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**COMMUNICATION FROM THE COMMISSION TO THE COUNCIL, THE
EUROPEAN PARLIAMENT AND THE EUROPEAN COURT OF AUDITORS**

**Prevention of fraud by building on operational results:
a dynamic approach to fraud-proofing**

{SEC(2007) 1676}

1. INTRODUCTION

Fraud, corruption and other illegal activities affecting the European Union's financial interests exploit weaknesses in or circumvent the processes in place for managing and controlling EU funds. In order to prevent fraud and corruption in all sectors of the EU budget — on both revenue and expenditure sides¹, it is therefore of the utmost importance that the authorizing services with OLAF's assistance continue to improve the prevention of fraud in the framework of financial management².

This communication sets out the Commission's new approach to fraud-proofing legislation, contracts, and management and control systems. It replaces the Commission communication on fraud-proofing legislation and contract management³ adopted by the Commission on 7 November 2001 with a view to implementing action 94 of the White Paper *Reforming the Commission*⁴.

2. BACKGROUND

2.1. OLAF and the reform

The European anti-fraud office (OLAF) was created in 1999. It fulfils its mission of combating fraud by conducting investigations as independent office, and by contributing to the design of the EU's anti-fraud strategy and preparing the necessary initiatives to create or strengthen legislation as a Commission department.

In 2000, the Commission embarked on administrative reform⁵. The financial management system was modernised by expanding the responsibilities of authorising officers and by increasing their accountability.

The White Paper *Reforming the Commission* contained measures to make better use of the expertise available within the institutions to improve the prevention of irregularities and fraud. This prevention policy was detailed further in the Commission communication *Protection of the Communities' financial interests — The fight against fraud — For an overall strategic approach*⁶.

Action 94 of the White Paper on reform, 'Fraud-proofing of legislation and contract management', introduced the following commitment:

"To render the present system of fraud-proofing more effective, Commission services will be required, when proposing new legislation with a potential impact on the

¹ Council Regulation (EC, Euratom) No 2988/95 of 18 December 1995 on the protection of the European Communities financial interests, OJ L 312, 23.12.1995, p. 1.

² Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities, as amended by Council Regulation (EC, Euratom) No 1995/2006 of 13 December 2006.

³ Commission communication concerning the fraud-proofing of legislation and contract management, SEC(2001) 2029, 07.11.2001 — not published in the OJ. See, however, point 3.3.

⁴ *Reforming the Commission — A White Paper — Part I* (COM/2000/0200 final).

⁵ White Paper 'Reforming the Commission', Part II (Action Plan), of 5 4 2000., COM (2000) 200 final/2.

⁶ COM(2000) 358 final.

Community budget, to submit draft proposals to OLAF for a risk assessment during inter-service consultations. DG Budget will be assisted by OLAF in the review of the Commission's systems for contract management (e.g. standard contracts, central contracts database, management tools). OLAF will also provide advice on fraud-proofing throughout the legislative process."

2.2. The communication on fraud-proofing of legislation and contract management

The purpose of the 2001 communication on fraud-proofing was to achieve the objectives of the White Paper on reform and of the Commission communication on the overall strategic approach to fighting fraud. Those objectives were to develop a culture of prevention and to strengthen the capacity of the basic legal instruments to withstand fraud or any other illegal activity. The prevention mechanism laid down in the 2001 communication covered two aspects: legislation and contract management.

Legislative fraud-proofing was limited to the most vulnerable items of legislation. Identifying vulnerable fields of European policies in advance made it possible to better target the consultation procedure. The communication introduced a cooperation process in four phases:

- (a) definition of criteria to identify high risk sectors;
- (b) identification of high risk sectors;
- (c) identification of legislative initiatives needing fraud-proofing analysis before adoption, and
- (d) upstream consultation of OLAF.

