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**Raising the Institutional and Professional Capacity
of the Corruption Prevention and Combating Bureau
(Part B and C)**

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Report on EU Funds

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List of abbreviations

ASM	Aid Scheme Manager
CA	Controlling Agencies
DG	Directorate General
EAGGF	European Agricultural Guidance and Guarantee Fund
EC	European Commission
ERDF	European Regional Development Fund
ESF	European Social Fund
FIFG	Financial Instrument for Fisheries Guidance
HRD	Human Resource Development
HRD OP	Human Resource Development Operational Programme
IB	Intermediary Body
IAD	Internal Audit Department
KNAB	Corruption Prevention and Combating Bureau
LIDA	Latvian Investment and Development Agency
MA	Managing Authority
MS	Member States
OP	Operation Programme
PC	Programme Complement
PA	Paying Authority
SF	Structural Funds
SPD	Single Programming Documents
TA	Technical Assistance

1. Introduction

This document forms an integrated output of Activity C concerning EU funds.

The report is based on two missions implemented in March and April to meet with KNAB staff and with key persons outside KNAB. Nine meetings have been implemented with relevant institutions with the focus on meeting 1st and 2nd level implementing bodies of the EU Structural Funds.

Meetings with the following institutions have been implemented:

- KNAB, Corruption Prevention and Combating Bureau
- Transparency International, Latvia - Delna
- The State Audit Office, Analysis and Development Department
- Ministry of Economics, Financial Department
- Ministry of Finance, Department of EU fund
- CFLA, Department of Programme Control and Management Department
- State Regional Development Agency, Department of Support
- Rural Support Service, Department of Support
- Providus, Research Institute

KNAB has asked to pay special attention to and meet with Latvian Investment and Development Agency (LIDA). But it has not been to establish a meeting with LIDA.

Appropriate Latvian laws and material has been provided by the local project coordinator.

In addition to this and as background for comparative analysis telephone interviews have been carried out with the EU Commission and EU Structural Funds administrations.

Together this forms the basis of the report on assessment and comparative analysis of the allocation of EU structural and cohesion funds.

Following the Inception Report, the present report contains two interlinked elements:

- Assessment and comparative analysis on Latvian legislation framework on the allocation of EU structural and cohesion funds.
- Analysis of EU legislation and practice in the field of control of allocation and use of EU funds including practice in EU countries on possible risks of corruption in the allocation of EU funds.

The main results and findings in the report will be presented at a seminar at KNAB on the 21st June 2006.

The report is structured in the following way:

Chapter 2 briefly describes the institutional complex in which the management of Structural Funds are taking place, in order to outline the possible factors of

influence on the management of the Structural Funds. Furthermore, it outlines the EU principles of anti-corruption.

Chapter 3 outlines the EU legislation and practice in the field of management and control of the Structural Funds.

Chapter 4 includes a specific description and assessment of the Latvian framework for Structural Funds management. In addition to this it includes recommendations on how to improve the framework for the allocation of the Structural Funds.

Chapter 5 outlines the fraud in the use of Structural Funds and common problems on irregularities in the Structural Funds. It also contains a presentation of the European Anti-Fraud Office (OLAF).

Chapter 6 presents the example of the Danish and Hungarian European Social Fund administration with focus on the legal framework and best practice on preventing irregularities and fraud in various parts of the implementation of the programme.

Chapter 7 contains concluding remarks, furthermore good governance principles for administration of the Structural Funds are set up.

The report has been developed by short term expert, Susanne Møller Nielsen.

2. Public Administrations and EU anti-corruption principles

2.1 The institutional complex

Institutional settings breed certain types of relationship and social practice and either punish or perpetuate "social norms". The notion of "conflict of interest" as a part of corruption tends to be stronger in northern European countries than in the southern European countries. These differences between (and even within) countries depend on the "levels of trust" in the public administrations.

To the extent that a public administration embodies ethic codes, or a sense of civic responsibility, duty, or even honour on the part of civil servants, this will depend not just on traditions or social norms but on a wide range of influences.

The administrations are parts of an institutional complex and although in some countries it may have clear borders between its personnel and organisational rules and procedures and those of other parts of the society, in many countries the administration is heavily penetrated by outside political influences and social practices.

The elements for an ethic infrastructure in the public service range from mechanisms internal to the administration, to the external framework and the nature of the civil society in which the administration is located:

- Political commitment
- Effective legal framework
- Efficient accountability mechanisms
- Workable code of conduct
- Professional socialisation mechanisms (including training)
- Supportive public service conditions
- Existence of some ethics co-ordinating body
- An active civil society playing the role of watchdog over the actions of public officials

Latvia has taken a number of steps to strengthen its rule of law, public administration and criminal justice system. Based on information from various sources including Transparency International corruption is still ranked as a major problem in Latvia; the most corrupt public institutions are the customs authority, traffic police, juridical authorities and public procurement office.

The elements mentioned above embody systems of political leadership, guidance and management within the administration but are highly dependent on conditions outside it.

The conduct of the individual civil servant will be conditioned by both the internal incentive structure of the bureaucracy – which will establish the supply of corrupt acts on the parts of public employees – and the external incentive structure which will establish the demand for corrupt acts by private agents.

This incentive structure will shape the extent of "rent seeking" behaviour on the parts of both private actors and public officials – i.e. the degree to which both will engage in a process of what can be called "illicit exchange", through paying

and accepting bribes or becoming involved in conspiracies to defraud the public sector for mutual enrichment.

The management of the Structural Funds (SF) is carried out in these different institutional complexes in each of the Member States (MS), which affect the efficiency and possibilities for corruption and fraud.

Thus, the SF management systems reflect the ways decisions are taken in the various public administrations in the MS and the ways financing is planned and allocated. Within the management of SF all the general problems of national governance in the specific MS can be identified.

