

„We research corruption in the
Czech republic and actively help
reduce it.“

EVALUATION OF THE RISKS OF FRAUD AND THEIR POSSIBLE PREVENTION

FOCUSING ON PROJECTS CO-FUNDED FROM THE RESOURCES OF THE EUROPEAN UNION

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Introduction

The Czech Republic has had experience with the administration of programmes and projects supported by the structural funds for the periods 2004–2006 and 2007–2013.

European funds represent a unique opportunity to fulfil the development objectives of a society. This obviously requires a society to have such development goals. The programme for the development of various areas by 2020 represents a basic prerequisite for the EU funds to be used effectively. If we know what we want to achieve and what resources are available, we will not waste European resources on unnecessary and overpriced projects.

Although the 2014–2020 programming period is in progress, due to a delay of a full launch of operational programmes, it is an opportunity for us to look into not only those elements of the implementation system that worked well, but also into those that didn't work well, and attempted to formulate recommendations for providers of subsidies and for the recipients. We hope that in this way, we will contribute to the prevention of deficiencies, errors, irregularities, and reduction of the fraud risk.

The aim of the publication is not to bring a comprehensive assessment of irregularity or fraud risks in the projects co-financed from the EU funds but to collect information from a variety of publicly available resources, in particular The Supreme Audit Office (SAO) conclusions, the Audit authority's inspection results, regional courts decisions, reports and recommendations of the European Commission and the European Anti-Fraud Office (OLAF), etc. focusing on the 2007–2013 programming period. Last but not least, it also makes use of the experience of subsidy beneficiaries and project administrators. These findings are complemented and compared with the current programming period, taking into account not only methodological materials, but above all, opinions and recommendations of those who work with the EU funds, be it subsidy providers or subsidy beneficiaries. This information has been collected at the round table for managing authority representatives held on September 22, 2016, the seminar for applicants held on October 6, 2016 and an international conference held on November 3, 2016. The fraud risk indicators that can be found in the publication are not an exhaustive list, and they shall be extended and updated based on the experience of managing and control authorities. Their purpose is to provide basic information and, as mentioned above, the information will be updated and more data will be added according to the managing and control authorities experience. The reported data and legislation are up to date as of November 2016.

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More information about the project and its outputs is available on <https://www.transparency.cz/lepsi-rizeni-rizik-podvodu-ve-fondech-eu/>

Ivana Dufková, project manager

EU Funds in the Czech Republic

Although programmes financed from structural funds were wistfully expected by NGOs, municipalities and companies in the last programming period, there has been a gradual disenchantment. One of the reasons is the fact that the application processes and the actual implementation of the projects were administratively rather challenging and complex for the subsidy applicants. Having this experience with project administration, many of the successful applicants did not wish to submit new projects. Other organizations adapted their project budgets to this situation so that ultimately only a portion of the resources was allocated for the actual project solution and a large part was allocated for administration. Therefore, EU funds are a symbol of bureaucracy, non-transparent procedures, meaningless activities and waste of money for many people. This image is also supported by media who are keen to show negative information and examples of misuse of financial means than any positive news.

From the point of view of the potential applicants for the structural funds subsidy, another problem was that available information about the offered types of subsidy for different types of beneficiaries was not presented clearly. The diversity of rules used within individual operational programmes contributed significantly towards the complexity of the management of the EU funds implementation process and to many errors made by providers as well as beneficiaries.

It is possible that following the introduction of the single methodological environment, the administrative burden will be partially reduced and the information will be better arranged and presented more clearly for both the applicants and the beneficiaries. However, the outputs of the “Satisfaction Indicators and Assessment of the Concept of the Single Methodological Environment” project suggest a number of persistent issues.¹

With the budget of EUR 454 billion for the period of 2014-2020, the European Structural and Investment Funds (the ESI funds) are the main tool of the European Union investment policy. It consists of five funds: The European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund (CF), the European Agricultural fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF). Together with other 19 Member States, the Czech Republic will also benefit from the Youth Employment Initiative (YEI).

The EU intends for these funds to contribute as much as possible to achieving the EU 2020 growth strategy – the Smart, Sustainable and Inclusive Growth Strategy, which is a long-term development vision of the European Union. In order for these funds to be better used for the benefit of the EU 2020 strategy, each state prepared a Partnership Agreement which was assessed and approved by the European Commission. Operational programmes serve as tools for its fulfilment. The distribution of allocated financial resources for the supported regions is specified in the individual documents.

The Czech Republic has been allocated EUR 24.2 billion from the ESI funds through 11 programmes for the period 2014–2020. Thus, together with the national contribution of EUR 7.88 billion, the Czech Republic has a total budget of approximately EUR 32 billion which can be invested into various areas ranging from creating jobs and growth to investments into research and innovation,

¹ Available from: <http://dotaceeu.cz/cs/Fondy-EU/Narodni-organ-pro-koordinaci/Evaluace/Knihovna-evaluaci/Hodnoceni-plneni-cilu-Koncepce-JMP-a-Zjistovani-naplneni-indikatoru-sp>

environmental protection, promotion of sustainable transport, promotion of employment and mobility of workers and improvement of social inclusion.

	2004–2006	2007–2013	2014–2020
Structural funds	ERDF ESF FS EAGGF FIFG	ERDF ESF FS	ERDF ESF FS EAFRD EMFF
Objectives of the cohesion policy	Objective 1 Objective 2 Objective 3 INTERREG URBAN LEADER EQUAL	the Convergence objective the Regional Competitiveness and Employment objective the European Territorial Co-operation objective	the Investment for Growth and Jobs objective the European Territorial Co-operation objective
Operational programmes	4 thematic OP 1 joint regional OP	7 thematic OP 9 regional OP 5 cross-border cooperation programmes 1 interregional cooperation OP 1 transnational cooperation OP 2 network OP	9 thematic OP 1 integrated regional OP 5 cross-border cooperation programmes 6 transnational and interregional cooperation programmes

Compared with the programming period 2007–2013, some new changes were introduced in the system of drawing funds from the European funds at the European as well as Czech level. The most important ones are:

- expanding the number of participating funds (the new funds are EAFRD and the EMFF, i.e. funds for rural development policy and the common maritime and fisheries policy);

- introducing a system of preliminary conditions;
- emphasis on strengthening of strategic management and planning during the preparation and implementation of the programming period, the Partnership Agreement and individual programmes, and the quality of strategic work in the Czech Republic in general.
- better measurability of the benefits of supported operations (emphasis on meeting set indicators);
- financial dependence on the speed and quality of funds drawing (performance framework)
- greater engagement of the territorially specific approach and usage of integrated tools;
- greater engagement of financial tools to the detriment of subsidies;
- electronic exchange of information between beneficiaries and relevant authorities;²
- thematic concentration (fewer growth-enhancing investment priorities)

The main news in the Czech environment include:

- reducing the number of programmes (reducing the number of thematic OP and the establishment of a single Integrated Regional Operational Programme instead of the original seven ROP);
- the concept of a Single Methodological Environment (to ensure the same rules within the whole system),³ a stronger role of central management;
- full electronisation of the whole process from application submission to final checks, including all communications with the subsidy provider;
- unified monitoring system for submitting European subsidy applications, their management when such a subsidy is obtained and administration of individual operational programmes. Applies to all European subsidies within the 2014–2020 programming period, excluding subsidies in agriculture.

A recommendation from 2004 already proposed a significant simplification of the implementation structure, which was a truly Sisyphean task, considering there were 26 programmes in place in 2007–2013. Reducing the number of operational programmes in the ongoing programming period will

² Member States will ensure that all information exchange between beneficiaries and the managing authority, certification authority, audit authority and intermediary bodies will be conducted through the system of electronic exchange of data no later than by December 31, 2015. [Regulation No 1303/2013, Article 122(3) of the European Parliament and the Council of the European Union].

³Available from: <http://www.dotaceeu.cz/cs/Fondy-EU/2014-2020/Metodicke-pokyny/Koncepce-jednotneho-metodickeho-prostredi>

show whether the impact on the alignment of competencies, powers and responsibilities of all elements of the implementation structure has been positive.

The basic umbrella document for drawing funds from the European Structural and Investment funds in the 2014–2020 programming period is the Partnership Agreement. It lays down basic principles, obligations, responsibilities and the manner of implementation management and coordination, thus creating a framework for the functioning of the system. The management of the Partnership Agreement is the task of the National Coordination Authority (NAC), which coordinates the implementation of programmes, cooperates with relevant partners at the national and regional level and ensures they are well informed. It convenes and controls the ESI funds Work Council consisting of the representatives of resorts in the role of managing authorities, NAC, Ministry of Finance of the Czech Republic and territorial, social and economic partners. The Payment and Certification Body of the Ministry of Finance is an independent body which checks whether the expenditure related to expenditure certification within the fund structures and the relevant programmes is appropriate. The body coordinates managing authorities with respect to the requirements for the expenditure certification. The Audit authority, which operates within the Ministry of Finance of the Czech Republic, is an independent body that conducts audits in the structure of funds and relevant programmes. It verifies whether the system works properly and whether all operations have been performed adequately, both at the level of operational programmes and at the level of the Payment and Certification Body. Based on the information provided by managing authorities, the Ministry of Finance of the Czech Republic informs, through its Central Contact Point AFCOS, the European Anti-Fraud Office about significant errors and, more specifically, irregularities that were identified during inspections of drawing funds from the ESI funds. It also serves as a methodological body for inspections, issuing methodological guidelines for the managing authorities, and supervises that inspections are conducted in a harmonized manner. Furthermore, in cooperation with NAC, the Ministry of Finance of the Czech Republic provides a methodological guidance to managing authorities in the area of inspections and coordinates the preparation of the central solution for the implementation of financial tools in the Czech Republic.