Preventing fraud and irregularities in contract management — the second aspect of the 2001 communication — was pursued at two levels:

- (a) Establishment of standard procurement contracts and standard grant agreements at central level (the Directorate-General for the Budget), clauses and procedures for procurement contracts and for grants were harmonised: contracts and standard agreements suitable for use by all Commission departments were drafted, and guides and guidelines (vade mecums, circulars etc.) were published.
- (b) At contract management department level, various instruments were to be developed, to be used by the Commission departments independently. Some of these are of individual interest, such as standard contracts and local databases, which may or may not interface with the general accounting database of the Commission.

2.3. The need for a new approach to fraud proofing

The objectives of the fraud-proofing procedure have been achieved. OLAF was closely involved in the successive revisions of legislation applicable to the execution of the EU budget and in the adoption of basic acts and standard instruments developed by Commission departments to implement the EU budget. For more details see the attached report on the achievements of the fraud-proofing procedure.

The most important financial provisions for the forthcoming years have already been fraud proofed, either through the formal fraud-proofing procedure or through interservice consultation. Standard anti-fraud provisions have been drafted and the legal framework laying down the rules for EU financial management is entering a period of stability. Consequently, the preventive mechanism set out in the 2001 communication now appears to be less appropriate in the current context. Furthermore, the new approach will contribute to the same objectives that the Internal Control Standards for Effective Management, notably standards 2,7 and 8.”

In addition, the Commission supports a policy of “simplification” which is partly intended “to pursue further consolidation, streamlining and simplification of internal procedures and working methods in the interests of effectiveness and efficiency and to strike a better balance between the level of risk and the cost of control”⁷. It is therefore appropriate to make upstream consultation of OLAF more flexible.

3. THE NEW APPROACH

3.1. Concept of the new approach

The new approach to fraud-proofing will be mainly based on the lessons learnt from OLAF’s operational experience. Exploitation of operational results will set up a new link between, experience on the ground and the measures adopted by the different Institutions to avoid fraud and irregularities. OLAF will better exploit the knowledge it has gained from operational and intelligence activities and will make it available to other Commission departments and to EU institutions and bodies.

The new approach entails identifying the lessons to be learnt from the results of investigative activities and intelligence analysis and communicating them to the appropriate authorities. For instance, OLAF will support departments implementing Community policies in their efforts to protect the Communities’ financial interests and it will issue recommendations for ensuring the highest possible security against fraud, corruption, and irregularities.

To be effective, this approach requires the competent authorities/departments to follow up these measures.

Systemic irregularities and weaknesses will receive special attention, in particular where straightforward and low-cost solutions are feasible (e.g. improving standard templates and/or documents such as declarations of absence of conflict of interest, exchanging data between different departments, amending vade mecums, etc.).

3.2. Expected improvements

The results of the revised fraud-proofing approach are expected to enhance the impact of investigations on preventing fraud, corruption, irregularities and other illegal activities affecting the EU’s financial interests.

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Communication from the Commission to the European Parliament and to the Council ‘Progress Report on the Commission Reform Beyond the Reform Mandate’ COM (2005) 668 final, of 21 12 2005.

The output will be a more proactive, supply-based flow of information. This flow of information will be independent of the Commission interservice consultations on initiatives relating to financial management.

OLAF will extend the scope of its support to other Commission departments by offering targeted analysis based on its own investigative and intelligence activities. The output from fraud-proofing will be made available to all the departments, EU institutions and bodies concerned (see points 5.1, 5.2 and 5.3).

3.3. Availability of the current consultation process

The current upstream consultation process on draft legislation set out in the 2001 communication (and on any specific risks or concerns identified by the department responsible for the proposal) will remain available to Commission departments upon request. An overview of the kind of instruments subject to this process is included in the attached Commission Staff Working Paper on the achievements of the 2001 communication.

For the adoption of standard procurement contracts and of standard grant agreements, the upstream consultation approach will be maintained. DG Budget will continue to update, following experience and revised legislation, the existing standard contracts and grant agreements/decisions and develop new models where necessary.