Thus fight against corruption, fraud and irregularities in the SF management system must be seen and targeted in a border perspective and be part of actions and measures toward public administration as a whole.

2.2 EU anti corruption principles

In relation to SF management, EU does not have direct and explicit anti-corruption principles included in the regulations. On the other hand the regulations do implicit relate to how a SF should be managed and controlled in anti-corruptive way. Thus the regulations, guidelines and principles builds on good governance principles which in cooperate anti corruption principles. Furthermore, the SF have principles on fraud and irregularities which relates to the implementation of the actual SF projects.

At the general level EU has produced several documents on fighting corruption, where the most relevant are:

- Article 29 of the Treaty on European Union mentions preventing and combating corruption as one of the ways of achieving the objective of creating and maintaining a European area of freedom, security and justice.
- The first communication on an EU anti-corruption policy suggested banning the tax deductibility of bribes and introducing rules on public procurement procedures, accounting and auditing standards, and measures relating to external aid and assistance.
- The Millennium Strategy on the Prevention and Control of Organised Crime reiterated the need for approximation of national legislation and to develop multidisciplinary EU policy and urged Member States to ratify the EU and Council of Europe anti-corruption instruments.
- The Communication on the fight against fraud, which sought to establish an overall strategic approach.

The Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee on "A Comprehensive EU Policy against Corruption" COM (2003)317 reviews the EU's progress in tackling corruption and suggests improvements to give fresh impetus to these efforts.

The aim is to reduce all forms of corruption, at every level, in all EU countries and institutions and even outside the EU. The Communication adopts the definition of corruption used by the United Nations' Global Programme against Corruption, i.e. "abuse of power for private gain". In its conclusion it sets out the principle elements of a future EU anti-corruption policy:

- a strong political commitment at the highest level;
- the implementation of existing anti-corruption instruments should be closely monitored and strengthened. The Commission recommends that the European Community adhere to the Council of Europe's conventions on corruption and participate in its monitoring mechanism, GRECO;
- EU Member States should develop and improve investigative tools and allocate more specialised staff to the fight against corruption;
- Member States and EU institutions and bodies should redouble their efforts to combat corruption damaging the financial interests of the European Community;
- common integrity standards should be established for public administrations across the EU;
- the efforts of the private sector to raise integrity and corporate responsibility should be supported;
- the fight against political corruption and illicit financing of social partner entities and other interest groups should be stepped up;
- corruption-related issues should be addressed in dialogues with acceding, candidate and other third countries;
- the EU should continue to make the fight against corruption an integral part of its external and trade policy.

In order to promote anti-corruption policies in the ten new EU Member States, candidate countries and other third countries, the Commission has drawn up ten general principles. Which are the following;

1. To ensure credibility, a clear stance against corruption is essential from leaders and decision-makers.
2. Current and future EU Members shall fully align with the EU acquis and ratify and implement all main international anti-corruption instruments they are party to (UN, Council of Europe and OECD Conventions).
3. Anti-corruption laws are important, but more important are their implementation by competent and visible anti-corruption bodies (i.e. well trained and specialised services such as anti-corruption prosecutors). Targeted investigative techniques, statistics and indicators should be developed. The role of law enforcement bodies should be strengthened concerning not only corruption but also fraud, tax offences and money laundering.
4. Access to public office must be open to every citizen. Recruitment and promotion should be regulated by objective and merit-based criteria. Salaries and social

rights must be adequate. Civil servants should be required to disclose their assets. Sensitive posts should be subject to rotation.

5. Integrity, accountability and transparency in public administration (judiciary, police, customs, tax administration, health sector, public procurement) should be raised through employing quality management tools and auditing and monitoring standards, such as the Common Assessment Framework of EU Heads of Public Administrations and the Strasbourg Resolution. Increased transparency is important in view of developing confidence between the citizens and public administration.

6. Codes of conduct in the public sector should be established and monitored.

7. Clear rules should be established in both the public and private sector on whistle blowing (given that corruption is an offence without direct victims who could witness and report it) and reporting.

8. Public intolerance of corruption should be increased, through awareness-raising campaigns in the media and training. Civil society has an important role to play in preventing and fighting the problem.

9. Clear and transparent rules on party financing, and external financial control of political parties, should be introduced to avoid covert links between politicians and (illicit) business interests.

10. Incentives should be developed for the private sector to refrain from corrupt practices such as codes of conduct or "white lists" for integer companies.

The EU has also established its own instruments to tackle corruption:

- The two conventions on the protection of the European Communities' financial interests and the fight against corruption involving officials of the European Communities or officials of the EU Member States
- The European Anti-Fraud Office (OLAF), set up in 1999, which has inter institutional investigative powers

3. Structural Funds management

3.1 Overview of the Structural Funds

The total budget for the SF amounts to EUR 195 billion in 2000-06.

The four types of SF are the following:¹

- The European Regional Development Fund (ERDF) contributes mainly to assisting the regions whose development is lagging behind and those undergoing economic conversion or experiencing structural difficulties
- The European Social Fund (ESF) mainly provides assistance under the European employment strategy ;
- The European Agricultural Guidance and Guarantee Fund (EAGGF) Guidance Section helps in both the development and the structural adjustment of rural areas whose development is lagging behind by improving the efficiency of their structures for producing, processing and marketing agricultural and forest products ;
- The Financial Instrument for Fisheries Guidance (FIFG) supports restructuring in the fisheries sector.

To improve the effectiveness of structural measures, Regulation (EC) No 1260/1999 reduced the number of Objectives from seven during the previous period (1994-99) down to three for 2000-06.

The Regulation also reduced the number of Community Initiatives from 13 during 1994-99 to four for 2000-06. The Initiatives are:

- Interreg III , which aims to stimulate cross-border, translational and inter-regional cooperation
- Leader+ , which promotes rural development
- Equal , which provides for the development of new ways of combating all forms of discrimination and inequality in access to the labour market
- Urban II , which encourages the economic and social regeneration of declining towns, cities and suburbs.