Fraud Risks in the EU Funds

Due to objections from the European Commission to the way the control and inspection systems had been set up, in 2012 (and at the beginning of 2013) the certification of operational programmes was suspended, thus, no payment requests were submitted to the Commission and the implementation was effectively interrupted. The unsatisfactory state of drawing the subsidies was caused by a series of problems, such as legislative shortcomings, the complex structure of operational programmes, the complicated methodology, a problematic personnel policy and institutional and personal conflicts of interest. In addition, first instance checks as well as external checks failed in this situation. Nevertheless, the increase in the number of fraud cases and the temporary freezing of funds for operational programmes, together with subsequent financial corrections which influenced the level of drawing from the European funds, resulted in gradual changes of policy.

Based on the experience from the 2007–2013 programming period, the European Commission recommended that managing authorities adopted an active, structured and focused approach to managing the fraud risk. The aim should be the adoption of active and adequate anti-fraud measures based on the zero tolerance principle using cost-effective resources.⁴

Yet the implementation structures continue to focus on general (non-specific) prevention, checks and, where appropriate, prosecution, much more frequently. The use of specific examples such as feedback for targeted prevention is rare and experience from one operational programme is usually not transferred to others. Frequent personnel changes and weak institutional memory reduce the capacity for the analysis of past errors, fraud and irregularities, and their transformation into appropriate recommendations.

This situation highlights the importance of checks of the process of redistribution of financial resources not only by the national and EU authorities but also by media, NGOs and the general public. The efficiency and possibilities of such broader checks are directly dependent on the degree of openness of the information policy and the accuracy of published information.

Publicly available information about individual operational programmes varied considerably in the past programming period. Disclosing data in unclear separate lists or limited options to search specific projects without a closer knowledge of their identifiers, restricted the possibilities of checks and analytical work with data. Data that has not been updated for a long time or a failure to disclose certain specific information (e.g. the precise allocation date/project approval) were additional similar shortcomings.

The current programming period is user-friendlier. Information for applicants is easily accessible; calls for project submissions, manuals, their current changes, numerous monitoring tables and other documentation for experts are available. However, information for general public allowing for civic checks of the EU funds is still insufficient. It is not easy to find information about the subsidy selection and allocation process, the ratio of co-funded and not co-funded projects, reasons for not allocating the financial support or details about the evaluation procedures. A significant step forward

⁴ http://ec.europa.eu/regional_policy/sources/docgener/informat/2014/guidance_fraud_risk_assessment_cs.pdf

is the introduction of the obligation to publish the minutes from the meetings of the operational programme selection boards, although it should be noted that not all managing authorities meet this obligation. Only basic (and hard-to-find) information about approved projects are currently available for the 2014–2020 programming period. The National Coordination Authority has promised to update and expand them in autumn 2016. We believe that as wide scope of information as possible and its easy accessibility will help to reduce the awareness of the EU funds as of an untransparent, closed and a little “mysterious” process for pre-selected applicants only. Such general perception increases the risk of real misuse of the EU funds.⁵

The following terms shall be used in this publication:

Irregularity means any infringement of a provision of Community or Czech Republic law resulting from an act or omission by an economic operator (a body involved in the implementation of programmes or projects co-funded from the EU budget – a beneficiary as well as a provider, an intermediary), which leads or could lead to a loss in the overall EU budget or the public budget of the Czech Republic, by accounting for an unjustified item of expenditure into the overall EU budget or the public budget of the Czech Republic.⁶

Category of irregularities:⁷ violation of budgetary discipline in accordance with Act No. 218/2000 Coll. on budgetary rules;

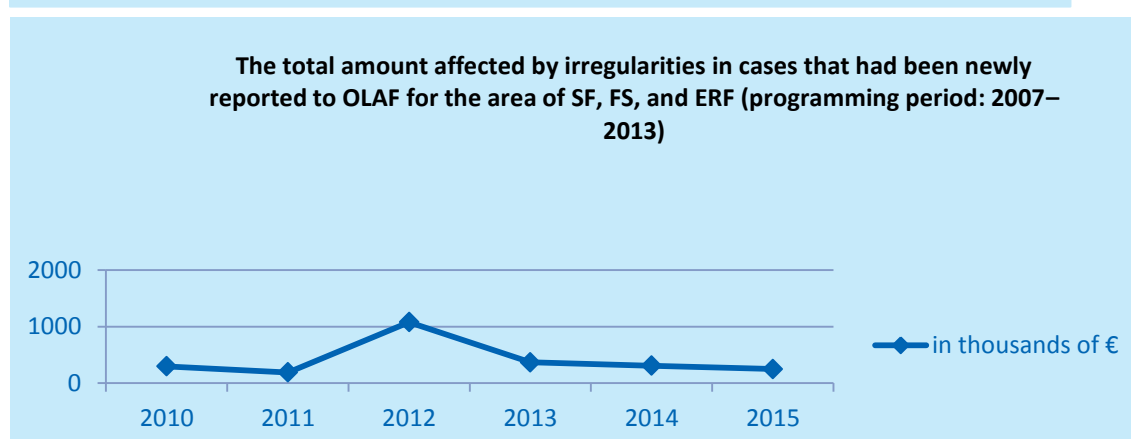
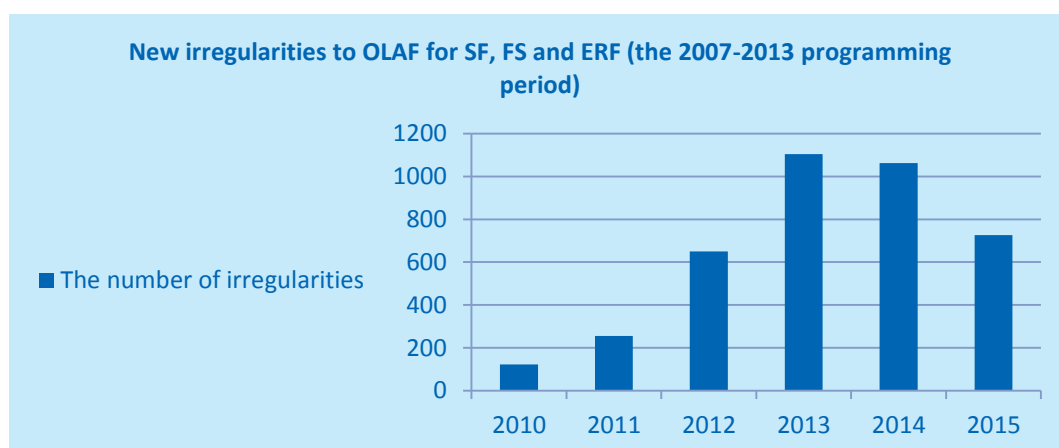
- violation of budgetary discipline in accordance with Act No. 250/2000 Coll. on budgetary rules of territorial budgets;
- errors related to functioning of the system and occurring in multiple projects as a result of serious deficiencies in control and check mechanisms, repeating with increased frequency, e.g. wrong settings of the system of checks;
- irregularities incurred in public expenditure carried out under other laws,⁸ the possibility of fraud, where the provider at the next level of resource provision is a bank;
- irregularities related for example with the violation of Act No. 134/2016 Coll., on public procurement;
- irregularities related to the suspicion of committing an offense.

⁵ <http://www.fondyeu.eu/> - a combination of data about co-funded projects with the business register data for past programming periods.

⁶ See Methodological guide – Irregularities: http://www.strukturalni-fondy.cz/getmedia/b0cc6e3e-8ac6-40a9-8cba-503df2c80654/MPN-aktualizace-rijen-2011_b0cc6e3e-8ac6-40a9-8cba-503df2c80654.pdf?ext=.pdf .

⁷ See Methodological guide – Irregularities: http://www.strukturalni-fondy.cz/getmedia/b0cc6e3e-8ac6-40a9-8cba-503df2c80654/MPN-aktualizace-rijen-2011_b0cc6e3e-8ac6-40a9-8cba-503df2c80654.pdf?ext=.pdf .

⁸ Act No. 48/2002 Coll., on the promotion of small and medium businesses.



The most frequent issues in the Czech Republic are:

- insufficient administrative checks preceding the application for payment;
- lack of information about the implementation;
- lack of audit trails;
- failure to review the compliance of project activities with the law;
- insufficient quality of check sheets;
- delegation of the performance of on-site public administration checks to another entity;
- failure to check accounting documents;
- failure to carry out ex-post checks;
- failure to follow up on necessary corrections;
- failure to validate whether beneficiaries are not in liquidation/insolvency register;
- screening of the upcoming operation based on incomplete documentation;
- failure to separate the approval and the control function.

Source: The SAO audit conclusions (2009–2014)

Suspected fraud is an irregularity which gives rise to the initiation of criminal proceedings at the national level in order to determine whether there was an intentional act and, in particular, whether there was fraud according to Article 1(a) of the Convention on the Protection of the European Communities' Financial Interests, prepared based on Article 3 of the Treaty on European Union.

