EUROPEAN COMMISSION
EUROPEAN ANTI-FRAUD OFFICE (OLAF)

Policy
Fraud Prevention

Training manual
Eliminating Fraud

1. Definitions

1.1. Definitions at the EU level

Irregularity[1] is "any infringement of a provision of Community law resulting from an act or omission by an economic operator, which has, or would have, the effect of prejudicing the general budget of the Communities or budgets managed by them, either by reducing or losing revenue accruing from own resources collected directly on behalf of the Communities, or by an unjustified item of expenditure".

Fraud:[2]

In respect of expenditure, is any intentional act or omission relating to:

- the use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the misappropriation or wrongful retention of funds from the general budget of the European Communities or budgets managed by, or on behalf of, the European Communities;

- non-disclosure of information in violation of a specific obligation, with the same effect;

- the misapplication of such funds for purposes other than those for which they were originally granted.

In respect of revenues, is any intentional act or omission relating to:

- the use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the illegal diminution of the resources of the general budget of the European Communities or budgets managed by, or on behalf of, the European Communities;

- non-disclosure of information in violation of a specific obligation, with the same effect;

- the misapplication of a legally obtained benefit, with the same effect.

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1 Council Regulation (EC) No 2988/95, Article 1 (2), OJ L 321, 23.12.1995, p.2

2 The Convention drawn up on the basis of Article K.3 of the Treaty on European Union, on the protection of the European Communities' financial interests, OJ C 316, 27.11.1995, p.49

Conflict of interests:

a) Financial Regulation

The Financial Regulation applicable to the general budget of the Union (Regulation n°966/2012) provides in article 57(2) a definition of the conflict of interests concerning budget implementation and management.

This definition states:

'1.Financial actors and other persons involved in budget implementation and management, including acts preparatory thereto, audit or control shall not take any action which may bring their own interests into conflict with those of the Union.

(…).

2.For the purpose of paragraph 1, a conflict of interests exists where the impartial and objective exercise of the functions of a financial actor or other person, as referred to in paragraph 1, is compromised for reasons involving family, emotional life, political or national affinity, economic interest or any other shared interest with a recipient'.

It is important to state that conflict of interests and corruption are not similar. Corruption usually requires an agreement between at least two partners and a bribe/payment/advantage of any kind. A conflict of interests concerns one person who may have the opportunity to give priority to his/her private interests to the detriment of his/her professional duties.

b) Public Procurement Directives

In 2013 political compromise has been reached in the Council on the Directive of the European Parliament and the Council on public procurement. Article 21 of the directive stipulate:

Member States shall ***ensure that contracting authorities take appropriate measures*** to effectively prevent, identify and remedy conflicts of interests arising in the conduct of procurement procedures so as to avoid any distortion of competition and to ensure equal treatment of all ***economic operators***.

The ***concept*** of ***conflicts*** of ***interest*** shall at least cover any situation where ***staff members of the contracting authority or of a procurement service provider acting on behalf of the contracting authority who are involved in the conduct of the procurement procedure or may influence the outcome of that procedure*** have, directly or indirectly, a ***financial, economic or other personal*** interest which ***might*** be perceived to ***compromise their impartiality and independence in the context of the procurement procedure.***

1.2. Definitions in the Greek law

The term **Fraud** is defined in the article 386 of the Greek penal code as follows:

1. One who with intent to enrich himself or another with an unlawful interest in property, causes damage to the property of another, by intentionally representing false facts as true or by illegally concealing or suppressing true facts in order to persuade another to commit an act or omission or toleration of the same shall be punished by imprisonment for not less than three months and in case of serious damage occurred two years by imprisonment for not less than two years.

2. The provisions of Article 72 with respect to a workhouse shall apply to such a case.

3. Confinement in a penitentiary for not more than ten years shall be imposed:

(a) if the offender perpetrates frauds as a profession or habitually and the total interest or the total damage to property exceeds the sum of 30.000 euros, or

(b) if the interest in property or the occurred damage exceeds the sum of 120.000 euros.

Corruption taking form of a **passive or active bribery** is penalised by respective articles 235 and 236 of the penal code. Article 235 reads:

The civil servant who, in breach of his duties, requests or receives, directly or through a third party, for himself or a third party, benefits of any nature or accepts a promise thereof in order to carry out an act or omission in relation to his duties or in breach thereof is punishable with imprisonment of at least one year and an obligatory fine equal to 50 times of the benefit and till the sum of 150.000 euros. In case of benefit not evaluated in money, the fine shall not be less than 10.000 and more than 150.000 euros.

2. If the value of the benefits exceeds the sum of 120.000 euros or if the perpetrator is an employee of the Ministry of Economics (he) is punishable with confinement in a penitentiary for not more than 10 years and an obligatory fine which shall not be less than 50.000 and more than 500.000 euros.

Article 236 concerns **active bribery** and reads**:**

Any person who promises or provides to a civil servant, directly or through a third party, benefits of any nature for himself or a third party so that the civil servant, in breach of his duties, carries out an act or omission in relation to his duties related thereto or in breach thereof is punishable with the penalty of article 235. The act is not punishable if the person declares the commission of the act to the public prosecutor of the court of misdemeanours or any investigating official or other competent authority, on his own free will and before being examined for the act, by producing a written report or by doing so orally, in which case a report is drafted accordingly. In this case, the gift or benefit that may have been confiscated or delivered to the investigator is returned to the person who gave it and the provision of article 238 is not applied.

2. If the value of the benefits exceeds the sum of 120.000 euros the act is punishable with confinement in a penitentiary for not more than 10 years and an obligatory fine which shall not be less than 50.000 and not more than 500.000 euros.

