

Special Report

Fighting fraud in EU spending: action needed

(pursuant to Article 287(4), second subparagraph, TFEU)



EUROPEAN
COURT
OF AUDITORS

Contents

	Paragraph
Executive summary	I-X
About this audit	I-IV
What we found	V-VIII
What we recommend	IX-X
Introduction	01-09
Definition of fraud	01-03
Protecting the EU's financial interests against fraud	04-09
Audit scope and approach	10-13
Observations	14-128
The Commission's insight into the scale, nature and causes of fraud is insufficient	14-49
Data on the detected fraud level is incomplete	21-32
The Commission lacks insight into the level of undetected fraud	33-37
The Commission's analysis of fraud patterns and fraud risks is insufficient	38-46
The Commission has not analysed the causes of fraud	47-49
There are weaknesses in the Commission's strategic approach to managing the risk of fraud	50-64
Under the Commission's governance model, responsibilities are split; however, corporate oversight of fraud risk management is insufficient	52-57
There are weaknesses in anti-fraud strategies and reporting on their effectiveness	58-64

Fraud prevention has not received enough attention	65-88
The Commission recently included fraud controls in top-level spending rules	66-70
A fraud risk assessment before adopting spending rules will be required as from 2021	71-75
Better use of data for fraud prevention is needed	76-88
OLAF's administrative investigations have led to prosecution in fewer than half of cases, and resulted in recovery of less than a third of the funds	89-124
The current fraud investigation system has inherent weaknesses	94-104
Administrative recovery of funds is hindered by insufficient evidence	105-124
Putting EPPO into operation will require coordinated effort	125-128
Conclusions and recommendations	129-142
The Commission's insight into the scale, nature and causes of fraud is insufficient	131-134
There are weaknesses in the Commission's strategic approach to managing the risk of fraud	135-136
Fraud prevention has not received enough attention	137-140
OLAF's administrative investigations have led to prosecution in fewer than half of cases, and resulted in recovery of less than a third of the funds	141-142
Annexes	
Annex I — Extract of relevant legal texts	
Annex II — EU and Member State bodies involved in managing the risk of fraud	
Annex III — Recent legislative initiatives in the EU's area of the fight against fraud	

Annex IV — Events triggering Member States to report cases of fraud under criminal investigation to the Commission

Annex V — Roles and responsibilities within the Commission for the outcomes of anti-fraud actions in EU spending

Annex VI — List of references

Acronyms and abbreviations

Glossary

Audit team

Executive summary

About this audit

I Fraud refers to any intentional act or omission designed to deceive others, resulting in the victim suffering a loss and the perpetrator achieving a gain. Fraud involving public funds is often linked with corruption, which is generally understood as any act or omission that abuses official authority, or seeks to bring about the abuse of official authority, in order to obtain undue benefit.

II The Commission and the Member States have a shared responsibility to protect the EU's financial interests against fraud and corruption. The European anti-fraud office (OLAF) is currently the EU's key anti-fraud body. It contributes to the design and implementation of the Commission's anti-fraud policy and conducts administrative investigation into fraud against the EU budget. In 2020, a European Public Prosecutor Office (EPPO) will start operating, with powers to prosecute crimes against the EU's financial interests in 22 Member States.

III As fraud prevention and detection are important for the EU's financial management, we decided to undertake a performance audit on the Commission's management of fraud risk in EU spending. In particular, we examined:

- the Commission's anti-fraud strategy, its fraud prevention tools and whether it has access to appropriate data on the scale, nature and causes of fraud in EU spending;
- whether OLAF's administrative investigations have led to prosecution and recovery.

IV We also considered the arrangements for establishing the EPPO and analysed whether the new body has the potential to address the current weaknesses.

What we found

V Over the last ten years, the Commission has taken steps to fight fraud against the EU budget. In particular, it adopted the 'Commission Anti-fraud Strategy' (CAFS) in 2011, and each Directorate-General (DGs) or group of DGs implements its own operational anti-fraud strategy. The Commission has also established an 'Early Detection and Exclusion System' (EDES), and an inter-institutional panel which advises on whether to exclude economic operators from EU financing on the grounds of fraud or corruption, among other possible

reasons. Each year, the Commission presents to the European Parliament and the Council a report on the 'Protection of the Financial Interests of the Union' (the 'PIF report').

VI However, we found that the Commission lacks comprehensive information 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. Some information is available on fraud patterns and schemes used in different sectors. There is no detailed analysis to identify what causes some recipients of EU money to behave fraudulently. This lack of information reduces the practical value of the Commission's strategic plans, such as the CAFS, which has not been updated since 2011.

VII The current approach, whereby OLAF launches administrative investigations after receiving information from other sources and whereby OLAF's investigation of suspected fraud is often followed by a criminal investigation at national level, takes up much time in a considerable number of cases and thus it decreases the chances to achieve prosecution. As a result, OLAF investigations result in the prosecution of suspected fraudsters in about 45 % of cases. As for the recovery of unduly paid EU money, in a number of cases, the DGs find that OLAF's Final Reports do not provide sufficient information to serve as a basis for initiating the recovery of unduly disbursed funds. In such cases, the DGs take (or outsource) further action in order to decide whether it is possible to recover the amount recommended by OLAF or they rely on evidence gathered through their own audits.

VIII We consider establishing the EPPO (in which 22 Member States will participate) to be a step in the right direction, but the current regulation poses several risks. Probably the most serious of these concerns the detection and investigation, which will be carried out primarily by the Member States' investigators under the authority of the EPPO. The regulation does not put in place any mechanism enabling the EPPO (or any other EU body) to urge Member State authorities to allocate resources to the pro-active work necessary for the investigation of fraud in EU spending, or to the cases handled by the delegated prosecutors. Another risk is that the extensive internal consultation and translation needed for the EPPO chambers' work may end up taking too long for criminal procedures, where time is very often the most limited resource.

What we recommend

IX Based on these observations, we consider that more drive and leadership is needed in the EU to take real action against fraud in EU spending. We therefore consider there is a clear need for the Commission, in cooperation with the Member States, to step up its fight against fraud in EU spending.

X The Commission should:

Recommendation 1: put in place a robust fraud reporting system, providing information on the scale, nature and root causes of fraud.

Recommendation 2: to achieve better coordination in tackling fraud, within the context of collegial responsibility for fraud prevention and detection, ensure that strategic fraud risk management and fraud prevention would be clearly referred to in the portfolio of one Commissioner; and adopt a new comprehensive anti-fraud strategy based on a comprehensive analysis of fraud risks.

Recommendation 3: intensify its fraud prevention activities. In particular, the Commission should:

- ensure that DGs use the early detection and exclusion system in direct and indirect management and call on the Member States to identify and flag fraudulent economic operators and the private individuals linked to them;
- urge all Member States to make active use of the ARACHNE database to prevent fraudulent and irregular use of EU funds.

Recommendation 4: reconsider OLAF's role and responsibilities in combatting fraud in EU spending in light of the establishment of the EPPO. In particular, the Commission should propose to the European Parliament and the Council measures to give OLAF a strategic and oversight role in EU anti-fraud action.

Introduction

Definition of fraud

01 Fraud¹ generally refers to any intentional act or omission designed to deceive others, resulting in the victim suffering a loss and the perpetrator achieving a gain. For example, if a grant beneficiary tries to intentionally mislead the funding provider in order to claim unjustifiably high expenditure, then that is fraud.

02 Fraud involving public funds is sometimes linked with corruption²³, which is traditionally understood as any act or omission that abuses official authority, or seeks to bring about the abuse of official authority, in order to obtain undue benefit. For example, if a grant beneficiary bribes an official to accept unduly high expenditure, then both fraud and corruption have been committed.

03 Irregularity⁴ 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, what differentiates fraud from other irregularities is malicious intent on the part of the perpetrator.

Protecting the EU's financial interests against fraud

04 Article 325 of the Treaty on the Functioning of the European Union (TFEU) provides a legal basis for protecting the EU's financial interests against fraud, corruption and other illegal activities (***Annex I***).

¹ See the legal definition in Article 3 of 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 (the PIF Directive).

² See recital (8) of the PIF Directive.

³ See the legal definition in Article 4 of the EU Directive 2017/1371 (PIF Directive).

⁴ Article 1(2) of Council Regulation (EC, Euratom) No 2988/95.

05 The European Commission must take the necessary measures to provide reasonable assurance that irregularities (including fraud) in the use of the EU budget are prevented, detected and corrected⁵. It shares this responsibility with Member States in the domain of shared management, e.g. in the Cohesion and Agriculture spending areas.

06 The ‘Directive on the fight against fraud to the Union's financial interests by means of criminal law’ (the ‘PIF Directive’)⁶ provides for harmonised definition of offences affecting the EU’s financial interests as well as penalties and statute of limitations for such cases. This Directive was adopted on 5 July 2017. Member States have to implement it into national law by July 2019⁷.

07 There are a large number of players involved in managing the risk of fraud against the EU budget, both at EU and Member State level (**Annex II**). The main ones are:

- The **European Anti-Fraud Office** (known by the abbreviation of its name in French **OLAF** - ‘Office européen de lutte antifraude’) is currently the EU’s key anti-fraud body. It contributes to the design and implementation of the Commission’s anti-fraud policy. It is the only body with independent investigative powers at EU level⁸.
- The **Commission's Directorates-General (DGs) and Executive Agencies** are responsible for setting up effective fraud risk management systems in the different areas of the EU budget.
- In shared management, **Member State programme authorities** are required to implement an adequate anti-fraud framework. Criminal investigation and prosecution are likewise entirely under the responsibility of the **national judicial authorities**.

⁵ See Article 32 of Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union (the Financial Regulation).

⁶ See Article 3 of the PIF Directive.

⁷ See Article 17 of the PIF Directive.

⁸ Article 1(2) of Regulation (EU, Euratom) No 883/2013 of the European Parliament and of the Council of 11 September 2013 concerning investigations conducted by the European Anti-Fraud Office (OLAF) and repealing Regulation (EC) No 1073/1999 of the European Parliament and of the Council and Council Regulation (Euratom) No 1074/1999.

- o In October 2017, twenty Member States⁹ decided to establish the **European Public Prosecutor's Office ("the EPPO")**. There are 22 Member States currently participating in the EPPO. This will be an EU body with powers to investigate and prosecute crimes against the EU's financial interests. Under Article 120(2) of the EPPO Regulation¹⁰, the body will not start operating earlier than three years after the date on which the Regulation enters into force, i.e. not before the end of 2020.

08 The European Court of Auditors (ECA) is the EU's independent auditor. We examine whether all revenue has been received and all expenditure incurred in a lawful and regular manner and whether the financial management has been sound. If, during our work, we identify cases of suspected fraud, we report these cases to OLAF for preliminary analysis and possible investigation¹¹.

09 Finally, under Article 325(4) of the TFEU, the ECA must be consulted on any measures to be adopted by the legislator in the fields of the prevention of and fight against fraud affecting the EU's financial interests. In recent years, the Commission has published several legislative proposals linked to the subject of this audit ([Annex III](#)). We have issued our opinion on some of these proposals¹².

⁹ Austria, Belgium, Bulgaria, Croatia, the Czech Republic, Cyprus, Estonia, Finland, France, Germany, Greece, Italy, Latvia, Lithuania, Luxembourg, Portugal, Romania, Slovakia, Slovenia, and Spain. The Netherlands and Malta have joined the EPPO in the course of 2018.

¹⁰ Council Regulation (EU) 2017/1939 of 12 October 2017 implementing enhanced cooperation on the establishment of the European Public Prosecutor's Office ('the EPPO').

¹¹ See paragraphs 1.35 and 1.36 of our 2016 Annual Report.

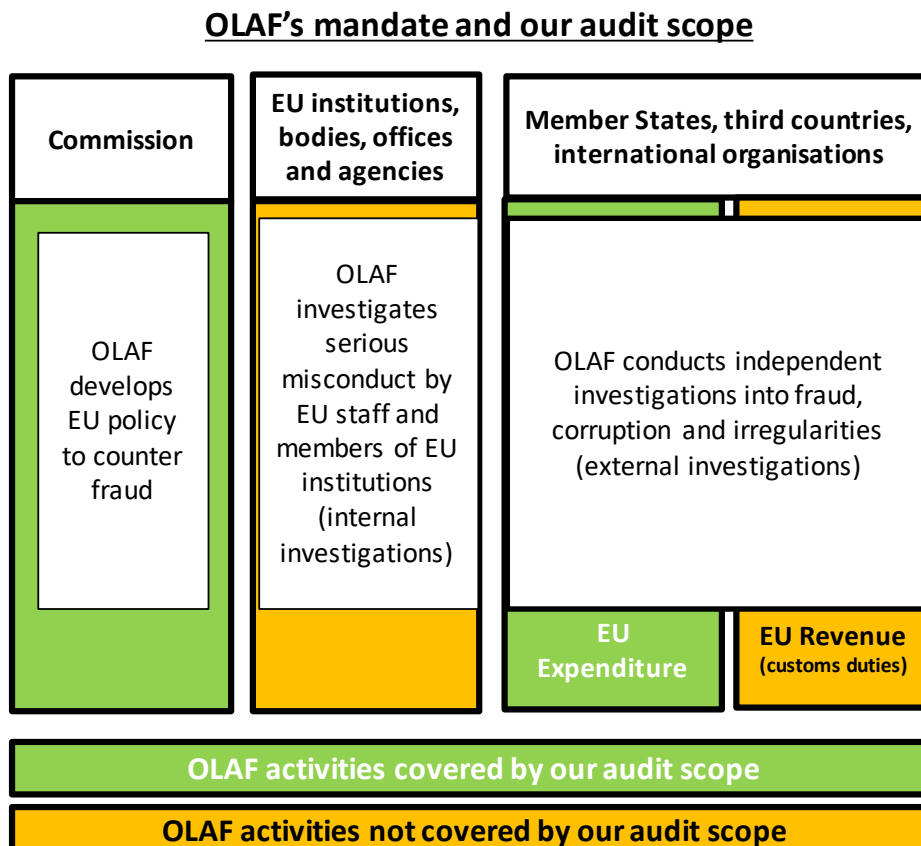
¹² See ECA Opinion No 1/2018 concerning the proposal of 2 May 2018 for a regulation of the European Parliament and of the Council on the protection of the Union's budget in case of generalised deficiencies as regards the rule of law in the Member States; ECA opinion No 9/2018 concerning the proposal for a regulation of the European Parliament and of the Council establishing the EU Anti-Fraud Programme; ECA opinion No 8/2018 concerning the proposal of 23 May 2018 on amending OLAF Regulation 883/2013 as regards cooperation with the European Public Prosecutor's Office and the effectiveness of OLAF investigations.

Audit scope and approach

10 Our audit assessed whether the Commission is properly managing the risk of fraud in EU spending. In particular, we examined:

- whether the Commission properly assesses the scale, nature and causes of fraud in EU spending;
- whether the Commission has an effective strategic framework for managing the risk of fraud;
- whether the Commission focuses sufficiently on preventing fraud;
- whether OLAF's administrative investigations lead to prosecution and recovery.

Figure 1 – Our audit scope for OLAF



Source: ECA.

11 We also considered whether the EPPO is likely to address the weaknesses we identified in the current set up of combating fraud in EU spending.

12 Our audit focused purely on fraud in EU spending. We covered all major EU spending areas (Agriculture, Cohesion, Research and External Actions). We focused mainly on the Commission's actions to prevent and respond to detected fraud. We did not examine OLAF's investigations into EU revenue. Regarding OLAF's external investigations, we focused on financial and judicial recommendations, because these are its main outputs¹³. Nor did we examine internal investigations against officials or other EU employees, members of institutions or bodies, or heads of offices or agencies.

13 We based our observations on the following sources of evidence:

- (a) analysis of relevant documentation (Commission and OLAF documents, ECA reports, relevant studies and research) and databases (i.e. IMS and Arachne);
- (b) interviews with OLAF officials and officials from seven spending DGs (DG AGRI, DG EMPL, DG REGIO, DG RTD, DG DEVCO, DG CNECT and DG HOME), as well as DGs and other internal services playing an important role in the Commission's oversight of fraud risk management (OLAF supervisory committee, SEC GEN, DG BUDG, and IAS);
- (c) interviews with bodies external to the Commission, such as Europol and Eurojust;
- (d) visits to Anti-Fraud Coordination Services (AFCOSs), public prosecutors' offices and relevant ministries in four Member States (Bulgaria, Berlin and Brandenburg in Germany, Rome and Perugia in Italy and Poland);
- (e) a survey sent to 28 Member States' Supreme Audit Institutions (SAIs), 23 of which replied; a survey sent by Europol in the framework of this audit to their 28 national contact points, 13 of which replied;
- (f) contributions from 15 experts (criminologists, legal and social scientists, prosecutors) who provided input and advice throughout the audit and commented on our preliminary findings.

¹³ Under the Commission's fraud preventive actions, we also covered OLAF's administrative recommendations.

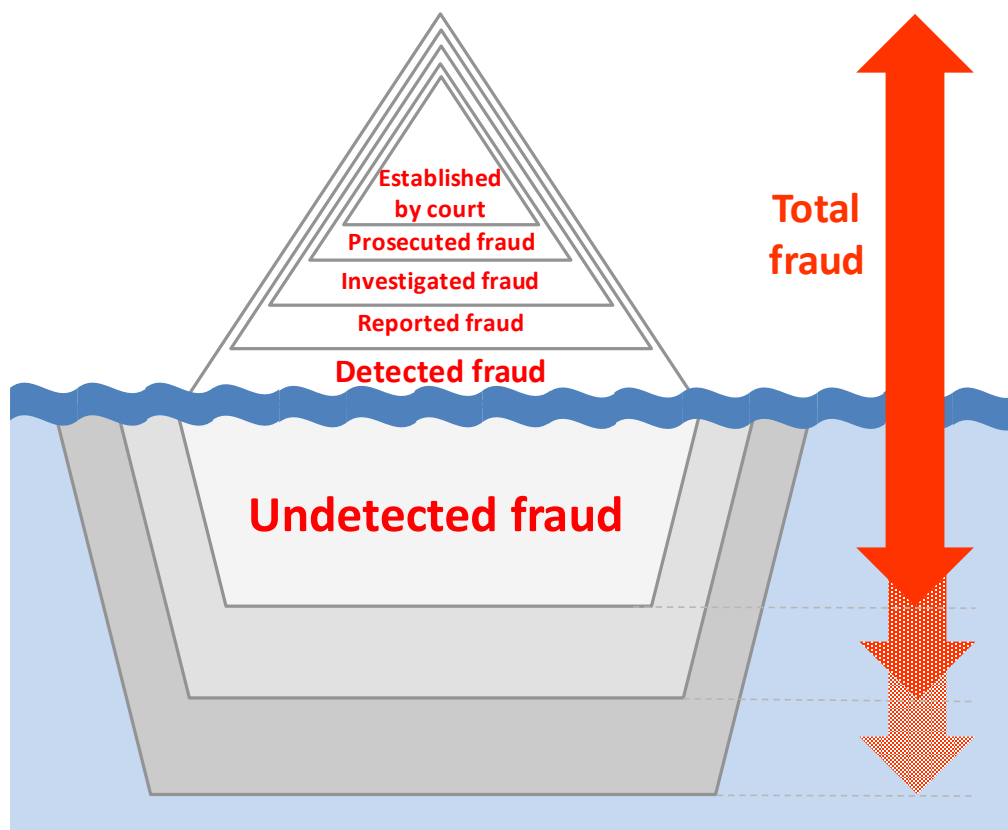
Observations

The Commission's insight into the scale, nature and causes of fraud is insufficient

14 Fraud measurement is the first step in a properly designed and implemented approach to countering fraud. Without good core data on fraud, it is more difficult to plan and monitor anti-fraud actions.

15 Fraud against corporately managed funds, such as EU money, is a hidden crime, meaning that it cannot be discovered without ex-ante or ex-post checks undertaken specifically for this purpose. Since such checks cannot be comprehensive and are not always productive, some cases remain undetected. This is compounded by the lack of any individual victims of fraud against corporately managed funds who would report such crimes and bring them to the attention of the relevant authorities. **Figure 2** represents undetected fraud and the stages between the detection of a case of suspected fraud and the establishment of fraud by a court.

Figure 2 – Levels of fraud

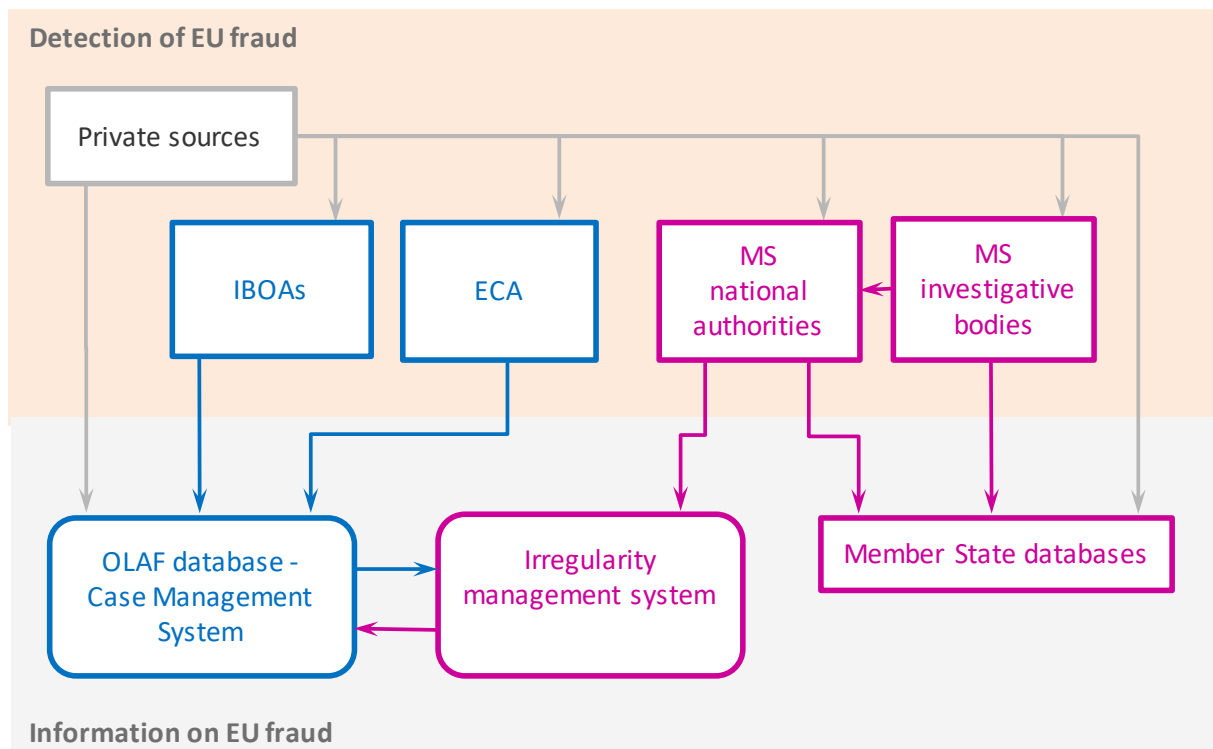


Source: ECA.

16 Because of its hidden nature, the phenomenon of fraud cannot be estimated purely on the basis of official statistics on reported and investigated cases. Sociological research methods could provide additional useful insights into the scale and nature of the problem.

17 In relation to EU spending, information on the detected fraud level is recorded within three different databases (**Figure 3**).

Figure 3 – Information on detected fraud



Source: ECA.

18 OLAF – as the EU’s key anti-fraud body – is responsible for collecting and compiling statistics and information on fraud in EU spending on behalf of the Commission. Member States and candidate countries are legally¹⁴ obliged to report to OLAF, as part of the Commission, all major cases of irregularities that they have detected in EU revenue (Traditional Own Resources) and expenditure (Cohesion, Agriculture and Pre-accession funds). They are also obliged to report whether these irregularities give rise to administrative or judicial proceedings initiated at national level to establish whether

¹⁴ The relevant provisions are Article 122(2) of Regulation (EU) No 1303/2013; Article 50(1) of Regulation (EU) No 1306/2013; Article 30(2) of Regulation (EU) No 223/2014; Article 5(5) of Regulation (EU) No 514/2014; Article 21(1)(d) of Regulation (EU) No 1309/13.

behaviour was intentional (suspected fraud) or whether fraud has been established by a definitive court decision (established fraud). Thus, Member States and candidate countries must first register an irregularity and then indicate whether that irregularity was fraudulent (suspected or established fraud) or non-fraudulent. This reporting in respect of expenditure is done through an IT system called the 'Irregularity Management System' (IMS). OLAF is in charge of this system. Reporting in respect of revenue is done via the OWNRES system, which is managed by DG BUDG.

19 OLAF has its own case management system, which provides information on closed and ongoing investigations into fraud, corruption and serious irregularities involving EU money. Member State authorities may also have their own databases for recording suspected fraud cases affecting either the financial interests of the EU or their national budgets.

20 In this section, we examine the quality of information used by the Commission on detected and undetected fraud levels and the type of analysis the Commission carries out in order to identify the most typical fraud patterns and schemes, causes of fraud, and the profile of EU fraudsters. We also assess how the Commission incorporates this information into its fraud risk assessments.

Data on the detected fraud level is incomplete

21 The Commission publishes the value of detected fraud, together with underlying analyses, every year in a report called the 'PIF report'¹⁵. According to this report, detected fraud in EU spending in 2017 amounted to €390.7 million, or 0.29 % of total payments from the EU budget (**Figure 4**).

¹⁵ Protection of the European Union's financial interests – fight against fraud 2017 Annual Report, COM(2018) 553 final.

Figure 4 – EU spending: detected fraud by spending area (2017)

EU spending area	From Commission data, Member States' and candidate countries' reporting (amount in million euro)	As % of payments
Cohesion and fisheries*	320*	0.94 %*
Natural resources	60	0.11 %
Direct expenditure	7	0.04 %
Pre-accession	3	0.18 %
Total	390	0.29 %

*For the cohesion and fisheries spending areas, which are entirely based on multi-annual programmes, the Commission suggests referring to data covering whole programming periods rather than to year-to-year changes. For the whole programming cycle 2007-13, detected fraud represents 0.44 % of the payments.

Source: ECA based on PIF Report 2017 (pp. 14, 22, 24 and 25) and the Commission Staff Working Document SWD(2018) 386 final "Statistical evaluation of irregularities reported for 2017" (pp. 47, 66, 102, 103 and 106).

22 To calculate these figures on detected fraud, the Commission uses its own data in cases where it manages the expenditure directly and, in cases concerning expenditure under shared management, it uses data forwarded to OLAF by Member States and candidate countries via the IMS.

