EUROPEAN COMMISSION
EUROPEAN ANTI-FRAUD OFFICE (OLAF)

Directorate D Policy
Unit D.2 Fraud Prevention

Handbook

The role of Member States' auditors in fraud prevention and detection

for EU Structural and Investment Funds

Experience and practice in the Member States

Developed by a working group of Member States' experts, directed and coordinated by – the Fraud Prevention, Reporting and Analysis unit in the European Anti-Fraud Office (OLAF)

DISCLAIMER

This is a working document intended to facilitate the implementation of EU Structural and Investment Funds (ESIF) and to encourage good practices. It is not legally binding on the Member States but provides Audit Authorities with general guidance and with recommendations of good practice.
This guidance is without prejudice to national legislation in the Member States. It should be read taking into account national legal frameworks, and may be adapted in light of these.
This handbook is without prejudice to the interpretation of the Court of Justice and the General Court or decisions by the Commission.

NOTA:

This document is not binding on the Member States, nor does it create any new rules or obligations for national authorities. It reflects good practices, it is purely indicative, and must not be used as a legal or normative basis for audit or investigative purposes.

Executive summary

This handbook was drafted through a joint working procedure involving experts from the Member States and OLAF. The Commission's services in charge of European Structural and Investment Funds (ESIF) were also consulted but are not as such co-authors of this Handbook[1]. The objective of the working procedure is to develop the cooperation and collaboration between national authorities and Commission services in the COCOLAF[2] Fraud Prevention Group through drafting a practical guide that Member States and the Commission can use as good practice, an administrative tool, and for guidance and support to strengthen their anti-fraud measures and strategies.

Within this framework, Member States chose the topic related to the role of auditors in fraud prevention and detection. The role of the auditors in the protection of the EU financial interests is crucial. It is based on the key principles established by the international audit standards, which have to be applied in the specific EU legal framework, taking into account the national framework As the legal framework for ESIF 2014-20[3] has been strengthened as regards fraud risk assessment and fraud prevention and detection, national auditors will have an enhanced role to play in the verification of the compliance of the responsible authorities with this new legislation. The 2014-20 legal framework requires Member States to develop anti-fraud measures in relation to managing EU funds. Auditors will have to assess if and how the relevant managing authorities and intermediate bodies will comply with this requirement.

A workshop involving experts from 11 different Member States highlighted the need for a handbook that would help

- improve auditors' awareness of their role in fraud prevention and detection, taking into account the new multi annual financial framework for 2014-20;
- exchange experience and good practice among auditors in the different Member States.

This document is the result of that work. It is built on the main outputs of discussions that took place during the workshop.

Two main aspects of the role auditors play in preventing and detecting fraud, were identified, namely:

- an audit role: auditors, as independent bodies, are in charge of giving assurance on the regularity and legality of the operations and accounts of audited bodies and on the proper functioning of a system in line with specified requirements;
- an advisory role: auditors may make recommendations to improve or correct weaknesses or failures in operations, accounts and systems. This may include contribution to adapting the legislation.

[1] Guidance 'Fraud Risk Assessment and Effective and Proportionate Anti-Fraud Measures' for the implementation of Article 125(4)(c) of Common Provisions Regulation (Regulation (EU) No1303/2013, has been produced by Structural Funds DGs. EGESIF 14-0021-00 of 16 June 2014

[2] Advisory Committee for the Coordination of Fraud Prevention

[3] Article 125(4)(c) of Common Provisions Regulation (Regulation (EU) No1303/2013)

The importance of specific fraud awareness training for the auditors was also identified.

It also appeared that approaches and practices to fraud prevention and detection differed, sometimes significantly, from one Member State to another. However there are many good ideas and good practices to exchange. This handbook therefore includes a significant number of examples.

The handbook also includes practical tools, such as an example of a Fraud Response Plan produced by a national authority and a table summing up the potential key inputs auditors may have in preventing and detecting fraud.

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Introduction

In 2012, OLAF set up a collaborative procedure with the Member States aimed at exchanging experience and good practices between the Member States and with the Commission. This procedure is organised within the framework of the COCOLAF Fraud Prevention Group. It is made up of a working group of Member States' experts and representatives from OLAF, DG Regional and Urban Policy, DG Employment, Social Affairs and Inclusion and DG Maritime Affairs and Fisheries. who worked for one year period on a specific topic selected by the Member States. For 2014, the Member States chose the topic of 'the role of auditors in fraud prevention and detection'.

This document was drafted as part of this procedure. It is a handbook aimed at increasing auditors' knowledge and awareness of their role in fraud prevention and detection in European Structural and Investment Funds (ESIF). This handbook is not binding on the Member States, nor does it create any new rules or obligations for national audit authorities. Its purpose is to help auditors in Member States develop their awareness of their role in the fight against fraud and their knowledge of the working practices of their colleagues in other Member States.

For this reason, this handbook is based on examples of good practices provided by the Member States' experts who took part in the working group.

Although the handbook is a good practice document aimed at Member State audit authorities, it can be also useful for the managing and certifying authorities, to better understand auditors role in preventing and detecting fraud and the need to fully cooperate with auditors to ensure due protection for the EU's financial interests.

EU legislation provides a framework for the audit authorities' work ESIF. It makes clear reference to international audit standards which provide guidelines on the role of auditors in fraud prevention and detection. The first chapter of this handbook outlines these general rules and provides references to the relevant national rules.

Auditors have a key role in providing an opinion on the effective functioning of management and control systems for operational programmes co-funded through the ESIF. The international audit standards state that the primary responsibility for preventing and detecting fraud rests both with management and those charged with governance of the entity. But auditors also have a role in the fight against fraud and must help the Member States to fulfil their obligations in preventing, detecting and correcting irregularities and fraud.

Auditors should consider fraud in a very broad sense, including corruption, money laundering, embezzlement and intentional infringement of public procurement rules.[4]

[4] The 'PIF Convention' on the protection of the Union's financial interests of 26 July 1995 provides a definition of fraud. As the legal framework has changed since it was passed, the PIF Convention is currently being revised. The Commission has issued a proposal for a Directive of the European Parliament and of the Council on the fight against fraud to the Union's financial interests by means of criminal law (COM(2012) 363 final of 11.7.2012).

Member State audit authorities have a statutory responsibility for two main types of audits: system audits and audits of operations. These two types of audits have different scopes and their potential contribution to fraud prevention and detection will therefore be considered separately. A chapter of this handbook is dedicated to each of them.

As in many areas, training is key to ensuring efficient and effective performance of the tasks. It provides an initial layer of knowledge and knowhow, based on fundamental principles. It also helps auditors keep their knowledge up-to-date and maintain a high level of performance and knowledge through continuing training. Auditors need specific training directly relating to their role in combating fraud. This training should be built on real cases and situations. Chapter 4 of this handbook addresses this issue and sets out some key ideas and examples.

This handbook does not discuss whether auditors have a role to play in fraud prevention and detection. Its aim is to support auditors in developing their knowledge and knowhow to identify how and where to invest time and resources to better contribute to the fight against fraud. The good practices described in this handbook by Member States' experts should help achieve this objective.

OLAF would like to thank the following experts for their contribution:

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1. Audit and fraud - the legal framework applicable to European Structural and Investment Funds (ESIF)

1.1. The EU legal framework

Article 317 of the Treaty on the Functioning of the European Union requires sound management in the use of the EU budget by the Member States in cooperation with the Commission. It also provides also for *'the control and audit obligations of the Member States in the implementation of the budget and the resulting responsibilities'*.

Articles 310 and 325 of the Treaty on the Functioning of the European Union require the Commission and the Member States to counter fraud and any illegal activities affecting the EU's financial interests. Member States are required to take the same measures to counter fraud affecting the EU's financial interests as they take to counter fraud affecting their own national financial interests.

As part of this shared management, Article 59.2 (b) of the Financial Regulation[5] [6] gives Member States the primary responsibility for preventing, detecting and correcting irregularities and fraud. Member States therefore have to build strong management and control systems to ensure sound financial management, transparency and non-discrimination.

For the new 2014-20 programming period, Article 125 (4) (c) of the Common Provisions Regulation (EU) No 1303/2013[7] [8] (the 'CPR') requires the managing authorities to put in place effective and proportionate anti-fraud measures that take into account any risks identified. Article 124(2) of this Regulation provides for the designation of managing authorities on the basis of a report by and the opinion[9] of an independent audit body that shall assess the designation against the criteria set out in annex XIII to the CPR. The Commission has issued guidance on the designation procedure[10] to support audit authorities in carrying out that task.

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[5] Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union, OJ L 298, 26.10.2012, p. 1

[6] See Annex 1 of this handbook

[7] This Regulation lays down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and lays down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repeals Council Regulation (EC) No 1083/2006.