Falsification of documents is penalised by article 216 of the Greek Penal Code, which reads as follows:

One who executes a forged document or one who alters a document with intent to use it to defraud another concerning a fact which may have legal significance shall be punished by imprisonment for not less than three months. His use of the document shall be deemed an aggravating circumstance.

2. One who knowingly uses a forged or altered document for such a purpose shall be subject to the same punishment.

3. If the person guilty of the above offenses (paragraphs 1-2) intended to enrich himself or another by causing damage or harm to a third party, he shall be punished by confinement in a penitentiary for not more than ten years if the total damage of enrichment exceed the sum of 120.000 euros.

4. The same punishment applies if the offender perpetrates forgery as a profession or habitually and if the total damage of enrichment exceed the sum of 30.000 euros.

1.3. Exercise

Qualify short cases described below as fraud or irregularity

1	A company was a member of a research network and produced machinery with the support of EU funds. It fell bankrupt and could not fulfil its contractual obligations towards the project coordinator. Following the bankruptcy, the former director seized the equipment which should have been delivered to the project coordinator, and attempted to sell the product to the network.	Fraud or Irregularity
2	A representative of a company made false statements regarding eligibility for an SME status, when applying for an EU grant. The company submitted an altered annual balance sheet and declared lower number of employees in order to fulfil the criteria for SME eligibility.	Fraud or Irregularity
3	A University, which was a member of a consortium, submitted to the consortium leader a technical and financial report. In the financial report the University miscalculated overhead costs by 5%.	Fraud or Irregularity
4	Lack of an information board indicating the EU financing of an infrastructure project. The board was not produced and its cost was not claimed as expenditure for the project.	Fraud or Irregularity
5	Several independent companies constituting a major part of the local market agree their bidding strategies in several calls for tenders published in a region. The companies want to ensure that all of them would be able to keep their staff employed during the economic crisis. They agreed on the prices which corresponded more or less to market prices.	Fraud or Irregularity
6	The selecting committee dispatched tender notices for procurement of several infrastructure projects just before the Christmas holidays with the minimum time, provided by law, left for response from the companies.	Fraud or Irregularity

2. Why does fraud occur?

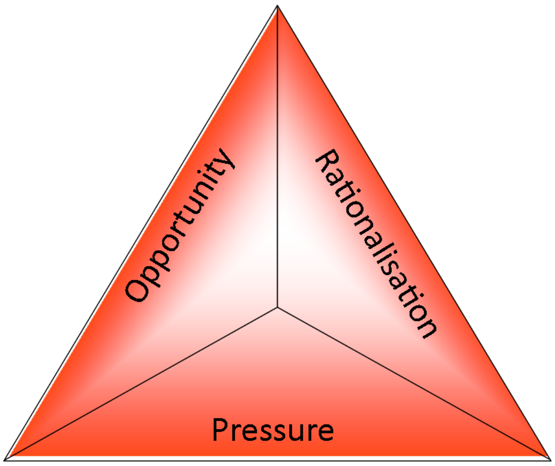
2.1. Fraud triangle

W.S. Albrecht et al.[3] identified in their work on fraud three components in the behaviour of fraudsters:

Perceived pressure: the need to commit illegal acts;

Perceived opportunity: the way fraudsters think they can perpetrate fraud without being caught, and:

Rationalisation of behaviour: behaviour and attitudes of the fraudster to make its fraudulent acts acceptable and in line with their internalized beliefs and convictions. This rationalisation is also known under the term "techniques of neutralisation".



The Fraud Triangle (from Albrecht: 'Fraud Examination'):

The classical example of perceived pressure is the need to steal food by poor, hungry persons. Another example is the need to embezzle funds by a business executive who can no longer afford paying the monthly mortgage or alimonies. Extortion is another factor that heavily determines the need to commit an illegal act. The category 'perceived pressure' also includes psychological or psychiatric disorders, such as a pathological need to steal or to swindle.

3 Albrecht, W.S., Albrecht, C.C. and Albrecht, C.O.: Fraud Examination, South-Western publications, 2005

Perceived opportunities consist of all those situations where fraudsters think they can abuse or exploit the vulnerabilities of somebody else to satisfy their own needs without facing criminal prosecution ('get away with it'). Perceived opportunities vary from a wallet left unattended in an office to the loopholes and vulnerabilities that have been identified after a careful examination of complex budget, tax or IT systems. These opportunities often provide an unexpected inspiration to scenario writers or crime authors but they also constitute an area where enforcement services run a serious risk of being outsmarted or even kept ignorant. A classification of perceived opportunities for in structural funds sector corresponds to the inventory of irregularities and suspected fraud that OLAF has investigated.

Rationalisation of behaviour consists of mental techniques to reconcile ('neutralise') behaviour that is known to be inconsistent with one's internalised moral beliefs. Understanding of neutralisation techniques is important as they can explain and sometimes even predict the attitudes, motives and behaviour of fraudsters and persons committing irregularities.

2.2. Profile of a fraudster[4]

Following a study done by the KPMG which investigated different aspects of fraud and fraudsters, a statistical picture presenting a typical fraudster appeared. Below you can find a portrait of an average fraudster. It does not mean that people having characteristics other than the ones mentioned on the list would not commit fraud but they would be statistically less likely to do so within a given organisation.

The typical fraudster would:

- be male
- be 36 to 45 years old
- commit fraud against his own employer
- works in a finance function or in a finance-related role
- hold a senior management position
- be employed by the company for more than 10 years
- work in collusion with another perpetrator.

4 Who is the typical fraudster? 2011, KPMG at http://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/Documents/who-is-the-typical-fraudster.PDF

3. Corruption – Observations, Cost and "Red Flags".

3.1. Observations

Observations presented below are coming from a report procured by OLAF and delivered by Price Waterhouse Coopers (PWC) in 2013[5].