23 Based on our audit results, outlined in the following paragraphs, we have concluded that these figures do not provide a complete picture of the detected fraud level in EU spending. This is the case for both shared management and other management modes.

24 Within shared management, the Commission's view is that the main problem of non-reporting concerns cases under investigation by prosecution services of which authorities in charge of implementing the programme in question are not aware¹⁶. Nevertheless, we have identified the following additional reasons why the scale of fraud is underreported:

- Member State authorities do not report all cases investigated by OLAF. Of the 20 OLAF cases we checked, we identified only three cases that Member State authorities had recorded in the IMS system.

¹⁶ Paragraph 2.4 of Commission Staff Working Document (2016)237 final explains the methodological assumptions behind the analysis of the reported irregularities.

- Fraudulent cases may also arise from the activities of intermediate public bodies involved in implementing an operational programme through project selection or public tendering:
 - EU law¹⁷ does not require Member States authorities to report fraudulent or non-fraudulent cases where public bodies exercised the powers of a public authority and did not act as an economic operator. We found problems of underreporting in cases where public bodies act as economic operators.
 - When fraudulent or non-fraudulent irregularities occur in project selection before a given project is awarded any funding, it is not always possible to identify the irregular or fraudulent project concerned in order to enter the necessary data into the IMS. We came across such cases in two Member States.
- To reduce their administrative burden, EU law obliges Member State authorities only to report fraudulent or non-fraudulent irregularities involving more than €10 000 in EU money¹⁸. For Agriculture and the European Social Fund, there are a large number of payments below the €10 000 threshold and, as a consequence, potentially fraudulent payments below the reporting threshold, which are not reported. During our audit, we identified one Member State where irregularities reported within IMS for the European Agricultural Guarantee Fund and European Agricultural Fund for Rural Development accounted for only a small share (7 %) of all irregularities detected by the Member State for these two Funds. On the other hand, from the 7 % of reported irregularities, the Member State qualified a high share (60 %) as suspected fraud.

25 The Commission has issued several guidelines¹⁹ on reporting irregularities and flagging them as suspected fraud. However, reporting still varies among Member States. This is mainly due to differing interpretations of ‘suspected fraud’ and ‘primary administrative or

¹⁷ See Articles 1(2) and 7 of Council Regulation (EC, EURATOM) No 2988/95 of 18 December 1995 on the protection of the European Communities financial interests; Article 2(37) of Regulation (EU) No 1303/2013; with Article 2(17) of Regulation (EU) No 223/2014; recital (3) of Commission Delegated Regulation (EU) 2015/1971; recital (3) of Commission Delegated Regulation (EU) 2015/1973.

¹⁸ Article 3(1)(a) of the Delegated Regulations 2015/1970, 2015/1971, 2015/1972, 2015/1973.

¹⁹ Handbook on requirement to report irregularities, COCOLAF/23-05-17/8.2/EN; Article 2(b) of Commission Delegated Regulation (EU) 2015/1970, 2015/1971 and 2015/1973.

judicial finding'²⁰. These definitions are important for determining precisely when an irregularity must be flagged as fraudulent (suspected fraud). The table in **Annex 4** shows that some Member States only qualify irregularities as suspected fraud after a final court decision, while others much earlier in the proceeding.

26 In order to place greater emphasis on detecting and reporting fraud, in 2015 OLAF introduced two new indicators: the 'fraud detection rate' (FDR), which is the value of suspected or established fraud detected in a Member State as a percentage of the total payments made in that country for a given period and the fraud frequency level (FFL), which is the number of suspected or established fraud cases in a Member State as a percentage of the total number of irregularities detected in that country for a given period. A similar indicator was created for non-fraudulent irregularities (the 'irregularity detection rate' or IDR and the 'irregularity frequency level' or IFL). **Figure 5** includes information on each Member State's FDR and IDR for the Cohesion area for the period 2007-2013.

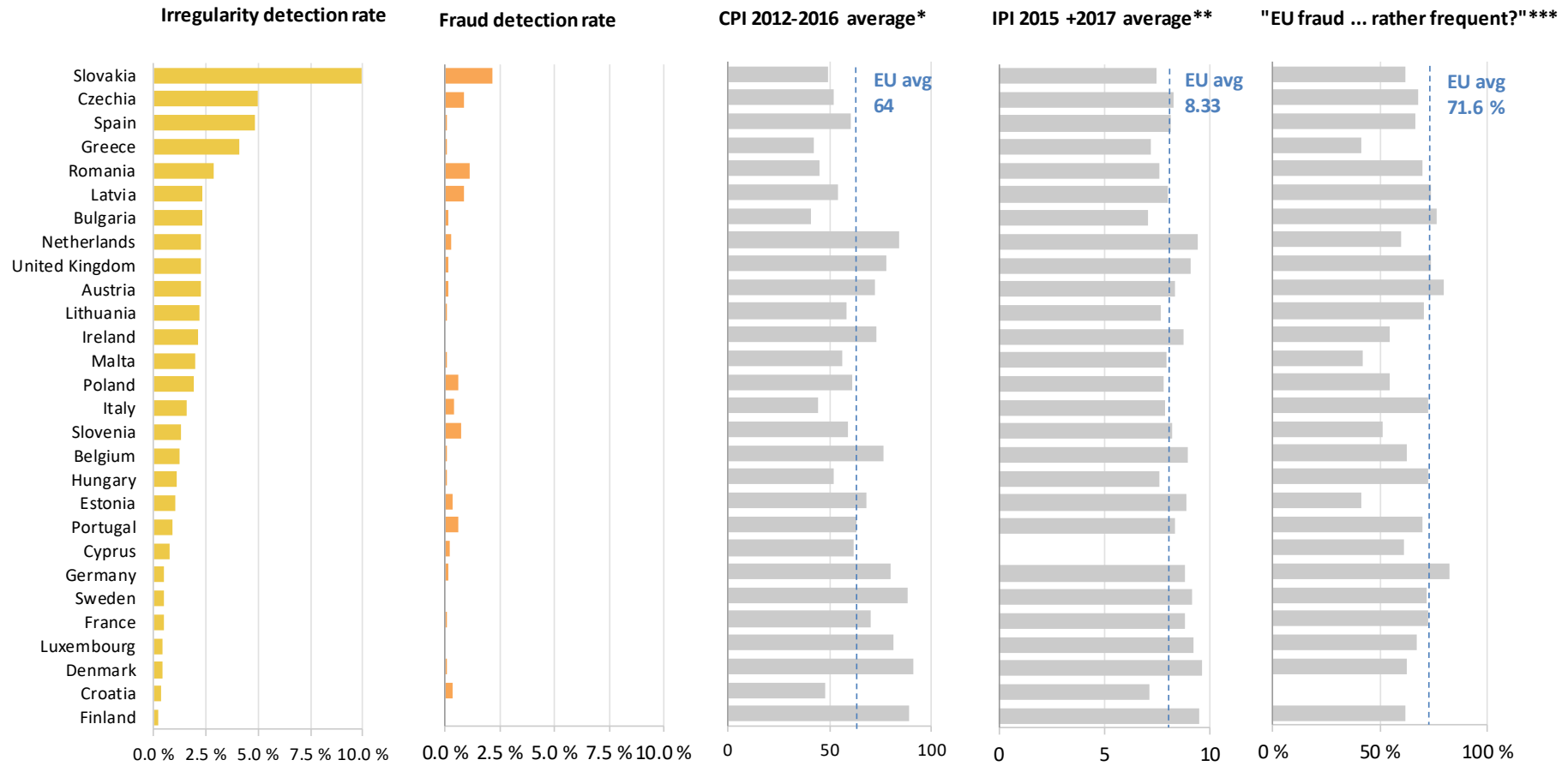
27 These indicators highlight that there are significant disparities in the level (value and number of cases) of irregularities and fraud detected and reported by Member States. For example, ten Member States reported less than ten suspected fraud cases throughout the whole 2007-2013 programme period, and twelve Member States had fraud detection rates of less than 0.1 %. Eight Member States categorised more than 10 % of all reported irregularities as suspected fraud, while for 14 other Member States, it was less than 5 %.

28 The Commission considers that the significant differences between Member States in terms of reporting on fraud and irregularity may be linked to the national system set-up to counter fraud rather than just to non-harmonised reporting. A more detailed analysis on the underlying reasons for these differences was not available from the Commission.

29 A further indication of problems with reporting or detection is that the correlation between official statistics on reported fraud detection rates and the results of corruption risk indicators is weak (**Figure 5**): some countries scoring low on Transparency International's Corruption Perception Index (CPI) or the Index of Public Integrity (IPI), and hence considered less transparent, report very few or even zero fraud cases.

²⁰ Article 2(b) of Commission Delegated Regulation (EU) 2015/1970, 2015/1971, 2015/1972 and 2015/1973 contains a definition of "primary administrative or judicial finding". These delegated regulations are adopted based on the powers conferred by the relevant basic acts, one of which is the Common Provisions Regulation (Article 122).

Figure 5 – Irregularity and fraud detection rate per Member State versus CPI, IPI and Eurobarometer results



* Transparency international's **Corruption Perception Index (CPI)** ranks countries by their perceived levels of corruption, as determined by expert assessments and opinion surveys. Ranking is on a scale from 100 (very clean) to 0 (highly corrupt).

** The **index of public integrity (IPI)** is a composite index consisting of six components: judicial independence, administrative burden, trade openness, budget transparency, e-citizenship and press freedom. It aims to give an objective and comprehensive picture of the state of control of corruption in 109 countries. Ranking is on a scale from 1 (low control of corruption) to 10 (high control of corruption).

*** The **2015 Eurobarometer** measures the perception of EU citizens. Q1_B. Defrauding the EU budget: The scale of the problem is rather frequent?

30 The Commission does not carry out comprehensive checks on the quality of data reported in the IMS; nor does it ask Member State authorities to provide assurance as to the reliability of the data reported. Partial checks on compliance with reporting obligations are performed within the framework of system audits.

31 Neither OLAF nor any other body within the Commission gathers information on criminal cases linked to EU financial interests investigated by national authorities. Member States have their own systems for recording cases under investigation, and nearly half of them do not differentiate between financial crimes affecting national interests and those affecting EU interests. As a result, neither the Commission nor such Member States have data on fraud in EU spending as a separate category.

32 In the area of expenditure, directly managed by the Commission, the value of suspected fraudulent spending is based on amounts flagged as fraudulent and recorded in the Commission's accounting system. We found that some data is not included in the value of suspected fraudulent spending. In some cases, the Commission claims back fraudulent money by offsetting this amount against future claims without establishing a formal recovery order. These cases are not always flagged as fraudulent, even though the Commission's guidelines require this. In addition, some suspected fraudulent cases do not require an OLAF investigation, but are followed-up by DGs through audits. These cases are not always included in the reported value of fraudulent spending. The Commission has not yet established clear guidelines on how to compile this data.

The Commission lacks insight into the level of undetected fraud

33 The Commission does not estimate undetected fraud. Nor has it ever carried out a crime victimisation or encounter survey focusing on fraud in EU spending. The Commission told us that it did not consider victimisation, encounter or perception surveys to be suitable tools for providing better insight into the overall scale of EU subsidy fraud, because an EU budget fraud victim survey would entail considerable costs and it is not clear to whom such sociological questions should be addressed.

34 However, perception and experience-based studies have been used for measuring corruption, which is also a hidden crime. Widely accepted indicators of corruption include Transparency International's corruption perception index and the World Bank's control of corruption indicator (WB-CCI). These indexes use the results of perception-based studies. Such surveys are not carried out to replace official statistics, but rather to complement them.

35 On top of perception-based surveys, there have also been some recent studies estimating the level of corruption risk or control of corruption using objective administrative data²¹.

36 Within the area of Cohesion, DG REGIO has initiated a study assessing the quality of government at regional level, using public procurement data. One of the performance indicators measured was the control of corruption risks (**Box 1**). Having a view of regional or sectoral variation in this connection is crucial for understanding corruption risks and managing them effectively.

Box 1

Study on the quality of government at regional level, using public procurement data

In 2017, DG REGIO initiated a region-by-region study on public procurement performance in EU Member States, using an innovative corruption risk indicator developed by the DIGIWHIST research project at the University of Cambridge. This method uses big data from large-scale public procurement databases (Tender Electronic Daily), company registry data and financial and ownership data²².

This corruption measurement method indicates that the variation between regions or sectors is greater than that between different countries, as comparing differences between countries masks a wide range of differences within those countries themselves.

37 These examples illustrate that it is in fact possible to gain insight into the scale of undetected fraud or corruption.

²¹ Fazekas, M., and Kocsis, G., (2017); Fazekas, M., Tóth, I. J., and King, P. L., (2016); Golden, M. and Picci, L. (2005). The Centre for Counter Fraud Studies at the University of Portsmouth has also developed a fraud loss measurement (FLM) method. See Button, M. and Gee, J. (2015).

²² Fazekas, M. and Kocsis, G. (2017); Fazekas, M., Tóth, I. J., and King, P. L. (2016); pp. 369-397.

The Commission's analysis of fraud patterns and fraud risks is insufficient

38 Knowledge of fraud patterns contributes to accurate and up-to-date fraud risk assessments and helps in identifying and applying the relevant controls to prevent and detect fraud.

39 The Commission analyses the different types of fraud in order to comply with:

- o its annual obligation to present to the European Parliament and the Council a report on the measures taken by the Commission and the Member States in the fight against fraud and the result of these actions (in the PIF report) and its obligations under sectoral legislation;
- o the Commission's internal control framework, which requires a fraud risk assessment.

40 The 2016 PIF report includes a section on types of irregularities reported as fraudulent for both Funds in the area of Agriculture, and for the "Research and technological development" (R&TD) priority area for the period 2007-2013 in the case of the Structural Funds. The report's analysis of modus operandi includes different types of irregularities reported as fraudulent²³.

41 In addition to the PIF report, OLAF has also prepared several analyses, called 'case compendiums', covering the main fraud patterns, vulnerabilities and red flags. These case compendiums provide a list of anonymised cases based on OLAF's investigative work, together with data from Member States.

42 These are good examples of how OLAF's investigative knowledge and other intelligence can be used to provide timely information on the key fraud threats to the EU budget. However, these compendiums are one-off documents that are not updated on a continuous basis. OLAF has produced four such case compendiums related to fraud²⁴, published in 2010, 2011, 2012 and 2013 respectively, but has not since published any update. For example, the most recent case compendium for Structural Funds, published in 2011, concerns the 1994-1999 and 2000-2006 programme periods.

²³ See for example the Commission working document SWD(2017) 266 final, part 2/2, table CP16, p. 64 accompanying the 2016 PIF report.

²⁴ In 2017, OLAF published a fifth case compendium related to internal investigations.

43 Currently, fraud risks are assessed at DG level. No central fraud risk assessment is carried out for the Commission as a whole and there is no corporate fraud risk register. Such information should feed the Commission's Anti-Fraud Strategy (CAFS). The CAFS, adopted in 2011, does not include any information on whether any underlying fraud risk analysis exists or on the results of such analysis.

44 We reviewed the fraud risk assessments performed by seven Commission DGs. These fraud risk assessments were based solely on an analysis of detected fraud, combining information from different internal sources (e.g. the IMS, OLAF, DGs' audit results and ECA findings). They do not use other information coming from external sources, such as national crime statistics or official government reports, or analyses and reports by NGOs, corruption risk indicators or surveys, to complement their fraud risk analyses. Therefore, the conclusion drawn by five of the seven spending DGs that the risk of fraud is low is not based on an exhaustive analysis covering all necessary elements²⁵.

45 The information in the global fraud register created by the Chartered Institute of Public Finance and Accountancy, together with the accountancy firm Moore Stephens, suggests that the risk of fraud could be high in grant spending (which accounts for a big share of EU spending). This register is based on a global survey of over 150 accountancy and fraud risk professionals across 37 countries, in order to gauge the most serious risk areas across the globe. Respondents considered 18 different types of fraud and bribery risk, scoring them from 1 (lowest risk) to 5 (highest risk). Almost half (48 %) of all respondents surveyed said that grant fraud posed a high or very high risk, putting it at number one on the register²⁶.

46 Some of the experts we consulted are of the view that it is important to use several different methods, tailored to the type of spending, to gain a better insight into the risk, scale and nature of fraud in EU spending. For example, for the Common Agricultural Policy, where funding is mainly granted through entitlements and there is less discretion in how EU money is allocated, one potential way to measure the scale of fraudulent spending might be by measuring fraud loss. For investment projects, it might be possible to establish the risk of fraud and corruption by analysing administrative datasets (big data) such as public tendering

²⁵ DGs EMPL, REGIO, AGRI, RTD and HOME.

²⁶ <https://www.moorestephens.co.uk/services/governance-risk-and-assurance/rhiza-risk-management-tool/global-fraud-risk-register#>.

and contracts databases, as well as grant applications and decisions. Surveying EU beneficiaries or bodies managing EU funds could also provide complementary information.

The Commission has not analysed the causes of fraud

47 Neither OLAF nor the Commission DGs have carried out a detailed analysis of the main causes of fraud, or of the characteristics of the people who commit it. The Commission does not consider that identifying the motivation of fraudsters would add significant value to its fight against fraud.

48 The most frequent type of suspected fraud we identify in our audits is beneficiaries artificially creating conditions to obtain access to EU funds. This modus operandi shows that fraudsters are not always organised criminals, but individuals (beneficiaries of EU funds) who intentionally break the rules in order to receive EU funds to which they believe they are legitimately entitled. Some of the experts highlighted the possibility of a causal link between the complexity of rules and fraud. **Box 2** provides an example we reported in our 2014 annual report²⁷.

Box 2

Artificially creating conditions to obtain rural development aid

A number of groups of people (who were part of the same family or part of the same economic group) set up several entities for the purpose of obtaining aid which exceeds the ceiling allowed under the conditions of the investment measure. The beneficiaries declared that these entities were operating independently, but this was not the case in practice, as they were designed to function together. They were effectively part of the same economic group, with the same place of business, staff, clients, suppliers and financing sources.

49 A study on corruption risks in EU Member States suggests that the opportunity for discretionary spending without adequate controls increases the risk of corrupt spending²⁸. Some of the experts highlighted similar kind of risks. It would therefore be appropriate for OLAF or the Commission DGs to analyse how the discretion in EU co-financed programmes affects the risk of fraud within a given spending area. This is particularly true in the area of

²⁷ European Court of Auditors, 2014 Annual Report, p. 229.

²⁸ Mungiu-Pippidi, A., (2013), pp. 10-11.

shared management (e.g. the European Structural and Investment Funds), where Member State bodies distributing these funds have discretion in setting eligibility criteria and conditions.

There are weaknesses in the Commission's strategic approach to managing the risk of fraud

50 Fraud is a cross-cutting issue. Successfully reducing it, therefore, requires efforts and a wide range of actions from many parties. At the same time, however, fighting fraud is not normally the core business of any particular operational unit within an organisation. Therefore, it is good practice to designate an entity or one top manager to lead and oversee the organisation's anti-fraud activities²⁹. Clearly defining the roles and responsibilities of the operational units involved is also crucial, as this is the only way to avoid duplicating roles and evaluate the actual impact of each player.

51 We examined whether the Commission has clear leadership and roles and responsibilities, along with appropriate oversight of fraud risk management. We also assessed whether the Commission has a well-designed anti-fraud strategy capable of guiding its day-to-day anti-fraud actions, and whether it properly measures the outputs of these actions.

Under the Commission's governance model, responsibilities are split; however, corporate oversight of fraud risk management is insufficient

52 We analysed the various bodies' typical (most frequent) roles and responsibilities for the key fraud-related outcomes at each of the phases in combating fraud: planning, implementation and reporting (***Annex V***).

53 Under the Commission's governance model, the roles and responsibilities of the Commission departments involved in anti-fraud actions are split. However, corporate oversight is insufficient. Most bodies have a consultative role. The key players responsible for anti-fraud actions are the College of Commissioners, the DGs and Member State authorities.

²⁹ A Framework for Managing Fraud Risks in Federal Programmes, GAO, July 2015, GAO-15-593SP, p. 10.

54 The President of the Commission sets out each Commissioner's responsibilities in individual mission letters. He requires all Commissioners to ensure the sound financial management of the programmes under their responsibility, including protecting the EU budget from fraud. The mission letter of the Commissioner for Budget and Human Resources, who is responsible for OLAF, requires him to focus on "strengthening investigation of fraud against the EU budget, corruption and serious misconduct within the European institutions, by supporting the work of OLAF, whose investigative independence must be preserved". Strategic fraud risk management and fraud prevention are not specifically referred to in the portfolio of this or any other Commissioner.

55 OLAF is the EU's key anti-fraud body and is required by Regulation (EU, Euratom) No 883/2013 (the 'OLAF Regulation') to contribute to developing the Commission's anti-fraud policy. However, neither OLAF nor any other Commission service plays a major role in overseeing the planning and implementation of the Commission's anti-fraud actions and the reporting on outputs. Given the Commission's governance model, OLAF itself is not responsible for any decision affecting the authorised officers by delegation (AODs) or Member States. It provides guidance and recommendations to those responsible for the various anti-fraud actions (**Annex V**).

56 The Commission shares responsibility for protecting the EU's financial interests against fraud with Member States in the spending areas of Cohesion and Agriculture. The Commission currently lacks any regular procedures for finding out how well Member States are following up suspected fraud cases. Nor does it have any effective mechanism for prompting Member States to take action against fraud, or for monitoring or influencing such action.

57 Several other international organisations have realised the need for such monitoring mechanisms. For example, the OECD Working Group on Bribery (WGB), whose members are drawn from Member State law enforcement and judicial authorities, drives and oversees the implementation and enforcement of the OECD Anti-Bribery Convention³⁰. The WGB has developed several procedures and practices by which it and the OECD member states can exert mutual influence to strengthen their respective capacities to implement the Convention (**Box 3**).

³⁰ OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.

Box 3**Monitoring mechanisms of the OECD Working Group on Bribery**

The WGB's main tool is a peer-review examination, where external experts assess each OECD member state's legislation and efforts to implement it. These country monitoring reports also contain recommendations which are later carefully followed up. The WGB also monitors on a rolling basis the criminal investigations opened by member states, produces studies and soft law measures aimed at strengthening integrity in the public sector and enhancing Member States' capacities to detect and investigate transnational corruption. This system of mutual learning and supervision has encouraged and helped the OECD member states to improve their performance in implementing the Convention.

There are weaknesses in anti-fraud strategies and reporting on their effectiveness

58 The strategic framework for the Commission's anti-fraud actions comprises both the strategy for the institution as a whole (the CAFS), adopted in 2011, and DG-level and/or sectoral anti-fraud strategies (AFS) developed by individual DGs or groups of DGs facing similar fraud risks, e.g. in Cohesion policy or research programmes. The Commission's justification for having individual and sectoral AFSs is that a 'one-size-fits-all' solution would not be the most efficient way to manage the risk of fraud, and that the different players' responsibilities vary depending on management mode and policy area.

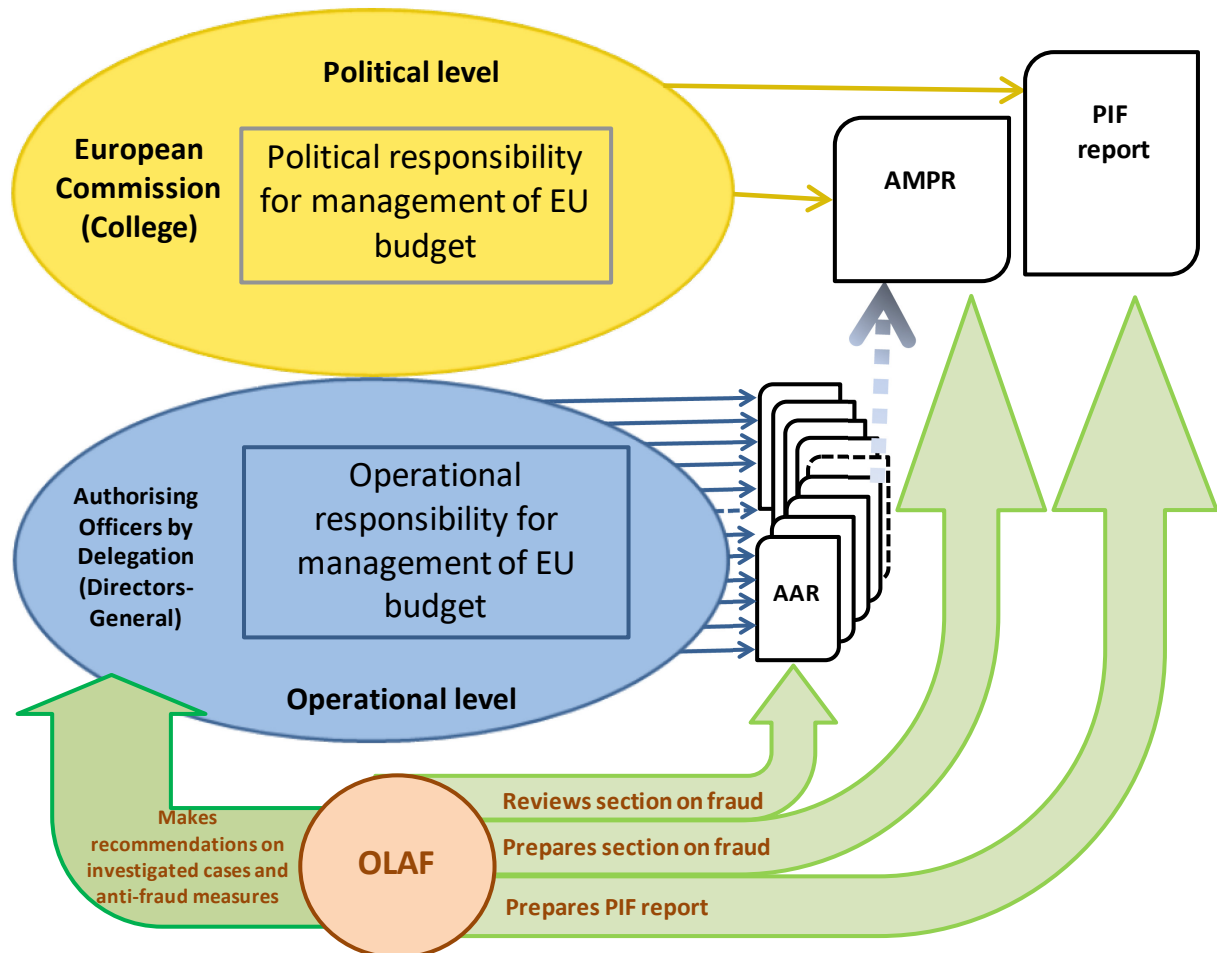
59 Although the CAFS was meant to have been completed by the end of 2014, some actions are still ongoing. As the Commission has not updated the CAFS since adopting it in 2011, we question whether it is fit to guide the Commission's anti-fraud activities in practical terms. The Commission informed us that an update of the CAFS is being prepared and will soon be adopted.