Simultaneously, it is also an irregularity subject to the reporting requirement according to Czech law, in particular from the perspective of the obligation of supervisory bodies to report suspected criminal activity identified during the inspection to authorities active in criminal proceedings.

Fraud is an intentional act or omission relating to one of the three options below:

a) use or presentation of false, incorrect or incomplete statements or documents resulting in the incorrect use or retention of funds from the general budget of European Communities or budgets managed by EC or in favour of EC;

b) failure to provide information is a violation of a specific duty with the same consequence;

c) use of resources defined in a) contrary to the purpose for which they were intended. The definition mentioned above states a necessary condition for the fulfilment of the fraudulent act – an intentional act or omission resulting in the damage of the EU budget or the public budgets of the Czech Republic.

Within the Czech Republic operational programmes the most frequent act will be the criminal offense of subsidy fraud which is defined in Section 212 of Act No. 40/2009 Coll., the Criminal Code:

The criminal offense of subsidy fraud is committed by someone who submits incorrect or grossly distorted information or who conceals important information in the application for a subsidy, subvention or a returnable financial assistance or contribution; who uses, not in a small scale, funds obtained through a subsidy, subvention or a returnable financial assistance or contribution for any other purpose than intended.

Furthermore, Section 260 of the Criminal Code stipulates special facts of the violation of financial interests of the European Communities.

In cases of suspected criminal offense, the initiation of criminal proceedings according to Section 158(3) Act No. 141/1961 Coll. (Criminal Procedure Code) is regarded as a decisive moment for the initial detection which is subject to the reporting of an irregularity because, under this provision, the procedure of the police authority is a certain guarantee that a criminal offense may have been committed.

A criminal offense committed in connection with the implementation of programmes or projects co-funded from the EU budget is always considered an irregularity.

Committing fraud is conditioned by three elements that can be described as a fraud triangle:⁹



Opportunity: Even if one has a motivation, he must have an opportunity. The likelihood that the fraud will not be revealed is crucial. Weak internal control, cumulation of decision-making and inspection functions or poorly set approval system all contribute to fraud. In the case of EU co-financed funds, there may be deficiencies in setting objectives (general, non-quantifiable, final status is not defined), deficiencies in the evaluation system (conflict of interests, failure to respect expert opinion) or granting of exemptions. The level of opportunity also depends on the social acceptability of unfair behaviour and the culture of the functioning of state authorities, private companies and external inspection and remedial mechanisms.

The subsidy provider violated the principle of the adequate separation of the function of the subsidy beneficiary from the inspection function of the managing authority by placing the inspection departments and the departments working on the agenda of the subsidy beneficiary in the same section managed by one deputy director of the subsidy provider.

Source: The SAO audit conclusion (2014)

Rationalization: People try to justify their behaviour by rationalizing it (“it’s fair to do it this way”, “it’s logical”, “everyone does it”, otherwise we can’t get the subsidy” etc.), they try to justify the violation of their internal moral norms (“to shout over the voice of conscience”).

Pressure, incentive vs. motivation: The “let’s spend what we have” factor, excessive bureaucratic obstacles, possible ideological pressure, one’s own importance (“it’s my right/entitlement to do so”) or coercion.

It was found out in two projects that the applicant reported changes in technical parameters of a structure (extension of a silage trough and reconstructing three instead of the original two objects). However, the project budgets as well as the claimed eligible expenditure remained unchanged. It is evident that the applicant overvalued the project budget, thus creating a financial reserve, which they used for the extension of the parameters of the structure.

⁹ Currently, the term “fraud diamond” is also used as it adds additional elements to the original three, e.g. ability (better organization, creation of a structure of concealment, relationships with auditors, etc.), see DORMINEY, Jack W. Beyond the Fraud Triangle: Enhancing Deterrence of Economic Crimes. FRAUD MAGAZINE [online]. 2011 [cited 2016-11-15]. Available from: <http://www.fraud-magazine.com/article.aspx?id=4294970127>

Source: The SAO audit conclusion (2010)

The common goal of all the bodies of the implementation structure should be breaking the fraud triangle – reducing the motivation through well prepared call to actions, clear rules and accessibility of information at large scale, and limiting the opportunity via an inspection system of high quality (not quantity) that includes, in particular, adequate surveillance and separation of responsibilities.

It is the Member States who are primarily responsible for setting up the management and control systems. They have to ensure that the systems work effectively and allow for the prevention of irregularities and fraud, and/or their detection and remedy. While the primary responsibility for the prevention lies with the managing authorities,¹⁰ its successful application requires combined efforts of managing and audit authorities which should, above all, help to identify the weaknesses of the implementation structure.

The different types of fraud and irregularities rarely occur in isolation: overestimation of costs is usually accompanied with fake invoices or non-standard subcontracting procedures; substitution of materials goes hand in hand with false certificates of origin; incorrect subcontracts are the result of rigging or incorrect application of procurement proceedings. The presence of a fraud indicator, especially more than one, should lead to increased vigilance and additional verification (for instance using open sources, cross-checks with information obtained from other contracts etc.). It is obviously not true that warning signals automatically mean fraud. However, increased awareness about indicators that are associated with the individual steps of the expenditure cycle, is an important measure for the prevention of fraud. A proactive approach to identify fraud indicators contributes to the increase of the likelihood of their detection and helps to reduce losses.

Typology of fraud risks by project phase

Before the implementation	During the implementation
Risks are related to the selection of the “incorrect” applicant	Risks are multiple
<ul style="list-style-type: none"> ➤ false declarations or fake documentation attesting financial and operational capacity, legal status or partnership 	<ul style="list-style-type: none"> ➤ increase of costs <ul style="list-style-type: none"> - overcharging: fake invoices, wages - unauthorized expenditure: missing documents, forged documents, false statements - embezzlement - unlawful use of financial transactions
<ul style="list-style-type: none"> ➤ a secret agreement with a representative of the provider, bribes, information leaks, irregularities in the preparation of the call, selection and allocation of subsidies 	<ul style="list-style-type: none"> ➤ illegal subcontracting <ul style="list-style-type: none"> - pre-arranged subcontracting - full/excessive/unapproved subcontracting

¹⁰ This area was the subject of the audit of designation in 2015 when the Ministry of Finance of the Czech Republic verified whether the OPs are prepared for the submission of interim payments and their certification.

<ul style="list-style-type: none"> ➤ a secret agreement in a public tender: candidates, offers, prices 	<ul style="list-style-type: none"> ➤ unlawful implementation/partial/no implementation <ul style="list-style-type: none"> - no/insufficient implementation - substitution of materials
	<ul style="list-style-type: none"> ➤ double financing

Source: OLAF

Despite the significant progress towards mitigating the risk of irregularities and fraud in drawing from the EU funds, some deficiencies still remain. The effectivity of the control systems is not complete. The control systems focus primarily on formalities, thus failing to check the achieved results in relation to the effectiveness of spent resources. Therefore, projects can be supported that do not take into account quality and principles of sound financial management. Given the delay in the process of approving operational programmes and the subsequent announcement of individual calls, there is a risk that the scenario from the 2007–2013 programming period will repeat. Towards the end of that period, an emphasis was placed on drawing resources from the EU funds rather than the effectiveness and effectivity of the projects. Problems and risks related to a long-term low drawing of allocated funds, insufficient number of quality projects and a lengthy process of preparation and execution of selection procedures repeated for several years. The impact of such practices was an increased risk of irregularities.

In this context, it is important to realize that achieving the program’s development goals rather than spending money is key. The adopted measures and announced calls must comply not only legally, administratively and technically but they must also correspond with the objectives and priorities that were set out in the individual operational programmes. The effectivity of the operational programme can be evaluated only if specific, measurable, achievable, relevant and timed objectives and subsequent selection of projects were set for all areas of activity in accordance with the principle of sound financial management while respecting the “value for money” principle. Monitoring systems must keep track of real results, control systems must focus, above all, on verification of benefits and the project’s necessity, rather than formal errors, which often leads to inadequate reduction of a subsidy.

The output and result indicators in the subsidy applications were set more as economic or statistical indicators (applicant’s gender and age, applicant’s legal status, specialization of the enterprise, type of investment, size of the enterprise, type of production, prevailing industry type of the enterprise) without a direct link to the objectives of the relevant programme. Monitoring indicators were set identically in various areas of support (e.g. structures and technology for crop production, adding value to food products etc.) The indicators did not allow to verify the effectivity and effectiveness of resources and it was not possible to use them to demonstrate that the project objectives were accomplished. At the same time, the way the indicators were set did not allow for the interim nor subsequent evaluation of the implementation of the projects in terms of their quality and results, and thus, of the entire programme with respect to the set objectives.

Source: The SAO audit conclusion (2010)

Selection and Evaluation of Projects

The 2014–2020 programming period has seen many improvements in this project stage – the managing authorities disclose the minutes from the evaluation boards (although not all of them state the names of participating members, the chairman, the secretary etc.), there is a database of evaluators and their selection independently of a project.

Despite some progress, applicants still perceive the evaluation processes and the selection of projects as untransparent. This may be due to the inappropriate setting of the project selection processes, failing to adhere to these processes, unclear competences of individual entities but often also due to insufficient or inappropriate communication from the managing authority with the applicants (successful as well as not successful). For example, the applicants complain that reasons for rejection of the application were not given or, more specifically, the reasons given were unclear. Although the managing authorities disclose selection criteria within their operational programmes in advance, applicants often say they are hard to understand. Applicants also criticize that the expected length of the evaluation process is not adhered to. This can result in not up-to-date data in the applications at the time of their approval, the applicants are under pressure, changes are made in the projects which presents a risk of errors or irregularities.

