root cause analysis, so they can get deeper insights into the real reasons why problems regarding fraud and corruption are occurring.

# 'The Panama Papers' - tackling transnational white collar crime through cross-border journalist collaboration

## Interviewing the two authors of the bestseller book *The Panama Papers*, Frederik Obermaier and Bastian Obermayer

By Gaston Moonen and Judith Stein, Directorate of the Presidency



Source: Stephanie Füssenich

Bastian Obermayer and Frederik Obermaier

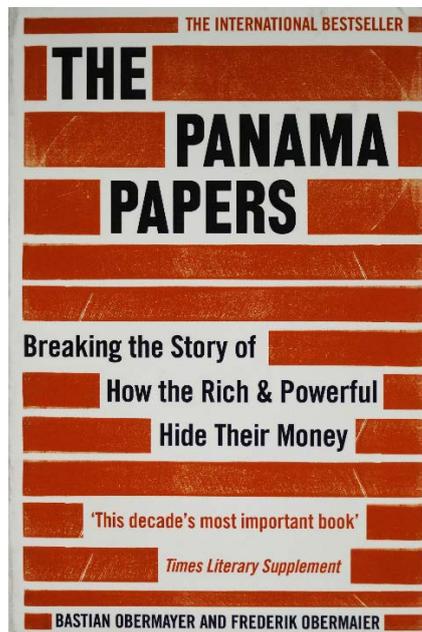
During a cold winter night in 2015, Bastian Obermayer received an electronic message from an anonymous source: 'Hello. This is John Doe. Interested in data? I'm happy to share.' This message marks the beginning of the biggest collaborative project in journalism history: the Panama Papers. The leak revealed data about how government officials, criminal regimes, businesspeople and celebrities covered their money with the help of offshore companies. Subsequently, the Prime Ministers of Iceland and Pakistan resigned. National authorities retrieved US\$1.2 billion since the information went public. However, did the way that the wealthy and powerful handle their prosperities really change substantially? Three years after the publication of the Panama Papers, Judith Stein and Gaston Moonen interviewed the two initiators of the project: Bastian Obermayer and Frederik Obermaier from the German newspaper *Süddeutsche Zeitung*. Both journalists received several awards for their investigative work.

### Big data unfolding a thrill

The 'Brothers Obermay/ier' - this is how their colleagues nicknamed them - have not always been investigating fraud and corruption. Their previous works include investigations on former Nazi criminals, the Ku-Klux-Klan in Germany and sexual abuse in a German Catholic school. 'For me, the first story that did not only touch the topic but got me diving into the topic of money laundering, corruption and opaque company structures, were the Offshore Leaks,' recounts Frederik Obermaier. As the Panama Papers, the Offshore Leaks were led by the International Consortium of Investigative Journalists (ICIJ). He continues: 'That was my first investigation in this field

The **International Consortium of Investigative Journalists** (ICIJ) that only nominated journalists get to join is based in Washington. Since its foundation in 1997, the ICIJ was responsible for the coordination of several international investigations on tobacco and human trafficking or dubious World Bank Projects. By now, it comprises around 200 members worldwide. Obermayer and Obermaier became part of the ICIJ in 2013.

and also the first one dealing with this big amount of data. At that point, there were 260 GB of data, which was already a huge amount of data for us and we struggled to work with it. You can imagine how it was to make that bigger step towards the two terabyte of data with the Panama Papers.'



### *The Panama Papers*

Almost 400 journalists from 80 countries investigated on 2.6 terabyte of data and published their results on 3 April 2016. The Panama Papers unfolded information about 214.000 offshore companies set up by the Panamanian lawfirm Mossack Fonseca. It disclosed how government officials, wealthy individuals and criminals all over the world shifted their money through shell companies in order to avoid taxes or hide the purpose of transactions. Connections between Mossack Fonseca and the inner circle of Vladimir Putin, the Assad regime in Syria, African heads of states, world star Lionel Messi and one third of the Icelandic government were revealed.

Cover of the international bestseller Bastian Obermayer and Frederic Obermaier published in 2016

The huge amount of data was also hard to grasp for their former chef, Hans Leyendecker, whom the ICIJ approached for the Offshore Leaks, remembers Frederik. 'He is rather the "paper-guy". So one of his first questions was if we could print out the 260 gigabyte of data - which he then realized is not that easy.' They hired a data journalist and a programmer to support them with the analysis of the data.

It was completely new ground for Bastian and Frederik. Frederik explains: 'It was like throwing us into cold water and we had to learn how to swim. And it was fun! Neither Bastian nor I would ever have imagined to work on bearer shares, nominee directors, company structures or trusts for several years, but we learned to love it. Now we could hardly imagine working in other fields. The work with gigabytes and terabytes of documents might seem boring or a little bit too technical to some, but as soon as you learn to read the data, it unfolds a complete thrill.' The investigation on the Panama Papers was like an addiction for the two journalists. Bastian Obermayer : 'It was really hard to stop, even for going to sleep. There were nights when Frederik and me clicked through the data until long after midnight and even got up at 4 o'clock in the morning to continue because the findings were so interesting.'

“ [on the Panama Papers data] Frederik and me [...]even got up at 4 o'clock in the morning to continue because the findings were so interesting.' ”

After the [Offshore Leaks](#) in 2013, [Luxembourg Leaks](#) and the [Swiss Leaks](#) followed until the first contact between 'John Doe' and Bastian in 2015. The amount of data offered are mind boggling. The source, whose identity remains unknown until today, transferred 2.6 terabyte of information to the investigation team, including 4.8 million emails, 3 million database files and 2.1 million PDF files about 214.000 offshore entities, all set up by the Panamanian law firm Mossack Fonseca. As a result, Mossack Fonseca ceased its activities in March 2018. Its two leaders, Jürgen Mossack, who has German nationality, and the Panamanian Ramón Fonseca, have been imprisoned but later set free again. The [investigation](#) against them is still ongoing.

In 2017, the [Paradise Papers](#), also initiated by the Brothers Obermay/ier, disclosed offshore activities of another 120 political leaders, including information about Queen Elizabeth II and Ukrainian President Petro Poroshenko and major global enterprises such as Apple or Nike. The leaks raised the public awareness to the topic; the Panama Papers made it to the front page of media outlets all over the world.



**Bastian Obermayer**

started his journalistic career at the *Süddeutsche Zeitung* after studying Politics at Ludwig-Maximilians

University in Munich and attending the German School of Journalism. He was soon recruited for the investigative team of his newspaper after he showed a clear preference for writing long-reads for the magazine of *Süddeutsche Zeitung*. Today he serves as the head of the investigative team. He was honoured for his journalistic work with several awards, including the 2017 Pulitzer Prize, the George Polk Award and the Barlett & Steele Award.

**Fiscal leaks as game changer?**

Former EU Commissioner Agirdas Semeta already called the Offshore Leaks a 'game-changer for future fiscal policy.' In how far have the leaks, not the least the Panama Papers, really changed the game? 'It would be naïve to think that we stopped the whole business of hiding money', admits Frederik. 'But we made it more expensive. After the Panama Papers, the Paradise Papers and other leaks, so many schemes are public that you have to put another layer or several layers of secrecy on your money.' Bastian explains: 'We don't think that there are no fraudsters anymore. They will find other ways. People will still try to dodge their taxes and to pay as little as possible. They will use whatever measures available to them, but the offshore world will play less and less a role.' In his eyes,

the largest impact of their work is the decreasing faith in the offshore business.

Bastian says that the biggest game-changer in the offshore world is that people know what happens now if their behaviour becomes public. 'Knowing that those big leaks happened several times already, many of the players who took part in the game before are now too afraid of being shamed publicly.' For his colleague Frederik, the main achievement of the leaks is that they sparked a public debate. 'I see it as a good consequence that we speak about it. We speak about complicated company structures. We speak about bearer shares. We speak about tax havens like Delaware, Luxembourg, Malta, Cyprus and Co. We speak about it not only in a specialist corner but it has become a public debate.'

“*Knowing that those big leaks happened several times already, many of the players who took part in the game before are now too afraid of being shamed publicly.*”

Earlier this year, during a conference in Berlin, Frederik discussed tax evasion with an audience aged 20 to 30. This shows an important development for him. 'Having an audience of nearly 200 people in that age speaking with you about tax havens would not have been realistic ten years ago. Now they realized that hiding money also affects their lives. They are realizing that if we have to pay for university, hospitals and childcare, it is also a consequence of money hidden behind opaque company structures.'

Bastian and Frederik observe that the increased public awareness has led to a rising pressure on banks from investigators, lawmakers and politicians. Deutsche Bank employees express frustration about the high number of critical questions concerning their bank's involvement in scandals like The Panama Papers or the Danske Bank scandal. 'This may hopefully lead to the conclusion that they don't behave like that anymore in the future. That they stick to legal and legitimate practices and do not try to take whatever option they see to hide money as soon as there is enough money involved that they can gain,' says Frederik.

In their book *The Panama Papers: Breaking the Story of how the rich & powerful hide their money*, the two describe that the ownership of a shell company is not against the law. It becomes illegal if the prospective income is not declared to financial authorities. However, *The Panama Papers* demonstrated that offshore companies are predominately used for hiding money or the identity of the actual owner of a property. Frederik thinks that clients will be more careful and hesitant in the future: 'Ethics become more and more important. Something being legal is not the ultimate bar anymore.'

“*Ethics become more and more important. Something being legal is not the ultimate bar anymore.*”

His colleague Bastian points out that it is necessary to separate between legal and legitimate, but that the separation is not always truthful. 'If we look at the Luxembourg leaks, for example. The former Minister of State (and long-time Minister of Finance) Jean-Claude Juncker was one of the architects of the Luxembourgish system. He always claimed: "But it's legal." Investigations then showed that the tax rulings awarded to Amazon and Fiat by Luxembourg were not legal. To really determine if something is legal or not, we have to have a thorough look at it.'

Bastian consequently encourages authorities to take a closer look whenever a scheme, which is considered legal, still seems suspicious. 'Because if something looks fishy, it often is.' Furthermore, he is also concerned about the legislation itself. 'Our demand is not only for companies not to use those practices but also for the people who are making the rules to change them. If people can legally avoid millions of taxes, then the scandal is not them doing it; the scandal is that it *is* legal!'



After studying Political Sciences and Journalism in the small town of Eichstätt, Germany and Bogotá, Colombia, **Frederik Obermaier** pursued a career as a foreign correspondent

in the Middle East. He started at *Süddeutsche Zeitung* with two years of traineeship and gradually converted to the investigative team after helping with research on the Hells Angels in Berlin. He wrote several books, one of them about the Ku-Klux-Klan in Germany and won several prizes, including the 2017 Pulitzer Prize for Explanatory Reporting together with Obermayer and the rest of their team.

“If people can legally avoid millions of taxes, then the scandal is not them doing it; the scandal is that it is legal!”

The investigative journalist is not the only one aiming for change in the tax regulations. Christine Lagarde, Managing Director of the International Monetary Fund, recently called for a 'fundamental rethink of international taxation' ([Financial Times, 2019](#)). In how far can actual change be expected? Bastian: 'Some countries are very focused on their own well-being, which reminds me of the bad guy in class who would only take advantage of everyone else's work.' The journalist therefore does not expect substantial developments within the next months.

However, Bastian thinks that more and more people do not like to have big exemptions for the big corporations. 'There is a new sense of injustice in this world. I think that most countries are already hearing it and are adapting their behaviour, so we have to force the rest to follow. I am not speaking of force in a military sense but there are many ways to help countries to understand that their behaviour lacks solidarity.' Bastian thinks countries should not shy away from taking counter measures to for example Switzerland in case they continue with their tax policy. 'That's a hard step, but if a country is not listening to many good arguments, maybe we have to take hard steps.'

### Tips pouring in for the Obermay/iers

The publication of *The Panama Papers* did not only have a global impact, it also changed a lot for the daily work of Bastian and Frederik as investigative journalists. The fact that they have been successful in protecting their sources on several occasions play a key role. 'Our sources have not ended up in prison, on trial or trapped in another country. I think that made us interesting for many potential whistle-blowers out there', explains Frederik. 'We are now receiving a lot of tips, a lot more than we can work with.'

He indicates that there is an example nearly every week. 'Recently I did an investigation on tax exemptions for the superrich in Switzerland with colleagues of *Süddeutsche Zeitung* but also colleagues in Switzerland and in Greece. Oliver Zihlmann, a Swiss colleague who worked with us on the Panama Papers, initiated the investigation. He brought us on board, together with a colleague from Greece, also involved in the Panama Papers. These are only small collaborations but they happen all around the world on a regular basis.

“We are working in an amazing international community of investigative journalists.”

We are working in an amazing international community of investigative journalists. If we do not have the capacity, we always know a journalist within this global network who might be interested in our information.'

### **International collaboration between journalists setting an example?**

For the two Obermay/iers there is clear evidence that journalistic collaboration can be observed all over the world. Bastian points out the collaboration of the *Organized Crime and Corruption Reporting Project (OCCRP)* on the Troika [Laundromat](#) and the collaboration of South-Africa on the Gupta [Leaks](#) as two outstanding examples. 'That shows that journalism has found a new answer to transnational problems: tackling transnational problems with transnational collaboration.'

This begs the question whether journalism can serve as an example for intensive cooperation in other fields, such as auditing. Frederik takes an optimistic stance: 'Not many journalists would have told you 20 years ago that it is possible for competitors to work together jointly in order to tackle international problems. If that is possible for our journalist community, and journalists are certainly not the easiest personalities to work with, I think collaborations are possible in any other field as well.' He points out that international cooperation requires to work not only across geographical borders but also across organisational borders.

“*If that is possible for our journalist community, [...] I think collaborations are possible in any other field as well.*”

A remarkable difference between the documents that auditors work with and the documents that the Obermay/iers receive is the trustworthiness of the information. Auditors usually visit the auditee in order to verify the information received with their own eyes. In the case of the Panama Papers, the investigators did not know anything about the source. The validity of the information therefore has to be checked more thoroughly. 'We can never trust the documents alone. We have to find a way to double- or triple-check it,' explains Frederik, adding that if a journalist does not find any other source that confirms what is stated in the original document, it will not be published. 'We had to kill a lot of stories because we did not find a second source. That is maybe not the case if you get a document from the government, from inside, and you know it is true. We used all kinds of databases, company registries, land registries, human sources and books to find evidence that the document we had was authentic and reliable.'

“*We had to kill a lot of stories because we did not find a second source.*”

Even several months after Bastian received the first leak from 'John Doe', he was not sure whether to trust the documents. Frederik and Bastian discussed the trustworthiness of the source on a daily basis because it seemed 'too good to be true,' which made Bastian even more suspicious. 'If something seems too good to be true, it's mostly not true. We were very, very cautious because one big mistake would have endangered the whole project. We never told our colleagues who joined the investigation that our documents were authentic. We only said "What we have found so far seems to be authentic. But we have to cross-check everything." Bastian therefore sees scepticism – not unknown to auditors – as key for their profession: 'It is very important and you have to be open until the very last moment to kill a story. You have to give it the benefit of a doubt for everyone you are dealing with and if you have second thoughts in the last minute, you have to stop it.'

### **Investigative journalists under threat**

While the sources of the Panama Papers and the Paradise Papers could successfully protect their existence, many journalists who published the results under their names faced serious threats. 2018, according to the [annual report](#) of the non-profit organisation *Reporters without Borders*, marked a new peak of violence towards journalists worldwide. This is especially due to rising violence in regions which have been relatively safe before, such as Europe and the United States. Around 200 journalists have been killed worldwide within the last three years, including the Slovakian journalist Ján Kuciak and the Maltese reporter Daphne Caruana Galizia who were both working on the fall-out of the Panama Papers.

As their source kept providing the journalists with live insights about Mossack Fonseca's operations during their investigation, the two journalists were able to follow how the company warned their employees about 'undercover journalists' and discussed their publications as 'the German case.' Which influences did those developments have on the professional and the personal life of Bastian and Frederik? Both journalists took several precautions, made their addresses less accessible in a public database in Germany.

'We have to be aware of the frightening development that more and more journalists are threatened, by words, even by individuals like Donald Trump, and also physically threatened,' admits Frederik. He points out that Germany is still a place where it is relatively safe to work as a journalist, compared to places like Russia, Latin America or parts of Africa. 'On the other hand, we thought that the same applies for other places within the European Union, like Malta or Slovakia. Now we saw journalists like Ján Kuciak and Daphne Caruana Galizia being killed there. That is something where we should all, as a society, speak up and stand up. If it is that easy to kill a journalist and silence our voices, it means that the crooks could win in the end. And this is certainly not what we all want.'