60 We examined the AFSs of seven spending DGs, covering all major spending areas: DG AGRI, DG CNECT, DG DEVCO, DG EMPL, DG HOME, DG REGIO and DG RTD. These AFSs included a number of output indicators or individual outputs supporting the set objectives. However, these objectives are only general and, in most cases, are not measurable. Of the 29 objectives we analysed, 18 involve "reinforcing", "raising", "fostering", "enhancing" and "improving" some anti-fraud activities, without showing the starting point (baseline) and target value.

61 The three key reports that include information on the Commission's anti-fraud actions are the PIF report, the annual management and performance report (AMPR) and the DGs'

annual activity reports. The College of Commissioners is responsible for the former two and the individual DGs for the latter (*Figure 6*).

Figure 6 – Commission reports that include information on anti-fraud actions



Source: ECA.

62 The annual PIF report presents the outputs of the Commission's and Member States' anti-fraud actions (e.g. revised regulations, strategies, directives or fraud awareness training), but it only assesses their effectiveness in terms of actual prevention, detection, recovery or deterrence to a limited extent. The PIF Report fulfils the obligation set out in Article 325(5) of the TFEU, which specifies that the Commission, in cooperation with Member States, must each year submit to the European Parliament and to the Council a report on the measures taken for the implementation of this Article.

63 Nor does the AMPR – one of the main accountability tools of the Commission – include information on the actual results of the institution's anti-fraud actions.

64 In their annual activity reports, DGs are required to report on the results of their anti-fraud actions, based on indicators defined within annual management plans (AMPs). The

DGs we analysed did not report on the effectiveness of the anti-fraud actions arising from their AFSs. Only DG EMPL and DG REGIO provided information in their 2016 AARs on outputs resulting from their use of the ARACHNE³¹ risk scoring tool and on their monitoring of Member States' implementation of risk-based anti-fraud measures.

Fraud prevention has not received enough attention

65 Preventing fraud before it occurs is a key element of an effective anti-fraud framework. We examined the Commission's key actions to prevent fraud, in particular, how the Commission assesses the risk of fraud before adopting spending rules and designs and implements appropriate fraud controls. We also analysed how the Commission uses data for fraud prevention purposes.

The Commission recently included fraud controls in top-level spending rules

66 The Commission's fraud-proofing activities date back to 2000, when the Commission decided to make its fraud-proofing of legislation more effective³². A specific fraud-proofing unit was set up within OLAF, which was in particular tasked with making sure that spending schemes had specific legal provisions against fraud, providing for proper fraud controls.

67 In 2007, the Commission communicated that it had achieved the objectives of its fraud-proofing procedures³³ and that standard anti-fraud provisions had been included in spending rules. In 2011, the Commission made fraud-proofing the first priority action of the CAFS. By 2011, however, the key spending rules for the 2007-2013 period had been adopted. It is only since the start of the 2014-2020 period that spending rules in the areas of Cohesion, Agriculture and Research include a requirement to implement effective and proportionate fraud controls before spending occurs (**Figure 7**). Previously, some anti-fraud controls were included at sub-legislative levels within the area of Research, e.g. in model contracts and agreements.

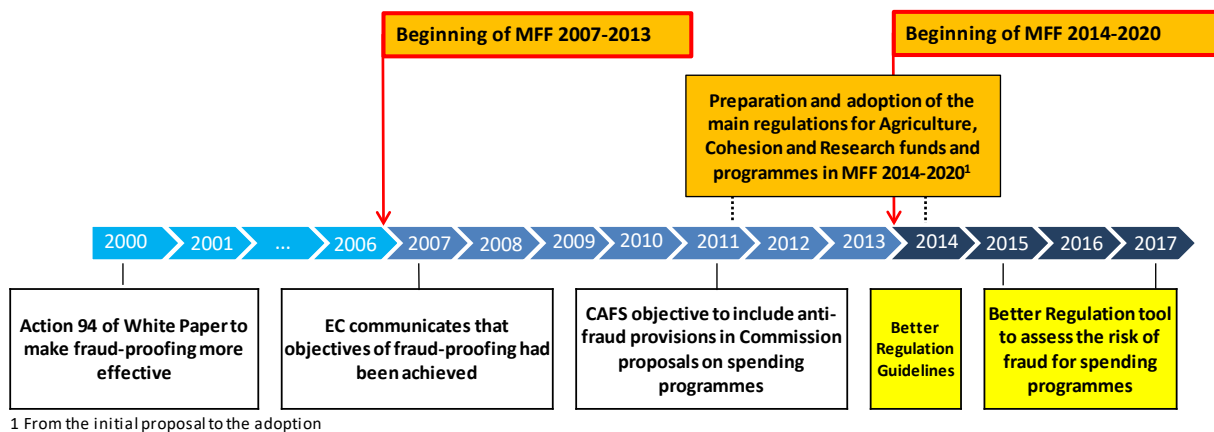
³¹ <http://ec.europa.eu/social/main.jsp?catId=325&intPageId=3587&langId=en>.

³² COM(2000) 200 final/2 – Reforming the Commission – A White Paper – Part II – Action plan, action 94.

³³ Prevention of fraud by building on operational results: a dynamic approach to fraud-proofing, SEC(2007) 1676.

68 In Cohesion, DG REGIO has decided to use an external private company to assess how Member States meet the requirement to implement effective and proportionate anti-fraud measures for the 2014-2020 programme period. In December 2016, the Commission signed a contract with a consultancy company to examine the measures taken by Member States to prevent and detect fraud and corruption for the European Structural and Investment Funds. The results should have been ready by the end of 2017, but there have been delays. No such assessment is planned for Agriculture.

Figure 7 – Timeline of the Commission’s fraud-proofing actions



Source: ECA.

69 Thus, the Commission included comprehensive anti-fraud provisions in all top-level spending rules in 2014. In the 2007-2013 programme period, this was not always the case.

70 Based on its investigations, OLAF also makes administrative recommendations to DGs highlighting weaknesses in their fraud prevention and detection controls. Between 2014 and 2016, OLAF made 113 such recommendations to various Commission services. It is not possible to evaluate the impact of these recommendations, as neither OLAF nor the DGs follow up on whether these recommendations have been implemented.

A fraud risk assessment before adopting spending rules will be required as from 2021

71 The Commission performs impact assessments to collect evidence in order to assess whether future legislative or non-legislative EU action is justified and how such action can

best be designed to achieve desired policy objectives. Based on the COSO framework³⁴, we would expect the Commission to assess the risk of fraud when performing these assessments.

72 Guidelines on how to perform impact assessments for spending rules (the Better Regulation Guidelines) were updated in 2015. This update did not, however, include any requirement to assess fraud risk as part of impact assessments³⁵. A specific fraud prevention tool was not added to these guidelines until in July 2017 (**Figure 7**).

73 As a result, this new requirement will only apply to the next generation of financial programmes (2021 onwards). Other than this requirement, there are no explicit requirements to assess the risk of fraud before establishing detailed implementing rules for multi-annual financial programmes (such as partnership agreements and operational programmes in Cohesion or rural development programmes in Agriculture).

74 We also analysed the information we received from OLAF on its role in inter-service consultations of different Commission services before adopting proposed rules. OLAF is required to provide an opinion on whether proposed laws properly take account of the risk of fraud. During 2014-2016, OLAF received 2 160 inter-service consultation requests from different Commission services. OLAF provided a positive opinion in 1716 cases (79 %) and a positive opinion with comments in 304 cases (14 %). In these cases, OLAF was satisfied with the proposed rules or proposed improvements. OLAF issued a negative opinion in two cases (0.1 %) and was late to issue an opinion in the remaining cases (6.9 %). **Box 4** provides an example when OLAF's input led to a change of rules.

³⁴ Principle 8 of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) 2013 Internal Control – Integrated Framework, requires organisations to consider the potential for fraud in assessing risks to the achievement of objectives.

³⁵ Better regulation for better results – An EU agenda, COM(2015) 215 final.

Box 4**Example of OLAF's input leading to changed rules**

When the partnership agreements (PA) for the 2014-2020 programme period were being drawn up these agreements did not contain any reference to the requirement for Member State authorities to implement proper fraud controls. As a result of OLAF's input a separate article was added to each agreement requiring Member States to put in place risk-based, effective and proportionate fraud prevention measures pursuant to Article 125(4)(c) of Regulation (EU) No 1303/2013 (the Common Provisions Regulation).

75 Other than the above outputs, we did not find any specific evaluation by the Commission listing which EU laws had been fraud-proofed or containing appropriate fraud risk analysis or anti-fraud provisions. Nor has there been any analysis of the Commission's new approach to fraud-proofing, as envisaged in the Commission's 2007 communication.

Better use of data for fraud prevention is needed

76 Data on operators at risk of committing fraud can be used to prevent the allocation of EU money to potential future fraudsters:

- For direct and indirect management, the Commission regards the Early Detection and Exclusion System (EDES) – a debarment and blacklisting system – as its main tool for preventing the allocation of EU funding to insolvent, irregular, unreliable or fraudulent economic operators.
- ARACHNE is an integrated IT tool for data mining and data enrichment, developed by the European Commission. Within Cohesion, DG REGIO and EMPL consider the ARACHNE risk scoring tool to be a key fraud prevention tool. According to these DGs, ARACHNE could help Member State authorities in identifying the riskiest projects and beneficiaries during ex-ante and ex-post checks.

77 We analysed the data included in these two tools.

Due to legal constraints, the Commission could not exclude economic operators for fraud or corruption committed before 2016

78 Debarment has acquired considerable importance in the European Union. This is because under the EU Public Procurement Directives, public contracts must not be awarded to economic operators who have been involved in criminal misconduct or found guilty of, among other things, corruption and fraud affecting the EU's financial interests.

79 The EU's debarment system dates back to 2008. With effect from 1 January 2016, the Commission replaced the previous exclusion and early warning system with the EDES. While Directors-General may still request an early detection warning, for exclusion, the key new feature introduced with this system is a central panel, which assesses exclusion requests from the Director-General of the relevant DG and provides recommendations on exclusion and potential financial penalties. It is the Director-General who ultimately decides whether or not to exclude an economic operator.

80 All EU institutions and bodies may make an exclusion request based on information transmitted by administrative or criminal proceedings, reports by OLAF, the European Court of Auditors or the Commission's internal auditors, decisions by the European Central Bank, the European Investment Bank and Fund or other international organisations, or on cases of fraud or irregularity decided by national authorities under shared or by delegated entities under indirect management. Audits by authorising officers or private-sector auditors are also a valuable source of information. Member State authorities have been granted access to exclusion decisions but are not obliged to take them into account in any shared management financing decision involving EU money.

81 Excluding an economic operator is a lengthy procedure. By 30 June 2018, i.e. two-and-a-half years after the EDES was introduced, the Commission as a whole had excluded 19 economic operators and published sanctions against eight. Even though within the area of shared management, Member State authorities reported 820 suspected fraud cases within IMS and OLAF concluded around 60 investigations with recommendations in 2016 alone³⁶, the Financial Regulation does not give the Commission any power to act if Member State authorities have not themselves initiated the exclusion of an unreliable economic operator. Therefore, no requests for exclusion of national economic operators co-financed by ESI funds were made by any of the three main DGs managing this spending (REGIO, EMPL and AGRI).

82 As regards exclusions for facts dating from before 2016, the main reasons for these were serious breaches of contractual provisions and grave professional misconduct. This is because the legislation at the time did not permit exclusion for fraud in the absence of a final judgment. To date, only two economic operators have been excluded for fraud or corruption, which limits the deterrent impact of this system.

³⁶ 2016 PIF Report, COM(2017) 383 final.

83 The EDES system provides the possibility of recording the details of individuals who have control, or representative or decision-making powers, over fraudulent companies. However, only for facts dating from 2016 onwards does the legislation permit the exclusion of an economic operator where a person serving on its administrative, management or supervisory board, or with powers of representation, decision or control over it, is himself or herself also currently under exclusion. Previously, only economic operators that had a contractual relationship with the contracting authority/authorising officer could actually be excluded. In the past, there have been cases where, by the time the possibility has arisen of excluding the economic operator concerned, the private individuals behind the fraudulent companies have already dissolved the company involved in the contractual relationship with the Commission and created a new one.

84 The World Bank and other international financial institutions have recently stepped up efforts to ensure that fraudulent economic operators are stopped and do not merely re-surface under different names (**Box 5**).

Box 5

The World Bank's suspension and debarment system

The World Bank uses a suspension and debarment system to fight corruption and fraud. The World Bank can suspend and debar both companies and private individuals, thereby rendering them ineligible for new contracts for World Bank-financed projects. All sanctions are published. In 2017, the World Bank temporarily suspended 22 firms and individuals and sanctioned 60³⁷. As of January 2018, the debarment list contained 414 debarred companies and individuals³⁸. The World Bank system has been in operation for more than ten years and, compared to the EDES, has fewer legal constraints. For example, there is no external judicial review of World Bank decisions, and publication conditions are less strict.

Member States do not fully exploit the potential of Arachne in preventing fraud

85 ARACHNE could help Member State authorities identify risky economic operators when performing checks before or after payment occurs. The usefulness of this tool depends on

³⁷ World Bank Annual Update, Integrity Vice-Presidency, p. 28, <http://pubdocs.worldbank.org/en/703921507910218164/2017-INT-Annual-Update-FINAL-spreads.pdf>.

³⁸ <http://web.worldbank.org>.

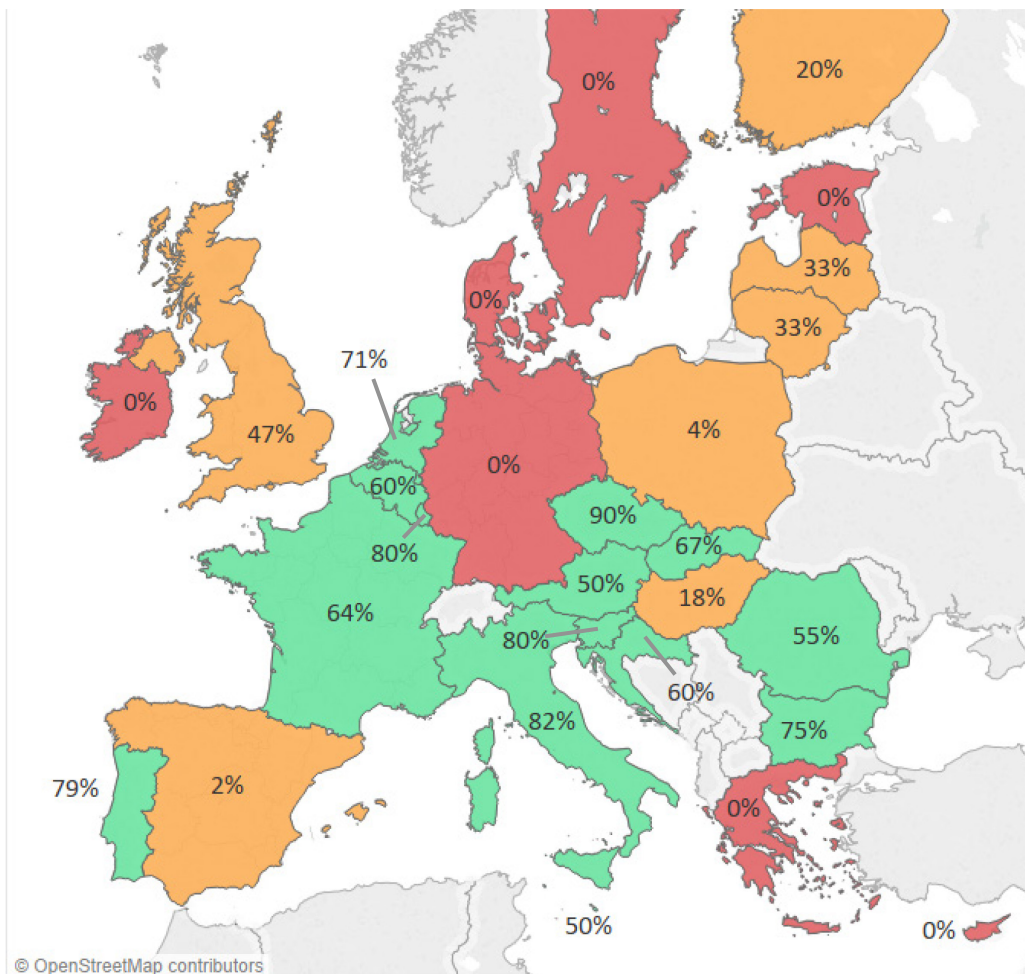
how much data Member States' managing authorities record in it and on whether it is used systematically. The use of this tool by Member State authorities is free of charge, but currently not obligatory.

86 In our 2015 special report on how the Commission and Member States address problems with public procurement in EU cohesion expenditure³⁹, we found that only 17 out of 28 Member States were either using the tool or had expressed their intention to do so. Therefore, in our 2015 report we recommended the Commission and Member States to further promote the use of such data-mining tools. Three years after our recommendation ARACHNE is still used for around 170 out of the total number of 429 operational programmes in 21 Member States (**Figure 8**).

87 This system does not currently offer any way of identifying whether an economic operator has been excluded within the Commission's system. Beyond Cohesion, fund managers in other EU spending areas do not have similar fraud risk scoring tools at their disposal.

³⁹ See European Court of Auditor's special report 10/2015 – Efforts to address problems with public procurement in EU cohesion expenditure should be intensified.

Figure 8 – Use of ARACHNE in Member States*



*Number of 2014-2020 Operational Programmes for which ARACHNE is used in each Member State as a percentage of that country's total number of 2014-2020 Operational Programmes.

Source: ECA, based on Commission figures.

88 Our analysis found the impact of the Commission's exclusion and sanctioning system to be limited. Moreover, exclusion applies only to spending managed directly and indirectly by the Commission, which means that excluded companies may, for example, continue receiving Cohesion funds. Although ARACHNE has the potential to be an effective fraud prevention tool, the system still contains only a limited amount of data 5 years after being launched.

OLAF's administrative investigations have led to prosecution in fewer than half of cases, and resulted in recovery of less than a third of the funds

89 Under the current EU legal framework, the main responsibility for enforcing anti-fraud legislation lies with the Member States, as only national authorities can conduct a criminal investigation and charge a person with a crime. Responsibility for recovering fraudulently obtained EU money depends on the EU spending area.

90 OLAF is currently the only body with independent investigative powers at EU level. In line with its mandate, OLAF investigates fraud, corruption or other illegal activities affecting the EU's financial interests⁴⁰. Based on its administrative investigations, OLAF may issue judicial, financial, administrative or disciplinary recommendations⁴¹. OLAF can also recommend precautionary measures to help prevent any increase in irregularities.

91 Judicial recommendations are addressed to competent national judicial authorities and mainly contain a proposal to open a criminal investigation against the person suspected (by OLAF) of having committed fraud or to continue the criminal investigation in the light of OLAF's findings and recommendations. OLAF's investigations are intended to make it easier for Member State authorities to bring an indictment in a particular case.

92 Financial recommendations are addressed to the responsible DGs and consist of a proposal to recover a certain amount of money or to prevent money from being spent unduly. Because such recommendations are not binding upon the DGs, here OLAF facilitates the DGs' work in preparing recovery orders and in requesting the exclusion of unreliable economic operators from further EU funding through EDES⁴².

⁴⁰ Article 1(1) of Regulation (EU, Euratom) No 883/2013 of the European Parliament and of the Council of 11 September 2013 concerning investigations conducted by the European Anti-Fraud Office (OLAF) and repealing Regulation (EC) No 1073/1999 of the European Parliament and of the Council and Council Regulation (Euratom) No 074/1999.

⁴¹ Between 2012 and 2016, in around 21 % of the investigations it closed with a financial recommendation, OLAF simultaneously issued a judicial recommendation.

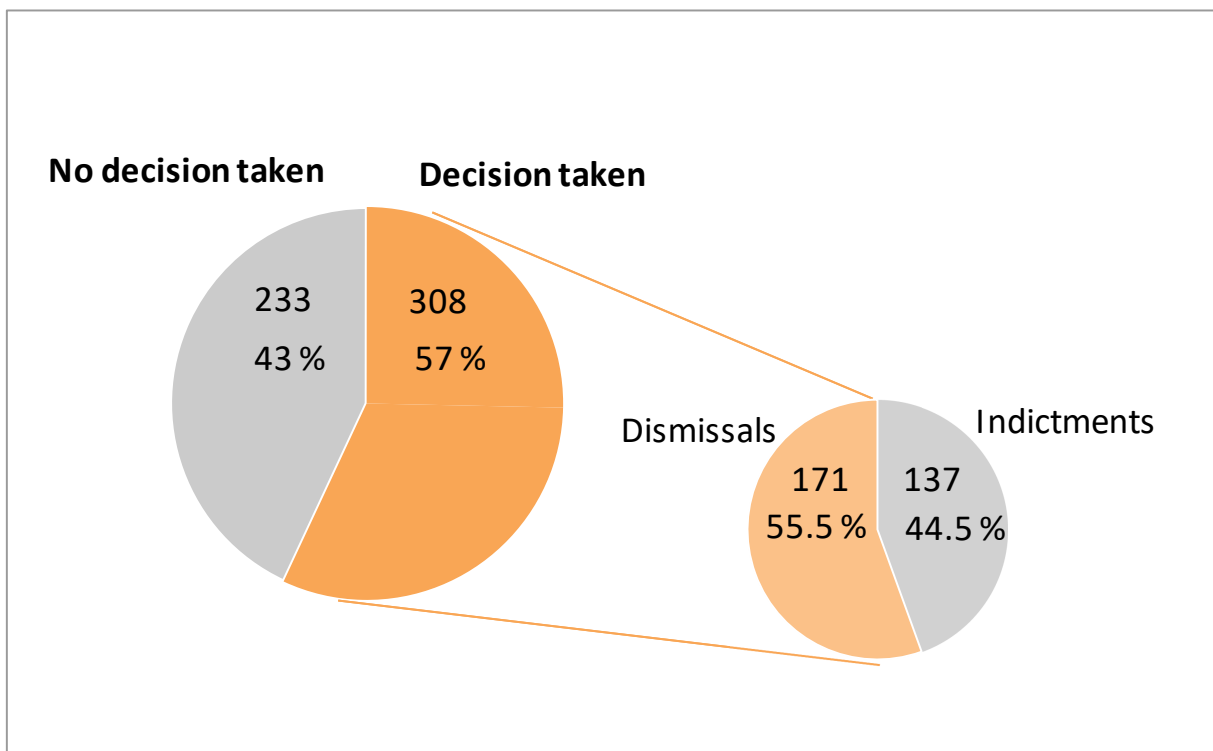
⁴² In addition to the external investigations, OLAF is also entitled to conduct internal investigations within EU institutions. We did not evaluate this particular OLAF task in the course of this audit. For administrative recommendations, see paragraph 70.

93 In EU spending areas under direct or indirect management, the DG which previously made the decision to make the payment concerned decides for itself whether to recover money from a fraudulent beneficiary. For EU spending areas under shared management, the responsible DG recovers the money from the Member State concerned through financial corrections. The national authorities are then responsible for recovering the EU money from the actual beneficiary. In this section, we examine what impact OLAF's administrative investigations have on the prosecution of fraudsters and on the administrative procedure to recover fraudulently spent EU money.

The current fraud investigation system has inherent weaknesses

94 Between 2009 and 2016, OLAF issued a total of 541 judicial recommendations. To date, Member State authorities have taken decisions on 308 of these recommendations, bringing indictments in 137 cases (44.5 %) and dismissing 171 cases (55.5 %). No information is available on the number of convictions. To date, Member State judicial authorities have made approximately 17 indictments per year as a result of cases initiated by OLAF (**Figure 9**).

Figure 9 – OLAF's judicial recommendations in 2009-2016



Source: The OLAF Report 2016, p. 33.

95 Given the unavailability of reliable data on the total number of EU fraud cases prosecuted in the Member States, we cannot provide any precise indication of the overall share of indictments initiated by national prosecutors as a result of OLAF's judicial

recommendations. Publicly available information and information provided to us by the national authorities we visited shows that OLAF judicial recommendations which have led to indictment account for a small proportion of the total number of indictments by national public prosecutors in relation to fraud in EU spending cases (**Box 6**).

Box 6

Prosecution of fraud involving EU money in five Member States

In Poland, 446 indictments and 50 conditional dismissals were issued in the period 2013-2016 (i.e. 124 indictments per year).

In Bulgaria in 2016, 72 persons were charged with fraud involving EU money, from 67 cases.

In Estonia in 2016, 50 individuals and 22 legal persons were charged with fraud in EU spending, from 15 cases.

In Hungary, according to the Ministry of Interior's crime statistics, 18 indictments were initiated in 2013, 16 in 2014, 6 in 2015, 7 in 2016 and 1 in 2017 (a total of 48 between 2013-2017)⁴³.

In Romania, prosecutors issued 30 indictments in 2016, arising from 39 cases previously investigated by DLAF⁴⁴. As a result, 115 individuals and 47 legal entities were sent to trial and, in four cases, a total of six agreements of guilt recognition were concluded.

96 **Figure 9** shows that more than half of the cases where the decision was taken by the Member State were dismissed. According to OLAF's own analysis of the information collected by Member States on judicial recommendations, the main reasons for dismissal were (**Figure 10**):

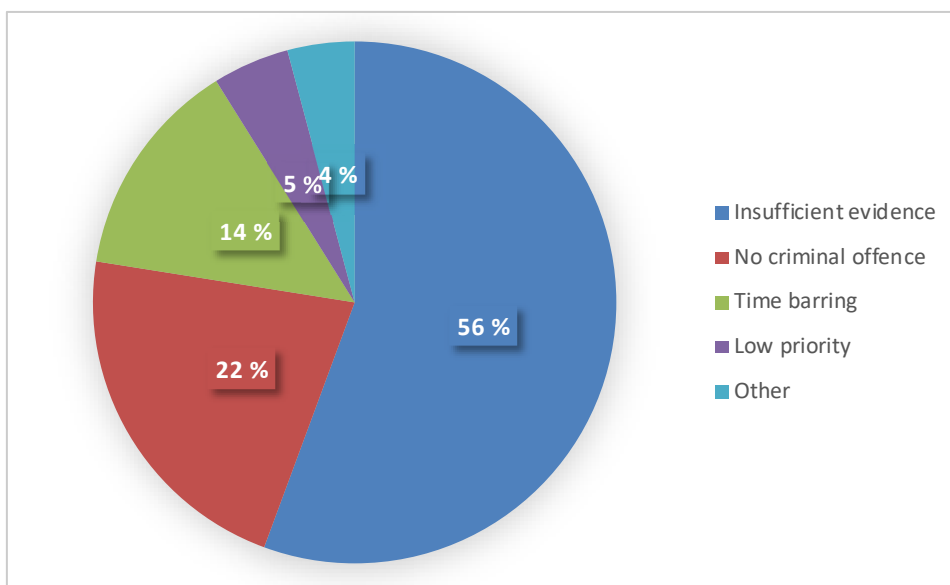
- evidence initially collected by OLAF or later by the national investigative authority considered insufficient for prosecution (56 %);
- action investigated by OLAF not considered a criminal offence under national law (22 %);

⁴³ <https://bsr.bm.hu/SitePages/Nyitolap.aspx> accessed on 15 February 2018.