The way the SF are allocated depends on a sharing of responsibilities between the European Commission (EC) and the MS:

- The Commission negotiates and approves the development programmes proposed by the States and allocates funding
- The states and their regions manage the programmes, implement them by selecting projects, and control and assess them
- The Commission contributes to monitoring the programmes, commits and pays out approved expenditure and checks the control systems established.

¹ Further details on the scope of each fund and on eligible measures can be found in the following regulations: No. 1260/1999 of the council of 21 June 1999 laying down general provisions on the SF; No. 1783/1999 of the European Parliament and the Council of 12 July 1999 on the ERDF; No. 1784/1999 of the European Parliament and of the Council of 12 July 1999 on ESF; No. 1257/1999 on EAGGF; No. 1263/1999 on FIFG.

3.2 Management and control of Structural Funds

The detailed management of any programme financed by the SF is always the responsibility of the MS.

The management and control of the SF is done by national civil servants. The liability of the individual officials is not tracked specifically in relation to the management and control of the SF.

This relates to the specific national rules for the public administration in the MS, which is normally formulated in a national Civil Servants Law – as it is also the case of Latvia. EU is not involved in how each MS chose to structure and control the national public administration as good governance is not a part of the EU Aquis.

Relevant sections in the Latvian Civil Servants Law are:

- Section 16: Duty to be Responsible for the Lawfulness of ones Actions of Failure
- Section 20: Determination of the Duties of Civil Service Positions
- Section 40: Disciplinary liability

There is no documentation of the individual decision making as civil servants in the implementation of the SF as they act on various levels in the decision making structure on trusted positions. They make decisions with their authority in the specific position and there is no investigation or track of decision making at the individual level specifically regulated in the SF regulations.

The implementation of the SF can be seen as taking place within a chain of delegation. Applying this principal/agent framework means that the relations between EU and the MS can be seen as a contractual relationship.

While the broad priorities of a programme are identified in cooperation with the Commission, the choice of measures and practical projects is the sole responsibility of the MS, but has to be approved by the Commission.

The reference regulations considered for the definition of the organisational principles underlying the definition of management and control systems are in particular the following articles in the EC Council Regulation no. 1260/1999.

In terms of EU law the EU regulations prevails national directives. Thus, the MS can not change or interpret the EU regulations on the SF implementation into national laws and national contexts. But the MS often chose to transform the EU regulations into national decrees which merely translate and underline the content of the regulations into a national decree. Thus the principle is that EU regulations are directly applicable.

The relevant regulations in the EC Council Regulation are listed below:

- Art. 32, ruling the payment procedures adopted by the European Commission and the duties of the Paying Authority (interim payments, payments of final balance, etc.)
- Art. 34, ruling the activities to be carried out by the Managing Authority (efficiency and correctness of financed operations, gathering and for-

warding of financial and statistic data, drawing up of the annual implementation report, etc.)

- Art. 38, laying down general provisions concerning the financial control by Member States
- Art. 39, defining the conditions for which financial corrections are required, and the rules to assess their amount
- Art. 40, laying down general provisions concerning ex-ante, mid-term and ex-post evaluations
- Art. 41, laying down the specific criteria for the conduction of ex-ante evaluations
- Art. 42, laying down the specific criteria for the conduction of mid-term evaluations
- Art. 43, laying down the specific criteria for the conduction of ex-post evaluations
- Art. 44, ruling the allocation of the performance reserve

The rules introduced by the Community regulations are based on the definition of the key functions related to the management and control of co-financed operations:

- Managing Authority
- Paying Authority
- Intermediate Bodies
- Routine check (1st level)
- Sample check of operations (2nd level)

The MS must appoint a Managing Authority (MA) for each programme. The MA is responsible for all the operations included in an intervention, with special reference to the effectiveness and compliance of management and implementation

Following article 32 and 34 of Council regulation 1260/1999 the tasks of the MA include:

- responsibility for managing assistance under SF, insuring proper financial management and accounting systems in place,
- implementing internal controls, assembly of data and progress reports for monitoring and evaluation purposes, providing information on
- expenditure using financial tables,
- submission of proposals for reallocation of funds and adjustments to programme complements.

Monitoring Committees are also set up, which are always the responsibility of the MS. These Committees, chaired by a representative of the MA, ensure the efficiency and quality of the implementation of the structural measures.

The MS and the Commission make a financial contract whereby the Commission undertakes to pay annual commitment appropriations on the basis of the adopted programming documents.

Each MS appoints a Paying Authority (PA) for each programme to act as intermediary between the final beneficiaries and the Commission. As laid down in Council regulation 1260/1999 and Commission regulation 438/2001, the PA is responsible for ensuring the correctness of the money flow. The PA, in collaboration with the MA, monitors the expenditure of the final beneficiaries and ensures that the Community rules are observed. The physical movement of funds (pay-

ment appropriations) from the Union to the MS actually happens when the Commission reimburses the actual expenditure of the final beneficiaries, approved and certified by the PAs.

The SF regulations provide for the possibility of a national or regional authority transferring management of a programme or sub-programme to an Intermediary Body (IB). An IB is a public or private body or service acting under the responsibility of managing or paying authorities or performing tasks on their behalf in relation to final beneficiaries or the bodies or firms carrying out operations (Art. 2 Reg. 438/2001).

The increased decentralisation of programme management calls for improved checking arrangements, which are the responsibility of the MS. The Commission itself monitors the effectiveness of the arrangements set up by the MAs and PAs.

The PA is responsible for the processing, certification and submission of payment applications and the collection of payments from the Commission, and ensures that the final beneficiaries receive the amounts they are entitled to, as stated in Articles 9 and 32 of EC Regulation no. 1260/1999.