Many things changed for Bastian since the publication of the Panama Papers. 'I think if we had to do it now, after Daphne and Jan have been killed, we would do things differently. We would not feel as comfortable as we felt back then. Not a single investigative journalist had been killed in the centre of Europe in the years before for doing the kind of work we did: not going to a warzone or reporting about the mafia. Just financial reporting. And then it happened two times!' For Bastian Germany is still a different spot where he still feels safe. 'But I don't feel as safe as I felt four years ago.'

“*I think if we had to do it now, after Daphne and Jan have been killed, we would do things differently.*”

Journalists as individuals are not the only ones who face threats. According to Frederik, all major media outlets have to consider themselves as potential targets of cyber-attacks or physical attacks on reporters. 'The *Süddeutsche Zeitung*, as other newspaper outlets, has learned its lesson. We stepped up our security, not only our IT security but we are also thinking and speaking more about operational security for us as journalists. Some have even done trainings on how to protect themselves when being attacked. We have to learn how to live with this situation and how to go on with our investigations in this more and more dangerous environment; because stopping to report on important issues is not an option for us and it should never be.'

### **Perception and reality**

Although Europe ranks relatively low in the [Transparency International Index](#), several European banks and politicians have been involved in money laundering and corruption scandals. Does this mean there is a gap between perception and reality? Frederik confirms this impression. 'I think too many people are still not aware of the fact how much European countries like Germany are havens for people who want to launder money.'

An example he gives, referring also to reports from investigators and academics, is the German real estate sector. 'We unfortunately do not see the necessary steps from lawmakers to stop the possibilities for money laundering here, for example by creating a public register of real estates or by enforcing the register of beneficial ownership in a more effective way.' He refers to the transparency register in place. 'But we have already encountered many cases in the past months that show that is basically a useless tool so far because authorities are not enforcing it. They don't even know how many companies are obliged to reveal their ultimate beneficial owner in this register.'

## Bright future for investigative journalism

As to whether something big like the Panama Papers project will happen again, Bastian is sceptical. 'It is very likely that we will not get a second project like this ever again.' But if it ever happened, he has a clear opinion on how to proceed: 'If there was another opportunity like the Panama Papers, in German you would say: "Jetzt erst recht!" Meaning as much as "now even more so." We don't want to give in. We are not going to step back just because bad people want us to step back. We have seen enough now to know that it is really important to go ahead.'

Investigative journalism took an important role in revealing the injustices in the way that the richest part of the population pay – or do not pay – taxes, in comparison to the broad majority who cannot afford tax avoidance. Nonetheless, journalism itself seems to struggle to find a beneficial business model to ensure its survival in the future. Bastian concurs with this view, making a clear distinction: 'While journalism itself is in a crisis, investigative journalism is certainly not. We find more and more people, also young people, who are interested in this field. The collaborative approach has brought all those huge successes in the last few years. Many papers and magazines realized that they have to find a way to show the readers that they have a unique selling point, that they have something to offer that the others do not have. One of those unique selling points is ... investigative journalism.'

'Maybe all those scandals and also regulations that were revealed by journalists lead to a better consciousness and awareness in the public what it means to have a free and investigating press out there. One that is holding the richest and powerful accountable,' says Frederik. He gives a concrete example: 'An increased demand for qualitative journalism became visible with the so-called "Trump Bump" in the beginning of 2018, which led to thousands of new subscriptions and a 66 percent higher profit for the New York Times ([Financial Times, 2018](#)).

“*An increased demand for qualitative journalism became visible with the so-called "Trump Bump" in the beginning of 2018.*”

Frederik is convinced that even if the traditional papers died out, investigative journalists would continue with their work on blogs, using crowdfunding and similar means to make it possible. 'We are in a deep mud, but investigative journalists are not as deep in it as journalism itself.' He goes a step further by calling it 'The golden times of investigative journalism.' Still, their investigative team is not yet as big as they would like to have it. With seven members, they barely survive, according to Bastian: 'The moment we have at least one longer investigation ongoing, we are in a big trouble because we do not have enough resources for all that we would like to do and what our boss expects us to do. It got better but it is not yet near where we want to go in terms of numbers.'

Nevertheless, the two journalists cannot imagine switching to a profession that offers better financial reward for their proficient knowledge. If Bastian would receive an offer, for example from a consultancy firm, he would and could not accept it. 'And why should we,' says Frederik.

“*I really doubt that there is a job similarly interesting and thrilling as investigative journalism out there.*”

'Investigative journalism is such an interesting job that offers so many insights and different facets. I really doubt that there is a job similarly interesting and thrilling as investigative journalism out there.' When asked whether they can provide any insight into their current investigation they only smile, saying: 'It involves something opaque... that is all we can tell.' As it turns out shortly after this interview, the two journalists had been working on the video about Austria's Vice-Chancellor Strache, who stepped back after the publication.

# The role of investigative journalists: the need for accountability, justice and sustained EU pressure

By Tom Gibson, Committee to Protect Journalists



Source: CPJ

Remembering Jan and Martina

Within a timeframe of less than six months Europe was shocked by two brutal killings of investigative journalists in two EU Member States. Daphne Caruana Galizia, a Maltese journalist investigating government corruption, was murdered on 16 October 2017. And in February 2018 Jan Kuciak was killed in Slovakia, a murder being motivated by his investigative reporting on fraud and corruption which had also, among other things, links to alleged misappropriations of EU agricultural subsidies and connections of organised crime to Slovak politicians. Tom Gibson, the Committee to Protect Journalists' (CPJ) lead advocate in Brussels, has been following the two cases on behalf of the CPJ and below zooms in on the case of Jan Kuciak and the threats investigative journalists face.

## 'All for Jan'

In Slovakia, 'All for Jan' has become a rallying cry of great symbolism. When Jan Kuciak and his fiancée, Martina Kušnírová, were murdered on 21 February 2018, it provoked a swell of national outrage and disgust amongst Slovaks. 'All for Jan' quickly became a motto for local campaigners pushing for justice.

It could have been because Jan Kuciak was the first [journalist](#) in Slovakia to be killed in relation to his work. It could have been because he was young, had indisputable integrity, and was driven by the ideals of what quality investigative journalism could achieve for society. It could have been because the murder seemed so callous: he and his fiancée were shot dead at their house in the small town of Velká Mača, an hour's drive from Bratislava. They were at home together. They had recently been planning their marriage. It could have been because the Slovak people had had enough of the deeply ingrained corruption that had plagued the country for such a long time, and resented that a voice who had tried, in a modest and reasoned way, to raise the alarm bell had been silenced as a result.



'All for Jan' protesters

Whatever it was, Kuciak's murder created a clamour in Slovakia that continues until today. In the immediate wake of his killing, there were mass street protests, amid calls by protestors for elections. The governing SMER-SD party, linked amongst others to the corruption allegations voiced by Kuciak, became subject to a new scrutiny. National pressure led to both the Interior Minister Robert Kalinak and Prime Minister Fico [resigning](#). Police chief Tibor Gaspar subsequently [stepped](#) down .

### Investigative journalist with a transparent approach

Before his death, Kuciak had worked with the Sarajevo-based Organized Crime and Corruption Reporting Project (OCCRP) and [Aktuality.sk](#) on an investigation into the Italian mafia group 'Ndrangheta and their increased presence -and economic interests- in Slovakia, and alleged links with the country's political elite.

Before his death, Kuciak had worked with the Sarajevo-based Organized Crime and Corruption Reporting Project (OCCRP) and [Aktuality.sk](#) on an investigation into the Italian mafia group 'Ndrangheta and their increased presence -and economic interests- in Slovakia, and alleged links with the country's political elite.

The young journalist had been carefully compiling sensitive information on men considered by the Italian police as extremely dangerous . The work was very risky and -like so many investigative reporters Kuciak exposed himself on a daily basis because he believed that his work served a higher purpose. In particular, his [requests](#) for official information from the authorities meant he could easily be identified as someone who was looking into powerful figures.

### Committee to Protect Journalists

The Committee to Protect Journalists (CPJ) is an independent, nonprofit organisation that promotes press freedom worldwide. Every year, hundreds of journalists are attacked, imprisoned, or killed. CPJ defends the right of journalists to report the news without fear of reprisal.

CPJ is made up of about 40 experts around the world, with headquarters in New York City. When press freedom violations occur, CPJ mobilizes a network of correspondents who report and take action on behalf of those targeted. CPJ reports on violations in repressive countries, conflict zones and established democracies alike. CPJ's work is based on its research, which provides a global snapshot of obstructions to a free press worldwide.

Shortly after he was killed, [Aktuality.sk](#) decided to [publish](#) the story that Kuciak had been working on. His last investigation showed how the 'Ndrangheta, through their links with the Slovak political elite, and as a result of weakened state institutions, had enabled the misappropriation of EU agricultural subsidies. This investigation raised important questions in Brussels about the role that some investigative journalists take in exposing financial crime which directly affects the interests of EU institutions, as well as the extent to which the EU has the ability to uphold the rule of law -and what, if anything, institutions can do to protect journalists. But importantly, Kuciak had also been investigating the dealings of a powerful businessman, Marián Kočner -in particular in relation to suspected tax fraud linked to a luxury apartment complex in Bratislava.

This incurred hostility from the well-connected and powerful individual.

'You can be sure that I will start paying special attention to you personally, Mr. Kuciak,' Kočner reportedly [told](#) him in September 2017, as he threatened to [collect](#) information on Kuciak and his family. Despite reporting the threat to the police, it remained uninvestigated.

"It has been 44 days since I filed a criminal complaint...for the threats. And the case probably does not even have a particular cop," Kuciak [wrote](#) on his Facebook page in October 2017.

### **Justice should be served**

Many journalists in the EU know that threats they receive will not be dealt with appropriately by the authorities. Many receive so many verbal and online threats -often targeting women journalists in particular- that they start to manage the abuse without any help. It becomes a reality. But this is unacceptable and EU institutions cannot stand for this. Action is needed.

For months following the murder, progress was slow: there were reports of flailing professionalism, including the [confiscation](#) of a journalists' mobile phone, and poor communication from the authorities about the case. It was unclear if the authorities would publicly identify or charge the suspected mastermind -or masterminds. When the Head of Police was replaced in June 2018, the authorities' response improved -including reports of good cooperation with the Italian police and EUROPOL. In September, four individuals were arrested and subsequently charged with carrying out the crime.

I travelled to Slovakia in both December 2018 and February 2019 to meet the authorities to discuss the case and support journalists campaigning for justice. During these trips, the Committee to Protect Journalists received repeated verbal assurances from the authorities that justice would be served. Kočner had been detained since 2018 on separate charges that included tax fraud (in an incident unrelated to Kuciak's murder), but since his detention, there had been rumours circulating that the authorities were building a case against him. In March 2019, these reports came to fruition and Kočner was [charged](#) with ordering the murder. More recently, on 11 April, one of those arrested reportedly [confessed](#) to the actual shooting of Jan Kuciak.

However, the Committee to Protect Journalists continues to call for the investigation to be broad and far-reaching. No stone must be left unturned if there is to be full justice. This may require looking at Kočner's links with Slovakia's political and business elite. All aspects of the murder need to be considered.

### **EU's institutional stand**

In Brussels, officials face the reality that many journalists working on sensitive subjects, including financial crime and corruption, are simply not safe.

The European Parliament [established](#) a Rule of Law Monitoring Group in June 2018 to examine, amongst other things, the murders of Jan Kuciak and Daphne Caruana Galizia. Chaired by Dutch parliamentarian, Sophie In 't Veld, it conducted missions to the two countries and channeled calls for parliamentary scrutiny on what was happening following the journalist murders. A March 2019 resolution [included](#) robust calls for improved journalist protection, justice for the families and the need to address corruption and financial crime in both Malta and Slovakia.

Commissioner Jourova also [conducted](#) missions to both countries in June 2018, meeting officials, expressing concern around the cases and assessing the compliance of both countries with EU financial requirements -in relation to the reports of wrongdoing raised by both journalists.

### **Addressing threats and creating a workable climate**

There remains an important discussion about what the EU can actually do to protect investigative journalists, or push national authorities to do more.

Firstly, political leaders within EU Member States have to take responsibility for harmful comments that create a hostile environment for journalists. Former Slovak Prime Minister Robert Fico has consistently displayed aggression towards journalists. "Shall all you comedians be knocked out," he [said](#) when journalists spoke at rallies in November 2018 in memory of Jan Kuciak. In November 2016, he [called](#) journalists 'dirty anti-Slovak prostitutes'. Such type of attacks are clearly unacceptable and EU officials should always challenge them.

Furthermore, Member States' responses to addressing threats and creating a climate favourable to investigative journalists need to be prioritized. In Slovakia, the work of an expert group set up by the Ministry of Culture, to make amendments to the existing Press Act should have been a significant moment in strengthening the legislative framework to protect journalists. However, two SMER-SD politicians instead hijacked the process, [inserting](#) a controversial amendment which would require media outlets to publish replies from any politician or public official, allowing for undue interference. It remains to be seen if the law, which currently remains on hold, shall end up a squandered opportunity.

### **Investigative journalism on the institutional agenda**

After European elections, it is vital for EU officials to ensure that the protection of investigative journalists remains on the institutions' agenda. The European Commission has traditionally not interfered into concerns around Member States' press freedom compliance, citing lack of competency. However, increasingly journalists are proving that their work helps defend EU rule of law concerns and is part of a broader interest.

When a new Commission President is appointed after May elections, can we hope for a strengthened Commission mandate and the continuation of political will to ensure that journalist protection remains a priority? Journalists need political support from the institutions and the time for Brussels to commit is now.

# Fraud and corruption in the EU: top four cases in recent times

By Camilla Barlyng, Directorate of the Presidency



Source: © CasimiroPT/shutterstock.com

Fraud is obviously not only an issue for governments. Taking four recent cases as examples, Camilla Barlyng, who has studied fraud-related issues and is currently doing a traineeship at the ECA, has been looking into fraud in the private sector in Europe. The selected cases represent different types of fraud and involve various political, financial and business actors from across the continent.

## Fraud – not only an issue for governments

There are many reasons for persistence in the fight against fraud and corruption. They undermine democracy and cost a lot of money – ranging between 179 and 990 billion euros per year for the EU alone. But apart from this, and perhaps even worse, fraud erodes public trust. Robust and effective oversight mechanisms are a government's main weapon against fraud, but sometimes, unfortunately, weaknesses in these mechanisms can also be the cause of fraud.

Detecting and properly sanctioning these wrongdoings is not an easy task, as every measure put in place to tackle and prevent fraudulent activities might create new loopholes. To make matters worse, globalisation adds to this complexity, for example because of difficult cross-border litigation.

Fraud is not only an issue for governments and the public sector. It affects a broad range of industries, comes in many shades and can involve many different actors. Below I focused on four different cases, known to the general public for reasons of size, characteristics, political consequences or direct impact on people's lives.

### Case 1: Danske Bank and Nordea

According to Transparency International, Denmark is one of the least corrupt countries in the world. It has gained international recognition for its outstanding governability, healthy economy and high living standards. Surveys show that Danes are among the happiest people in the world, something experts like to attribute to a 'secret' ingredient: trust. For these reasons Denmark is probably not the first country that springs to mind when you think about fraud. Even so, the country has faced a series of money-laundering scandals within its banking system in recent years, suggesting weaknesses in the Danish oversight mechanisms.

Since 2015, two big Scandinavian banks, Danske Bank and Nordea, have been mentioned in connection with national and international investigations into illegal transactions. Allegedly, the banks were involved in different international money laundering schemes that systematically overlooked suspicious payments in specific Danish and Estonian branches. Knowing your customer was an important issue and a moving target.

Up to this time, [some €200 billion](#) in payments had flowed through the non-resident portfolio of Danske Bank's Estonian branch between 2007 and 2015. In the case of Nordea, the [Financial](#)

[Times](#) estimates that around €700 million in suspicious money flowed from Russia and former Soviet states through the bank from 2005 to 2017. In terms of effectively managing the anti-money laundering risks, both banks seem to have made some serious mistakes.

One key problem: who was responsible for external supervision? While Danske Bank is Danish, the suspicious activities occurred in the bank's Estonian branch and that context differs significantly from the Danish one. Thus, it was not clear to either the Danish or the Estonian banking supervision authorities who would or should report the detected inconsistencies to agencies with sanctioning power. The cross-border nature of the case limited cooperation and distorted oversight mechanisms, which blurred the question of final responsibility.

A similar logic applies in the case of Nordea, which does business in Denmark, Sweden and Finland. The challenge posed by cross-border supervision increased when Nordea reorganised from a subsidiary structure into a branch structure, after which it moved its legal headquarters from Sweden to Finland, a member of the European banking union, in 2018. The main problem in these situations is that it only takes money launderers a couple of seconds to complete transactions through banks in multiple countries, while it takes law enforcement years or even decades to unravel the money flow and adjust legislation accordingly.

