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Anti-Fraud and the First level Controllers:

EC guidance and core legal issues

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Τα Προγράμματα Ευρωπαϊκής Εδαφικής Συνεργασίας (INTERREG) συγχρηματοδοτούνται από την Ευρωπαϊκή Ένωση και Εθνικούς Πόρους των χωρών, που συμμετέχουν σε αυτά
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Legal background

Article 280, par.1 of the Treaty establishing the EC:

"The Community and the Member States shall counter fraud and any other illegal activities affecting the financial interests of the Community through measures to be taken in accordance with this Article, which shall act as a deterrent and be such as to afford effective protection in the Member States".

Financial Regulation No. 966/2012

Article 59 - Shared management with Member States

2. "When executing tasks relating to the implementation of the budget, Member States shall take all the necessary measures, including legislative, regulatory and administrative measures, to protect the Union's financial interests, namely by: … (b) preventing, detecting and correcting irregularities and **fraud**".

Common Provisions Regulation No. 1303/2013 (the 'CPR')

Article 122 - Management and control systems–responsibilities of MS

2. "Member States shall prevent, detect and correct irregularities and … notify the Commission of irregularities ….and shall keep it informed of significant progress in related administrative and legal proceedings".

Article 125 - Functions of the managing authority

4. "As regards the financial management and control of the operational programme, the managing authority shall: … (c) put in place effective and proportionate **anti-fraud measures** taking into account the risks identified".

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Irregularity - Indication - Suspected fraud – Fraud

"Irregularity" means any infringement of a provision of EU law, resulting from an act or omission by an economic operator, which has or would have the effect of prejudicing the general budget of the EU.

"Indication of fraud" means irregularity considered to include bad intention.

"Suspected fraud" means **an irregularity** that gives rise to the initiation of administrative or judicial proceedings **at national level** in order to establish the presence of **intentional behavior.**

"Fraud" means any intentional act or omission relating to

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

The main factor in identifying "fraud" is **"deliberate intent"** to commit an irregularity. **The component of intentional deceit is what distinguishes fraud from** (the more general term of) **irregularity**.

An irregularity which is **submitted to a prosecution service** should always be treated as **"suspected fraud".**

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Indicative list of typical cases of irregularities described as "suspected fraud"

The **First Level Controllers** are **key actors** in the whole anti-fraud system, as **they are competent to detect suspected fraud,** in the framework of their administrative or on-the-spot verification checks.

A non-exhaustive list of cases of irregularities considered as suspected fraud includes:

- false/falsified accounts
- false/falsified (supporting) documents
- description of the facts, products, operations, goods, origin or destination that is known to be false
- presentation of applications that are known to be false
- misappropriation of funds or goods
- fictitious execution of an action, project, use or processing
- misrepresentation or falsification of the nature, quality or quantity of an action, project, product
- fictitious economic operator

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Unclear cases

In the previous cases, the deliberate nature of the irregularity is obvious, since it is clear that the legal/natural person/entity that committed the irregularity **was aware that its acts or omissions would have an impact on public funds.**

It is not always that obvious for the First Level Controllers to distinguish whether an irregularity should be considered as suspected fraud or not.

In the situations below, for example, intent should be checked **by the First Level Controllers** case by case, as the economic operator might have acted in good faith or negligently:

- Combination of incompatible aid
- Failure to present accounts or supporting documents
- Failure to complete a transaction

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Red flags

A red flag is an indicator of possible fraud or corruption. It is an element or a set of elements that are unusual in nature or vary from normal activity. It is a signal that something is out of the ordinary and may need to be investigated further.

The presence of a red flag should make **the First Level Controller** more vigilant in order **to confirm or deny that there is a risk of fraud.**

Reactivity is also of great importance. The lifting of the doubts that the flag has raised is the responsibility of the Managing Authorities.

The existence of red flags does not mean that fraud has arisen or may occur, but that the situation should be checked **by the First Level Controllers** and monitored (by the respective MA) with due dilligence.

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Fraud types

Any fraud type classification is recommended to be tailored to the specific circumstances and environment in which an organisation is working. According to ACFE (Association of Certified Fraud Examiners), fraud is divided into 3 fraud types, as a starting point for an organisation to identify which areas are vulnerable to fraud:

- **1. Intentional manipulation of financial statements** (e.g. inappropriately reported revenues)
- **2.** Any type of **misappropriation of tangible or intangible assets** (e.g. fraudulent expense reimbursements)
- **3. Corruption** (e.g. bribery, bid rigging, undisclosed conflict of interest, embezzlement).