[8] See Annex 1 of this handbook

[9] Models of the report and the opinion of the independent audit body are provided by the Commission Implementing Regulation (EU) No 1011/2014 of 22 September 2014 (annex III and annex IV) laying down detailed rules for implementing Regulation (EU) No 1303/2013 of the European Parliament and of the Council as regards the models for submission of certain information to the Commission and the detailed rules concerning the exchanges of information between beneficiaries and managing authorities, certifying authorities, audit authorities and intermediate bodies. OJ L 286, 30.09.2014, p. 1

[10] EGESIF-XXXYY-EN

Article 59 of the Financial Regulation also sets out general requirements under shared management for audit authorities. Audits concern three main objects:

management and control systems;
expenditure/operations; and
annual accounts and management declarations.

Article 59 of the Financial Regulation and Article 127 of the CPR provide for three main types of audits under shared management:

1. system audits on the proper functioning of the management and control system of the operational programme;

2. audits on operations on an appropriate sample of operations, drawn up on the basis of the declared expenditure;

3. audits of annual financial accounts and management declarations.

The audit bodies responsible for these audits must be independent and must carry out their function and deliver an opinion in accordance with internationally accepted audit standards. This opinion must include assurance of the legality and regularity of expenditure and of the functioning of control systems.

Table 1 of Annex IV of Commission Delegated Regulation (EU) No 480/2014[11] outlines a list of key requirements of the management and control systems for the managing authorities that need to be assessed in the 2014-20 programming period. This list now includes for the first time a key requirement covering anti-fraud measures for the managing authorities and intermediate Bodies. Audit authorities will now have to assess whether Key requirement 7 ('Effective implementation of proportionate anti-fraud measures') has been met. This means that control systems put in place for fraud prevention and detection will require more specific attention and reporting than in the previous programming period.

Nevertheless, in accordance with Article 30.2 of the aforementioned delegated regulation, a serious deficiency in the key requirement anti-fraud measures will not in itself be sufficient to determine a serious deficiency in the effective functioning in the management and control system but must be combined with evidence of a shortcoming in any of the other key requirements listed in table 1 of Annex IV of the same regulation.

The Commission issued a guidance 'Fraud Risk Assessment and Effective and Proportionate Anti-Fraud Measures'[12] for Member States and Programme Authorities in

[11] Commission Delegated Regulation(EU) No 480/2014 of March 2014 supplementing Regulation (EU) No 1303/2013 of the European Parliament and of the Council laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund OJ-L138, of 13.05.2014, p.5-44

[12] EGESIF- 14-00021-00 of 16 June 2014

ESIF. This note provides further guidance for audit authorities on verifying managing authorities' compliance with Article 125 (4) (c). Annex 4 of this guidance gives audit authorities a draft checklist for assessing how well managing authorities and intermediate bodies comply with Article 125(4) (c). It could be part of the checklists used by audit authorities when carrying out system audits.

It is also worth mentioning Article 148 (4) of the CPR which anticipates that, despite the principle of proportional control of operational programmes, the audit authority may carry out audits of operations if a risk assessment or an audit by the European Court of Auditors has established a specific risk of irregularity or fraud. It is the case if there is any evidence of serious deficiencies in the effective functioning of the management and control system of the relevant operational programme[13].

1.2. The international framework

The 2014-20 legal framework requires adherence to 'internationally accepted auditing standards'[14] when carrying out audits. There are three main sets of international audit standards, namely:

1. the standards of the International Auditing and Assurance Standards Board (IAASB), under the International Federation of Accountants;
2. the International Standards of Supreme Audit Institutions (ISSAI), issued by the International Organisation of Supreme Audit Institutions;
3. the standards of the Institute of Internal Auditors.

All three sets of standards provide similar guidance on auditors' obligations in fraud detection.

International Federation of Accountants

Among the 36 standards of the IAASB, ISA 240 deals with 'the auditor's responsibilities relating to fraud in an audit of financial statements'. This standard sets out the following principles:

1. auditors are primarily only expected to discover fraud if this goes beyond the materiality threshold;

2. if auditors suspect fraud, they are expected to take further steps;

3. auditors should take into account specific fraud risk factors when planning their audit activities. For these purposes, materiality should be considered to have qualitative aspects;

[13] See Annex 1 of this handbook
[14] See Article 127-3 of the CPR

4. when obtaining reasonable assurance, the auditor is responsible for maintaining professional scepticism throughout the audit. This includes thinking and acting out of the box;

5. particular attention must be paid to communication and documentation in cases where fraud is suspected.

Under ISA 330, ´the auditor's responses to assessed risks´, the auditor is required to determine the overall response required to address the assessed risks of material misstatement due to fraud in financial statement. However there is an unavoidable risk that some material misstatements may not be detected, especially where these result from fraud.

International Organisation of Supreme Audit Institutions

ISSAI 1240 relates to 'The Auditor's responsibilities relating to fraud in an audit of financial statements'. It refers directly to International standard on Auditing (ISA) 240 (see below) and provides supplementary guidance for public sector auditors. In particular, it states:

> ´…there may be general public expectations for public sector auditors to report any non-compliance with authorities detected during the audit or to report on effectiveness of internal control. These additional responsibilities and the related fraud risks need to be considered by the public sector auditor when planning and performing the audit.´(p.4)
>
> ´The requirements for reporting of fraud in the public sector may be subject to specific provisions of the audit mandate or related legislation or regulation, in line with paragraph 43 of the ISA regarding communication to a party outside the entity. Such parties may include regulatory and enforcement authorities. In some environments, there may be a duty to refer indications of fraud to investigative bodies and even cooperate with such bodies to determine if fraud or abuse has occurred. In other environments, public sector auditors may be obliged to report circumstances that may indicate the possibility of fraud or abuse to the competent jurisdictional body or to be the appropriate part of the government or legislature such as prosecutors, the police and (if relevant to legislation) affected third parties. Public sector auditors take care to avoid interfering with potential investigations or legal proceedings. Public sector auditors need to be familiar with applicable laws and regulations in regard to reporting, communication and documentation of indications or suspicions of fraud. Furthermore, public sector auditors consider the need to obtain legal advice in issues regarding indications of fraud.´(p.21)

Institute of Internal Auditors

International standards for the professional practice of internal auditing, issued by the Institute of Internal Auditors, set out the following principles in relation to fraud risks and detection through assurance activities and audits:

1. internal auditors must have sufficient expertise to evaluate the risk of fraud and the manner in which it is managed by the organisation, but they are not expected to have the level of expertise of a person whose primary responsibility is detecting and investigating fraud (standard 1210.A2);

2. internal auditors must exercise due professional care by considering the … probability of significant errors, fraud, or non-compliance … [15](standard 1220.A1);

3. the internal audit activity must evaluate the potential for the occurrence of fraud and how the organisation manages fraud risk (standard 2120.A2); and

4. internal auditors must consider the probability of significant errors, fraud, non-compliance, and other exposures when developing engagement objectives (standard 2210.A2).

These standards all highlight two different roles for auditors:

a) an audit role: auditors, as independent bodies, are in charge of giving assurance on the regularity and legality of the operations and accounts of the audited bodies and on the proper functioning of a system in line with specified requirements;

b) an advisory role: auditors may make recommendations to improve or correct weaknesses or failures in operations, accounts and systems which may include recommendations for improving the legislation.

These different roles in fraud prevention and fraud detection will be developed in later sections of this handbook.

1.3. The national framework

In addition to the EU legal framework, some (but not all) Member States have included provisions in national legislation to better define audit procedures.

The EU legal framework is quite general and leaves room for manoeuvre for Member States. They can structure and carry out audits in accordance with their rules, organisational structure and principles. This must be taken into account when considering the role of auditors in fraud prevention and detection.

[15] Extract of the Standard 1220.A1

Some examples illustrating the differences between Member States

In Estonia, government decree No 125 from 8 May 2007 sets out the framework for conducting audits on structural assistance. It requires that the audit authority, when auditing EU co-financed operations to follow the definition of internal auditing, the code of ethics, the international standards for the professional practice of internal auditing and the practice advisories issued by the Institute of Internal Auditors.

In The Netherlands, the ISA set by the International Federation of Accountants are transposed into national legislation, that applies to registered accountants and auditors therefore must apply these standards in their professional practice.

2. How system audits help to prevent and detect fraud

A system audit aims to obtain reasonable assurance that the management and control system functions effectively and efficiently in order to prevent errors and irregularities (including fraud) and that, if these appear, the system is capable of detecting and correcting them.

When carrying out their work, auditors may detect weaknesses in the system that require action in the systems itself. Auditors have a key role to play in this respect. In particular they have a duty to draw the attention of the managing and certifying authorities to any weaknesses. These authorities have primary responsibility to apply solutions to address the shortcomings detected, which will help prevent fraud.

Auditors may come across circumstances that suggest that fraud may have occurred. In these cases, they must inform the relevant authority without delay for further action. The relevant authority may be the managing authorities, law enforcement services, or OLAF, depending on the details of the suspected fraud and on the relevant national procedures for fraud notification. This will help with fraud detection.

2.1. System audits and fraud prevention

Fraud prevention has become a topic in itself. The 2014-20 legal framework requires a further step in preventing fraud from Member States. Anti-fraud measures for ESIF operational programmes are covered by the CPR which requires managing authorities to put in place effective and proportionate anti-fraud measures, on the basis of a fraud risk assessment. The regulations include a requirement for audit authorities to provide an assessment on the functioning of management and control systems within operational programmes, including an assessment of the anti-fraud measures put in place[16].