In 2010 a total of EUR 2 406 billion – or around one fifth of EU GDP – was spent by government, public sector and utility service providers on public works, goods and services. PWC collected data in eight EU Member States (Hungary, Italy, Lithuania, Netherlands, Poland, Romania, Spain) in five sectors of the economy where EU funds are spent (and thus not necessarily public procurement cases involving EU funds). The 5 selected sectors of the economy were: road/rail construction, water/waste, urban/utility construction, training and R&D/High tech/Medical products.

The main findings of the report:

> The involvement of EU funding significantly reduces the risk of corruption.
>
> Bid rigging (a contract is promised to one party, although for the sake of appearance other parties also present a bid) is observed in almost half (48% of cases observed) of the practices and most present in Water & Waste and R&D projects. Bid rigging is encountered more frequently in Hungary, Poland, Lithuania and Italy.
>
> Kickbacks (a portion of the sum that a winning contractor received that is designated for the official in exchange for betraying the public) are encountered in about 1 out of 3 cases. This practice appears to be rather equally spread across all sectors. Kickbacks are the most frequent form of corruption encountered in Spain and Romania.
>
> Conflict of interests practices were encountered in around 1/5th of cases and across all sectors, though slightly more frequent in the Training and Urban/utility construction sector.

5 "Identifying and Reducing Corruption in Public Procurement in the EU" http://ec.europa.eu/anti_fraud/documents/anti-fraud-policy/research-and-studies/identifying_reducing_corruption_in_public_procurement_en.pdf

3.2. Cost of corruption

The overall (net) direct public loss due to corruption is estimated to be 13% of the budgets involved. Corruption is thus expected to explain over 2/3rd of the direct public losses in corrupt/grey cases concerned.

An important source of performance loss for corrupt/grey projects is inefficiency due to cost overruns (either at the time of the contract award or through additions to/extensions of the initial contract). These occurred in 53% of corrupt/grey cases, amounting to 22% of the total average budget involved. The average overrun per corrupt/grey project amounted to 28% of the average budget. The relative size of overrun is highest in the case of small tenders, e.g. in the area of training.

Delays of implementation, another source of inefficiency, affected 30% of corrupt/grey cases, and the related loss is estimated to be 6% of the total budget for corrupt/grey projects analysed. The average cost of delay represents 9% of the total budget of an average corrupt/grey project concerned. Delays are rather equally spread across the sectors, with road & rail encountering a higher share of cases (59%), followed by urban/utility construction (38% of cases analysed).

An overall 48% of the corrupt/grey cases analysed encountered further performance issues in the form of ineffectiveness, e.g. they did not meet their original objectives. An estimated 3% of the total budget analysed is considered lost due to ineffectiveness. Training and R&D projects appear to be most problematic from an effectiveness point of view, as respectively 75% and 69% of the corrupt/grey projects encountered such performance issues.

The direct costs due to corruption in public procurement in the year 2010 for **road & rail** in the eight Member States studied is estimated at **1.9 % to 2.9%** of the overall value of procurements in the sector published in the Official Journal, i.e. EUR 488 million to EUR 755 million.

The estimated direct costs due to corruption in public procurement in the year 2010 for **water & waste** in the eight Member States studied is estimated at **1.8% to 2.5%** of the overall value of procurements in the sector published in the Official Journal, i.e EUR 27 million to EUR 38 million.

The estimated direct costs due to corruption in public procurement in the year 2010 for **urban/utility construction** in the eight Member States studied is estimated at **4.8% to 6.6%** of the overall value of procurements in the sector published in the Official Journal, i.e. EUR 830 million to EUR 1 141 million.

The direct costs due to corruption in public procurement in the year 2010 for **training** in the eight Member States studied is estimated at **4.7 % to 15.9%** of the overall value of procurements in the sector published in the Official Journal, i.e. EUR 26 million to EUR 86 million. These numbers are only indicative and the inaccuracy of these figures is large due to the small number of training cases that could be studied.

The estimated direct costs due to corruption in public procurement in the year 2010 for **R&D** in the eight Member States studied is estimated at **1.7% to 3.9%** of the overall value of procurements in the sector published in the Official Journal, i.e. EUR 99 million to EUR 228 million.

Taken together, **the overall direct costs of corruption in public procurement in 2010 for the five sectors studied in the eight Member States constituted between 2.9% to 4.4% of the overall value of procurements in the sector published in the Official Journal**, or between EUR 1 470 million and EUR 2 247 million.

These levels are substantially above the more general estimate of the overall costs of corruption within the EU, namely a 1% of GDP-level across all Member States, all sectors and all types of corruption according to the European Commission.

3.3. Red flags identified in public procurement

Overview of red flags identified - including assumptions about patterns of corruption

	Assumption	*Shorter name*
1	Strong inertia in the composition of the evaluation team of the tender supplier	Strong inertia in composition of evaluation team
2	Any evidence for conflict of interest for members of the evaluation committee (for instance because the public official holds shares in any of the bidding companies)	Conflict of interest for members of evaluation team
3	Multiple contact offices/ persons	Multiple contact points
4	Contact office is not directly subordinated to the tender provider	Contact office not subordinated to tender provider
5	Contact person not employed by the tender provider	Contact person not employed by tender provider
6	Any elements in the terms of reference that point at a preferred supplier (e.g. unusual evaluation criteria or explicit mentioning of the brand name of the good instead of general product characteristics)?	Preferred supplier indications
7	Shortened time span for bidding process (e.g. request on a Friday for a bid to be sent the following Monday)	Shortened time span for bidding process
8	Procedure for an accelerated tender has been applied	Accelerated tender