If the MA and the PA coincide or are in the same organisation, an adequate separation of the respective functions should be provided (Articles 3 and 9 § 4, Reg. 438/2001).

Routine check activities (first level) are carried out in parallel with intervention management and are represented by all those controls accompanying the activities of the MAs and PAs and of IBs.

The reporting is done to the relevant MA. The MS do not have to reflect these rules in the national laws as they have to follow and respect the EU legislation for the implementation of the SF.

But each MS can choose to have a national law for the implementation of the SF which is the case of Latvia with the "EU Structural Funds Management", Cabinet of Ministers Regulation no. 200, 30th March 2004. The purpose of the Law is to prescribe the SF management in Latvia insofar as such management is not prescribed by the legislation of the EU. The law prescribes the rights and duties of the institutions involved in the management of SF, the status of decisions taken at the Monitoring Committee and the Management Committee and the procedures for the taking, contesting and appeal of decisions of institutions involved in the management of SF. For further details please refer to section 4.1.

Sample check activities (second level) are aimed at verifying the efficacy of the management and control systems implemented and, based on selective criteria and on a risk analysis, the statements of expenditure presented at the various levels involved (Art. 10 Reg. 438/2001). Such activity must refer to a significant sample of operations, corresponding to at least 5% of the total eligible expenditure. Sample check activities are also aimed at obtaining the completion statement. Such statement shall be drawn up by a person or department having a function independent of the designated MA, of the person or department of the PAs in charge of the certification as per Art. 38, § 1, letter d) in Regulation 1260/1999, as well as of the IBs (Art. 15 Reg. 438/2001).

The reporting is done to the relevant MA. Also for the regulation holds that the MS do not need to include it in national law as it is regulated in the EU legislation and concerns with way payments are regulated. But for example Denmark has in addition to the EU legislation adopted a national law and decrees for example for the administration of the European Social Fund. In chapter 6 the Danish set-up and set of regulations and decrees are described in details.

The fundamental principle on which the management and control system act is the integration of the components involved in the implementation of co-financed initiatives:

- management activities (programming, ordinary management, payment, reporting, etc);
- risk assessment;
- routine check activities (1st level);
- sample check activities (2nd level);
- monitoring system.

Management activities must ensure the effectiveness and correctness of the implementation and in particular of the activities stated in Art. 34 of EC Regulation 1260/1999.

It is up to each MS to chose the administrative set-up of the SF and ensure the effectiveness and correctness. This can be done by clear and transparent operational procedures. It does on need to be reflected in a national law as the Art 34 is part of the EU legislation for the implementation of the SF which the MS has to follow.

But for example Latvia has a number of national laws and regulations which reflects the EU regulations. For more details of Latvian legal framework of the SF implementation please refer to chapter 4.1.

Risk analysis is the activity that allows to identify and oversee those internal and external factors that may compromise the fulfilment of intervention objectives, with special reference to the objectives of sound financial management, which should consider strategic as well as management and financial risks.

Strategic risks are linked to the definition of program guidelines, objectives and Community resources. Management risks are related to operational procedures for implementation (e.g. preliminary inquiries take too long, personnel is insufficient, etc.). Financial risks derive from a wrong use or loss of resources (e.g. wrong allocation of resources to a specific beneficiary, financial corrections, etc.). The organisation of management and control systems cannot be set up without a preventive risk analysis.

In order to ensure the fulfilment of strategic objectives of the SF, a close integration of various risks is required. This may be obtained through the circulation of an information flow of various evaluation and monitoring reports. In the case of Community programming, such circulation may be implemented by the monitoring system, represented by the information system in charge of the physical, financial and procedural monitoring of interventions.

Routine (1st level) check and sample (2nd level) check activities are described above.

Under an organisational profile, the sample check of operations and the issue of the completion certificate (Art. 38, § 1, letter f) of EC Regulation 1260/1999) may be entrusted to one or more persons, provided that:

- control tasks are duly separated from operation implementation or payment tasks
- the person or department in charge of issuing the completion certificate is functionally independent of the MA, the department or person from the PA in charge of the certifications as per Art. 38 § 1, letter d) of Regulation no. 1260/1999, and of intermediate bodies (Art. 15 Reg. 438/2001).

Each Administration may also decide whether to perform sample checks directly or through independent bodies. Also, the issue of intervention completion certificates may be outsourced.

Error and irregularity prevention activities and error detection and correction activities are among the main objectives of a management and control system. The Administration responsible for an intervention must adopt, through first-level control and management procedures, tailored actions aimed at preventing any error and irregularity. The body responsible for second-level control shall verify the overall reliability of the system and shall detect and report any deviations.

The correct operation of a management and control system cannot do without the assessment of risks by the body responsible for second-level control, to be used as a basis for the selection of the sample of operations to be controlled. The detection and assessment of the main risk factors is essential especially with reference to the need to establish the size and nature of the sample of operations to be tested for the reliability of the management and control system. For assessment purposes, risks may be classified as:

- inherent risks of the management system
- control risks, i.e. the possibility that a systematic control be unable to prevent or detect errors or irregularities

As a general rule, inherent risks are directly related to factors such as:

- complexity of reference regulations
- plurality of management levels
- payments made on the basis of applications and/or self-certifications
- absolute value of the operation
- type and characteristics of the final beneficiary
- modest skills of management personnel

4. Legal and Institutional framework of SF in Latvia

4.1 Legal framework

The MS has chosen different types of SF administrations depending on the size of the country as well as the traditions for centralisation and other different factors, such as political reasons.

Based on this outline below, the Latvian SF management system builds on a legal framework which has centralised the financial management of the funds and where the content and implementation of the funds have been decentralised.