In reaction to the scandals and the announcement of a general election, Danish lawmakers have recently agreed to strengthen financial crime fighting efforts by granting the Danish financial supervisory authority (FSA) more resources. Danske Bank and Nordea have felt the distrust of investors and customers. Shares have fallen and customers have left.

### **Case 2: Operation Marques**

In 2014, Portugal was startled by an international scheme of influence peddling, embezzlement, tax evasion, illegal campaign funds and corruption involving actors from all walks of life and sectors of society in mainly Portugal and Brazil. The scheme revolved around public officials, up to the highest level of government, rewarding construction companies with state tender contracts, and around the selling, buying and merging of state/privately-owned telecommunication companies. A big Portuguese financial institution funnelled and laundered money from Portugal and Brazil, which eventually led to the collapse of the bank in question, Banco Espírito Santo (BES). Millions of clients were left penniless and the popular saying: 'follow the money' led investigators to European, Latin American and African countries.

Another important aspect of the scandal was that it occurred in the context of the Portuguese economic crisis. In practice, it is widely recognised that there were major failures in management and supervision of financial institutions, topped with a slow, costly and unpredictable justice system. As a response to the crisis, Portugal's bailout conditions included numerous reforms of the justice system and the central bank of Portugal. Nevertheless, these measures did not prevent the collapse of several banks in 2014 and 2015, nor did it effectively reduce legal and judicial bottlenecks.

In sum, the economic and societal effects brought about by the scandal have been extensive, especially regarding the financial losses of private stakeholders. The collapse of the BES is estimated to have drained the Portuguese state of more than €5 billion and the cost continues to [increase](#).

### **Case 3: Cum-Ex Tax Scandal**

Are people that take advantage of loopholes in the legal framework criminals or clever individuals that care little about social responsibility? This is one of the main questions that haunt investigators in what has been labelled the biggest tax robbery in European history.

#### **Dividend stripping**

is a short-term trading practice, employed to gain tax advantages. The investor buys a stock shortly before a dividend has been declared with the intention of selling it immediately after the dividend is paid.

The tax rebates scheme involved private stakeholders, banks, accountancy firms, financial houses and law firms across the European Union and the United States. The aim of the scheme was to [mislead](#) governments: 'into thinking a stock had multiple owners on its dividend payday who were each owed a dividend and a tax credit.' Thus, by exploiting an interpretation of the tax code, multiple people were able to claim ownership of the same shares and thereby the right to a tax rebate. A key element in the fraudulent trading activities was that those involved took advantage of cross-border tax loopholes and shortcomings in the current systems of information exchange and cooperation between EU Member State authorities in the fields

of taxation and financial crime. Whereas the German Government had reportedly been aware of the dividend arbitrage trading schemes for years, it only informed other Member States in 2015. Similarly, Danish tax authorities failed to act on numerous warnings that the tax refund procedures were being exploited.

A central problem here is that tax laws have become very complex. In 2016, Correctiv, a German non-profit investigative journalism group, started to gather evidence and unravel the puzzle of this cross-border tax [plundering](#). Since then, governments have launched investigations into the practices of illicit tax refunds and are filing criminal investigations against alleged perpetrators. The problem is that many of these are hiding in third countries outside of the EU. In the meantime, another type of tax dodge, known as dividend stripping (cum-cum) emerged, stripping governments of even more taxpayer's money.

According to experts, for example Jacques de Larosière, Chairman of the High-Level Group on Financial Supervision in the EU, EU Member States clearly need to step up their game against illicit financial activities through a collective front that facilitates cross-border information sharing and prosecution. While the actors involved, especially banks, have felt reputational damage, politicians have steered free of responsibility. It is estimated that the Cum-Ex scheme alone has swindled Europe's taxpayers of a whopping €55 billion.

#### **Case 4: Dieseltgate**

In September 2015, the United States Environmental Protection Agency (EPA) found that the German car giant, Volkswagen (VW), had deliberately manipulated diesel emission tests in approximately eleven million cars worldwide, among these 500 000 in the United States. For years VW had been installing an illegal software in its car models to allow the vehicles to perform better in test conditions than they actually did on the road. Without the 'defeat device' the engines emitted nitrogen oxide pollutants up to 40 times above what was legal in the US. By doing so, VW systematically inflated financial gains at the expense of the environment and public health.

As emphasised in the ECA's briefing paper [The EU's Response to the "Dieseltgate" Scandal](#) (February, 2019), the European Commission's Joint Research Centre (JRC) warned in 2011 about significant inconsistencies between vehicle NOx emissions under test conditions and those observed on the road. Even though the Commission launched investigations into ways to address the issue, the problem remained unsolved, as the testing of cars continued to have several flaws and loopholes. As regards compensation, the EU's fragmented system of regulation makes it unlikely that consumers in the EU will manage to achieve similar compensation packages to those negotiated for VW's American customers. Fortunately, however, the European Parliament is currently looking into new rules to help consumers join forces to seek compensation against unlawful practices committed by companies, since other car makers were also found to have installed dubious software to adapt to testing conditions.

In 2018, VW agreed to pay more than €1 billion in fines in Germany and in the Netherlands for obtaining unfair economic advantages. The exposure damaged VW's reputation among consumers and investors and the political and economic consequences of the scandal for Germany's flagship manufacturing industry were significant.

#### **Looking Ahead**

Fraud also remains a problem in the private sector, as illustrated by the examples above. The selected cases are also interesting as they indicate that the banking and financial industries are likely to be the most affected. After all, fraud is a typical 'white collar' crime. Finally, globalisation plays a role, with deregulation in banking and finance offering countless new possibilities for fraudsters. A recurrent concern is that, while crime does not stop at borders, regulation, auditing and prosecution are limited by borders and by national regulations, rules and administrative arrangements.

Hence, compliance with social, economic and environmental rules and norms continues to be a moving target for all actors in society. Even though, the mechanisms put in place to detect and prevent financial crimes may not be enough, the cases that surfaced show that they are at least working to some extent. Enhanced international cooperation is needed to strengthen the fight against fraud and corruption.

## Foresight and audit

# De-cluttering data to make the fight against fraud more effective

By Lara Dobinson and Corinna Ullrich, European Anti-Fraud Office (OLAF)



The digital revolution offers new possibilities, but also new challenges for fraud fighters. European Anti-Fraud Office (OLAF) analysts are working on finding the best ways to exploit the huge amounts of data available to them, not only to detect but also contribute to preventing fraud. Lara Dobinson and Corinna Ullrich are heading units in (OLAF) that deal with large amounts of information.

They explain how OLAF aims to enhance its analytical capability, and improve both the connectivity of databases and the quality of data.

The issue of handling large amounts of data has been on everybody's mind lately. Getting data, mining it, sharing and protecting personal data have topped the agenda of EU leaders and regular citizens alike.

The truth is that complex organisations tend to hold huge volumes of data. However, these are often scattered across several departments and therefore underused. What institutions need are not only analytical and data management tools, but also clear plans - how can we exploit the data we have to further the goals we want to achieve? In OLAF's case, how can we be more effective in not only fighting fraud, but also in preventing it?

### Efficiency gains in operational analysis

Today's world of investigation has reached an unprecedented level of complexity due to the multitude of data sources, the variety of formats of the information and, equally importantly, the size of the data that is gathered in a case. This means that identifying entities and the links between them has become more and more problematic. In this respect, OLAF is currently working on solutions that tackle these issues in an efficient and innovative manner, both at the level of its software and its processes.

The part of the analytical process that has been subject to the most important changes in the last decade is that of collation, or assembly. The massive production and easier availability of data have turned the investigative phase of data collation into a very time consuming and resource intensive stage. The traditional methods of sorting data in a common format that can then easily be processed and extracted is, due to the increased flow of information, no longer a viable practice. This can actually paralyse investigations. Finding sufficient evidence that a fraud has been committed within the exponential increase of data has become more challenging than ever.

OLAF has therefore extensively developed its internal data analysis capacity to support the investigative function of the office. This relates to both analysing incoming data of possible investigative interest that may result in the opening of an investigation, as well as the operational analytical support assisting both investigators and, where needed, the national authorities in situations where an investigation has been referred to them.

In all these tasks, searching and dynamically presenting clear and comprehensive data is key to a better understanding of the information gathered. At the same time, data

should be ready for enrichment without affecting the raw information already gathered. The tools that OLAF is developing aim to improve operational analysis through more efficient data aggregation, better searching and retrieving of key information, extraction of all possible meanings from a single piece of information and, of course, providing the ability to pivot on a specific entity in order to obtain as much information as possible.

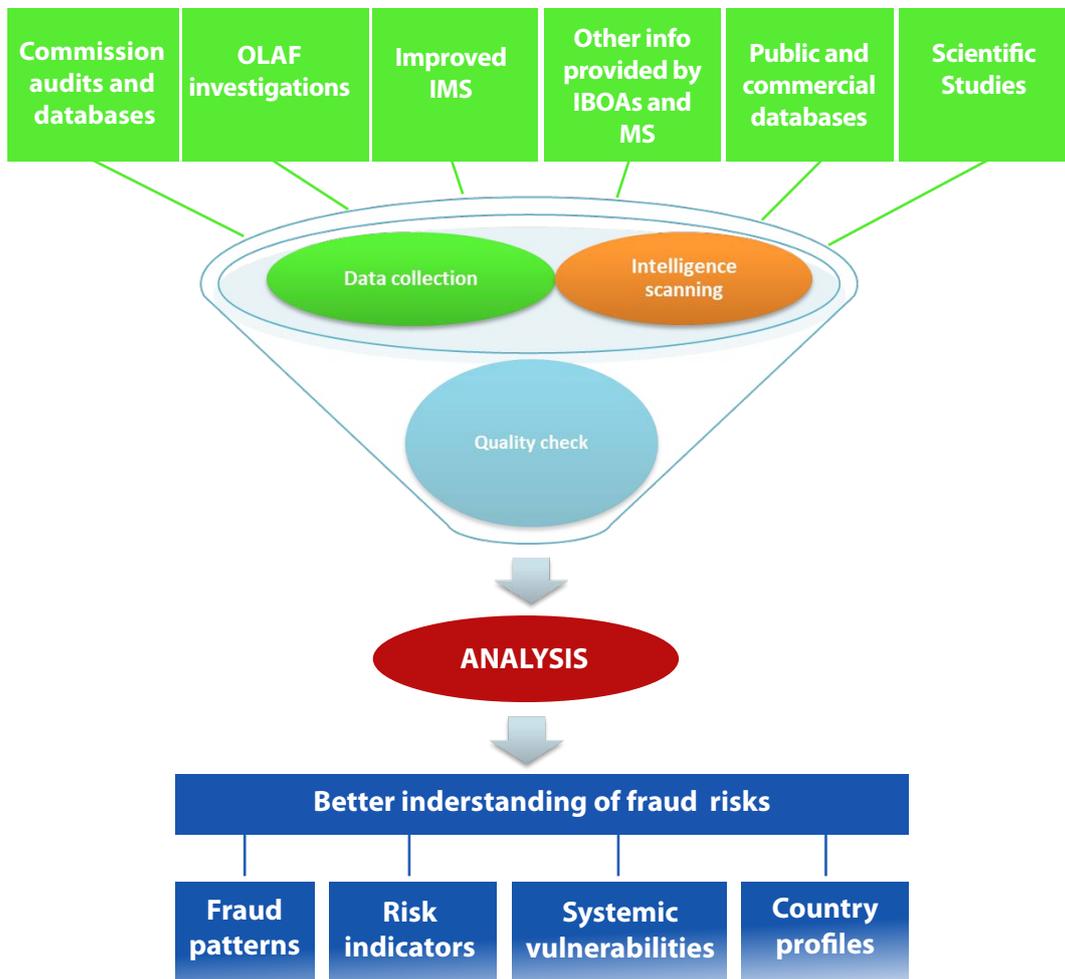
All these features aim to eliminate the risk of missing crucial information, while offering the possibility to cross-check existing entities against newly extracted ones and alert the analysts and investigators on incoming potentially interesting data. For OLAF, investigative success depends on the ability to get key fraud indicators out of the clutter of big data into a structured and searchable environment through improved data analysis tools.

### A focus on fraud prevention

In addition to its investigative work, OLAF also works closely with Member States, the other European Commission services and other EU Institutions to prevent or discourage fraud. For example, under the previous Commission's Anti-Fraud Strategy, OLAF experts had developed over the last years a system of 'red flags' which can indicate whether a particular procurement project has a higher probability of suffering from fraud or corruption. Red flags can relate to bidders (who could for example, have multiple undeclared connections between them), to evaluation teams, or to the procedures themselves (very large tenders, too short timespan for the application process, changes in the project description after the award, etc.).

**Figure -collection and analysis of fraud related data**

#### Information source:



The recently adopted new Commission Anti-Fraud Strategy (CAFS)<sup>1</sup> will take fraud prevention in the Commission to the next level, and OLAF will be the one steering its implementation. The 2019 CAFS rests on two pillars: further improved cooperation between the Commission services and an enhanced analytical capability through innovative analytical tools, higher connectivity of databases and improved data quality. The Commission commits to increasing the amount of data at its disposal and enhancing its exploitation for analysis purposes, in particular by bringing together information collected in different databases and concerning different areas of the EU budget.

These more in-depth analyses based on much broader, yet tailored data collection and intense cooperation with the relevant stakeholders will provide more meaningful information in general and in relation to specific sectors and/or Member States. In the future, through the more efficient use of data, OLAF could become not only more effective as an investigative service, but also a European center for excellence in fraud prevention and analysis.

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<sup>1</sup> COM (2018)0386

## Foresight and audit

# Big data analytics as a tool for auditors to identify and prevent fraud and corruption in public procurement

By Isabelle Adam, Government Transparency Institute, and Mihály Fazekas, Central European University and Government Transparency Institute

While, in the past, research on fraud and corruption has typically revealed only the tip of the iceberg, developments with big data analytics offer new opportunities for detecting and measuring fraud and corruption and recommending prevention measures. Isabelle Adam, analyst at the Government Transparency Institute in Budapest, and Mihály Fazekas, founder of the Institute and assistant professor in the School of Public Policy at Central European University, explain how this works. They describe the different factors at work in government contracting and the potential of e-procurement data to pinpoint specific issues that need to be looked at by policy-makers and investigators.

### Big Data analytics

With the increasing use of electronic and online administrative tools — such as e-procurement platforms — making administrative records readily and extensively available in structured databases, public procurement has become a data-rich area of public spending. This development has fundamentally reconfigured our ability to understand and govern public procurement systems, as it transforms the ways in which performance, including fraud and corruption risks, can be measured. While fraud and corruption measurement is inherently difficult and has for a long time relied on proxies such as expert surveys or institutional reviews, big data analytics offers a unique new level of precision on a scale that can be used for systemic, real-time risk assessment frameworks.

The application of big data analytics can serve as a tool for auditors to identify and prevent fraud and corruption in public procurement:

- it facilitates decisions about monitoring, audit and investigations concerning individual transactions and organisations;
- it informs country or sector-wide policy decisions on resource allocation (e.g. capacity development efforts) and regulations (e.g. on reporting thresholds or publicity requirements).

Big data analytics can help authorities to identify contracts or organisations for in-depth audit or request higher levels of reporting. For example, finance departments, regulatory agencies and anti-corruption bodies might use procurement data analytics to identify unusual or suspicious transactions for audit or further investigation, or to stake out high-risk areas for in-depth supervision. Experts have even coined new terms to describe specific uses — such as ‘audit analytics’ to refer to audit entities’ use of analytics to monitor financial transactions or test the effectiveness of internal controls and compliance procedures. Quantitative corruption risk analysis can also be applied to inform policy decisions addressing particular risks, such as measures targeting service delivery or programme performance monitoring.

### ECA Journal Short Read

**Government contracts and big data analytics** – big data in public procurement can help auditors on two levels: (1) it can facilitate decisions about monitoring, audit and investigations; (2) it can inform country or sector-wide policy decisions on resource allocation and regulations.

**Measuring corruption requires a proxy** – a ‘corruption risk index’ (CRI) has been developed, combining four observable risk indicators: (1) tendering risk; (2) political connections; (3) supplier risk; and (4) contracting body risk.

**Interpreting procurement data is difficult** – publication practices, format and data quality vary between different online publication platforms and systems, leading to a lack of transparency.

**A comprehensive, standardized dataset** – the EU-funded DIGIWHIST project has collected, standardised and republished data from 32 countries in a dataset containing about 20 million contracts from across Europe. This enables auditors to measure fraud and corruption in public procurement at unprecedented levels of precision.

## How to measure fraud and corruption in government contracts?

In the last decade, a global evidence base for corruption risk scoring using big data analytics has emerged, a range of scholars having developed objective corruption proxies which rely on behaviours directly observable in procurement data<sup>1</sup>. We have devised a concept of corruption which is tightly matched to the area of public procurement and to readily measurable institutionalised and recurrent forms of corruption. Thus corruption in the allocation and performance of public contracts means bending rules of open and fair access in order to benefit a closed network. The aim is to steer the contract to the favoured bidder without detection in an institutionalised and recurrent fashion by avoiding or biasing competition.