9	Size of the tender exceptionally large (average value plus two times the standard deviation)	Tender exceptionally large
10	Time-to-bid allowed to the bidders not in conformity with the legal provisions	Time-to-bid not conform the law
11	Bids submitted after the admission deadline still accepted	Bids after the deadline accepted
12	Few offers received	Number of offers
13	Any artificial bids (e.g. bids from non-existing firms)	Artificial bids
14	Any (formal or informal) complaints from non-winning bidders	Complaints from non-winning bidders
15	Awarded contract includes items not previously contained in the bid specifications	Award contract has new bid specifications
16	Substantial changes in the scope of the project or the project costs after award	Substantial changes in project scope/costs after award
17	Any connections between bidders that would undermine effective competition	Connections between bidders undermines competition
18	All bids higher than the projected overall costs	All bids higher than projected overall costs
19	Not all/no bidders informed of the contract award and on the reasons for this choice	Not all/no bidders informed of the award and its reasons
20	Contract award and the selection justification documents not publicly available	Award contract and selection documents public
21	Inconsistencies in reported turnover or number of staff	Inconsistencies in reported turnover/number of staff
22	Winning company not listed in the local Chamber of Commerce	Winning company not listed in Chamber of Commerce
23	No EU funding involved (as % of total contract value)	% of EU funding (= 0)
24	Share of public funding from the MS is involved (as % of total contract value)	% of public funding from MS
25	Awarding authority not filled in all fields in TED/CAN	Awarding authority not filled in all fields in TED/CAN
26	Audit certificates issued by unknown/local auditor with no credentials (cross-check reveals external auditor is not registered, not active or registered in a different field of activity)	Audit certificates by auditor without credentials
27	Any negative media coverage about the project (e.g. failing implementation)	Negative media coverage

4. Anti-fraud cycle

Fraud has to be tackled in a comprehensive manner. A single isolated action might not lead to effectively combating fraud. It might stop a single occurrence, but in order to limit the fraud phenomenon, a comprehensive action is needed. The anti-fraud cycle is meant to facilitate a comprehensive approach to tackle fraud.

4.1. Prevention

The fight against fraud needs to be pro-active. Fraud needs to be combated by strong preventive mechanisms with the aim of minimising future opportunities for fraud. Usual fraud prevention tools are unambiguous messages from the political level and top management that fraud is not tolerated, awareness raising and training of staff, providing for anti-fraud checks, fraud proofing of legislation and processes, etc.

4.2. Detection

Irregularities indicating fraud can be detected by various actors — programme managers, auditors, competitors in a call for tender, participants in an EU-funded project, investigative journalists etc. However, if efforts to detect fraud and irregularities are not carried out in a structured and systematic manner, the risk that fraudulent and irregular activities will pass unnoticed is high.

4.3. Investigation and prosecution

In the structural funds sector, the national law enforcement bodies are primarily in charge of investigating fraud cases. Upon receiving information from the Commission or other sources (anonymous allegations, whistle-blowers, informants, etc.), OLAF may decide to open an investigation or coordination case. Managing, certifying and audit authorities should facilitate investigations.

4.4. Sanction and recovery

Recovery action against fraudsters should be carefully prepared and vigorously taken forward by the relevant authorities. Criminal sanctions and, where available, exclusion from further financing are particularly important from a fraud deterrence perspective.

5. Red flags

Red flags are warning signals, hints, indicators of possible fraud!

The existence of a red flag does not mean that fraud exists but that a certain area of activity needs extra attention to exclude or confirm potential fraud.

Some patterns, practices and specific forms of activity are red flags that could signal irregularities or fraud.

The most common schemes are presented below:

5.1. Undisclosed conflicts of interests

A situation of conflict of interests[6] can occur e.g. if an employee of the contracting organisation has an undisclosed financial interest in a contract or contractor. An employee might e.g. secretly own a supplier or a contractor, set up a shell company through which he or she purchases supplies at an inflated price or have an undisclosed interest in property sales or leases.

It is essential that staff disclose conflicts of interests. It is then usually up to the person's superior to decide which measure to implement to tackle the situation in a timely manner.

Red flags:

- unexplained or unusual favouritism of a particular contractor or seller;

- continued acceptance of high priced, low quality work etc;

- contracting employee fails to file or complete conflict of interest declaration;

- contracting employee declines promotion to a non-procurement position;

- contracting employee appears to conduct side business;

- close socialisation between a contracting employee and service or product provider;

- unexplained or sudden increase in wealth by the contracting employee;

6 OLAF has developed a comprehensive document on conflict of interests issue which discuss definitions, red flags and practical tools to prevent conflict of interests. "Identification of conflict of Interests in public procurement procedures in the field of structural actions. A practical guide for managers." The document is annexed.

- contracting employee has an undisclosed outside business;

- contractor has a reputation in the industry for paying kickbacks;

- undocumented or frequent changes to contracts increasing the value of the contract;

5.2. Collusive bidding

Contractors in a particular geographic area/region or industry can conspire to defeat competition and raise prices through various collusive bidding schemes.

Complementary bidding

Complementary bids, also known as "shadow" bids, are intended only to give the appearance of genuine bidding and not to secure the buyer's acceptance. Cooperating bidders agree to submit higher priced or deliberately non-responsive bids to allow the selection of a favoured contractor at an inflated price. The winner shares a percentage of its profits with the losing bidders, hires them as subcontractors, or allows them to win other high priced contracts. Complementary bids may also be submitted from shell companies or from affiliated firms.

Bid suppression

For bid rigging schemes to succeed the number of bidders must be limited and all must agree to the conspiracy. If a new (a so-called "diver") or uncooperative bidder enters the competition, the price inflation will become apparent. To prevent this, the conspirators may pay-off outside companies not to bid or use more forceful means to discourage their participation. The conspirators can also coerce suppliers and subcontractors not to deal with non-cooperating companies to protect their monopoly.