⁴⁴ The Fight Against Fraud Department (DLAF) is a Romanian national authority with investigative powers, responsible for protecting the EU's financial interests in that country. See statistics from DLAF's 2016 annual report, p. 11.

- o statute of limitation (i.e. time limit for initiating criminal proceedings) under national law passed (14 %)⁴⁵.

Figure 10 – Main reasons for dismissal



Source: Analysis of Member States' follow-up of OLAF's judicial recommendations issued between January 2008 and December 2015; page 1.

97 As indicated above, in 36 % of cases, either Member State authorities did not regard the crime identified by OLAF as a criminal offence under national law, or the time limit for criminal proceedings under national law had elapsed. We note that it is not always possible to prevent a case from becoming time-barred; national prosecutors may also reach a different conclusion as to whether an offence has been committed. This is why close cooperation between OLAF and national authorities is of paramount importance⁴⁶.

98 During our interviews in four Member States, national prosecutors indicated that, in most cases, they have no contact with OLAF before receiving the Final Report. They also indicated that they would prefer to be informed of any suspected criminal offence much earlier than at the end of the OLAF investigation, and that if they were, they would assist

⁴⁵ Analysis of Member States' follow-up of OLAF's judicial recommendations issued between January 2008 and December 2015; p. 1.

⁴⁶ Article 12 of Regulation (EU) No 883/2013 states that OLAF '... may transmit to the competent authorities of the Member States concerned information obtained in the course of external investigations in due time to enable them to take appropriate action in accordance with their national law'.

OLAF and, where appropriate, start their own criminal investigation in order to avoid cases becoming time-barred.

99 Therefore, the fact that many cases are dismissed by national prosecutors because no crime has been committed or because cases have become time-barred indicates that, to date, there are weaknesses in the cooperation between OLAF and national authorities.

100 *Figure 10* shows that 56 % of dismissed cases have been dismissed due to lack of evidence. This means that in every second dismissed case, evidence collected by OLAF, along with evidence collected later by national authorities during criminal investigation, has not led prosecutors to initiate indictment.

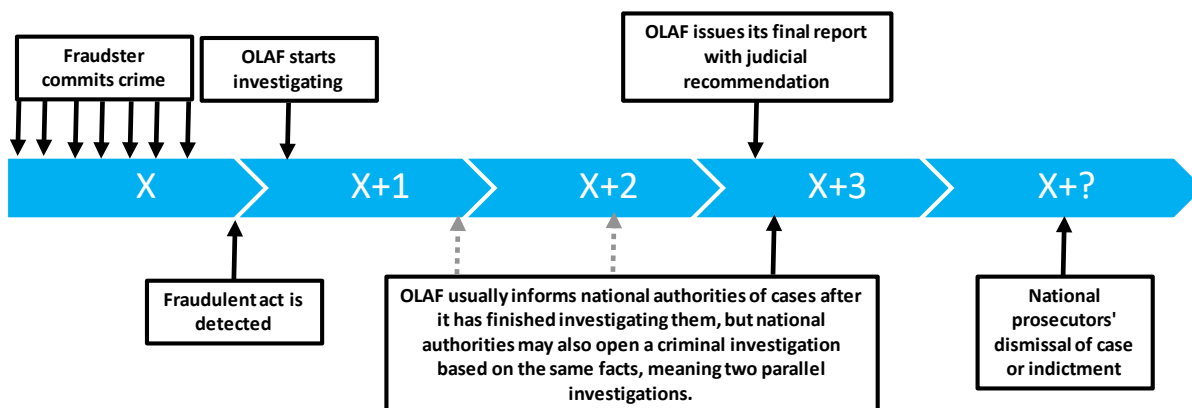
101 Our interviews with representatives from national authorities, independent academics and EU institutions (including OLAF) indicate that the main reason for dismissal is not lack of evidence, but rather that cases are too old. It is not necessarily that the time limit for a given case has already expired or is about to expire, but rather that it is already years since the alleged offence was committed.

102 This is not to say that OLAF's investigations take too long. In most cases, OLAF conducts administrative investigations after the act in question has been detected and reported. It is therefore dependent on the timeliness of the information it receives in particular from IBOAs and Member States. Furthermore, OLAF's administrative investigation then needs to be followed by a further criminal investigation in the Member State concerned. A person cannot be prosecuted without the case having been investigated in accordance with national law. The extent of the investigation varies from country to country, but some action is required in every Member State. Therefore, OLAF's investigations, no matter how well conducted, often have a high risk of passing their 'sell-by date'.

103 *Figure 11* indicates the timeframe for cases investigated by OLAF. Data provided by OLAF shows that, in 2017, it took OLAF an average of two months to select cases and around 22 months to investigate them⁴⁷. Assuming that OLAF receives information on suspected fraud cases around one year after they have been committed and submits its Final Report to judicial authorities without delay, national authorities only receive information on an alleged offence on average three years after it has been committed. For complex cases, it may take even longer.

⁴⁷ See 2017 OLAF report, p. 53.

Figure 11 – Timeframe for cases investigated by OLAF



Source: ECA.

104 In our view, the current system, whereby OLAF’s administrative investigation of suspected fraud is followed by a criminal investigation at national level, takes up much time in a considerable number of cases and thus it decreases the chances to achieve its final goal – prosecution.

Administrative recovery of funds is hindered by insufficient evidence

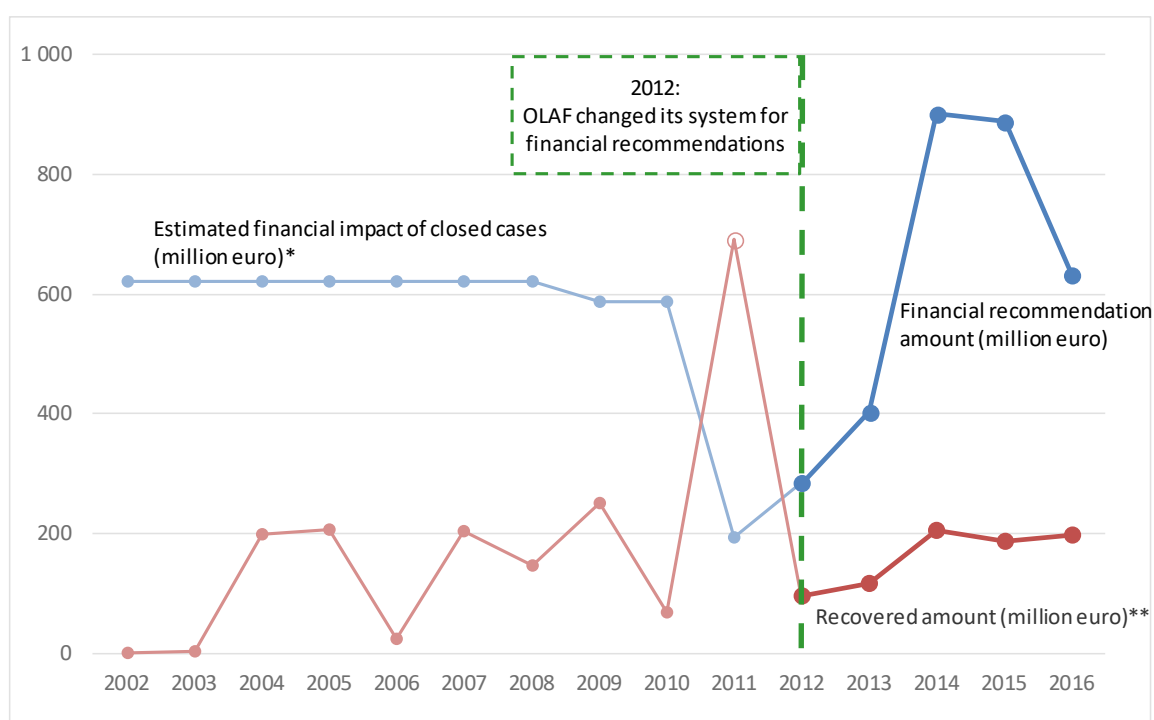
105 If OLAF finds any irregularity (whether suspected fraud or otherwise) and is able to estimate the amount to be recovered, it issues a financial recommendation.

106 *Figure 12* presents the amounts OLAF recommended for recovery between 2002 and 2016. Based on the available data, we estimate the total value of OLAF financial recommendations during this period at around €8.8 billion (for 2008 and 2009, we use the average for all other years). By the end of 2016, a total amount of €2.6 billion (30 %) had been recovered. The figures indicate that although the total annual value of OLAF recommendations varies greatly, in most years (with the notable exception of 2011), the amount recovered has been in the region of €200 million (the average over the last 15 years is €173 million).

107 According to the statistics we received from seven spending DGs (REGIO, EMPL, AGRI, RTD, CNECT, HOME and DEVCO), between 2012 and 2016, OLAF recommended a total of €1.9 billion in recoveries, from 358 cases. By the time of our audit, the DGs’ recoveries and financial corrections amounted to €243 million (13 % of the total recommended) from 153 cases (i.e. 43 % of cases). We acknowledge that the recovery process may still be ongoing for a significant number of the remaining OLAF financial recommendations. Recovering unduly disbursed EU money is a lengthy procedure: based on our sample of cases where recovery was successful, we estimate that the average time taken to complete recoveries is around 36

months. This being the case, we would expect a much higher recovery rate for recommendations issued between 2012 and 2014 than the 15 % (of the total amount recommended by OLAF) that the DGs have recovered to date.

Figure 12 – Amounts recommended for recovery and amounts recovered, 2002-2016



* In its 2008 annual report, OLAF estimated the financial impact of the cases it has closed since it was established in 1999 at more than € 6.2 billion. The average over a 10 -year period works out at around € 620 million per year; as there is no data for 2008 and 2009, we used the average for the years 2002-2011;

** Since 2012, OLAF presents in its annual report the total amount recommended for recovery and the cumulative amount recovered during the year as a result of OLAF investigations completed in previous years.

Source: ECA based on OLAF annual reports, 2002-2016.

108 The figures indicate that, in a significant proportion of the cases OLAF closes with a recommendation to recover unduly paid EU money, either no such recovery takes place or the amount recovered is significantly lower than that recommended.

109 This has been confirmed by our audit: written evidence shows that, in a number of cases, DGs did not consider that OLAF's reports provided sufficient information to serve as a

basis for initiating the recovery of unduly disbursed funds⁴⁸. The DGs either took (or outsourced) further action in order to decide whether recovery would be possible, or relied on evidence provided by their own audits.

110 When OLAF issues a judicial recommendation and/or sends a report to Member State judicial authorities, the financial recovery procedure is in some cases suspended. We found a number of cases where the recovery procedure had been suspended and the DGs had been asked by OLAF not to disclose any information to the national authorities or the beneficiary. We acknowledge, however, that there can be a trade-off between criminal investigations and speedy financial recoveries.

111 Nevertheless, using administrative procedures to recover unduly paid EU money is still more efficient and less costly than recovering these funds through criminal proceedings by means of asset freezing and confiscation. A recent Europol survey on criminal asset recovery within the European Union has revealed that the amount of money currently being recovered in the EU is only a small proportion of estimated criminal proceeds⁴⁹.

Shared management

112 In shared management, DGs do not recover money directly from beneficiaries but instead apply different financial procedures to protect the EU budget. In most cases, DGs REGIO and EMPL apply financial corrections whenever OLAF issues a financial recommendation. It is left up to the Member State concerned to decide what corrective action to take against beneficiaries once the DG has applied a financial correction. Under the principle of shared management, DGs REGIO and EMPL have no obligation to check the amounts recovered from beneficiaries.

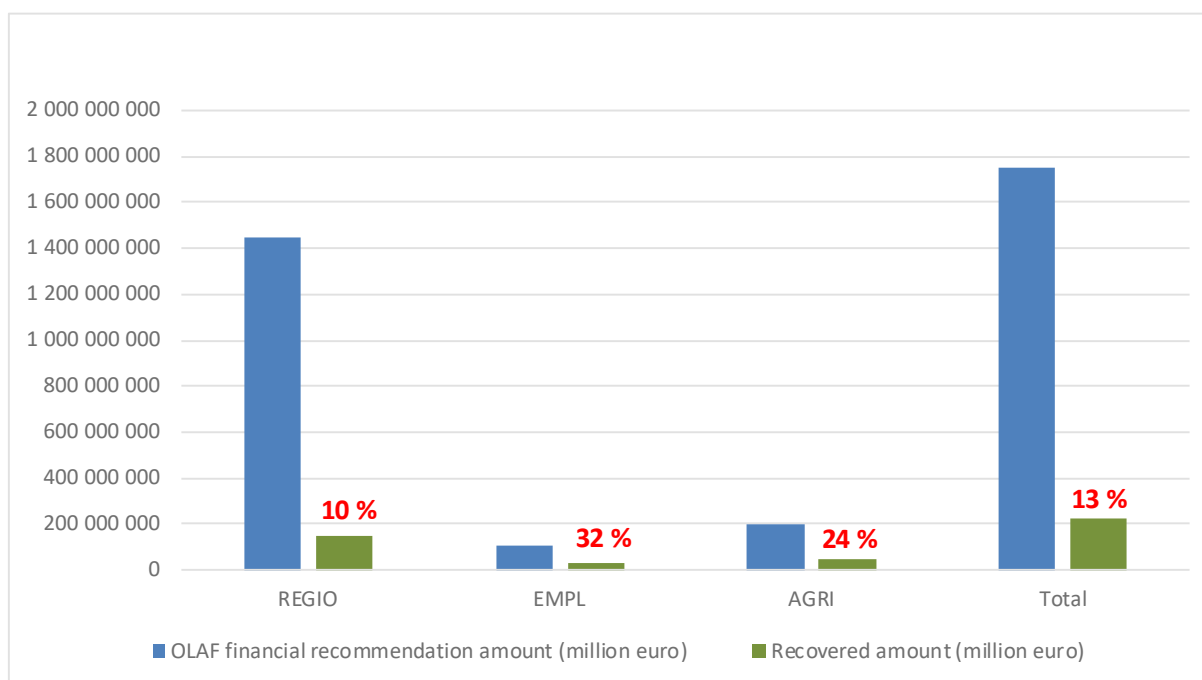
113 DG AGRI rules do not clearly stipulate the main steps for following up OLAF's financial recommendations. For example, there are no deadlines for Member States to contest the recovery amount recommended in the OLAF report. DG AGRI sees its role as that of overseeing the recovery exercise, which is entirely the responsibility of the Member State concerned.

⁴⁸ For 59 cases out of 150 cases with recovery resulting from OLAF financial recommendations the amount recovered is 70 % or lower than what OLAF recommended.

⁴⁹ Does crime still pay? Criminal asset recovery within the EU; Survey of statistical information 2010-2014; Europol, 2016.

114 *Figure 13* shows the total value of financial recommendations OLAF sent to DGs REGIO, EMPL and AGRI between 2012 and 2016, together with the amounts recovered by the time of our audit. The three DGs received 268 OLAF financial recommendations in the period 2012-2016. Money has been recovered in 125 of these cases (47 %). The recovery rate does not increase significantly if we only consider those OLAF financial recommendations the three DGs received between 2012 and 2014. From these cases, the three DGs managed to recover 15 % of the combined total amount recommended by OLAF (DG REGIO – 10 %; DG EMPL – 19 %; DG AGRI – 33 %). We note that in October 2016 OLAF issued new instructions on drafting and calculating financial recommendations. As the new instructions are relatively recent, their full impact has yet to be seen in the system.

Figure 13– Recoveries by DGs REGIO, EMPL and AGRI resulting from 2012-2016 OLAF recommendations



Source: ECA based on Commission figures.

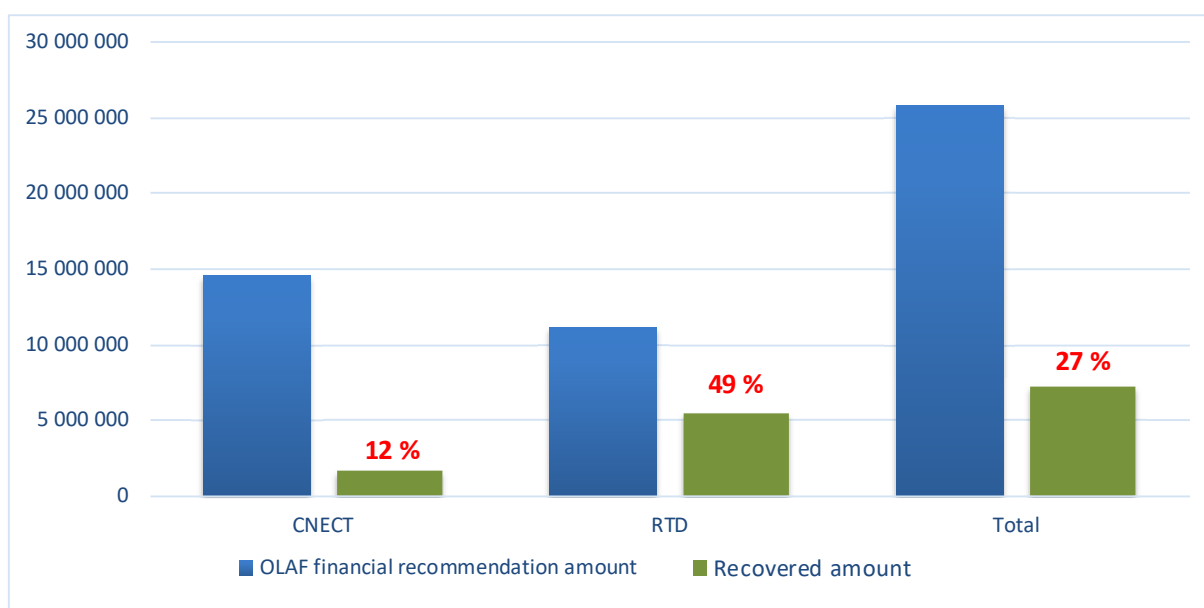
115 According to DGs REGIO and EMPL, one of the main reasons for not recovering recommended amounts is that OLAF's Final Report does not directly substantiate the amount recommended. For example, in one case, the DG asked an external company to perform a further legal analysis of OLAF's finding. In another related case, the DG, after consulting DG MARKT and the Commission's Legal Service, decided not to recover the amount recommended by OLAF due to the high litigation risk. Another reason why the full amount recommended was not recovered in some cases was that, in the past, OLAF had

recommended higher corrections for non-compliance with public procurement rules than those actually applied, by the DGs concerned, on the basis of the Commission's guidelines⁵⁰.

Direct management (DGs CNECT and RTD)

116 *Figure 14* shows the total value of OLAF financial recommendation sent to DGs CNECT and RTD between the years 2012-2016, together with the amount recovered up until the time of our audit. The two DGs received 36 OLAF financial recommendations between 2012 and 2016. Nine cases (25 % of cases) have been fully recovered. In one exceptional case, DG RTD recovered eight times the amount recommended by OLAF because the total amount recovered from the beneficiary also included extrapolated amounts based on the DGs' own audits. In this case, we consider the amount recommended by OLAF to have been fully recovered. The recovery rate increases slightly if we only consider those OLAF financial recommendations the two DGs received between 2012 and 2014. From these cases, the two DGs overall managed to recover 34 % of the total amount recommended by OLAF

Figure 14 – Recoveries by DGs CNECT and RTD resulting from 2012-2016 OLAF recommendations



Source: ECA based on Commission figures.

⁵⁰ Commission decision of 19.12.2013 on the setting out and approval of the guidelines for determining financial corrections to be made by the Commission to expenditure financed by the Union under shared management, for non-compliance with the rules on public procurement, C(2013) 9527 final.

117 We checked 20 OLAF financial recommendations (10 for DG CNECT and 10 for DG RTD) out of 37 cases covering 86 % of the combined total amount recommended by OLAF to these two DGs. Based on this, we found that the main reasons for delays in recovering funds and for non-recovery after OLAF investigation are:

- o ongoing criminal investigations or proceedings;
- o insufficient evidence having been provided in OLAF reports; and
- o companies having already been liquidated by the time OLAF closes the case.

118 The time taken for a spending DG to report a case to OLAF and the speed of OLAF's investigation may be important factors in determining the success of a recovery procedure, as time is very important in cases where DGs recover funds directly from beneficiaries. For cases where the recovery is still ongoing, the average time taken since the start of OLAF's investigation is five years. Where fraudsters liquidate or dissolve companies, often immediately following the announcement of an audit or OLAF investigation, the chances of a recovery are rather limited.

119 DGs can react more quickly and avoid the cost of recovering funding from a beneficiary if they can prove through their own audits that contractual obligations have been breached. In these cases, the responsible DG bases its preparatory work for the recovery order on its own audit results rather than on the OLAF report. We found that, in cases where the DG had not carried out an audit and the only source of evidence was the OLAF investigation file, it was more difficult for the DG to issue the recovery order for the amount recommended by OLAF as the DG considered the available documentation insufficient.

120 In addition, debtors sometimes bring cases before the European Court of Justice to recover part of the rejected costs and/or damages from the Commission. When this happens, the amount recovered cannot be considered final until the ECJ case is closed.

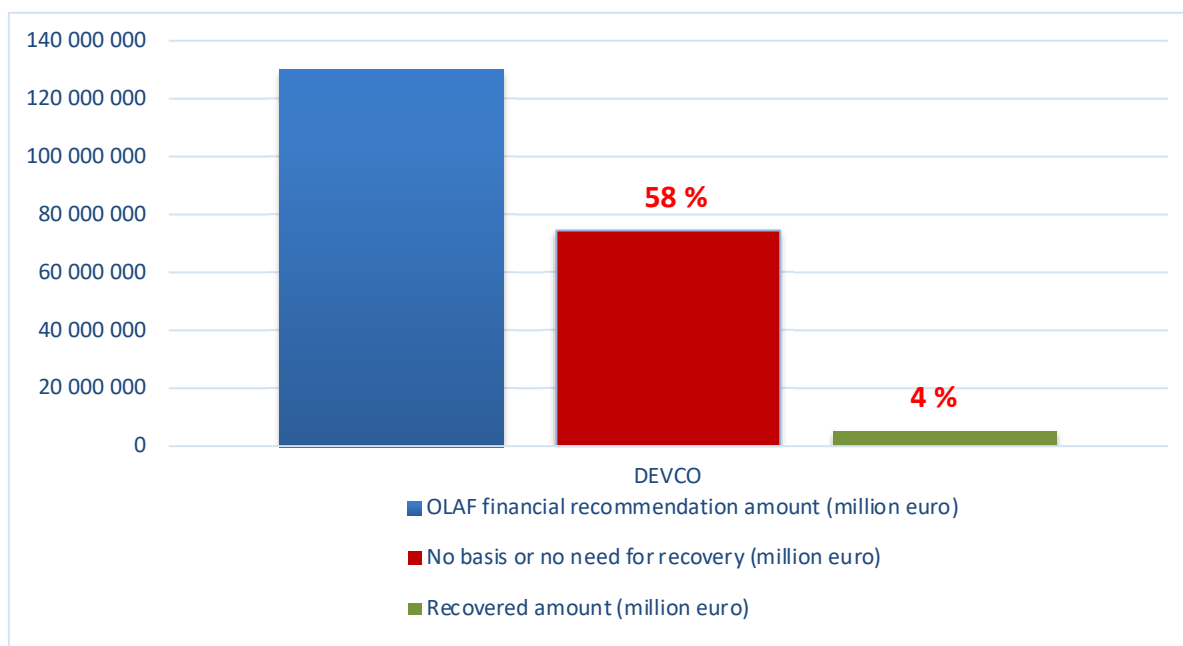
Indirect management (DG DEVCO)

121 Under indirect management, DG DEVCO entrusts budget implementation tasks to beneficiary countries, international organisations and development agencies in non-EU countries.

122 *Figure 15* shows the total value of OLAF financial recommendations sent to DEVCO between 2012 and 2016, together with the amount recovered up until the time of our audit. DG DEVCO received 53 OLAF financial recommendations in the period 2012-2016. There

have been recoveries in 20 cases (38 % of cases)⁵¹. The recovery rate does not increase significantly if we only consider those OLAF financial recommendations the DG received between 2012 and 2014. From these cases, DG DEVCO managed to recover 6 % of the total amount recommended by OLAF.

Figure 15 – Recoveries by DG DEVCO resulting from 2012-2016 OLAF recommendations



Source: ECA based on Commission figures.

123 In cases representing 58 % of the total value of OLAF financial recommendations, DG DEVCO did not recover the EU money concerned, either because it considered there was no legal basis for doing so or because it decided against issuing a recovery order⁵². Based on the 10 OLAF financial recommendations we examined, the main reason why DG DEVCO did not recover the amounts recommended by OLAF was that DG DEVCO considered there was insufficient evidence.

124 In three out of 10 cases, representing a significant value of OLAF financial recommendations, DG DEVCO decided not to recover. Given that it operates in a high-risk environment, and given the potential risks to the implementation of its policy, DG DEVCO

⁵¹ DG DEVCO also has grant and procurement contracts and budget support operations under direct management. However, our audit focused on spending under indirect management.

⁵² If we only consider OLAF financial recommendations issued between 2012 and 2014, then this rate increases to 82 %.

may in some circumstances decide not to recover EU money from beneficiaries. In countries with unstable political and judicial systems, the chances of recovery through a criminal or civil (administrative judicial) procedure are quite clearly low and an OLAF investigation may often be the only way to investigate a fraud allegation. OLAF does not analyse in sufficient detail which cases have yielded successful recoveries and what are the reasons for DGs not to proceed with recoveries or only recover a much lower amount than recommended by OLAF. This would help OLAF to better target its investigations.

