

The Court of Auditors' role with regard to fraud

Caption: Excerpts from three reports of the Court of Auditors concerning the Court's role with regard to fraud:

(1) Annual Report concerning the financial year 1977 accompanied by the replies from the institutions; (2) Annual Report concerning the financial year 1994, together with the institutions' replies; (3) Special Report No 8/98 on the Commission's services specifically involved in the fight against fraud, notably the 'unité de coordination de la lutte anti-fraude' (UCLAF) together with the Commission's replies.

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Court of Auditors

Annual report concerning the financial year 1977 accompanied by the replies of the institutions transmitted to the authorities responsible for giving discharge and to the other institutions on 30 November 1978 ⁽¹⁾

(in accordance with Article 84 of the Financial Regulation of 21 December 1977)

[...]

Fraud

1.16 The detection of fraud was widely discussed in connection with the establishment of the Court of Auditors and it is appropriate that the Court, in its first Annual Report, should comment on this matter.

1.17 We should be clear what is meant by fraud. It has been defined as criminal deception, the use of false representations to gain an unjust advantage. In the Community context it is the deliberate misappropriation of money or goods, inevitably involving breaking the law or the relevant rules and instructions of the organization concerned. It is necessary to distinguish fraud in this sense from actions designed to exploit loopholes in existing legislation. These, although they may result in material benefits which were not intended by the legislators, cannot be considered to constitute fraud. Indeed they may be carried on openly, whereas it is the nature of fraud to be secret. In any such cases where the existing law contains loopholes or results in exploitation which is thought to be undesirable, it may be necessary to revise the law to ensure that its original purpose is achieved. But actions which remain within the law cannot be considered to be fraudulent.

1.18 It is the responsibility of the administration of any organization to draw up financial statements which show a true record of transactions undertaken and to set up and operate a sound system of financial control which will assist in achieving this aim and in reducing the likelihood of fraud. Fraud may be perpetrated on an organization either by its employees or by third parties. Internal fraud usually poses fewer problems for the organization than fraud by third parties. The system of financial control can often be devised to identify clearly a member of the staff who has practised fraud. This itself is an effective deterrent and thus reduces the risk from this source. With third parties such deterrent is more difficult to devise and the risk of loss through this form of fraud is thus more serious.

1.19 In order to assist in the application of these general principles to the Communities, the Court of Auditors will, in the course of its work, be making recommendations to the institutions to improve the efficacy of the various systems of financial control. This will contribute to the effort to minimize the possibility of fraud, particularly, for the reason stated above, from third parties.

1.20 It is in this way that the Court can most effectively contribute to the task of preventing fraud in Community affairs. But the problems involved in detecting fraud should not be underestimated. Although the conduct of normal audit procedures may indicate weaknesses in financial control which could give rise to fraudulent practices and may reveal evidence of actual fraud it is not possible to guarantee that all fraud will be revealed by audit examination. An independent auditor may apply tests to the documents presented to him to determine whether they are genuine or false but this must necessarily be on a selective basis because of the sheer volume of the documents involved.

1.21 It must also be remembered that in the Communities certain items of income and expenditure such as own and EAGGF expenditure are accounted for under the control of Member States and are in some cases also subject to audit by their respective national audit organizations with whom the Court intends to liaise closely as provided for in the Treaty.

Reply of the Commission

The Commission has made the following reply to the comments made by the Court in paragraphs 1.16 to 1.21:

The Court of Auditors devotes much of its attention to the problem of preventing fraud prejudicial to Community finances. The Commission understands that the Court wishes to improve the efficacy of the various systems of control operated not only within Community institutions but also within all national paying agencies which are variously involved in the implementation of Community policies. The Commission is always open to suggestions in this area and to any other ideas which might help stamp out fraudulent practices perpetrated while Community policies are being carried out.

[...]

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**Court of Auditors
Annual report concerning the financial year 1994 ⁽²⁾**

[...]

The Court of Auditors' role with regard to fraud

0.29. The Essen European Council concluded that fraud, waste and mismanagement of Community resources needed to be tackled with the utmost vigour, and recalling that the Treaty on European Union had given new powers to the European Parliament, the Council, the Commission and the European Court of Auditors, called for concerted action by these institutions and the Member States.

0.30. The primary responsibility for prevention, detection and investigation of fraud lies with those who manage and supervise policy execution in the Commission and the Member States. They have to ensure the existence of adequate systems of internal control, including segregation of duties, proper authorization procedures and an effective internal audit function and ensure that intentional irregularities (whether fraud or gross negligence) are detected, investigated and sanctioned.