The legal framework for the SF management in Latvia consists of the following main types of documents:

- Single Programming Document, 17th June 2004
- EU Structural Funds Management, Cabinet of Ministers Regulation no. 200, 30th March 2004
- Instruction of the Ministry of Finance
- Agreements concluded between the Managing Authority and each 2nd level Intermediate Body, agreement concluded between the Managing Authority and the Paying Authority
- Law on "Prevention of Conflict of Interest in Activities of Public Officials"

The Single Programming Document (SPD), Objective 1 Programme for Latvia has five priorities for which activities in Latvia are financed by the SF:

- Promotion of Territorial Cohesion, financed by ERDF
- Promotion of Enterprises and Innovation, financed by ERDF
- Development of Human Resources and Promotion of Employment, financed by ESF
- Development of Rural Areas and Fisheries, financed by EAGGF and FIFG
- Technical Assistance

The total allocation of SF in Latvia for 2004 – 2006, including co-financing, is almost 860 million EUR:

Structural Fund	Total (SF + Co-financing)
ERDF	490.000.000 EUR
ESF	182.000.000 EUR
EAGGF	140.000.000 EUR
FIFG	43.000.000 EUR
Technical Assistance (ERDF, ESF, EAGGF)	23.000.000 EUR

All activities financed by SF are divided into 3 implementation types:

National programmes	Package of projects which are elaborated in accordance with specific national sector strategies No competition between projects
Open call for applications	Open competition
Aid programmes	Same conditions as open call for applications

EU Structural Funds Management Law

The purpose of the Law is to prescribe the SF management in Latvia insofar as such management is not prescribed by the legislation of the EU. The law prescribes the rights and duties of the institutions involved in the management of SF, the status of decisions taken at the Monitoring Committee and the Management Committee and the procedures for the taking, contesting and appeal of decisions of institutions involved in the management of SF.

Thus, the law determines:

- The overall tasks and responsibilities of the institutions which are involved in the management of the SF
- The delegation to the Cabinet of Ministers to regulate the specific areas in the management of the SF
- Administrative process and procedures for the SF project applicants which differs from the ordinary administrative procedure described in the Law on Administrative Procedure

In brief the institutional framework for the management of SF in Latvia is the following:

1. Managing Authority – Ministry of Finance

Tasks:

- Elaboration of SPD, PC and TA National programme
- Overall management, implementation, control, monitoring and evaluation of the programme
- Secretariat for Monitoring and Steering Committees

2. Paying Authority – State Treasury

Tasks:

- Financial management and processing of payments

3. First Level Intermediate Bodies – ministries

Tasks:

- Elaborate sector interventions in case of national programme projects
- Select projects according to general quality and specific criteria
- Approve aid schemes, national programmes

4. Second Level Intermediate Bodies and Aid Scheme Managers

Tasks:

- Call for proposals
- Receive projects applications and ensure administrative assessment
- Enter into contact with final beneficiaries or bodies/firms carrying out operations in case of National programmes, open call for applications and Aid schemes
- Carry out control

The Bodies and Managers are the following:

ERDF	Central Finance and Contract Agency
ESF	State Employment Service (measures for development of employment)
ESF	Professional Education Development Programme Agency (measures for development of education)
EAGGF/FIFG	Rural Development Service
Aid Scheme Managers	Latvian Development Agency Society Integration Foundation Social Assistance Fund State Regional Development Agency

5. Steering Committee – 4 in total, one for each Structural

Tasks:

- Approve guidelines for applicants, including the project application form and standard contract between 2nd IB/ASM and final beneficiary/ body or firms carrying out operations in case of SF National Programmes
- Give opinion to: list of projects of open calls for applications, SF National Programmes and their projects, Aid Schemes
- Monitor on a regular basis implementation of priorities and measures on each SF level

Decrees of the Ministry of Finance

The Latvian Law "Internal Audit Law" of 31st October 2001 stipulates the following provisions:

The ministry or institution that the Cabinet of Ministers of the Saeima has empowered to perform the functions of implementation institutions shall perform internal audits of the EC fully or partially financed programmes and projects, including in the municipalities and business companies, which have received funding under EC programmes or projects.

It is the Ministry of Finance, Internal Audit Department (IAD) who is responsible for this audit function, and the legal framework for this is:

- Internal Audit Manual
- The Ministry of Finance Procedure for Sample Check of compliance of projects financed by SF, SF Claims for reimbursement and expenditure declaration.
- Charter of the Internal Audit Department and of Division
- Job descriptions

A number of different decrees defined the requirement of the MA and in relation to Financial Management & Control and Publicity.

A. Decrees on requirements of the Managing Authority:

- *Aid Scheme Evaluation Procedure (Decree no 501, 28th May 2004)*
- *Guidelines for Agreements between Institutions Involved in the Management of the Single Programming Document and Agreements with Financial Beneficiary (Decree no 504, 28th May 2004)*
- *Requirements for the 1st and 2nd level Intermediate Bodies (Decree no 854, 29th September 2004)*

- B. Decrees on Financial Management and Control
- *Procedure for Verifications of Individual Operations on the Spot (Decree no 712, 16th August 2004)*
 - *Procedure for Sample Check of Compliance of Projects Financed by SF, SF Claims for Reimbursement and Expenditure Declaration (Decree no 502, 28th May 2004)*
 - *Procedure for Communication of Irregularities Disclosed in the Process of Implementation of Assistance Granted under the SF (Decree no 546, 7th June 2004)*
 - *Procedure on Registration and Recovery of the Sums Wrongly Paid (Decree no 724, 28th August 2004)*
- C. Decrees on publicity measures:
- Decree on Visual Identity Guidelines (Decree no 503, 28th May 2004)
 - Procedures for the publication of information relating to co-financed SF projects (Decree no 964, 3rd November 2004)

Law on "Prevention of Conflict of Interest in Activities of Public Officials"

National legislation in Latvia regulates conflict of interest for civil servants, but employees of agencies are not in civil servants status. Delna has worked on applying civil servants status to employees of agencies and project evaluators, so that the employees of the agencies and project evaluators would be subject to the norms and sanctions stated in the Law on "Prevention of Conflict of Interest in Activities of Public Officials". The purpose of this law is:

- to endure that the actions of public officials are in the public interest
- to prevent the influence of a personal or financial interest of any public official
- to promote openness regarding the actions of the public officials and their liability to the public as well as public confidence regarding the actions of public officials

4.2 Assessment of Latvian SF management system and recommendations

Latvia has adopted national laws which support and "translate" the EU regulation on SF management into a national setting which is done by the majority of MS.