2.1.1 Audit role

According to ISSAI 1240 and ISA 240:

responsibility for preventing and detecting fraud rests with those charged with governance and management of the organization ;

auditors should evaluate the risk that misstatements in the financial statements may arise from fraud; and

auditors should report suspected fraud cases to those charged with governance and management, and to regulatory and enforcement authorities.

[16] See chapter 1.1

The information note on fraud indicators for European Regional Development Fund, European Social Fund and Cohesion Fund[17] notes that '*by exercising adequate professional scepticism, auditors should be particularly alert to opportunities for fraud, such as control weaknesses in the control and management systems. In particular, if the management and control environment can be considered high risk, the note recommends that auditors make enquiries with managing authorities about their views as to risk of fraud in order to test the anti-fraud measures in place'*.

ISA 240 describes professional scepticism as: '***an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.***' It means, for example, that even though the documents submitted to the auditor certify a correct and legal situation, he/she must show caution and reserve. If the auditor appreciates that there is a risk of fraud, he/she may decide to perform supplementary tests and checks, including extending the segment audited.

2.1.1.1. Audit strategy

Article 127.4 of Regulation (EU) 1303/2013 requires the audit authorities to prepare an audit strategy for the performance of audits within eight months of adoption of an operational programme. It is important that fraud prevention and detection within the implementing bodies are adequately covered by the audit authority in this document.

In 2014, the Commission prepared a guidance note on the audit strategy[18]. Under Section 3 of this guidance note on risk assessment, audit authorities are advised to develop a system of risk assessment in order to prioritise a programme of systems audit work. It is recommended that overall risk assessment is undertaken by the use of risk assessment table which includes both inherent and control risk factors.

In section 4.2 of this guidance note on the audit strategy, the implementation of effective and proportionate anti-fraud measures underpinned by a fraud risk assessment, is identified as a specific thematic area to be covered.

2.1.1.2. Assessment of the management and control systems

Article 72(h), Article 122(2) and Article 125(4)(c) of the CPR and Table 1 of Annex IV of the Commission Delegated Regulation (EU) No 480/2014 refer to Key Requirement 7, which relates to the '*effective implementation of proportionate anti-fraud measures'*. This key requirement has been subdivided into seven key criteria which are listed in Annex 2 to this handbook. For the 2014-20 programming period, although not explicitly a requirement in the regulation, for the first time, audit authorities will be required to test anti-fraud measures in their assessment of management and control systems.

[17] COCOF Note 09/0003/00-EN, adopted on 18 February 2009

[18] Guidance on the Audit Strategy – EGESIF XX-EN, paragraph 4.2.3

The Commission prepared an updated guidance note that sets out a common methodology for assessing management and control systems in Member States[19]. Audit authorities are strongly advised to apply the methodology outlined in this guidance note when evaluating the management and control systems in managing authorities and intermediate bodies.

Audit authorities must keep in mind that managing authorities must adopt a proactive, structured and targeted approach to managing the risk of fraud and put in place anti-fraud measures that are effective and proportionate taking into account the risks identified.

In line with these principles, the guidance note 'Fraud Risk Assessment and Effective and Proportionate Anti-Fraud Measures' produced by the Commission gives to audit authorities a tool to assess the anti-fraud measures put in place by the managing authorities. This tool consists in a checklist joined in Annex 4 of the guidance note.

When planning system audits, auditors will be required to perform a risk assessment on the environment in which the audited bodies operate.

This means that auditors must:

- understand the activities of the audited body and the environment in which it carries these out;
- follow up of recommendations of previous audits;
- evaluate the audited body's internal control system;
- identify and assess risks, including the risk of fraud.

More specific, key questions to ask on fraud include (non-exhaustive list):

- Is there a specific fraud risk assessment process and how often is it carried out?
- What is the general approach towards fraud? Does it flow from the senior management (e.g. tone in communication from the top)?
- Is there a specific policy, included in national legislation, on fraud, abuse and misuse of grants? What are the consequences when fraud, abuse or misuse of grants is discovered? Are there penalties for these?
- Is the selection process for applicants/projects carried out objectively?
- Is specific attention paid to fraud detection in management checks?
- Does the audited body assess the risks of fraud properly? Are appropriate counter-measures put in place?
- Are any of the audited body's control measures vulnerable to conditions that make fraud more likely (incentives/pressure, opportunity, attitudes/rationalization)?[20] Are actions taken to reduce the potential impact of these?
- Does the internal control system comply with the legal requirements on anti-fraud measures? Are there procedures in place to reduce the possibility of fraud (e.g.

[19] Guidance for Member states and Programme Authorities on the Designation Procedure – EGESIF XXX-EN
[20] For examples, see ISA 240, Appendix 1- Examples of fraud factors

existence of detailed checklists, involvement of more people involved in the decision-making process, application of the "four-eyes principle" to checks that are carried out, etc.)

Useful sources of information could be (non-exhaustive):

meetings with the senior management and procurement officials in the audited body;
the audited body's procedure manuals;
review of management verification checklist being used to ensure fraud prevention and detection are adequately covered
review of Operational Programme grant schemes that are not subject to open calls for proposals,
information provided to the auditor by law enforcement services and regulatory authorities about risky areas related to the audited body's functioning (A good practice could be for auditors to make agreements with these authorities on exchanging knowledge, information, results of their activities, etc.)
information from the whistleblowing procedure
review of possible links between several operations and organisations involved
information from risk scoring tools (e.g. Arachne)
the database 'Irregularity Management System' storing the irregularities' reports made by the Member States to OLAF

In Romania, the national audit authorities and the Fight against Fraud Department (DLAF) have signed an agreement to work together which includes:

- bilateral consultation on developing new legislation relating to fraud issues that impact on the core business of the audit authorities and the DLAF;
- organisation of meetings, conferences and shared training
- notification by the audit authorities to the DLAF of potential fraud cases
- exchange of information on fraud cases, to assess the risk of fraud;
- access to the DLAF database (and in particular the Irregularities Management System) for the audit authorities, on written request;
- bi-annual DLAF communication to the audit authorities of a list of controlled bodies.

When selecting a sample of control tests for walk through the practical functioning of the management and control system, auditors should use random sampling methods (or other methods set out in international audit standards). They should not try to select potentially fraudulent cases (e.g. based on information provided by law enforcement services and regulatory authorities). This might lead to a wrong assessment of the functioning of the management and control system in the audited body, as the sample might be skewed towards fraudulent cases. However, these types of cases could be selected as a complementary sample, to specifically evaluate fraud management processes.

Audit authorities should carry out its systems audit work on the anti-fraud measures as early as possible in the programming period and as often as is necessary. They should also systematically review the implementation of effective and proportionate anti-fraud measures at the level of intermediate bodies as part of its programme of systems audits.[21]

Examples of system weaknesses that may have fraud implication[22]

Lack of training for staff in the managing authorities on identification of red flags[23]: this could lead to false, inexact or incomplete documents (such as invoices, bank guarantees, works certificates, tax certificates, financial accounts, technical documents etc.) being missed;

Lack of specific checks on whether someone involved in drafting terms of reference for a tender has a personal or economic interest in the tender. (For example, in a situation where a tenderer, who is later awarded the tender, draws up the terms of reference himself and hands them over to the contracting authorities, solely to prove that the tender documentation was formally published.)

Lack of specific checks on whether someone involved in the decision-making process has a personal or economic interest in the decision they have to take. (For example, in a situation where the employees of a managing authority deliberately unfairly favour a specific beneficiary , breaking the applicable rules and procedures and allowing the beneficiary to receive non-reimbursable funding that they were not entitled to, as they did not meet the legal criteria for the funding. ;

Lack of use of risk scoring tools (e.g. Arachne).

If, as a result of carrying out a system audit, an auditor finds deficiencies or a clear lack of control measures, he/she should report these issues and draw up appropriate recommendations to improve the functioning of the management and control system and help prevent fraud. The results of system audits should also be taken into account when planning audits of operations.

[21] See Section 5.2 of the Guidance 'Fraud Risk Assessment and Effective and Proportionate Anti-Fraud Measures'- EGESIF 14-0021-00 of 16 June 2014

[22] Further examples are set out in annex 2 of the Guidance 'Fraud Risk Assessment and Effective and Proportionate Anti-Fraud Measures'- EGESIF 14-0021-00 of 16 June 2014

[23] A red flag is an indicator of possible fraud, corruption, etc. It is a signal that something is out of the ordinary and may need to be investigated further.

2.1.2. Advisory role

ISA 240 requires auditors to note deficiencies and gaps in an audited body's internal control system and to inform those in charge of the governance of these entities about these shortcomings. Thanks to their experience and knowledge of the environment, auditors can identify corrective measures and solutions to remedy any weaknesses. They can also take advantage of their wider experience to identify lessons to be learnt and any new '*red flags*'. This will allow knowledge on how to identify potential fraud cases to be shared between auditors and staff in managing and certifying authorities (see chapter 4 of this document on training).