Bid rotation

The conspirators submit complementary bids or refrain from bidding in order to allow each bidder to be the low bidder on a rotating basis. The rotation can be based on geographic area – one road contractor gets all work in one region, another company in the next – or by type of job, or by time, etc

Market division

The cooperating companies may divide markets or product lines and agree not to compete in each other's area, or to do so through collusive measures, such as submitting only complementary bids. Sometimes employees may be involved in collusive bidding schemes – sometimes with a financial interest in the “competing” businesses – and receive a share of the inflated prices.

Red flags:

- winning bid is too high compared to cost estimates, published price lists, similar works or services or industry averages and fair market prices;

- persistent high prices by all bidders;

- bid prices drop when new bidder enters the competition;

- rotation of winning bidders by region, job, type of work;

- losing bidders hired as subcontractors;

- unusual bid patterns (e.g. the bids are exact percentage apart, winning bid just under threshold of acceptable prices, exactly at budget price, too high, too close, too far apart, round numbers, incomplete, etc);

- apparent connections between bidders, e.g. common addresses, personnel, phone numbers etc;

- contractor includes subcontractors in its bid which are competing for the main contract;

- qualified contractors fail to bid and become subcontractors or low bidder withdraws and becomes a subcontractor;

- certain companies always bid against each other, others never do;

- losing bidders cannot be located in the Internet, business directories, have no address etc (in other words they are fictitious);

- correspondence or other indications that contractors exchange pricing information, divide territories, or otherwise enter informal agreements;

5.3. Unbalanced bidding

In this fraud scheme contracting personnel provide a favoured bidder with useful inside information which is not available to other bidders, for example, that one or several line items in a request for bid will not be used in the contract (some line items may also be vague or ambitious on purpose and the favoured bidder is instructed how to respond). This information allows the favoured firm to submit a lower price than the other bidders, by quoting a very low price on the line item which will not be included in the final contract. Unbalanced bidding is one of the more effective bid rigging schemes as the manipulation is not as obvious as in other popular schemes, such as unjustified single source acquisitions.

Red flags:

- particular line item bids appear to be unreasonably low;

- changes are issued soon after contract awards to delete or modify line item requirements;

- line items for bids are different than the actual contract;

- bidder close to procurement personnel or participated in drafting specifications.

5.4. Rigged specification:

Requests for bids or proposals might contain specifications which are tailored to meet the qualifications of a particular bidder, or which only one bidder can meet. This is particularly common in IT and other technical contracts. Specifications which are too narrow can be used to exclude other qualified bidders, or to justify single source acquisitions and avoid competition altogether. A pattern of rigged specifications which favour a particular contractor suggests corruption.

Red flags:

- only one or a few bidders respond to request for bids;

- similarity between specifications and winning contractor's product or services;

- complaints from other bidders;

- specifications are significantly narrower or broader than similar previous requests for bids;

- unusual or unreasonable specifications;

- high number of competitive awards to one supplier;

- socialisation or personal contacts between contracting personnel and bidders during the bidding process;

- the buyer defines an item using brand name rather than generic description.

5.5. Leaking bid data

Contracting, project design or bid evaluation personnel can leak confidential information to help a favoured bidder formulate a technical or financial proposal, such as estimated budgets, preferred solutions, or the details of competing bids.

Red flags:

- poor controls on bidding procedures, e.g. failure to enforce deadlines;

- winning bid just under the next lowest bid;

- some bids opened early;

- acceptance of late bids;

- late bidder is the winning low bidder;

- all bids are rejected and contract is re-bid;

- winning bidder communicates privately with contracting personnel by e-mail or otherwise during bidding period.

5.6. Manipulation of bids

In a poorly controlled bidding process contracting personnel can manipulate bids after receipt to ensure that a favoured contractor is selected (changing bids, "losing" bids, voiding bids for alleged errors in specifications, etc)

Red flags:

- complaints from bidders;

- poor controls and inadequate bidding procedures;

- indications of changes to bids after reception;

- bids voided for errors;

- a qualified bidder disqualified for questionable reasons;

- job not re-bid even though fewer than the minimum number of bids were received.

5.7. Unjustified single source award

This scheme often results from corruption, in particular if the pattern is repeated and questionable. Such awards can be made by splitting purchases to avoid competitive bidding thresholds, falsifying single source acquisition justification, drafting very narrow specifications, extending previously awarded contracts rather than re-bidding.

Red flags:

- single source awards above or just below competitive bidding thresholds;

- previously competitive procurements become non-competitive;

- split purchases to avoid competitive bidding threshold;

- request for bid mailed only to one service provider.

5.8. Split purchase

Contracting personnel may split a purchase into two or more purchase orders or contracts in order to avoid competition or higher-level management review. For example, if the threshold is € 250,000, a single procurement of goods and services for € 275,000 can be split into two contracts – one for goods for € 150,000 and the other for € 125,000 – to avoid bidding. Split purchases (often called "salami slicing") can indicate corruption or other schemes by a purchasing employer.

Red flags:

- two or more consecutive, related procurements from the same contractor just under competitive bidding or upper level review thresholds;

- unjustified separation of purchases, e.g. separate contracts for labour and materials, each of which is below bidding thresholds;

- sequential purchases just under the thresholds.

5.9. Commingling of contracts

A contractor with multiple similar work orders might charge the same personnel costs, fees or expenses to several of the orders, resulting in over-invoicing.

Red flags:

- similar invoices presented under different jobs or contracts;

- the contractor invoices for more than one job for the same time period.