There are several types of fraud and/or irregularities that occur when a project or a bid are being processed and relate to granting a subsidy or making a contract. The most frequent risk at this stage is the fact that the process will favour a specific applicant who would not normally obtain the subsidy. In this case, usually one or more EU principles guiding the granting of subsidies and public procurement is breached (i.e. transparency, equal treatment, zero profit, co-financing rules, as large competition as possible, proportionality and sound financial management for public procurement). There may be attempts for preferential treatment on an individual basis (e.g. the acquisition of untrue statements or documents related to the eligibility to gain specific application for a subsidy) or the applicant works with the contracting party (i.e. the use of the undisclosed conflict of interest or direct corruption) or works with other candidates in order to distort competition.

Projects assigned to specific evaluators were thematically the same, for example the same person tended to be chosen for the Integrated Development City Plan. In this case, the evaluators were selected without a proper draw. Subsequently, a fake “Record of the draw of evaluators” was prepared. Only external evaluators with whom the management of the operational programme has certain relations tended to be selected. When one of the defendants suggested that people with whom the management does not have any experience be also included among the evaluators, the management answered that rather not and expressed concern that they “don’t want to be criticized for anything should there really be a problem”. When experts were being selected, their profession and the absence of the conflict of interests were not taken into account. Unlike the employees of the administration department, external evaluators were willing to subsequently change their decisions and add points to the unsatisfactory projects.

Source: Regional court in Ústí nad Labem, ref. no. 51 T 17/2013 KS

However, in the project selection and evaluation phase, irregularities on the applicants' side who try to present themselves in a better light, are more frequent. Such conduct most often includes making untrue statements about the quality of the applicant related to the eligibility criteria or their qualifications, or even a submission of documents that are evidently false or forged.

The convicted person who was an executive director of a consultation company processing documentation and applications for subsidies for several municipalities, processed and submitted several applications for subsidies within the Operational programme Cross-border Cooperation with forged signatures of Austrian partners. The subsidies were supposed to be used for the organisation of social events at the Moravian-Austrian border. A sworn declaration regarding the non-application of a stamp with a fake signature of Austrian partners was submitted in several cases.

The convicted was sentenced to imprisonment in the duration of 2.5 years, which was conditionally suspended for 4 years, and she was banned to have a statutory body function and to be a member of a collective statutory body of trading companies and cooperatives for the period of 5 years.

Source: Regional court in Brno, ref. no. 40T 15/2014

Unlike fake or forged documents, at this stage, it can be hard for the evaluators to detect false statements. Indicators of false information usually come to light during subsequent verifications which can be performed by evaluators using internal or open sources. We realize that additional checks cannot be conducted for every accepted application, but if checks are made regularly based on fraud risk analysis or at least on an ad-hoc basis, this type of fraudulent behaviour can be detected in time. The undeniable advantage of such a finding (before the subsidy is granted) is that it prevents any financial damage. Therefore we recommend that the risk management systems in individual managing authorities included such checks, stating the relevant sources of information.

Due to the fact that workers in charge of checking the eligibility and selection criteria often work under tight deadlines, they usually do not perform additional checks. At the same time, the excessive use of sworn declarations and reliance on the fact that the applicant provided correct data, is a serious mistake, and it would therefore be appropriate to replace them with proven documents. The usage of sworn declarations needs to be considered critically especially in cases where the claimed fact has a major impact on the decision about granting a subsidy and its amount (declaration about de minimis subsidy, no-debt declaration, integrity declaration etc.). If a proper evidence is possible and effective, and yet the provider systematically uses sworn declarations, the risk of non-compliance with the programme objectives due to ineligibility of the beneficiary increases. This also applies for the assessment of financial health – cases where a company in insolvency received a subsidy should not be repeated. If the applicant has financial difficulties, the risk of not fulfilling the project objectives and the projects sustainability increases significantly. Although the financial health indicator cannot be considered as the only reliable tool for the protection of funds, it is the indicator of the applicant's solvency, thus a certain form of the protection of the Czech Republic and the EU resources¹¹.

¹¹ Methodological guide for the management of calls for action, assessment and selection of projects in the 2014–2020 programming period, Version 3 (MMR – NOK)

The call stated that the target group in the supported projects are candidates for employment regardless of whether they are registered at the Employment Office or not. In order to join the project, only sworn declaration was required. The Supreme Audit Office found out that persons who were employed, had a business or acted as statutory representatives of civic associations participating in the project, also received wage contributions. The objective of the priority axis was to increase employment rate of the unemployed or those at risk in the labour market.

Source: The SAO audit conclusion (2012)

Examples of fraud indicators

False statements

The area of activity and financial capacity

- the entity is not known in the given area or it does not conduct given activity (wrong entry in the Commercial Register, the absence of financial statements, annual reports etc.);
- inconsistencies in the description of previous activities or in the CV of the project team;
- a reference to publications cannot be found online;
- irregularities in the declared turnover, number of employees (compared to public registers);
- discrepancies between stated information and information presented on the website, or an out-of-date website;
- excessive reliance on the EU subsidies;
- number of projects significantly exceeds the capacity of the beneficiary.

Legal form

- other entities with a similar name and unclear legal form (small or medium-sized enterprise, research institution, NGO etc.) are registered at the same address, have the same phone number, same representatives/management;
- according to the Register the entity's business is different or the entity has not carried out any activity in recent years.

Partnership

- the partner does not exist, does not carry out any activity or is not eligible to do so;
- the partner is linked with the applicant (the same names in the management, similar titles, same addresses etc.).

False documents

- "modified" financial statements;
- printing errors, an unusual foreign language, additions, colours;
- the documents had been dated a long time ago;
- discrepancies in dates, names, numeric data;
- a header of an authority who is not entitled to issue the document;
- the amount declared for co-financing does not correspond with the entity' property.

Source: OLAF

Another factor which can lead to fraud, is a conflict of interest. It is difficult to detect it because hiding it only requires to forget to report such fact or falsely declare that there is no conflict of interest. The conflict of interests may be the source of various modi operandi in order to secure privileged access to information and preferential treatment. An indicator of risk can be an unclear definition of the concept of the “relationship to the project”, missing records about the departure of biased members of the selection board, repeated re-evaluation of the selection committee decisions, a larger amount of corrections in the voting tickets or an unjustified re-evaluation of the original decision.

Managing authorities should also focus on possible conflicts of interest of evaluators of applications for funds in cases where evaluators themselves process projects within given priority axes, or more specifically areas of support, be it for their own use or commercially for external entities. One of the ways of preventing the risk of the conflict of interest is that the managing authorities ensure that during the implementation of a given program, the evaluators will not participate in the preparation of projects submitted in the same priorities (or at least calls) that they evaluate. This rule should be adhered to even at the cost of their higher financial remuneration because from the transparency point of view, such conflicting interests of evaluators are unacceptable. Another related issue is the fact that selection boards may change the order of projects recommended for funding over the results of the scoring. Although it is obvious that it is the allocation of funds that plays a role in the selection, such practice raises suspicion of lack of transparency and the application of subjective measures.

A large number of biased members in selection boards, more specifically, people who had a relationship to the negotiated projects, decided about the approvals of such projects. This fact is apparent from the minutes of the meetings of the selection boards where names of those members who are "in relation to the project" were stated. Through the chosen selection of members of the selection boards, MA burdened the selection process with a considerable risk of questioning the impartiality of selection boards, thus questioning the objectivity of the actual selection of projects.

MA did not define in any internal document “the relationship to a project”, a term that is used in the minutes of the meetings in connection with the bias against certain projects. MA issued internal guidelines outlining procedures for selection boards, which are in contradiction with the Declaration of Impartiality and Confidentiality, and which enabled the participation of a high number of selection board members who were identified as biased. In some cases, biased members did not leave the selection board as required by the rules of procedure...

The rules of procedure of the selection boards does not clearly state the voting method and the selected method is not recorded in the minutes of the selection board meetings either. Some voting tickets used at the meetings of the selection boards feature a greater amount of corrections. It is not clear, if these corrections were made during the vote or in a different moment of the negotiations about the projects. A correction of the vote results also applies to a member of a board who should not have been present in the vote for that particular project due to possible bias.

Source: The SAO audit conclusion (2011)

In conclusion, we should also mention shortcomings occurring in the evaluation and selection phase which are not primarily caused by a conscious effort to act unfairly, but, in effect, may contribute to irregularities or fraud in the implementation phase. These are:

- incomplete factual evaluations, missing assessment of the adequacy and economy;
- missing guarantees of the sustainability of the project
- missing default and target indicator values, completely missing or insufficient indicators, an underestimation of the target value of monitoring indicators;
- setting too general goals ("to improve", "to enhance", etc.), without defining the final state;
- failing to retain information necessary for evaluation purposes, supporting documents for the record of the voting, failure to comply with archive requirements for check sheets, non-standard negotiations between the evaluators and the applicant without making a record;
- unjustified recommendation for funding despite a negative opinion of experts, recommendation for funding in contradiction to provisions of the Rules of Procedure of the Monitoring Committee, inconsistency in information stated in the evaluation of the quality and content of the project application, missing justification for the evaluation;
- failure to set the minimum number of points for funding the project, failure to state the evaluation criteria (points), criteria concern the applicant not the project and its outputs, failure to secure the evaluation by two independent evaluators, missing detailed records about the evaluation;
- uncompleted administration of subsidy applications that were not in accordance with terms and conditions;
- granting of exemptions in the form of individual acts.