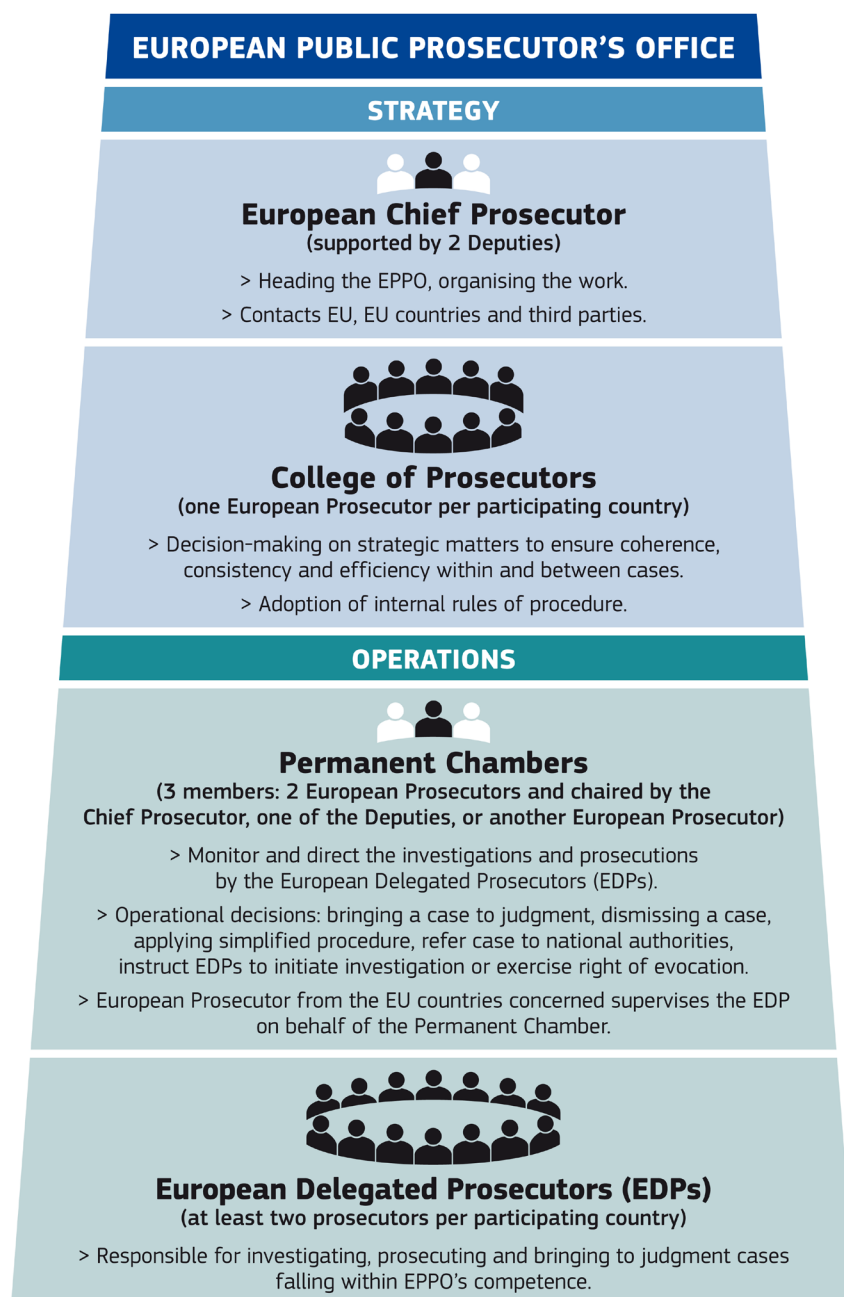
Putting EPPO into operation will require coordinated effort

125 In October 2017, twenty Member States adopted a regulation to enhance cooperation on establishing the European Public Prosecutor's Office ('the EPPO')⁵³. This will be the EU body with powers to investigate and prosecute crimes against the EU's financial interests.

126 The EPPO is designed to operate at two levels: one centralised and the other decentralised. The centralised level consists of an European Chief Prosecutor (ECP), and one European Prosecutor (EP) per Member State (two of which will be Deputy Chief Prosecutors) located at the EPPO's Central Office in Luxembourg, while the decentralised level consists of European Delegated Prosecutors (EDPs) working in the Member States. The European prosecutors, divided into chambers, will be responsible for supervising the EDPs and, in exceptional cases, will conduct investigations themselves. The EDPs will be in charge of investigations carried out in the Member States concerned (**Figure 16**).

⁵³ The Netherlands and Malta have joined the EPPO in the course of 2018.

Figure 16 – The EPPO’s structure



Source: Commission.

127 We have analysed the regulation setting up the EPPO in light of our observations on the current set-up for investigating and prosecuting fraud in EU spending. We assessed whether the EPPO will address the following key issues:

- o the current system, whereby OLAF's administrative investigation of suspected fraud is followed by a criminal investigation at national level, takes up much time in a considerable number of cases; and
- o weaknesses in cooperation between OLAF and national authorities.

128 In general terms, we consider establishing the EPPO to be a step in the right direction. However, we would like to highlight several risks that indicate that the EPPO may not address the above-mentioned problems:

- The regulation provides that the EPPO chambers will become supervisors of the operational work of the delegated prosecutors. In order to challenge the opinion of a delegated prosecutor, or even to discuss it with him or her, the chamber will need adequate expertise in national criminal law and procedure in specific cases, not to mention the need for translation. This means that, in order to fulfil its supervisory function, the EPPO's Central Office needs sufficient staff and resources, including national legal experts⁵⁴. An extensive internal consultation and translation may end up taking too long for criminal procedures, where time is very often the most limited resource.
- Under the EPPO Regulation, investigation will be carried out primarily by Member State investigators under the authority of the EPPO. The regulation does not put in place any mechanism enabling the EPPO (or any other EU body) to urge Member State authorities to allocate resources to the pro-active work necessary for the investigation of fraud in EU spending, or to the cases handled by the delegated prosecutors. Since a delegated prosecutor will need the support of its relevant national authority to conduct the investigation necessary for bringing the case to court, their effectiveness will remain heavily dependent on national authorities.
- The EPPO Regulation⁵⁵ allows EU institutions, bodies, offices and agencies (IBOAs) to have OLAF carry out a pre-evaluation of cases to be forwarded to EPPO. Because time is critical to the success of a criminal investigation, excessive use of this option may adversely affect the timeliness of any subsequent action. The future arrangements for cooperation between OLAF and EPPO should make it possible to decide quickly whether to initiate a criminal procedure, or forward the case for investigation by the Member State concerned or by a responsible EU institution by means of an administrative procedure.

⁵⁴ The Commission estimates the cost of the EPPO, with 115 employees, at €21 million per year.

⁵⁵ See recital (51) of Council Regulation (EU) 2017/1939 of 12 October 2017 implementing enhanced cooperation on the establishment of the European Public Prosecutor's Office ('the EPPO').

Conclusions and recommendations

129 Our audit assessed whether the Commission is properly managing the risk of fraud in EU spending. We examined in particular the measures taken by the Commission to prevent and deter potential fraudsters and to recover funds where fraud has been committed.

130 Based on our observations, we consider that more drive is needed in the EU to implement an effective strategic framework for managing the risk of fraud based on sound assessments. We consider there is a clear need for the Commission to step up its fight against fraud in EU spending by clarifying and reinforcing the responsibilities of the various parties involved in managing the fight against fraud.

The Commission's insight into the scale, nature and causes of fraud is insufficient

131 The Commission does not have comprehensive and comparable information on the detected fraud level in EU spending. The Commission's own reporting of detected fraud in areas managed directly by it is not complete. Within shared management, 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 does not carry out comprehensive checks to ensure the quality of data reported in the IMS; nor does it ask Member State authorities to provide assurance as to the reliability of the data reported. The spending DGs perform partial checks on irregularity reporting systems at national level within the framework of system audits ([paragraphs 21 - 32](#)).

132 The Commission has not yet established a way of gaining insight into undetected fraud in order to complement the official statistics, even though there are several accepted ways to obtain insight into the scale of fraud ([paragraphs 33 - 37](#)).

133 We also consider the available qualitative information on the nature and causes of fraud to be insufficient. Some information is available on fraud patterns and schemes used in different sectors, but the information available is not systematically updated. Moreover, we did not find detailed analyses or any study by the Commission to identify what causes some recipients of EU money to commit fraud.

134 Studies using objective corruption proxies have also revealed that the risk of corruption may be increased by discretion in spending and excessive bureaucratic controls,

which act as a barrier to market entry for other suppliers, thereby making corrupt deals easier to sustain ([paragraphs 38 - 49](#)).

Recommendation 1 – Gain better insight into the scale, nature and causes of fraud in EU spending

With a view to a properly designed approach to countering fraud against the EU's financial interests, 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:

- (a) 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.
- (b) 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.

Timeframe: end of 2022

There are weaknesses in the Commission's strategic approach to managing the risk of fraud

135 There are weaknesses in anti-fraud strategies of the Commission and reporting on their effectiveness. While it does have a formal anti-fraud strategy – the Commission Anti-fraud Strategy (CAFS) – the Commission has not updated it since 2011. We therefore question whether it is fit to guide the Commission's anti-fraud activities in practical terms. We note the Commission's intention to update the CAFS ([paragraphs 58 - 64](#)).

136 Under the Commission's governance model, roles and responsibilities for anti-fraud actions are split. The various Commission DGs and services each have their own anti-fraud strategies. There is no central body in charge of ensuring appropriate corporate oversight of anti-fraud activities. This could potentially be a role for OLAF ([Recommendation 4](#)). Strategic fraud risk management and fraud prevention are not specifically mentioned in the portfolios of any single Commissioner ([paragraphs 52 - 57](#)).

Recommendation 2 – Ensure leadership of the Commission’s anti-fraud actions

2.1. To achieve better coordination in tackling fraud, within the context of collegial responsibility for fraud prevention and detection, the Commission should ensure that strategic fraud risk management and fraud prevention would be clearly referred to in the portfolio of one Commissioner.

2.2. The Commission should ensure that, its new anti-fraud strategy:

- is preceded by a comprehensive analysis of fraud risks, using a wide range of data from different sources to establish the scale, nature and causes of fraud in EU spending;
- contains meaningful objectives and measurable indicators; and
- includes reporting based on the achievement of objectives.

Timeframe: end of 2022

Fraud prevention has not received enough attention

137 Although the Commission’s fraud-proofing activities date back to the year 2000, comprehensive anti-fraud provisions were only included for the first time in all top-level regulations for the 2014-2020 period ([paragraphs 66 - 70](#)).

138 Assessing the risk of fraud before adopting spending schemes and putting in place anti-fraud controls is potentially an effective way to reduce fraud losses. For the 2014-2020 spending programmes, however, the Commission required such an assessment of the draft rules only late in the process. Thus, these will only be implemented for the next generation of financial programmes after 2021. In shared management, the Commission did not ask Member States to assess the risk of fraud in their 2014-2020 programmes before adopting them. It is, however, in this area that around 70 % of the EU budget is spent ([paragraphs 71 - 75](#)).

139 Using data for fraud prevention and deterrence can be an effective way either to identify risky economic operators before allocation of funds or to improve future compliance by debarring economic operators and individuals who have been detected committing fraud. Within the Commission, there have been DG-level initiatives to establish such databases, but the use of these tools has been rather limited and not sufficiently coordinated. In particular, the preventive and deterrent impact of the Commission’s exclusion and sanctioning system

is limited, as the DGs in charge of Cohesion policy and Agriculture do not have the power to initiate an exclusion request for fraudulent economic operators supported through these funds. In addition, Member State authorities are not obliged to take exclusion decisions into account in any financing decision involving EU money.

140 Since 2013, DGs EMPL and REGIO have had their own internally developed fraud prevention tool, ARACHNE. Such a tool has the potential to be effective, but currently it still does not contain sufficient data. It is the responsibility of Member States to provide such information on fraudulent economic operators and the private individuals linked to them (paragraphs 76 - 88).

Recommendation 3 – Increase the use of fraud-prevention tools

3.1. In relation to the rules for implementing the spending programmes in the post-2020 period, the Commission should perform a fraud risk assessment and ask Member States to carry out a detailed fraud risk assessment before adopting programmes.

Target implementation date: 2020

3.2. Regarding the Commission's exclusion system, the Commission should

- (a) ensure that DGs use the early detection and exclusion system in direct and indirect management;
- (b) call on Member States to identify and flag fraudulent economic operators and the private individuals linked to them.

3.3. The Commission should urge all Member States to actively participate in the ARACHNE database by submitting timely data and to exploit the opportunities big data offers to prevent fraudulent and irregular use of EU funds.

Timeframe: end of 2019

OLAF's administrative investigations have led to prosecution in fewer than half of cases, and resulted in recovery of less than a third of the funds

141 OLAF judicial recommendations result in the prosecution of fraudsters in around 45 % of the cases. The current system, whereby OLAF launches investigations after receiving information from other sources and whereby OLAF's administrative investigation of

suspected fraud is often followed by a criminal investigation at national level, takes up much time in a considerable number of cases and thus it decreases the chances to achieve its ultimate goal – prosecution ([paragraphs 94 - 104](#)).

142 In a number of cases (concerning fraud or irregularities), DGs do not consider that OLAF's reports provide sufficient information to serve as a basis for initiating the recovery of unduly disbursed funds. In such cases, the DGs take (or outsource) further action in order to decide whether recovery is possible or they rely on evidence provided by their own audits ([paragraphs 105 - 124](#)).

Recommendation 4 – Reconsider OLAF's role and responsibilities in combatting fraud in EU spending in light of the establishment of the EPPO

The Commission should reconsider OLAF's role and responsibilities in combatting fraud in EU spending in light of the establishment of the EPPO.

In particular, the Commission should propose to the European Parliament and the Council measures to give OLAF a strategic and oversight role in EU anti-fraud action.

This could include OLAF acting as an oversight body responsible for:

- (a) leading the design, and monitoring and supervising the implementation, of the Commission's anti-fraud policy, with a specific focus on providing real time detailed analysis of fraud patterns (modus operandi) and the causes of fraud;
- (b) co-ordinating and monitoring anti-fraud activities in Member States.

Timeframe: end 2022

This Report was adopted by Chamber V, headed by Mr Lazaros S. Lazarou, Member of the Court of Auditors, in Luxembourg at its meeting of 14 November 2018.

For the Court of Auditors

Klaus-Heiner Lehne
President

Annexes

Annex I — Extract of relevant legal texts

Article 3 of the PIF Directive

“Fraud affecting the Union's financial interests

2. For the purposes of this Directive, the following shall be regarded as fraud affecting the Union's financial interests:

- (a) in respect of non-procurement-related expenditure, any act or omission relating to:
 - (i) the use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the misappropriation or wrongful retention of funds or assets from the Union budget or budgets managed by the Union, or on its behalf;
 - (ii) non-disclosure of information in violation of a specific obligation, with the same effect; or
 - (iii) the misapplication of such funds or assets for purposes other than those for which they were originally granted;
- (b) in respect of procurement-related expenditure, at least when committed in order to make an unlawful gain for the perpetrator or another by causing a loss to the Union's financial interests, any act or omission relating to:
 - (i) the use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the misappropriation or wrongful retention of funds or assets from the Union budget or budgets managed by the Union, or on its behalf;
 - (ii) non-disclosure of information in violation of a specific obligation, with the same effect; or
 - (iii) the misapplication of such funds or assets for purposes other than those for which they were originally granted, which damages the Union's financial interests”.

Article 325 of TFEU

“The Union and the Member States shall counter fraud and any other illegal activities affecting the financial interests of the Union 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, and in all the Union's institutions, bodies, offices and agencies.”

Annex II — EU and Member State bodies involved in managing the risk of fraud

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

Annex III — Recent legislative initiatives in the EU's area of the fight against fraud

- **The Directive on the fight against fraud to the Union's financial interests by means of criminal law (PIF Directive)** was adopted by the co-legislators on 5 July 2017. Member States have two years (until 6 July 2019) to transpose it into their national legislation. It harmonises the definition of four criminal offences (fraud, corruption, money laundering and misappropriation) as well as sanctions and limitation periods.
- **Regulation 2017/1939 setting up the EPPO** has been adopted in October 2017. The EPPO is expected to start operating from late 2020 or early 2021 onwards in 22 Member States and will be competent to investigate crimes against the EU budget including serious cross-border VAT fraud over €10 million.
- **The proposal to amend the OLAF's Regulation 883/2013 (COM(2018) 338)** concerning investigations conducted by the OLAF as regards cooperation with the EPPO and the effectiveness of OLAF investigations adopted in May 2018.
- **The new Financial Regulation** entered into force in July 2018.

Annex IV — Events triggering Member States to report cases of fraud under criminal investigation to the Commission

Event	BE	BG	CZ	DK	DE	EE	IE	EL	ES	FR	HR	IT	CY	LV	LT	LU	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE	UK	
After indictment	√			√	√			√						√							√		√			√			
After initial sentence	√				√			√						√						√			√			√			
After definitive sentence- final court decision	√			√	√			√	√					√		√	√	√		√	√		√	√	√	√			
Other	√	√	√			√	√			√	√	√	√		√				√	√	√	√		√			√	√	

Annex V — Roles and responsibilities within the Commission for the outcomes of anti-fraud actions in EU spending

Commission bodies	Planning			Implementation			Reporting		
	Fraud risk analysis	Anti-Fraud Strategies	Management Plan	Ex-ante and ex-post fraud controls	Prosecution	Recovery	Reporting on suspected and confirmed frauds (PIF report)	Annual Activity Report	Annual Management and Performance Report
European Commission (College)	Informed	Responsible	Not involved	Informed	Not involved	Informed	Responsible	Informed	Responsible
Member of the Commission, in charge of Budget and HR	Informed	Consulted	Informed	Informed	Not involved	Informed	Consulted	Informed	Consulted
Corporate Management Board	Consulted	Informed	Consulted	Not involved	Not involved	Not involved	Not involved	Consulted	Consulted
DG Director- AOD	Responsible	Responsible	Responsible	Responsible	Not involved	Responsible	Consulted	Responsible	Consulted
OLAF*	Consulted	Consulted	Consulted	Consulted	Consulted	Consulted	Consulted	Consulted	Consulted
Central Services: Sec Gen and DG BUDG	Consulted	Consulted	Consulted	Informed	Not involved	Informed	Consulted	Consulted	Consulted
Internal Audit Service**	Not involved	Informed	Not involved	Not involved	Not involved	Not involved	Informed	Informed	Informed
Clearing House Group ***	Not involved	Not involved	Not involved	Not involved	Not involved	Not involved	Not involved	Not involved	Not involved
The Audit Progress Committee****	Informed	Informed	Informed	Informed	Not involved	Informed	Not involved	Informed	Informed
OLAF Supervisory Committee	Not involved	Not involved	Not involved	Not involved	Informed	Informed	Not involved	Not involved	Not involved
Fraud Prevention and Detection Network of the Commission	Consulted	Consulted	Not involved	Consulted	Not involved	Not involved	Informed	Not involved	Not involved

* Consultation of OLAF on all other actions in the Planning and Implementation Phases is facultative, except where such actions are based on a recommendation by OLAF.

** Following its Charter and International standards, does not have any management responsibility at any stage of the anti-fraud cycle

*** The Clearing House Group can be informed on a case based approach not on a general systemic approach.

**** The APC is informed of issues arising in these areas indirectly, i.e. on the basis of internal and/or external audit findings. The APC is informed about key points of the AARs and of the draft AMPR.

We divided the key players involved in combating fraud into the following four categories:

- **Responsible:** the person or body actually completing a given task and/or is being ultimately answerable to public for the implementation of an activity or decision;
- **Consulted:** the person or body providing an opinion on a particular action or decision before it is taken, including preparation/ review or presentation of the draft documents to those responsible for decision;
- **Informed:** the person or body to be informed after a decision or an action is taken. They may be required to take action as a result of the outcome;
- **Not involved.**

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Acronyms and abbreviations

AAR: Annual activity report

AFCOS: Anti-fraud coordination services

AFS: Anti-fraud strategy

AMPR: Annual management and performance report

AOD: Authorising officer by delegation

CAFS: Commission anti-fraud strategy

DG: Directorate-General

ECJ: European Court of Justice

EDES: Early detection and exclusion system

EPPO: European Public Prosecutor's Office

IBOAs: EU institutions, bodies, offices and agencies

IMS: Irregularity management system

MFF: Multi-annual financial framework

OLAF: European Anti-fraud Office

PACA: Primary administrative or judicial finding

PIF: Protection of the European Union's financial interests

Glossary

Better regulation: The design of policies and laws so that they achieve their objectives at minimum cost. Better regulation is about making sure that the EU actually delivers on the ambitious policy goals it has set itself. It is about ensuring that the policy solution chosen is the best and least burdensome way to reach those objectives. It is a way of working to ensure that political decisions are prepared in an open, transparent manner, informed by the best available evidence and backed by the comprehensive involvement of stakeholders. (Source: Better regulation toolbox).

Conviction: A court's judgement by which the defendant is found to be guilty of having committed a crime. A person can be considered convicted only when the judgement is final.

Corruption: Corruption is the abuse of power for private gain. It comprises of any act or omission that misuses official authority, or seeks to influence the misuse of official authority, in order to obtain an undue benefit.

Detected fraud: Detected fraud includes suspected and established fraud.

Early detection and exclusion system (EDES): The EDES is the new debarment system established by the Commission as of 1 January 2016 to protect the EU's financial interests against unreliable economic operators. Its purpose is to facilitate the early detection of such operators, their exclusion from receiving EU funds, the imposition of financial penalties and, in the most severe cases, the publication of information related to such exclusions or penalties.

Error: An irregularity arising from non-compliance with legal and contractual requirements.

Established fraud: Established fraud describes a case that has been judged to constitute 'fraud' by a definitive criminal court decision.

Financial corrections: can be implemented by a Member State by deducting irregular expenditure from the Member State's payment claim, by paying a recovery order issued by the Commission, or by decommitment. The deduction can take two forms: withdrawal or recovery from beneficiaries.

Fraud: Fraud is an intentional act of deception intended for personal gain or to cause a loss to another party ([Annex I](#)).

Fraud risk: In line with the 2016 fraud risk management guide of the Committee of Sponsoring Organizations of the Treadway Commission (COSO), organisations should

perform comprehensive fraud risk assessments to identify specific fraud schemes and risks, assess their likelihood and significance, evaluate existing fraud control activities and implement actions to mitigate residual fraud risks.

Impact assessment: Impact assessments contribute to EU decision-making processes by systematically collecting and analysing information on planned interventions and estimating their likely impact. Impact assessments must be carried out for all major policy initiatives (i.e. those presented in the annual policy strategy (APS) or, later, as part of the Commission's legislative work programme (CLWP)), with some clearly defined exceptions. In addition, other significant initiatives can be covered on a case-by-case basis.

Indictment: An official notification given to a natural or legal person by the prosecutor of an allegation that he or she or it has committed a criminal offence and by which the prosecutor brings the prosecution to court.

Irregularity: An irregularity is an act which does not comply with EU rules and which has a potentially negative impact on EU financial interests, but which may be the result of genuine errors committed both by beneficiaries claiming funds and by the authorities responsible for making payments. If an irregularity is committed deliberately, it constitutes fraud.

Irregularity Management System (IMS): The Irregularity Management System is a secure electronic tool for reporting, management and analysis of irregularities. IMS is part of the Anti-fraud Information System (AFIS), developed and maintained by OLAF, which facilitates the exchange of information between OLAF and relevant administrations.

Primary administrative or judicial finding (PACA): A 'primary administrative or judicial finding' is a first written assessment by a competent authority, either administrative or judicial, concluding on the basis of specific facts that an irregularity has been committed. It may subsequently be revised or withdrawn as a result of developments in the course of the administrative or judicial procedure.

Prosecution: A prosecutor's decision to charge the defendant with a crime.

Protection of the European Union's financial interests (PIF): Protection of the EU's financial interests is a key element of the EU policy agenda to strengthen and increase the confidence of citizens and ensure that their money is used properly. It concerns not only the management of budget appropriations, but extends to all measures which negatively affect its assets and those of the Member States, to the extent that those measures are relevant to EU policies.

Suspected fraud: An irregularity that gives rise to the initiation of administrative or judicial proceedings being brought at national level to establish whether behaviour was intentional is categorised by the Commission and Member States as 'suspected fraud'.

REPLIES OF THE COMMISSION TO THE SPECIAL REPORT OF THE EUROPEAN COURT OF AUDITORS

"FIGHTING FRAUD IN EU SPENDING: ACTION NEEDED"

EXECUTIVE SUMMARY

Introduction

The Commission agrees with the ECA on the importance of fighting fraud in EU spending and therefore welcomes the decision of the Court to do a Special Report on the topic. It is a complex and multi-faceted subject matter that challenges any observer attempting to get an overview. This challenge is heightened by factors such as the joint responsibility of the Commission and the Member States for the protection of the financial interests of the EU and the multitude of actors involved in the fight against fraud at both levels. The ECA, although an experienced observer, does not take these factors fully into account.

Because of the importance it attaches to financial management and control in general, and to fighting fraud specifically, the Commission created OLAF and reformed its entire system for financial management and control almost 20 years ago, allowing the College of Commissioners to take overall political responsibility for the management of the budget. The architecture of this system has since been continuously improved and refined through sustained efforts by the Commission, not least thanks to successive audits by the ECA (notably two Special Reports on OLAF in 2005 and 2011). These efforts have been intensified in recent years, with the first CAFS of 2011 which is currently being updated, the creation of EDES in 2016, the updated internal control framework of 2017, the new Financial Regulation of 2018, the recent proposal to revise the OLAF Regulation and the ongoing process of setting up the EPPO, just to mention a few of numerous initiatives. The Commission also considers that the benefits of these initiatives, and the overall progress achieved in the past years aimed at reinforcing the financial management and control system of the Commission, are substantial.

The Commission would furthermore like to emphasise that it focuses its limited financial and human resources on areas where it can make the biggest difference, ensuring the highest level of cost-effectiveness, and respecting the principles of proportionality and subsidiarity. This means that it has deliberately chosen not to perform some of the activities that the ECA is suggesting it should perform in the present Special Report. The Commission is currently considering the resource implications of the recommendations of the ECA in the context of the ongoing revision of the CAFS.

V. The specific issues raised by the ECA regarding the Commission's anti-fraud policy cannot be seen in isolation from the important developments listed below:

- Revision of the Staff Regulations for officials and other servants of the European Union in 2013;
- Updated integrated control framework and peer review of fraud risk in 2017; Directive (EU) 2017/1371 on the fight against fraud to the Union's financial interests by means of criminal law (PIF Directive);
- Regulation 2017/1939 setting up the EPPO;
- Proposal of 2018 to amend the OLAF Regulation 883/2013;
- New Financial Regulation 2018/1046;
- Initiative for a revision of the Financial Framework Regulation on decentralised agencies;
- Proposals for post-2020 spending programmes;

- Ongoing update of the Commission's Anti-Fraud Strategy (CAFS).