Based on these *'lessons learnt',* auditors can also provide advice and contribute effectively to the fight against fraud when new legislation is drafted.

In The Netherlands, the audit authority is part of the government's Central Audit Service, which is located at the Ministry of Finance. It has an advisory role in developing national legislation. It focuses on preventing abuse and misuse of grants by testing whether the intended rules in the draft legislation are applicable and auditable in practice, based on its knowledge and practical experience.

2.2. System audits and fraud detection

2.2.1. Audit role

Section 4 of ISA 240, on the auditor's responsibilities relating to fraud when auditing financial statements, states that the primary responsibility for preventing and detecting fraud lies with those charged with the organisational governance and the management of the audited body.

However, if an audit authority identifies suspected fraud while carrying out its systems audit work, it needs to react immediately to protect the EU and national budgets. A pre-existing and well-known procedure may facilitate auditors' decision-making when facing a potential fraud case.

In Ireland, the ERDF audit authority has developed a Fraud Response Plan for auditors to use when they suspect fraud in either a systems audit or an operations audit. The objective is to ensure **'that timely and effective action is taken'**. The document outlines the path to follow in case of detection of a potential fraud case to ensure that the Audit Authority correctly reports the case to the appropriate authorities whilst ensuring that the annual reporting deadlines are not put at risk as a result of any investigation. A copy of this plan is included at Annex 4 of this handbook.

Existing measures and internal control and supervision mechanisms, if properly implemented, should reduce the possibility of fraud taking place, but they do not make it impossible. Frequent and carefully selected audits in sensitive areas are a useful instrument for auditors. They may help identify systemic weaknesses in anti-fraud

measures and may also help to detect potential fraud cases. Thematic audits are therefore useful tools.
In accordance with ISA 240*,* auditors must draw up audit procedures, based on a risk assessment, which allow them to obtain reasonable assurance that any significant damage caused by fraud is discovered.

Any audit is subject to an inherent risk that significant deficiencies in the internal control system will not be detected, even though the audit has been planned and carried out correctly. Auditors must show particular professional vigilance and rigorous analytical judgment, as fraud includes actions carried out to hide its existence, such as secret agreements between several people, forgery of documents, concealment or non-presentation of documents, data or information,.

Professional scepticism is key. Audit evidence must be critically assessed. For example, auditors should be alert to:

audit evidence that contradicts other audit evidence obtained;
information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence; and
conditions that may indicate possible fraud.[24]

If an auditor, based on his/her professional judgment,[25] believes that there are indications of potential fraud, he/she must investigate further. He/she may decide to perform supplementary tests and checks, extending the segment audited.

The auditor may conclude that potential fraud affects the whole system or only part of it, or he/she may conclude that there are one or more isolated potential fraud cases. In all cases, he/she must react quickly and inform the relevant authorities, taking into account all circumstances surrounding the case(s). The auditor, based on the evidence discovered, must rigorously and thoroughly analyse the situation, structure the evidence on which the finding is based, and decide whom to inform.

In the first instance, the right people to inform are likely to be those charged with governance of the audited entity, if there is no reason to think that they are involved in the case(s). For beneficiaries co-financed governance is held by managing authorities or intermediate bodies. Otherwise the auditor must notify the case(s) directly to the judicial authorities, without prejudice to any national legislation relating to the confidentiality of information obtained during an audit.

Auditors must also inform the responsible national authorities which have to notify the Commission (OLAF) of irregularities and suspected fraud cases in line with the applicable sectoral rules on reporting irregularities[26].

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[24] ISA 200, point A.18
[25] The definition of 'professional judgment' is given in ISA 200 : 'the application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of audit evidence'.
[26] E.g., for the 2007-13 programming period, section 4 (Articles 27-36) of Commission Regulation (EC) No 1828/2006 of 8 December 2006 setting out rules for the implementation of Council Regulation (EC) No

2.2.2. Advisory role

If an auditor concludes that potential fraud affects the managing system itself, he/she must inform those charged with governance, unless these people may be involved in the potential fraud. In accordance with Article 127.5(b) of the CPR, he/she must give an opinion on the proposed and corrective actions, if any are required. Auditors may have a very significant input here, and their opinions will be particularly useful for those in charge of governance in adapting or correcting measures already in place, if necessary.

As noted in section 2.1.2, auditors may use the statements made when carrying out their audits to gain knowledge of the area and identify key elements that will help them better understand the conditions for fraud and methods to efficiently counteract it. Auditors can also refer to good practices identified during audits that showed no weakness. They can use all these 'lessons learnt' to share their knowledge with stakeholders.

Auditors may have different levels of advisory input. They may help support managing authorities, intermediate bodies and certifying authorities develop their

- risk analysis;
- red flags;
- anti-fraud policy and measures;
- training.

However, support from auditors must not put their independence at stake. Auditors should not be part of the decision-making process regarding any document they will have to evaluate during their audit.

Knowledge acquired by auditors should be shared between auditors and, as necessary, should also be discussed with the police, the judiciary and legal services. For more on this, see chapter 4, below.

1083/2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and of Regulation (EC) No 1080/2006 of the European Parliament and of the Council on the European Regional Development Fund as amended and for the 2014-20 programming period, Article 122 of the CPR.

3. How audits of operations help to prevent and detect fraud

Audits of operations are carried out to obtain reasonable assurance on the legality and regularity of expenditure declared to the Commission. Audits must be based on representative samples. The sampling unit may be an operation, a project within an operation or a payment claim by a beneficiary and declared to the Commission.

Given the nature of audits of operations, an auditor's contribution to fraud prevention when carrying out audits on operations may be fairly limited. However, auditors may identify specific weaknesses that result from recurrent fraud patterns. Auditors can draw up recommendations for improving the system, based on their findings during audits of operations. This therefore forms part of the fraud prevention aspect of the auditor's role.
Audits may also lead to the detection of individual fraud cases. This would fall under the fraud detection aspect of the auditors' role.

3.1. Audits of operations and fraud prevention

Commission Delegated Regulation No 480/2014 provides some clarification on the way audits of operations should be carried out. In particular, Article 27 (5) requires audit authorities to extend their audits where problems detected appear to be systemic in nature and therefore entail a risk for the other operations under the operational programme. It is complemented by Article 28 (12) which states that 'where irregularities or a risk of irregularities have been detected, the audit authority shall decide on the basis of professional judgment whether it is necessary to audit a complementary sample of additional operations or parts of operations that were not audited in the random sample in order to take account of specific risk factors identified'.

Therefore the option to audit a complementary sample may provide a tool for the audit authority to contribute actively to fraud prevention where fraudulent activity may be suspected.

3.1.1. Audit role

When carrying out the audit of operations, auditors also:

- identify and evaluate all internal and external risks and threats that could negatively affect expenditure eligibility or cause an irregularity or fraud;
- review the audited body's surroundings and background focusing on areas with increased risks of fraud , including reviewing information concerning stakeholders, suppliers, and using risk-analysis tools (e.g. Arachne) or similar IT tools;
- identify potentially fraudulent behaviour; and

- if needed, exchange information with law enforcement services (e.g. police departments, law enforcement agencies, OLAF, etc.) in accordance with EU, international and national rules.

This helps auditors to make up their minds as regards potential areas of risk to focus on when carrying out audits. When identifying irregularities, auditors must all supporting documentation, allowing them to draw a conclusion concerning the potential existence of fraud. If necessary, auditors must ensure further examination, including additional audits, to establish the scale of the problem, and must recommend the necessary corrective actions. Auditors should reflect on the present, meaning how to act directly and immediately on the irregularities detected. As far as possible, auditors should also consider the future, and determine whether prevention measures could be suggested and implemented to avoid irregularities in the future.

Auditors may also draw conclusions relating to fraud prevention, even in situations where no potential fraud has been detected. This can happen when an audit of operations, based on a sample, has identified some areas of risks or weaknesses.

3.1.2. Advisory role

The auditors' advisory role complements their audit role. If auditors identify good prevention practices while carrying out their audits on operations, they should consider collecting these and sharing them among relevant stakeholders. People who implement good practices in their daily work frequently do not see the good quality of their work and therefore are unlikely to share them with others. Auditors may play a key role in this area. Because they carry out multiple audits, they have a good overview of good practice and should therefore help detect and share this.

Auditors must also recommend corrective action when they detect problems. Stakeholders would find a compilation of fraudulent practices detected in the country, or in particular funds, regions, or businesses, and possible corrective actions or measures to implement very helpful. A compilation like this would help to spread a shared knowledge based on previous audits, including among investigative authorities and organisations taking part in the judicial process.

In Lithuania, the National Audit Office, the Special Investigation Service (which deals with corruption) and the Financial Crime Investigation Service (which deals with fraud) have signed cooperation agreements. They meet and discuss subjects of common interest and share information.

Auditors should always use their experience to spread awareness of fraud.

