

APPROACHES TO EU ANTI-FRAUD INSTRUMENTS

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The objective of this paper is to attempt to reconstruct the patterns of general fraud schemes and, in parallel, to analyze and argue which are the main tools that have emerged and are constantly evolving to counter the spread of fraud in different sectors and channels of the modern landscape. Thus, the main purpose is not to present an all-encompassing analysis of the entire scope of the fraud literature, but to provide a description of the different forms of fraudulent behavior in the context of a company's activities, the prevalence and consequences of such behavior. It is therefore essential to ensure the existence and effective tools in order to prevent, measure and assess the risks that may arise from fraudulent operations, with the ultimate aim of nipping in the bud the sequence of illicit maneuvers between the ranks of corporate life. In this paper, we start by defining the key elements that revolve around the concept of fraud, while considering the exogenous and endogenous variables that influence it.

Keywords: *Anti-fraud policy; Anti-fraud strategies; Audit authority; European Commission; Tax fraud.*

JEL Classification: G32, F42, H72, H75.

1. INTRODUCTION

Although several measures have been put in place at national and EU level to promote the detection of fraud, especially tax fraud, there are still many gaps in Member States' practices (Lederman et al., 2019). This can be seen clearly in the divergence of practices between Member States and across EU funds, which may mean that good practices are not implemented across the whole EU (vulnerabilities are higher in cross-border cases). As fraudsters are constantly developing their methods to evade detection, the risks of fraud remain high, highlighting the need for harmonized approaches and implementation of best practices.

The European Commission has provided support to managing authorities in the form of capacity building, IT tools, risk assessment analysis and best practice guidelines. There is also cooperation with audit authorities to develop and exchange good practices in the field of audit and to ensure that good practices are applied in all Member States.

Many examples of good practice in Member States' approaches to fighting fraud have been identified. These involve IT systems and databases, red flags tools, risk assessments and capacity building (Bakhtigozina et al., 2017). Key features of these practices include combining data and tools in a single platform and ensuring that intelligence registers and risk analysis tools are available to all national authorities involved in the fight against fraud in the EU.

2. EU POLICY FRAMEWORK FOR COMBATING FRAUD WITH COMMUNITY FUNDS

The European Commission has taken various measures to combat fraud against the EU budget. In particular, it adopted the "Commission Anti-Fraud Strategy" (CAFS) in 2011. Following a review in 2019, it was agreed as a priority to equip the Commission with a stronger analytical capacity and a more centralized surveillance system to help identify, prevent and detect fraud against EU financial interests.

Regarding fraud under shared management, DG REGIO, DG EMPL and DG MARE, developed a Joint Anti-Fraud Strategy (JAFS) in 2015, which was updated in December 2019 after an updated risk assessment. This strategy highlighted the importance of early detection and fraud prevention measures in the fight against fraud. In 2021, several initiatives were implemented based on the action points set out in the JAFS. In addition, in response to the Covid-19 pandemic and the additional financial measures made available to Member State authorities, discussions on further updating this risk analysis continued with other commission services as well as with programming authorities in other Member States. An important source of information on fraud affecting EU funding programs is the Commission's annual report on the Protection of the Union's Financial Interests (PIF report), which is presented to the Council and the European Parliament. The most recent report was published in September 2021 and covers the 2020 financial year. The report details measures taken to combat fraud in the EU budget and provides figures on the levels of fraud reported by Member States.

Member States regularly report fraudulent irregularities in shared management funds to OLAF via the Irregularities Management System (IMS), which is also used for pre-accession and neighborhood policy instruments, which are not part of shared management. In view of other recent developments, the European Public Prosecutor's Office (EPPO) started its work on 1 June 2021. EPPO has been given the responsibility to investigate, prosecute and bring to court offences against the EU's financial interests (e.g. various types of fraud, VAT fraud with losses of more than €10 million, money laundering, corruption). In the area of shared management, EPPO's activities should also be beneficial in contributing to the fight against fraud. Despite these and other initiatives, the European Court of Auditors has argued that the Commission does not have complete information on the extent, nature and causes of fraud in EU spending (Reffett, 2010). In addition, the Court notes that when it comes to identifying fraud, how to respond to it, and how Member States coordinate their interventions, there is room for improvement. There is an urgent need for a more proactive approach to fraud detection.

