

The European Social Fund and Risks of Fraud to the Detriment of the European Union

4.



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Foreword

David Smolej

Fraud to the detriment of the European Union is spread across various areas of European funds. One of these areas is covered by the European Social Fund, which indirectly affects the economic prosperity in the European Union and its Member States. The main fields funded from the European Social Fund are integration of job seekers back into the labour market, education and other areas ensuring social and health security. The financial resources of the European Social Fund are much lower than those of other Funds, for example the European Regional Development Fund. However, this does not mean that the European Social Fund is protected from risks of fraud in the use of allocated funds. Admittedly, few criminal offences were detected in this area in the past; however, this is not a sufficient indicator of the actual situation. With a view to improving the effectiveness of the detection and investigation of criminal offences linked to the absorption and use of financial resources from the European Social Fund, this collection of papers opens with a presentation of the European Anti-Fraud Office (OLAF), as the key European agency for the protection of financial interests of the European Union. The papers that follow present the European Social Fund and the Ministry of Labour, Family, Social Affairs and Equal Opportunities of the Republic of Slovenia, as the intermediate body awarding allocations of funds to end beneficiaries. The journal also describes the control mechanisms and discusses ways to determine the eligibility of expenditure for funds obtained from the European Social Fund. In the final paper, prosecution of criminal offences of fraud to the detriment of the European Union is demonstrated on a theoretical case.

In short, the journal gives an overview of the key issues relating to the European Social Fund, with emphasis on potential risks of fraud.

David Smolej
Editor

The role of the European Anti-Fraud Office in protecting the financial interests of the European Union

Tamás Iván Kovács, PhD, Head of Prevention with OLAF

The European Anti-Fraud Office (hereinafter: OLAF) has budgetary and administrative autonomy, designed to make it operationally independent. Upon receiving a request for investigation, OLAF first checks whether the request falls within the competence of its authority or meets the criteria for opening of investigations, and then classifies each open investigation into one of four categories:

- internal investigations - administrative investigations within the European Union (hereinafter: EU) institutions and bodies for the purpose of detecting fraud, corruption and any other illegal activity affecting the financial interests of the EU, including serious matters relating to the discharge of professional duties;
- external investigations - administrative investigations outside the EU institutions and bodies for the purpose of detecting fraud or other irregular conduct by natural or legal persons. Cases classified as external investigations are the ones where OLAF conducts the majority of the investigative input;
- coordination cases - OLAF contributes to investigations carried out by national authorities or other Community departments by facilitating the gathering and exchange of information and contacts; and



OLAF has budgetary and administrative autonomy, designed to make it operationally independent.

- assistance in criminal proceedings - OLAF provides assistance to competent authorities of Member States or non-EU states in the conduct of criminal proceedings.

OLAF protects the financial interests of the EU by investigating fraud, corruption and other illegal activities. It also detects and investigates serious matters relating to the discharge of professional duties by members and staff of the EU institutions and bodies that could result in disciplinary or criminal proceedings. Furthermore, it supports the EU institutions, in particular the European Commission, in the development and implementation of anti-fraud legislation and policies. OLAF's strategy is based on its 360 degree responsibility for anti-fraud actions, including prevention and investigation. Another key element of its work is fraud risk assessment and enhanced protection of areas exposed to fraud and corruption.

The strategy of OLAF also comprises strengthening of legal instruments needed for prevention, investigation and prosecution of fraud, and calls for co-operation of competent bodies on the national and EU levels. The work it performs is of investigative nature, but is normally classified as administrative. OLAF issues recommendations and

instructions to national authorities on the most appropriate course of action in specific cases.

The strategy also comprises strengthening of legal instruments needed for prevention, investigation and prosecution of fraud, and calls for cooperation of competent bodies on the national and EU level.

In the first step of the procedure, OLAF receives information about possible fraud (from government bodies, citizens, whistleblowers, etc.). All allegations

received undergo an initial assessment to determine whether the incoming information meets the criteria for opening an investigation, falls within

OLAF's competency to act, or falls within the Investigative Policy Priorities. An important criterion in this process is OLAF's competence to investigate a case, the credibility of incoming information, the scope of the case, and its financial impact. The Director-General then decides whether to dismiss the matter or open an investigation or coordination case. After the investigation is completed, OLAF issues the institutions and bodies of the EU with a report that specifies the disciplinary, legal, financial and administrative instructions and recommendations.

