Casebook of **OLAF investigations** in the field of **external aid**

EUROPEAN ANTI-FRAUD OFFICE

Europe Direct is a service to help you find answers to your questions about the European Union.

Freephone number (*):

00 800 6 7 8 9 10 11

(*) Certain mobile telephone operators do not allow access to 00 800 numbers or these calls may be billed.

More information on the European Union is available on the Internet (http://europa.eu).

Cataloguing data can be found at the end of this publication.

Luxembourg: Publications Office of the European Union, 2012

ISBN 978-92-79-25394-2
doi:10.2784/59230

Printed in Belgium

PRINTED ON TOTALLY CHLORINE-FREE BLEACHED PAPER (TCF)

The European Union together with its Member States is the world's largest donor of official development assistance (ODA). In 2010 alone, the EU and its Member States provided EUR 53.8 billion, which is more than 50 % of global aid. The European Commission itself is responsible for the management of around EUR 11 billion of aid per year.

For aid to be effective, it is first of all important that the funds disbursed reach those who need the aid. Any diversion of resources from the activities foreseen to address poverty reduction and sustainable economic development is not only prejudicial to the financial interests of the European Union as a donor, but also to the effectiveness of the EU's aid policy. This is why the fight against fraud, corruption and other irregularities must involve all members of staff with responsibilities for implementing the EU's external aid budget.

In 2011, the Commission adopted its new anti-fraud strategy, which aims at updating and modernising the way fraud against the EU budget is tackled within the Commission. The objective is to ensure that the EU budget is managed in line with the principles of sound financial management including the prevention of, and fight against, fraud.

I am glad to introduce to you one of OLAF's key deliverables in the context of that new strategy, this *Casebook of OLAF investigations in the area of external aid*. This casebook complements similar compendia that OLAF has produced earlier in the areas of research and structural actions.

Of course, fraud is a highly complex phenomenon, and it is difficult to eliminate it completely. Furthermore, fraudulent methods evolve rapidly. Nevertheless, we can win many battles in the fight against fraud by raising the awareness of staff on where fraud risks lie, and by increasing the ability of the spending departments to detect and deal with serious irregularities.

This casebook is aimed at staff responsible for the administrative and financial management of EU grants and contracts in the field of external aid. OLAF shares information on fraud patterns, modi operandi, vulnerabilities and fraud indicators and this document includes an analysis which puts forward a series of fraud indicators or red flags related to each type of fraud. By following the sequence of the expenditure lifecycle, staff working in operational and financial departments can use these red flags to identify potential problems and prevent or reduce financial damage. Becoming familiar with the red flags associated with every step in the expenditure lifecycle is an important measure of fraud prevention.

The casebook is, therefore, a tool which will help staff managing EU external aid funds within Commission services and implementing partners, such as non-EU countries and international organisations, to carry out better targeted verifications and control measures, to detect, at an early stage, signs that fraud may be present and to prevent damage to the EU's financial interests.

Algirdas Šemeta
European Commissioner for Taxation and
Customs Union, Audit and Anti-Fraud

In the 12 years since the creation of the European Anti-Fraud Office (OLAF), we have conducted investigations in many of the countries receiving development and humanitarian assistance from the EU budget and the European Development Fund (EDF). Drawing on its investigative experience, OLAF has amassed considerable knowledge of fraud patterns, modus operandi and fraud indicators related to the implementation of external assistance funds.

This casebook brings together information and lessons learnt from over a hundred cases selected and analysed by OLAF staff specialised in fraud prevention. It aims to become a practical tool to be used by the actors involved in the management of EU funds for the purpose of developing better and more efficient fraud prevention and detection methods.

OLAF has recently changed its organisation and working methods with a view to achieving increased efficiency, transparency and accountability, and closer links with Commission services and other EU institutions. These changes reflect OLAF's unique position within the Commission, conducting administrative investigations in all EU institutions and bodies, including the European External Action Service and the European Investment Bank, and playing a key role in the implementation of the Commission's anti-fraud policy. The recent changes make the distinction between OLAF's role in policymaking and its investigative role clearer, while maintaining and promoting the synergies between the two.

In its new form, OLAF will continue to support the various services implementing the EU's external aid policies in drawing lessons from our investigative experience to ensure that the EU aid effectively reaches and benefits those who need it. The fight against fraud and corruption in the spending of EU money is an essential part of EU efforts to reduce poverty and foster development beyond its borders.

I am, therefore, particularly pleased to present to you the first *Casebook of OLAF Investigations in the area of external aid*, which complements OLAF's existing fraud prevention work illustrated by the compendia in the areas of research and structural actions.

Giovanni Kessler
Director-General of
the European Anti-Fraud Office

Table of **Contents**

Introduction

The Commission's Anti-Fraud Strategy(1), which was adopted by the Commission on 24 June 2011, aims to update and modernise the way in which fraud against the EU budget is addressed within the Commission with a view to ensuring that the EU budget is managed in line with the principle of sound financial management. Prevention and detection of fraud lie at the core of the strategy, which acknowledges fraud risk as part of the Commission's existing risk management process. Risk awareness and development of the necessary prevention tools are key elements in reducing the incidence of fraud related to the management of EU funds.

While the strategy confirms that fraud prevention and detection is primarily the responsibility of the authorising officers by delegation, it also emphasises the importance of the role of the European Anti-Fraud Office (OLAF). The Office will play a proactive and reinforced role, actively assisting the services in the development and implementation of fraud prevention policies.

To this end, OLAF has undertaken, inter alia, to share with Commission departments and other institutions involved in the management of EU funds the lessons learned from the results of investigative activities and fraud risk analyses. In particular, one key deliverable defined in the Communication from the Commission 'Prevention of fraud by building on operational results: a dynamic approach to fraud-proofing'(2) is a compendium, or a casebook of:

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

This casebook presents an in-depth analysis of OLAF's investigations in the field of external aid, following a consultation with the Commission departments responsible for implementing the EU external aid policies. The analysis focuses on fraud patterns, modi operandi, vulnerabilities and red flags and contains several illustrative anonymised examples. It follows the project management cycle and takes as a cut-off point the signing of the contract/grant agreement between the contracting authority and the contractor/beneficiary, grouping fraud categories according to the moment when they occurred (i.e. before or during the implementation of the project or contract).

---

(1) COM (2011) 376 final.

(2) COM (2007) 806 final.

The casebook has been designed to meet the fraud prevention needs of a wide range of users, mainly in authorising departments within the Commission and EU Delegations, the European External Action Service (EEAS), the European Investment Bank (EIB), third countries and international organisations, as well as OLAF and the Commission's Internal Audit Service (IAS):

- financial actors, such as initiating and verifying agents, and authorising officers by subdelegation;
- authorising officers by delegation responsible for management and control systems,
- internal audit capabilities (IAS);
- external audit units and external auditors;
- OLAF evaluators, investigators and analysts.

The information contained in this casebook can further feed into fraud prevention activities of individual directorates-general, such as:

- training for newcomers;
- raising awareness among experienced staff;
- taking decisions relating to risk management;
- improving control systems;
- setting priorities with regard to document verification, on-the-spot checks, audits, etc;
- helping OLAF evaluators to assess whether OLAF should open an investigation;
- conducting audits, OLAF investigations.

The analysis is based on information from over a hundred OLAF investigations. Although this casebook contains only a few illustrative examples in each fraud category, the entire database of anonymised cases in external aid is available online (http://myintracomm.ec.europa.eu/serv/enu/fraud-prevention/ToolBox/Documents/casebookext.pdf)

(Access is restricted to Commission staff only)

Fraud patterns, modi operandi and red flags in the **external aid** sector

1. Sector-specific assessment

The legal framework and practical arrangements for budget implementation vary from one policy sector to another, and even between spending programmes run by the Commission under direct management. Although certain fraud patterns are common to all sectors, this casebook focuses on the external aid policy field, in order to ensure that it is tailored to meet the needs of a specific group of users who are familiar with a given set of rules and practices.

The external aid sector accounts for 5.7 % of the EU budgetary commitments over the 2007-13 financial framework. However, the proportion of OLAF's investigations in the field of external aid out of the total number of external investigations (3) is much higher, as Table 1 shows:

Table 1: External aid investigations opened yearly by OLAF (4)

Year	External investigations in external aid	All external investigations	%
2007	58	128	**45.3 %**
2008	35	104	**33.7 %**
2009	29	101	**28.7 %**
2010	34	97	**35.1 %**
2011	28	110	**25.5 %**

Programmes in the external aid sector are funded from both the general budget of the European Union and from the European Development Fund (EDF), and they are implemented under various forms of management. In addition to the relevant Commission departments (the Directorate-General for Development and Cooperation – Europeaid, the Directorate-General for Humanitarian Aid and Civil Protection, the Directorate-General for Enlargement and the Service for Foreign Policy Instruments), the EEAS, the EU Delegations in third countries, the European Investment Bank, national public authorities in third countries that

(3) External investigations are administrative investigations carried out by OLAF outside the European Union institutions and bodies for the purpose of detecting fraud or other irregular conduct by natural or legal persons.