3.2. Audits of operations and fraud detection

An audit of operations is carried out by testing and checking operations at two levels in particular: the level of the beneficiary and the level of managing authority / intermediate body). These are therefore typically audits where auditors may come across potential fraud. Nevertheless, auditors conduct administrative not criminal procedures. The scope of their power and authority is therefore rather limited when it comes to detecting the particular circumstances of suspected fraudulent activity. In addition, the key objectives of both criminal and audit procedures are different. An audit of operations is of administrative nature, aiming to assess the legality and regularity of the implementation of a project, while the criminal procedure aims to detect and/or investigate operations to provide evidence the intention to defraud.
In other words, suspicious cases that raise red flags must be clarified immediately (with meaning as quickly as possible) by cross-checking the available information and by carrying out further checks. Auditors decide, on the basis of their professional judgment what further measures should be taken. They therefore have to assess all circumstances of the case. Auditors must pay particular attention to circumstances relating to intention, as intention is what makes the difference between simple irregularities and cases of suspected fraud.

3.2.1. Audit role

When planning audits, auditors might decide to conduct targeted audits of operations based on the risk of fraud, in order to improve fraud detection.

In the United Kingdom, the Department for Work and Pensions (DWP) has deployed an IT system to automate the interface between the department and its contractors. This has enabled automated checks via the interface, validation of contractor claims prior to payment and facilitation of additional targeted controls. It therefore helps to intercept and prevent potential irregular or fraudulent claims.

All information gathered when investigations by the DWP's internal investigations are closed is analysed. This then feeds into the creation of targeted audit controls. These targeted audit controls are revised on a rolling basis taking into account any new areas of risk and *modus operandi* identified by investigations.

These targeted controls and targeted audit trails can then be enriched with external data to further improve fraud prevention and detection.

This automated targeted approach replaced random manual checking and vastly increased fraud detection rates. Audits of random samples rarely detect fraudulent activity.

3.2.1.1. Preparation of the audit

The preparation of each audit of operations is very important. It may include the following steps:

consulting other auditors who have been working in the same area;
checking for any identified breaches of existing controls and using any data mining tools available;
carrying out external checks using the internet, government departments and other data sources available (e.g. Arachne or similar IT tools);
contacting teams and organisations that are involved in managing and monitoring the contract;
collecting available reports, comments and opinions from these teams and organisations;
liaising with the teams responsible for all aspects of the contract and fraud investigation;
developing and refreshing knowledge of fraud trends, investigation outcomes and /or any new controls introduced, and any evidence of fraud indicators
checking relations with other operations.

Depending on national legislation and the pre-audit checks, auditors may consider un-notified or short notice audit visits, if there are major concerns. They may also discuss their plans with an investigator prior to arranging the audit.

The preparation phase helps improve the quality of the audits because it helps auditors, who frequently work under tight time constraints, to better orientate their searches and attention on key areas and/or areas of particular risk. National audit authorities may also give some direction to auditors to support them in their work.

Examples of an auditor's particular areas of focus in Ireland

during physical on-site operations, carry out audits to check for asset misappropriation;
take a closer look when an operation earns income, especially if the income is cash-based;
be vigilant for any signs of collusion or conflict of interests in the award of public procurement contracts;
check for favouritism or conflict of interests in the evaluation of tenderers;
be vigilant to false labour claims made by projects and to falsified documents more generally;
carry out cross-checks on the potential for EU double funding.

3.2.1.2. Tools

The following documents produced by the Commission (including OLAF) and Member States may be useful in everyday audit work:

- COCOF 09/0003/00 of 18 February 2009 - Information Note on Fraud Indicators for ERDF, ESF and CF
- Compendium of anonymised cases – structural actions
- Practical guide on conflict of interests in public procurement procedures
- Practical guide on forged documents.

They describe red flags, fraud patterns and anti-fraud measures that may be very helpful when carrying out audits of operations.

In Slovakia, the national authorities have produced checklists for auditors to help them to make their decisions.

IT tools may be also of great help in preparing and carrying out audits of operations. Subject to national legal constraints relating to data protection, data analytics can be used at this stage to enrich the risk assessment process, cross-check data with other public or private sector organisations and detect potentially high-risk situations. The Commission offers also a specific data mining tool called Arachne which can be used to detect risky operations and projects. Audit authorities may also find this risk-scoring tool useful.

Member States may also have developed IT tools adapted to their particular needs or may use specific databases.

In Estonia, different databases (e.g. the register of structural assistance, the public procurement register, the e-business register, etc.) are used to gather corroborative information during audits. For example, checks on the structural assistance register can be conducted to detect whether double founding of the same invoice occurred.

3.2.1.3. Steps to follow in case of suspected fraud

Auditors must always act within the parameters of the relevant legislation and international accepted standards and instructions. They should keep in mind the limits of their powers and their obligations towards the audited body, particularly with regard to the body's rights. An auditor should be able to draw a demarcation line between an audit and an investigation and clearly identify the moment when the suspicion of fraud has been firmly established. At this point, the case must be passed on through the right channels to the appropriate national authorities, in accordance with national rules and procedures. The Commission should also be informed, in accordance with the sectoral regulations on reporting irregularities.

The auditor's role in detecting a potential fraud case is limited to detecting and recording suspicious circumstances based on the facts established by their audit, including on-the-spot checks. In some Member States, there are specific teams which are responsible for investigating these cases. Auditors must report suspicious circumstances to these teams, whose staff have the appropriate professional skills to investigate fraud. This phase provides the opportunity to carry out more thorough checks or additional on-the-spot checks or to involve other authorities, as necessary. At the end of the process, auditors should be able to make a well-founded decision as to whether there was an irregularity and, if so, the corrective financial measures that should be be applied. They should also be able to decide whether the case should be reported to judicial authorities and whether the Commission should be updated via the Irregularity Management System (IMS).

In Malta, the Internal Audit and Investigations Department is in charge of audits and financial administrative investigations relating to EU funds. These two types of procedures are conducted by different units. If potential fraud is detected, audit units pass on the relevant information to the Financial Investigations Unit for further checks and inquiries.

After carrying out its checks, the Financial Investigations Unit issues a financial investigation report. This is sent to the Permanent Secretary of the Ministry if the outcome of the financial investigation requires administrative measures and to the Office of the Attorney General if the outcome of the financial investigation shows that a criminal offence has been committed. The Office of the Attorney General then evaluates the report and, if the Attorney General agrees with the report's conclusions, passes the financial investigation report on to the Maltese police to begin a criminal investigation.

In the United Kingdom, the Department for Work and Pensions (DWP) has an Internal Audit and Investigations Department. Internal Audit and Internal Investigations are two separate teams that work collaboratively.

- Internal Audit is responsible for providing assurance to the DWP and the Commission on the effective functioning of the management and control systems for the ESF operational programme.
- Internal Investigations is responsible for investigating cases of serious internal and contractor fraud and abuse concerning staff and contracts, across all areas of the DWP.

Auditors must be very careful to present the facts related to the fraud case in an unbiased way. Opinions should never be expressed in the report. The report should only include relevant facts that can be supported with evidence.

3.2.2. Advisory role

As a result of their audits of operations, auditors gain a lot of knowledge and knowhow of the environment, conditions and situations in which fraud can occur. It is very important that they share this knowledge. To do this, auditors can act at different levels.

a. Auditors can alert legislators if cases of fraud appear regularly due to loopholes in legislation.

b. Auditors can advise on developing or enriching of manuals, guidelines and documents that may be used by stakeholders, including managing and certifying authorities, audit authorities, investigative units, the police and judicial authorities.

c. Auditors can help develop an appropriate training policy and relevant training modules. (See chapter 4)

For example, the Commission has published several documents providing support for fraud detection, listed in paragraph 3.2.1 (b) of this document. They provide general guidelines and recommendations, and reflect best practice in Member States and the Commission. These documents could be adapted so that they better fit national contexts and procedures. Auditors could provide valuable input to this adaptation process, in light of their experience in the field. The content of these national documents could be then widely publicised among all staff that may be involved in detecting fraud.

More generally, experience from audits should be taken into account when drawing up procedural guidelines, planning of audit activities or training audit staff.