In 2013 OLAF received 1,294 items of incoming information. A total of 961 allegations were dismissed, 253 investigation cases and 34 coordination cases were opened, 415 investigation and coordination cases were concluded, and 353 recommendations were issued. OLAF co-operates with the European Parliament, the Council of the European Union, the European Court of Auditors, and others. The European Commission encourages each Member State to designate a national Anti-Fraud Coordination Service (hereinafter: AFCOS) to facilitate effective co-operation with OLAF.

Cohesion Policy at the Ministry of Labour, Family, Social Affairs and Equal Opportunities

Zoran Kotolenko, Director of Cohesion Policy Implementation Office at MLFSAEQ

The Ministry of Labour, Family, Social Affairs and Equal Opportunities (hereinafter: MLFSAEQ, or the Ministry) performs tasks relating to the following areas:

- individual employment relationships, consents to night work of women, mediation of temporary and periodical work to pupils and students, collective agreements, social partnerships, labour inspection, detection and prevention of undeclared work and employment, pension and disability insurance system, health and safety at work;
- employment policy in Slovenia and abroad, unemployment insurance, scholarships and lifelong learning, domestic and foreign employment policy, unemployment insurance, subsidised student meals, mutual recognition of qualifications, free movement of persons within the European Union (hereinafter: EU), absorption of Cohesion Funds, social entrepreneurship;
- family policy, family relations, parental care and family incomes;
- social protection and social care services, mental health, social assistance to endangered persons, families and groups, training for children with disabilities, and protection of persons who are unable to take care of themselves, development of the network of providers of social care public services;
- position and comprehensive care of disabled persons;
- protection and rights of war veterans, war invalids and victims of war, and upkeep and maintenance of graves and graveyards of war veterans and victims of war; and

The MLFSAEQ is also responsible for the implementation of absorption of the EU Cohesion Policy funds.

- equal opportunities.

Cohesion Policy is a major field of activity within the Ministry. The responsibility for its implementation rests with the Cohesion Policy Implementation Office. The Office coordinates the planning, implementation, reporting, evaluation and control of the funds of the European Cohesion Policy and the Fund for European Aid to the Most Deprived. The Office is also the Ministry's point of contact for all matters relating to the implementation of EU funds.

The Ministry also participates in the implementation of Priority Axis 10 and Priority Axis 11.

The basis for the absorption of EU funds is, inter alia, represented by the Partnership Agreement between Slovenia and the European Commission and the Operational Programme for the implementation of the EU Cohesion Policy, which specify 11 thematic objectives or priority axes. The Ministry is the Lead Authority involved in the implementation of Priority Axis 8 (promoting sustainable and quality employment and supporting labour mobility) and Priority Axis 9 (promoting social inclusion and fighting poverty in all forms of discrimination), and also participates in the implementation of Priority Axis 10 (investing in education, training and vocational training for skills and lifelong learning) and Priority Axis 11 (improving the institutional capacity of public authorities and stakeholders and contributing to an efficient public administration). Priority investments of Priority Axis 8 are:

- access to employment for job-seekers and inactive people, including long-term unemployed and those who are furthest from the labour market, including through local employment initiatives and the promotion of workers' mobility;
- sustainable integration of young people into the labour market, in particular unemployed persons and persons not included in education or training, also young people who are exposed to social exclu-

sion and young people from marginalized communities, including through guarantees for young people, and

- active and healthy ageing.

Priority investments of Priority Axis 9 are:

- active involvement, including the promotion of equal opportunities and active participation and improvement of employability;
- promoting viability of affordable, sustainable and high-quality services including health and social services of a general interest;
- investing in health and social infrastructure which contributes to the development on national, regional and local levels, reducing inequalities in health status, promoting social inclusion through access to social, cultural and recreational services, and transition from institutional services to community service;
- promoting social entrepreneurship and vocational integration in social enterprise and the social and solidarity economy to increase access to employment, and
- investments in the framework of local, community-led, development strategies.

Within the scope of the Ministry, the highest risk of fraud against EU funds is associated with encrypted connections between companies and creation of false invoices for fictitious services, which are most difficult to detect. Further risks arise from the small size of the market and the relatively low number of qualified providers in specific areas (studies, assessments, evaluations, specific programmes, e.g. NLP, psychology), whilst the fraud risk in programmes intended to promote inclusion of unemployed persons is considerably lower than in programmes for employees and companies. The Ministry adapts and changes the programmes to on the basis of the conclusions of audits and recommendations issued by the Court of Audit and audit authorities.