It should be noted that the recommendations of the EDES Panel go much beyond cases of fraud or corruption: they encompass also, *inter alia* grave professional misconduct, serious breach of contractual obligations, irregularities in the meaning of Council Regulation (EC, Euratom) No 2988/95.

VI. There is no cost-effective method to estimate undetected fraud reliable and defensible enough for evidence-based policy. The methods mentioned by the ECA would not be well-suited in this specific context (see Commission's replies to paragraphs 14–16, 33–37).

In its annual PIF Report, the Commission provides statistics on suspected and detected fraud based on the reporting of the Member States.

The current reporting system represents a good practice in the field of data collection on fraud and is continuously improving. Its limits are overstated in the present Special Report (see Commission's replies to paragraphs 23-31).

The Commission considers that an analysis of what causes some recipients of EU money to behave fraudulently would not be the best use of its limited resources. The Commission gears the analysis of fraud towards the areas and tools that provide maximum effectiveness and efficiency (see Commission's replies to paragraphs 14–16, 29, 33–37, 47).

VII. With regard to the overall impact of OLAF's investigations, it is important to note that the precautionary measures issued by OLAF (see Article 7 of Regulation 883/2013) and the overall deterrent effect of OLAF's actions are also important elements which need to be assessed. The analysis concerning the follow-up of OLAF's investigations is based on a relatively small number of interviews with Commission services and Member States' judicial authorities. Moreover, the analysis of the role and responsibilities of other actors in the current system, in particular other EU institutions and Member States, to detect and investigate irregularities and to take appropriate follow-up measures, is limited. Analysing the anti-fraud action of the Commission and of OLAF requires a comprehensive approach.

As regards the indictment rate, the efficiency of OLAF's investigations cannot be measured by this single criterion, as indictment is only one of the many outcomes of OLAF investigations. It is frequent good practice that OLAF and national judicial authorities work in parallel and coordinate their operational activities. OLAF has in recent years improved its cooperation with the judicial authorities on the follow-up to its recommendations.

The difficulties regarding the follow-up given by national authorities to OLAF's judicial recommendations are a long-standing challenge, well-known to OLAF, the Commission and the Member States. To address this challenge, the Commission has proposed the creation of the EPPO. Also, the recent Commission proposal to amend Regulation 883/2013 aims to improve the follow-up to OLAF's judicial recommendations, notably by clarifying the admissibility of the results of OLAF's investigations in judicial proceedings in Member States.

With regard to recovery, OLAF has taken action to clarify the information provided in its final reports and the content of the recommendations in relation to estimated amounts to be recovered. OLAF issued "*Instructions on drafting Financial Recommendations and related sections of the Final Report*" in October 2016 which should make OLAF recommendations easier to implement. The effect of these instructions on financial recommendations will only be fully visible in the future.

Furthermore, in July 2017 OLAF issued new "*Guidelines on Financial Monitoring*" designed *inter alia* to shorten the period for the spending Directorates-General to calculate the amounts to be recovered.

See Commission's replies to paragraphs 94–125.

VIII. The EPPO Regulation, adopted under enhanced cooperation¹, introduces a significant institutional innovation which will considerably step up the protection of the EU budget against fraud and will also change the landscape of justice in Europe. It will operate as a single body across all participating Member States. The EPPO will be directly responsible for the investigations, prosecutions and bringing to judgement of crimes affecting the financial interests of the Union, hand in hand with national authorities, which will be under an obligation to abide by instructions given by the European Delegated Prosecutors. Member States are also responsible to allocate sufficient resources and have signalled their willingness to do so. The Commission and Member States are working intensively to ensure that the EPPO can start operations at the end of 2020.

IX. Fighting fraud against the EU budget is a joint task and obligation of the Member States and the Commission according to Article 325 TFEU.

X.

Recommendation 1:

The Commission partially accepts the recommendation.

The Commission, in close cooperation with the Member States, has considerably improved its irregularity reporting system over the past years, allowing for a better and more refined analysis.

The Commission is committed to further improve the reporting of irregularities and fraud and the analysis of the nature of fraud, including on the basis of tailored data collection and a better understanding of the overall anti-fraud framework in the different Member States.

It is, however, not possible to establish an estimate of the scale of the undetected fraud which is reliable and defensible enough for evidence-based policy, also taking into account the constraint of the efficient use of the limited resources available to the Commission.

See detailed Commission replies to recommendation 1 in the conclusions and recommendations section at the end.

Recommendation 2:

The Commission partially accepts the recommendation in as far as it concerns the adoption of a new comprehensive anti-fraud strategy. Please refer to the Commission's reply to Recommendation 2 in the recommendations and conclusions section regarding the possible timeline for a comprehensive analysis of fraud risks.

Regarding the recommendation relating to the portfolio of a given Commissioner, the Commission considers that its current internal organisation in practical terms already reflects the recommendation.

See also Commission's reply to paragraphs 50-54.

Recommendation 3:

First indent: The Commission accepts the recommendation.

¹ See Council Regulation (EU) 2017/1939 on the creation of the European Public Prosecutor's Office (EPPO) of 12 October 2017.

In accordance with the Financial Regulation, the relevant Directorates-General are obliged to use the early detection and exclusion system where the circumstances require it. Several actions have already been conducted to promote the use of EDES.

The Commission will continue to call on the Member States to identify and flag fraudulent economic operators. A modification of the Financial Regulation by the legislator would be necessary in order to oblige the Member States as far as shared management is concerned to flag fraudulent economic operators. The Commission had initially proposed a clear obligation for the Member States to use IMS data as grounds for exclusion (COM(2014)358). However, Member States opposed any obligation to exclude on the basis of the information they provide in IMS.

See detailed Commission replies in the conclusions and recommendations section at the end.

Second indent: The Commission accepts the recommendation.

The Commission has provided information on the ARACHNE system in all Member States. However, ARACHNE is used on a voluntary basis as there is no legal obligation to enforce its use. The Commission will continue to provide assistance to the authorities concerned.

Recommendation 4:

The Commission partially accepts the recommendation.

The Commission has already taken action to adapt OLAF's legislative framework and operations in view of the setting-up of the EPPO by putting forward a proposal to revise Regulation 883/2013 (COM(2018)338).

The fight against fraud will be reinforced through complementary action by the EPPO and OLAF. OLAF's fundamental role and responsibility of fighting fraud in EU spending through administrative investigations will not change, however, with the setting up of the EPPO.

The Commission shares the ECA's view that OLAF could assume a stronger role with regard to the anti-fraud policies of the Commission services and executive agencies. Such a strengthened role is being considered in the upcoming update of the Commission Anti-Fraud Strategy (CAFS).

Vis-à-vis the Member States, OLAF will continue to perform its coordinating and advisory functions, notably as the lead service for irregularity reporting and the Advisory Committee for the Coordination of Fraud Prevention. Likewise, the Authorising Officers responsible in the Directorates-General in charge of shared management will continue to exercise their responsibilities with regard to the Member States.

See detailed Commission replies in the conclusions and recommendations section at the end.

INTRODUCTION

5. Articles 317 and 325 TFEU lay down the Member States' duty to cooperate in, and joint responsibility for, the protection of the Union's financial interests in a more general manner. That responsibility includes, *inter alia*, further areas of shared management of EU expenditure, as well as the revenue side of the Union budget.

9. The specific issues raised by the ECA regarding the Commission's anti-fraud policy cannot be seen in isolation from the important recent legislative initiatives and other developments in the area of the fight against fraud listed in chronological order below:

- The revision of the Staff Regulations for officials and other servants of the European Union was made in 2013 to strengthen the legal framework, notably with regard to possible conflicts of interests and increased transparency.
- The updated integrated control framework and peer review of fraud risk was adopted by the Commission on 19 April 2017, under which the most important risks (including fraud) are

assessed by the responsible Authorising Officers, reported on in their Annual Activity Reports and discussed with central services in a peer review process.

- The Directive on the fight against fraud to the Union's financial interests by means of criminal law (PIF Directive) was adopted by the co-legislator on 5 July 2017. Member States have two years (until 6 July 2019) to transpose it into their national legislation. The Directive provides a harmonised legal framework reducing obstacles to an effective cooperation, notably by harmonising the definition of four criminal offences (fraud, corruption, money laundering and misappropriation) as well as sanctions and limitation periods. The material competence of the EPPO is based on the PIF Directive.
- Regulation 2017/1939 setting up the EPPO has been adopted in November 2017. The EPPO is expected to start operating from late 2020 or early 2021 onwards in 22 Member States and will be competent to investigate crimes against the EU budget including serious cross-border VAT fraud over EUR 10 million. The EPPO will bring actions against criminals directly in front of national courts which should lead to more successful prosecutions and a better recovery of the defrauded money.
- The proposal to amend the OLAF's Regulation 883/2013 (COM(2018)338) concerning investigations conducted by the OLAF as regards cooperation with the EPPO and the effectiveness of OLAF investigations was adopted in May 2018. While the EPPO will focus on criminal cases affecting the EU budget, such as corruption or fraud with EU funds, or cross-border VAT fraud criminal investigations, OLAF will continue its administrative investigations into fraud affecting the Union's financial interests in all Member States, including investigations leading to criminal prosecution in Member States that do not participate in the EPPO. The Commission proposal to amend OLAF's Regulation 883/2013 aims to provide clarifications to the cooperation between the OLAF and the EPPO, and to ensure the widest possible protection of the EU's budget. The proposal also aims to enhance the effectiveness of OLAF investigation tools, in particular checks and inspections, as well as access to bank account information.
- The new Financial Regulation entered into force in July 2018 and reinforces the means to counter shell companies and the use of tax havens by intermediaries managing EU funds. It consolidates the European Early Detection and Exclusion System (EDES) by making it fully applicable to implementing partners under indirect management. More generally, it simplifies financial rules, making them easier to control and less fraud prone.
- The revision of the Financial Framework Regulation on decentralised agencies has been proposed by the Commission to strengthen the governance of EU decentralised agencies in particular in the area of fraud, notably with the introduction of an obligation for decentralised agencies to report cases of fraud or investigations to the Commission without delay and of the obligation on agencies to adjust their internal control systems where they run decentralised offices away from the main seat. This revision is targeted to enter into force by 1 January 2019.
- The proposals for post-2020 spending programmes contain specific recitals and provisions regarding the protection of the EU financial interests, notably on the competences of OLAF. Further anti-fraud provisions have been included in the proposal for a Common Provisions Regulation.
- The update of the Commission's Anti-Fraud Strategy (CAFS), originally adopted in 2011, is ongoing. In this process, OLAF has compiled a qualitative fraud risk assessment as a synthesis of the contributions received from the different Commission services.

OBSERVATIONS

Common reply to paragraphs 14-16:

The issue of fraud measurement has been discussed and analysed intensively. Although the Commission agrees with the ECA that it would be desirable, it is not possible to have an estimate of the undetected level of fraud reliable and defensible enough for evidence-based policy, also taking

into account the constraint of the efficient use of the limited resources available to the Commission. While useful for other purposes, the research methods suggested by the ECA would not be well-suited to this context and would risk leading to biased decision-making or, at least, to an added-value not proportionate to the cost. This is further discussed in the replies to paragraphs 33–37.

On the basis of these considerations and in line with the provisions of Article 325(5) TFEU, the Commission has decided to focus on the scale and nature of irregularities and (suspected or established) fraud detected and reported *via* the well-established IMS and is constantly refining this method. This approach provides solid knowledge about the weaknesses actually exploited by fraudsters.

The Commission is aware of the limitations of this approach, but considers that, at present, this is the most effective method. Activities in the anti-fraud area should be seen as a continuously developing process that builds on achievements and developments, which may seem insufficient if checked against a theoretical model but need to be assessed in relation to the overall complexity of the system and its historical development. Such an evolutive approach paves the way for future improvements. Further steps can be taken such as better exploiting the existing databases.

23. The Commission has continuously improved the quantity and quality of the irregularity reporting. The reporting obligation and its derogations and limitations are presented in the material supporting the PIF Report and namely in the Commission Staff Working Document (2016)237 final (explicitly quoted also in relation to the PIF Report 2016). See Commission's replies to paragraphs 24–31.

24.

First bullet point: The new *"Handbook on reporting of irregularities in shared management"*, prepared by OLAF in cooperation with experts from the Member States, clearly indicates OLAF's final report as one of the facts generating the obligation on Member States to report. IMS provides for a specific field to indicate the reference number of the OLAF investigation. However, this key information may not always be known at the level of the reporting authority in the Member State. The Commission notes that the quality of the data depends on the quality of the reporting by the Member States.

Second bullet point:

First sub-bullet point: Fraudulent cases arising from the activities of intermediate public bodies involved in implementing an operational programme through project selection or public tendering must be reported in IMS, with some limited exceptions (i.e. reporting threshold). The reference made by the ECA is related to the definition of "economic operator", which does not include public bodies exercising their prerogatives as public authority. The *"Handbook on reporting of irregularities in shared management"* refers to the case-law of the European Court of Justice to limit the situations in which public bodies are not considered to act as an economic operator (therefore limiting the situations which are not reported via IMS).

Second sub-bullet point: From a legal point of view, the obligation to report "suspected fraud" cases covers also cases for which no payment has been made. However, it is true that non-fraudulent irregularities for which no payment has been made are covered by derogation to report.

From a technical point of view, IMS has no mandatory fields, besides those related to the fund and programming period. The field "project name" can therefore be left empty and does not prevent reporting.

Third bullet point: The Commission acknowledges that a certain amount of information may be lost due to the reporting threshold of EUR 10 000. However, it mainly relates to minor cases which, to a large extent, concern individual perpetrators operating simple fraudulent schemes. Therefore the

added value of this information would be limited. The majority of these cases are also likely to be dismissed by national prosecution services.

However, Member States are obliged to follow up on detected irregularities, regardless of the reporting threshold.

The Commission estimates that the “final detection rate” would change only marginally in case there were no thresholds².

25. The Commission acknowledges that reporting practices can vary not only per country but also per reporting authority. Relevant explanatory information can be found in the various Commission Staff Working Documents accompanying last years’ PIF Reports.

The Commission continuously works on streamlining the reporting practice as much as possible by informing and advising Member States *via* meetings, trainings, manuals, guidance notes, handbooks and feedback on reported cases. In addition, actions concerning the reliability of IMS data are taken (see reply to paragraph 30). The handbook quoted by the ECA was issued in 2017. This cannot yet have had any impact on information analysed by the ECA and presented in Annex 4.

It should be considered that the issues raised by the ECA may have an impact on the detection rate of the specific reporting year, but that such impact decreases significantly in respect of multiannual analyses or analyses focussed on a whole programming period, like those published and updated every year in the Commission Staff Working Document “*Statistical evaluation of irregularities*”.

26. The introduction of fraud detection rates has helped to have an objective indicator to measure the performance of Member States, rather than comparing absolute numbers, representing another step forward in a continuous process.

27. While detection rates are indicators of fraud to be considered, direct comparison of detection rates must be put into context. The overall anti-fraud framework in the different Member States is the background against which data on detections and related differences among Member States should be interpreted. OLAF analyses such data and works with Member States to improve prevention, detection and reporting in the Member States.

28. Analysing the underlying reasons for differences in reporting implies analysing the 28 national anti-fraud systems in detail. This is a resource-intensive approach which could be only progressively implemented.

29. While it might be considered in the context of a broader and deeper analysis of the overall anti-fraud framework in the different Member States, the absence of a strong correlation between reported fraud detection rates and perception of corruption should not be over-emphasised. Corruption is one of the many *modi operandi* through which fraud against the EU budget is perpetrated.

Furthermore, see Commission's replies to paragraphs 33–37 about perception indexes.

² In 2005, the reporting threshold was increased from EUR 4 000 to EUR 10 000. At the time, an estimation was made of the amount of information lost in the process: the increased threshold would have implied a reduction of about 45% of the reported number of irregularities, but a loss of only 5% of the related financial amounts. Translated in terms on the fraud detection rate in 2017, this would imply a figure 0.22% instead of 0.21%.

30. In relation to the reliability of IMS data, the Commission itself does not have the capacity of auditing it on a general scale. However, OLAF invests in streamlining the reporting practices of the Member States (see reply to paragraph 25) and in performing basic quality checks.

Checks relating to the irregularity reporting systems are performed in the framework of system audits.

Member States have to put in place effective and proportionate anti-fraud measures as part of their management and control system, based on a risk assessment. This is a specific regulatory anti-fraud requirement for 2014–2020 introduced in the Common Provisions Regulation (Article 125(4)(c) CPR). In the guidance note related to this Article, the Commission indicates that the establishment of clear reporting mechanisms is a key element of prevention as well as detection. It is confirmed that suspected fraud must be reported by the authority designated by the Member State in line with the requirements under Article 122(2) CPR.

As concerns regional policy, under Key Requirement 7, the Commission's auditors check whether under a certain Operational Programme Managing Authorities have complied with their general obligation to prevent, detect, report and correct irregularities, including fraudulent ones. Some audit findings by the Commission services have covered *e.g.* the absence of reporting through IMS with regard to irregularities detected.

As concerns the Common Agricultural Policy, the Commission assesses the quality of the data in IMS in the context of its EAGGF Guidance audits. Irregularities (including fraud cases) are reported in an annex to annual accounts.

In connection with audits, the Commission requests the audit authorities to carry out verifications on the implementation of the anti-fraud measures. The standard scope of the Commission's own early preventive audits (EPSAs) also includes the review of the anti-fraud measures.

31. There are no perfect systems for the collection of data on criminal cases linked to the EU financial interests investigated by national authorities, and national systems are mostly incomplete and not accessible to the Commission.

Even the Member States which collect criminal investigation statistics tend to have very generic data, which relate to violations of Criminal code articles rather than specifying the EU or national fund or the type of operation affected.

Therefore the most complete system which systematically collects information about criminal cases linked to the EU financial interests is IMS. As any system, the Commission acknowledges that IMS may be further improved.

Common reply to paragraphs 33–36:

The Commission considers that, in the context of measuring fraud in the EU budget, estimating fraud through victimisation, encounter and perception studies is not fit-for-purpose, as these methods are more focused on identifying or using risk indicators for specific purposes and in specific sectors on the basis of administrative data. The ECA makes reference to survey-based indexes for measuring corruption and suggests that this methodology can be translated in the context of measuring undetected fraud against the EU budget. These methods are open to several criticisms highlighted by the same publications referred to by the ECA itself. Furthermore, these difficulties are significantly increased in relation to certain areas of budget expenditure, such as development aid.

In addition, according to paragraph 3.14 of the ECA's Annual Report 2015, the Composite Indicators Research Group (financed by the EU) has pointed to the fact that composite indicators, while they illustrate the bigger picture, may lead to simplistic policy conclusions.

Therefore, while useful for other purposes, victimisation, encounter or perception surveys would not be well-suited for measuring fraud to EU spending and would risk leading to biased decision-making or, at least, to an added-value not proportionate to the cost.

Finally, the Financial Regulation provides that the EU budget shall be implemented in compliance with the proportionality principle and an effective and efficient internal control. In this respect, the prevention, detection, correction and follow-up of fraud and irregularities is based on best international practices, and rests on the implementation of an appropriate risk management and control strategy coordinated among appropriate actors involved in the control chain. The Financial Regulation provides that internal control and budget implementation should evolve with an improvement of the cost benefit ratio of controls. In other terms, the cost of controls must be proportionate and commensurate with results in terms of recovery.

The Commission is committed to improving the risk management assessment and control strategy.

Box 1

The Commission underlines that the quality of control of corruption was only one of the indicators used in the study "*Assessing the quality of government at the regional level using public procurement data*".

37. The Commission considers that the examples of the ECA illustrate that the Commission can enhance its fraud analysis. However, the illustrated methods are not cost-effective to estimate the scale of undetected fraud or corruption in a robust, reliable and defensible manner to support evidence-based policy initiatives, given the diversity of the EU budget.

39. OLAF analyses fraud also to comply with Regulation 883/2013. OLAF contributes to the design and development of methods of preventing and combating fraud, corruption and any other illegal activity affecting the financial interests of the Union. OLAF promotes and coordinates, with and among the Member States, the sharing of operational experience and best procedural practices.

Common reply to paragraphs 40-42:

The PIF Report refers to the whole budget of the EU and for this reason it must keep a general approach. The analysis is deepened, refined and enriched year after year (as recognised by the main stakeholders: the Member States and the European Parliament). The PIF Report 2017, for instance, includes a detailed analysis by component in the agricultural policy and adds an analysis of "Transport", another priority area.

OLAF analyses the nature or *modus operandi* of fraud, in general (through the PIF Report) and more in-depth (through specific projects). OLAF's own analytical work on fraud patterns and systemic vulnerabilities could indeed be intensified and broadened, as suggested by the ECA, depending on the resources devoted to analysis and prevention. Although spending programmes develop over time, the fundamentals of the programmes, and therefore the risks of fraud, will not change substantially. The case compendiums therefore remain valid and useful.

The Commission considers that the analysis of fraud patterns and systemic vulnerabilities should be a priority while noting that such studies are very resource-intensive.

43. In accordance with Article 74(2) of the Financial Regulation, the Commission has a decentralised structure for internal control, including risk analysis and anti-fraud action. It relies on the capacities and competences of Authorising Officers by Delegation that are entrusted with management of EU funds, including the identification and mitigation of fraud risks. This is why these risks are assessed primarily at the level of Directorates-General.

However, the Commission services are guided and supported in their fraud risk management at the corporate level in multiple ways, e.g. through the Commission's Internal Control Framework of

2017 and the corresponding Implementation Guide, through OLAF's 2016 *"Methodology and guidance for DGs' anti-fraud strategies"* and through exchange of views and best practice, notably in the Commission's Fraud Prevention and Detection Network.

For the on-going update of the Commission's Anti-Fraud Strategy (CAFS), the Commission is making use of the services' individual risk analyses, which OLAF has compiled into a qualitative corporate fraud risk assessment.

44. Commission services act in compliance with effective and efficient internal control, as required by Article 36(1) of the Financial Regulation, both in choosing analytical methods for their fraud risk assessment and in determining the anti-fraud controls that will be deployed to mitigate fraud risks. That said, the Commission intends to reinforce OLAF's analytical capabilities, which will, in due course, contribute to a refinement of fraud risk assessments (see the Commission's replies to recommendations 1, 3.1 and 4).

Some Commission services, in particular DG REGIO, use external sources as appropriate (e.g. Transparency International and DIGIWHIST).

45. Without a detailed analysis of the methodology used to establish the global fraud risk register of the Chartered Institute of Public Finance and Accountancy, it is difficult for the Commission to assess its added value for protecting the Union's financial interests. Doubts in this respect are raised by the fact that the register assigns a significantly higher fraud risk to payroll fraud (41%) than to procurement fraud (32%).³ No comparable trend is reflected in OLAF's investigations.⁴

46. The Commission agrees, in general, that the analysis of fraud-related data could be strengthened (see Commission's reply to recommendation 1). However, the Commission is not of the opinion that the suggested avenues of analysis are superior to assessment methods currently used by Commission services.

As concerns DG AGRI, EU bodies managing Common Agricultural Policy funds are closely followed by the audit services of DG AGRI to ensure they have the appropriate management and control systems in place. Through this exercise, beneficiaries are surveyed indirectly, too.

The assurance framework established by the Commission to ensure legality and regularity of expenditure minimises at the same time the risk of fraud.

47. The Commission services' priority is engaging in identifying vulnerabilities and fraud schemes and in awareness-raising actions about these schemes.

Regarding the causes of fraud, the Commission is considering intensifying work on profiling fraudsters targeting the EU budget, as one of the tasks of an enhanced analysis function as recommended by the ECA..

48. The "modus operandi" referred to by the ECA (i.e. the nature of fraud, such as artificially created conditions) is covered by OLAF's analytical work.

Because complex rules tend to be error and fraud prone, the Commission has proposed simplification of general and sectoral financial rules. Evidence shows that this is working for instance in reducing irregularities and fraud in Horizon 2020. The 2018 Financial Regulation further

³ <https://www.moorestephens.co.uk/news-views/november-2017/misspending-public-money-is-top-risk-area-for-frau>

⁴ See OLAF Report 2016, pp. 15-18, for the importance of procurement fraud.

simplifies the rules on reimbursement of costs, promoting the use of the simplified cost options (lump-sums) and of forms of financing not linked to costs. By doing so, it provides simpler and less fraud prone financial rules for the 2021-2027 spending programmes.

Box 2

The Commission shares the ECA's concern. To prove artificial conditions, the strict conditions set out by the European Court of Justice need to be followed. It is vital to preserve legal certainty of beneficiaries who act in accordance with the applicable legislation. Therefore, paying agencies can only refuse payment based on clearly established evidence, and not on mere suspicions. Accordingly, they often invest time and effort to gather conclusive evidence and subsequently launch recovery procedures.

49. The "opportunity for discretionary spending" referred to by the ECA is linked to the subsidiarity principle but not without limits: eligibility criteria and conditions must be agreed with the Commission and cannot be subsequently modified unilaterally. In that sense, spending is never fully discretionary.

The "allowed" degree of discretionary spending is related only to certain areas of shared management, where Member States must formally designate authorities that will manage the funds and also have the obligation to put in place a Management and Control System (MCS) with adequate management verifications and an independent audit body.

The Commission conducts audits (system audits and audits of operations) where risks are identified. Payments to programmes can be interrupted in cases of serious deficiencies to the MCS.

Therefore, the legal framework for shared management in the Programming Period 2014-2020 ensures that controls are in place at all levels, taking into due account the risks linked to discretionary spending.

Managing Authorities have some discretionary powers, but programme implementation is scrutinised by an Independent Audit Body and they remain subject to EU law, Commission/ECA audits and OLAF investigations.

Nevertheless, the Commission will consider the ECA's suggestion to analyse how discretion in EU co-financed programmes affects the risk of fraud.

Common reply to paragraphs 50-54:

Strategic fraud risk management and fraud prevention are important objectives for the Commission.

It has put in place a decentralised model of financial management, where Authorising Officer by Delegation, e.g. Directors-General, are responsible for internal control, including risk management and fraud prevention. Since 2017, all Commission services are obliged to appoint a senior manager in charge of risk management, to support and advise the Authorising Officer by Delegation on matters of internal control, including fraud risk management. In addition, it should be noted that Member States also play an important role in the fraud risk management for the EU budget, in particular in the areas under shared management.

The Member of the Commission in charge of anti-fraud steers and puts forward initiatives to improve the fight against fraud, while the College of Commissioners takes overall political responsibility for the management of the EU budget. Each Member of the Commission receives fraud-related information directly by the service under his or her responsibility and reports important cases to the College.