Source: The SAO audit findings in the 2007–2013 programming period

Again, it is necessary to emphasize the importance of setting objectives and the corresponding criteria as well as the monitoring indicators. The monitoring indicators must be able to provide useful data relating to the evaluation of projects, determining optimal budgets and any assessment of cost-effectiveness or effectivity of the investments. A common mistake is establishing indicators that cannot be evaluated quantitatively, or setting evaluation criteria that do not reflect the issues of economy and effectivity of the projects but are used only to select the subsidy applicants (e.g. based on the size a company or the length of the history in the field). A question whether the submitted project could be implemented without a subsidy should not be ignored either.

Given the above, we recommend that the managing authorities make use of a more rigorous risk analysis during the process of evaluation of projects. This should be a binding rule. Experience shows that early detection of risk or its prediction, create space for its effective prevention, or more specifically, mitigate its impacts at a time when large financial sums had not been allocated. The evaluators should at least undergo a risk analysis training and the gained knowledge should be flexibly implemented in the whole risk management process.

Project Implementation

Most of the cases where irregularities were identified were fraudulent practices during the implementation phase. However, it should be emphasized that in many cases, where serious deficiencies occurred prior to granting the subsidy and at the time of granting it, further irregularities always occurred in the implementation phase.

The bulk of irregularities in this phase is related to the increase of the costs by the beneficiary. There are procedures based on which the beneficiary may be entitled to a refund of the costs incurred that did not occur or are not eligible under the subsidy, or the beneficiary may increase the costs actually incurred.

If there is a discrepancy between the costs incurred and the amount required to be paid, it is an intentional attempt of unjust enrichment at the expense of the provider. This often occurs through falsified invoices or employees' statements of work. A replacement of materials or products is also common – costs reported for a certain product do not correspond with costs incurred because the used material/product differs from that stated in the contract. There has also been a specific case of a claim for a refund of costs incurred prior the start of the project (the wear and tear of the product does not correspond with the stated date of the acquisition, backdated occupancy permit decision etc.).

Invoices which serve as the main material for the release of payments are the most frequently counterfeit items. There are several typical indicators that the inspection bodies should pay attention to.

Examples of fraud indicators:

Invoices, accounting documents

- printing errors, unusual foreign language;
- manipulation: additions, different colour etc.;
- a non-existent receipt of acceptance of invoiced services or goods;
- accounting records do not match the payments;
- mismatch between the prices invoiced, quantities, item descriptions or terms with the items in the contract, the contract of purchase, the delivery protocol, inventory lists, records of consumption;
- more invoices for the same amount, with the same number, date, etc.;
- photocopies of invoices (a possible indicator of double financing);
- the incompleteness of invoices (e.g. name, address, date of issue are missing, or it is not possible to identify the area of activity of the supplier);
- numbers and dates of invoices for the same delivery are not in chronological order;
- the invoice does not describe the delivery in sufficient detail;
- "cascading" deliveries (the beneficiary carries out the contract through a supplier who demands it again);
- suspicious certificates of origin or other signs of the fact that the product does not meet

the rules of the origin of the goods – different catalog numbers, another appearance of the product, common defects, unusual or missing serial numbers (this can also indicate a catenation of supplies);

- payment in cash;
- discrepancy between the invoice and other documents;
- a repeated delivery by one entity without obvious efforts to qualify for the discount;
- the only invoice for the greater part of the cost of the project;
- invoiced amounts to whole numbers;
- unjustified purchases abroad (usually for a price higher than the usual price).

Other documents, audit report, statements

- missing, incomplete or conflicting ancillary documents relating to travel costs (a missing travel report, boarding passes, etc.);
- change of the name of the beneficiary may also mean a change of the legal form;
- a missing registration of the auditor or his/her registration in another area of activity;
- unprofessional form of the audit report;
- printing errors;
- mismatch in the data.

Source: OLAF

The convicted, a beneficiary of a subsidy, was a managing director of XX, spol. s.r.o (Ltd.). At the same time, he/she was the project manager of a grant project in the area of education and was responsible for keeping the accounts. Company XX had not performed any factual activity up to that point and did not have any experience with education. His/her crime consisted of falsifying signatures of eligible subsidy beneficiaries (experts in education). The defendant, inter alia, requested that the eligible beneficiaries sign blank expenditure documents. The convicted backdated the documents and added amount of the paid funds later. He/she explained to the beneficiaries that he/she needed the signature on the blank documents for the subsidy provider immediately and that he/she will pay the money as soon as they arrive. Expenditure documents earmarked for wages and travel were falsified. He/she also stated a higher office rent. The funds were used to pay the company XX's obligations or were used for personal enrichment by the convicted.

Source: Regional court in Hradec Králové, ref. no. 9T9/2014-512

Costs related to workers is a special category where cost increases occur. Labor costs are more prone to overcharging than material costs because the staff and external consultants usually work on several projects/tasks simultaneously; alternatively work is overcharged but it cannot be proved with relevant papers. It is difficult to discover the manipulation without an on-site check.

The subsidy beneficiary reported more work load corresponding to the approved position of a payroll – HR interviewer than what was estimated in the audit cited and used as an argument for the approval of the project budget; there were months when the beneficiary's work load multiplied. During the project implementation, the beneficiary did not have a methodology or an internal regulation for the selection of staff for professional positions or for setting the rates for their remuneration. Hourly rates for certain comparable positions were established with significant differences.

Source: The SAO audit conclusions

Manipulation with work statements (their changes or the creation of fictitious statements of work) is a fairly common practice. In order to identify the deficiencies and contradictions, it is necessary to use regular cross-validation of the recorded working time with other documents (travel documents etc.)

In this case, legal entity was convicted. A civic association submitted a request for the reimbursement of a payroll contribution for one of the employees as part of the monitoring report on the implementation of a project. The entitlement for the payment of funds equivalent to the super gross salary for the month of June was claimed although the employee started working for the civic association from August 1. The civic association used the money for other purposes.

Source: Regional court in Ostrava, no. 49 T 10/2012-445

Examples of fraud indicators

Staff and external consultants costs

- sudden, significant changes in remuneration;
- a disproportionate percentage of employees payed via indirect costs;
- a large number of employees/the same employee transferred from direct to indirect costs and vice versa;
- irregularities in the recording of working time (corrections, incorrect signature, additional details);
- significant differences in the expected and the actual unit price or the number of units without corresponding changes in the scope of work or job description;
- the number of people involved in the project does not correspond to the number of employees, massive recruitment is expected (typically, new employees have significantly lower wages);
- employee qualification does not match the requirements of the job description from the project.

Another type of fraudulent activity is the substitution of materials or products. Delivered goods/services may be in smaller than the prescribed amount, may be faulty, of materials other than specified by the contract, etc. One of the classic examples of non-compliance with the rules concerning the proof of origin of goods is the use of fraudulent certificates, false labelling of products, fake subcontracting, etc. The substitution usually leads to an increase in prices and is accompanied by other irregularities, such as falsifying documents and irregular subcontracting.

The convicted was a managing director of a company that was the recipient of a subsidy for the promotion of tourism through commercials on TV. As the managing director, he was the only person responsible for the project implementation as well as the accuracy of documents and information provided by a managing authority. During the project implementation there were technical problems with connecting to some TV stations and it was found out that older technical components will have to be used in some cases (older graphic cards, older decoder cards, software, different scope of training etc.) However, no changes were made in the monitoring reports, thus false information about the expenses eligible for funding was submitted. Expenditure was not substantiated by invoices or other accounting documents.

Source: Regional court in Pilsen, ref. no. 34 T 13/2012

A specific area of the "replacement of goods" is the organisation of workshops, study visits and trainings, where irregularities are very common. Typical methods for claiming a refund of the costs which either did not incur or were significantly lower than declared, include: organizing fewer activities than planned, falsification of attendance sheets, failing to pay allowances to participants and the falsification of expense documents, the use of fictitious subcontractors for the realization of trainings and the submission of inaccurate information in project reports.

Project participants did not meet criteria for the defined target group. Secondary vocational school graduates who passed the matriculation exam from Information and Communication Technologies were included in the Computer Basics course by the Labour Office.

Checks revealed other cases, where it was reasonably doubted that certain candidates require to be included in the project. For example, two people who were financially supported because they were supposedly looking for a job were two elementary school headmasters (requalification for a welder). Similarly, a person was financially supported who was simultaneously the beneficiary's supplier. In one case, many of the participants of the project were the employees of the subsidy beneficiary and employees of companies linked with the beneficiary from the personnel point of view. Persons employed as accountants participated in requalification courses to become sewers, members of the teaching staff to become masseurs, etc.

The beneficiary used the subsidy to pay for various courses that, based on the documents, took place simultaneously and with the same participants. This beneficiary also claimed expenses for people who participated in the courses only partially.

Source: The SAO audit conclusions

A common type of the fake increase of costs is submitting the request for payment twice. The beneficiary claims an expense twice in the same project under different budget categories. For example, administrative costs can be included in salary costs, but also claimed separately as project (indirect) costs; or the same expense is included in two different contracts.