0.31. The Court, as external auditor, has to review critically the arrangements made by management. It has always done this to an appreciable extent and Court annual or special reports have consistently drawn attention to weaknesses in legislation, in accounting and in financial management systems and indicated the risks involved as well as concrete cases involved. Although the Court, like other audit institutions, does not have the power to investigate crime (a task for the police and judicial authorities) but it plays its part by paying due attention to the prevention and deterrence of irregularities in general (whether intentional or not) and stimulating effective action by the appropriate authorities when audit indicates that some fraud may have possibly occurred or circumstances have arisen which are particularly favourable to the potential fraudster.

0.32. The Court has responded to the Essen Council's conclusions by reviewing those aspects of its audit methodology that relate most closely to the area of fraud. It has adopted specific objectives for the critical examination of legislation and associated management and control systems, the systematic identification of high risk areas (including the possible involvement in irregularities of people working within or directly for the EC institutions) and the development and implementation of general procedures for appropriate audit testing in high risk areas. In performing this task, the Court will remain in touch with all the bodies concerned.

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Court of Auditors

Special report No 8/98 on the Commission's services specifically involved in the fight against fraud, notably the 'unité de coordination de la lutte anti-fraude' (UCLAF) together with the Commission's replies ⁽³⁾

(pursuant to Article 188c(4), second subparagraph, of the EC Treaty) (98/C 230/01)

[...]

1. Introduction

Scope of the audit

1.1. At the beginning of 1997 the Court decided to carry out an audit of the services of the Commission responsible for the fight against fraud, especially the 'Unité de Coordination de la Lutte Antifraude' (UCLAF). To date the audit work has covered an evaluation of the measures taken to establish appropriate legal, organisational and administrative arrangements to ensure the success of UCLAF's mission, an assessment of the effectiveness of UCLAF based on an examination of all its units, enquiries in the United Kingdom and the Netherlands ⁽⁴⁾ and a global examination of the anti-fraud responsibilities of the Security Office, DG XIX and DG XX.

Main observations

1.2. The Commission has, in particular since 1990, made a major effort in its fight against fraud. This has led to a better legal and administrative framework in this area (see paragraphs 2.4–2.6). However, Conventions and Protocols agreed under the third pillar have still not been ratified (see paragraph 2.11).

1.3. A structure within the Commission has been created for the fight against fraud (see paragraphs 2.20–2.23). However, the organisational arrangements, including those in relation to the Member States, are not always clear, and are often complicated and cumbersome (see paragraph 2.34, table 1, paragraphs 3.21–3.23 and 3.35–3.36). Furthermore, security measures and procedures are frequently not correctly implemented (see paragraphs 2.28–2.32).

1.4. UCLAF has been given more tasks, more powers and more staff. The number of temporary staff is about 50 % of total staff which creates a lack of continuity in the organisation (see paragraphs 3.2–3.4).

1.5. The databases of UCLAF were not fully operational or effective (see paragraphs 3.29–3.33). The databases were rarely used and the information kept by three of the four operational units within UCLAF did not reconcile with the database Pre-IRENE (see paragraphs 3.8–3.10).

1.6. Management information was insufficient for the effective management of the high number of cases held by UCLAF (see paragraphs 3.10–3.12). Furthermore the lack of standard methods of documentation and file management is considered a serious weakness (see paragraphs 3.13–3.18).

1.7. Cooperation between Member States and Commission is hampered by the manner in which the privileges and immunities of the European Union's staff are implemented (see paragraphs 3.24–3.26). In addition, UCLAF in its inspections on Member States' territory has had to cope with serious constraints related to national legislation (see paragraphs 3.20–3.23).

1.8. Recovery of amounts unduly paid is hindered by the fact that the information on the amounts recovered

is incompletely recorded (see paragraphs 4.3–4.5). Furthermore Member States do not strictly respect their obligation to communicate all information to the Commission in this regard (see paragraphs 4.6, 4.7, 4.11, 4.19, 4.20).

1.9. It is to be noted that for EAGGF-Guarantee legislation has been adopted to create a so-called ‘black list’. So far, the results are disappointing (see paragraphs 4.12–4.14).

1.10. A number of preventive actions have been taken in the fight against fraud (see paragraphs 2.13–2.15, 2.19). The risk analysis study, carried out by the Joint Research Centre (JRC), however, suffered serious delays and only part of the areas that were intended to be included in the study could be covered (see paragraphs 2.16–2.18).

1.11. Elements of the data about cases of fraud, published in the Commission’s annual report on the fight against fraud are incomplete and therefore misleading (see paragraphs 5.4–5.11).

1.12. Procedures and responsibilities concerning the fight against internal corruption and breaches of discipline are unclear and incomplete (see paragraphs 6.3, 6.11–6.13). In particular there are no clear guidelines for investigations (see paragraphs 6.5–6.7) and there is no clear policy (such as a ‘zero tolerance’ policy) (see paragraphs 6.8–6.9). There is exaggerated hesitation to lift the immunity of European Union staff suspected of corruption (see paragraph 6.10).