The individual mission letters by the President of the Commission are committing each Commissioner to pay specific attention to sound financial management of EU funds which

reinforces the Commission's political commitment to apply the principle of zero tolerance for fraud and to systematically ensure the protection of the EU budget from fraud.

The Commission considers that OLAF could assume a stronger and more strategic role as a coordinator with regard to the anti-fraud policies of the Commission services and executive agencies.

The Commission notes that Annex V is a simplified presentation of its governance model. The Commission also notes that, in reality, its model of financial management differentiates between political and operational responsibilities.

55. The Commission takes the view that OLAF already has a role in providing an overview of anti-fraud actions and reporting on outputs. *Inter alia*, OLAF is lead service for the design of the corporate anti-fraud strategy and coordinates its implementation. Moreover, OLAF provides methodological guidance for departmental anti-fraud strategies and monitors their implementation by taking part in the central review of Management Plans and Annual Activity Reports.

OLAF's oversight role is being considered in the ongoing update of the CAFS.

56. The 2014–2020 Common Provisions Regulation (CPR) has introduced for the first time a regulatory requirement obliging Member States to put in place effective and proportionate anti-fraud measures, based on a risk assessment.

The Commission launched a stock-taking study on the implementation of Article 125(4)(c) in all Member States in 2017. This study was finalised in 2018 and the findings demonstrate that overall Member States have put in place proportionate anti-fraud measures in relation to the risks identified.

A thematic audit on the effectiveness and proportionality of anti-fraud measures has been launched by DG EMPL in 2018 (covering DG REGIO and DG EMPL programmes).

The Commission is monitoring with the Member States' programme authorities in cohesion policy each fraud case brought to its attention.

Regular exchanges of best practices take place in the Advisory Committee for the Coordination of Fraud Prevention (COCOLAF) and are reported in the annual PIF Report.

59. Important recurrent activities provided for in the 2011 CAFS (such as updating departmental anti-fraud strategies, fraud-proofing of funding instruments and anti-fraud training) continue still today and are accounted for in the services' Annual Activity Reports. Likewise, the principles guiding the Commission's fight against fraud as announced in the 2011 CAFS remain valid.

60. The Commission confirms that the objectives in its anti-fraud strategy are largely of a general nature; however, the objectives are implemented through very specific actions which are accompanied by output indicators.

Where possible and adequate the Commission has defined quantitative targets (e.g. participation in anti-fraud trainings or fraud awareness level in the Directorates-General), which are embedded in the anti-fraud strategies (AFS) and in the relevant strategic planning and programming documents (Management Plans/Annual Activity Reports).

That said, the Commission agrees with the ECA on the desirability of increasing the result-orientation and measurability of its anti-fraud action. Further improvements in this respect will have to build on an enhanced analysis function as recommended by the ECA, which can, however, only gradually be implemented.

62. The annual PIF Report presents the outputs of the Commission's and Member States' anti-fraud actions but also assesses, albeit at a limited level, the effectiveness of some of these actions, especially the anti-fraud measures taken by the Member States.

Although the PIF Report does not provide an absolute assessment of the effectiveness of all horizontal anti-fraud actions adopted by the EU and its Member States, it does achieve its mission according to Article 325(5) TFEU with its comprehensive overview on anti-fraud actions taken. As concerns the assessment of the total effectiveness of these actions, more targeted, in-depth and resource-intensive studies would be required.

63. The Annual Management and Performance Report (AMPR) for the EU budget is a report built on the information made available by the Authorising Officers by Delegation in their Annual Activity Reports. As far as anti-fraud action is concerned, it includes a section with information on anti-fraud strategies and, as of 2017, a section on the protection of the EU budget. The Commission will give further consideration to the most suitable way of presenting its anti-fraud policies in the AMPR. However, this corporate report, which covers the whole spectrum of Commission policies and activities, will have to retain its summarising nature. More information on the Commission's anti-fraud actions is provided in the annual PIF Report and in the Annual Activity Reports of the Directorates-General. The latter include a subsection dedicated to fraud prevention and detection.

64. The Commission agrees with the ECA on the desirability of increasing the result orientation and measurability of its anti-fraud action.

See also Commission's reply to paragraph 60.

67. The Commission underlines that Article 125(4)(c) of the Common Provisions Regulation has provided the framework for the Commission services to reinforce their anti-fraud efforts in the 2014–2020 ESI Funds. However, already during the 2007–2013 programming period, the Commission services implemented effective and proportionate irregularity controls before spending occurred with a view to protect and safeguard the EU budget.

An overview of achievements of the Commission's earlier fraud-proofing measures is presented in a Commission Staff Working Document of 2007.⁵ For the Programming Period 2007–2013, the Commission initiated e.g. a review of Member States' obligations to report irregularities under shared management.⁶

Sector-specific legislation in the domain of shared management contains provisions on irregularities, of which fraud is a sub-category; those provisions have been in place for a long time.

68. The study initiated by the Commission on “*Preventing fraud and corruption in the European Structural and Investment Funds – taking stock of practices in the EU Member States*” provides an overview of the Member States implementation of article 125(4)(c) of the Common Provisions Regulation (CPR). This study was finalised in 2018 and amongst others gives an overview of practices and actions taken in the Member States. The study is considered as a first step and on the basis of its findings follow up and further actions will be considered by the Commission.

70. The lack of a standardised procedure for the follow-up of administrative recommendations, which are all different, cannot be interpreted as lack of impact of such recommendations. OLAF is, in fact, working on the outcome of such recommendations on a case-by-case basis. OLAF and the

⁵ SEC (2007) 1676.

⁶ Commission Regulation (EC) No 2035/2005 of 12 December 2005, OJ L 328, 15.12.2005, p. 8.

Commission are currently exploring how to strengthen the monitoring of the follow-up to OLAF's administrative recommendations.

71. Assessment of fraud risk is part of the Commission's framework for conducting impact assessments of legislative proposals. Tool #25 on prevention of fraud was added to the Better Regulation Toolbox in its 2017 revision.⁷ Fraud risk should only be addressed in an impact assessment when it is relevant to do so. This is a key principle of proportionate analysis underpinning the Commission's impact assessment system.

72. The Better Regulation Guidelines prior to 2017 did not prevent fraud risk assessments. For the 2014–2020 period, such assessments were carried out, even if not required by the Better Regulation Guidelines at the time. Spending programmes were fraud-proofed in cooperation between the spending departments and OLAF, in accordance with the 2007 Commission Communication on fraud-proofing and the 2011 CAFS. The 2017 revision of the Better Regulation Guidelines now explicitly provides for a fraud prevention tool.

73. Prevention, detection, correction and follow-up of fraud and irregularities are amongst the objectives of internal controls (Article 32 of the Financial Regulation).

In the context of shared management, which concerns 80% of the EU budget, the risk of fraud has to be assessed by the managing authority in its programme's context (Article 125(4)(c) of the Common Provisions Regulation). The proposals for the 2021–2027 programmes contain a provision requiring that the authority responsible for managing the programme "*put in place effective and proportionate anti-fraud measures and procedures, taking account of the risks identified*". This provision, once adopted, will apply to the seven shared management funds covered by the Common Provisions Regulation.

While the requirement of fraud risk assessments in the process of designing spending programmes will be formalised even more strongly for the Multiannual Financial Framework (MFF) post-2020, fraud-proofing was already a principle upheld by the Commission in the current MFF.

More specifically, the Commission considers that it has properly addressed the issue of fraud prevention and detection controls by proposing a range of substantial measures in each of its legislative proposals of 29 May 2018 accompanying the MFF package:

- the legislative financial statements list measures to be taken for preventing fraud and irregularities;
- dedicated provisions identify who (e.g. Commission, Member States) shall impose proportionate anti-fraud measures and procedures, taking into account the risks identified;
- a specific recital recalls the competences of OLAF (and EPPO from 2020) and lists the regulations from which those competences originate.

OLAF has examined the pertinence of those measures for fraud-proofing prior to their adoption by the Commission.

In addition, the new Financial Regulation has brought about simplified methods of financing, which are less prone to fraud, such as the possibility to use lump sums, flat-rate financing and unit costs for grants.

⁷ https://ec.europa.eu/info/files/better-regulation-toolbox-25_en.

75. The Commission proposed in the Multiannual Financial Framework post-2020 spending programmes horizontal recitals and provisions regarding the protection of the EU financial interests against unreliable economic operators.

In accordance with the Financial Regulation, the necessary and equivalent rights and access have been granted to the Commission, OLAF, the EPPO and the ECA.

The possibility to reuse the contributions from the funds as provided for in Common Provisions Regulation serves as an incentive for the Member States to apply financial corrections themselves.

The Commission provides systemic fraud proofing and is revising the way the fraud proofing is done in the context of the ongoing update of the CAFS.

See also reply to paragraph 72.

80. Decisions on sanctions are not only based on information received by the entities listed in this observation. They can also be based *i.a.* on information from audits by authorising officers or under their responsibility, disciplinary measures by competent supervisory bodies responsible for the verification of the application of standards of professional ethics, and decisions by the Commission or competent national authorities relating to the infringement of EU or national competition law.

In the future, facts established in the context of audits or investigations carried out by the EPPO should also be a source of information.

81. Exclusion of unreliable economic operators on the basis of a recommendation by the panel referred to in Article 143 of the Financial Regulation (formerly Article 108 of the 2012 Financial Regulation) requires a certain procedure, to respect the right to be heard and the proportionality principle.

82. Fraud or corruption frequently matches other grounds of exclusion. Therefore, where exclusion for fraud or corruption was not legally possible for facts committed before 2016, exclusion was taken on other applicable grounds, such as grave professional misconduct and serious breach of contract, and the deterrent impact of the system was ensured.

83. For facts dating from before the entry into force of the new Financial Regulation in August 2018, the legislation will allow excluding natural persons in exclusion situations and who are essential for the award or for the implementation of legal commitments.

84. For facts dating from 2016 onwards, the Financial Regulation allows for the exclusion of economic operators where a manager is in a situation of exclusion. Where applicable, the Commission will make use of this possibility and considers that other institutions and EU bodies should do the same.

The new Financial Regulation provides for means to counter shell companies and the use of tax havens by intermediaries managing EU funds.

It is important to note that the legal constraints in which both systems operate are different. In particular the World Bank decisions are not subject to appeal and/or national judicial legal orders.

Common reply to paragraphs 85 and 86:

ARACHNE can form an important support for effective and proportionate anti-fraud measures according to Article 125(4)(c) of the Common Provisions Regulation (EU) 1303/2013. It is designed to help Member States authorities to prevent and detect errors and irregularities among projects, beneficiaries, contracts and contractors.

Since 2013, the Commission services have been informing the Member State authorities on a regular basis about the potential benefits of using ARACHNE.

87. The Commission is investigating whether the data from the EDES system (and potentially ABAC) can be integrated into ARACHNE, also with a view to allowing direct management spending to be tested for the presence of fraud indicators.

88. The development of ARACHNE was completed in May 2013 (first installation) and the data from the Member States who decided to integrate ARACHNE in their anti-fraud strategy have since then been gradually included.

EDES applies to all aspects of direct and also indirect management, since the entry into application of the new Financial Regulation.

The new EDES system was put in place in 2016 and thus the ECA's findings are based on public figures only relating to the initial period up to 30 June 2018. This does not allow for an assessment of the functioning of the system, including of its deterrent effects.

90. The Commission notes the following additional and important aspects for assessing the impact of OLAF's administrative investigations:

- an in-depth analysis of administrative recommendations to address systemic shortcomings;
- precautionary measures issued by OLAF in the course of an investigation pursuant to Article 7 of Regulation 883/2013 to avoid further aggravation of fraud or irregularities;
- the deterrent effect of OLAF investigations on potential fraudsters;
- the responsibilities for Commission services and Member States (reporting to OLAF and implementing its recommendations) to render OLAF's work effective in practice.

Furthermore the Commission and/or OLAF have initiated a number of key reforms to increase the effectiveness of OLAF's investigative activities . These reforms include:

- OLAF instructions to investigators on financial recommendations (2016);
- OLAF's review of its monitoring regime for recommendations to ensure quicker follow-up (2017);
- the PIF Directive (2017);
- the revision of the Financial Regulation (2018);
- the proposal to amend Regulation 883/2013 to improve, *inter alia*, the investigative tools to OLAF and facilitate the uptake of OLAF's final reports (2018).

91. OLAF's judicial recommendations may also contain general proposals to the judiciary to consider OLAF's findings in the final report in their entirety which widens the scope of judicial action.

92. In line with Article 11(1) of the OLAF Regulation, OLAF's recommendations indicate the action to be taken by the IBOA and the competent authorities of the Member States. Pursuant to Article 11(2), OLAF's final reports constitute admissible evidence in administrative or judicial proceedings in Member States in the same way and under the same conditions as administrative reports drawn up by national administrative inspectors. In order to further improve the impact of OLAF's investigations, the Commission has in its proposal for amending Regulation 883/2013 introduced measures to strengthen the usability of OLAF's final reports in national proceedings.

94. The follow-up given by national authorities to OLAF's judicial recommendations is a long-standing challenge, well-known to OLAF and the Commission. As explained below, this is due to a number of factors, e.g. the fact that each Member State has its own prosecution policy with regards to PIF offences.

To address this challenge, the Commission has proposed the creation of the EPPO. It is expected to bring a more consistent and effective prosecution policy in EPPO Member States for crimes affecting the EU budget, leading to more prosecutions, convictions and a higher level of recovery.

Moreover, differences in the scope and definition of criminal offences have been further addressed by Directive (EU) 1371/2017 (the "PIF Directive") (see also reply to paragraph 97).

The recent proposal to amend Regulation 883/2013 aims *inter alia* to enhance the effectiveness of OLAF's investigative function, and it is therefore expected that the use of OLAF investigation results in judicial proceedings in Member States will be improved.

To better understand the precise reasons for dismissals and to improve the follow-up of its investigations, OLAF has undertaken an in-depth analysis of Member States' follow-up to its judicial recommendations issued between 1 January 2008 and 31 December 2015, examining 169 judicial recommendations issued by OLAF and dismissed by Member States' judicial authorities, out of a total of 317 recommendations. OLAF is in constant dialogue with Member States' judicial authorities to improve the indictment rate.

95. As regards the comparison between numbers of indictments resulting from OLAF's judicial recommendations and numbers of national own prosecutions, the different context and conditions under which OLAF operates as compared to national authorities need to be considered. .

The responsibility to counter fraud and any other illegal activities affecting the financial interests of the Union is incumbent on the Union and on the Member States⁸ as a shared responsibility. In this context, Member States' action naturally takes a larger share in numerical terms. This is also illustrated by the figures published by the Commission on an annual basis in its reports on the protection of the European Union's financial interests (PIF Reports)⁹.

Action at EU and national level is complementary and the fact that the EU level is equipped with its own investigative capacity is a crucial building block in the fight against fraud as a whole. Both levels benefit from close cooperation.

In addition, even when not leading the investigation, OLAF often forwards information and provides assistance to the competent authorities in the Member States and, especially in the context of coordination cases, contributes to investigations carried out by national authorities.

96. The Commission notes that the ECA report does not compare the indictment or dismissal rates for OLAF's judicial recommendations with comparable data from the Member States. This would have facilitated the assessment of whether OLAF's recommendations have an appropriate impact at national level.

As the number of indictments in itself has limited informative value, OLAF has undertaken a more in-depth analysis of Member States follow-up to OLAF's judicial recommendations issued between 1 January 2008 and 31 December 2015, mentioned above under paragraph 94.

⁸ Cf. Article 325 TFEU.

⁹ For the latest version, see Report from the Commission to the European Parliament and the Council, 'Protection of the European Union's financial interests – Fight against fraud 2017 Annual Report', Brussels, 03.09.2018, COM(2018) 553 final. A similar tendency is reflected by other systems relying on complementarity of investigations at EU and national level (e.g. enforcement of EU competition rules, see <http://ec.europa.eu/competition/ecn/statistics.html>).

This analysis was not limited to the expenditure area – the subject of the ECA’s audit – but included also internal investigations and the revenue area, i.e. customs investigations.

First bullet point: According to the OLAF's analysis of Member States' follow-up of OLAF's judicial recommendations, the category of cases with “insufficient evidence” encompasses a wide range of heterogeneous factual and legal situations. It includes, in particular, cases where a full collection of evidence was in practice not feasible for OLAF because of the limitations of its investigative powers as well as situations where Member States' authorities questioned the evidentiary value of OLAF's final report due to the uncertainty of the applicable legislation.

In addition, the number of cases dismissed due to “insufficient evidence” (a common explanation for not opening a case) may also vary according to the different procedural rules and practices in the Member States. In general, the Member States have a wide margin of appreciation at the various stages of investigation and prosecution.

It should also be emphasised that in a significant number of cases, OLAF does not receive the detailed reasoning on the actual grounds for dismissal.

Second bullet point: Despite the degree of harmonisation achieved under the PIF Convention (and pending the transposition of the PIF Directive), there are still notable differences in national criminal laws at a detailed level which may affect the question of whether a certain conduct is considered an offence at Member State level. OLAF always conducts a first assessment considering whether the facts under investigation fall under the definition of EU fraud according to the applicable EU legislation. It is then the competence of national authorities to decide whether to follow-up OLAF's recommendations or not.

Third bullet point: While time barring can in principle be regarded as an "objective" reason, the qualification of a certain set of facts as a crime falls under the sole competence of judicial authorities, which enjoy a considerable margin of assessment in this regard. Whether a case is considered time-barred may for instance depend on the degree of gravity attributed to a given offence which may have a significant impact on the prescription period applicable. Also the assessment of e.g. the question when an offence was started and when it ended, whether there was a continuous or repeated conduct, as well as questions of interruption and suspension involve complex assessments based on specificities of national legal frameworks. In many cases, OLAF is able to check this with national authorities and may focus on enabling financial recovery.

It should be noted that avoiding time barring is the joint responsibility of all actors, in particular EU institutions and Member States who should provide information to OLAF in a timely manner.

See also Commission's reply to paragraph 97.

97. OLAF cooperates closely and constructively with many national authorities. This applies during the investigative phase (coordination of investigative activities, exchange of information, assistance to get access to bank accounts, etc.) as well as in the subsequent phase (implementation of OLAF's recommendations by national authorities). Where differences appear between OLAF and national authorities regarding the interpretation of the law or the facts, a meeting can be organised.

The Commission underlines that Member States' judiciaries are and should be independent from OLAF. The national authorities may therefore reach different conclusions than the ones drawn by OLAF. The challenge arising from the significant differences among Member States in the scope and definition of criminal offences as well as in statutes of limitation has been specifically addressed by the new PIF Directive (EU) 1371/2017 (in particular Articles 3 and 4). Member States have to transpose the PIF Directive by July 2019. In addition, the PIF Directive includes for the first time specific rules on limitation periods for PIF offences (Article 12). The Commission's proposal

to amend Regulation 883/2013 addresses *inter alia* the need for clarification of the legal framework for OLAF's investigation measures.

98. The cooperation between OLAF and national prosecutors is well established and – in general – functioning well. OLAF investigations often complement the national investigations by covering aspects going beyond the national case. Close coordination between national authorities and OLAF is considered as good practice in OLAF and often takes place to avoid duplication of efforts and limit risks for the respective investigative activities.

The Commission emphasises the fact that, on the basis of Article 12 of Regulation 883/2013, OLAF often informs the public prosecutors' offices before the conclusion of the investigation.

99. The Commission notes that the dismissal of cases by national judicial authorities is not necessarily due to weaknesses in the cooperation between OLAF and the national authorities although there is room for improvement (see also Commission's replies to paragraphs 97 and 98). Important reasons why facts, for example, may be time-barred would be that OLAF received the initial information too late or that the recipient of the judicial recommendation did not act on it in an efficient manner.

OLAF generally does not deliver to judiciaries time-barred cases.

100. The Commission would like to underline the complexity of the matter.

In fact, the investigative powers of an administrative office are not comparable to those attributed to investigative bodies working for the national public prosecutor's offices. It may therefore happen that, despite great investigative efforts deployed by OLAF, its limited investigation powers and practical possibilities do not allow collecting clear evidence of a criminal offence. Therefore, important elements of evidence of a fraud, such as the payment of bribes, the individual responsibilities of the persons concerned, or the *mens rea*, may not be obtained.

Moreover, Article 11(2) of Regulation 883/2013 is not *per se* a sufficient legal basis to allow all Member States' judicial authorities to use OLAF reports as evidence in trial.

Therefore, in some Member States, after receiving the OLAF final report, prosecutors start investigation activities once again in order to acquire admissible evidence. In these cases, the insufficient evidence that justifies the dismissal is not the evidence collected by OLAF, but the evidence collected by national investigators (see also Commission's reply to paragraph 102).

Conversely, it appears that sometimes prosecutors expect the OLAF final report to be a ready-to-use product, which does not require any further investigation activity or, when prosecutors cannot use evidence collected by OLAF, just requires repeating investigation activities already carried out by OLAF investigators. Then, if evidence is not already available in full in the OLAF final report, the case may be dismissed because evidence is deemed insufficient.

There are also cases where dismissals appear to be motivated by limited knowledge of the rules governing EU funding and notably the obligation of the beneficiary to provide accurate information.

Dismissals by national authorities might also take place in politically sensitive cases.

Nonetheless, OLAF continuously works on improving the quality of final reports and the follow-up to its recommendations. A number of projects are already under preparation, such as new templates for the final reports.

101. The period that has elapsed since the alleged offence was committed is not only linked to the duration of OLAF's investigations, which has decreased continuously over the past years, but also to the detection of the fraud, the timing when it was communicated to OLAF and the time when the national prosecutor finally acted on OLAF's recommendation.

The Commission notes that the analysis concerning the follow-up of OLAF's investigations is based on a relatively small number of interviews with Commission services and Member States' judicial authorities.

See also Commission's reply to paragraph 99.

102. The Commission's 2017 evaluation of the OLAF Regulation has identified as the main factor hindering the follow-up to judicial recommendations the fact that the Regulation does not sufficiently ensure the use of OLAF reports as evidence in trial in the Member States. In some Member States, after receiving the OLAF final report, prosecutors carry out all the investigation activities once again in order to acquire admissible evidence. This raises efficiency issues, and may lead to offences becoming time-barred.

The question of admissibility has been addressed in the Commission's proposal to amend Regulation 883/2013.

It should be taken into account that not all Member States apply the legality principle: in those where the launch of a case is a discretionary decision of the judicial authority, an OLAF final report can be the decisive argument in favour of opening a judicial investigation.

103. The Commission notes that the average duration of closed and ongoing investigations was 15.8 months and that the average duration of the selection corresponding to these cases was 1.8 months.¹⁰

OLAF opens investigations following the analysis of information of potential investigative interest received by OLAF from external sources. This is done without undue delay.

It is also OLAF's normal practice to open cases following information retrieved in the framework of its own investigative activities to promptly tackle irregular conduct.

104. The creation of the EPPO will help rectify certain shortcomings of the current system of investigations and prosecutions of offences against the financial interests of the EU. OLAF, as all EU IBOAs and Member States' competent authorities, will have to report to EPPO without undue delay any suspicion of possible criminal offence falling within the EPPO's investigative competence. The EPPO will thus be able to directly start criminal investigations and prosecutions of cases of suspected fraud, and bring those cases to court. The Commission has adopted its proposal for the amendment of Regulation 883/2013, which will adapt the functioning of OLAF to the establishment of the EPPO, to ensure close cooperation based on the complementarity of their respective mandates.

Pending the setting-up of the EPPO, OLAF ensures the mutual exchange of information with the competent national authorities under Article 12 of Regulation 883/2013 by transmitting in due time to the competent national authorities any relevant information obtained in the course of external investigations.

It should furthermore be noted that the average duration of closed and ongoing OLAF investigations has significantly decreased compared to past years (from 22.4 months in 2011 to 15.8 months in 2017).

Common reply to paragraphs 106-108:

¹⁰ See 2017 OLAF Report.

As stated by the ECA, recovery usually takes several years, and therefore comparing amounts recommended and recovered during the same period does not provide an accurate measurement and underestimates the amount of recoveries. Under shared management, it is the responsibility of the Member States to recover the unduly spent amounts from the beneficiaries.

In addition, the financial impact of the precautionary measures recommended by OLAF and the amounts thus prevented from being unduly spent have not been included in the scope of the audit and have therefore not been analysed.

The Commission notes that the actual recoveries following the investigations by OLAF exceed by far the costs of OLAF.

109. OLAF has continuously worked on improving the quality of its final reports and recommendations. Notably, in October 2016 OLAF issued new instructions to investigators to ensure the clarity of information provided by OLAF with respect to estimated amounts to be recovered.

See also Commission's reply to paragraph 115.

110. The ECA's findings in paragraph 110 highlight the fact that there is sometimes a question of timing to be considered when a double objective needs to be pursued, namely that of recovery of unduly paid sums and of not jeopardising the criminal investigation at national level. This is why recovery procedures are at times put on hold. This situation is, however, relatively rare and concerns cases where there is a national pre-trial procedure ongoing and the national judicial authorities have expressly requested OLAF to ensure strictest confidentiality for a certain period of time (normally until the performance or finalisation of certain activities). The periods during which recovery procedures are put on hold are generally short.

In most of the cases, however, the financial recovery procedure is conducted in parallel, independently from the judicial procedure, according to the rules on recovery following administrative irregularities. The issue is addressed in the "*OLAF Guidelines on the use of OLAF Final Reports by Commission Services for recovery procedures and other measures in the direct expenditure and external aid sector*", which states that administrative and/or financial penalties may be taken without prejudice to any action taken at national level and that the Authorising Officer by Delegation (AOD) should not await the outcome of criminal proceedings (if any) before taking administrative or recovery action, unless specifically asked to do so by OLAF.

112. The Commission is of the opinion that by applying financial corrections in the area of shared management, including when recommended by OLAF, and by ensuring that the corresponding amounts are withdrawn from the programme expenditure, the EU budget is protected.

When a shared management Directorate-General, e.g. DG REGIO, receives a final case report from OLAF, it sends a financial follow-up letter to the Member State to request the recovery of EU funds in line with the OLAF final report. The Member State is requested to provide its observations. In case the Member State disagrees with OLAF's assessment and recommendation, DG REGIO assesses the Member State's reply against all applicable rules and takes a final position. The AOD may decide to follow the conclusions of the OLAF final report and implement the recommendation as set out in the report, including by proposing the Commission to adopt a financial correction decision of the appropriate amount, taking into account applicable law.