(4) *Source*: Internal OLAF statistics.

have a financing agreement with the Commission and various international organisations also play an important role in the implementation of EU funds.

Traditionally, the centralised direct management mode has been used for the majority of commitments for activities financed by the general budget of the European Union, whereas the EDF used to be associated more with decentralised management. In addition to thematic budget lines, certain regional programmes and, in general, activities financed by the general budget, the centralised direct management mode is also used for budget support, which represents an increasing proportion of the commitments under the EDF portfolio too.

From 2003 to 2009, the EU committed about EUR 13 billion in aid to third countries through budget support, which is about **one quarter of the overall amount of aid** committed during that period. ([5]) The EU provides budget support to countries that meet a number of eligibility criteria which are defined in the Communication from the Commission on The future approach to EU budget support to third countries. ([6]) Disbursements are conditional on continued adherence to these eligibility criteria and may also be subject to specific conditions reflecting result-based performance criteria and indicators.

Budget support is the transfer of financial resources from the donor directly to the national treasury of the partner country. The financial resources thus received become part of the global resources of the partner country and are then used in accordance with the public financial management of the partner country. Budget support may take the form of general budget support (i.e. to support a country's national development strategy), or sector budget support (i.e. to support actions in a particular sector).

From the point of view of prevention and detection, the implementation of budget support measures involves specific risks: because the funds allocated via budget support are fungible, they disappear in the domestic budget and their proper use can only be ensured and monitored by means of domestic tools. The Commission has no control over or power to monitor specific financial operations. The Commission can suspend or cancel further disbursements when cases of serious fraud or corruption are not handled efficiently by the third-country authorities. However, the financial impact of fraud on the EU funds cannot be established exactly (although EU funding can be expressed as a percentage of a given national budget sector) and the Commission has no way of recovering the defrauded amounts as such.

In this context, the efficient *ex ante* screening of a partner country's compliance with the eligibility conditions for receiving budget support as concerns its public financial management is critical. OLAF takes the view that it is essential for the Commission to thoroughly assess whether a country is actively fighting fraud and corruption and whether it is equipped

([5]) Green Paper on Budget Support (COM(2010) 586 final).

([6]) COM(2011) 638 final.

with the appropriate anti-fraud mechanisms to detect and combat fraud, in particular by judicial means, such as adequate inspection authorities and sufficient judicial capacities. The response of a country receiving budget support in cases of fraud and corruption should also be continuously monitored by means of a risk assessment framework, and failure to continue providing assurance should result in EU budget support being suspended until the authorities have taken appropriate action to prevent such fraud in the future.

Budget support is not the only risk area in external aid. As shown by the analysis of fraud patterns presented in Section 2, this sector is vulnerable to conflict of interests and corruption under decentralised management. Over time, OLAF has investigated a series of cases in which tenderers obtained access to privileged information before or during the submission stage, or were given preferential treatment at the evaluation stage. Most of these cases concerned procedures launched under decentralised management. This suggests that there is a need for better methods of raising awareness of fraud among third-country officials involved in managing EU funds on behalf of third countries, and for the active involvement of the EU Delegations in *ex ante* compliance checks, including endorsing the results of selection procedures and applying monitoring measures.

Irregularities in subcontracting is yet another area of concern; such practices entail the risk that the process of selecting a subcontractor will favour a particular entity which would not normally be in a position to win the contract. This casebook identifies a substantial number of cases where grant beneficiaries/contractors failed to observe the rules on further subcontracting of project activities (i.e. full subcontracting, no application of procurement procedures, failure to comply with the rules of origin, etc.). OLAF has also come across several cases in which the prior authorisation of the Commission for subcontracting under decentralised management had not been granted and yet the project was continued. In every case, better regular monitoring of the implementation of the project, as well as closer attention to a series of red flags which can point to the existence of predefined subcontracting, may have helped in detecting and correcting irregularities at an earlier stage.

Lastly, given the plethora of international donors, a particular risk for the external aid sector is double funding of activities. Sustained donor coordination and the regular exchange of information can help to avoid double-funding, while projects such as Transparent Aid (TR-AID) which consists of a database with information on projects funded by donors ought to be fully developed and used by financial staff. However, such coordination may be difficult to achieve with small national donors that are active, but not necessarily well known in the field.

2. Analysis of fraud patterns, modi operandi and red flags

OLAF has conducted an analysis of the fraud patterns detected in its investigations in the area of external aid. The analysis identifies the types of fraud occurring at each stage of the expenditure life cycle and the most frequent modi operandi associated with them.

The case-based information collected in the casebook reveals that particular types of fraud and irregularities seldom occur in isolation: cost inflation is normally accompanied by false invoices or irregular subcontracting procedures; product substitution takes place under false certificates of origin; irregular subcontracting is the result of the manipulation or incorrect application of tender procedures.

The analysis puts forward a series of red flags related to each type of fraud. Red flags are indicators that may identify irregularities or fraud. The presence of red flags, especially when more than one such red flag is detected in relation to the same project, should make financial staff more vigilant and lead to additional verifications (e.g. by using open sources, crosschecking with information obtained from other contracts, etc.). Where appropriate, the authorising officer by (sub)delegation should be informed of the presence of those indicators in order to adopt preventive/conservative measures, such as performing additional checks, requesting a suspension of payment, identifying the transaction and flagging it for random audit or second-level financial verification, going on the spot to collect evidence on the proper implementation of the action, or submitting the issue to OLAF.

Within the expenditure life cycle, each actor should be able to adapt the indicators provided by OLAF or any other sources (audit, other donors, etc.) to their own working reality which is determined by specific geographical trends, the cultural dimension of managing external aid, financial management in the Delegation, the kind of beneficiary or the type of contract.

By following the sequence of the expenditure life cycle, staff working in operational and financial departments can use these fraud indicators or 'red flags' to identify potential problems and prevent or reduce financial damage. Increased awareness of the red flags associated with every step in the expenditure life cycle is an important measure of fraud prevention.

This analysis follows the structure of the expenditure life cycle. Cases are grouped into two main categories (Table 2). The first category consists of cases of fraud occurring before the signature of the contract/grant agreement between the contracting authority and the contractor/beneficiary (i.e. before the implementation phase). The second category covers cases of fraud that occur after the contract/grant agreement has been signed (i.e. during the implementation phase).

Table 2: Types of fraud risks by stage in the expenditure lifecycle

Before implementation	During implementation

Risks are related to selecting the 'wrong' candidate/applicant
• False statements and/or false documents regarding operational and financial capacity, legal status, consortia
• Collusion with members of the contracting authority, bribes, information leaks, irregularities in the preparation of the call, selection and award
• Collusive tendering: bidders, offers, prices
	Risks are multiple
	• Inflation of costs
	  – Cost overcharging: false invoices, staff costs, double-claiming
	  – Ineligible expenditure: missing supporting documents, false documents, false reports, false declarations
	  – Embezzlement
	  – Irregular use of outturn
	• Irregular subcontracting
	  – Predefined subcontracting
	  – Full/excessive/unauthorised subcontracting
	• Irregular implementation/partial/no implementation
	  – No/insufficient implementation
	  – Product substitution
	• Double funding

3. Fraud patterns before the implementation of the project/contract

The number of observed cases involving irregularities and fraud before the contract/grant agreement has been signed is fairly small ([7]). However, this does not necessarily mean that fraudsters are less active at this stage, but rather that fraud may be more difficult to detect.

There are several types of fraud and/or irregularities which occur in the process and are related to the award of a grant or a contract. The most common concern at this stage is the risk that the process will favour a particular applicant/tenderer ([8]), that would not be

([7]) Exceptional retroactive funding where EU funds are delivered to support actions already started before the signature of the grant agreement is not taken into account for taxonomy purposes. However, those cases existed and could be identified on a need-to-know basis.

([8]) This analysis uses 'applicants' to refer to all the legal and natural persons submitting applications in order to obtain a grant. 'Tenderers' refers to all the economic operators which submit a tender in an open procurement procedure, but also to candidates participating in restricted and negotiated procurement procedures.

in a position to win the grant/contract under normal competition circumstances. If this happens, there has usually been a breach of one or more of the EU principles governing the award of grants and procurement contracts (i.e. transparency, equal treatment, non-cumulativity, no retroactivity, co-financing and no profit for grants and transparency, equal treatment, widest possible competition, proportionality and sound financial management for procurement).

Fraudsters may attempt to obtain preferential treatment at this stage by operating on their own (i.e. producing false statements or documents concerning their eligibility to win a particular grant/contract), by operating in collusion with the contracting authority side (i.e. taking advantage of undisclosed conflict of interests situations or the outright corruption of officials), or by operating in collusion with other candidates with the aim of distorting competition.

3.1. No collusion, fraudster operates alone

This category mainly includes irregularities committed by grant applicants/tenderers in order to present themselves in a better light. This behaviour most commonly consists of submitting false statements about the candidate's performance with regard to the various eligibility or exclusivity criteria, or even documents in the application/tender file that are blatantly false or falsified. An example is provided in Case study No 1.