[...]

7. Conclusion

7.1. As this enquiry did not include the Member States and the Commission’s operational DGs in great depth the findings concentrate on UCLAF. The Commission has, in particular since 1990, made a major effort in its fight against fraud relating to European funds which has resulted in a better legal and administrative framework for the fight against fraud. At the end of 1994 the Commission began setting up UCLAF as a central service with requisite financial, police, customs, judicial and tax expertise. However, improvements to security measures, the internal management procedures, intelligence and information systems and the cooperation with the responsible authorities of the Member States are of vital importance.

7.2. An overall evaluation of the results achieved by UCLAF up to now is difficult. However, the information on recoveries communicated by the Member States and included in the Annual Reports on Fight against Fraud is not reliable and does not differentiate between recoveries due to work of UCLAF and that of the national authorities. Furthermore in the area of direct expenditure no easily accessible information exists on the total amount to be recovered as a result of investigations effected by UCLAF. Finally the instruments ‘black list’ and ‘fraud proofing’ of legislation have only been introduced recently and have had a limited impact so far.

7.3. UCLAF needs a management system that holds information on the status of actual or former cases from the moment of receiving or obtaining the initial suspicion, to the administrative enquiry, seize of national authorities, penal investigation, prosecution, trial, decision and recovery. Without such a system an overall evaluation of its performance is virtually impossible.

7.4. The first steps have been taken in an ambitious programme to fight fraud simultaneously from all sides (prevention, enforcement and administrative and judicial cooperation). Important efforts still have to be made to put these initiatives fully into effect. None of the Conventions and Protocols agreed in the context of the third pillar has yet been ratified.

7.5. Fraud against the Community budget is often transnational. The enforcement agencies, however, operate according to a huge number of different procedures and in dispersed order in a very time-consuming way. In contrast the fraudsters themselves can operate in real time using their international networks of contacts. The procedures in place can simply not cope with the new criminal networks. Assistance from the

Commission and the information exchange between UCLAF and the judicial authorities of Member States constitute the beginning of a solution. However, a major obstacle still is the lack of common standards of evidence, which prevents Member States from accepting evidence gathered in other Member States. Therefore a 'European Law Enforcement Area' ⁽⁵⁾ with clear, limited objectives reflecting the specific responsibilities of the institutions regarding the protection of the Community's financial interests is necessary.

7.6. UCLAF has to play a difficult role. It has administrative tasks in relation to the protection of the financial interests of the Community which belong to the first pillar but also it has responsibilities related to judicial investigations, which belong to the third pillar, without support from an independent European judicial authority able, to launch and direct investigations and bring prosecutions as appropriate. The liaison and criminal law expertise interface described in paragraph 3.4 only represents a preliminary solution to the existing problems ⁽⁶⁾. On 25 November 1997 the Commission presented a communication to the Parliament Committee on Budgetary Control (DOC(SEC97) 2182/2) entitled 'Improving Action against Incompetence, Financial Irregularities, Fraud and Corruption'.

7.7. UCLAF has no competence to carry out enquiries related to the other Community institutions. In the Community context this has to be considered as a serious weakness in the legal and organisational framework of the fight against fraud. Priority should be given to finding a solution to this problem and any proposal for the reorganisation of the fight against fraud at European level should address this. In this context it is also necessary to define the responsibilities of Europol and UCLAF in such a way that synergy effects can be ensured.

This report was adopted by the Court of Auditors in Luxembourg at its meeting of 10 and 11 June 1998.

For the Court of Auditors
Bernhard FRIEDMANN
President

⁽¹⁾ Excerpt from the Court of Auditors' Annual Report concerning the financial year 1977 together with the institutions' replies, OJ C 313 of 30 December 1978.

⁽²⁾ Excerpt from the Court of Auditors' Annual Report concerning the financial year 1994 together with the institutions' replies, JO C 303 of 14 November 1995.

⁽³⁾ Excerpt from the Court of Auditors' Special Report No 8/98 on the Commission's services specifically involved in the fight against fraud, notably the 'unité de coordination de la lutte anti-fraude' (UCLAF) together with the Commission's replies, JO C 230 of 22 July 1998.

⁽⁴⁾ According to the legal and administrative framework action to combat fraud affecting the Community's financial interests is primarily the responsibility of the Member States (see chapter 2). For this reason it was decided to include in this audit controls at national level.

⁽⁵⁾ Speech of Mr. Klaus Hänsch, President of the European Parliament, addressed to the interparliamentary conference on fraud, organised on the initiative of its Committee on budgetary control, on 23 and 24 April 1996.

⁽⁶⁾ But it is no solution to the problem that UCLAF does not have the right to tackle the fraud in other European institutions. Furthermore in the field of the fight against corruption it is questionable whether UCLAF should be responsible.