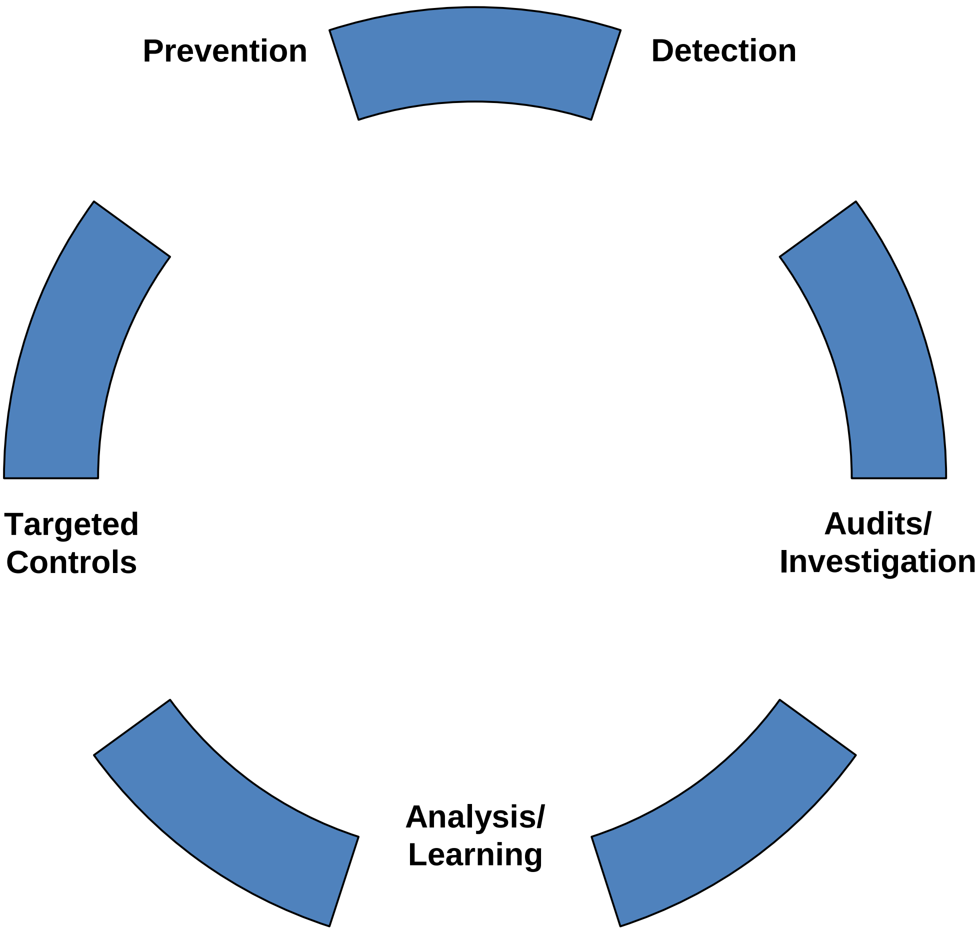
Compiling fraudulent practices detected by national audit authorities and producing a casebook could be very useful for all stakeholders. Efficient detection of fraud will be made easier by sharing explanations of how information relating to the cases investigated is processed. The stages of this processing could include processing of initial information, identifying red flags, identifying the potentially fraudulent behaviour, measures taken by auditors/investigators, the results of the case and any applied sanctions. Sharing this information could also help to improve the consistency of professional decisions made by auditors in their everyday work.

The system could be made more efficient by setting up structured platforms allowing the sharing of ideas, information, experience and knowledge between all stakeholders. These professional meetings could provide a regular opportunity to process and share audit experiences.

4. Specific training in fraud prevention and detection

Training is key to allowing auditors to develop their skills in fraud prevention and detection. Particular attention therefore needs to be paid to this issue. Training should be fully adapted to meet auditors' real needs, taking into account the obligations and limitations of their role.

Training should be considered as part of the following process:



This process creates a cycle where lessons learnt by analysing audits/investigations are used to create targeted controls and targeted audit controls which feed into prevention and detection.

Auditors need to be fully aware of their responsibilities in fraud prevention and detection. They should undertake initial fraud awareness training, followed by regular refresher training. Initial training could be in the form of a presentation by the fraud investigation team or authority or by senior auditors or via e-learning, where available. The rationale behind this is to ensure experience is shared between stakeholders and, especially, between senior auditors and investigators and new staff. Regular refresher training will ensure that knowledge and awareness are kept up-to-date taking into account the changing face of fraud.

4.1. Induction training for new auditors

Induction training for new audit authority staff should focus on basic fraud awareness training and cover the following:

- definitions of fraud;
- fraud in the International Auditing Standards including the specificities related to audit in public sector;
- EU regulations and guidance on fraud;
- the role of OLAF; and
- examples of fraud in EU co-funded projects.

In particular, training should focus on the following areas:

- the EU and national framework for the fight against fraud, including: the concept of fraud, stakeholders at EU and national level, the powers each actor has and, especially, the extent and limit of an auditor's powers, the difference between the auditors' powers and those of the investigators, auditors' obligations to report fraud;

- general knowledge on the anti-fraud cycle and the fraud issues, including: the four main stages of the anti-fraud cycle(prevention, detection, investigation/prosecution, recovery/sanctions), the role of each stakeholder, the effects, impacts and consequences of fraud.

4.2. Continuous training

Continuous training is necessary to ensure auditors maintain a consistent level of vigilance towards fraud issues. In addition, fraud patterns change over time and it is therefore important for auditors to receive up-to-date dated information.

In case of important changes in the legal framework it is also important to organise specific training for the existing auditors. The implementation of the new 2014-20 legal framework requires the national authorities to organise specific training on this new legislative and procedural framework. In particular the new obligations made to the auditors to consider and assess anti-fraud measures put in place by the managing authorities on the basis of a fraud risk assessment require the auditors to extend and deepen their skills and knowledge in fraud area.

Audit authorities could seek support from the Commission that plans to provide targeted roll-out support, when needed, to assist Member States in implementing Article 125 (4) (c) of the CPR and the guidance note 'Fraud Risk Assessment and Effective and Proportionate Anti-fraud Measures'.[27]

[27] See the executive summary of the guidance note EGESIF-14-0021-00

Staff who works in the fields of public procurement, technical, economic development, education, etc. should have systematic training separately.

Therefore regular refresher training is necessary. Specific training going deeper into some main issues should also be organised.

In Estonia, auditors in the audit authority in the Ministry of Finance have also taken part in several special training courses relating to fraud detection and prevention, including:

- organisational and external fraud risks;
- evaluation of data integrity;
- interviewing and interrogation techniques;
- assessing the risk of corruption;
- red flags; and
- case studies.

Appropriate vigilance and up-to-date knowledge can also be ensured through seminars and conferences that bring stakeholders from different organisations together.

In Hungary, the Anti-Fraud Coordination Service organises professional events on a regular basis for staff involved in irregularity management of structural actions. These workshops and conferences are held to facilitate the introduction of best practice, the exchange of experiences and the presentation of any changes to the legal environment. Representatives of the judicial investigation authorities and administrative audit organisations from Hungary and other Member States are invited to give presentations as appropriate, depending on the conference topics.

Training in Lithuania

Training for auditors in Lithuania focuses on improving professional scepticism, including:

- improving general knowledge (ISA, ISSAI, etc.);
- corruption and fraud awareness; and
- public procurements.

Training should focus on the following areas:

main risk areas, including:
- business sector;
- funds;
- geographical area etc…

Examples of issues to consider in delivering contracts for supporting reinsertion of disadvantaged people under the European Social Fund (ESF) programme (UK Department for Work and Pensions)

- high performing contract;
- performance spikes;
- incentive/reward/bonus schemes for contractor employees and advisers;
- incentive payments to participants;
- high volume of complaints; and
- any other areas of concern identified by the pre audit checks / consultation.

red flags or fraud indicators that would allow the detection of potential fraud cases or system weaknesses: examples of red flags are listed in annex 4;

tools that can be used to detect fraud, including databases, scoring tools like Arachne, or similar IT tools;

behaviour and the correct procedure to follow if fraud is suspected;

In Malta, auditors are given the following recommendations on behaviour:

show a non-threatening attitude to help convince the audited body to provide useful information;
be fair in judgements and do not try to trick people in order to obtain information;
adapt to different personalities and circumstances and communicate in the language of the interviewee;
take an unbiased approach, based on the facts relevant to the suspected fraud case, not opinions on them.

cooperation with the managing authorities, the intermediate bodies and the certifying Authorities and law enforcement services including exchange of information.

It might be helpful to put together a training document package, including sample payment requests and supporting documents by subsidised activity areas, which shows red flags. It would allow the new auditors to gain experience during training, based on former audits of operations.

4.3. Helping to train other stakeholders

Auditors with experience in preventing and detecting fraud may also be involved in disseminating their knowledge to managing or certifying authorities and other stakeholders who are involved in the fight against fraud in structural and investment funds.

Conclusion

Primary responsibility for preventing and detecting fraud rests with managing authorities.[28] However, success in the fight against fraud depends on a combination of efforts by management and certifying authorities, auditors and other stakeholders. Each actor in the chain must play his/her role in protecting the EU's financial interests.

Auditors can play an important role in preventing and detecting fraud at different levels. Recommendations made by auditors to strengthen management and control systems will, in most cases, also have a positive impact on fraud prevention. Part of an auditor's duties is to specifically audit the implementation of Article 125.4 (c) of the CPR (which states that Member States must put in place effective and proportionate anti-fraud measures). Last but not least, auditors should also note any suspicions of fraud and report these to the competent authorities.

This handbook is based on the experiences of Member States and aims to support the exchange of good practice among auditors from all Member States. It is not exhaustive. The handbook may be also of use for managing and certifying authorities to help them better understand how auditors can support them in setting up anti-fraud measures, policy or strategy.

Potential key inputs by auditors in preventing and detecting fraud when carrying out system audits or audits of operations relating to European Structural and Investment Funds are summarised in the table in Annex 5.