The material of the legal framework for the allocation of SF in Latvia can be characterised as clear and corresponds to the EU regulations which determines the rules at the Community level on management and control of the SF. The general Latvian legal framework specifies the national SF management system in Latvia.

Thus, the legal framework is in place for control of the allocation of the SF. The important question is how the regulations are being implemented in practice and how internal administrative procedures are developed and implemented in accordance to good governance and anti-corruption principles.

Based on the meetings with both 1st and 2nd level bodies it seems that there are well developed guidelines for the management, control and evaluation of projects.

But very few concrete internal guidelines (in Latvian) have been provided to the consultant. On this basis it is not possible to make an assessment the guidelines.

The quality of the guidelines is of utmost importance in the practical management and control of the SF – especially for inexperienced staff in the SF administration working with the complicated and comprehensive rules and regulations of the EU SF management system.

It could be considered to make detailed yearly internal evaluations and assessments of these guidelines in the different organisations in order to define the need for clarification of the guidelines.

The monitoring, control and audit regulations in the SF management system relates to the how the money is being used in relation to the objectives of the programmes.

The SF regulations relate to and secure in principle that the money which have been allocated to the programmes and the projects are used in the right way; meaning that the objectives of the programmes and the specific measures are met.

A special SF unit in the EU Anti-Fraud Office (OLAF) has been set up to combat fraud and irregularities in the implementation of the projects. The activities of the office are described in details in section 5.2.

In relation to the allocation and thus the selection of the specific projects it can be argued that the SF regulations do not cover sufficiently enough how the selection procedures are being implemented.

In this part of the SF management cycle there are several opportunities and channels for influence and use bribery in the decision making process which leads to the selection of the projects.

It is in this specific part of the SF administration - the selection of projects - there is a need to improve the legislation and administrative procedures of both the selection process as well as the preparation activities of the tenders and calls which comes before the selection of projects.

Thus it is of utmost importance that these procedures are being developed in a way so they are transparent and follow both good governance and EU's anti-corruption principles.

This is an important task for national Latvian organisations to fight against an unequal influence on the project selection process. Until now this has not been sufficient or successful.

Based on research and information from Transparency International, Latvia – Delna there are several recent cases which show that there are severe problems in the administration of the selection procedures of SF projects in Latvia.

This applies for a number of elements in relation to the allocation of SF funds:

- Information about the tenders/call
- Deadlines
- Procurement procedures

- Application procedures
- Selection criteria
- Selection procedures
- Information to winning/loosing project applicants

In general there is need to secure transparency and openness in the SF tendering and project selection system in order to secure equal opportunities of the applicants. In some fund administrations the need is more urgent and the cases are more severe.

A specific unit in KNAB should specifically focus on the SF in Latvia and it should be strengthened in order to influence and monitor these organisations which are responsible for the development of the selection procedures (relevant ministries and Intermediary Bodies). KNAB should be empowered to monitor what takes place in the Selection Committees of the various SF programmes.

This unit should be strengthened in order to develop suggestions for general laws, regulations and internal administrative procedures for the selection of SF projects – thus how the SF are being allocated.

Furthermore, it should inspire the relevant ministries of the various SF and especially their connected Intermediary Bodies in the development of good governance administrative procedures which can minimise corruption, bribery, pressure and lobby influence.

The focus should be on:

- Monitoring of Selection Committees (analytical)
- Development of laws and procedures (juridical)
- Suggestion for institution building in the Intermediary Bodies (organisational)

Thus, there is a need to improve and develop clear and transparent internal administrative procedures to insure this equal treatment of the applicants.

Risk zones of cooperation, fraud and irregularities can be reduced by good governance principles and by an effective implementation of SF regulations. In Chapter 7 on final remarks and recommendations a list of good governance principles is outlined based on EU best practices.

5. Combating Fraud in EU and in Structural Funds

5.1 Fraud in EU

Fraud can occur at all stages of the granting procedure, between different kinds of persons and different kinds of institutions, at different moments and in different ways.

According to the Convention on the Protection of the EC's financial interests of 26th July 1995, fraud is an intentional act or omission relation to:

- The use or presentation of false, inaccurate or incomplete statements or documents, which has as its effect the misappropriation or wrongful retention of funds from the general budget of the EC or budgets managed by, or on behalf of the EC.
- The misapplication of such funds for purpose other than those for which they were originally granted

More generally, the Commission has defined fraud as any infringement of a juridical rule by persons or institutions that provokes a financial damage to the budget of the EU.

The absence of European procedure and material law in criminal matters is a problem, but does not render on itself European fraud non punishable.

All MS laws do have a comprehensive criminal law, covering different kinds of fraud, through which European fraud can be punished: forgery and use of forged instruments, false declarations, swindling, breach of trust, misapplication of legally granted funds.

Thus, this is also covered by Latvian law, where criminal liability for fraud according to Latvian Criminal law is the following:

Section 177. Fraud

(1) For a person who commits acquiring property of another, or of rights to such property, by the use, in bad faith, of trust, or by deceit (fraud), the applicable sentence is deprivation of liberty for a term not exceeding three years, or custodial arrest, or community service, or a fine not exceeding sixty times the minimum monthly wage.

(2) For a person who commits fraud, if commission thereof is repeated, or by a group of persons pursuant to prior agreement, the applicable sentence is deprivation of liberty for a term not exceeding six years, or a fine not exceeding one hundred times the minimum monthly wage.