CASE STUDY No 1:
False documents, no implementation

FRAUD PATTERN: An ineligible company submitted false documents to obtain an EIB loan and failed to implement the action and reimburse the loan.

The feasibility report failed to inform the EIB about a similar project for which the company had obtained financing from a different body several years earlier; this previous project was never carried out.

In order to release the first instalments of the loan, the company had to prove that it had already paid its own contribution to the project; false accounting documents were used, as the company had never possessed the capital it declared as its own contribution.

Furthermore, the company submitted false invoices from non-existent suppliers in order to conceal payments from the project accounts channelled to the personal accounts of its directors and shareholders.

VULNERABILITIES: No exchange of information between the various donors on unreliable economic operators — the company had applied the same modus operandi in a different project financed by a different bank 10 years previously; no opportunity to detect false documents; no thorough scrutiny of the capital structure of the company.

RED FLAGS: Weak financial capacity of a loan applicant; declaration of own contribution does not correspond to the capital owned by the loan applicant as reported in public databases; false invoices; company not known in the particular sector of activity; cross-checking reveals major omissions/inconsistencies in the past activity reported by the applicant; delays in implementation.

When no supporting documents are required in order to prove that a candidate meets the eligibility criteria and is not in any of the fixed exclusion situations, there is a risk that the evaluators may be confronted by false statements. **Unlike false/falsified documents, the falsity of declarations may be particularly difficult for the evaluator to detect at this stage**. Most of the time, the indicators (red flags) associated with the presentation of false information only come to light during additional verifications which can be carried out by the evaluator using internal sources of the Commission or open sources. **Ideally, such basic checks should be carried out on a random basis, including on the applicants/tenderers that have not been short-listed or approved for EU funding,** as their participation in the call for proposals/tender contributes to the evaluators' overview of the pool of eligible beneficiaries and contractors.

As staff in charge of checking eligibility and selection criteria often work to tight deadlines, they do not necessarily carry out additional checks. **Over-reliance on the statements made by applicants/tenderers, however, is a serious vulnerability**. Additional verifications cannot be carried out for each and every application/offer received, but if checks following a fraud risk analysis or at least random checks are performed regularly, this type of fraudulent behaviour can be detected. The incontestable advantage of detecting such fraud in the early stages (before award) is that it avoids incurring any financial damage. Such fraud may be detected at a later stage in the expenditure lifecycle, but that involves the additional burden related to establishing its financial impact and recovering the unduly paid funds and, in many cases, to cancelling the call and renewing the procedure.

The following red flags may indicate that the candidate is omitting relevant information or misrepresenting the reality:

False statements — RED FLAGS
› REGARDING THE OPERATIONAL AND FINANCIAL CAPACITY
Entity is not known in the field of activity
Inconsistencies in the presentation of past activities (cross-checking with Commission internal or open source information reveals important omissions or other inconsistencies with the past activity reported by applicant/candidate)
Inconsistencies in the presentation of CVs of staff involved in action or work programme (cross-checking with Commission internal or open source information reveals that CVs may have been tailored to the call)
References to publications in the specialised press cannot be found online
Weak financial capacity — inconsistencies in the reported turnover (cross-checking with public registries of legal entities depicts significantly different figures)
Inconsistencies in the reported number of staff (cross-checking with public registries of legal entities reveals significant differences in the figures)
Inconsistencies between the report presented and the general presentation of the applicant on their web page
Web page of applicant/tenderer does not correspond to the image given in the application/tender or is not up to date
Excessive dependency on EU funding
› REGARDING THE LEGAL STATUS/STRUCTURE OF THE APPLICANT
Other entities with similar names and unclear legal status (i.e. not-for-profit v profit-making, SMEs v non-SMEs, research institutes v companies, etc.) are registered at the same address or have the same telephone number
Other entities with unclear or different legal status (see above) have the same legal representatives/managers
Entity is not registered in the local/national public registry
Entity is registered in local/national public registries in a different field of activity
Other public databases reveal that the entity is dormant (last known activity dates back a long time)
› REGARDING THE CONSORTIA
Partner does not exist or is inactive (cross-check)
Partner is not eligible for funding
Partner is linked to main applicant (same names appear in the management structure; similar company/NGO names; similar address; similar phone number)
Additional red flags raised at implementation stage: one NGO is replaced or withdrawing from implementation
Additional red flags raised at implementation stage: one partner incurs disproportionately high expenses compared to the other(s)
Additional red flags raised at implementation stage: representatives of one partner do not attend any project progress meetings

Another category of fraud refers to false or falsified documents. The call for proposals/tender specifies a series of documents which must be provided in the application file. The evaluator may also request additional documents. These documents typically refer to certificates issued by various public authorities (i.e. to certify that the applicant/candidate is not in any of the exclusion situations), audit certificates or audit reports issued by external auditors or financial statements. **An important vulnerability when confronted with this type of fraud is the lack of skills of the staff to detect false or falsified documents when evalutating the offers.** Nevertheless, some typical errors or inconsistencies in the documents presented may indicate that they are false or have been falsified.

False/falsified documents — RED FLAGS
› OFFICIAL DOCUMENTS ISSUED BY PUBLIC AUTHORITIES
Typos: the presence of typos may indicate that the document is not official; documents are often in a language which is outside the range of languages spoken by the evaluators, hence random checks could be performed
Dates: document is dated a long time ago
Tampering: additions, different colour, etc.
Inconsistencies concerning numbering, dates, names, etc.
Headings of a ministry that is not competent to deliver the certification
› AUDIT CERTIFICATES OR AUDIT REPORTS ISSUED BY EXTERNAL AUDITORS
Audit certificates issued by unknown/local auditor with no credentials (cross-check reveals external auditor is not registered, not active or registered in a different field of activity)
Unprofessional presentation of certificates
Proforma content not fitting the facts
Content not linked to the project itself (wrong name, wrong figures)
Typos (may indicate certificate is falsified)
Inconsistencies in dates
› FINANCIAL STATEMENTS AND ACCOUNTING DOCUMENTS
Declared turnover does not correspond to information found by random cross-verification of public databases
Declared number of permanent staff does not correspond to information found by random cross-verification of public databases
Company does not exist/has no recent activity recorded in public registries
Outdated/inconsistent presentation of company activity on the Internet
Declaration of own contribution does not correspond to the capital owned by the applicant (as recorded in public databases)

3.2. Collusion with contracting authority — conflict of interests, corruption

This category mainly comprises irregularities committed by a tenderer that has access to privileged information or is favoured during the selection process by public officials working for the contracting authority (typically the evaluation committee). Restricted and negotiated procedures are particularly vulnerable to such irregularities.

The grant applicant/bidder may actively approach, or be approached, by members of the contracting authority, either directly or via intermediaries, in order to propose/receive requests of bribes or kickbacks against privileged information or preferential treatment before or during the selection process. **This type of behaviour is very difficult to detect if both sides are cooperating, as they will attempt to carefully conceal the exchange. Nevertheless, third parties may become aware of the arrangement/attempt to bribe and sound the alarm.**

Another way of securing access to privileged information or preferential treatment is if the applicant/candidate and a public official of the contracting authority have shared interests — such as family, business, etc. Although more tangible than the instances of corruption, in the sense that information about the public official's shareholding, board membership, investments or their family connection with the applicant could be revealed by searching for it, conflict of interests is difficult to deal with because concealing it only requires omitting to report this information or falsely declaring that no conflict of interests exists.

Conflict of interests can be at the source of various modi operandi to secure access to privileged information and a preferential treatment: technical specifications and other information about the tender/call may be leaked in advance, allowing the preferred bidder to tailor its offer to maximise compliance; information about the call may be inappropriately published so that it does not reach other competitors; tender procedures may be ignored or circumvented; competitors may be eliminated on unjustified grounds; revealing information on tenders received thus enabling a tenderer to modify its bid after the deadline for submitting tenders; accepting a bid that does not respond to the requirements or comes from a bidder that has a history of very poor performance in other contracts; planting artificial tenders.

One type of modus operandi that is difficult to detect is exercising influence on decision-makers via the intervention of third parties. In this situation, the bidder does not have any direct contact with officials of the contracting authority, but uses the 'services' of consultants or lobbyists, for which he usually pays a success fee representing an agreed percentage of the contract value, such as was the case in the Case study No 2 below:

CASE STUDY No 2:
Leak of information

FRAUD PATTERN: A European company working in the field of building infrastructures paid a fee to a lobbyist in exchange for privileged information about a call for tender.

The lobbyist had access to one of the members of the evaluation committee with whom he had previously worked. The member of the evaluation committee disclosed internal information which enabled the company to submit a cheaper offer than any of the other bidders. The arrangement was that the risk of presenting a cheaper offer would be offset during implementation by amendments to the contract.

VULNERABILITY: Lack of technical expertise to assess the case for agreeing on signing riders to the contract.