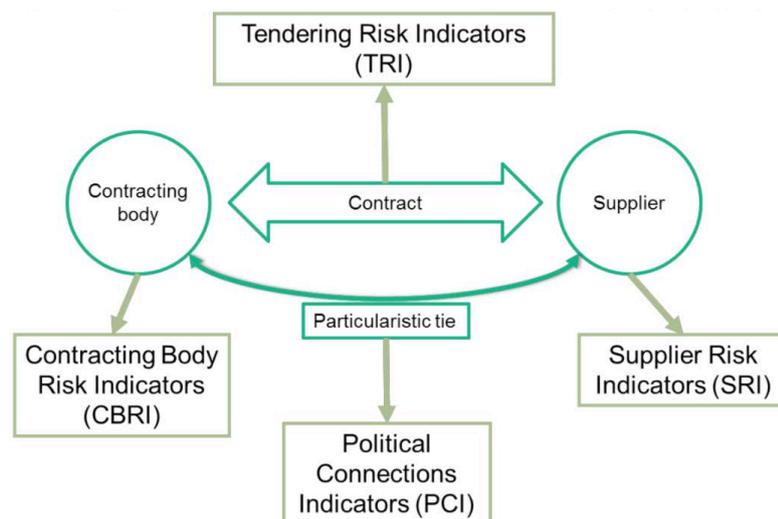
This definition implies that, when measuring corruption, its underlying logic must be contrasted with a competitive market logic. As a proxy for corruption, we propose analysing the process of awarding contracts, as well as key outputs such as number of bidders and market concentration. Crucially, lack of bidders (single bidder) is an outcome of the corruption process, whereas procedural rules that limit competition (e.g. shortening the advertising period) are inputs. The relationship between biases in the tendering process (inputs) and single bidding (output) forms the measurement model and can serve as a validity test when selecting proxy indicators for constructing a corruption risk index.

In our conceptual model, the existence of any form of corrupt contract allocation depends on at least four components:

- a) a corrupt transaction allowing for rent generation for actors involved (contract);
- b) corrupt relations underpinning collective action by corrupt groups (particularistic tie);
- c) an organisation enabling rent allocation (contracting body); and
- d) an organisation extracting corrupt rents (supplier).

These four components serve as a framework for risk assessment, leading to four groups of indicators (see **Figure 1**).

**Figure 1: Components of corrupt exchange and corresponding indicator groups**



Note: green denotes components of the corrupt scheme; grey marks the indicator groups

Source: Fazekas et al, (2018)

<sup>1</sup> For a detailed overview see Fazekas, M., Cingolani, L. & Tóth, B. (2018), [Innovations in Objectively Measuring Corruption in Public Procurement](#). In Helmut K. Anheier, Matthias Haber, and Mark A. Kayser (eds.) *Governance Indicators. Approaches, Progress, Promise*. Ch. 7. Oxford University Press, Oxford.

In each of these groups, there is a wide array of elementary corruption risk indicators which derive from proven cases and are validity tested on large-scale datasets:<sup>2</sup>

- **Tendering risk indicators** capture all micro-level aspects of tenders and contract implementation which signal corrupt manipulation of the procurement process in order to generate rents and allocate them to the connected companies, e.g. the tailoring of tender conditions to a single company in an otherwise competitive market;<sup>3</sup>
- **Political connections indicators** provide clues to the particularistic ties (e.g. kinship, friendship or professional relations) between bidders and political officeholders who are able to influence the public procurement process, some of which are established as institutionalised forms of connections such as political party financing<sup>4</sup> or lobbying;<sup>5</sup>
- **Supplier risk indicators** signal the use of winner companies as vehicles of rent extraction and the distribution and hiding of assets, the measurement of which is an inherently challenging exercise requiring companies to be evaluated in multiple dimensions, e.g. registry attributes, financial information and ownership data;
- **Contracting body risk indicators** capture weaknesses of the formal bureaucratic structures that are designed to shield contracting bodies from pressure to favour connected bidders, such as transparency index scores,<sup>6</sup> political appointment and contract approval rights,<sup>7</sup> auditing information, prosecution, budget transparency and controls, or asset declarations.<sup>8</sup>

As an objective proxy measure of high-level corruption in public procurement that operationalises the definition of corruption given above, we can combine these indicators into a composite corruption risk index (CRI). For simplicity of interpretation, the CRI is given as a simple arithmetic average of individual risk indicators, falling between 0 and 1, with 1 representing the highest observed corruption risk and 0 the lowest. It allows for consistent comparison across time and organisations and can be further validated using alternative corruption proxies.<sup>9</sup>

### Where are data and risk indicators to be found?

In the EU, public procurement is regulated by national and EU legislation, which require a generally high degree of transparency, typically through the use of online publication platforms. However, publication location, format and quality vary greatly between systems. First, publication formats typically consist of a large volume of HTML pages rather than a structured, single file dataset, which makes quantitative data analysis impossible. Second, threshold values determine whether national or EU rules apply. High-value tenders<sup>10</sup> must be advertised on the EU-wide platform Tenders Electronic

2 Fazekas, M., Cingolani, L. & Tóth, B. (2018, idem)

3 Fazekas, M., & Kocsis, G. (2017). Uncovering High-Level Corruption: Cross-National Corruption Proxies Using Government Contracting Data. *British Journal of Political Science*. Available at: <https://doi.org/10.1017/S0007123417000461>

4 OECD (2014), OECD Foreign Bribery Report: An Analysis of the Crime of Bribery of Foreign Public Officials, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264226616-en>

5 David-Barrett, E. (2011). *Cabs for Hire? Fixing the Revolving Door Between Government and Business*. London

6 Williams, A. (2015). A Global Index of Information Transparency and Accountability. *Journal of Comparative Economics* 43(3): 804–24

7 Dahlström, C., Fazekas, M., & Lewis, D. E. (2018). Agency Design and Corruption Risks: Procurement in the United States Federal Government. In APSA 2018 Annual Meeting. Boston: APSA

8 Fazekas, M., Tóth, I. J., & King, L. P. (2016). An Objective Corruption Risk Index Using Public Procurement Data. *European Journal of Criminal Policy and Research*, 22(3), 369–397

9 For a detailed explanation of CRI building using data from 28 European countries, see Fazekas & Kocsis (2017), idem.

10 For the current thresholds see: [https://ec.europa.eu/growth/single-market/public-procurement/rules-implementation/thresholds\\_en](https://ec.europa.eu/growth/single-market/public-procurement/rules-implementation/thresholds_en)

Daily (TED),<sup>11</sup> but publication practices for typically lower-value tenders on national platforms differ by country.<sup>12</sup> Thus the sources and format of procurement data vary greatly. Third, data quality often falls short of legal requirements. Key data fields such as contract value are missing for a large proportion (up to 30-40%) of tenders on many platforms (Mendes-Fazekas, 2018).<sup>13</sup>

All these obstacles create an opaque environment for practitioners, bidders and citizens. Addressing this issue, the Horizon 2020-funded project DIGIWHIST<sup>14</sup> has collected, standardised and republished data from 32 countries (28 EU Member States, Norway, Iceland, Switzerland, Georgia) and the EU institutions, using both national and EU data sources. DIGIWHIST began by building web scrapers that automatically download all public procurement announcements. Next, algorithms were developed to extract data from publication texts and map diverse national terms and formats on to a standardised data structure. Thirdly, data from the many publications relating to the same tendering process (covering e.g. corrections) was connected and consolidated. Finally, the raw data was cleaned, e.g. organisational identifiers were generated if not shown by the source.

The unified and regularly updated DIGIWHIST dataset contains about 20 million contracts from across Europe, including those republished using the global Open Contracting Data Standard (OCDS). All public contracts from all 33 jurisdictions can be downloaded on opentender.eu in a standardised and well documented data format. In addition, indicators measuring transparency, corruption risks and administrative quality have been developed and made easily analysable on opentender.eu through online dashboards (Figure 2) and search functions.

**Figure 2: Examples of dashboards for Slovakia showing market analysis visualisations**



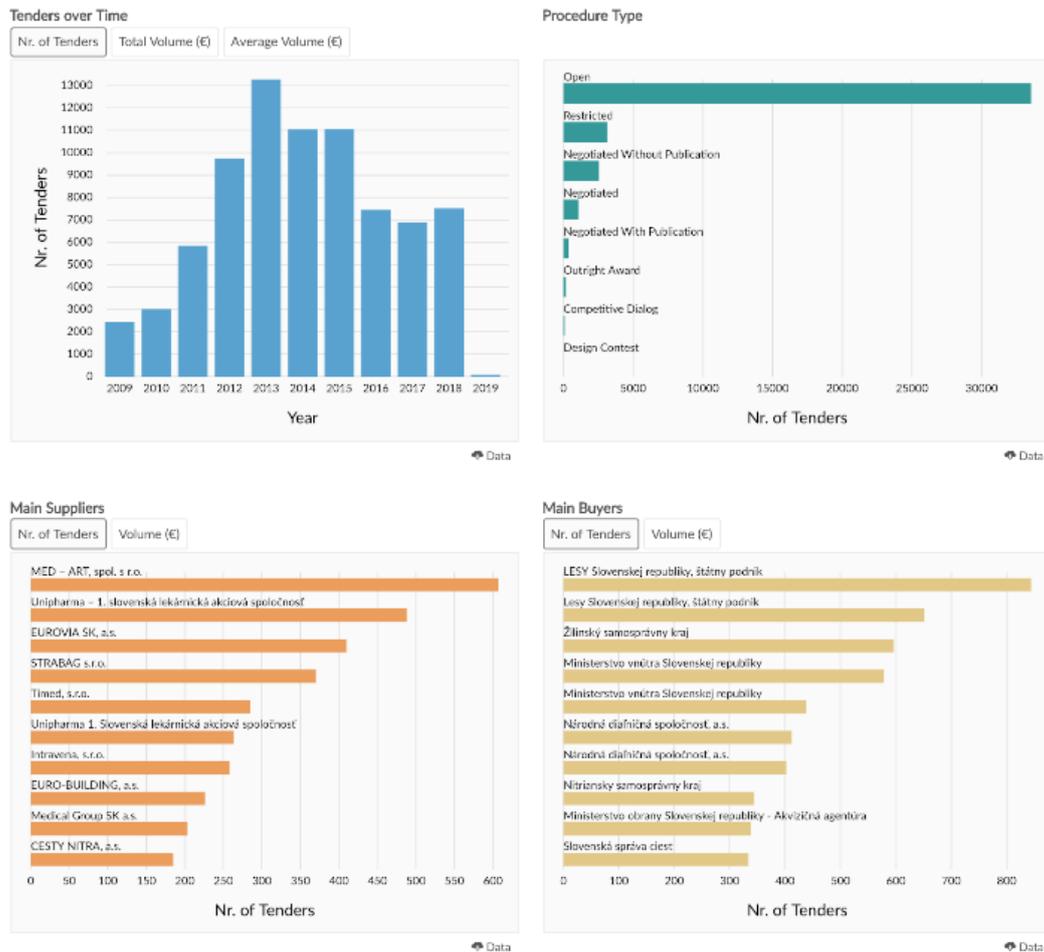
11 See <http://ted.europa.eu/TED/main/HomePage.do>

12 For a thorough and standardised mapping of national regulations see: <http://europam.eu/>

13 Mendes, M. & Fazekas, M. (2017). DIGIWHIST Recommendations for the Implementation of Open Public Procurement Data. Available at: <https://opentender.eu/blog/2017-03-recommendations-for-implementation/>

14 See <http://digiwhist.eu>

## Big data analytics as a tool for auditors to identify and prevent fraud and corruption in public procurement



Source: <https://opentender.eu/sk/dashboards/market-analysis>

### How can big data analytics be used for policy?

Big data analytics can support auditors in two principal ways:

- helping to target and conduct audits; and
- informing policy decisions on resource allocation and regulations.

We provide one brief example for each of these to showcase the power of big data in public procurement.

#### *European Investment Bank: Using big data analytics for proactive integrity reviews*

The European Investment Bank (EIB) finances projects, typically in the infrastructure sector, across the EU of over €50 billion annually.<sup>15</sup> Thousands of procuring entities manage these projects, leading to tens of thousands of contracts. To manage risks across such a large portfolio, every year the EIB screens and audits a handful of its counterparts (organisations receiving EIB loans). In this process, the Fraud Investigations Division of the EIB's Inspectorate General conducts 'proactive integrity reviews' with the aim of mitigating risks and avoiding large financial losses.

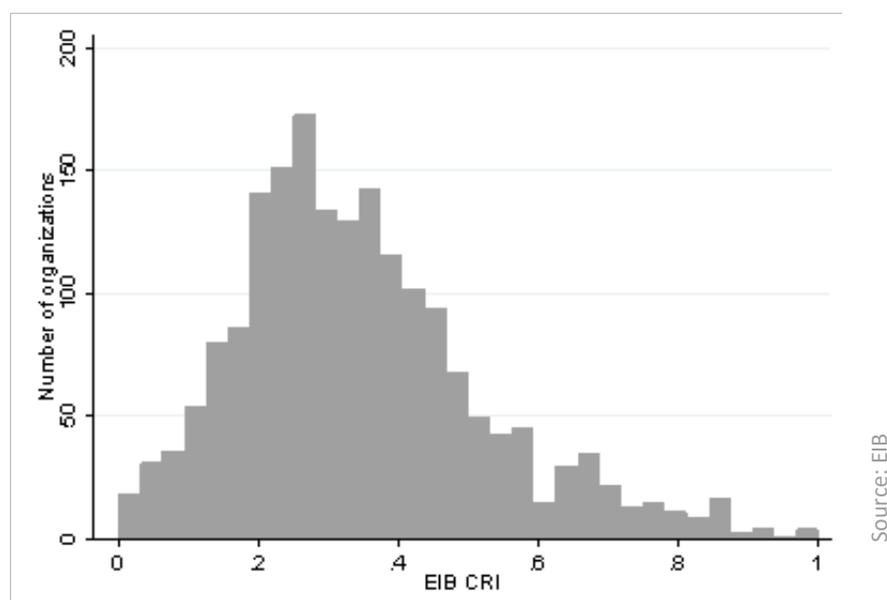
Identifying and auditing selected counterparts takes place in three main stages. Each stage makes use of a complex set of quantitative and qualitative data to review, filter and select entities for which the EIB uses data visualisation tools to facilitate the analysis

<sup>15</sup> European Investment Bank (2018). Financial Report 2017. European Investment Bank, Luxembourg

of results. In the first stage, as organisations tend to be consistent over time and across their diverse activities, a quantitative organisational profile is created using diverse data points, including all the public procurement activities of EIB counterparts and financial performance. Next, by looking at a number of quantitative risk factors, a small sample of highest-risk organisations is taken for in-depth desk research, including a review of media reports. Lastly, an even smaller sample is identified for on-site audits based on the combined qualitative and quantitative evidence.

A key component of quantitative risk-scoring tracks corruption proxies in over 500 000 government contracts made publicly available by EIB counterparts. To create a suitable database, each EIB counterpart was matched to official public procurement records collected by DIGIWHIST<sup>16</sup> across the EU. Ten different corruption risk indicators were calculated for the sample of EIB counterparts to match the specific markets of EIB spending. To help identify high-risk counterparts, individual corruption risk indicators such as single bidding were combined into a composite CRI. The distribution of EIB counterparts according to this overall risk score can be seen in.

**Figure 3: Distribution of EIB counterparts according to the EIB CRI, full sample**



Note: the highest risk entities are located on the right hand side with CRI values around 0.7-0.8. In simple terms, an organisational CRI of 0.8 means that on average an organisation's tenders present 8 out of 10 red flags which clearly indicates pervasive risks.