[28] See articles 72 (h) and 125 (4) (c) of the CPR

Annex 1- Main EU legal provisions for auditors

Financial Regulation (No 966/2012 of 25 October 2012)

Article 59 Shared management with Member States

…

2. When executing tasks relating to the implementation of the budget, Member States shall take all the necessary measures, including legislative, regulatory and administrative measures, to protect the Union's financial interests, namely by:

(a) ensuring that actions financed from the budget are implemented correctly and effectively and in accordance with the applicable sector-specific rules and, for that purpose, designating in accordance with paragraph 3, and supervising bodies responsible for the management and control of Union funds;

(b) preventing, detecting and correcting irregularities and **fraud**.

In order to protect the Union's financial interests, Member States shall, respecting the principle of proportionality, and in compliance with this Article, and the relevant sector-specific rules, carry out *ex ante* and *ex post* controls including, where appropriate, on-the-spot checks on representative and/or risk- based samples of transactions. They shall also recover funds unduly paid and bring legal proceedings where necessary in this regard.

...

5. Bodies designated pursuant to paragraph 3 shall, by 15 February of the following financial year, provide the Commission with:

(a) their **accounts on the expenditure** that was incurred, during the relevant reference period as defined in the sector-specific rules, in the execution of their tasks and that was presented to the Commission for reimbursement. Those accounts shall include pre-financing and sums for which recovery procedures are underway or have been completed. They shall be accompanied by a **management declaration** confirming that, in the opinion of those in charge of the management of the funds:

(i) the **information** is properly presented, complete and accurate;

(ii) the **expenditure** was used for its intended purpose, as defined in the sector-specific rules;

(iii) the **control systems** put in place give the necessary guarantees concerning the legality and regularity of the underlying transactions;

(b) an **annual summary** of the final audit reports and of controls carried out, including an analysis of the nature and extent of errors and weaknesses identified in systems, as well as corrective action taken or planned.

The accounts referred to in point (a) of the first subparagraph and the summary referred to in point (b) of the first subparagraph shall be accompanied by **an opinion of an independent audit body**, drawn up in accordance with **internationally accepted**

audit standards. That opinion shall establish whether the **accounts** give **a true and fair view**, whether **expenditure** for which reimbursement has been requested from the Commission is **legal and regular**, and whether the **control systems** put in place **function properly**. The opinion shall also state whether the audit work puts in doubt the assertions made in the **management declaration** referred to in point (a) of the first subparagraph.

Common Provisions Regulation No. 1303/2013 of 17 December 2013 (the 'CPR')

Article 122 -Management and control systems – responsibilities of Member States

…

2. Member States shall prevent, detect and correct irregularities and … notify the Commission of irregularities[29] ….and shall keep it informed of significant progress in related administrative and legal proceedings.

Article 125- Functions of the managing authority

4. As regards the financial management and control of the operational programme, the managing authority shall:

…

(c) put in place effective and proportionate **anti-fraud measures** taking into account the risks identified;

Article 127 - Functions of the audit authority

1. The audit authority shall ensure that audits are carried out on the proper **functioning of the management and control system** of the operational programme and on an appropriate sample of operations on the basis of the **declared expenditure**. The declared expenditure shall be audited based on a representative sample and, as a general rule, on statistical sampling methods.

…

3. The audit authority shall ensure that audit work takes account of **internationally accepted audit standards**.

…

5. The audit authority shall draw up:

(a) an **audit opinion** in accordance with the second subparagraph of **Article 59(5) of the Financial Regulation**;

[29] The delegated and Implementing acts on the reporting of irregularities are under preparation.

(b) a **control report** setting out the main findings of the audits carried out in accordance with paragraph 1, including findings with regard to deficiencies found in the **management and control systems**, and the proposed and implemented corrective actions.

Where a common management and control system applies to more than one operational programme, the information required under point (b) of the first subparagraph may be grouped in a single report.

6. The Commission shall, in order to ensure uniform conditions for the implementation of this Article, adopt **implementing acts** laying down models for the audit strategy, the audit opinion and the control report. Those implementing acts shall be adopted in accordance with the advisory procedure referred to in Article 150(2).

7. The Commission shall be empowered to adopt **delegated acts**, in accordance with Article 149, to set out the scope and content of audits of operations and audits of the accounts and the methodology for the selection of the sample of operations referred to in paragraph 1 of this Article.

8. The Commission shall be empowered to adopt **delegated acts**, in accordance with Article 149, laying down detailed rules on the use of data collected during audits carried out by Commission officials or authorised Commission representatives.

<u>Article 148 - Proportional control of operational programmes</u>

1. Operations for which the total eligible expenditure does not exceed EUR 200 000 for the ERDF and the Cohesion Fund, EUR 150 000 for the ESF or EUR 100 000 for the EMFF shall not be subject to more than one audit by either the audit authority or the Commission prior to the submission of the accounts for the accounting year in which the operation is completed. Other operations shall not be subject to more than one audit per accounting year by either the audit authority or the Commission prior to the submission of the accounts for the accounting year in which the operation is completed. Operations shall not be subject to an audit by the Commission or the audit authority in any year if there has already been an audit in that year by the European Court of Auditors, provided that the results of the audit work performed by the European Court of Auditors for such operations can be used by the audit authority or the Commission for the purpose of fulfilling their respective tasks.

...

4. **Notwithstanding paragraph 1**, the audit authority and the Commission may carry out audits of operations in the event that a risk assessment or an audit by the European Court of Auditors establishes a specific risk of irregularity or **fraud**, in the case of evidence of serious deficiencies in the effective functioning of the management and control system of the operational programme concerned, and, during the period referred

to in Article 140(1). The Commission may, for the purpose of assessing the work of an audit authority, review the audit trail of the audit authority or take part in the on-the-spot audits of the audit authority and, where, in accordance with internationally accepted audit standards, it is necessary for the purpose of obtaining assurance as to the effective functioning of the audit authority, the Commission may carry out audits of operations.

Annex 2- List of the seven assessment criteria under Key Requirement No 7: Effective implementation of proportionate anti-fraud measures

7.1 Carry out a fraud risk assessment

Before beginning programme implementation, managing authorities must carry out an assessment of the impact and likelihood of fraud risks for the key processes in the implementation of the operational programmes. This fraud risk assessment should ideally be repeated annually or every two years, depending on risk levels. The results of the fraud risk assessment should be endorsed by the senior management of the managing authority.

7.2 Anti-fraud measures must be structured around four key elements in the anti-fraud cycle: prevention, detection, correction and prosecution.

7.3 Adequate and proportionate preventive measures, tailored to the specific situations

These measures need to be in place in order to mitigate the residual risk of fraud to an acceptable level. (They may include a mission statement, a code of conduct, the tone set by the senior management's communication, the allocation of responsibilities, training and action taken to raise awareness, data analytics, and up-to-date awareness of fraud warning signs and fraud indicators).

7.4 Appropriate detective measures of 'red flags' are in place and effectively implemented.

7.5 Adequate measures are in place once a suspected case of fraud is detected.

These measures ensure clear reporting mechanisms for suspicions of fraud and for control weaknesses, requiring appropriate coordination with the audit authority, the competent investigative authorities in the Member State, the Commission and OLAF.

7.6 Adequate procedures for appropriate follow up of any potential recoveries of EU funds spent in a fraudulent manner

7.7 Adequate follow-up procedures to review any processes, procedures and controls connected to potential or actual fraud

Follow-up procedures must be in place to review any processes, procedures or controls connected to potential or actual fraud and should feed into subsequent reviews of the fraud risk assessment.

Annex 3 - An example of a Fraud Response Plan produced by a national authority

Below follows an example of the fraud response plan produced by the ERDF audit authority in Ireland.

1. Introduction & Definition of Fraud

1.1 This 'Fraud Response Plan' has been prepared as a procedural guide for the staff of the ERDF Audit Authority with the objective of ensuring that timely and effective action is taken in the event of identifying fraud or attempted fraud in the performance of our statutory functions set out under Article 62 of Council Regulation (EC) No 1083/2006.

1.2 As a unit within the Department of Public Expenditure and Reform, the ERDF Audit Authority is bound by the Department's zero tolerance towards fraud.

1.3 Article K.3 of the Treaty of the European Union on the protection of the European Communities' financial interests defines "fraud" in respect of expenditure, as any intentional act or omission relating to:

> *"the use of 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"*

2. International Auditing Standards

2.1 Article 127.3 of Regulation (EU) No 1303/2013 states that the audit authority should ensure that audit work takes account of internationally accepted audit standards. ISA 240 on the auditor's responsibility relating to fraud in an audit of financial statements outlines in paragraph 4 that the primary responsibility for the prevention and detection of fraud rests with those charged with the governance of the entity and management.

2.2 Paragraph 8 of the same ISA states that the auditor should always maintain a professional scepticism throughout their audit work with regards to fraud.

3. Initial Reporting and Assessment of Fraud

3.1 Should ERDF auditors in the course of their work identify what they believe to be a potential fraud, they should report this immediately to their line manager (usually Audit Manager) who should in turn promptly inform the Head of the ERDF Audit Authority.