RED FLAGS: Particularly cheap offer. Contractor requested a contract rider shortly after the start of the works.

The following red flags may highlight the existence of a non-disclosed conflict of interests, which, apart from constituting an irregularity, may indicate corruption.

Conflict of interests and corruption — RED FLAGS
> BRIBERY AND KICKBACK INDICATORS
Recipients break procurement rules or attempt to influence subordinates to ignore standard procedures (see below)
Close socialisation between an official from the contracting authority and a bidder
Unexplained or sudden increase in wealth of an official from the contracting authority
Contractor has a reputation in the industry for paying kickbacks
Undocumented or frequent changes to contracts which increase the value of the contracts
Official from contracting authority declines promotion to a position which is not linked to procurement
Conflict of interests declaration is missing (9)

(9) Undeclared conflict of interests situations may lead to the manipulation of tender procedures at different stages before the award.

> PREPARATION
Same persons working on specifications for several years
Vague specifications
Specifications and Terms of Reference (ToR) copied from previous contracts
ToR establishing a quasi de facto monopoly (listing experience, skills or data which identify a reduced number of possible bidders)
Very detailed specifications (including brands)
Long decision circuits (signatures of a large number of persons)
Consultation of economic operators or individuals to 'help' staff of the contracting authority to prepare specifications
Inappropriate contacts between contracting authority representatives and potential bidders at the preparation stage
Questions, contacts from interested tenderers before the publication of the tender
Restricted local market
Highly specialised procurement
Deviation from normal financial circuits
Undocumented amendments to draft terms of reference
> PUBLICATION
Requests for information before or immediately after the publication of the call
Questions not based on published version of call
Shortened time span for bidding process (e.g. request on a Friday for a bid to be sent the following Monday)
> SUBMISSION
Submission on the first day of the time period detailed in the publication (indicates prior knowledge of the content)
Submission on the last day of the time period detailed in the publication (may indicate alteration of the draft bid depending on the other bids already received by the contracting authority)
Backdating of submitted offers when these are not submitted by postal mail or registered mail
Similar layout and signatures in different proposals
Small number of proposals
Unusual spread of offered prices
Missing documents
'Perfect' proposals
Participation of a single tenderer/receipt of one single eligible offer in a tender procedure
Unusually cheap offer (usually followed by the contractor requesting a contract rider shortly after the start of contract execution)

Documents proving the applicant's eligibility are missing
Family names in application file correspond to family names of members of the evaluation committee
Signatures on the availability and exclusivity statements of experts pre-date the publication of the tender
'Artificial' bids: bids from non-existing companies (specific indicators: same spelling mistakes in different offers; same address and/or telephone numbers in different offers)
> EVALUATION, NEGOTIATION AND AWARD
Very few bidders shortlisted
Professional background of evaluation team members points to a possible conflict of interest with applicants
Evaluation team member fails to submit the declaration on conflict of interests
Significant difference between the negotiation result and the initial proposal
Recurrent winner of procurement procedure
The lowest complying bidder is not selected
Inappropriate contacts between contracting authority representatives and bidder(s)
Significant arithmetical errors in the selected bid — after correction, large percentage increase in total price of the offer
CV of evaluator(s) indicate recent prior employment in one of the companies participating in tender
Dissolution of the evaluation committee after the first evaluation (in order to ensure a result different from the evaluation)
Non-winning bidders report inappropriate contacts from officials
Complaints from other bidders
Awarded contract includes items not previously contained in the bid specifications
Deviation from normal financial circuits (e.g. transfer of the first tranche before or immediately after the signature of the contract)
Contract riders requested shortly after signature

Because **it is difficult to detect collusion between a tenderer and an official** working or having a close relationship with the project, **the prevention of conflicts of interest must rely primarily on raising awareness among officials and private companies/NGOs**. Information about corrupt/conflict of interests practices is most likely to be revealed by third parties (other officials, (ex-) partners of the officials, other bidders) who are best placed to notice their existence. It is, therefore, essential to create positive incentives and ensure the protection of whistleblowers.

In 2007 and 2008 OLAF identified a systematic fraud scheme involving consultants selling confidential information about upcoming contracts to their clients. This information, which was obtained from the Commission via illegitimate actions, was used by the consultants' clients to prepare bids for the upcoming contracts. The consultants themselves did not enter into contractual arrangements with the Commission and their company information was not recorded in the Commission's contract databases. The 'hidden consultant" had influenced the preparation of the projects and its terms of reference by lobbying and bribing staff working on the project. They also located experts for client companies who could carry out the assignment, prepared the proposals, and influenced the awarding of contracts for a success fee. The scheme relied on the complicity of staff involved in the preparation and implementation of EU projects. After some time, it became clear that this was a systemic phenomenon of corruption spread over as many as 30 cases recorded by OLAF.

The EU external aid sector may be particularly vulnerable to the risk of conflict of interests and corruption under decentralised management ([10]) due to the fact that the staff responsible are not subject to the same rewards and ethical requirements as Commission staff ([11]). Knowledge of existing corrupt practices or a high ranking of the third country managing the funds in international corruption indexes should result in **reinforced monitoring measures on the part of the EU Delegations** (more risk-based audits, greater diligence in endorsing the results of selection procedures, diligence in treating requests for contract riders, etc.). For important contracts, this may require a sound knowledge of the procurement market of the country in question.

The training of officials involved in managing EU funds on behalf of third country beneficiaries should systematically include fraud awareness. Similarly, if external consultants participate/assist in the pre-award stages of procurement procedures, they must also have followed proper training, be obliged to sign confidentiality agreements and be subject to reporting requirements if they notice any anomaly pointing to possible corruption or conflict sof interest. ([12])

In addition to awareness, **the following measures are recommended in order to reduce the risk of conflict of interests: evaluators should be rotated on a regular basis in order to avoid the development of clientelistic relations with economic operators active in specific sectors; failure to observe the requirement to declare any conflict of interests (i.e. signing false declarations) should be associated with dissuasive penalties; finally,**

([10]) Most cases in this cluster refer to contracts passed under decentralised management.

([11]) The Staff Regulations and Conditions of Employment of Staff provide for a number of requirements with which the staff have to comply and which should deter staff from transgressions. Moreover, several factors in the 'fraud triangle' (opportunities, pressures and justifications) that are necessary for fraud to appear occur more often and are stronger in the context of decentralised management. Examples are the absence of job security or social and fiscal advantages in the salaries of staff working on contracts under decentralised management.

([12]) The OECD has developed a set of guidelines for managing conflict of interests in the public service (http://www.oecd.org/dataoecd/51/44/35365195.pdf).

evaluators should be obliged to report any attempts to unduly influence the decision-making process in a tender procedure.

Staff should be made clearly aware that acceptance of any advantages offered by economic operators, even outside any procurement context, puts the staff member in a psychologically delicate position in relation to the company which has made an investment for which it will expect a return one day [13] and in relation to other companies, which will regard the person concerned as being potentially biased or, in the worst case, open to corrupt practices.

3.3. Collusion with other candidates

The third type of fraudulent behaviour at this stage is bid-rigging, or collusive tendering. This is when one candidate conspires with its 'competitors' in order to inflate market prices for the goods, works or services offered[14]. Those market sectors or geographical areas in which a restricted number of companies operate — such as large infrastructure works in difficult geographical areas and SME support in particular geographical areas — are particularly vulnerable to bid-rigging. Again, restricted procedures are more vulnerable to such irregularities than open procedures.

Bid-rigging usually includes one of the following modi operandi for distributing the profits obtained by collusive tendering among the conspirators:

- subcontracting the losing bidders to carry out parts of the contract by the tender winner;
- the rotation of offers in different calls for tender: the same group of colluding bidders apply and their offers are adjusted so that each one wins one or more of the calls;
- bidders in restricted procedures deliberately make weak but valid offers to favour a winning tender, contenting themselves with receiving 'backhanders' for having pretended to be competitors;
- artificial bidding, or bid suppression schemes, which are the result of agreements between competitors to withdraw a submitted bid so that the designated winner remains the lowest qualifying bidder
- market allocation: competitors agree to carve up the market and not compete against each other in certain areas.

---

[13] 'There's no such thing as a free lunch', meaning that one does not get something for nothing in exchange.

[14] The OECD has developed a series of guidelines to fight bid-rigging in public procurement (http://www.oecd.org/document/29/0,3746,en_2649_40381615_42230813_1_1_1_1,00.html).