Double expenditure claiming is similar to double financing but in the latter case the beneficiary submits the same expenditure items to different donors, thus gaining financial support that is not declared to the EU. This type of fraudulent activity can probably be prevented through cooperation (information sharing) between large international donors only but it is difficult to collect data related to financing projects from all small donors operating in the given thematic area. If there is suspicion, other potential donors should be contacted directly. Also, a simple search on the Internet can reveal financial resources from different sources going to similar projects or to the same beneficiary. This is especially true for organizations that are part of a broader group of specifically oriented non-governmental organizations, and thus have potential access to a greater number of donors.

Public Procurement

Irregularities related to public procurement are the most common issues in the implementation phase of the project.

Public procurement contracts play a significant role in the Czech economy; they are also areas with the highest perception of corruption. Therefore, we devote a separate chapter to them.

Czech Republic							
Overview	Total procurement 21,480,000,000 EUR		Procurement % GDP 14%		2013 GDP 156,932,600,000 EUR	Contracting authorities 1,989	
Procedures applied	Open 72%	Restricted 3%	Negotiated procedure with call 5%	Negotiated procedure with no call 18%	Competitive dialogue 0%	Direct award 3%	Other 0%
Share of the contract notices by buyer	National 25%		Regional/local 25%		Body governed by public law 24%	Other 26%	
Contract type	Services 33%		Works 17%		Supplies 50%	Framework agreement 8%	
Ex ante conditionality criteria as of 2014	EU rules Partially met		Transparency Fully met		Training Fully met	Admin. capacity Partially met	
E-procurement adoption	E-notification Mandatory		E-access Mandatory		E-submissions Partly mandatory	Uptake rate 0%	
Perceived corruption (affirmative answers)	Corruption widespread in society				Corruption widespread in business		
	Business 94%		Individuals 96%		At national level 77%	At regional/local level 67%	
TED indicators	Value of tenders 6,083,478,093 EUR		Of total procurement 28%		# contract notices 5,376	# contract awards 5,951	
Other indicators	Received single bid 19%		# days for decision 104.2		Price only criteria 82%	MEAT criteria 18%	
	Won by foreign firms 5%		Related to EU funds 42%		Joint purchase 5%	Central purchasing No	

Source: Public procurement – Study on administrative capacity in the EU, Czech Republic Country Profile. Available from: http://ec.europa.eu/regional_policy/sources/policy/how/improving-investment/public-procurement/study/country_profile/cz.pdf

The report concludes that public procurement plays an above average role in the Czech economy. Responsibilities are decentralized, with contracting authorities processing their own procurement at all levels of government without central coordination. While there is no central purchasing body at the national level, there is a move to increase aggregation of procurement demand through joint purchasing at the Ministry level. The Czech Parliament passed a comprehensive procurement reform law in 2012 in an effort to boost transparency and efficiency, and improve public confidence in the process. The reforms were substantial and wide ranging, but there were implementation issues with a number of the core provisions, and substantial portions of the law were subsequently repealed. The report goes on describing the legislative and institutional framework of public procurement, personnel issues, the usage of various tools (including electronic), risks of corruption, irregularities and findings of national audit authorities. The report concludes with strengths and weaknesses of public procurement in the Czech Republic and makes recommendations for improvement.

The Supreme Audit Office as well as the European Commission¹² identified significant issues in the area of public procurement co-funded from the EU projects. Persistent problems include setting potentially discriminatory criteria and biased evaluations. In addition, the contracting authorities often lack the ability to apply other criteria than price. This is related to warnings about insufficient qualification of contracting authorities. The excessive use of negotiation proceedings without publication (in 2015, one third of public tenders were without publication, and the Czech Republic returned to the worst position among the OECD countries), and insufficient use of central purchasing are criticized. Introduction of the contract register is rated positively but there is still pressure on public administration¹³ to be more efficient and transparent. Issues related to the conflicts of interest in EU funds administration were also mentioned by the Security Information Service (BIS).¹⁴

The most common deficiencies in the procurement process:

- evaluation of tenders does not happen according to established criteria;
- stating a particular brand of the product without a variant solution;
- property or personnel links of applicants/recipient and applicants;
- failure to remove the non-eligible applicant/applicant who did not meet qualification criteria/submitted an incomplete bid;
- contradiction between the contract and the draft of the contract in a bid;
- failure to meet the deadline for the contract;
- selection of a supplier without the selection procedure;
- ambiguous, incomparable and uncontrollable evaluation criteria/failure to meet principles of transparency;
- missing written report about the meeting of the evaluation board;

¹² See SAO Annual reports for 2013, 2014, 2015, Council Recommendation on the 2015 National Reform Programme of the Czech Republic and Council opinion on the 2015 Convergence Program of the Czech Republic. Available from: http://ec.europa.eu/europe2020/pdf/csr2015/csr2015_council_czech_cs.pdf.

¹³ See Working document of the European Commission departments. Available from: http://ec.europa.eu/europe2020/pdf/csr2016/cr2016_czech_cs.pdf and Council Recommendation on the 2016 National Reform Programme of the Czech Republic and Council opinion on the 2016 Convergence Program of the Czech Republic. Available from: http://ec.europa.eu/europe2020/pdf/csr2016/csr2016_czech_cs.pdf.

¹⁴ See the Security Information Service (BIS) annual report. Available from: https://www.bis.cz/vyrocnizprava890a.html?ArticleID=1104#_Toc378162430.

- overstated (discriminatory) definition of the minimum level of qualifications;
- missing clarification of the criteria and the method of evaluation in the tender dossier;
- selection of the tenderer in conflict with the contents of the evaluation;
- evaluation of tenders in conflict with the manner described in the tender documents;
- failure to exclude the conflict of interest of the members of the evaluation board.
- contract with other than the winning tenderer.

Source: Conclusions of the inspection bodies in the programming period 2007-2013

In relation to subsidies, one can state that the nature of irregularities in public procurement on the part of the beneficiary has a similar pattern as the selection of projects on the part of the provider: there is a risk that the selection process favours a specific vendor who would not, under normal circumstances, obtain the contract (tailor-made contract). In this case, the conditions will most likely not conform to the best quality and price ratio principle. Failure to comply with the rules for the selection of suppliers is related to the violation of deadlines and the evaluation transparency requirements, incorrect procedures when assessing the fulfilment of qualification criteria, failure to conduct the necessary selection procedure or failure to transfer the necessary conditions arising from the winning tenders into the contracts entered into.

There may be three reasons for tailor-made contracts:

1. Beneficiary, who must assign a portion of the project, has an economic or personal interest to award the contract to a particular entity. In most cases, the recipient's ownership structure partially or completely overlaps with a "predefined" supplier.

In any case, such a supplier is selected based on a failure to apply or an inappropriate application of rules for public procurement (the tender is not announced, the tender is divided, the selection procedure is fake, the selection procedure has no results or the results are rigged).

Another example of preferential treatment is providing access to information that is not available to other applicants and that influence the bid price. Typically, this can concern information regarding the reduction of the volume of contracted services, which is reflected in the contract to be signed with the selected candidate. Such a contract does not contain some items originally included in the call for a bid (or selected items are modified for the purposes of the contract) and the selected candidate is instructed how to formally include this information into the bid (i.e. a technical solution), so that it is not obvious that its price is purpose-built. This procedure allows the favoured applicant to submit a lower bid price compared to other candidates because the favoured applicant knows which items can be undervalued without ultimately making a loss because these items will not be included in the contract at all. It is one of the most effective systems of fraud because the manipulation is not as obvious as in other systems (e.g. an unjustified solicitation of a single supplier).

Tailor-made contract is often associated with "cascading" subcontracting. This system allows the subsidy beneficiary to select a supplier who purchases services/goods from another subcontractor (instead of purchasing services/goods directly from the provider).

This often results in the reimbursement of costs that did not incur, on the basis of fictitious invoices.

2. Suppliers can also actively reach out to subsidy beneficiaries. For example, some consulting firms offer potential applicants help with drafting the project application. As soon as the beneficiary obtains the subsidy, they assign a large part or even the whole implementation of the project to the consulting firm, in exchange for a mutually agreed upon administration fee.

Offering discounts is another typical practice. It enables the beneficiaries to establish an exclusive relationship with one or more suppliers and, in return, receive significant discounts (which are not reported to the managing authority) or a turnover bonus related to purchases financed from EU funds.

3. The last option, though less common, is a situation where the beneficiary does not try to rig the tender but potential suppliers enter into collusive agreement in an attempt to increase prices for goods, works or offered services. The potential risk sectors are: construction industry (especially large infrastructure projects) and certain geographic areas where only a small number of entities operate. The fact that expenditure incurred on the basis of such agreement is considered ineligible by the European Commission is also problematic. Given the fact that they can occur without the knowledge of the contracting authority, it is necessary to harmonize practices of audit institutions and prepare clear guidelines for dealing with such situations. At the same time, it should be noted that the dangers of a prohibited agreement significantly endanger open procurement procedures.

Indicators of collusive agreements

- all candidates have consistently high bid prices;
- rotation of the winning candidate in the region, the type of contract and the type of work;
- the winning bid is too high in comparison with the cost estimates, price lists, similar works or services, the usual prices on the market or in the sector concerned;
- an unusual pattern of bids (for example, the bids will vary exactly by one percent of the price, the winning bid is just under the threshold/exactly at the specified maximum value, bids are too high/too similar/diverge too much, sums are rounded, bids are incomplete, etc.);
- Some companies always bid with the same contractor, others never bid;
- apparent links between the candidates (common address, staff, phone number, etc.);
- unsuccessful tenderers cannot be traced on the Internet or in business registers, they do not have any address (in other words, they are fictional).