Control of the European Social Fund

**Vesna Aristovnik, Head of Control Service, Ministry of Labour,
Family, Social Affairs and Equal Opportunities**

The basis for the work of the Control Service within the Ministry of Labour, Family, Social Affairs and Equal Opportunities (hereinafter: CS) in the programming period 2007–2013 is represented by Article 13 of Commission Regulation (EC) No 1828/2006, which specifies that verifications shall ensure that the expenditure declared is real, that the products or services have been delivered in accordance with the approval decision, that the applications for reimbursement by the beneficiary are correct, and that the operations and expenditure comply with Community and national rules. The verifications include procedures to avoid double-financing of expenditure with other Community or national schemes and with other programming periods.

In the scope of its main tasks, the CS:

- conducts verifications in accordance with the applicable Commission Regulations,
- carries out financial controls of Structural Funds projects,
- assesses the eligibility of expenditure,
- checks the performance of contracts,
- checks the correctness of declared services and expenditure, and
- verifies and ascertains the allegations and facts leading to irregularities.

Verifications include procedures to avoid double-financing of expenditure with other programmes.

The CS conducts administrative verifications of payment applications submitted by beneficiaries, on-the-spot verifications, administrative verifications of applications for reimbursements, and administrative

The CS conducts verifications with beneficiaries to check the declared use of funds from the ESF.

verifications of calls for proposals, invitations to tender, and public procurement. Administrative controls are carried out before disbursing funds from the state budget and include overviews of applications for payment and supporting documents

(contracts, invoices, proof of service rendered, payment receipts, etc.). In the previous programming period (OP HRD 2007–2013), the CS performed administrative verifications of 227 operations, 91 of which were declared regional scholarship schemes. It carried out system checks of 100% of applications for payment in 78 operations, random sample checks in 43 operations, and in the remaining 15 operations the CS performed 100% checks on a part of applications for payment, and random sample checks on the remaining applications. The CS performs on-the-spot verifications with beneficiaries to control the designated use of funds from the European Social Fund. The aim of these verifications is to ensure that the declared expenditure is real and used for the purpose for which Cohesion Policy funds were allocated. On-the-spot checks are based on the Annual Plan, which is prepared by the managing authority on the basis of the fraud risk assessment or direct selection following a report or any other suspicion of infringement, at the initiative of the guardians of the agreements, stakeholders, etc. In the programming period OP HRD 2007–2013, the CS conducted 199 on-the-spot verifications. On-the-spot checks were also performed by the Slovenian Human Resources Development and Scholarship Fund and the Employment Agency of the RS, who carried out a total of 1,556 on-the spot checks. The main fraud risk areas that have been identified include:

- subsidies for employment (risk of irregularity: early termination of employment or employment contract; in this case the employer is obliged to return a proportionate part of the subsidy);

- scholarships (scholarship recipients are required to fulfil their study obligations within a given period of time and then seek employment with the scholarship giver; the scholarship giver is obliged to provide the scholarship recipient with employment after the recipient has successfully completed the studies; if any of the parties fails to fulfil its obligations, an irregularity is detected and a claim for recovery of paid scholarship funds must be made);
- salaries and reimbursement of other labour costs (violations of labour law – incorrect recruitment procedures, double-financing – subsidies for salaries of disabled workers and project work, salaries paid into savings accounts, etc.);
- travel expenses (rejection of travel expenses on the grounds of wastefulness, absence of business trip reports, proofs of attendance, attendance lists, etc).

In the period 2008–2015 the CS approved 92% and rejected 8% of applications for payment. The CS manages fraud risks by adapting the system of controls to any change, which means that it uses checklists to keep track of the changes, keeps records of public procurement notices and beneficiaries, runs weekly meetings to ensure the exchange of information among staff and has access to the data of the Health Insurance Institute of the Republic of Slovenia.

Until now, the Ministry has filed with the competent authorities two reports of suspicion of fraud relating to the funds of the European Social Fund. The procedures are currently underway. The Employment Agency of the RS has already filed ten criminal charges for fraud to the detriment of the EU. Three cases have already been finally decided. In two of these cases the perpetrator was found guilty of the offence and in one case prosecution has been suspended for a definite period of time.