Bid-rigging — RED FLAGS
> BIDDER-RELATED INDICATORS
Same supplier often wins
Any indications of market allocation (geographic allocation of winning tenders in the same sector)
Regular suppliers fail to bid on a particular tender, but continue to bid for other tenders
Unexpected withdrawal of bid
Rotating bids
Losing bidders subsequently hired as subcontractors
A company requests a bid package for itself and another competitor
A bidder does not appear to have the financial/technical capacity to complete the contract
Several bidders make similar enquiries about the bid
Losing bidders are fictitious: they cannot be found on the Internet, in business directories, etc.
> OFFER-RELATED INDICATORS
Identical mistakes (e.g. typos) in bid documents submitted by different bidders
Similar format (stationery, font, handwriting, etc.)
References to competitors' bids, other bidders' letterhead or fax number
Several offers faxed from the same fax number
Several offers posted from the same post office
Some bid documents appear to have been deliberately drafted in a negligent manner (indicating artificial bids)
Pricing
Identical miscalculations
Identical cost estimates
Financial offers in bids are distinct from one another by a systematic percentage (e.g. 1 %, 3 %, 10 %)
Financial offers in bids are too close together or too far apart (less than 1 % or more than 10 %)
Losing bid prices are in round or unusual numbers (e.g. EUR 350 000 or EUR 65 888)
Total bid price inflated compared with cost estimates (indicates cover price)
Sudden and identical increases in price or price ranges by bidders that are not justified by cost increases
Transportation costs quoted are similar in offers by local and non-local companies

4. Fraud patterns during the implementation of the project/ contract

4.1. Inflation of costs

Most cases in which irregularities were detected and submitted for investigation by OLAF concern fraudulent practices occurring during the implementation phase of the contract or grant agreement. It is also important to note that, in many of the cases in which fraud occurred in the pre-award and awarding phase, further irregularities/fraud were also committed in the implementation phase.

The bulk of the irregularities in this phase are related to the inflation of costs by the beneficiary. There are many types of modi operandi that a beneficiary can use in order to claim reimbursement for costs which were not incurred or are not eligible under the contract/ grant in question or to overcharge certain costs which were actually incurred.

(a) Cost overcharging

Beneficiaries incur costs and they submit claims for reimbursement based on them. When there is a discrepancy between the cost incurred and the amount claimed for reimbursement, there is a deliberate attempt to mischarge the contracting authority. This mischarging often occurs by means of falsifying invoices from providers or time-sheets of staff. It can also occur via product substitution, when the costs declared for a particular product do not correspond with the costs incurred because the product acquired is different from that specified in the contract (Section 4.3).

Labour costs are a particular category of inflated costs. Labour costs are more susceptible to overcharging than material costs because staff and external consultants usually work on several projects/tasks simultaneously. When external experts are hired to work on a project, the actual labour could be done by persons other than the experts specified in the proposal. Situations in which top key experts are replaced by less experienced experts may affect the quality of the end product and, consequently, result in overpayment by the Commission and a reduction in the actual costs for the service provider. The manipulation of time-sheets (by altering them or creating fictitious time-sheets) is a common practice. There is very little regulation of the mandatory content of time-sheets for fee-based contracts (Article 24.2 of the General Conditions to Service Contracts) and these documents are not standardised, with the result that each contractor can develop his own system for recording the time worked. **Such flexibility in the application of the contractual pro-**

visions related to time-sheets can lead to fraud. Payments should be validated only on verification that the procedures related to recording time worked are respected. Regular cross-validation of time recorded and other supporting documents (travel documents, etc.) could help in detecting anomalies.

Overcharging staff/labour costs — RED FLAGS
Time-sheets appear suspicious (copies instead of originals, scanned-and-printed or non-original signatures; dates on time-sheets do not correspond to dates of the work days claimed
Time-sheets are missing/incomplete
Contracts with individual experts cannot be found in the project accounts
Accompanying invoices documenting staff costs are not from the consultancy declared as subcontractor, but from a different company
Name of expert appears in several projects running concurrently (check for double funding)
Frequent/substantial replacement of experts
Labour charges are not consistent with the progress registered in the contract
Experts' names in final report do not correspond to the experts' names set out in the offer
Amount of time declared on time-sheets appears grossly inflated

Another vulnerability that needs to be highlighted is the frequent use of contract amendments or riders. This often occurs in contracts concerning infrastructure works for which longer contract periods are required. When negotiating amendments, the contracting authority is in a relatively weak position, as it does not have the same room for manoeuvre as in the stage prior to the conclusion of the contract itself. Moreover, the contracting authority is often under time pressure and dependent on the information provided by the contractor. Numerous expensive amendments to the contract could indicate weak or underperforming management, making irregularities and fraud more likely to occur.

One interesting modus operandi detected in several cases investigated by OLAF is the system of 'voluntary donations', applied by NGOs receiving EU grants. This consists of paying staff according to the budgeted levels specified in the grant agreement and subsequently cashing a return from staff members which the NGO then uses for a range of other purposes (organisational maintenance, other projects, private expenditure, etc.). When this is recorded in the NGO's accounts, it is registered as a 'donation' or 'voluntary contribution' from staff. Such practices are often difficult to detect — if the NGO transfers the full salary amount that is due to the staff members and subsequently requests a return in cash, there is little trace of the irregularity. This type of irregularity will not normally be picked up by a regular financial audit of financial transactions.

Overcharging staff/labour costs — 'voluntary donations' RED FLAGS
Knowledge of existing 'voluntary donations' or 'salary topping-up (2)' systems in the beneficiary organisation
Cash payment of salaries
Differences in salaries budgeted under the EU project and the general salary scale of the beneficiary organisation
Incidental discovery of voluntary donations which correspond exactly/closely to the difference above

The most frequent type of overcharging is the practice of submitting claims twice (i.e. co-mingling of contracts/grants). A beneficiary may submit claims two or more times to the same donor in the same project, under different budget categories. For example, administrative costs can already be included by the beneficiary in the salary costs, but also claimed separately as project overheads (indirect cost).

CASE STUDY No 3:
Inflated staff costs

FRAUD PATTERN: A UK-based expert involved simultaneously in 15 EU-funded projects systematically submitted double and triple payment claims for days worked on projects. As the expert was recruited via different consulting companies, these companies were not always aware of the double claims; the companies failed to check the work of the expert they contracted as a freelance and relied on the latter's statements.

The declarations of exclusivity and availability signed by the expert in relation to each of the projects were false.

VULNERABILITIES: The databases currently available do not allow the simultaneous participation of experts in several projects to be detected. The risk that an expert double-claimed days worked in several projects is high. Consulting companies do not have recourse to in-house expertise but mainly contract freelance experts on whom they do not carry out sufficient checks.

RED FLAGS: Name of expert appears in several projects running at the same time; amount of time declared on time-sheets appears grossly inflated; limited availability of experts with specific expertise recurrently needed; inconsistency between travel documents and work declared for projects.

(15) Salary top-ups are systems via which donor funds are used to make cash payments to national civil servants in order to increase the monthly pay of those civil servants above that of colleagues of the same grade and pay scale.

However, probably the most common type of double-claiming is when the beneficiary submits claims twice or even more often to the same donor in different contracts, or submits them to different donors (Section 5) such as in Case study No 3.

The following are a few typical pointers to the double claiming of costs.

Overcharging staff/labour costs — double claiming/co-mingling of contracts — RED FLAGS
NGO/contractor has many grants/contracts running simultaneously (similar products)
Names of experts appear in more than one contract
Contractor uses different time-monitoring systems for its regular staff and for staff contracted out to work as external experts in EU-funded projects
Salaries are paid in cash

In order to prevent such situations, **OLAF has recommended that the names of the key experts proposed, as well as all the members of a consortium who obtain a particular grant/contract, should be registered in CRIS (Common RELEX Information System).** As a first step, the Directorate-General for Development and Cooperation has submitted these names for framework contracts.

(b) Ineligible expenditure

The absence of supporting documents can often hide more serious irregularities, such as non-implementation, fictitious subcontractors, product substitution, etc. The fact that a beneficiary/contractor fails to submit the necessary supporting documentation or that there are major gaps in the supporting documentation submitted may itself be an indicator that closer monitoring is needed. The fact that payments were authorised even if (part of) the supporting documents are missing indicates a defective financial circuit mechanism and may even point to corruption in the contracting authority.

The same considerations apply to **false and falsified documents** (Case study No 4). A contractor/grant beneficiary would usually present false/falsified documents in order to cover up for other irregularities occurring during the implementation of the contract/grant agreement, such as:

- action not performed/or not performed according to the contractual provisions or rules (mainly product substitution);
- fictitious subcontractors;
- non-release of payments due to subcontractors;
- (for grants only) own contribution not committed;
- problems with the project audit process;
- costs claimed do not correspond to actual costs (cost mischarging);
- double funding (original sent to one donor, photocopy to another);
- embezzlement (money used for personal enrichment).

CASE STUDY No 4:
Falsified bank statements

FRAUD PATTERN: The local partner of an NGO, which received an EU grant, presented falsified bank statements as supporting documents in order to hide the misuse of EU funds.

Some of the funds received for the implementation of the project were used to reimburse loans relating to debts previously incurred by the NGO, and some were used to finance other branches of the NGO that were not involved in the funded project.

VULNERABILITIES: The audit did not uncover any suspect transactions; auditors were not able to detect falsified bank statements.

RED FLAGS: Large project implementation delays; poor quality of project output; missing or inconsistent supporting documents; weak financial situation.

The items most frequently encountered in the category of false/falsified documents are invoices, which are the main supporting documents for the release of payments. There are several typical indicators to which the staff verifying the supporting documents should pay attention, as they may indicate falsifications.