### *European Commission: Using big data analytics for policy reform*

Public procurement plays a crucial role in economic development and quality of government across the EU, where it accounts for about 13% of GDP. The European Commission's Directorate-General for Regional and Urban Policy (DG REGIO) has been keen to assess the quality of regional governance in Member States' public procurement.<sup>17</sup> To do so, it has developed a conceptual model in four dimensions:

<sup>16</sup> see <http://digiwhist.eu>

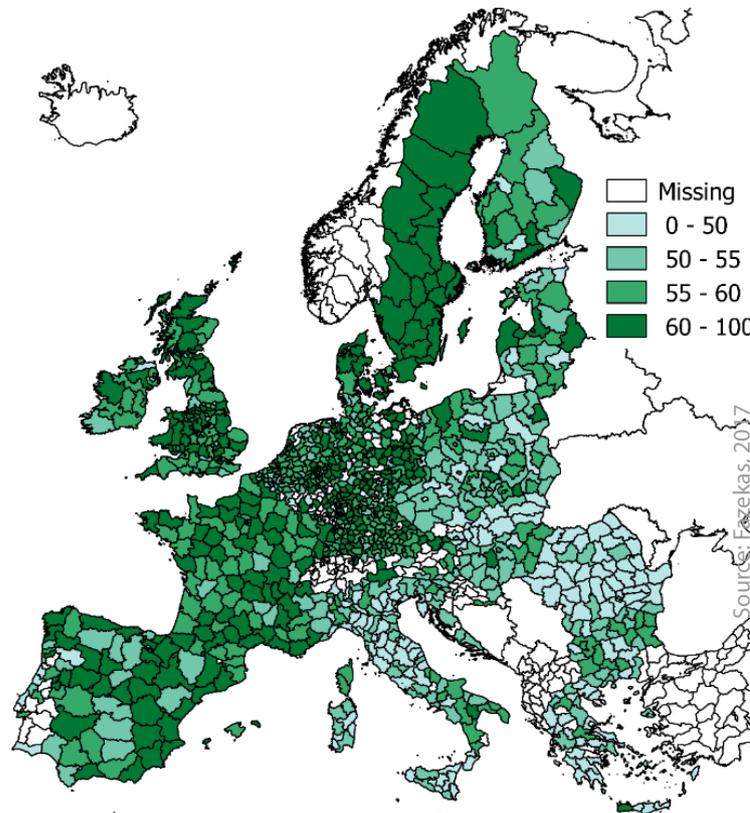
<sup>17</sup> For the full paper see: [https://ec.europa.eu/regional\\_policy/sources/docgener/work/201703\\_regional\\_pp\\_governance.pdf](https://ec.europa.eu/regional_policy/sources/docgener/work/201703_regional_pp_governance.pdf)

- transparency (e.g. amount of information published in procurement announcements);
- competition (e.g. average number of bidders);
- administrative efficiency (e.g. length of decision-making);
- corruption (e.g. use of non-open procedures).<sup>18</sup>

To calculate the indicators for each of these dimensions as well as a composite score, a database of 1.2 million contracts resulting from local/regional tenders between 2006 and 2015 was compiled from TED.

The indicators allow for a high level of resolution. For example, the NUTS3<sup>19</sup> layer can be used (see **Figure 4**) to reveal the extent of in-country variance in procurement governance, which is particularly pronounced in large federal countries such as Italy, but also in smaller countries like Greece. It also demonstrates regional similarities across national borders, such as in parts of northern Austria and the southern Czech Republic.

**Figure 4: Map of procurement good governance scores (darker colours indicate better governance performance), NUTS3, TED, 2006-2015**



DG REGIO has also used data analytics to obtain a better understanding of single bidding, which is one of the most crucial corruption risk indicators. The aim here is to identify strategic problem areas and formulate policy recommendations for Member States.<sup>20</sup>

18 Fazekas, Mihály, (2017): Assessing the Quality of Government at the Regional Level Using Public Procurement Data. WP 12/2017, Brussels: European Commission, Directorate-General for Regional Policy

19 This is the Nomenclature of territorial units for statistics, which has three sub-groups:  
NUTS1: major socio-economic regions  
NUTS2: basic regions for the application of regional policies  
NUTS3: small regions for specific diagnoses  
for more information see: [http://epp.eurostat.ec.europa.eu/portal/page/portal/nuts\\_nomenclature/introduction](http://epp.eurostat.ec.europa.eu/portal/page/portal/nuts_nomenclature/introduction)

20 Mihály Fazekas (2019) Single bidding and non-competitive tendering procedures in EU Co-funded Projects. European Commission, Brussels

Hence, explanatory models for single bidding in competitive markets have been built and can be visualised in [dashboards](#) showing data collected by the DIGIWHIST project on public procurement above and below the EU threshold for four Member States with high single bidding rates and sufficient data quality: Czech Republic, Hungary, Latvia, and Poland. The models use regression methods to identify which variables of economic fundamentals, administrative capacity and integrity are the most powerful predictors of single bidding.

- The results suggest a number of policy recommendations for lowering single bidding rates and thus reducing corruption risks:
- leveraging economic opportunities, such as aggregating demand;
- investing in the administrative capacity of procuring entities, e.g. improving the average speed of decision-making;
- strengthening public sector integrity, e.g. pursuing open tendering procedures with adequate advertisement periods rather than direct contracting.

### **Big data analytics for auditors**

In sum, we can draw a number of conclusions on the key issue of how big data analytics can serve as a tool for auditors. First, big data enables auditors to measure fraud and corruption in procurement procedures with unprecedented precision, since, as shown by the EIB example, it pinpoints individual high-risk transactions and organisations. Second, the wide scope of public procurement datasets covering 5-10% of annual GDP allows for a systematic assessment of institutional vulnerabilities, which, as shown by the DG REGIO example, can steer policy reform.

The EU-wide use of electronic procurement platforms has made the costs of real-time fraud and corruption assessment relatively low, which supports the widespread and regular use of big data tools by auditors and policy-makers.

# Reaching out

## The Hague 2: Second meeting of SAIs on accrual accounts in the public sector

By Peter Welch, Director, Sustainable Use of Natural Resources Directorate



The The Hague Pond, not far from the Glazen Zaal, meeting place of EU SAIs in February 2019

For the second year running, the Algemene Rekenkamer, the Dutch Supreme Audit Institution (SAI), invited representatives from EU SAIs to a meeting in the Hague to discuss the topical issue of accrual accounting in the public sector. So on a bright February Monday Peter Welch, ECA Director, found himself with several SAI colleagues in what he called the 'impressive surroundings' of the Glazen Zaal where the meeting took place. Peter was pleased to be invited to moderate the discussion once again and presents some of the key points raised in the meeting.

### Europe lagging behind in introducing accrual accounting

It is easy for discussions on accruals accounting in the public sector to wander into complex, technical areas. But I believe we managed to avoid this in the Hague, perhaps inspired by some words from Ewout Irrgang, (Vice-president of the Algemene Rekenkamer) when opening the meeting: 'Discussions on budgeting, accounting and financial reporting systems, cash-based or accrual, are not technical. They are about enabling decision makers – like managers, ministers and members of parliament – to consider all relevant information and to take well-informed decisions based on that information; and – ex-post – about enabling the same parties to have a meaningful accountability dialogue based on complete, true and fair information.'

All participants were from Europe, but Delphine Moretti from the Organisation of Economic Cooperation and Development (OECD) was able to bring us up to date with the wider situation on the adoption of accruals accounting. In Europe progress in adopting accruals accounting is often discussed in relation to the European Public Sector Accounting Standards (EPSAS) project (run by our neighbours in Luxembourg of the European Commission's DG Eurostat), but concrete projects often have their origins in national debates (and sometimes in International Monetary Fund recommendations). Around the world there has been a great push towards producing accruals accounts – to the extent that Europe might be seen to be making slower progress than some other regions. In general, this push towards accruals is based on applying the International Public Sector Accounting Standards (IPSAS).

Within Europe, the typical progress towards accruals has been that central government has required their use by agencies, local government and other public sector bodies, before adopting them for central government itself. Almost all European countries now either have accruals accounts for central government, or have a project to introduce them – with the key hold-outs being the Netherlands and Germany and Ireland (recently the subject of an OECD Review). The

aspirations of the EPSAS project are for 'Whole of Government' accounts (ie consolidated accounts covering the whole of the public sector). These are much harder to find.

### **Accruals enabling better parliamentary control**

One of the highlights of the day was a presentation from two Dutch parliamentarians: Joost Sneller and Bart Snels. As they explained, they represent different political parties, with Joost Sneller being part of the governing coalition, and Bart Snels part of the opposition. But they have worked together because they both see accruals as enabling better parliamentary control, more rational decision-making and better accountability. The fruit of their labour is a pilot exercise covering two government departments with a heavy role in investment decisions (Defence and Infrastructure). We look forward to seeing how this pilot exercise works out.

Much of the discussion consisted of a roundtable from the different SAIs. The Algemene Rekenkamer is preparing a concise summary of this – also taking into account the questionnaire responses they received. I will not attempt to replicate this, but to draw on some of the themes that recurred in the discussion.

A key point was the source of the standards applied. Many administrations had based their standards on an existing set of standards (in practice either IPSAS or the standards applied in the private sector in their country). A few had attempted to draw up their own standards, in part by reconciling different approaches used by different parts of the public sector in the past. At the end of the discussion, it seemed clear that using existing standards rather than adapting existing practice was the quicker and better route.

A recurring point in these discussions is the suggestion that accruals accounts mean losing cash budgeting, and the linked suggestion that cash budgets tell budgetary authorities all they need to know. Delphine Moretti made it clear that in practice most administrations who have moved to accruals accounting have retained cash budgeting – and the SAIs present confirmed this. There is a more interesting point about how useful cash budgets are. I would argue that budgets tend to focus on those areas where administrations would like to spend money, but that increasingly accrual-based balance sheets provide information on where administrations will need to spend money. Administrations using cash budgeting are better informed if they if they present the corresponding accrual information at the same time – accrual informed cash budgeting or 'if cash is king, accrual is queen' as Martin Dees of the Algemene Rekenkamer puts it.

The clearest expression of this is probably the provision for incurred pension costs (although this is a provision that some administrations who have already moved to accruals in most respects are reluctant to show on the balance sheet). But future cash flows will also be generated by decommissioning costs, and by legal cases (such as medical negligence claims). So even if cash budgets remain the first preference of most administrations, there seems to be a good case for supplementing them with some balance sheet review, and with balance sheet targeting too (i.e. proactively managing the level of liabilities).

### **Being realistic about accruals' benefits**

Advocates of greater use of accrual accounts (like myself) should to be realistic about their benefits. They do not provide a one stop solution for decision-makers: they will not, for example, warn you of the likely fiscal impact of a slowdown in the economy. And even administration who have complemented the standard financial statements with a fiscal sustainability statement seem capable of ignoring the warning signals these provide. Nevertheless, accrual based financial statements provide decision-makers and opinion-formers with vital information on the public sector.

There are several opportunities for finance ministries and public sector account preparers to discuss accounting issues. Opportunities for public sector auditors to share their views are much rarer. The Hague meetings of 2018 and 2019 have therefore provided a valuable forum for auditors. So this year's meeting ended with sincere thanks to our hosts, and a strong desire that we would find a way to continue the discussions in the future.





ECA President Klaus-Heiner Lehne's and ECA member Rimantas Šadžius' meeting with Audit Committee Chairwoman Ingrida Šimonytė and European Affairs Committee Chairman Gediminas Kirkilas

choices lie ahead. It seems very likely that the next EU budget, for the period 2021 to 2027, will be based on contributions from 27 Member States rather than 28. Although the exact timing of any change in the structure of payments remains uncertain, the principles of prudent financial management dictate that we should make provision for a budget with fewer contributors.' Adding to this, he noted that it is not up to auditors to try and predict the future. Klaus-Heiner Lehne: 'We are not economic forecasters - but it is our role to advise on sensible contingency planning!'

President Dalia Grybauskaitė highlighted the importance and need for greater transparency of the use of EU funds, which should help in strengthening the role of supervisors. She welcomed the fact that the ECA's reform increased its focus on performance audit, as this would allow a more rapid identification of potential risks and enable Member States to respond quicker to emerging problems, increase efficiency in the usage of EU funds and achievement of the goals set.'



ECA President Klaus-Heiner Lehne and President of the Republic of Lithuania Dalia Grybauskaitė

Last but not least, the delegation had a fruitful discussion on how to make best use of the EU budget with students of the Vilnius University Institute of International Relations and Political Science. The delegation also visited an EU-funded project at Vilnius University Life Sciences Centre.

### **Our future – increased emphasis on added value**

The ECA President's key message to the Lithuanian authorities and the wider public was related to the future EU budget. Klaus-Heiner Lehne: 'These are challenging times for the EU. Hard

Prime Minister Saulius Skvernelis, together with his ministers for Finance and for Transport, expressed appreciation for the ECA's approach to strengthen working relationship with national governments. When discussing the future of EU finances, they expressed concerns about finding a right balance between traditional policy areas and future challenges as well as being able to be flexible enough to respond it.

But the visit provided also the opportunity to exchange good

practices between the ECA and the National Audit Office of Lithuania (NAOL). In 2016, the NAOL launched a system to make data from its audit recommendations made in performance audit reports publicly available, with new possibilities offered on the NAOL's website. This informs citizens about how the public sector entities comply with audit recommendations, if they are carrying out the action plans for the implementation of recommendations, and if this is done in a timely manner. General Arūnas Dulkys presented the system to monitor the implementation of its recommendations.

The NAOL keeps on developing the monitoring of the implementation of recommendations. In the near future, it is planned to identify the expected audit impact, the expected changes brought about by recommendations, indicators for the assessment of changes, and deadlines for achieving changes in audit reports. Likewise,

while having finished the monitoring of recommendations of the completed audit, it will aim assess the audit impact and open even more data on the results of the monitoring of recommendations.

**Transparent follow-up**

Adequately implemented audit recommendations are key for the NAOL to make a real positive impact on the public sector governance, while publicity is one of the significant measures that may encourage the public sector institutions to act more efficiently and address weaknesses more willingly.

In order to inform the public about this follow-up, the NOAL publishes constantly updated and detailed information on the implementation of [all audit recommendations](#) on its website.

Biannual reports on the implementation of recommendations that the NAOL submits to the Parliament are mentioned as best practice in one of the OECD overviews 'Developing Effective Working Relationships between Supreme Audit Institutions and Parliaments.'

# Reaching out

## Budgetary Control Committee of the German Bundestag visits the ECA

By Roberto Gabella Carena, Directorate of the Presidency



From left to right: Andreas Schwarz, Dr. Gesine Lötsch, Klaus-Heiner Lehne (ECA), Ulla Ihnen, Axel E. Fischer, Ulrike Schielke-Ziesing, Dr Heinrich Kreft, Claudia Rathjen, Thomas Arntz (ECA), Martin Weber (ECA)

Strengthening the relations with national parliaments is one of the strategic goals of the ECA for the 2018-2020 period. On 18 March 2019, ECA President Klaus-Heiner Lehne welcomed a delegation of the Budgetary Control Committee of the German Bundestag at the ECA. Roberto Gabella Carena reports on the discussions.

### German tête-à-tête in Luxembourg

As a follow-up to last year's presentation given by ECA President Lehne at the German Bundestag, a delegation of the Budgetary Control Committee of the German Bundestag, headed by its chairman Axel Fischer, paid a visit to Luxembourg. During this one-day visit, the five Members of Parliament first met with their counterpart at the Luxembourgish parliament, the Chambre des députés, together with the German Ambassador, Heinrich Kreft.

This was followed by an exchange of views about the work of the European Stability Mechanism (ESM) with its Managing Director Klaus Regling. The visit of the delegation was concluded by a discussion with ECA President Klaus-Heiner Lehne to learn more about the work of the ECA.

#### Interest in various topics

The German Members of Parliament were particularly interested in the audit arrangements for the ESM, and the role of the ECA therein, and recent audit work, such as the 2017 special report on maritime transport, the 2018 special report on passenger rights, and the issue of outstanding commitments (or RALs – *reste à liquider*). The meeting also provided an opportunity to discuss good practices in managing and making best use of the financial support provided from the EU budget and the specific role of the national and regional audit offices (Bundesrechnungshof and Landesrechnungshöfe) in auditing EU funds.

President Lehne provided also background information on the ECA's audit approach and ECA's cooperation with the Supreme Audit Institutions (SAIs) and regional audit bodies in the Member States, including the coordination and cooperation on audits.

# Reaching out

## ECA participates in SIGMA /OECD meeting on reporting practices to increase impact

By Marton Baranyi, Directorate of the Presidency



Source: SIGMA/OECD

Participants of the 2019 SIGMA Roundtable meeting on 'Reporting practices to increase impact'

On 20 and 21 March 2019, SIGMA, the initiative to provide support for improvement in governance and management, organised 'Roundtable on reporting practices to increase impact' at the premises of the Organisation for Economic Cooperation and Development in Paris. Experts from the French Cour des Comptes, the Swedish (name) and the ECA contributed to this roundtable event by giving presentations and input into the discussions. Marton Baranyi, institutional relations officer, reports.

### Delivering on the right topic, at the right time for the right audience

SIGMA (Support for Improvement in Governance and Management) is a joint initiative of the Organisation of Economic Cooperation and Development (OECD) and the EU, primarily financed by the EU budget. As its mission statement claims, its key objective is to strengthen the foundations for improved public governance, and hence support socio-economic development through building the capacities of the public sector, enhancing horizontal governance and improving the design and implementation of public administration reforms.