5.10. Costs mischarging

A contractor can commit fraud by intentionally charging costs which are not allowable or reasonable, or which cannot be allocated, directly or indirectly, to a contract. Labour costs are more susceptible to mischarging than material costs because employee labour can in theory be charged to any contract. Labour costs can be manipulated by creating fictitious time sheets, altering time sheets or supporting documentation or simply invoicing for inflated labour costs without supporting documentation.

Red flags:

- excessive or unusual labour charges;

- labour charges inconsistent with contract progress;

- apparent changes to time sheets;

- time sheets cannot be found;

- the same material costs charged to more than one contract;

- charging indirect costs as direct costs.

5.11. Defective pricing

Defective pricing occurs in contracts if contractors fail to disclose current, complete and accurate cost or pricing data in their price proposals resulting in an increased contract price.

Red flags:

- contractor refuses, delays or is unable to provide supporting documents for costs;

- contractor provides inadequate or incomplete documentation;

- out-of-date pricing information;

- apparent high prices compared to similar contracts, price lists or industry averages;

5.12. Failure to meet contract specification

Contractors which fail to meet contract specifications and then knowingly misrepresent that they have met them commit fraud. Examples of such schemes include the use of sub-standard building materials, inferior quality parts, failure to lay the required foundation in road projects etc. The motive, of course, is to increase profits by cutting costs or to avoid penalties for failing to meet deadlines etc. Many such schemes are difficult to detect without close inspections or tests by independent subject matter experts. The fraudsters may seek to bribe the inspectors though.

Red flags:

- discrepancy between test and inspection results and contract claims and specifications;

- absence of test of inspection document or certificates;

- low quality, poor performance and high number of complaints;

- indications from the contractor's expense records that the contractor did not e.g. purchase materials necessary for the works, does not own or did not lease equipment necessary for the work or did have the necessary labour on the site (NB: this type of cross-checking can be valuable).

5.13. False, inflated or duplicate invoices

A contractor might knowingly submit false, inflated or duplicate invoices, either acting alone or in collusion with contracting personnel as the result of corruption.

Red flags:

- invoiced goods or services cannot be located in inventory or accounted for;

- no acknowledgment of receipt for invoiced goods or services;

- questionable or no purchase order for invoiced goods or services;

- contractor's records do not reflect that the work was done or that the necessary costs were incurred;

- invoice prices, amounts, item descriptions or terms exceed or do not match contract items, purchase order, receiving records, inventory or usage records;

- multiple invoices with the same amount, invoice number, date etc;

- sub-contracts in cascade;

- cash payments;

- payments to off-shore companies.

5.14. Phantom service provider

a) An employee can authorise payments to a fictitious seller in order to embezzle funds. The scheme is most common where there is a lack of segregation of duties between requisition, receipt and payment.

b) Contractors can set up phantom companies to submit complementary bids in collusive bidding schemes, to inflate costs or simply to generate fictitious invoices. Experience has shown that fraudsters tend to use names of companies which are similar to the names of real companies.

Red flags:

- service provider cannot be found in any directories, the Internet, Google and other search engines etc;

- service providers address cannot be found;

- the service provider lists incorrect street address or phone number;

- off-shore company used.

5.15. Product substitutions

Product substitution refers to the substitution, without the purchaser's knowledge, of inferior quality items for those which are specified in the contract. At worst, product substitution can be life-threatening, e.g. deficiencies in infrastructure or buildings. Substitution is particularly attractive in contracts calling for expensive high grade materials that can be replaced by similar appearing, much less expensive, products. The substitution often involves component parts which are not easily detected. Specially created samples can also be presented for inspection in order to deceive.

Red flags:

- unusual or generic packaging: packaging, colours or design different than the norm;

- discrepancy between expected appearance and actual appearance;

- product identification numbers differ from published or catalogue numbers or numbering system;

- above average number of test or operation failures, early replacements, or high maintenance or repair costs;

- compliance certificates signed by unqualified or non-certified person;

- significant difference between estimated and actual costs for materials;

- contactor is behind schedule but quickly catches up;

- unusual or obliterated serial numbers; serial numbers are not consistent with legitimate manufacturer's numbering system;

- invoice or inventory item numbers or descriptions do not match purchase order terms.

5.16. Incurred labour costs

Without any external independent or physical verification, labour is very vulnerable to manipulation. A promoter might knowingly claim false labour, direct and indirect. The critical issue is whether the employee's time is properly charged to the project actually worked on. (No third party documentation may exist such as invoices, purchase orders, etc., to support labour costs).

Red flags:

- distinctive charging patterns;

- sudden, significant shifts in charging;

- decrease in charges to projects/contracts in overrun or near ceilings;

- a disproportionate percentage of employees charging indirect;

- large number of employees reclassified from direct to indirect or vice versa;

- same employees constantly reclassified from direct to indirect or vice versa;

- weak internal controls over labour charging, such as employee time cards signed in advance, employee time cards filled in by the supervisor, time cards filled in with pencil or time cards filled in at the end of the pay period;

- actual hours and euros consistently at or near budgeted amounts;

- use of adjusting journal entries to shift costs between contracts, R&D, commercial work;

- significant increases or decreases in charging to sensitive accounts;

- employee's time charged differently than associated travel costs.

5.17. Uncompensated overtime

An economic operator might knowingly claim false overtime where it usually does not grant informal credit for extra hours, such as additional time off. The critical issue is whether the employee's time is properly charged to the project actually worked on. No third party documentation exists.

Red flags:

- professional staff required to work a significant amount of unpaid overtime on a variety of projects-both direct and indirect;

- salaried employees only charging the regular hours worked during any day for an extended period;

- a pattern of management directed unpaid overtime with employee bonus based on the extra hours worked;

- overrun contracts/projects worked on only during unpaid hours.