Eligibility of Cohesion Policy expenditure

Darja Rovšek and Mojca Medvedović, MSc, Economic Crime Investigators

The main objective of the Operational Programme for Human Resources Development (hereinafter: OP HRD) is to invest in human capital to enhance innovation, employability and economic growth, thereby contributing to higher employment rates, social inclusion, closing of regional differences, and higher standards of living. By 30 April 2015, Slovenia had been allocated EUR 760,594,011 (EU part) from the OP HRD. The value of payments from the budget of the Republic of Slovenia (hereinafter: RS) in this period totalled EUR 687,909,881 (EU part) and certified applications for reimbursement amounted to EUR 657,388,031 (EU part). In the period 2007–2013 about 50 irregularity reports relating to the European Social Fund (hereinafter: ESF) were lodged and forwarded to the European Anti-Fraud Office (hereinafter: OLAF). This is the final figure, which does not include closed cases. The register of the Government Office for De-

According to statistical data, the number of fraud cases in the field of public funds is highest with regard to banking and finance, and the public sector.

velopment and European Cohesion Policy (hereinafter: GODECP) contains records of 348 irregularities with values under EUR 10,000.00, but the figure needs to be increased to account for irregularities listed in the separate records of the Ministry of Labour, Family, Social Affairs and Equal Opportunities, which contain 7,430 detected irregularities on programmes and 76 detected irregularities on projects, that is a total of 7,854 irregularities.

According to statistical data, the number of fraud cases in the field of public funds is highest with regard to banking and finance, and the public sector.

The question as to why people commit fraud can be explained with the widely accepted fraud triangle, which originated from Donald R.

Cressey's hypotheses. There are three elements behind the accomplishment of fraud: pressure, opportunity, and rationalisation. What really brings a person to perceive all three factors to be fulfilled depends primarily on the situation in which the person finds him or herself. Pressure is mainly about financial motive (e.g. greed, personal loans, unexpected financial losses), bad habits (e.g. drugs, gambling), occupational pressure (e.g. dissatisfaction with the working environment and job, a feeling of being underpaid). It is crucial to understand that any person might face these types of pressure and, if not prepared, is likely to turn to fraud to seek a solution to the problem. The opportunity arises in the absence of strong or active internal control systems, giving the person a chance to commit fraud. Rationalisation is normally about creating some justification for the fraudulent actions committed ("Everybody does that", "I've been working for this company for 15 years, they owe me as much," etc.). We can say that rationalisation is closely connected with the personal integrity of the perpetrator, who perceives fraud as an acceptable activity.

It is important to note that fraud is defined as an act that includes elements of deception.

Fraud relating to the use of European Union (hereinafter: EU) funds can be explained as the use or presentation of false, incorrect or incomplete statements or documents, or non-disclosure of information, which has as its effect the misappropriation, wrongful retention or misapplication of funds from the general budget of the EU, or its other budgets. Put simply, fraud is a deliberate act of deception intended for personal gain or to cause a loss to another party, in money, kind, or through avoidance of obligations. However, in order to commit fraud the perpetrator needs a motive, and money is the primary motive in frauds relating to the allocation of ESF resources for financing of operations. Working towards this motive, certain companies entitled to reimbursements of their project expenditure choose to intentionally deceive institutions controlling the use of EU funds, exert pressure during the decision-making process in order

to secure beneficial outcomes, and present false documents to prove that certain operations are carried out in line with the set objectives.

The irregularities relating to fraud against EU funds, which has been classified as a criminal offence, amounted to EUR 315 million (0.25% of total EU expenditure) in 2012, whilst the irregularities without elements of a criminal offence totalled EUR 2.6 billion in 2012 (2.06% of total EU expenditure).

Member States are committed to combating all forms of illegal action which is to the detriment of the financial interests of the EU.

It needs to be stressed that our objective is to safeguard the financial interests of the EU and improve the trust of the citizens and ensure correct use of their funds. Member States are committed to combating all forms of illegal action which is to the detriment of the financial interests of the EU.

It is important that cases of fraud and other irregularities are properly handled and measures are taken to prevent such actions and safeguard the general financial interest across the European Union. Slovenia's absorption of EU funds is based on complex bureaucratic procedures of implementation, reporting, and control, which means that Slovenia is responsible for developing effective procedures and seeking relevant solutions which will ensure that the allocated funds are spent for the declared purpose. Furthermore, Slovenia must strive to remove the administrative obstacles hindering the absorption of funds, assume an active role in detecting fraud in this area, and ensure that suitable internal control systems and fraud detection mechanisms are put in place. Fraud detection relating to the ESF and reports to OLAF do not necessarily mean that our projects and operations are lacking in quality. Instead, these results communicate to Brussels that the country has good, highly qualified and competent staff and sound control systems, and is able to prevent deliberate fraudulent acts intended to secure personal gain or cause injury to EU citizens.