4. THE PROCESS FOR IMPLEMENTING THE NEW APPROACH

Within the new approach, investigative activities will feed the deliverables transmitted to the Commission departments, EU institutions and bodies concerned while intelligence activities will provide assessment of risks for thematic fraud-proofing.

Fraud-proofing and intelligence will complement each other: the fraud-proofing process will identify issues deserving a thorough, thematic approach to be carried out through intelligence methods and intelligence will deliver data exploitable for fraud-proofing deliverables.

4.1. A large pool of information

The process for implementing the fraud-proofing approach does not exclude any source of information.

OLAF will analyse its investigative activities in a structured and multidisciplinary manner. This analysis will include information resulting from internal and external investigations, and other operational activities carried out by OLAF.

In addition to the legal obligation to inform the Commission and OLAF of any concrete indications of suspected fraud, the new fraud proofing approach will allow for a better flow of information between control bodies. Results of audit work will be included in the information pool, especially the relevant findings of audits performed by the Internal Audit Service (IAS). This Service will inform the Office of potential systemic irregularities likely to constitute a risk of fraud identified during its audits.

The same information on potential systemic irregularities should be provided to OLAF by both the Internal Audit Capacities (IACs) and the ex-post control entities of the operational departments (data from the ABAC Audit tool).

Where appropriate, the European Court of Auditors' reports and findings, and audit reports from authorising Directorates-General, will enrich fraud-proofing analysis. Annual Activity Reports and other management reports clearly identifying vulnerabilities and measures adopted following OLAF recommendations will complete the analysis.

Information from Member States' authorities, including audit and control bodies, will be used to further contribute to the new approach. The irregularities notified by national authorities under Community legislation⁸ provide indications of potential risks. National case law directly linked to the protection of EU financial interests will not be excluded from the fraud-proofing analysis.

4.2. Main steps of the fraud-proofing process

The main steps of the process are the following:

- (1) Information is collected from investigations and other operational results, and from other external sources (referred to in 4.1). The information collected from individual cases will be completely anonymised in order to avoid disclosure of personal, confidential or sensitive data;
- (2) Analysis of the information collected to identify possible weaknesses/vulnerabilities either in legislation, contracts or management/control systems and analysis of sets of cases;
- (3) Identification of recommendations to avoid the weaknesses identified or to improve proofing to fraud, corruption and other illegal activities;
- (4) Findings and recommendations are transmitted to Commission departments, EU institutions and bodies concerned;
- (5) Feedback is received from Commission departments and from EU institutions and bodies.

5. RECOMMENDATIONS AND OTHER INSTRUMENTS FOR INFORMATION SHARING

The process described is designed to produce recommendations and fraud-proofing output. These will be directly addressed to the Commission departments, EU institutions and bodies concerned either individually or collectively, in particular for "policy families".

⁸ Commission Regulation (EC) No 1681/94 of 11 July 1994 concerning irregularities and the recovery of sums wrongly paid in connection with the financing of the structural policies and the organisation of an information system in this field OJ L 178, 12.7.1994, p. 43–46 and Commission Regulation No 1848/2006 concerning irregularities and the recovery of sums wrongly paid in connection with the financing of the common agricultural policy and the organisation of an information system in this field and repealing Council Regulation (EEC) No 595/91

The recommendations issued by OLAF will not be of a binding nature. They will be discussed, where appropriate, through an open and flexible dialogue with addressees.

Their implementation falls under the responsibility of Commission departments, EU institutions and bodies concerned, including evaluation of the cost/benefit, and the administrative burden of such implementation,

5.1. On a case-by-case basis

OLAF will provide ad hoc recommendations where the protection of the EU's financial interests require particular action from the department, EU institution or body concerned.

The department concerned will be invited to consider adopting and/or implementing appropriate action to remove or mitigate specific risks or vulnerabilities identified by OLAF. In addition, the Commission departments concerned will feed OLAF back on the actions undertaken to prevent damage to the EU's financial interests, and EU institutions and bodies will be requested to do so.