(3) For a person who commits fraud, if it has been committed on a large scale, or it has been committed, acquiring narcotic, psychotropic, powerfully acting, poisonous or radioactive substances or explosive substances, firearms or ammunition, the applicable sentence is deprivation of liberty for a term of not less than five years and not exceeding thirteen years, or a fine not exceeding one hundred and fifty times the minimum monthly wage, with or without confiscation of property.

Section 178. Insurance Fraud

(1) For a person who commits intentional destruction, damage or concealment of the property of himself or herself for the purpose of receiving insurance money, the applicable sentence is deprivation of liberty for a term not exceeding two years, or custodial arrest, or community service, or a fine not exceeding forty times the minimum monthly wage.

(2) For a person who commits compelling or persuading another person to destroy, damage or conceal insured property, or other influencing for the same objectives, if such has been committed by the owner of the property for purposes of receiving insurance moneys, the applicable sentence is deprivation of liberty for a term not exceeding three years, or custodial arrest, or a fine not exceeding sixty times the minimum monthly wage.

(3) For a person who commits the acts provided for in Paragraphs one and two of this Section, if such have been committed for purposes of obtaining a large amount of insurance moneys, the applicable sentence is deprivation of liberty for a term not exceeding six years, or a fine not exceeding one hundred times the minimum monthly wage.

Section 321. Misappropriation of a Bribe

(1) For a person who commits misappropriation of a bribe which a person has received in order to provide to a State official, or which he or she has accepted, pretending to be a State official, the applicable sentence is deprivation of liberty for a term not exceeding four years, or a fine not exceeding one hundred times the minimum monthly wage.

(2) For a person who commits misappropriation of a bribe which a State official has received in order to provide it to another State official, or which he or she has accepted claiming to be another State official, the applicable sentence is deprivation of liberty for a term not exceeding six years.

However the co-existence of 25 different law bodies is not likely to facilitate prosecution and effective punishment of the offenders.

Some MS explicitly assimilate fraud to the EU budget to fraud to the national budget, while others have legal provisions that apply solely to acts that harm the national budget.

Regarding the unlawfully obtaining of grants, some models of criminal law proceed from the active deception principle, while in others simple misrepresentation suffices. In some countries, there must be a conscious false statement accompanied by some form of conduct or manipulation designed to make it credible. In other systems omissions or misleading statements are enough to ground a criminal offence. Not all countries treat as an offence the misappropriation of funds lawfully received by grant or subsidy and criminalise failure to use the funds for the purposes or on the terms of the grant. This applies for examples for Denmark, Sweden and Finland where the charges only can be to pay back the money to the MA.

5.2 European Anti-Fraud Office (OLAF)

European Anti-Fraud Office (OLAF), was established in 1999 as successor to the 'Co-ordination of fraud prevention' task force (UCLAF) of the Secretariat-General of the Commission. Despite being part of the European Commission under the responsibility of the Commissioner in charge of the budget, the office has an individual independent status to pursue its investigative functions. OLAF thus enjoys investigative independence to detect and monitor fraud in e.g. the customs field, misappropriations of subsidies and tax evasion concerning the Community, and to fight corruption or any other illegal activity related to the finances of the Community.

On behalf of the Commission OLAF carries out all powers of investigation that derive from Community legislation and agreements with third countries. The office can "conduct internal investigations in all the institutions, bodies, offices and agencies established by or on the basis of the EC and Euratom Treaties" (Regulation No 1073/99, paragraph 7) and is entrusted "to conduct on-the-spot checks and inspections in the Member States" (*ibid.*, paragraph 9).

Essential for the effective execution of the office's investigative responsibilities is the close co-operation with national partners (investigation services, police, legal and administrative services, etc.) not only because the latter collect the traditional own resources of the Community but also because they implement almost 80% of the Community budget.

OLAF, DG Audit and the operational DGs share responsibilities for monitoring the system and irregularity communications at the Community level while the MS hold the primary responsibility for dealing with irregularities detected and for making financial corrections.

In the framework for the communication and follow-up of detected irregularities concerning SF (Regulation (EC) 1681/94), OLAF is the lead authority. This means that the authorities dealing with SF in the Member States supply OLAF with communications referring to details of detected irregularities (with a financial impact exceeding EUR 4 000) and provide the office with updates on such cases.

The obligation for reporting irregularities is set out in Regulation no. 595/91 for the Agriculture sector, Regulation nos. 1681/94 and 1831/94 for Structural measures and Regulation no. 1150/2000 for own resources.

The distinction between irregularities and frauds is that frauds are criminal acts as determined only by a judge in the context of judicial proceedings. As such, it is only when the judicial procedure has come to an end that the actual amount of fraud can be determined.

The main responsibility for managing and controlling SF expenditures lays down with the MS. Even though, when allegations of serious irregularities or fraud are brought to OLAF's knowledge, the Office may, after careful assessment, decide to intervene. It is Unit B8 for Structural Actions in OLAF which deals with fighting fraud against SF.

OLAF keeps therefore close relations with the Operational DGs that are responsible at the Commission level for the SF (DG REGIO, DG Employment, DG Agriculture and DG Fishery) as well with MAs and Controlling Authorities (CA) in the MS.

When an external investigation is opened OLAF performs (according to Regulation 2185/96) on-the-spot controls on the denounced beneficiaries, but also cross checks (suppliers, customers, transporters) in order to ascertain the reality and regularity of the expenditures financed by the European budget. These actions are developed with the assistance of the national authorities.

Regulation 2185/96, in particular cross checks performed under it has proved to be an essential tool in frauds detection. Organised fraud in SF normally means that documents, registers, book accounts, statements of the beneficiary fully comply with the expenditure's declarations submitted to the authorities. However, mutual agreements in order to defraud both the European and national budgets, are often uncovered when checking other economic operators related to the financed operations: Beneficiaries and suppliers are all the same and the financed operations have no materiality, over invoicing, ineligible nature of the expenditures, reversing to the beneficiary of part of the money paid to the suppliers, operations out of the eligible period etc.