In 1999, the European Commission created OLAF, an independent body with a mandate to detect, investigate and prevent economic crime involving EU funds. While OLAF's includes anti-fraud policy and advisory activities, its main mission is to investigate and make appropriate reports and recommendations on possible offences within its mandate. OLAF is also empowered to carry out independent administrative investigations into fraud, corruption and other illegal activities with a negative impact on the EU's financial interests, as well as into serious misconduct by EU officials, staff and members of the EU institutions (Sandgren, 2005). Although OLAF has no powers of prosecution, it has numerous investigative tools at its disposal, including the authority to carry out on-the-spot checks and to interview witnesses and concerned people (Dyck et al., 2010). *Tools for strengthening the fight against fraud*

The Commission will build on its existing tools and develop new ones to address the challenges that arose during the COVID-19 pandemic and new ways of managing EU funding.

3. ARACHNE

The Commission encourages the use of ARACHNE, an integrated IT tool for data mining and data enrichment. It has been developed by the Commission to support managing authorities in administrative controls and management verifications of the Structural Funds (European Social Fund and European Regional Development Fund). It has also been extended to European Agricultural Fund for Rural Development (EAFRD) projects and will be used for all agricultural funds following the CAP reform.

ARACHNE establishes a comprehensive database of EU projects implemented under the Funds, provided by managing authorities and paying agencies, and enriches this data with publicly available information to identify, based on a set of risk indicators, projects, beneficiaries, contracts and contractors that may be susceptible to risks of fraud, conflict of interest and irregularities. The tool provides extremely valuable risk alerts to enrich management checks, but provides no evidence of error, irregularity or fraud. ARACHNE can increase the efficiency of project selection, management checks and further strengthen fraud identification, prevention and detection.

In view of the risks that may arise, it is necessary and appropriate to make widespread and systematic use of tools such as ARACHNE, which would allow the fight against fraud, irregularities, conflicts of interest and double funding to be stepped up (Stanojevic, 2018).

4. EARLY DETECTION AND EXCLUSION SYSTEM (EDES)

The Commission manages the Early Detection and Exclusion System (EDES). EDES is referred to in Articles 135-145 of the Financial Regulation applicable to the EU budget. It is an instrument that strengthens the protection of the EU's financial interests against unsafe entities and persons by excluding them from participating in the procedures of awarding EU funds, under direct and indirect management. Prohibited practices include a wide range of behaviors affecting professional integrity (e.g. fraud, corruption and serious professional misconduct) and poor performance (such as significant shortcomings in contract implementation). In particular, EDES allows:

- Early detection of entities or persons, which pose a risk to the EU's financial interests;
- The exclusion of such economic operators from obtaining EU funds under direct and indirect management and/or the imposition of a financial penalty;
- Recording the above information in the EDES database, which is accessible to the community of financial actors responsible for the implementation of Union funds;
- In most serious cases of exclusion, publication of the names of entities or persons involved on the Commission's website.

EDES allows for a centralized assessment of exclusion cases while protecting the fundamental rights of the persons and entities concerned, in particular their right to be heard. The uniqueness and strength of EDES lies in

the power given to EU institutions and bodies to act in the absence of a final national decision or, where applicable, a final administrative decision. The imposition of sanctions can be based on established facts and findings arising from audits, verifications or controls carried out under the responsibility of the competent authorizing officer, investigations by OLAF or non-final administrative decisions by national authorities or international organizations.