The event was addressed to the Supreme Audit Institutions (SAIs) of the EU candidate and potential candidate countries (Albania, Bosnia-Herzegovina, Montenegro, North Macedonia, Serbia and Turkey) and was supported by experts from the French Court des Comptes, the Swedish National Audit Office, and the ECA. The aim of the roundtable was to discuss and share experiences on reporting practices to increase impact, since all SAIs face the challenges of how to be both more effective with their reports and increase the impact of their work. The difficult question of how to deliver the 'right report' at the 'right time' to the 'right audience' turned out to be a common challenge for all participating SAIs.

It also became clear that certain SAIs have particular challenges in certain areas when it comes to increasing the effectiveness of their reporting practices. Some SAIs mentioned internal challenges, others complained about the lack of public trust, or the lack of public understanding of the role and duties of a SAI. The following up of audit recommendations was also a significant issue: some SAIs indicated that their audit recommendations are not followed up to an acceptable degree, other SAIs updated on issued related to the follow-up of their recommendations. The role of the legislator was also highlighted several times: many SAIs mentioned that they do not have sufficient impact on the legislative work in their respective national parliaments.

### **ECA products and support aimed at improving SAIs impact**

In her welcome to the participants, Elisabeth Franco, the ECA's liaison officer, highlighted the different types of support provided by the ECA to the supreme audit institutions of the EU candidate and potential candidate countries, ranging from professional training to the ECA's specific internship programme for auditors of the SAIs concerned, and expertise provided in the framework of parallel performance audits.

Martin Weber, ECA director of the Presidency, gave a presentation on how the ECA aims at delivering the 'right' reports. He spoke not only about the ECA's programming procedure and the different inputs (such as the European Parliament's role) to the ECA audit programme, but also highlighted the new tools and ways explored by the ECA to reach out to both its stakeholders and the citizens, in order to deliver the 'right reports.' He also touched upon issues related to the ECA's diversification of its audit products in recent years, and explained how the new communication tools, the significant increase of presentations to stakeholders and the foresight methods help to increase the ECA's impact.

The event organised by Sigma was a very interesting and useful one, since it provided the opportunity to discuss common challenges faced by all SAIs regarding the results achieved by SAIs with their audit work and reports.

# Reaching out

## Auditors Alliance Meeting 2019, OECD, Paris

By Daniel Tibor, Directorate of the Presidency



On 22 March 2019, the Organisation for Economic Cooperation and Development (OECD) invited for the second time external and internal auditors to exchange at the annual Auditors Alliance Meeting in Paris. Established in 2018, this forum is meant to provide a platform for public sector auditors to share external and internal audit insights and best practises. This year's meeting included – under the theme “Auditors & Technology” – four main sessions focussing on auditing in an age of digital disruption, strategic audit analytics for safeguarding integrity, adapting to change and the use of new technologies for audit, and opportunities and risks of artificial intelligence and automating audit.

For the European Court of Auditors (ECA) Ms Magdalena Cordero (Director of Information, Workplace and Innovation) took part as panellist and presented one of the initiatives taken by the Court to respond to the challenges of adapting to change and the use of new technologies for audit: the ECA Lab. The laboratory, both virtual and physical, is meant to facilitate research and develop activities based on personal interests and initiatives of both IT experts and auditors who aim to leverage the potential of new technologies for audit, but also act as a focal point for auditors faced with a more and more digitised audit universe.

There was general agreement among the panellists that audit institutions need to properly address the risks related to the constantly increasing use of IT tools and systems on the auditees' side, if they want to stay relevant. This would i.a. require audit institutions to open up and establish interdisciplinary teams consisting of auditors, data analysts, mathematicians, statisticians, etc. On the other hand, IT can be the auditor's best friend to further strengthen accountability and control systems. There is no need for being the rabbit caught in the headlights. Or as a brave internal auditor put it: “I cannot see much disruption in the audit universe, I rather see a faster pace of evolution than we were used to.”

Thus, the lesson learned in Paris might be summarised as an imperative: demistify IT, it is not magic! Digitisation does not necessarily require an IT auditor (depending on the scope, of course), but a capable and open-minded performance auditor.

# Reaching out

## European Parliament grants discharge on the 2017 EU budget

By Helena Piron Mäki-Korvela, Directorate of the Presidency



Commissioner Günther Oettinger and ECA President Klaus-Heiner Lehne at the European Parliament in Strasbourg, on 26 March 2019

Amids a full agenda, also in view of finalising key legislation before the upcoming elections in May 2019, the European Parliament granted discharge to the Commission for the general budget of the EU during its March session in Strasbourg. Helena Piron Mäki-Korvela, senior institutional relations officer, gives an update.

### Sustained improvement in the EU's financial management welcomed

The Parliament's discharge decision closes the budgetary cycle and is a perfect opportunity to look back at what has been achieved by the Union, with the funds allocated from its budget to programmes and projects across all Member States and beyond. On 26 March 2019 ECA President Klaus-Heiner Lehne participated in a lively debate with Members of the European Parliament (EP) on the 2017 discharge at the EP plenary in Strasbourg, together with Commissioner Günther Oettinger and Minister-Delegate for European Affairs George Ciamba.

The EP rapporteur for the general budget, MEP Ines Ayala Sender (S&D), was pleased that the Court was in a position to issue again a clean opinion on the accounts and revenue, and – for the second year in a row – a qualified opinion on payments. She raised however concerns over the remaining challenges such as the use of financial instruments and trust funds, problems related to public tenders and how to deal with climate change and defence. Minister-Delegate Ciamba welcomed sustained improvement in the management of the EU budget, as evidenced by the gradual reduction of the overall estimated level of errors, while calling for further simplification of rules that lead to a more transparent and accountable use of EU funds.

Commissioner Oettinger reminded the audience of the importance of continuously working together towards better performance of EU funds. He underlined the importance of achieving EU added value and the actions taken so far to that effect. Klaus-Heiner Lehne thanked the MEPs for their support for the recommendations in the ECA special reports and urged them to use our independent audit work in the coming election as objective factual point of reference, namely our annual reports, special reports and opinions on the next Multiannual Financial Framework. He also pointed out that 'As auditors we are not here just to complain or to punish. Rather, in a constructive spirit we want to help things improve where we see the need.'

**MEP concerns on low absorption and fair public procurement**

While pointing out some success stories in the EU spending across policy areas, such as with the Erasmus+, EU assistance in Burma and the sustained improvement in the financial management of EU funds by Member States, several MEPs were concerned of the persistent errors and weaknesses found in specific areas of EU spending. In particular, they raised the issue that public procurement rules in some Member States may in some cases be circumvented, thus preventing fair competition and creating a risk to EU's financial interest. They also called the Commission to take action for tackling the mounting backlog of payments resulting from Member States' low absorption rate. MEPs also urge the Commission to remedy the currently unequal distribution of farm payments.

Immediately after the debate, MEPs voted on the detailed discharge reports for the 2017 financial year. The outcome of the vote was similar as in previous years: the EP granted discharge to the European Commission for their management of the EU's general budget, the European Development Fund, the other EU institutions and bodies, 40 EU agencies and 9 Joint Undertakings. At the same time, discharge was postponed in the case of the Council and the European Council, due to their lack of cooperation with the EP regarding its own discharge for the use of EU budget, and of the European Asylum Support Office due to shortcomings in procurement procedures.

# Reaching out

## ECA contributing to Eurofi's high-level seminar in Bucharest

By Victoria Gilson, Private Office of Rimantas Šadžius, ECA Member



The Eurofi High Level Seminar 2019

From 3 to 5 April 2019 the Romanian EU Council Presidency and Eurofi, a European think-tank dedicated to Financial Services, organised a conference to discuss the deepening of the Economic and Monetary Union and the progress made with regard to Capital Markets Union implementation. The event took place in Bucharest where more than 200 speakers and around 1000 participants from business, politics, academia, international and national authorities gathered. ECA Member, Rimantas Šadžius, was invited to speak at the conference and Victoria Gilson, assistant in Rimantas Šadžius' private office, reports on the event.

### **Eurofi's annual event in Bucharest**

Eurofi is a not-for-profit organization created in 2000. Eurofi annually organizes two major international events gathering industry leaders and EU and non-EU (Switzerland, USA, Japan) public decision makers for discussions on the major on-going regulatory projects in the financial area and the role of the financial sector in fostering growth as well as informal networking. These events are organised twice a year in association with the EU Presidencies, in parallel with informal ECOFIN councils. It is a platform for exchanges between the financial services industry and the public authorities addressing issues related to the financial regulation and supervision, and the economic and monetary context relevant for the EU financial sector, for many years chaired by Jacques de Larosière.

The main topics that were addressed in Bucharest in April 2019 were the impacts of Brexit on the financing of the EU, diversification of the financing of SME implementation of the Banking Union, priorities for implementing a Capital Markets Union and a possible evolution towards a fiscal union and further economic integration in the Eurozone. Top representatives, coming from European Union institutions, consumer representatives, academics, prominent political figures and national governmental authorities from around the globe gathered in Bucharest to debate and exchange views on the impacts for the financial sector of the economic challenges the EU is facing.

Rimantas Šadžius was invited to speak in the session dedicated to 'CMU post-Brexit.' His intervention served as a starting point for a subsequent panel discussion, with top-representatives of European business, consumers and supervisors. It grappled specifically with the subject of 'The importance of supervision for the CMU and expected impact of the agreed outcome of the ESAs review.'

### **Relation to ECA work**

Over the past few years, the ECA has been working extensively on economic governance and financial supervision issues like audits of European supervisory agencies, the Banking Union (Single Supervisory Mechanism and Single Resolution Mechanism), as well as the implementation of the Stability and Growth Pact. In the aftermath of the 2008-2009 crisis, the ECA recognised that much more is needed to promote efficiency and adequate accountability in the EU financial and economic governance, where EU institutions can and should add significant value, and convergence of national actions at Member States level is vital. In recent years, we conducted a number of interesting audits focused in these fields, e.g. on Banking Union (SSM and SRM); implementation of the Stability and Growth Pact; performance of the European Supervisory Authorities (ESAs).

One of our most recent publications examined whether European Insurance and Occupational Pensions Authority (EIOPA) effectively contributed to supervision and financial stability in the European insurance sector. The focus of the audit reflected the recent shift in EIOPA's priorities from regulation to supervision, which provided a good base for discussions. This audit manifestly showed how the EU financial market fragmentation stood in the way of reforms undertaken to secure financial stability, harmonize regulation or improve supervision. It creates a situation where supervision (or lack of it) of the entities depends solely on the legal form of a business rather than on its nature.

### **Timing and relevance**

The Capital Markets Union action plan comprises a wide range of measures aiming to further develop EU capital markets. The legislative proposals include a pan-European personal pension product (PEPP), ensuring true portability of personal pension rights, the Small and Medium Enterprises (SME) listing package, making it easier for SMEs to raise capital on public markets, and measures to facilitate the cross-border distribution of investment funds. On top of this, the Commission introduced a large number of non-legislative actions (about 60 actions). Among those, there is an ambitious Venture Capital fund-of-funds programme to increase the size of VC funds in the EU and to encourage cross-border VC activity, as well as an EU strategy on supporting local and regional capital market developments. All of those building blocks should contribute to deep and liquid, Union-wide capital markets.

The ECA is currently undertaking an audit of the progress in the European Capital Markets Union (CMU) project. Our intention is to check whether the EU has in reality delivered on its promise to diversify business financing and ease access to non-bank resources within and across national borders, in particular for smaller entities. We will also reflect on whether, by going in this direction, the EU has managed to maintain a level-playing field and sufficiently protected market participants on both – demand and supply – sides. Eurofi's seminar was one of the events that neatly contributed to this discussion.

# Reaching out

## 6th Global Audit Leadership Forum (GALF) – from small to big

By Martin Weber, Directorate of the Presidency



6th Global Audit Leadership Forum (GALF), April 7-9, 2019 Shanghai, China

In 2019, GALF moved from small to big: while last year's meeting took place in Luxembourg, as it was organised by the ECA, this year's 6th GALF was organised in Shanghai, which is one of the world's biggest urban agglomerations, with more than 24 million inhabitants. But size also mattered for the topic: Big Data. The aim of GALF is to provide a forum for informal discussions between leaders of Supreme Audit Institutions, and the ECA participated with a delegation consisting of ECA President Klaus-Heiner Lehne, Lazaros Lazarou, ECA Member, and Martin Weber, Director of the Directorate of the Presidency. Martin highlights some of the main issues discussed in Shanghai.

### 15 SAIs present at the 6th GALF

On 8 and 9 April 2019, the heads and representatives of 15 different Supreme Audit Institutions (SAIs) met for the 6th Global Audit Leadership Forum (GALF) in Shanghai, the economic and financial centre of the People's Republic of China. During these two days more than 40 delegates discussed the opportunities and challenges Big Data audits represent, as well as the approaches of the participating SAIs to making use of Big Data analysis.

### China: partner or systemic rival?

From the EU perspective, the GALF meeting came at a particularly interesting point in time: China is the EU's second-biggest trading partner after the USA, and the EU is China's biggest trading partner. In recent years, China's economic power and political influence have grown on an unprecedented scale and at breathtaking speed, making it a leading global power.

In March 2019, the European Commission<sup>1</sup> described China for the first time as a cooperation partner with whom the EU has closely aligned objectives, a negotiating partner with whom the EU needs to find a balance of interests, an economic competitor in the pursuit of technological leadership, but also as a systemic rival promoting alternative models of governance. Above all, the discussions at the 6th GALF illustrated that SAIs across the globe face many similar challenges in their work.

### **Big data: a strategic issue for SAIs transcending geographical and political borders**

In her welcoming speech, Auditor General Hu Zejun of the China National Audit Office (CNAO), underlined that Big Data auditing was a strategic choice and a big historic opportunity for the Chinese SAI. ECA President Klaus-Heiner Lehne, who, as the host of last year's GALF2, was invited to open the meeting together with this year's Chinese host, welcomed the choice of topic, as Big Data was already changing public auditing and would do so to an ever greater extent in the years to come, transcending geographical and political borders. He also informed the meeting about the ECA's future foresight initiative and its recommendations in the area of digital audit.

Big Data is omnipresent in China, and this was also evidenced in the keynote speech by Auditor General Hu Zejun, who explained that the CNAO had identified the need to make better use of IT as one of its key challenges. She also proposed three goals for this 6th GALF meeting: first, to help participating SAIs in promoting good governance and advancing ecological and environmental governance: second, to actively confront the challenges raised by the IT revolution by leveraging Big Data, and, finally, to strengthen cooperation and exchanges between SAIs for their mutual benefit.

### **Several initiatives regarding digitalisation for Big Data**

Rajiv Mehrishi, Comptroller and Auditor General of India, then presented the challenges faced by his SAI in making use of IT. He also referred to recent developments in the work of the Working Group on 'Big data' of the international Organisation of Supreme Audit Institution (INTOSAI).

Aleksei Kudrin, the recently appointed President of the Russian SAI, talked about the reforms introduced during his time as Russian Minister of Finance, aimed at digitalising tax systems and public procurement. From his new perspective as external auditor, he referred to the more than 300 different governmental IT systems used in Russia. The Russian SAI had now set up a new Department of Digitalisation to tackle the challenges in auditing these systems.

In the discussion, one of the concerns raised was the difficulty for SAIs in accessing data. The Auditor General of South Africa, Kimi Makwetu, reported that as government administrations increasingly moved towards digitalising their processes, auditors faced the risk of being left behind. The Auditor General of Australia, Grant Hehir, referred to the challenges of Big Data and the use of artificial intelligence and machine learning for compliance auditing and data protection. From the ECA perspective, Klaus-Heiner Lehne drew attention to differences between public and private auditors, where the latter had much easier access to their client's data, allowing them to audit the full data set on a continuous basis. This was, however, much more difficult for public auditors, in particular in the EU context where the ECA had to deal in its audits not only with the EU, but also with national, regional and even local administrations. One of the issues discussed was the extent to which legislative changes were required to enable SAIs to make full use of the potential offered by digital audit.

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<sup>1</sup> European Commission, Joint communication to the European Parliament, the European Council and the Council: EU-China – A strategic outlook, 12 March 2019

<sup>2</sup> For more information on the 2018 GALF, please have a look at [\(link\)](#).



The ECA delegation at the 6<sup>th</sup> GALF

From left to right: Lazaros Lazarou, Klaus-Heiner Lehne, Martin Weber

Discussions on the first day of this GALF meeting were not limited to these issues: other topics were cybersecurity, data mining, data analytics and digital reporting. And there were insights into some concrete audits, with John Ryan, the Auditor General of New Zealand, presenting a case study on how data analysis was used in an audit on mental health. The representative of the U.S. Government Accountability Office (U.S. GAO) provided some background to their strategic foresight project (see also [ECA Journal October 2018](#)) and referred to a pilot the U.S. GAO had carried out to test the potential of digital audit in the field of combating tax fraud. Also the SAIs of France, Hungary and the United Arab Emirates gave presentations of their work in this area.