3.2 The Audit Manager / Head of ERDF Audit Authority should immediately report the fraud or suspected fraud to the Head of Internal Audit or Chief Executive Officer (or person of similar rank) of the body being audited.

3.3 Line management should not undertake preliminary enquiries until any suspicion has been reported to and advice taken from the audited body's Internal Audit/CEO. It is imperative that enquiries should not prejudice subsequent investigations or corrupt evidence.

3.4 Depending on the body being audited and this body's own Fraud Response Plan, the Head of Internal Audit or Chief Executive Office should advise on an internal or external initial fact finding exercise to determine if there is reasonable suspicion that a fraud has occurred. This exploration of the facts should be carried out discreetly and as speedily as possible after the suspicion being raised.

3.5 If the preliminary enquiry finds that a fraud has not been attempted nor perpetrated but internal controls were deficient, such an occurrence should be included as a finding in the systems audit or operations audit report. It should also be recommended that management should review their controls systems with a view to ensuring they are adequate and effective

4. Formal Reporting Stage

4.1 If the preliminary enquiry confirms the suspicion that a fraud has been attempted or perpetrated, the audited body's management should be advised that all original documentation (including electronic documentation) is preserved in a safe place for further investigation. This is to prevent the loss of evidence, which may be essential to support subsequent disciplinary action or prosecution.

4.2 A brief note should also be prepared by the Audit Manager on the evidence from the ERDF Audit Authority's work which identified the fraud. This note should be immediately forwarded to the audited body's Head of Internal Audit / Chief Executive Officer and the Programme Managing Authority. Information to be included in this note would involve:

a brief description of the circumstances surrounding the suspected fraud,
means of discovery,
approximate value,
the name(s) of suspected perpetrator(s).

4.3 Where the fraud may have been perpetrated externally, the ERDF Audit Manager should advise the audited body management of the need to inform other government departments / bodies that have an interest or may be affected.

4.4 ERDF Audit Authority staff should take no further action in relation to the fraud investigation or any legal proceedings as primary responsibility for the detection of fraud rests with those charged with the governance of the entity and management.

4.4 If possible and to ensure progress is being made to achieve the European Commission's statutory reporting deadlines, the operations or systems audit should continue to be performed. However, any individual (s) from the audited body suspected of being involved in the fraud should not provide any further assistance to ERDF Audit Authority staff and a request should be made to the audit body's management to provide an alternative official(s).

5. Results of the Internal Investigation

5.1 During the audited body's own internal investigation, the ERDF Audit Authority should maintain contact with the Head of Internal Audit / Chief Executive Officer and ensure that they immediately inform the ERDF Audit Authority of the results of the internal investigation.

5.2 If it is proved that a fraud occurred, brief details of this occurrence should be recorded in the draft systems or operations audit report including an estimated valuation of the fraud affecting the amount of total eligible / total public expenditure declared along with the ERDF co-financed element. As part of the contradictory reporting procedure, management of the audited body should be invited to comment on the fraud finding.

5.3 If the contradictory comments provide confirmation that a fraud has been perpetrated, the draft finding should be formalised in the final operations or systems audit report and a valuation put on the fraud including the co-funded amount. The final systems or operations audit report should also recommend that the Programme Managing Authority must complete an Irregularity Report for OLAF.

5.4 If the internal investigation confirms that a fraud has not been attempted nor perpetrated but internal controls were deficient, such an occurrence should be included as a finding in the systems audit or operations audit report. It should also be recommended that management should review their controls systems with a view to ensuring they are adequate and effective

6. Liaison with the An Garda Síochána (Ireland's National Police Service)

6.1 Before the internal investigation has been performed, the ERDF Audit Authority should advise management of the audited body to inform An Garda Síochána of all cases of suspected fraud. This is to facilitate the prompt and effective processing of investigations in cases of suspected fraud.

7. Other Reporting

7.1 Once confirmed that a fraud has been perpetrated, should the body involved be a public body (a body receiving 50% of its financing from the State), then the ERDF Audit Authority should advise the body to report the fraud to the Comptroller and Auditor General (the supreme audit institution in Ireland).

7.2 If the audited body has received the funding subject to the fraud from within one of the NSRF operational programmes and there exists an Intermediate Body in the next step of the cascade, they should also be advised to inform this Intermediate Body of the fraud.

7.3 If the body being audited has an Audit Committee, it should be advised to inform the Audit Committee of the circumstances concerning the fraud and seek the Committee's advice/approval for any follow up or disciplinary action.

8. Recovery of Losses

8.1 Once the fraud (on declared expenditure to the European Commission) has been quantified and referred to in the final operations and systems audit report, the report should be copied to the Programme Certifying Authority where the fraud incident will be included in the Annex XI Recoveries and Withdrawals statement prepared on 31st March each year.

8.2 The Programme Certifying Authority will be responsible for ensuring that the total eligible and total public amount of the fraud that has been reported as an irregularity is recovered from the audited body or the programme.

8.3 Any further losses resulting from the fraud not involving the co-funded operation being audited should not be followed up by the ERDF Audit Authority. These are a matter for the management of the audited body.

9. Follow-up Action

9.1 Following on from any internal fraud investigation, the Managing Authority should be advised to review the systems in operation at the body involved for the potential for any systemic risk. The review should examine the current fraud risk arrangements to determine if there is any action needed to strengthen controls and therefore reduce the risk of another fraud in future. The ERDF Audit Authority should be advised of any systemic impact.

9.2 Should there be potential for systemic frauds and irregularities, the ERDF Audit Authority should invoke the procedures agreed with the Managing Authority for following up on systemic errors.

10. Dealing with Enquiries from the Media and Others

10.1 ERDF Audit Authority staff must not discuss any aspect of the fraud investigation with the media or others as this may seriously jeopardise any future disciplinary action or criminal prosecution.

10.2 All enquiries from media sources about suspected or actual cases of fraud must be referred to the audited body's Head of Internal Audit or Chief Executive Officer.

10.3 ERDF Audit Authority staff must not communicate any details of the fraud to any person not officially involved in the investigation.

Annex 4- Examples of red flags to consider during audits of operations for the ESF programme

These examples were produced by UK DWP.

1. high performance / results
2. high levels of hospitality spending (look out for specific spending by one member of staff or specific employees)
3. performance spikes in a geographical area or specific to individual or groups of employees
4. incentive/reward/bonus schemes for contractor employees
5. incentive payments (including vouchers) to participants
6. poor financial controls including on petty cash, vouchers, bonus payments and travel expenses
7. high volume of participant complaints
8. high volume of people spending short periods on the programme followed by successful employment placements (look out for specific contractor and/or internal staff involvement indicating potential collusion)
9. high volume of placements with same employer
10. evidence of sharp practice
11. evidence of insufficient pre-employment checks on contractor employees (potential risk of hiring staff with criminal records for fraud)
12. performance spikes in a geographic area or related to specific contractor employee(s)
13. concerns about culture, especially where the culture appears to be risk-taking – and driven by tough targets, and where sharp practice is condoned by management
14. high staff turnover or movement of contract managers from one contractor to another

15. difficulty obtaining information, for reason such as the information being not available, at another site, with the accountant, accidentally destroyed or missing

16. poor quality of participant files, indicating lack of compliance

17. spelling mistakes, incorrect dates or incorrect dates of birth

18. national insurance numbers, other references and telephone numbers in an incorrect format

19. pre-signed uncompleted documents

20. generic reports for participants

21. similar signatures or handwriting

22. similar employer stamps

23. identified inconsistencies or non-compliance, with this being rationalised as the norm, or an accepted work around which has perceived management support.

Annex 5- Table of potential inputs for auditors in preventing and detecting fraud in system audits and operations audits

(Not exhaustive)

Role of auditors	Fraud prevention	Fraud detection
System audits *Audit role*	▪ testing the anti-fraud measures in place; ▪ testing the response given by the managing authority when it detects fraud; ▪ setting up red flags when there is a risk of fraud.	▪ identifying indicators of fraud.
Advisory role	▪ participating in setting up a national anti-fraud strategy, by sharing their knowledge ;giving advices to improve the legislation in place; ▪ taking part in training based on their knowledge and experience.	▪ reporting weaknesses or deficiencies; ▪ formulating appropriate recommendations or corrective measures for the management or certifying authorities.
Audits of operations *Audit role*	▪ identifying and evaluating all internal and external risks that could result in fraud; ▪ using their knowledge to identify fraud indicators; ▪ cooperating with the managing authority and with those in charge of fraud investigation, by providing information, conclusions and findings to improve fraud prevention.	▪ introducing targeted audits of operations, based on fraud risks; ▪ detecting indicators of fraud; ▪ following steps outlined in agreed fraud response plan if fraud is suspected
Advisory role	▪ using their experience to disseminate their knowledge to stakeholders and to raise awareness of fraud; ▪ creating a list of of fraudulent practices detected during their audits to spread fraud awareness.	▪ reporting weaknesses or deficiencies to the competent authority without delay, or at least as soon as practicable; ▪ if appropriate, drawing up recommendations to avoid future fraud.