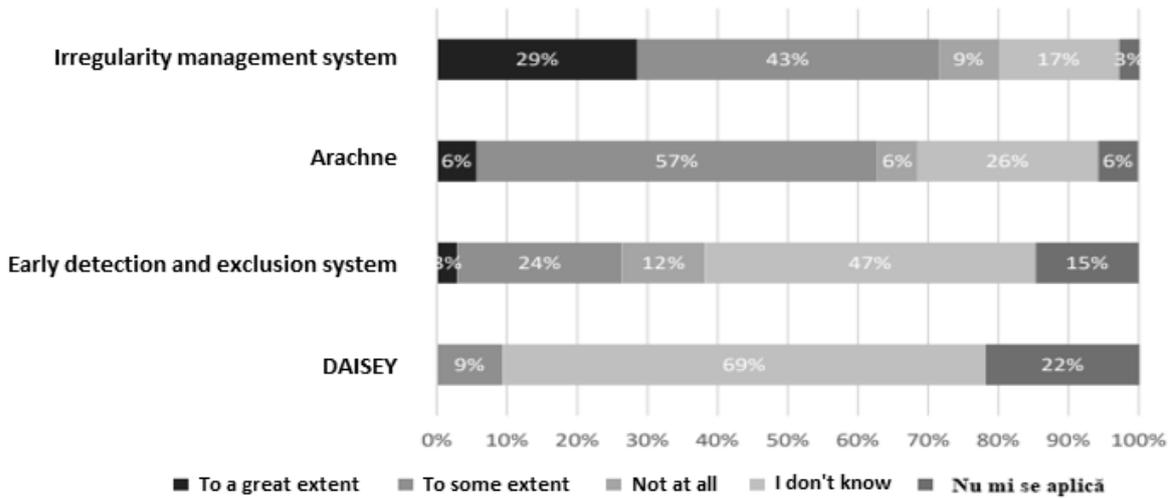


Figure 1 - The effectiveness of anti-fraud instruments developed by the EU
Source: CSES online survey

The decision to impose sanctions on bad economic actors may be taken by the authorizing officer responsible only after first obtaining a formal recommendation from the centralized interinstitutional committee.

5. ANTI-FRAUD KNOWLEDGE AND RESOURCE CENTRE

Among the initiatives OLAF supports is the Anti-Fraud Knowledge and Resource Centre (OLAF Report, 2022). This online facility provides access to a wider range of material (a library, definitions and glossary, guidelines and legislation, etc.) and includes a best practice section.

The Commission's Anti-Fraud Knowledge and Resource Centre lists 37 best practices under a number of headings - whistleblowing systems, systems and tools, cooperation mechanisms, red flags, sanctions, training and guidance. In each case there is a brief description, an explanation of the key success factors and an indication of replicability elsewhere. Some good practices focus specifically on EU funds under shared management, while others have a wider role in tackling fraud in relation to public spending in general. We will examine and add to the Anti-Fraud Knowledge Centre's good practices later in this section. In the survey for this study, we asked respondents to rank the various good practices identified by the European Commission's Anti-Fraud Knowledge Centre (this was done on a scale of 1 to 5, with 1 meaning that the practice is not useful for fraud prevention and 5 meaning that the practice is very useful). As can be seen in the graph below, whistleblowing systems, tools for identifying "red flags" and training programs ranked relatively well, although the situation is not clear.