5.2. General recommendations and compendium of common cases

Recommendations will also be made broadly available to stakeholders based on the risk analysis and fraud patterns resulting from the review of a set of common cases presenting similarities in the irregularities found. The Commission departments concerned will feed OLAF back on the measures which they subsequently undertake to avoid similar situations within their responsibilities and EU institutions and bodies will be requested to do so.

In addition, a compendium of anonymised cases, including a description of fraud and irregularity patterns and the modus operandi, will be compiled and made available on a need-to-know basis to staff in Commission departments (and other institutions where appropriate).

5.3. Guide to prevention of fraud

The Commission initiative on Sound and Efficient Financial Management⁹ (SEM 2000) was launched in 1995. The first two phases were intended to improve financial management within the Commission whilst the main objective of the third phase was to improve the management of that part of the Community budget (over 80%) managed by the Member States.

A "Guide to testing for vulnerability to fraud"¹⁰ was adopted by the Commission as a follow up to recommendation No 7 of SEM 2000¹¹. This guide, published by the

⁹ Commission initiative 'Sound and efficient management' (SEM 2000): European Commission General Report 1995, point 976.

¹⁰ Doc SG/C/3/ED D96 of 6 May 1996, not published in the OJ.

¹¹ Available only in French, internal decision issued from the former archiving systems. Communication de la Commission adoptée sur communication de Mme Gradin. Etanchéité de la législation à la fraude: mise en œuvre de la recommandation n°7 de SEM 2000, phase 2, SEC (1996) 1802/4 du 11 Octobre 1996.

Secretariat-General of the Commission, is still available to assist Commission staff involved in financial management and protection of the EU's financial interests.

A new version of the guide, published by the Commission under the responsibility of OLAF, will be made broadly available to all stakeholders, including Member States. It will be based on the information produced by the fraud-proofing process and will be designed as a web-based tool. The guide could be divided and delivered by sector or policy family if appropriate.

5.4. Information for control and audit bodies

When implementing the new approach to fraud proofing, special attention will be paid to structural or systemic weaknesses not already analysed by audit and control bodies or not detected via other systematic controls. Such systemic weaknesses or potential loopholes in management systems detected within EU institutions will be communicated, in addition to management, to the IAS, the IAC's concerned or the Internal Auditors of other EU institutions and bodies.

5.5. The flexibility of the new approach

In order to become a permanent additional obstacle to fraudsters and to counter systemic irregularities, the new fraud-proofing policy needs to be designed as a flexible tool capable of adapting quickly to changing realities.

OLAF will constantly evaluate the need to refocus fraud-proofing activities on specific areas and to adapt the process of analysis to maximise its effectiveness. This might — at some stage — require its activities to focus on specific sectors of the EU budget, depending on the risks or vulnerabilities identified and resources available. The fraud-proofing process will initially focus on the Direct Expenditure sector.

6. CONCLUSION

The new fraud-proofing policy established in this communication aims to improve prevention of fraud and corruption on the basis of the lessons learnt from OLAF's investigative and other operational activities.

The results of this new process will be addressed to Commission departments and the other institutions concerned and will be shared with Member States involved in the management and/or control of EU revenue or expenditure. The first results — expected in the second half of 2008 — will be ad hoc recommendations and the compilation of a compendium of common cases.

After a trial period of three years, an evaluation of the approach set out in this communication will be carried out.

The Commission will report on its fraud-proofing activities through the Commission's annual report on the fight against fraud, published under Article 280 of the Treaty.

7. ANNEXES

- (1) Diagram of the process.
- (2) Staff Working Paper on Achievements of the fraud-proofing mechanism set up under the Commission communication on fraud proofing of legislation and contract management adopted on 7 November 2001

**PREVENTION OF FRAUD BY BUILDING ON OPERATIONAL RESULTS:
A DYNAMIC APPROACH TO FRAUD-PROOFING**