False/falsified documents — RED FLAGS
› INVOICES
Typos: the presence of typos may indicate that the document is not official; documents are often in a language which is outside the range of languages spoken by the evaluators, hence random checks could be performed
Dates: document is dated a long time ago
Tampering: additions, different colour, etc.
No acknowledgement of receipt for invoiced goods or services
Questionable purchase order, or no purchase order, for invoiced goods or services
Accounting records do not reflect the payment
Invoice prices, amounts, item descriptions or terms exceed or do not match contract items, purchase order, receiving records, inventory or usage records
Multiple invoices showing the same amount, invoice number, date, etc.
Submitted invoices are identical except for their serial number

Photocopied invoices (may indicate double funding)

Invoices do not contain full information (name, address, date of issuance, profession of the supplier)

Serial numbers and dates of multiple invoices presented do not match (i.e. chronological order does not appear logical)

Invoices do not describe purchases in sufficient detail

Cascade subcontracting (i.e. a grant beneficiary does procure services/goods directly from a contractor but uses a contractor who in turn subcontracts the services/goods)

Cash payments

Inconsistencies between invoices and other supporting documents (e.g. train tickets are submitted, but participants declare travelling by bus)

› AUDIT CERTIFICATES

Audit certificates issued by unknown/local auditor with no credentials (cross-check reveals external auditor is not registered, not active or registered in a different field of activity)

Unprofessional presentation of certificate

Typos (may indicate certificate is falsified)

Inconsistencies in dates

› OTHER SUPPORTING DOCUMENTS (CERTIFICATES OF ATTENDANCE, SUPPORTING TRAVEL DOCUMENTS)

Missing, incomplete or inconsistent supporting documents linked to travelling (no mission report, no boarding passes, etc.)

› DECLARATIONS

Name change of beneficiary could also indicate a change in the legal status of the entity

Invoices from the same subcontractor presented regularly, but no rebate/discount declared

(c) Embezzlement of funds/project property for private use through other means

Fraudsters are often motivated by a desire for personal enrichment. The modi operandi for misusing funds for personal enrichment range from retaining the difference between declared costs and real costs by submitting inflated false invoices to diverting the payments to banks in countries or areas that do not disclose information about account holders as happened in Case study No 5:

CASE STUDY No 5: Embezzlement

FRAUD PATTERN: An NGO misled several donors into paying amounts of money to its foreign accounts, claiming that human rights organisations could not be officially registered in the country concerned and could not receive funds in foreign currencies.

The Commission accepted the argument and paid the grant to a Swiss organisation holding a Swiss bank account. The funds committed by the donors were received on the account of a 'sister association' of the beneficiary NGO and subsequently transferred to a private commercial entity which had almost the same name as the grant beneficiary. The payments were declared as 'consultancy fees' but were in reality used for the purchase of private real estate and a vehicle. Once a new branch was established in another European country, a similar pattern was followed with a view to embezzling funds for private purposes. The beneficiary did not keep its accounting records by project or by donor; expenses incurred were recorded without any categorisation of projects or donors. Neither did the vouchers and supporting documentation bear any identification that would facilitate correlation with a project or a donor.

In the absence of donor-related accounting and separation of expenses, incomes, vouchers or documents, it was not possible to determine whether expenditure claimed to have been incurred for a given project was correctly accounted for in that project (double funding from different international donors, disbursement of smaller salaries to the project staff than stipulated in the grant agreement).

VULNERABILITIES: Accepting dubious requests to receive payments outside the entity's country of registration; absence of donor coordination.

RED FLAGS: NGO originating from a developing country requesting to receive the grant on a European bank account; inconsistent audit reports presented by the beneficiary.

The following indicators, although not specific only to this type of fraud, may point to cases of embezzlement.

Embezzlement — RED FLAGS
Lack of regular reporting
Delays in reporting/implementation
Missing/incomplete supporting documents (bank statements, etc.)
'Dedicated' bank account is with a bank outside the entity's country of registration or the country in which operational activities take place (especially Cyprus, Switzerland, etc.)
Inconsistencies in audit reports (different results if more than one audit; audit certifies all expenditure as eligible, but there is no supporting documentation)
Rental costs not in line with averages in the country in question
False/falsified documents
Fictitious subcontractors
Invoices contain suspicious details (e.g. ineligible items such as medical care)
Problems with procurement
Amount of expenditure in local currency corresponds exactly to the budget despite considerable alterations of the conversion rate over time
Complaints from suppliers claiming delays in payment
Large amounts of money disbursed in cash

(d) Irregular use of outturn: remaining assets are not returned to their owner

This category refers to the irregular use of the assets remaining or generated during a project. In external aid, such assets (equipment, buildings, etc.) should normally be returned to the beneficiary country once the project has ended. Although there was only one such case in the sample of analysed investigations, it is a case that had a significant financial impact and was spread over several third countries. The grant beneficiary was bound by contractual obligations to transfer dedicated equipment to the third countries in which the project was taking place. At the end of the implementation period, all equipment was transferred fictitiously to the third country authorities, but this transfer was followed by side agreements which allowed the NGO to continue using the equipment for other projects.

4.2. Irregularities in subcontracting

Apart from the presentation of false and falsified invoices, the most common type of irregularity occurring at the implementation stage is related to subcontracting.

With regard to grants it can be noted that, as the purpose of both procedures is to select a contracting partner, the nature of irregularities occurring in the awarding of subcontracts and the appointment of staff by the beneficiary displays a similar pattern to those occurring in the awarding of the contract by the contracting authority: the risk is that the process of selecting a subcontractor might favour a particular entity which would not normally be in a position to win the contract (i.e. predefined subcontracting). When this happens, the terms of the contract will most likely not conform to the best-value-for-money principle (i.e. the best price-quality ratio available on the market).

The procurement rules and thresholds are clearly communicated to all beneficiaries of grants and their application is a contractual obligation. However, **the system is vulnerable to fraud occurring at this stage especially because there is little or no control by the Commission/contracting authority over whether the procurement rules are being correctly applied.**

With regard to contracts, and especially contracts for consulting services to third-country authorities, etc. the context is different. Partial subcontracting is generally allowed, but subject to Commission approval. This approval requirement is designed to ensure that the quality of the offer, and in particular the level of expertise of the key experts named in the offer, is not diminished and that the tenderer to whom the contract was awarded is not replaced by another company. In this respect, full subcontracting would render the application of a strict tender procedure pointless.

Predefined subcontracting may occur for three main reasons:

(a) The beneficiary/contractor that must subcontract parts of the project/contract has an **economic or personal interest** in allocating the contract to a particular entity. In most cases, the beneficiaries' ownership partially or totally overlaps with that of the predefined subcontractor. In other cases, people in the close circle of the contractor's ownership are owners or managers of the predefined subcontractor. In all cases, the predefined subcontactor is selected via the non- or mis-application of procurement rules (no tender at all, split purchases or 'salami slicing', bogus tender, tender organised but no follow-up on results, tender organised but results are manipulated).

Predefined subcontracting is often linked with cascade subcontracting. In this scheme, instead of buying directly from a provider, the grant beneficiary/contractor relies on a contractor that purchases the services/goods from another contractor. Often the predefined subcontractors act as intermediaries between the contractor and the original supplier (especially for goods). Most often, this leads to the inflation of the original price, but it can also be a modus operandi used to hide the real origin of goods in order to comply with the rules of origin. A typical example is presented in Case study No 6:

CASE STUDY No 6:
Cascade subcontracting

FRAUD PATTERN: Certificates of origin falsely declaring eligible origin of goods supplied.

An Italian company (A) operating in the health and sanitation sector supplied goods of Chinese origin which were not eligible under the conditions of the contract. In order to hide the origin, the company declared to an Italian chamber of commerce that the goods were of Italian origin, indicating that it had purchased them from another Italian company (B). However, these goods were purchased from China by a company (C) which then sold them to (B), which acted as an intermediary. Companies B and C had the same ownership and they were also closely connected to the management of company A.

VULNERABILITIES: The false declaration was not made to the EU Delegation, but to the Italian chamber of commerce, which then issued the certificates on the basis of the information and draft certificates provided by the company. The modus operandi was very rudimentary: the intermediary company only replaced the boxes which contained the goods to hide their origin.

RED FLAGS: Indication of origin on products and packaging tampered with, overwritten, blackened or missing.

Another frequent consequence of predefined subcontracting is charging on the basis of fictitious invoices for costs which were not really incurred. In this modus operandi, the subcontractor does not deliver the goods/services, and part of the money paid for the fictitious goods/services is usually redirected to the contractor.

(b) **Subcontractors may also actively approach beneficiaries of EU grants/contracts**. For example, some consulting companies approach potential grant applicants offering to help write grant proposals. Once the grant is obtained, the beneficiary subcontracts a large part, or even, the entire implementation of the project to the consultancy in return for a mutually agreed management fee.