5.18. Consulting/professional services

The services were properly supported with detailed consulting agreements, invoices and reports. The subjects covered were germane to the contractor's operations and provided appropriate recommendations to improve the efficiency of certain operations. The contractor implemented the majority of the recommendations. The applicable agreements contained the necessary level of detail and the fees were considered reasonable. However, for some companies contracted, their services were not previously used. The agreements were not specific in what services the companies were to provide; however, they did detail who would perform the services and the hourly rate involved. The individuals' resumes were not available. The fees were higher for these new companies. The company representative could not explain the higher fees or the specifics of what services were to be provided. Moreover, invoices from these companies for services rendered in addition were vague in describing services and only referred to the agreement. The expense was a lump sum with no breakdown of hours spent, hourly rate, travel expenses or other expenses. No trip reports or other summary reports were available. No additional information on these companies was available; the promoter was unable to provide anything other than verbal assurances of the services provided. Finally, the invoices showed a post office box as a mailing address and no listing of these companies in the telephone directory.

<u>Red flags:</u>

- no formal signed agreements or contracts; however, large sums paid for "services rendered" based on invoices with few specifics;

- formal agreements or contracts exist but are vague as to services to be rendered, and no other documented support, such as detailed invoices, trip reports or studies, exists to justify the expenses;

- services paid for were used to improperly obtain, distribute or use information or data protected by law or regulation;

- services paid for were intended to improperly influence the content of a solicitation, the evaluation of a proposal or quotation, the selection of sources for contract award or the negotiation of a contract, modification or claim. It does not matter whether the award is by the prime contractor or any tier subcontractor; - services paid for were obtained or performed in some way that violated a statute or regulation prohibiting improper business practices or conflict of interest;

5.19. Labour categories

A contractor's proposal for a renewal of time and material (T&M) contract, which had been awarded on a yearly basis for the last two years, indicated that the incurred hourly rates were significantly lower than the proposed rates, except for the administrative category. The original proposal had a full work force on board when the contract was originally bid. After being awarded the contract, the contractor hired/used employees at lower salaries than proposed. The qualifications of some of the newly hired employees were below the requirements per the request for proposal. The contractor had placed many of the newly hired employees in labour categories, for which they did not qualify.

<u>Red flags:</u>

- significant differences between proposed and actual unit costs or quantities with no corresponding changes in work scope or job requirements;

- task-by-task invoicing consistently at the ceiling level established in the contract. An exception would be if the contract/work order specifies how many hours to bill;

- specific individuals proposed as "key employees" not working on the contract;

- proposed labour not based on existing work force. Massive new hires needed. New hire labour rates significantly lower than proposed;

- employees’ skills do not match the skill requirements as specified for their labour category or the contract requirements;

- employees typically charged indirect by the company being charged direct to the contract;

- partners’, officers’, supervisors’ and other employees’ time being charged in noncompliance with the contract terms or with the company’s established accounting policies and procedures.

5.20. Exercises

Identify as many red flags as possible in the following case studies:

<u>Case study 1</u>

A municipality acting as final beneficiary received a subsidy to renovate and preserve an old historic building. It delegated the implementation of the works to a contractor company. However, the contract signed between the final beneficiary and the contractor provided for the renovation of the building in order to turn it into a hotel.

Therefore, contrary to what had been declared by the final beneficiary and in breach of the call for proposals and of the aim of the operational programme, the subsidy was used to turn the building into a hotel, rather than preserve the heritage it represented. Moreover, the final beneficiary submitted false invoices to the Managing Authority, in order to inflate its costs.

Modus operandi: The municipality submitted to the Managing Authority its application for a subsidy for the purpose of renovating an old historic building.

However, the application was supported by false declarations and false documents seeking to prove that the applicant fulfilled all the eligibility criteria laid down by the call for proposals. The false declarations referred to the ownership of the land and of the building to be renovated, as well as to the real aim of the project (to convert an old historic building into a hotel rather than preserve the local heritage). Due to the political pressure exerted on the Managing Authority by representatives of the municipality and to the false documentation submitted, the project was accepted for funding. The final beneficiary committed the works to a contractor company in which the major and other representatives of the municipality had an economic interest. Finally, during the implementation stage of the project, the final beneficiary submitted false invoices produced by its contractor in order to inflate its costs.

<u>Case study 2</u>

A final beneficiary (a cooperative venture established among local governments) obtains a subsidy for building an infrastructure and appoints a natural person as project manager. The project manager is entrusted with all the powers of the final beneficiary without the final beneficiary taking any measures for checking or monitoring his activity. The works for implementing the project are entrusted to a contractor company in which the project manager has a relevant economic interest, since he is its principal stakeholder. Therefore, the party appointed by the final beneficiary as manager of the project and the contractor of the final beneficiary had interests that conflicted with those of the final beneficiary.

The convergence of interest between the project manager and the contractor company, together with the absence of controls on the activity of the project manager, allowed actions to be taken which were not in accordance with the contract drawn up between the final beneficiary and the contractor and which contributed to maximising profit of the contractor company.

Modus operandi: At the stage of awarding the subsidy, the final beneficiary brought pressure on the Managing Authority to fund a specific project. The pressure was facilitated by the specific nature of the final beneficiary (local government), which had strong political influence. After the award of the project, the final beneficiary appointed a project manager to implement it. The project manager — having the full capability to act on behalf of the final beneficiary — on the one hand delegated the works to a contractor company largely owned by him and, on the other hand, maximised the profit of the contractor company by concealing the failure to comply with the terms of the contract stipulated between the contractor and the final beneficiary.

6. Tools

This section will give a quick overview of some straightforward checks which could be performed in order to verify a red flag. The intention of the manual is neither to give you investigative tools nor to burden you with additional procedures but to give you an idea of quick checks which could be performed either to confirm or to exclude your suspicion of fraud.