**Second big discussion item: environmental auditing**

The second part of the GALF meeting had a different topical focus: environmental auditing, with contributions from the SAIs of Japan, Italy, France, Russia and India, as well as a case study performed live on stage by auditors from the CNAO acting out the exit meeting for an environmental audit in China.

The CNAO clearly set a new benchmark in organising the 6th GALF meeting. This included broadcasting images of the GALF meeting on Chinese television. And the vibrant and innovative city of Shanghai was a more than suitable setting for this conference. Next year's meeting will be hosted by the SAI of India, followed by the SAI of the United Arab Emirates.



ECA President Klaus-Heiner Lehne on Chinese television

# Reaching out

## ECA hosting a European Coordinators meeting – discussing Transport Flagship Infrastructure projects

By Guido Fara, Investment for Cohesion, Growth and Inclusion Directorate



On 9 April 2019, the European Coordinators and a delegation of European Commission and the Innovation and Networks Executive Agency (INEA) staff visited the ECA in Luxembourg. They participated in a seminar organised within the ongoing ECA performance audit on EU co-funding for Transport Flagship Infrastructure. Guido Fara, who is one of the auditors for this audit, reports.

### Flagship Infrastructure projects – European megaprojects

Transport policy has always been a cornerstone of the European integration process (for more information on EU transport policy, see ECA Journal 1/2019). In 1992, the Treaty of Maastricht introduced the concept of Trans-European Networks. These consist of networks in the fields of transport, energy and telecommunication infrastructure. Transport Flagship Infrastructure (TFI) projects have always played a key role for the transport network.

TFIs are mega projects which have a total eligible cost of 1 billion euro per project and strategic importance for the European Union, because of their relevance for the Trans-European Network for Transport (TEN-T) and the expectation that they will deliver a transformational socio-economic impact. Examples of these are Malpensa Airport in Italy or the Øresund link between Denmark and Sweden, both of which have already been completed. Other projects such as the Vitoria-Dax High Speed Line between Spain and France and the Lyon-Torino connection between Italy and France are still in their planning or implementation phase.

### TEN-T's European Coordinators

Nine Core Network Corridors were established as part of the TEN-T regulation, covering the most important long-distance flows in the network. These corridors are specifically intended to improve cross-border links within the EU and to accelerate the implementation of the networks along these axes.

To make sure these projects are implemented efficiently, the European Commission has nominated a *European Coordinator* for each of the core network corridors and also for two horizontal priorities: the European Rail Traffic Management System (ERTMS) and Motorways of the Sea (MoS).

These European Coordinators support the implementation of the network corridors or horizontal priorities. In addition, they prepare a corridor work plan and present their annual progress reports to the European Parliament, Council, Commission and Member States concerned.

### **The European Coordinator seminar at the ECA**

The ECA is currently conducting a performance audit on EU co-funding for Transport Flagship Infrastructure (TFI). This audit focuses on the role of the European Commission in ensuring that the national process leading to the construction of TFI projects is robust, transparent and in line with the EU's long term planning, as well as that EU co-funded investments in TFI are cost-efficient.

When looking at the TFI projects and at the megaprojects actually selected for the audit, it is clear that all of them represent major investments along one core network corridor. European Coordinators can therefore play a key role in the effective supervision of TFI at EU level, and, as a consequence, they are relevant stakeholders in the context of our audit work and forthcoming report.

In this context, we hosted a seminar on 9 April in which the European Coordinators and representatives of the European Commission and of the Innovation and Networks Executive Agency (INEA) staff, led by Director Herald Ruijters of the Commission's Directorate General for Mobility and Transport, took part. The delegations discussed the on-going audit work with, Oskar Herics, the ECA Member coordinating the audit Luc T'Joen, the Head of Task for the audit, and met with the audit team, and other ECA principal managers and auditors working on transport-related topics.

### **A platform for discussion**

The seminar allowed the ECA's auditors to get a better understanding of the Coordinators' views on specific projects and to present the main issues identified so far during the audit. The Coordinators, the European Commission and INEA appreciated the fact that they were able to comment on those aspects and provide clarifications on their exact role in addressing them.

In his introductory remarks, Oskar Herics emphasised that the seminar presented an innovative approach – allowing the ECA to undertake the most effective way of working. He concluded that open and direct discourse on concrete projects brought added value to all parties – to the ECA as well to the European Coordinators and the Commission - and contributed to the best possible performance of all our tasks.

There was also an exchange of views on horizontal themes, during which European Coordinators in charge of corridors where no TFI had been examined during the audit fieldwork, could also address particular concerns. Furthermore, among other topics, participants discussed recommendations of ECA Special Report 13/2017 on the European rail traffic management system.

### **Added value**

Following this seminar, both the participants in the delegation from the European Commission and the European Coordinators stressed the added value of such exchanges. In fact, these opportunities of reflection between the ECA and the Coordinators on the status of the TEN-T could ensure that sound financial management considerations are better integrated into the implementation of EU transport policy.

# Reaching out

## Jacques de Larosière visits the ECA to speak about the viability of the Eurozone

By Laura Frederika Lalikova, private office of Alex Brenninkmeijer, ECA Member



### Jacques de Larosière – an impressive career in finance

Jacques de Larosière has spent almost his entire career working for financial institutions, such as the International Monetary Fund, the Banque de France and the European Bank for Reconstruction and Development, mostly in leading positions. He also founded, in 2000, the non-profit organisation Eurofi, the European think tank dedicated to financial services. He is also well-known for the *De Larosière Report*, a report he prepared for the European Commission, advocating ambitious reforms of the supervision and regulation of financial institutions and markets in the EU in the light of the 2008-2009 financial crisis. The report helped the EU to strengthen supervisory arrangements and the review of systemic risks in the financial system.

On 30 April 2019 Jacques de Larosière, Chairman of the High Level Group on Financial Supervision in the EU, visited the ECA in Luxembourg to share his views on the Eurozone and its perspectives. Laura Frederika Lalikova, assistant in the private office of Alex Brenninkmeijer, provides insights on the main issues presented.

### Trust and the financial system

Jacques de Larosière had chosen as the main theme of his presentation the viability of the Euro (and of Eurozone) 20 years after its creation in 1999. Before going into the topic's specifics, he reflected on the relevance of external auditors in the public sector: 'Without a Court of Auditors, no country, no institution can survive. A Court of Auditors is the reminder that a public body is a body of the people. And that someone must check whether public money is utilised as it ought to be. That is indispensable everywhere and in particular in the European system.' He also referred to the role the financial system in the EU plays regarding trust, saying that the primary goals of the system were to be workable and respected, and thus trusted. He underlined that overall the Euro project had worked out well, but merely stating the good was not going to lead us towards the better. He went on to describe a number of tensions that had to be considered for the future.

### Weaknesses in the Eurozone architecture

According to Jacques de Larosière the – still - relatively recent financial crisis was said to have revealed unfortunate weaknesses in the Eurozone architecture and provided a clear warning sign about how the success or failure of the Eurozone could determine the EU's future. He explained that between 2000 and 2009 there was a remarkable divergence in economic policies. While some countries pursued very domestic-demand-driven policies, others pursued more prudent export driven policies. But eventually, the countries that allowed themselves more exuberant economic policies were penalised by a market reaction that forced those countries to adjust. In the end it was not the mechanisms of the EU that returned some form of discipline – it was the markets and private investment decisions.

### Eurozone compared with the rest of the world

Jacques de Larosière also commented on the position of the Eurozone vis-à-vis the rest of the world, saying that the EU was currently the biggest engine driving savings in the world. In fact, the total surplus of the EU was equivalent to the total deficit of the USA. In his view the EU's surplus and the channelling of it to a country like the USA was not problematic per se, but what might be problematic was that, structurally, Europe would grow more slowly than the USA. He also referred to the paradoxical situation in Europe that a country like Germany exported its surpluses to the external world, but not to those parts of the EU that were in need of more investment. He therefore called for a greater circulation of capital in Europe.

Another issue he pointed out was that, although the EIB was doing good work in re-equilibrating these capital movements, the situation in the USA was very different: while in the US 80% of the asymmetrical shocks to the economy were taken care of by capital mobility, in the EU this was close to zero. He also noted that the financial system in Europe was not under-regulated, on the contrary. Again, comparing with the USA, he observed that the US regulatory system for banks (*Dodd-Frank Act*) was in principle equivalent to the EU's with one major exception: the US system did not impose the Dodd-Frank Act on small community banks. The US recognised the importance to the small community of local banks in financing small and medium sized enterprises, and recognised that these banks were not sufficiently big and solid to meet the same regulatory requirements as larger banks.

Jacques de Larosière remarked that this most certainly was the theme one must keep in mind going forward, giving special consideration to the dual resolution system in Europe: a European system for the big systemic banks, and national systems for the small ones. In his view this had the potential to create significant tension, which was also manifested in a recently published decision of the European Court of Justice *Italy and Others v Commission* (Joined Cases T-98/16, T 196/16 and T-198/16).

One of the questions put to Jacques de Larosière was whether the issue of money laundering posed systemic risks to the Eurozone's financial sector. He indicated this was an issue that would not go away, simply because of human nature - trying to circumvent rules - amplified by the *financialisation* of the market, i.e. too much finance being around. His view was: 'This is not a game we will win without taking appropriate action.'

At the end of his lecture, Jacques de Larosière put forward three issues he considered relevant for the future of Europe:

- reducing levels of taxation on non-financial enterprises that are in the export business would cure a big part of the enormous inconsistency problem encountered today;
- the creation of a bank, alongside the European Investment Bank, that would re-channel liquid savings into equity investments;
- more effective enforcement of existing regulations, rather than adding new regulations.

He concluded that 'Europe is a great idea, and it is the only idea we have. But we must demonstrate common sense, move closer to the concerns of ordinary people, and focus less on technocratic science. We must be a Europe that people understand... Let us hope!'

# Reaching out

## ECA participates in conference on EU audit innovation in Bucharest

By Marc-Oliver Heidkamp, private office of Klaus-Heiner Lehne, ECA President



Source: Romanian Court of Accounts

Participants in the conference in Bucharest on 7 May 2019

On 7 May 2019 ECA President Klaus-Heiner Lehne and ECA Member George Pufan participated in the conference EU audit innovation and increasing the advisory role of SAIs in the benefit of society in Bucharest.. The conference was organised by the Romanian Court of Accounts as part of Romania's current Presidency of the Council of the European Union. Marc Oliver Heidkamp, attaché in the ECA President's private office, reports.

### Audit innovation and SAIs' advisory role

The conference opened with speeches by the Romanian Prime Minister, the Minister for European Affairs, the President of the Senate and the Vice-President of the Chamber of Deputies. The delegates were then also welcomed by Milhai Busuioc, President of the Romanian Court of Accounts. Several heads of EU Supreme Audit Institutions (SAIs) were present and gave presentations on the different themes discussed during the conference.

In his keynote speech, ECA President Klaus-Heiner Lehne focused on the link between audit innovation and the advisory role of SAIs. He stressed that a well-functioning public financial audit system contributes to good governance and ultimately helps to secure the rule of law. He described how the role of SAIs had evolved over time. Alongside their traditional function of financial watchdog, he noted that SAIs were increasingly being expected to provide support throughout the entire legislative process, from the making and application of laws to evaluating the performance of the underlying policies. Mr Lehne also stressed how important it was for public auditors to keep up with an increasing pace of change, and to be ready to face future challenges when they appear. It is against this backdrop that the ECA has launched its future foresight initiative, which will support and guide the day-to-day audit work of the ECA.

As an example of the advisory role a SAI can play, George Pufan presented the ECA's performance audit on the Single European Sky (SES) initiative to improve air traffic management across the EU (special report No 18/2017). He particularly focused on the recommendations made in this report to ensure that air transport remains an important component of the EU internal market, promoting the mobility of persons and goods while propelling economic growth.



Source: Romanian Court of Accounts

Klaus-Heiner Lehne and Mihai Busuioac

### **Intensive exchange between peers**

Vítor Caldeira, President of the Court of Audit of Portugal (and former ECA President), shared his views on perspectives for public-sector auditing in Europe. He identified the digital transformation as a source of unprecedented risks, but also opportunities, with new ethical questions arising. Miloslav Kala, the President of the Czech Supreme Audit Office, presented an innovative tool for SAIs, the Benchmarking Information Exchange Project (BIEP), through which SAIs could share performance data resulting from their audits. Jaakko Eskola, the Deputy Auditor General of Finland, gave an inspiring account of the digitisation of financial auditing in Finland and other imminent advances in that field. Janar Holm, the Auditor-General of Estonia, complemented this with his vision of the changing role of SAIs through the use of digital solutions. Wolfgang Wiklicky, Director General of the Austrian Court of Audit, used practical examples to show how sharing experience in public-sector auditing can benefit everyone.

Krzysztof Kwiatkowski, President of the Supreme Audit Institution of Poland, offered his view on the increasing significance of the advisory aspect of the work of SAIs. Tzvetan Tzvetkov, President of the Supreme Audit Institution of Bulgaria, addressed the question of how SAIs contribute to improving citizens' lives, and stressed the importance of performance auditing to this end. Laszlo Domokos, President of the State Audit Office of Hungary, emphasised the social dimension in the advisory work of SAIs. Lastly, Rémi Frenzt from the French Court of Accounts concluded the discussion with a critical view on the limits of performance auditing in view of the advisory nature of the mandate of SAIs, bringing together the two main topics discussed at the conference.

# Reaching out Europe Day 2019 – sharing a sense of belonging... and a cake

By Gina Wittlinger, Directorate of the Presidency



Source: Gina Wittlinger

The ECA 2019 Schuman Day team in Luxembourg, from left to right:  
Istvan Ertl, Ornella Menetto, Christelle Bianchi, Sabine Maur-Helmes, Paolo Pesce

On 9 May Europe Day is celebrated and since this year it is also a public holiday in Luxembourg. In the center of the city of Luxembourg, on the 'Place d'Armes,' the EU institutions, several Member States and a number of political parties presented themselves and provided information on their work, the EU in general and the elections in May. Gina Wittlinger, who just started her internship in the ECA, went out to experience the atmosphere, and some personal impressions.

## A European feeling...

I started a traineeship at the ECA this month and thus I am quite new to the EU environment. I took the public holiday as an opportunity to see how people in Luxembourg celebrate this special day. I understand that similar events take place in Brussels (4<sup>th</sup> May) as well as in Strasbourg (19 May). In Brussels the ECA Team was once again present at the stand in the Berlaymont building to explain what auditing EU funds and policies entails, and how the ECA contributes to making Europe an even better place. My colleagues indicated that this year's edition was a very good one, as the queues of EU citizens stretching in front of the Berlaymont, the Council and the Parliament, were still impressively large at 6 o'clock in the evening.

In Luxembourg the 9 May 2019 started gloomy. It was raining and I left my home with a feeling of apprehension on who would attend despite the weather. When I arrived on the Place d'Armes, it was, however, already quite crowded and I made my way through throngs of people, passing by the stands representing each country in the EU. I stopped at some of them and looked at the materials, usually brochures about the country and information on the elections in May this year. It seemed a lot of material and hard to relate to. The Austrian representatives had prepared a game where you could solve a riddle about the coming elections. That attracted at least some people.



The ECA Team in Brussels on 4 May 2019. From left to right: Damijan Fiser, Kevin Deceuninck, Agnese Balode, Aurélie Girault, Jean-Francois Hynderick, Martina Pellegrini

I met some friends and we moved on to try some of the food. Due to the Romanian presidency of the Council a whole area was dedicated to that theme. It was decorated in Romanian style, people were wearing traditional clothing and offering Romanian dishes. We tried some goulash and deserts with plum inside.

I spotted the ECA representatives and went to greet them. They also had prepared a quiz for people interested in the ECA, which is a good way to bring our work closer to the people. Some questions were rather hard to solve for someone who is not well acquainted with our activities. But still I spotted some groups of people trying to do so fervently to win an ECA mug.

### **...topped with a European taste**

We left not to miss the sharing of the traditional giant European cake, which has a strong symbolic meaning and closed the official part of the event. People were already queuing up to get a piece. I stood in between a group of Italians, behind me people were speaking French, German and Lëtzebuergesch. The rain had stopped, and the sun started to show itself. Everyone collected his cake and we ate it, enjoying the cake, the sunlight and the festive atmosphere.

Before leaving, I collected some opinions from others about this Schuman Day. First, I talked to a boy from Luxembourg City and asked him what this day meant to him and why he had come here. He said that Europe Day was about being together with friends and about sharing a sense of belonging no matter where you came from. He also told me that he would vote for the first time this year and had come here with that in mind to get some information.