However, business consultants can also turn out to be shell companies, created with the sole purpose of redirecting the money for the personal enrichment of representatives of the contractor/beneficiary. In such a scheme, the consultant receives a success fee for assisting the contractor/beneficiary in the preparation of its application and later reappears as an important subcontractor in the project. The success fee is channelled in the form of bribes to individuals holding key positions in the contractor/beneficiary's structure.

Another typical modus operandi is the offering of rebates, as illustrated by Case study No 7. Under such a scheme, contractors establish a privileged relationship with one or more suppliers and receive in return important rebates (not declared to the contracting authority) or premia on the turnover related to EU funded purchases.

CASE STUDY No 7:
Cascade subcontracting

FRAUD PATTERN: An NGO awarded contracts to a company which, in turn, paid back 5 % of the total contract amounts. The NGO considered these payments as donations; for the company they were commission on turnover. The NGO charged the Commission for the full amount, thus making undue profit. Regular subcontracting would not have allowed a supplier to pay such commissions, which can be regarded as kickback payments. In fact, the same company also arranged procurement procedures for the NGO and requested suppliers to pay commissions, which were once again eventually charged to the Commission.

VULNERABILITY: Unclear legal situation with regard to commissions on turnover and the use of external procurement offices.

RED FLAGS: Prices of supplies not in line with market prices.

(c) Lastly — although this is less common — the contractor may not be intentionally involved in the misallocation of further contracts **because potential subcontractors are engaging in collusive tendering**, conspiring with one another in order to inflate market prices for the goods, works or services offered, as shown in Case study No 8.

CASE STUDY No 8:
Bid-rigging

FRAUD PATTERN: A district community centre receiving a grant under decentralised management launched a call for tenders in order to provide training via an external contractor. Both the district community centre and the winning tenderer committed irregularities. The district community centre failed to analyse market prices and conditions for the services to be provided. The evaluation and selection committee included members without the skills necessary to evaluate the offers submitted by the bidding companies and who were in an unclear situation as regards conflict of interests. The winning tenderer submitted a signed proposal on behalf of a second company, which was not aware of the submission. The subcontractor of the first company bid for the same tender under different company names to manipulate the perception of market conditions and increase the number of bids. The identity of the legal entities and the signatures in the bids were forged.

VULNERABILITIES: Lack of market research before launching the tender, which would have made it possible to estimate the approximate costs of the services, lack of skills of evaluation committee members, lack of supervision by the beneficiary of the grant.

RED FLAGS: Unjustified high prices, request for change of contract, low number of bidders, false documents.

Apart from predefined subcontracting, fraudulent contractors/beneficiaries may also engage in excessive or full subcontracting without obtaining the authorisation from the contracting authority. Although the contractor/beneficiary was selected via a competitive procedure on the basis of the quality-price combination of its offer, full or excessive subcontracting actually entrusts the implementation of the contract/project to an entity which would probably not have obtained the contract if it had itself participated in the competitive procedure. Usually, this scheme is employed in service contracts where consulting companies secure a large number of contracts on the basis of their good credentials, but fail to implement some of them, and subcontract smaller companies to do it instead. In service contracts such practices often result in product substitution (Section 4.3), because the experts announced in the offer are usually replaced, or the subcontractor does not have the relevant experience and credentials to carry out the job, etc.

CASE STUDY No 9:
Irregular subcontracting

FRAUD PATTERN: An NGO inflated costs by using the services of a linked commercial company. Representatives of a Member State non-profit NGO founded and ran a commercial company located on the same premises. Grants awarded to the NGO were partly implemented by the company and invoiced to the NGO. The services were provided without any procurement procedure and enabled the company to make a profit, which would not have been possible had the NGO implemented the grant itself.

VULNERABILITY: The control system did not detect irregular subcontracting by grant beneficiary.

RED FLAGS: Staffing of NGO does not permit implementation of large development projects; linked commercial company present on the premises of the NGO.

A particular vulnerability that became apparent in several OLAF cases was the **mismatch between the subcontracting provisions in the terms of reference for the selection of the contractor and the contractual provisions.** OLAF came across cases in which subcontracting was clearly not allowed under the terms of reference, meaning that all candidates were aware that, when preparing their offers, they would be expected to implement the project on their own. However, once the winning candidate had been designated, the contract stipulated that subcontracting was allowed as long as the contracting authority was informed. This mismatch allowed the contractor to have an unfair advantage over the other bidders.

Both predefined and full/excessive subcontracting are most often accompanied by a failure to respect procurement procedures (no tender at all, split purchases or 'salami slicing', bogus tender, tender organised but no follow-up on results, tender organised but results are manipulated). This is a major area of concern because the way in which contractors/grant beneficiaries select their subcontractors is largely outside of the control of the contracting authority. **One possible preventive measure would be the obligation on contractors/beneficiaries to submit substantial procurement related files and the selection of subcontractors to the contracting authority for endorsement. Important subcontracts passed by grant beneficiaries should always be verified to ascertain whether the cost incurred reflects local market prices. A thorough knowledge of market prices by EU Delegation staff is the best way to identify overcharging through irregular subcontracting.**

Predefined subcontracting — RED FLAGS
Cascade subcontracting
Addresses, names of managers/owners, telephone numbers and other contact details of contractor and subcontractor coincide/are very similar
Split purchases: amounts subcontracted are often just under the threshold for competitive procurement
Limited number of tender procedures to implement a project involving purchases for a substantial amount
Any indication that the subcontractor may be a shell company (subcontractor cannot be found in listings; has a non-existent or an incorrect address and/or phone number; is an offshore company)
Repeated awards to the same contractor
Documentation regarding the selection of subcontractors (tender, etc.) not kept or not provided to the contracting authority
Dubious certificates of origin or any other signs that the products do not comply with the rules of origin (may also indicate chain subcontracting)
Any sign of irregularity in tender procedures (fictitious bidders, identical mistakes in bid documents submitted by different bidders, similar format of bids, bids submitted from the same fax number, artificial bids, bids too close together or too far apart, etc.)
Inflated cost, not corresponding to local market prices
False/falsified invoices
Invoices received from individuals rather than companies

Full/excessive unauthorised subcontracting — RED FLAGS
Frequent replacement of some or all experts
Experts replaced immediately/shortly after start of the project
Important project reports appear to have been drafted by a subcontractor
Invoices for a suspiciously high overall amount are issued by the same subcontractor
Invoices do not provide a detailed breakdown of cost categories (vague items such as 'management/administrative fee' for large amounts should raise the alarm)
Invoices from a subcontractor not approved by the contracting authority
Long delays in implementation
Unsatisfactory quality of implementation

In general, the Commission/EU Delegation project task managers or, in the case of decentralised management the responsible officers of the contracting authority, play a paramount role in preventing and detecting illicit patterns of fraud in procurement by the contractor or beneficiary. **Sound and regular review and monitoring of the implementation of the project is the most effective fraud prevention and detection measure. This comprises maintaining a proper risk management matrix, conducting regular review meetings with the imple-**

menting body and monitoring visits in the field. Collecting and reviewing administrative and management records is a very important part of these activities.

4.3. Action not implemented/partly implemented or not implemented according to the rules

Several of the OLAF investigations analysed for this casebook concern projects which were either not implemented or implemented only in part, or which were not implemented according to the contract or rules. In many of these cases, due to a **faulty monitoring of the project progress**, several years passed before any reparatory action could be taken.

CASE STUDY No 10:
Action not implemented

FRAUD PATTERN: A European company involved in several public procurement procedures used the following modus operandi: it made the best bid by offering high-quality supplies at very low prices. Once the contract was awarded, the company asked for an advance payment of 60 %, following which it requested the extension of the contract duration and several other contractual changes. In this particular case, as the authorising officer did not accept the requested changes and since the company had not performed any part of the contract theAuthorising Officer terminated it and requested reimbursement of the pre-financing. It also turned out that the company used guarantee certificates issued by a company that was under a preventive seizure of assets regime requested bycreditors. The guarantee for the advance payment therefore proved worthless for the Commission.

VULNERABILITIES: The company presented a guarantee certificate issued by a company that provided financing only as a small sideline and did not meet the necessary requirements of transparency, sound finances/assets or professional propriety, as could be seen from its balance sheets; no coordination between departments — the company successfully followed the same modus operandi in contracts in several third countries.

RED FLAGS: Guarantee certificates issued by unknown or small companies; bid value significantly lower than other tenderers for goods of similar quality and technical specifications; extension of the contract and other contractual changes requested immediately after receipt of the advance payment.