The statements made by the accountants showed that if the originator agreed with the invoice, facts were not verified, and provided the invoice had all accounting requirements, the money would

be paid out. In this case, the originator of the transaction was someone who subsequently handled the funds on the account to which the money was remitted (the person responsible for the project). Although it was suspicious that the same company got invoiced for a very diverse set of services (selection of ropes, promotion and advertising, processing of studies and the creation of educational materials), nobody checked the data for a relatively long period of time). The association, which received orders and then sent invoices, was founded for the purpose of the contract at the time of the initiation of the project's implementation. The convicted was empowered to decide about the money spent from the subsidy while simultaneously being the final recipient of the large part of the funds as the supplier of the services. In the position of a statutory authority which he held in the association, he/she prepared invoices for fictitious or incorrectly valued work for which he received funds within the project. Influencing the selection of the supplier was accompanied by the purchase of overpriced goods and services and wasteful handling of resources. Additionally, services and goods were obtained at higher prices than usual at the place and time.

The convicted participated in the preparation of the project application, prepared documents, content and purpose of the projects and influenced the assignment of smaller jobs to particular entities. At the time of the submission of the project application, a large portion of work was already done. Issued invoices and subsequently collected money covered the costs incurred during the preparation of the project at the very beginning.

Source: Regional court in Ústí nad Labem, ref no. 50T 14/2013-3770

Situations also occur when the subsidy beneficiary selects a supplier in a proper selection process based on the combination of quality and price, who subsequently entrusts the contract to an entity who would most likely not obtain the contract in the selection process. Such practices are common in contracts for services when a contractor gets a larger number of contracts based on their qualification and previous experience. They do not have a capacity for some of these contracts and hand them over to another organization. This often leads to the change of the originally stated expert or trainer, substitution of products, etc. In the case of specialized activities, it is necessary to verify whether the subcontractor has the necessary permissions to perform the given activity.

Tailor-made contracts or excessive use of other subcontractors is usually accompanied by a failure to respect procurement procedures. It is a major problem because the way the beneficiary selects its suppliers is largely outside the control of the subsidy provider. One of the possible preventive measures could be the beneficiary's obligation to – for major procurement contracts – present all documentation, including the choice of the supplier, for an approval prior to entering into the contract. It should be also always verified whether the financial transactions in such contracts correspond with usual prices and whether the qualification requirements or technical specifications are not discriminating.

Indicators of tailor-made contracts

- "cascading" supplies;
- addresses, names of directors/owners, phone numbers and other contact details of the contracting authority and the supplier match/are very similar;
- split purchase: prices are often just tightly below the threshold for announcing a tender;
- a small number of selection procedures for the implementation of a project that requires high-value purchases;
- any signal that the supplier is a shell company (non-existent or incorrect address/phone number, off-shore company);
- recurring contracts with the same supplier;
- documentation relating to the selection of suppliers (the contract notice, evaluations, etc.) is not archived or is not presented to the managing authority;
- any signal of irregularity in the selection process (fictional candidates, same errors in bids submitted by various candidates, similar bid format, bids made from the same email address/data box, fake bids, bids that are too similar or very different);
- exorbitant price that does not correspond with the usual price;
- invoices from individuals instead of a company;
- items in the call for bids are different from those in the contract;
- removal or change of specifications of some of the items immediately after signing the contract;
- small number of tenderers;
- unusual or unjustified technical requirements;
- the winning bid is just below the set price limit;
- premature opening of bids/accepting bids after deadline
- cancellation of bids and the repetition of the tender;
- personal communication between the winning supplier and the employees of the contracting authority;
- unjustified or frequent changes in the contracts that increase the value of the contract;
- permanent acceptance of high prices, low quality of work, etc. (possible conflict of interest).

Indicators of the use of full/excessive sub-contracting

- match in person/address of the owner/co-owner of the supplier and the contracting authority;
- frequent change of some (or all) of the experts;
- experts are exchanged immediately/shortly after the commencement of the project;
- important project reports are handled by a subcontractor;
- invoices for suspiciously high total amounts are issued by the same subcontractor;
- invoices do not include a detailed breakdown into budget items (vague items such as "management/administration fee" for high amounts);
- delay in the implementation of the project;
- unsatisfactory quality of the implementation of the project;
- insufficient qualifications of the subcontractor or insufficient technical equipment for the execution of the contract.

Public procurement is closely linked with the issue of extra work. The Czech Republic has been repeatedly criticized by the European institutions for an unwarranted and excessive use of this tool, which leads to repeated problems in project management and regulation of their costs. Extra work and amendments to contracts should therefore be reduced as much as possible, or more specifically, should be regulated more strictly,¹⁵ and there should be options for anonymous reporting of suspicious practices.

Public procurement legislation is generally considered to be too complex. It is the lack of clarity and ambiguity of certain provisions that has been criticized. In addition, in connection with projects co-financed by the EU funds, various audit bodies apply different interpretations of the rules, which leads to unnecessary errors and misunderstandings. Many contracting authorities consider the guidelines in manuals as too theoretical and this is why they favour price as the sole selection criterion in the majority of cases.

It will therefore be necessary to increase the coordination of authorities responsible for the management and control of the European funds during the programming period in order to harmonize the interpretation of rules in specific cases. Clearer and practically focused recommendations should enable the contracting authorities to find the process of public procurement easier to navigate. They should obtain practical recommendations for the selection of the supplier also with respect to the evaluation of the quality and price ratio, and the entire life cycle of the usage of costs should be included. An introduction of online help (helpdesk) for tackling individual cases is a welcome tool. The obtained material should be utilized in the creation of manuals or in the methodology of control activities.

Conclusions and Recommendations

To answer the question whether there is a comprehensive set of specific conclusions and recommendations is very difficult. The EU funds are such a diverse system and such a complex structure of rules and procedures that to prepare a universal and yet specific set of recommendations relating to the prevention of fraud and corruption is almost impossible.

¹⁵ In this context, the increase of the limit for extra work in the new Public Procurement Act is incomprehensible, see Section 222(5) of Act No. 134/2016 Coll. on Public Procurement.

Looking at the situation in the allocation of European funds, there are apparent positives. These include the fact that the implementation of European funds is based on the principle of programming. This means that spending resources has:

- a predetermined target;
- a set timeline (a beginning and an end);
- a financial framework (volume of resources);

indicators for evaluating the appropriateness of the allocation of the resources (i.e., set inputs, outputs and outcomes);

- designated authorities responsible for the implementation, etc.

It is a very different situation than that which prevails in the allocation of most of the national resources that are largely distributed on the principle of institutional funding. This means that an institution/body/authority receives public funds for its activities because it exists, and exists because it receives money.

On the other hand, a large amount of funds for projects co-financed by the EU and the fact that although there are alarming examples of inefficient drawing from these funds and of fraud, the sanctions (with some exceptions) are mostly in the form of financial penalties imposed for breaches of the budgetary discipline or unauthorized expenditures. Therefore, the impression is that a project is difficult to obtain, but once the subsidy is granted, “things can always be sorted out somehow”. Not only the complexity of the issue and the need for highly specialized workers in managing authorities comes into play, but also a lack of staffing capacity of the supervisory bodies.

The efforts to simplify the implementation structure can be certainly seen as a positive step but the guidelines and rules for granting subsidies remain complicated, and despite the introduction of a single methodological environment, we can't say at this point that bureaucracy has been reduced. The persisting problem is that, on the one hand, there is no clear transfer of best practices, and on the other hand, an analysis of mistakes from previous programming periods is missing. Frequent personnel changes, low institutional memory, a rather uncoordinated data collection in the area of fraud and corruption by the managing, control and audit bodies and its transformation into the programming documents contribute to the fact that the prevention of fraud risk is not sufficiently effective. This is also accompanied by the fact that for the detection of fraud (in technology-specific areas with a complex structure of parties involved) a long-term work experience of control workers and their deep knowledge of the specific field are necessary. Therefore, all control authorities should focus on the retention of experts and the use of qualitative criteria for the establishment of the monitoring plan at the expense of blanket checks.

Given the difficulties in proving fraudulent conduct and remedying the damaged reputation, it is

generally desirable to prevent fraudulent activity rather than to deal with its consequences. Thus, the anti-fraud strategy must take into account the fact that fraud may occur, and therefore, it is necessary to design and implement a variety of measures to detect it. Risk management should be approached as a management of a large project. The current practice of accomplishing individual tasks without the managing authorities' staff and their managers considering previous findings, should be abandoned.

The new programming period has brought a positive shift with respect to transparency of processes. A good example is the extension of mandatory items for a list to be disclosed, featuring all recipients of subsidies, easier access to the results of the evaluation of projects, a clearer procedure for revocation and a mandatory disclosure of all evaluations (available on www.dotaceEU.cz in the "library evaluation"), etc. Attempts to make information provided to public more accessible and better arranged is also evident; individual specific projects can be traced according to various parameters (project title/beneficiary name/priority axes etc.). The advantage of such a presentation is an interactive link to a detailed description of the project. The disadvantage is a cluttered layout of the project list, which does not allow for a comprehensive comparison of projects according to allocation volumes, or the inability to effectively search for projects without prior knowledge of some of their identifiers. On the other hand, the level of information practice, user-friendliness and data updates of the individual sources (NOK, OP) still remains rather variable. Despite many improvements, the topic of European funds and the information about individual projects, their goals and benefits still remain a "terra incognita" for the general public.