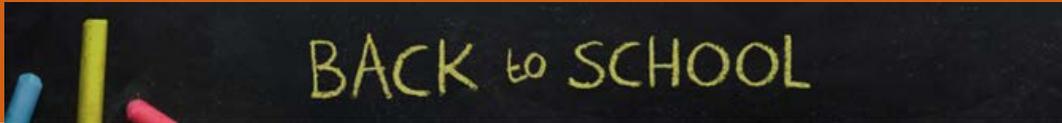
Next, I approached an elderly woman and upon my asking, she told me that she was French but living in Luxembourg. In France, she said, they instead celebrate Victory Day on the 8 May, which is rather backward looking. To her Europe Day, however, is about the future.

On my way back, I again made my way through the crowd, pondering my experiences. I came to Europe Day without any expectations and I left with the feeling that people in Luxembourg agree that 'Europe,' as we know it today, is indeed something worthy of celebrating.

# Reaching out

## ECA goes back to school – ECA auditors participating in the EU B2S programme

Ágnes Godány, Directorate of the Presidency



Explaining to EU citizens on how the EU works and what the different institutions do most often works best if done on a personal basis. The EU Back to School (B2S) programme does exactly that to the younger part of the EU population. Several people working for the ECA have participated in the programme to discuss the EU with high school students in EU Member States. The European Commission decided to extend the reach of the programme by including universities and Ágnes Godány, within the ECA the coordinator for the B2S programme, gives some insights and presents several staff impressions of participating in the B2S programme.

### Good participation levels

The EU's inter-institutional programme 'Back to School', also abbreviated as B2S, offers EU staff the opportunity to visit schools in the Member States to share their experience, and to exchange views on the EU project with young people. The programme, which the European Commission started in 2007, aims to 'give Europe a face' and to take part in discussions with school students on European issues of interest to them. Many EU colleagues from various EU institutions went back to their home country, most often to their own high school, to share experiences, explain EU issues, but also to find out what young people want and expect from Europe. The EU institutions consider the program as excellent support for promoting awareness of the approaching European Parliament election at the end-of May 2019.

The ECA has been participating in the B2S programme since 2013. 100 ECA colleagues participated in the programme, going back to the secondary schools to discuss with young people aged 14 to 19. In the second half of 2018 the European Commission, the key driver and organiser of the B2S programme, decided to extend the reach of its programme by including universities. The ECA joined the new programme labelled now as the 'Back to University' (B2U) on 1 May 2019.

For the classic B2S programme, specific training is provided for candidate 'ambassadors' to help them make the most of their visit. Also for the additional programme B2U training is developed to meet the different requirements of addressing university students.

### Reflections of some Back-to-Schoolers 2018 – 2019:

Participation levels from ECA colleagues are high, and so is their enthusiasm when they come back and to participate again in the future. People from various different places and different levels in the ECA participate: auditors, directors, translators, ECA Members, etc. Below a reflection of some of the reactions received.

#### Klaus-Heiner Lehne Lehne, President



*I am a great fan of Back to School and take part whenever I can. Going to meet schoolchildren, the upcoming generation of European citizens, is the best way to understand their preoccupations and also their expectations. They are often extremely curious and practically-minded, and they never take what I say at face value. I try to encourage them in their inquisitiveness and at the same time explain why the European Union, including its Court of Auditors, exists and why it is important in our daily lives. At the end of the day, it is our collective legacy to them, and it will be for them to shape it in the years to come, not least by becoming active participants and electing their local, national and European representatives.*

**Charlotta Torneling, Auditor**



*Explaining how the EU functions to teenagers was a good opportunity for reflection on the work we do and I found it motivating and inspiring that the students listened attentively: they were really learning something new. What made it a particularly memorable experience for me was a teacher pointed out the impact – in the sense of opening up a new perspective – it could have on students seeing someone with a similar background to theirs now working for the EU.*

**Magdalena Cordero Valdavidia, Director –**



*Back to School was a very interesting and emotional experience. It was the first time in almost 40 years that I went back to my school in Moreda de Aller in Asturias, and remembered and shared with the students my memories about the girl that I was who wanted to leave the village to change the world and how these ideas brought me to work at the European level.*

*I focused my presentation about the European Union on its solidarity projects - in the difficult moment of the refugee crisis - reminding the students how Europe had enormously transformed our mining valley in the middle of Asturias. I presented the great opportunities it offers to young people and I learnt how my school is already participating in European initiatives. A very fruitful dialogue. The session was even published in the regional newspaper. An event that filled me with pride and that I recommend to all officials.*

**Frantisek Baranec, Translator**



*The Back to school project was for me an enriching and energising experience. It meant going back in time (visiting the old school, meeting some of the former teachers) and at the same time having the possibility to share information on the EU with the next generation. Highly recommended!*

**Carl Westerberg, Auditor**



*I realised that to present oneself in person, coming from the same town and background, having made a journey to the EU, gave a high impact of the interest and attention of the students. Seeing it is possible and listening to first-hand information of the functioning of the EU is most appreciated and valuable. Therefore, I believe my Back-to-school mission did raise the awareness of the EU for the school students and brought EU closer to the periphery of far north Europe.*

**Kristina Maksinen, Auditor**



*My first B2S experience last year exceeded all my expectations. The students and teachers were welcoming and very interested in discussing and expressing their views about the EU and asking questions about my journey to becoming an official at the Court. While I had the opportunity to share my own experience, I learned even more about what they think and what matters to them. It is a rewarding experience that I would recommend to all my colleagues.*



**Joaquin Hernandez Fernandez, Auditor**

*It was great! B2S program helps students to understand that the European Union is not only Brussels and EU bodies are open to everybody (including people coming from remote small towns!). By sharing our experience, we really encourage young people to open their minds and to work abroad.*



**Raffaella Missio, Translator**

*In 2018, the B2S programme provided me with the opportunity to meet some 150 students in total in two different cities in Italy. It was a great experience that I would recommend to each and every colleague. I firmly believe that meeting people (in particular young people), explaining them our work and our challenges, and being ready to answer their questions is the best way to promote EU values: it is useful for citizens, because they realise how much they are benefitting from the EU, and it is important for us, as EU officials, because we can improve our understanding of social phenomena and be more effective in carrying out our mission.*

**Nicola Berloco, Auditor**

*B2S is not only an excellent exercise for public speaking but also a way to keep contact with my town (Altamura, Italy) and a tool to share the feeling that even my small town, although geographically distant, is very close to EU Institutions, much more than students think. Concrete examples are: the “bread of Altamura” which received by EU the PDO (Protected Designation of Origin) as “Pane di Altamura” and the “lentils of Altamura” which received the PGI (Protected Geographical Indication) as “Lenticchia di Altamura” by EU as well. In particular this year, Matera, a neighbouring town, is European capital of culture.*



**Laure Gatter, Auditor**

*For the young people I met, the EU is something completely foreign. This very humbling experience made me realise how important is it for us, EU officials, to go out and tell the future generations that they are the EU.*



**Martin Weber, Director**

*Participating in the Back-to-School initiative has been highly interesting, not the least because of the European elections at the end of May this year. Those who say that young people are not interested in EU affairs are clearly wrong. In March 2019 I returned to ‘my’ Gymnasium Neureut in Karlsruhe to discuss with around 90 students. Not an easy day, because the European Parliament had passed the EU copyright Directive the previous day; and many (mostly young) people – including many YouTuber’s - had protested against this legislative proposal. So we had a very good discussion about the market dominance of some of the social media platforms, the risks associated with upload filters, or the potential for censorship, but also how EU laws come into being, why such regulation is adopted at EU rather than at national level, about lobbying at EU and national level and how EU citizens and NGOs can participate in EU law making. These are topics that clearly matter to these students, and I must admit that I was quite impressed how well informed they were. Much more than we were during my time in school.*

**Antonella Stasia, Auditor**



*My participation in the B2S project exceeded my expectations! I wanted to show the students how they could relate to the EU, how it had made a concrete impact in their lives. And what I found was a group which was both interested and receptive. The students showed me as well the results of the work they had carried out the EU throughout the academic year. They even gave me a blue booklet, with the yellow stars of the EU flag, with a contribution from each one of them. I am definitely looking forward to repeat this experience!*

**Ramona Bortnowschi, Auditor**



*It was a great honour to discuss and promote the EU values and prospects with the young generation. In addition to the positive emotions I felt from going back to my high school, I was impressed by the pupils' open mind, broad interests and high ambitions to make a difference. I am grateful for the support received, as it allowed me to make the B2S project a valuable experience - for me and my audience.*

**Ingrid Ciabatti, Auditor**

*I had the amazing opportunity to go to both the primary school of my niece and my high school in Florence, where I was warmly welcomed by one of my former teachers, now Deputy Principal – so many emotions! It was great to raise the enthusiasm of pupils towards the EU project, give a different point of view to Eurosceptic students and instil their curiosity in what the EU does.*



**Thomas Obermayr, Head of Cabinet**



*I presented the "back to school programme" to my former school in Vienna most recently on Friday, 10 May. Personally, I want to stress that undertaking this programme presents a real "added value" - especially in light that the school was heavily interested in participating. Since around 160 students attended the event, it was even required to hold the presentation three times. There were a lot of questions arising from students' side; they appreciated the topic, even though the level of knowledge on the EU differs a lot. I find this is mostly due to the different background of the students, as they come from all over the world - from North-Africa to South America and from Middle East to China.*

*What's more, Austrians can already vote at the age of sixteen years, and the majority of the students, I met, have the opportunity to vote in the upcoming EU election (at the end of May 2019) and they have agreed to do so. I firmly believe that this sounds tempting.*

*Final point, my former school announced to report concerning this issue on its website, including publishing pictures, from the said three presentations that I have undertaken.*

**Martina Pellegrini, Project Manager**



*As the pilot project "Back to University" of the European Commission opened to other institutions as a parallel programme of Back to School, I immediately took the opportunity to fly to the University of Trieste to share my experience with the students.*

*Going back to my translators faculty was a great "flashback" of seeing me 15 years ago with a dream, of working one day for the EU, and now that this dream became true. My presentation focused on the idea that when someone really wants something, they can get it.*

*I gave an overview of my "variegated" career and shared a few tips on career opportunities, which students were very interested in hearing.*

*If you are not scared of speaking (again) in front of your old teachers, but that luckily will not evaluate your presentation, just go and enjoy spending some time with students as you were just a few years ago.*

## ECA publications in March/April/May 2019

### Special report N° 04/2019

Published on 14 March 2019



### The control system for organic products has improved, but more can be done

The control system for organic products in the EU has improved in recent years, but challenges remain, according to a new report by the European Court of Auditors. Further action is needed on remaining weaknesses in the Member States and on the supervision of imports as well as on product traceability, say the auditors.

[Click here for our report](#)

### Briefing Paper

Published on 19 March 2019



### Challenges to effective EU cybersecurity policy

Multiple challenges in strengthening EU cybersecurity remain despite the progress made, according to a new Briefing Paper from the European Court of Auditors. As the risk of falling victim to cybercrime or a cyberattack increases, it is essential to build resilience through strengthening governance, raising skills and awareness, and improving coordination, say the auditors. They also highlight the importance of meaningful accountability and evaluation to help the EU achieve its aim of becoming the world's safest digital environment.

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### Audit preview

Published on 20 March 2019



### Ecodesign and energy labelling

The European Court of Auditors is conducting an audit of EU measures for ecodesign and energy labelling of products, including household appliances. In particular, the auditors will assess these measures' contribution to the EU's energy efficiency and environmental objectives.

[Click here for our report](#)

## ECA publications in March/April/May 2019

### Audit preview

Published on 27 March 2019



### Auditors examine EU oversight of state aid to banks

The European Court of Auditors is conducting an audit of EU monitoring of public support granted to the financial sector over recent years. In particular, the auditors will examine how the European Commission ensures that aid remains exceptional and limited to what is strictly necessary. They will also assess the appropriateness and effectiveness of the procedures in place for state aid control.

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### Rapid case review

Published on 28 March 2019



### Allocation of Cohesion policy funding to Member States for 2021-2027

A new rapid case review by the European Court of Auditors published today looks at the process for determining the amount of cohesion funding available to EU countries under the next seven-year spending plan.

[Click here for our report](#)

### Briefing paper

Published on 1 April 2019



### EU support for energy storage

The EU needs better energy storage to meet its energy targets and achieve its climate objectives, according to a new briefing paper by the European Court of Auditors. The auditors identify challenges to energy storage technologies in the EU, both for the grid and transport. They warn that EU battery manufacturing capacity lags behind international competitors and might remain below the European Battery Alliance's 2025 target.

[Click here for our report](#)

## ECA publications in March/April/May 2019

### Rapid case review

Published on 2 April 2019



### Outstanding commitments in the EU budget – A closer look

The backlog of money committed under the EU budget but not yet paid out has reached a new high, which could create significant financial risks for the future, according to a new rapid case review by the European Court of Auditors. The value of payments that the European Commission will need to make was €267 billion at the end of 2017 and is set to grow further. The auditors warn that this may restrict the Commission's ability to manage future needs or settle future payment requests on time.

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### Special report No 05/2019

Published on 3 April 2019



### FEAD-Fund for European Aid to the Most Deprived: Valuable support but its contribution to reducing poverty is not yet established

The Fund for European Aid to the most Deprived (FEAD) contributes to Member States' approaches to alleviating poverty, according to a new report from the European Court of Auditors. But it still mainly funds food support and does not always target the most extreme forms of poverty. Its function as a bridge towards social inclusion still has to be demonstrated, the EU auditors stress.

[Click here for our report](#)

### Audit preview

Published on 25 April 2019



### Urban mobility in the EU

The European Court of Auditors is conducting an audit of EU action to improve the mobility of people in cities and densely populated areas. The auditors will examine how the European Commission and Member States use the EU funding available to put into action their urban mobility policies and whether the Commission provides effective support to Member States. The auditors will also assess the progress made in recent years in managing traffic congestion.

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## ECA publications in March/April/May 2019

### Annual activity report

Published on 2 May 2019



### 2018 activity report

The activity report gives a comprehensive account of the ECA's audit reports and publications, checks in Member States and non-EU countries, and its activities with institutional stakeholders – mainly the European Parliament, the Council and national parliaments - in 2018. The auditors also provide key information on their staff, management and finances, applying the same standards of transparency and accountability to themselves as they do to those they audit.

[Click here for our report](#)

### Opinion No 1/2019

Published on 15 May 2019



Concerning the proposal for regulation BC-01-2019 of the Budget Committee of the European Intellectual Property Office laying down the financial provisions applicable to the Office ('the proposed Financial Regulation')

[Click here for our report](#)

### Special report No 06/2019

Published on 16 May 2019



### Member States should step up efforts to tackle fraud in EU cohesion spending.

Despite improvements over recent years, EU Member States' efforts to tackle fraud in cohesion spending remain too weak, according to a new report from the European Court of Auditors. Member States' assessments of the effectiveness of their anti-fraud measures are too optimistic, say the auditors. Detection, response and coordination still need substantial strengthening to prevent, detect and deter fraudsters effectively.

[Click here for our report](#)

# NEXT EDITION

## Sustainable Development Goals – How can auditors contribute?

On the brink of summer, the ECA Journal will dive into the Sustainable Development Goal (SDGs), an initiative from the United Nations (UN). According to the UN, these goals are the blueprint to achieve a better and more sustainable future for all. They address the global challenges we face, including those related to poverty, inequality, climate, environmental degradation, prosperity, and peace and justice.

All EU Member States have individually committed themselves to achieve the SDGs, and in April 2019, the Council called for the implementation of the 2030 Agenda to be accelerated 'both globally and internally, as an overarching priority of the EU, for the benefit of its citizens and for upholding its credibility within Europe and globally.'



In our next issue, we will find out what the SDGs mean for the European Union, its Member States and countries elsewhere. What are the challenges, how are the SDGs linked with individual policy areas, and which initiatives have been taken to promote and implement SDGs. Furthermore, we will look into the role of auditors in ensuring the delivery of the SDGs. How they can effectively audit such long-term goals, and what audit work national and international audit institutions are doing to support worldwide sustainable development.

### Save the date: 17 JUNE 2019 ECA organises a Sustainability Forum in Brussels.

The ECA will be publishing a review on the topic of sustainability reporting in the wider EU context. During the **Sustainability Forum** on 17 June 2019, the ECA will present its review and bring together the public and private auditing sectors along with European policy makers to discuss what information stakeholders are looking for, how to deliver it efficiently, and how the auditing world can contribute to achieving the Sustainability Agenda.

If you are interested to attend please send a message to [ECA-Sustainability-Reporting@eca.europa.eu](mailto:ECA-Sustainability-Reporting@eca.europa.eu) The seminar is free but **places are limited**, so register early!



17 JUNE 2019  
#SustainabilityReportingECA



**Sustainability Reporting Forum**  
Trust, Transparency and the Role of Auditors





**EDITION  
HIGHLIGHTS**

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