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The "Fraud Triangle"

There are 3 elements behind the perpetration of fraud, which can be summarised as the "fraud triangle":

1. **Opportunity**: even if a person has a motive, an opportunity must be given. Slack internal control systems may give rise to an opportunity. ***The presumed likelihood of the fraud not being detected is a crucial consideration for the fraudster*.** Fraud may also occur, if controls are not applied or if persons in position of authority create opportunities to override existing controls.
2. **Rationalisation**: a person can develop a justification for himself/herself by rationalising their acts.
3. **Financial pressure, incentive or motive**: the "need or greed" factor. Pure greed can often be a strong motive. Other pressure can arise from personal financial problems or personal vices.

"Breaking the fraud triangle" is key to fraud prevention. Of the 3 elements, opportunity is most directly affected by strong internal control systems and therefore it is the element which can most easily be managed.

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A “classic” fraud scheme: forgery

The notion of forgery covers all kinds of illegal alterations to documents, including forgery, falsification, false content etc.

Falsification of documents as a means of gaining access to EU funding has been confirmed in many fraud cases. Early detection **by the First Level Controllers** would allow a quick reaction and launching of preventing measures to ensure efficient protection of the EU’s financial interests.

A forged document is a document in respect of which the truth is altered. The document does not accord with reality.

Two types of alteration:

Physical: a document may be modified physically, e.g. by crossing out of items or references, manuscript addition of information etc.

Intellectual: the content of the document does not accord with the reality, e.g. false description of services rendered, false content of a report, false signatures on an attendance list etc.

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Document forgery (2)

All types of documents provided by beneficiaries to obtain grants, to participate in a public procurement process or for reimbursement of expenditure ***may be affected by forgery*** (contracts, identity papers, CVs, bank guarantees, balance sheets, invoices, reports, timesheets, attendance lists, websites and others).

The presentation of a forged document may have consequences, including financial, on the whole project or on a part of it.

The Managing Authorities must assess the extent of the anomaly. If it is isolated, they may cancel only the ineligible costs or the invoice. Without prejudice to the national legislation in force, **they may also consider cancelling the whole funding.**

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Document forgery (3)

<u>Penal consequences</u>: Forgery of documents and the use of forged documents (notably to obtain EU funding) **constitute a criminal offence in all MS and is punishable by imprisonment.**

When faced with a document that may have been forged, **the First Level Controllers should immediately inform the Managing Authority**, without prejudice to the internal and national rules in force.

<u>Methods of detection</u>:

1. Risk-based analysis
2. Cross-checks using databases (FLC)
3. On the spot checks (FLC)
4. Coordination between managing and police/judicial authorities.

<u>Detection of forged documents requires due vigilance on the part of First Level Controllers. FLCs have to eliminate or confirm their doubts related to a document, to ensure proper handling of the file.</u>

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Document forgery (4)

Examples of forged documents:

- Unusual number of a document and lack of stamp
- Certificate with unusual number
- Different inks used in an invoice
- Invoice issued by a company operating in a sector beyond the scope of the financing
- Forged bank statements (confirmation of bank operations)
- Forged (altered) invoices
- Falsified attendance list
- Falsified hotel invoice

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Public procurement and contracting fraud

A non-exhaustive list of common and recurrent fraud schemes in the area of contracts and public procurement:

1. Corruption – bribes and kickbacks
2. Undisclosed conflict of interest
3. Collusive bidding
4. Unbalanced bidding
5. Rigged specifications
6. Leaking bid data
7. Manipulation of bids
8. Unjustified single source awards
9. Split purchases
10. Co-mingling of contracts
11. Cost mischarging
12. Defective pricing
13. Failure to meet contract specifications
14. False, inflated or duplicate invoices
15. Phantom service providers
16. Product substitution

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Detection and reporting of Fraud Risks:

The role of the First Level Controllers

The Programmes management structures developed systems, including internal working procedures that detect behavior in a timely manner, namely:

The First Level Controllers use verifications checklists, which help in detecting potential fraud indicators.

In accordance with the internal procedures, ***FLCs shall immediately inform the Managing Authority and the respective National Authority and other relevant national bodies*** (in accordance with the stipulations of the relevant legislation enforced) on a potential fraud.

Potential fraud can be detected through the entire management process of a project, starting from application, implementation and authorisation and certification of reimbursement claims.

Thank you

Unit A’
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and the «Interreg Europe» Programme

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