In case the Member State agrees with the OLAF financial recommendation, it is then for the national authorities to recover the funds from the respective beneficiaries. Under the Common Provisions Regulation (EU) 1303/2013, Member States are obliged to recover amounts unduly paid following an irregularity. While the Commission has no obligation to check the amounts recovered from each beneficiary, the system audits include verification of the accuracy of expenditure of

amounts withdrawn and amounts recovered recorded in the certifying authorities' accounting system. In addition, Member States have a strong incentive to detect and correct fraud and irregular expenditure, since they may replace irregular amounts which are detected after the submission of the accounts by making the corresponding adjustments in the accounts for the accounting year in which the irregularity is detected.

113. In shared management, it is the Member States' responsibility to determine an amount to be recovered in line with EU legislation and national legislation where applicable. DG AGRI monitors in a systemic way whether Member States manage the recovery of debts properly and, if necessary, follows up in the context of the conformity clearance procedure.

The EU budget is protected by the application of the so called 50/50 rule. It provides that when debts are not recovered within a specified time limit, half of the relevant amount, including interests, is re-credited to the EU budget. Moreover, in case the debt was not recovered due to negligence of the Member State, the total amount of the debt is re-credited to the EU budget.

114. As the ECA itself states in paragraph 107, recovery is a lengthy procedure, taking an average of 36 months, which means that it can take even longer in individual cases. For example, one such recommendation issued in the period 2012-2014, and in which a final decision has yet to be taken, accounts for 20% of the overall amount recommended to DGs REGIO, EMPL and AGRI in that time frame. Therefore, the rate of recovery can be expected to increase over time.

The Commission notes that the ECA's analysis does not include the amounts prevented from being unduly spent from the EU budget as decided by the Commission following OLAF's recommendations. These amounts alone total EUR 160 million with regard to recommendations issued between 2012 and 2014 and would, for the sake of comparison, be equal to 16% of the overall amount recommended for recovery to the three Directorates-General in that time frame.

The Commission underlines that EU money has been recovered or withdrawn, where possible, in order to safeguard the EU budget.

See also reply to paragraphs 106-108.

115. The final decision on the amounts to be recovered falls under the scope of activity of the Authorising Officer by Delegation.

The main reason for not recovering the amounts as recommended by OLAF has been the lack of legal base to apply a financial correction.

The instructions to OLAF staff on drafting and calculating financial recommendations dated October 2016 provide, *inter alia*, for a detailed outline on how to determine the relevant amounts (estimated impact of the facts established, estimated amounts to be recovered and the estimated amounts to be prevented from being unduly spent) as well as the information provided in the recommendation document and final report supporting these amounts. These instructions were followed up in July 2017 by OLAF with the adoption of "*Guidelines on Financial Monitoring*" which refocuses and simplifies the monitoring of financial recommendations. As the new instructions and revised guidelines are relatively recent, their full impact has yet to be seen in the system.

See also Commission's reply to paragraph 114.

116. The Commission highlights that the amount of the recovery orders issued by DG CNECT and DG RTD as a follow-up to OLAF final reports exceeds the total value of the recommendations sent to the Directorates-General. A substantial part of the recoveries was hampered by liquidation of the beneficiaries concerned after the OLAF investigation. This is particularly the case for DG CNECT, where the liquidations prevented the recovery of EUR 7.86 million, accounting for more than 50% of the total amounts for which recovery orders were established.

As reported by the ECA, recovery usually takes several years. The recovery process continues for many financial recommendations issued during the period 2012–2016 and was still pending at the time of the ECA audit.

OLAF's instructions on financial recommendations (see Commission's reply to paragraph 115) clarify, *inter alia*, how to determine the relevant amounts, including the estimated amounts to be recovered using, where possible, IBOA's own rules.

117. The Commission takes note of the 20 cases examined and would like to add that also other Directorates-General than DG CNECT and DG RTD are involved in direct management.

First bullet point: OLAF's final reports can be used in financial and administrative procedures unless OLAF indicates specific reasons why this cannot be done due to the criminal investigation. See also Commission's reply to paragraph 110.

Second bullet point: See Commission's reply to paragraph 109.

In case a spending DG is of the view that a final report does not contain clear or adequate evidence, it may contact OLAF and ask for clarifications.

Third bullet point: The Commission would like to point out that in many cases the liquidation following insolvency of a beneficiary happens after the closure of the case by OLAF, after the recovery order has been issued or the enforceable decision taken.

119. The scope and nature of an audit is different from that of an OLAF investigation and will not cover aspects such as corruption, fraud and other serious financial irregularities. Audits may not identify the full amount to be recovered and may not necessarily lead to exclusion of entities by the EDES panel.

See also Commission's reply to paragraph 109.

120. The number of such actions is limited in relation to the number of recommendations issued by OLAF.

Common reply to paragraphs 122-123:

The Commission notes that also DG NEAR and DG ECHO are recipients of OLAF financial recommendations in the field of indirect management.

The ECA states that at the time of the audit recoveries had been made regarding 38% of OLAF's financial recommendations. Given the time it takes to make meaningful progress in the recovery process, this percentage will further increase over time.

With regard to the sample, see Commission's reply to paragraph 117 on direct management which applies *mutatis mutandis* also for the sample on indirect management.

124. The Commission notes that DG DEVCO's operations are implemented in a particular context: geographically dispersed operations, high number of operations, diversity of implementing organisations and partner countries and a diversity of aid delivery methods. In addition, the legal and law enforcement contexts applicable to DG DEVCO's operations are very different compared with operations under shared management and much more diverse. OLAF takes this and the likelihood of recovery into account in its selection procedure. It should be noted that many beneficiaries also of external aid are based in Europe and therefore can be excluded from future funding following an OLAF investigation.

The default approach of DG DEVCO is to follow OLAF's recommendations. However, when there are important reasons not to follow OLAF's recommendations, DG DEVCO reports back to OLAF on the decision and measures taken.

The high-risk environment in which DG DEVCO operates can therefore explain why DG DEVCO sometimes does not follow up on the financial recommendations of OLAF.

OLAF and DG DEVCO will engage in a still closer cooperation in order to increase the number of successful recoveries.

126. The EPPO will be a single, independent European prosecution office operating across the participating Member States. European Delegated Prosecutors will be responsible to investigate, prosecute and bring to judgement crimes affecting the financial interests of the Union, thereby working hand in hand with national law enforcement and judicial authorities. European Prosecutors located at central level will, on behalf of the Permanent Chambers, supervise the investigations and prosecutions carried out by the European Delegated Prosecutors or, in exceptional cases, conduct the investigations themselves.

This novel approach will substantially enhance the current level of effectiveness and efficiency in the fight against crimes affecting the financial interests of the Union.

127. See Commission's replies to paragraphs 97-104.

128.

First bullet point: The EPPO represents a very substantial improvement to the current mechanisms of judicial cooperation among Member States. Moreover, its structure (Permanent Chambers and European Prosecutors from each Member State) is designed to bring in the necessary national expertise while ensuring the development of European investigation and prosecution policies.

The decision-making processes in the EPPO take due account of the need for swift investigatory and prosecutorial action and for ensuring a common investigation and prosecution policy of the EPPO. The need for internal consultation and translation is inherent to an EU body operating across Member States and tackling cross-border crime.

The investigations of the EPPO will be primarily carried out by the European Delegated Prosecutors under the supervision of the European Prosecutor coming from the same Member State as the European Delegated Prosecutor, and under the direction and instruction of the competent Permanent Chamber. The European Prosecutors sitting in the Permanent Chambers are familiar with the legal system and know the language of the European Delegated Prosecutors they supervise. In addition, the staff in the EPPO headquarters supporting the College and chambers will need to reflect an appropriate coverage and balance of legal systems and languages to support their work. The EPPO Regulation also allows the Permanent Chambers to delegate its decision-making powers to the supervising European Prosecutor in specific cases, where an offence is not serious enough or the proceedings are not complex.

The work of the EPPO should, in principle, be carried out in electronic form. This will further facilitate the communication between the European Delegated Prosecutors, the supervising European Prosecutors and the Permanent Chambers. Should there be need for additional translations, the EPPO may seek such services from the Translation Centre of the bodies of the EU.

Second bullet point: The Commission does not share the ECA's assessment. The EPPO will be directly responsible for the investigations, prosecutions and bringing to judgement of crimes affecting the financial interests of the Union. In this respect, European Delegated Prosecutors, who will be equipped with the same powers as national prosecutors in addition to those following directly from the EPPO Regulation, will carry out the investigations hand in hand with national authorities, while the latter shall ensure that all instructions given by the European Delegated Prosecutors are followed.

The EPPO Regulation contains also very specific obligations on Member States to provide European Delegated Prosecutors with the resources and equipment necessary to exercise their functions (Article 96(6)).

In addition, OLAF, because of its very mandate in the area of PIF, is called on to become an important source of information to the EPPO. Union institutions and bodies may use OLAF for a preliminary verification of allegations in cases where they lack the expertise to assess whether certain information may need reporting to the EPPO.

Third bullet point: Article 24 of the EPPO Regulation clearly states that all institutions, bodies, offices and agencies of the Union and the authorities of the Member States shall without undue delay report to the EPPO any criminal conduct in respect of which it could exercise its competence. It is the EPPO that will thereupon decide whether to exercise its competence by either initiating a criminal investigation or use its right of evocation. The purpose of the preliminary evaluation mechanism is to allow IBOAs to make use of OLAF and its specialised expertise to assess information available to the IBOA and to provide the EPPO with good quality information. It shall be efficient and not hamper the decision making process by the EPPO.

The Commission proposal for the revision of Regulation 883/2013 contains a specific provision on the preliminary evaluation by OLAF, including a strict deadline for its completion.

CONCLUSIONS AND RECOMMENDATIONS

130. The specific issues raised by the ECA regarding the Commission's anti-fraud policy cannot be seen in isolation from the important recent legislative initiatives and other developments in the area of the fight against fraud listed below:

- Revision of the Staff Regulations for officials and other servants of the European Union in 2013;
- Updated integrated control framework and peer review of fraud risk in 2017;
- Directive (EU) 2017/1371 on the fight against fraud to the Union's financial interests by means of criminal law (PIF Directive);
- Regulation 2017/1939 setting up the EPPO;
- Proposal of 2018 to amend the OLAF Regulation 883/2013;
- New Financial Regulation 2018/1046;
- Initiative for a revision of the Financial Framework Regulation on decentralised agencies;
- Proposals for post-2020 spending programmes;
- Ongoing update of the Commission's Anti-Fraud Strategy (CAFS).

Please see Commission's reply to paragraph 9.

131. The legal constraints of the current irregularity reporting system and the complexity of the task have not been sufficiently reflected in the ECA report.

The Commission is aware of certain limits of its reporting system but has progressively and continuously worked to improve the irregularity reporting by Member States (see Commission's replies to paragraphs 24 and 25). As the ECA itself indirectly acknowledges in paragraph 31, currently there is no other system (national or within the EU institutions) collecting data on fraud to the same level of detail as IMS.

132. There is no cost-effective method to estimate undetected fraud reliable and defensible enough for evidence-based policy (see Commission's replies to paragraphs 14–16). The methods mentioned by the ECA would not be well-suited in this specific context (see replies to paragraphs 33–37).

133. The Commission agrees that the analysis of fraud patterns and vulnerabilities should be a priority while taking into account that such studies are very resource-intensive.

The Commission considers that an identification of the motivation of fraudsters would not add significant value to its fight against fraud. Furthermore, some of the causes highlighted in the report have already been targeted by legislative proposals such as the 2018 Financial Regulation or the relevant risks have been duly taken into consideration in the audit activity of the Management and Control Systems in shared management. See Commission's replies to paragraphs 39–49.

134. In the domain of public procurement, the EU has broadened and facilitated market access, in particular for SMEs, with the reform of the Public Procurement Directives in 2014 and further initiatives. Those policy impulses, aiming at e.g. enhanced transparency, more digitalised processes and simplification, are also reflected in the new Financial Regulation and will contribute to reducing the risk of corruption.

Recommendation 1 – Gain better insight into the scale, nature and causes of fraud in EU spending

The Commission partially accepts the recommendation.

The Commission, in close cooperation with the Member States, has considerably improved its irregularity reporting system over the past years, allowing for a better and more refined analysis.

The Commission is committed to further improve the reporting of irregularities and fraud and the analysis of the nature of fraud on the basis of tailored data collection and a better understanding of the overall anti-fraud framework in the different Member States.

It is, however, not possible to establish an estimate of the scale of the undetected level of fraud which is reliable and defensible enough for evidence-based policy, also taking into account the constraint of the efficient use of the limited resources available to the Commission.

a) The Commission partially accepts recommendation 1 a).

The Commission agrees to enhance IMS further, subject to a feasibility study and availability of resources. The inclusion of all spending areas may imply significant development costs and may impact significantly on the overall performance of IMS. It would also require legislative proposals.

From the Commission's point of view, integrating completed OLAF investigations should in principle be possible. However, due to data protection rules and confidentiality requirements, ongoing investigations would have to be excluded. Also for completed investigations, reporting should be done by the Member States in order to ensure that national confidentiality rules on criminal investigations are respected. Furthermore, as regards investigations by the future EPPO, it is not up to the Commission to make any commitment.

It should also be pointed out that the Commission proposed in 2014 abolishing the threshold of EUR 10 000 as of which Member States must report investigations concerning fraudulent irregularities in IMS. Member States, however, rejected this proposal.

b) The Commission partially accepts recommendation 1 b).

The Commission intends to enhance the analysis of the risks of fraud and corruption against the EU budget, including the analysis of the nature and causes of fraud. In this context, risk indicators could be identified. The methods suggested by the ECA (encounter surveys and indexes based on administrative data) are, however, not suitable for the EU budget and their cost would not be justified in relation to the expected results.

135. While the Commission's anti-fraud strategies currently use few measurable objectives and indicators, general principles and priorities set out in anti-fraud strategies contribute to a coherent approach in the Commission's fight against fraud (see Commission replies to paragraphs 59–64). Reporting on the effectiveness of both the corporate and the departmental anti-fraud strategies will

improve once an enhanced analysis function as referred to in the Commission's reply to recommendation 1 will be operational.

136. Strategic fraud risk management and fraud prevention are important objectives for the Commission.

It has put in place a decentralised model of financial management, where Authorising Officers by Delegation, e.g. Directors-General, are responsible for internal control, including risk management and fraud prevention. Respective responsibilities and duties are well defined and since 2017, all Commission services are obliged to appoint a senior manager in charge of risk management, to support and advise the Authorising Officer by Delegation on matters of internal control, including fraud risk management.

Information on anti-fraud measures are reported to the College of Commissioners which takes overall political responsibility for the management of the EU budget. Each Member of the Commission receives fraud-related information directly by the service under his/her responsibility and reports important cases to the College.

The individual mission letters by the President of the Commission are committing each Commissioner to pay specific attention to sound financial management of EU funds which reinforces the Commission's political commitment to zero tolerance for fraud and to systematically ensure the protection of the EU budget from fraud.

The Commission considers that OLAF could assume a stronger and more strategic role as a coordinator with regard to the anti-fraud policies of the Commission services and executive agencies. OLAF's oversight role is being considered in the ongoing update of the CAFS.

Recommendation 2 – Ensure leadership of the Commission's anti-fraud actions

The Commission considers that its current internal organisation in practical terms already reflects the recommendation 2.1. See also Commission's reply to paragraphs 50-54.

The Commission partially accepts recommendation 2.2

The Commission accepts most of the substance of the recommendation. The Commission estimates that its anti-fraud strategy can only gradually be adapted to comply with the recommendation, the full implementation of which could be achieved around the mid-point of the Multiannual Financial Framework 2021–2027.

First indent: The Commission shares the ECA's view that its anti-fraud strategy should be preceded by a comprehensive fraud risk assessment.

The implementation of such a fraud risk assessment would however take time and have important resource implications as it would require not only the establishment of an enhanced analysis function, as referred to in the Commission's reply to recommendation 1, but also the pursuit of appropriate data collection and analysis over several years (see Commission's replies to paragraphs 14–16, 29, 33–37, 47).

137. The Commission notes that, to a considerable extent, for the 2014–2020 period fraud-proofing was carried out at the sub-legislative level, notably by drafting model contracts and agreements. Furthermore, in shared management, clear provisions have been in place concerning irregularities, of which fraud is a sub-category.

See Commission's reply to paragraph 67.

138. With the "*Better Regulation Toolbox*" of 2017 (see Commission's replies to paragraphs 71 and 72 above), fraud-proofing was formally integrated in the legislative drafting process. Nevertheless,

fraud-proofing of spending programmes was already required under the Commission Anti-Fraud Strategy of 2011,¹¹ i.e. for the Multiannual Financial Framework 2014–2020.

The 2021–2027 Multiannual Financial Framework proposal of the Commission on the Common Provisions Regulation contains a provision requiring the authority responsible for managing the programme to "*put in place effective and proportionate anti-fraud measures and procedures, taking account of the risks identified*". This provision, Article 68(1)(c), applies to the seven shared management funds.

139. Under shared management, it is up to Member States to take all necessary measures to protect the EU financial interests, in particular those preventing, detecting and correcting irregularities and fraud, as appropriate and on their own responsibility. In this respect, they have access to the exclusion decisions taken as part of EDES.

As far as the feeding of information into EDES is concerned, national authorities have to transmit information of detected fraud and/or irregularity, where required by sector-specific rules. This is done through an interface between IMS and EDES.

See also Commission's reply to paragraph 138.

140. The Commission is continuously promoting the use of ARACHNE with the Member States (see Commission's replies to paragraphs 85-88 and recommendation 3.3).

Recommendation 3 – Increase the use of fraud-prevention tools

The Commission partially accepts recommendation 3.1.

The package of legislative proposals for the Multiannual Financial Framework was launched in May and June 2018, i.e. before receipt of the ECA's recommendation. Those proposals were fraud-proofed to the extent possible within the tight deadlines for the launch of the MFF package.

Already under the current MFF Member States are required to put in place effective and proportionate anti-fraud measures taking into account the risk identified, pursuant to Article 125(4)(c) of the Common Provisions Regulation (EU) 1303/2013. The Commission considers that a fraud risk assessment is an ongoing exercise, not linked to any particular timeframe. The Commission's Common Provisions Regulation (CPR) proposal supports the requirement to carry out a fraud risk assessment. However, it does not foresee a specific timing from Member States to do it. The Commission is of the opinion that adding a requirement to be met before adoption would delay the programme adoption, which goes against the objective of the CPR.

A study on Member States' compliance with this provision is being finalised. Member States will build on this experience for their future fraud risk assessment.

The Commission is considering reinforcing OLAF's analytical capabilities, which would, in the course of the 2021-2027 programming period, contribute to a refinement of the Commission's fraud risk assessments (see the Commission's replies to recommendations 1 and 4).

The Commission accepts recommendation 3.2 a).

In accordance with the Financial Regulation, the relevant Directorate-General is obliged to use the early detection and exclusion system where the circumstances require it. Several actions have already been conducted to promote the use of EDES.

The Commission accepts recommendation 3.2 b).

¹¹ COM (2011) 376 final, p. 8, paragraph 'Fraud prevention'.

A modification of the Financial Regulation by the legislator would be necessary in order to oblige, as far as shared management is concerned, the Member States to flag fraudulent economic operators.

The Commission had initially proposed (COM (2014)358) a clear obligation for the Member States to use IMS data as a ground for exclusion. However, Member States opposed any obligation to exclude on the basis of the information they provide in IMS.

The Commission accepts recommendation 3.3.

The Commission has provided information, targeted training and active support and guidance on the ARACHNE tool to all Member States. However, ARACHNE is used on a voluntary basis as there is no legal obligation to enforce its use. The Commission will continue to provide active assistance to all authorities and encourage those Member States which do not sufficiently (or not at all) use Arachne to do so, as outlined in the "*Charter for the introduction an application of the Arachne Risk Scoring Tool in the management verifications*" shared with all Member States.

See Commission replies to paragraphs 85–88.

141. With regard to the overall impact of OLAF's investigations, it is important to note that the precautionary measures issued by OLAF (see Article 7 of Regulation 883/2013) and the overall deterrent effect of OLAF's actions are also important elements of fighting fraud which need to be assessed.

The analysis concerning the follow-up of OLAF's investigations is based on a relatively small number of interviews with Commission services and Member States judicial authorities.

The Commission highlights that also other actors, in particular other EU institutions and Member States, have in the current system important roles and responsibilities to detect and investigate irregularities and to take appropriate follow-up measures.

As regards the indictment rate, the efficiency of OLAF's investigations cannot be measured by this single criterion, as indictment is only one of the many outcomes of OLAF investigations. It is frequent good practice that OLAF and national judicial authorities work in parallel and coordinate their operational activities without losing time. OLAF has also improved its cooperation with the judicial authorities on the follow-up to its recommendations.

The difficulties regarding the follow-up given by national authorities to OLAF's judicial recommendations are a long-standing challenge, well-known to OLAF, the Commission and the Member States. To address this challenge, the Commission has proposed the creation of the EPPO. Also, the recent Commission proposal to amend Regulation 883/2013 aims to improve the follow-up to OLAF's judicial recommendations, notably by clarifying the admissibility of OLAF investigation results in judicial proceedings in Member States.

See also Commission's replies to paragraphs 94–104.

142. OLAF has taken action with the aim of clarifying the information provided in final reports and the content of the recommendations in relation to estimated amounts to be recovered. OLAF issued "*Instructions on drafting Financial Recommendations and related sections of the Final Report*" in October 2016 which should make OLAF recommendations easier to implement. The effect of these instructions on financial recommendations will only be fully visible in the future.

Furthermore, in July 2017 OLAF issued new "*Guidelines on Financial Monitoring*" designed *inter alia* to shorten the period for the spending Directorates-General to calculate the amounts to be recovered.

See also Commission's replies to paragraphs 106–124.

Recommendation 4 – Reconsider OLAF’s role and responsibilities in combatting fraud in EU spending in light of the establishment of the EPPO

The Commission partially accepts the recommendation.

As regards the investigative function of OLAF, the Commission has taken action to adapt OLAF's framework for investigations to the establishment of the EPPO in its proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU, Euratom) No 883/2013, of 23 May 2018, COM(2018)338.

The proposed relationship between the two bodies should be based, as prescribed by the EPPO Regulation, on the principles of close cooperation, exchange of information, complementarity and non-duplication.

In addition, the proposal foresees targeted changes to enhance the effectiveness of OLAF investigations.

OLAF's administrative investigations will maintain their specific added value to the benefit of the overall protection of the Union budget. See also Commission’s replies to paragraphs 126–128.

With regard to fraud prevention and fraud risk analysis, the Commission intends to reinforce OLAF’s role (see Commission's replies to recommendations 1–3).

a) The Commission shares the ECA’s view that OLAF could assume a stronger role in the anti-fraud policies of the Commission services and executive agencies. Such a strengthened role is being considered in the upcoming update of the CAFS (see Commission's replies to paragraphs 50-54 and recommendation 2.1).

As far as real time detailed analysis of fraud patterns and the causes of fraud is concerned, please refer to the Commission's replies to recommendations 1 and 2.2. To the extent possible, the Commission will increasingly present fraud patterns found in OLAF investigations in case compendiums.

b) *Vis-à-vis* the Member States, OLAF will continue to perform its coordinating and advisory functions, notably as the lead service for irregularity reporting and the Advisory Committee for the Coordination of Fraud Prevention. Likewise, the Authorising Officers Responsible in the Directorates-General in charge of shared management will continue to exercise their supervisory role over the Member States.

OLAF will then in turn review the anti-fraud policies of those spending Directorates-General, as outlined above.

The analytical component of OLAF's enhanced role can only gradually be implemented and will not be fully operational before the mid-point of the Multiannual Financial Framework 2021–2027 (please refer to the Commission's reply to recommendation 2.2.). As the ECA acknowledges, a comprehensive fraud risk assessment forms the basis for fully effective fraud risk management. Consequently, the OLAF’s analytical capabilities and its reinforced oversight role will gain effectiveness in a gradual process.

Audit team

The ECA's special reports set out the results of its audits of EU policies and programmes, or of management-related topics from specific budgetary areas. The ECA selects and designs these audit tasks to be of maximum impact by considering the risks to performance or compliance, the level of income or spending involved, forthcoming developments and political and public interest.

This performance audit was carried out by Audit Chamber V Financing and administration of the EU, headed by ECA Member Lazaros S. Lazarou. The audit was led by ECA Member Juhan Parts, supported by Ken-Marti Vaher, Head of Private Office and Margus Kurm, Private Office Attaché; Judit Oroszki, Principal Manager and Head of Task; Tomasz Plebanowicz, Deputy Head of Task; Rogelio Abarquero Grossi, Daria Bochnar, Jana Janeckova and Anzela Poliulianaite, Auditors. Michael Pyper provided linguistic support and Valérie Tempez-Erasmi provided secretarial assistance.



From left to right: Ken-Marti Vaher, Judit Oroszki, Tomasz Plebanowicz, Juhan Parts, Michael Pyper, Daria Bochnar, Anzela Poliulianaite, Jana Janeckova, Rogelio Abarquero Grossi, Valérie Tempez-Erasmi, Margus Kurm.

Event	Date
Adoption of Audit Planning Memorandum (APM) / Start of audit	4.4.2017
Official sending of draft report to Commission (or other auditee)	26.6.2018
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Protecting the EU's financial interests against fraud is a key responsibility of the European Commission. The Commission's own Directorates-General, Executive agencies and Anti-Fraud Office (OLAF) work with a large number of other organisations, including authorities in the Member States and the future European Public Prosecutor's Office (EPPO).

In this audit we assessed whether the Commission is properly managing the risk of fraudulent activities to the detriment of the EU budget. We found that the Commission lacks comprehensive and comparable data on the detected fraud level in EU spending. Moreover, it has so far not carried out any assessment of undetected fraud, nor detailed analysis of what causes economic actors to engage in fraudulent activities. This reduces the practical value and effectiveness of the Commission's strategic plans for protecting the EU's financial interests against fraud. The current system, whereby OLAF's administrative investigation of suspected fraud is followed by a criminal investigation at national level, takes up much time in a considerable number of cases and thus it decreases the chances to achieve prosecution. In addition, OLAF's final reports often do not provide sufficient information to initiate the recovery of unduly disbursed funds. Fewer than half of OLAF investigations have led to prosecution of suspected fraudsters and resulted in recovery of less than a third of unduly paid EU money.



EUROPEAN
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Publications Office

EUROPEAN COURT OF AUDITORS
12, rue Alcide De Gasperi
1615 Luxembourg
LUXEMBOURG

Tel. +352 4398-1

Enquiries: eca.europa.eu/en/Pages/ContactForm.aspx

Website: eca.europa.eu

Twitter: @EUAuditors

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