The following red flags may indicate that the action is not being correctly implemented and should trigger additional verifications:

Action not/partially implemented — RED FLAGS
Lack of regular reporting
Delays in reporting/implementation
Complaints from suppliers claiming delays in payment
No answers to the letters sent by the contracting authority (if the first letter is returned and the contractor/beneficiary cannot be contacted, preventive action should be taken immediately)
Website of beneficiary/contractor contains outdated information or no longer exists
Mismatch between amount disbursed and progress reported; no signs of start of implementation after cashing the advance payment
(Repeated) requests to extend the contract and other unjustified contractual changes shortly after the start of the contract
Unjustified requests for contract termination
Any indication of false/inflated invoices
Any indication of embezzlement

'Product substitution' is another type of fraudulent activity in this cluster. This occurs when the contractor/grant beneficiary delivers products which fail to meet the contractual specifications. The goods/services delivered can come in less than the specified quantity, they may be faulty, the purchases may be of second-hand material when the contract specifies new material, etc. One classic example is the failure to observe the rule of origin for goods and the attempt to conceal this by means of fake certificates, false labelling of products, artificial subcontracting, etc. Product substitution usually results in the inflation of prices and is accompanied by other irregularities, such as falsification of documents or irregular subcontracting.

CASE STUDY No 11: Product substitution

FRAUD PATTERN: The subcontractor in charge of organising hotel and rural tourism training for young nationals of an EU candidate country carried out only a fraction of the activities stipulated in the grant contract while the beneficiary of the grant received the whole amount of funding. The beneficiary subcontracted a company to carry out eight weeks of professional training for 15 trainees. According to the beneficiary's final report, the trainees were given a fully-fledged vocational training programme. In fact, the subcontractor did not organise any proper practical vocational training at all. Some parts of the 'training' were directly provided by the beneficiary itself and were severely lacking in professionalism. In addition, hotel and tourism companies were asked whether the trainees could stay on their premises and 'watch how a hotel works'; the trainees were never actively involved or given practical training in the provision of any service. The subcontractor approached these hotel and tourism companies on an ad hoc basis, without offering them remuneration or concluding a contract.

VULNERABILITIES: Lack of verification systems and guidelines as to the choice of subcontractors, especially as regards their capability to carry out the actions contractually agreed.

RED FLAGS: The final report does not give much detail on the activities carried out and the entities involved; the individual reports of the trainees do not fully match the content of the final report; the entity actually carrying out the works or services is not normally active in the sector concerned.

One field of activity which appears to be particularly vulnerable to 'product substitution' fraud is the organisation of seminars, study visits and trainings. Typical *modi operandi* for claiming the reimbursement of costs which were either not incurred or were significantly lower than those declared in this field include, but are not limited to: organising fewer activities than programmed; falsifying attendance sheets; not paying per-diems to participants and falsifying their receipts; 'hiring' fictitious subcontractors to deliver the training;and presenting inaccurate information in the project reports.

The building of large infrastructure is another area where 'product substitution' frequently occurs. In 2010, OLAF carried out an analysis of the construction of road infrastructure funded under the EU's external assistance budget. The report of this analysis highlights the following findings.

- About one third of OLAF investigations in the external assistance area and/or infrastructure construction cases were related to the road transport sector. Two thirds of the cases were related to infrastructure facilities for other transport modes, public services or housing. Only 20 % of the cases were related to the external assistance sector. The remaining 80 % involved interventions funded under the structural funds and pre-accession assistance. More than half of the cases were related to contracts under decentralised management.
- The substantiated allegations most frequently observed were 'underperformance' (incomplete works or bad quality) and 'collusive behaviour'. Falsification of documents was the most frequent modus operandi, followed by collusive behaviour, whereas the 'wrongdoer' was found among staff of private companies in 50 of the 96 cases.

- The substantiated allegations were related to facts that had occurred during the implementation of a contract (51 cases), rather than during the preparatory stages;
- More than half of the 96 cases analysed were opened on the basis of information provided by external sources, i.e. information originating from outside the 'chain of control'. Most of the investigations where 'corruption' was the main allegation were opened on the basis of information from external sources, whereas most of the investigations where 'underperformance' was the main allegation were based on internal sources.

A further sample of 120 contracts concluded between 2005 and 2010 was drawn from CRIS, which contains information on more than 120 000 contracts. Most of the contracts were concluded under decentralised mode and funded by the EDF.

- Riders were needed for more than 50 % of the contracts. This percentage was significantly higher for large contracts signed between 2005 and 2008, where up to 90 % of contracts required riders.
- Budget overruns occurred in 30 % to 60 % of the contracts, depending on the value and/or age of the contract. Budget overruns amounted to 26 % of the initial aggregated amount of the (multi-annual) contracts that were concluded between 2005 and 2008.
- The initial value of contracts with riders and/or overruns is substantially higher than the value of contracts without riders and overruns.
- The 120 works contracts were awarded to 84 contractors. However, 10 contractors obtained 38 contracts (32 %), accounting for 71 % of the financial resources. 8 of these 10 contractors were based in the EU.

These findings suggest that the existence of threats and vulnerabilities to which the EU is exposed ought to be taken into account, for example by improving the technical capacity of the contracting authority to manage the preparation and implementation of contracts and by the awareness of financial staff about these vulnerabilities and red flags to identify the threats.

Product substitution — RED FLAGS
Suspicious invoices (regional telephone access codes, addresses, characters)
False/falsified invoices
Brand name of product delivered does not correspond with brand name indicated in offer
Requests to modify technical specifications immediately after cashing the advance payment
Any indication that the labelling of products has been tampered with: stickers, no label, blackened labels, serial numbers tampered with
For grants: inconsistencies between project reports and supporting documentation; any sign of falsified receipts and invoices; any indications of fictitious subcontracting; complaints from participants; complaints from subcontractors

5. Double funding

Double funding has similarities to the double claiming of expenses (Section 4.1) but, in the case of double funding the fraudster submits the same item of expenditure to different donors and obtains additional financial support which is not declared to the EU (Case study No 12). While this type of fraudulent activity can be avoided by means of sustained donor coordination with the large international donors, it is difficult to coordinate funding information with all small donors active in the field. As happened in one case, fraudsters can develop schemes by which one entity obtains funding from the EU for a particular project and another one submits the same proposal to another donor. When the grants are awarded, the second company becomes the subcontractor of the first in the EU project.

CASE STUDY No 12:
Double funding

FRAUD PATTERN: A German NGO obtained EU funding for 16 development projects in Africa, Asia and Latin America. Each of the 16 projects had received funding from other donors, which the NGO failed to declare to the EU.

The NGO was part of a global group of NGOs with its headquarters in Switzerland and its administrative and operational management headquarters in an EU Member State. The administrative headquarters coordinated all funding applications. Each project was submitted for funding to the EU by the German NGO and to a second donor (i.e. Unesco, the World Bank or a national aid agency) by a different member of the NGO group. The project proposals were presented in different languages and although the contents were essentially the same, the headings of the proposal were presented in a different order.

Once funding was obtained, the individual NGOs would transfer the funds to the bank accounts of the two headquarters in Switzerland and the EU member state, which further redistributed part of the money to ongoing projects. Since the projects were over-financed, the global NGO made over several years a profit of almost USD 4.5 million.

There were also problems in the implementation of some projects: one project had not started as long as two years after the first payment, another project had not received any funds at all from the global NGO, while other projects had already been completed before the funding from the EU was received.

VULNERABILITIES: Lack of any donor coordination prior to the investigation; lack of field knowledge (i.e. with a sound knowledge of what was going on in the sector of activity, a situation where EU funding was granted for projects that had received funding from other donors and had already been completed could have been avoided).

RED FLAGS: Several donors are supporting the same sector of activity in the same geographic area; the beneficiary is part of a group of NGOs active in the same sector and having potential access to many donors but does not declare other funding.

If suspicion is raised, other potential donors should be contacted directly. A simple Internet search may already reveal funding from different sources for similar projects or to the same beneficiary. Where beneficiaries receive funding from different donors, joint audits would ensure that the auditors receive a full picture.

Double funding — RED FLAGS
Several donors are supporting the same activity sector
The beneficiary refuses to give access, during an audit, to documents relating to similar projects being implemented
The beneficiary is part of a group of NGOs carrying out an activity in the same sector and having potential access to many donors

Four cases of recently disclosed double funding were identified and substantiated as a result of targeted investigations and improved co-operation between international donors. An improved exchange of information on external assistance projects between donors would enable the Commission, including its Delegations, to check whether or not a proposal for which funding is requested already benefits from support by other donors or, alternatively, whether a completed project for which final payment is requested has not benefited from funding by a third party. This exchange could take place within the framework of the IT-tool developed under the Transparent Aid (TR-AID) project.

Taking swift action at the first sign of that irregularities may be present should help to reduce the financial damage and avoid difficult recovery procedures. That irregularities are often only discovered at a late stage is partly due to a lack of knowledge about fraud and red flags. The regular training sessions provided to financial staff should also include modules targeted at raising awareness to fraud risks and provide staff with the skills necessary to detect fraud and irregularities.

OLAF's investigative experience also shows that double funding is associated with using falsified documents in half of such cases: raising awareness and training financial staff on ways to recognise falsified documents more easily appears to be a key element in reducing instances of double funding.

European Commission

Casebook of OLAF investigations in the field of external aid

Luxembourg: Publications Office of the European Union

2012 — 48 pp. — 17.6 × 25 cm

ISBN 978-92-79-25394-2
doi:10.2784/59230