Fraudster in order to perform a fraud needs to create a parallel reality and convince you that their reality is the true one. However no matter how complex setups there are they always have one flaw - they are not real. They will have several or even many plausible points in their scenarios but there will be points detached from reality.

The more elaborate scheme the more it costs to set it up and run. Therefore the highest possible gains from fraud would induce more sophisticated cover-up operations. It does not exclude that in big schemes you will not find low-cost solutions but the rule goes rather the other direction. Complex schemes involving many actors and resources drive towards high value fraud. In order to embezzle small amounts nobody will install complicated schemes unless it is a repetitive scheme which can bring considerable gains. We should not forget that fraudsters work like enterprises which calculate their income.

6.1. Company

The first level of checks should look at companies, be it beneficiaries or subcontractors: Do they really exist? Are they active on the market? Are they known, respected companies in their environment? The best tool to start the research is a company register in a given country. As the regulations differ between countries, information available in such registers differ. However, basic information can be usually retrieved.

Very good overview of the commercial registers available worldwide can be found here:

> http://www.companieshouse.gov.uk/links/introduction.shtml#reg

When checking information about a company, particular attention should be paid to the place where it is established. In some instances it could be useful to use the Street view by Google to verify whether a building with a given address exists and whether a plaque of a company is attached at the entrance.

When checking information about a company the following questions could help to test the reality of a company:

> Is the address given on the application form the same as the one mentioned in the register?

Is the company registered in a tax haven?

Are the bank details for a company the same as register address? One should pay special attention to unusual addresses: PO Box, apartments, etc.

Is a company a newly created structure?

Does a company have subsidiaries and if so, do they participate in the same project?

Is the declared activity the same as the activity for which the company applied for financing?

What is the state of a company finances? Do they have capacity to implement a project? The general rule of a thumb is that if EU contribution constitutes above 40% of a company's turnover there is a high dependency on EU funds and higher risk of fraud.

6.2. Company's website

It is a good practice to visit a company's website. Nowadays the majority of respected companies have invested in websites. Special attention should be paid if a company website is under construction.

Is the content of a website similar to its declared activities?

Are information on the website up to date and in conformity with declared in an application and in the commercial register?

Who is the owner of the domain?

Is a company an owner of its domain or it is owned by someone else?

The ownership of a domain can be established at the following address:

http://www.domaintools.com/

http://www.networksolutions.com/whois/index.jsp

Depending on a red flag observed, it might be interesting to go back and see how the webpage looked in the past. Was a company always doing the same business or it has changed profile in the meantime? A good tool to see how a webpage looked like in the past is 'Waybackmachine'. The website records webpages back in time and allows you to compare a present website with its historical content:

http://web.archive.org

6.3. Key staff

Nowadays almost everybody is present on the internet, notably as a member of a social or professional network which holds information about him/her. Using the example of social/professional networks listed below, on can try to establish whether a person exists and has the qualifications he or she claims.

It is hardly probably that renowned scientist would not have his or her publications available on the internet. If there are publications of an expert, do they match the area of expertise claimed by the expert?

Usually the simple Google search would allow you to establish basic facts about a person but for a more in depth check of people's profile on of the following websites could be helpful:

Linked-in	http://www.linkedin.com/
Facebook	http://www.facebook.com/
Knowem	http://knowem.com/
Pipl	http://www.pipl.com/
Yasni	http://www.yasni.co.uk/
123 people	http://www.123people.com/

6.4. Forged documents

OLAF has developed a comprehensive document tackling the issue of forged documents – "Detection of forged Documents in the field of structural actions. A practical guide for managing authorities". The document presents the set of red flags in the format of documents, content of documents and circumstances. It provides as well ideas for methods of detection and practical examples. The document is annexed.

6.5. Conflict of interests

OLAF in cooperation with Member States' experts has developed a practical guide for managers – "Identification of conflict of interests in public procurement procedures in the field of structural actions". The document presents the set of red flags linked to conflict of interests, ideas for methods of detection and practical examples. The document is annexed.

7. Irregularity Management System

The Irregularity Management System (IMS) is a web based application that supports Member States and candidate countries needs to structure and execute reporting tasks steaming from regulations implementing Common Agriculture and Regional policies. Respecting funds[1] associated regulations; countries are obliged to report irregularities that arise.

IMS is an application of the Anti-Fraud Information System, which is developed and maintained by OLAF for a secure exchange of information between Member States and the Commission.

At the moment works are on-going works to stream line and simplify reporting procedure. Seven existing modules are being merged into one for the next Multiannual Financial Framework.

Every reporting country has per module a liaison officer managing access right at the level of a country and responsible for quality of reports submitted. Following changes in modules extensive training will be provided to liaison officers and responsible staff.

Data stored in the IMS are used for various analysis and reports prepared by the Commission, as Protection of the European Communities' Financial Interests, Member States and candidate countries.

Sectorial legislation, reporting manuals, technical specification and any other informative documentation can be found in the CIRCABC interest group Irregularity Management System: https://circabc.europa.eu

[1] European Regional Development Fund, European Social Fund, European Agriculture Guarantee and Guidance Fund, Financial Instrument for Fishery Guidance, European Agriculture Guarantee Fund, European Agriculture Fund for Rural Development, European Fishery Fund, Pre-Accession Funds.

8. Fraud Notification System

Fraud Notification System (FNS) allows any informant (i.e. citizens, economic operators) to report suspected cases of fraud and corruption via the OLAF website. The system allows an informant to remain anonymous and limits the required formalities. The informant should just be as precise as possible. The FNS has a simple and user-friendly interface and enables a dialogue with OLAF investigators. The system is available in English, French, German and Dutch, but any language can be used to report fraud.

The FNS can be accessed through OLAF's home page: https://fns.olaf.europa.eu/