The increasingly sophisticated collection, storage and analysis of data bring an opportunity to fight fraud. Within the relevant laws and regulations of the Member States, and when taking them adequately into account, the data analysis can be used to significantly enrich the process of risk assessment, cross-checking of the data with other public or private sector organizations (e.g. tax authorities, ministries and credit companies) and to identify potentially high-risk situation before the allocation of financial resources. In this context, it is worth mentioning the European Commission project ARACHNE, which aims to create a comprehensive database of projects implemented within the framework of the Structural funds in the EU Member States and create a tool of publicly available information as a set of risk indicators, based on which it will be possible to predict risky projects and contracts.¹⁶

The risk identification and management prior to the allocation of the subsidy must be accompanied by regular evaluation and monitoring of the project implementation, not only from the perspective of meeting the formal criteria in the project description, but also in terms of its effectivity, economy and effectiveness of individual projects and whole operational programmes. This is possible only if specific, measurable, achievable, relevant and timed objectives are set for all areas of activities in

¹⁶ "Managing authorities shall put in place effective and proportionate anti-fraud measures taking into account the risks identified." - Article 125(4)(c) of Commission regulation (EU) No 1303/2013.

accordance with the principle of sound financial management. However, extraneous criteria should not be evaluated. All evaluation aspects should be understandable, unambiguous, containing suitable and unique scales.

Example:

Description of a specific objective

Region X wants to strengthen the innovation of small and medium enterprises. The problem that needs to be tackled is the lack of capacity of the in-house innovations.

Therefore, the *result indicator* is a percentage of small and medium-sized companies using in-house innovation.

This indicator is taken from the set of indicators used in Regional Innovation Scoreboard – RIS). It is defined as follows:

Small and medium-sized businesses with in-house innovation activities. Innovative businesses are enterprises that have introduced new products or processes, either a) in-house, or (b) in combination with other businesses.

This indicator does not include new products or processes developed by other companies.

The starting point is the percentage of SMEs with in-house innovations in the year preceding the program (25%).

The goal is a higher percentage of these small and medium-sized enterprises. The region assumes that it is possible to achieve 30-35% by the end of the programming period.

Monitoring of the result indicator

The evaluation of regional innovation is updated every two years. The data is collected through Community Innovation Survey, which takes place every two years.

Evaluation

The evaluation will focus on the mechanisms and barriers that prevent SMEs take advantage of in-house innovation. The potential factors influencing the decision-making process of SMEs are:

- the availability of a loan;
- the ability to get qualified professionals;
- an innovative environment, i.e. the level of cooperation between businesses, universities and public institutions.

Two surveys — one targeted at businesses, the other at the public administration – conducted three years after the beginning of the programming period will provide the necessary information. The key issue is that the respondents determine the order of the above factors and identify further factors. The survey results will be interpreted through assessment and discussions with the

beneficiaries and subsidy providers.

Source: Guidance Document on Monitoring and Evaluation.– European Cohesion Fund. European Regional Development Fund. Concepts and Recommendations. Available from:
http://ec.europa.eu/regional_policy/sources/docoffic/2014/working/wd_2014_en.pdf

Programming documents must be based on high-quality analysis of what is to be achieved through the programme – description of the current status, description of the desired status, description of the barriers to achieving it and description of activities (including project types) that can achieve it. Every programme must contain interim and final measurable objectives and results for the assessment of success in terms of primary outputs as well as impact. The selection of projects and the evaluation criteria should be determined by the objectives. Priority must be given to those proposals that enable achieving outputs at lower cost. Projects that could lead to expected objectives but at the price of disproportionate costs must be excluded. Furthermore, it is necessary to set a minimum threshold that a proposed project should meet in order to be eligible for funding, which would result in excluding poor quality proposals, even if it means that not all resources for the particular call will be drawn. Fraud and corruption, the 3E approach and result-orientation are interconnected. If the main objective of the whole implementation structure is to spend all allocated funds without any clear ideas about the benefits of the European funds, then it is not surprising that only formal attention is given to the risk of fraud and corruption. And yet high-quality preparation of calls, well-chosen objectives, expected results and clear monitoring indicators are essential conditions for the mitigation of the extent of the irregularities and fraud. This should be linked to a better consistency with national legislation in the area of financial management, control and sanctions. Using the EU funds correctly for effective and efficient programs will be more meaningful than drawing 100% funds and considering it a primary success criterion.

On the other hand, an irregularity is any infringement of the conditions under which resources from the ESI funds were provided to the Czech Republic. The question is how to deal with such violations, which are, from the financial point of view, negligible and at the same time do not affect the implementation of the project or the quality of its outputs. Other problematic areas are for example the still persistent issues in Act No. 218/2000 Coll.¹⁷ and No. 250/2000 Coll.,¹⁸ the impossibility of reduction of a subsidy and the need to proceed in certain cases through a remission. The issue of

¹⁷ The Budgetary Rules Act.

¹⁸ The Budgetary Rules for Territorial Budgets Act.

irregularity confirmations and the determination and enforcement of levies is also complex. Pursuant to Act No. 218/2000 Coll., subsidy providers do not enter into this process; it is the financial authorities that deal with it. Overall, the system of enforcement through financial authorities is complicated, which is also caused by their unified procedures. Another problematic area are the blanket corrections in the national legislation, the payment of funds for expenditures affected by an error, and lengthy acknowledgments of irregularities. It would be appropriate to consider amending the national legislation in order to simplify the rules. To do this, it is also necessary to define the system of checks, guidelines for the scope of a sample on individual control levels and basic principles and procedures for the effective operation of checks. Also, these measures should be strengthened through efficient exchange of information between all stakeholders that represent all types and levels of checks. Checks should primarily focus on the verification of benefits and needs, and at the same time, on compliance with the principles of effectiveness, economy, and effectivity; checks should not primarily focus on formal errors. It is also important to ensure that subsidies are not reduced inadequately based on formal errors.

Last but not least, it should be noted that each programming period is a new experience for the Czech public administration and for the Czech citizens. The goal, of course, does not have to be the state of perfection, but a change for the better. The fact that European funds are perceived by many as an opportunity for quick and easy enrichment instead of a chance for a development of the society, does not have to be repeated. At the same time, it should be noted that attempts to misuse European funds are not mass-associated with the failure of the implementation structure.

Examples of good practice of successful implementation of projects (views of subsidy beneficiaries):

- thorough familiarity with the terms and conditions of the call;
- careful preparation of the project = easier implementation;
- managerial project management, periodic inspection of outputs and their comparison with the intermediate objectives and monitoring indicators;
- correct setting of the schedule of activities within the project;
- a well selected project team;
- consistent inspection of supplier(s) – outputs and adherence to schedule;
- if problems in the project occur, address them immediately with the subsidy provider, unnecessary administrative errors can be prevented this way;
- tenders and selection of suppliers should be conducted in advance and the schedule should be customized so that it can absorb any delays caused by potential withdrawal of candidates from the tender;
- establishing the principle of continuous improvement and enhancement of project

management through a systematic evaluation;

- consistency in the implementation and monitoring of compliance with the project objectives and conditions stipulated by the subsidy provider.

Source: Příklady dobré praxe aneb jak na strukturální fondy Evropské unie (Examples of good practice or how to make the best of the EU Structural Funds). Available from: <http://www.osf-mvcr.cz/file/3768/>.

Summary of recommendations:

- Mitigate the accent to draw funds without considering the quality of the projects, their clearly defined and verifiable objectives and outputs, effectivity and sustainability. Set up monitoring systems based on these parameters as well.
- Use all tools to stabilize the staff in managing authorities and supervisory bodies, strengthen their professional capacity through training, internships, etc. as much as possible.
- Create and adhere to the system of sharing good practice.
- Set the control mechanisms so that the inspection is exercised in the required scope and quality to detect weaknesses threatening public budgets in order to remedy the situation without the need for corrections.
- Strengthen the ex-ante control focusing on the identification of potential risks, provide the staff of managing authorities with easily accessible and user-friendly tools enabling cross-checks of the data (in particular those stated through honorary declarations). More consistently use the ex ante financial analysis tools (CBA) and the assessment of the risk of the deadweight effect and the transfer effect (the actual need for funding from public sources and favouring a commercial entity).
- Continue increasing transparency, especially for the public – easy availability of up-to-date information on beneficiaries, course of the project, results, conclusions of inspections, etc.
- Strengthen positive publicity of processes and results of the ESI funds in the Czech Republic.

LIST OF ABBREVIATIONS

3E principle	economy, effectiveness, effectivity
AFCOS	Anti-Fraud Coordination Service
CBA	Cost-Benefit Analysis
CF	Cohesion Fund
EAFRD	European Agricultural fund for Rural Development
EC	European Commission
EMFF	European Maritime and Fisheries Fund
ERDF	The European Regional Development Fund
ESF	European Social Fund
ESI funds	European Social and Investment Funds
EU	European Union
MF	Ministry of Finance of the Czech Republic
MMR	Ministry for Regional Development of the Czech Republic
SAO	Supreme Audit Office
NCO	National Coordination Authority
OLAF	European Anti-Fraud Office
OP	Operational programme
MA	Managing authority
YEI	Youth Employment Initiative