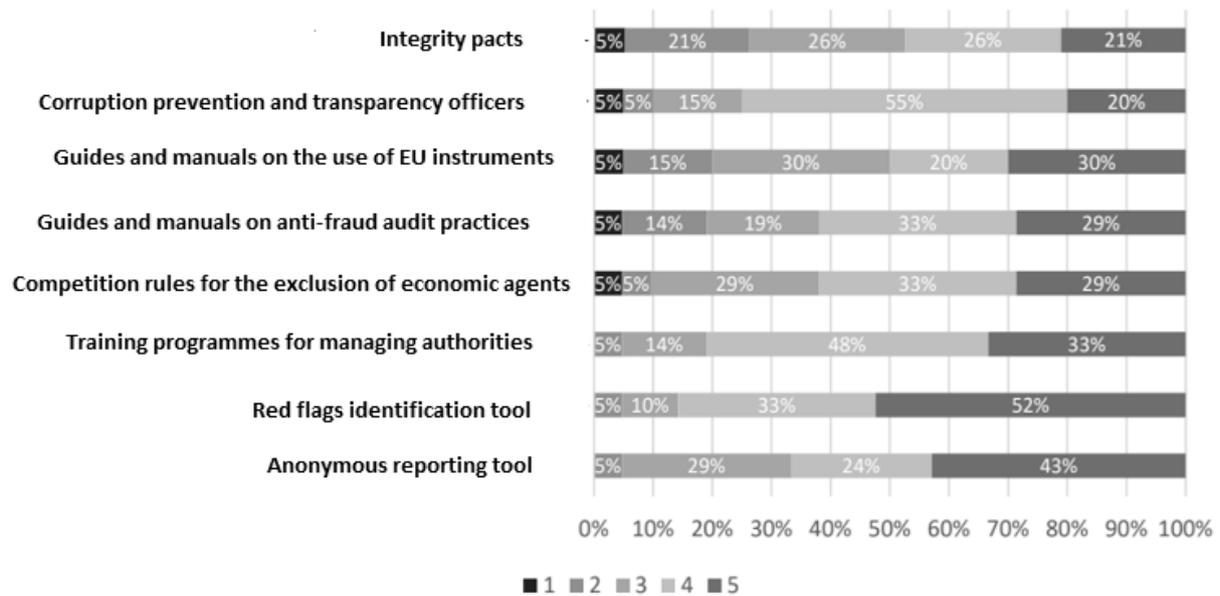


Figure 2 - Ranking of best practices identified by the Anti-Fraud Knowledge Centre

Source: CSES online survey

6. PROJECT GETI

The GetI project aims to increase the analytical capacity of OLAF staff working on both operational and strategic tasks by improving the accessibility and visualization of information, speed and flexibility in querying data.

The diversity of data formats and the volume of unstructured data has generated in recent years the need for an environment, tools and functions to facilitate analytical work. Through a collection of open source and commercial software, GetI aims to automate many time-consuming tasks and implement modern technologies such as artificial intelligence.

7. NATIONAL ANTI-FRAUD STRATEGIES

In 2021-2022, EU Member States have communicated the development of more IT tools to strengthen the protection of the EU's financial interests (Masli et al., 2010), which will be of particular importance in addressing the challenges arising from the COVID-19 pandemic and new ways of managing EU funding (Table 1).

Table 1. IT tools implemented by EU Member States in 2021-2022

Member State	Instrument	Budgetary Sector
Bulgaria	Use of a centralized electronic platform in public procurement	All expenses
Czech Republic	Updating procedures for verifying ownership structures and conflicts of interest	Cohesion policy
Denmark	Merging data to identify cases of double funding	Cohesion policy
Estonia	Launch of an information and notification website on cybercrime	Horizontal
Germany	Self-assessment of fraud risk for ESF and ERDF federal programs	Cohesion policy
Hungary	Utilization of ARACHNE and EDES	Cohesion policy and the Most Deprived Fund
Lithuania	Purchase of analytical software and hardware to implement anti-money laundering and anti-terrorist financing measures	Horizontal
Netherlands	Enhanced digital grant application	Agriculture
Romania	Digitized checks of ESI competent bodies to streamline public procurement controls	Cohesion policy
Spain	Direct access by AFCOS to Spanish social insurance databases	All expenses
Sweden	Better statistics on procurement	All expenses

Source: www.eur-lex.europa.eu

8. CONCLUSION

Funds under shared management account for around 70% of all EU spending programs and the ability of EU Member States, supported by the European Commission, to combat irregularities and fraud is clearly important to help protect EU finances. This is particularly true for EU-funded programs under shared management, as it is the national authorities that primarily control expenditure.

The health crisis caused by COVID-19 has had a huge economic and social impact on our lives, and the EU response, through the resources foreseen for the next EU budget and the Next Generation EU is the biggest recovery plan in Europe. There is a need to emphasize close and effective cooperation with national authorities as they adapt to deal with new risks and new ways of managing EU funds. Management and a significant part of spending programs for 2023-2029 will be performance-based and EU Member States will have a greater share of responsibility in the near future.

Recommendations

- EU Member States need to step up their efforts to ensure the reliability and accuracy of the data reported to the Commission via the IMS.
- The EU Financial Regulation, as well as national regulations, should require reporting authorities to regularly validate the data reported through IMS.
- Member States should be encouraged to make greater use of EU tools to help detect fraud.
- Access to EDES and ARACHNE should be extended to all EU funds under shared management. In cooperation with national authorities, a regular assessment of the functioning of these systems should be carried out so that improvements can be made where necessary.
- Steps should be taken to improve cooperation between national authorities involved in monitoring fraud budget with EU funds.
- More efforts should be made to exchange best practices in the fight against fraud in EU funds under shared management.
- As fraudsters' strategies are constantly evolving to evade detection, it is essential to carry out a regular review of the effectiveness of measures taken to combat fraud in order to ensure consistently high standards.
- More emphasis should be placed on system audits, where national authorities regularly assess their audit practices and internal control systems for EU funds under shared management to ensure that they are effective and reliable.

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