The criminal offence of fraud to the detriment of the European Union through the case law of the Specialised State Prosecutor's Office

Matej Mavrič, Specialised State Prosecutor's Office

Pursuant to the first paragraph of Article 229 of Criminal Code (2012) (hereinafter: CC-1), the criminal offence 'fraud to the detriment of European Communities' is an act perpetrated by any person who avoids expenses by way of using, or submitting, false, incorrect, or incomplete statements or documents, or does not reveal data, and thus misappropriates, or unlawfully withholds or uses inappropriately, funds of the general budget of the European Union, or of the budgets managed by the European Union or managed on its behalf (hereinafter: EU funds). In practice, the EU funds protected under the above specified Article refer to the Structural Funds, the Cohesion Fund, the European Social Fund, and the European Regional Development Fund. Thus, the act specified in the first paragraph is committed by any person who avoids expenses by way of using, or presenting, false, incorrect or incomplete statements or documents, or by not revealing data.

According to the second paragraph of Article 229 of CC-1, the criminal offence concerned is perpetrated by any person who acquires funds by means of offences referred to in the preceding paragraph (e.g. misappropriation, wrongful retention, misuse of funds). It can be concluded that this second paragraph will actually be more widely applied in practice, since the acts under the first paragraph are a type of 'EU tax evasion'. The fourth paragraph of the same Article, which is also interesting and is a novelty in the Slovenian legal system, defines the accountability of managers or other authorised persons if they render possible, or do not prevent, the above specified criminal offences.

The above article lays down the provisions for safeguarding EU funds.

Fraud to the detriment of European Communities is a relatively new criminal offence, which was introduced to Slovenia's legal system with the adoption of the amended Criminal Code (CC-1). According to the unofficial statistical data obtained from the information system of the State Prosecutor's Office, the number of reported cases of fraud to the detriment of the EU has been increasing gradually, and several final convictions have already been rendered in cases of fraud against the EU.

However, the existing case law does not clearly and definitively show in what cases the substantive article can be used, i.e. in what cases the court will find that the criminal offence of 'fraud to the detriment of the European Union' has been committed and all elements of the crime have been proven. This is particularly relevant with regard to the diversity of the funds allocated to EU projects, as well as the diversity of the projects financed from these funds. The processing of real fraud cases in practice has shown that one of the main issues to be addressed is how to determine the origin of payment of funds and identify the source from which the funds concerned were actually paid.

The European case law concerning the criteria for the acquisition and use of EU funds is either non-unified or non-existent.

hard to prove that the perpetrator acted with an intent to commit a crime.

However, in certain cases problems may arise from the current non-unified or even non-existent European case law concerning the criteria for the acquisition and correct use of EU funds, in particular special-purpose EU funds. If the rules for correct utilisation of EU funds are not clear, it is very

The European case law concerning the criteria for the acquisition and use of EU funds is either non-unified or non-existent.

The criminal offence of 'fraud to the detriment of the European Union' can be explained in simple terms using a theoretical case. This theoretical

case is based on a publicly announced invitation to apply for co-financing of tuition as part of the programme for reducing educational deficits.

The main objective of the public invitation was to improve access to education, elevate the general education level of adults to completion of secondary education, and contribute to better employment opportunities. The public call is co-financed by the European Social Fund. Co-financing covers reimbursements of eligible tuition costs to beneficiaries who have completed, in full or in part, within the period specified in the invitation to tender, an adult secondary education programme (lower vocational, secondary vocational, secondary professional, vocational-technical, vocational professional or general upper secondary).

The tender conditions specify, inter alia, that the applicant:

- is a citizen of the Republic of Slovenia,
- is between 25 and 63 years of age on completion of the educational programme or on completion of any given academic year,
- pays the declared expenses from own resources and receives no funding from other sources,
- pays the tuition fees within the eligible period,
- submits the application between the date of publication of the invitation and the date when all available funds have been spent, or by 15 July 2013.

It can be concluded that in order to commit a fraud, the potential perpetrator would not attend schooling but would support the application for reimbursement with false documentation about the education and payment of tuition fees (whilst retaining or spending reimbursed funds). In a slightly different case, the perpetrator would attend the educational programme but would receive tuition funds from another source without disclosing this information upon submission of the application for reimbursement (and would retain or spend the reimbursed funds).

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