OLAF's reports are often referred to the judicial authorities in the MS.

The practices of the MS's administrations still vary, though improvements have been achieved thanks to the efforts made to harmonise their approaches. The data communicated by the Member States remains sometimes incomplete. Furthermore, the distinction between "suspected frauds" and other irregularities is not consistent as MS do not always have the same definition of criminal risk.

One of OLAF's roles is to provide information and guidance on the implementing provisions of Regulation (EC) 1681/94, which deals with the communication of irregularities detected by the Member States to the Community level. A central aspect of its guidance for Member States is to define an irregularity. The office does this by referring to Article 1(2) of Council Regulation (EC, Euratom) No 2988/95 which defines an irregularity as "any infringement of a provision of Community law resulting from an act or by an economic operator, which has or would have, the effect of prejudicing the general budget ... by an unjustified item of expenditure". Generally, the distinction between fraud and an irregularity is that the former is an intentional act and a criminal offence, while the latter is any infringement of Community law resulting from an act or omission.

5.3 Types of fraud and irregularities in Structural Funds

The information on fraud and irregularities is received from the OLAF office, B8 on Structural Actions. The general types of irregularities in SF are based on a presentation by Maria-Rosa Sa, Head of Unit.

In addition to this, the information is based on the annual reports from OLAF which are available at the homepage of OLAF, including the "2004 Report from the Commission Protection of the EC's financial interest and the fight against fraud. Statistical Evaluation of Irregularities – Agricultural, Structural and Cohesion Funds and Own Resources".

In general the charges for violating the rules are to pay back the money which the project has received on a basis which has proven to be incorrect.

But some cases can also end by the national judicial authority issues arrest warrants, including civil servants working at the Managing Authority, if they have been involved. It depends of the national law in the member state.

Based on information from the Unit 8 and reports from OLAF the known problems regarding irregularities and fraud within SF the following can apply for all of the funds:

Over-invoicing:

The beneficiary asks his supplier for inflated invoices. This happens especially if both belong to the same company. Another mechanism is the channelling of over-charged prices via a third entity (e.g. supplier writes various invoices, these are then incorporated in a single global invoice issued to the beneficiary by an intermediary company.

Change of eligibility period:

Falsifying documents or declaring expenses that did not fall in the period eligible for reimbursement/funding.

If tendering is necessary:

Frequently tendering procedures are disrespected.

In relation to the specific funds the most known or common problems are as follows:

ERDF:

Projects concerning the ERDF are often carried out by public entities, specially for Objective 1 areas. The major problem is in the tender procedures which are not always carried out in a fair, unbiased and transparent manner. Also, since public works/infrastructure project with substantial impact on the environment are often being carried out, environmental regulations have to be observed.

ESF:

Cases concerning the ESF often cover training activities. In these projects, the teachers and instructors are often not correctly paid by the beneficiary. Another common situation of fraud is to falsify the list of seminar/course par-

ticipants. Furthermore, overheads or general costs are often charged to the project.

EAGGF-Guidance Section:

Project receiving funds from the EAGGF can normally be found in the settings of local level measures. Here, attention has to be paid to the proximity between farmers and suppliers, the problem of false invoicing has been observed in various cases.

FIFG:

Under FIFG funding, joint ventures are set up in third countries outside EU and vessels are registered here. However, the obligation to fish in third country waters for 36 months with these vessels is often not respected. Moreover, fish caught in these waters are not sold on the EU market as it should be. When projects concern the modernisation of vessels, normal repairs are declared as modernisation on invoices. In the course of the modernisation of fish-producing factories, over-invoicing and the declaration of second hand good as new have been observed.

Following the 2004 Report from the Commission Protection of the EC's financial interest and the fight against fraud, MS reported 3.339 irregularities, of which 3.049 under Regulation no. 1681/94 and 290 under Regulation no. 1831/94. The total EU budget amount affected by irregularities in 2004 was about 695 MEUR, 532 MEUR of which related to the SF and 163 MEUR to the Cohesion fund. Irregularities notified in this sector correspond to 1.95% of the budget allocated to structural measure in year 2004. For further details about the reported irregularities by the MS, please refer to annex 1 and 2.

It is difficult to highlight a real trend in irregularities concerning the Structural and Cohesion Funds as projects and actions financed through them take place on basis of multi-annual programmes. It is very likely that the increased number of reported irregularities with 34 % from 2003 to 2004 is influenced by improved controls and better compliance with the reporting obligation more than a rise of the irregularities.

In 2004, four new MS submitted their first communications related to the SF: Latvia, Estonia, Hungary and Poland.

For three MS the number of communications remained relatively stable (Austria, Finland and the Netherlands), while five MS saw a decrease in the number of notifications (Spain, France, Ireland, Luxemburg and United Kingdom. All others reported an increasing number of cases, for some significant (Italy, Germany, Portugal, Greece and Belgium). Relevant differences in the number of cases reported remain between the MS. The fact that figures from Italy are now in line with those from Germany opens according to the report the questions whether some under-reporting may still characterise other big MS, in particular Spain and France.

As regards to trend of irregularity reporting, MS can be divided into three groups:

- Decreasing: Spain, France, Ireland, Luxemburg and United Kingdom
- Stable: Austria, Finland, the Netherlands
- Increasing: all other MS

The most frequently occurring irregularity is "not eligible expenditure".

The most frequently occurring modus operandi in "suspected fraud" cases are "false or falsified supporting documents".

The ESF seems to present a higher percentage of cases of "suspected fraud" than other funds in the irregularities reported in 2004.

Irregularities concerning the ERDF have been increasing in number and financial impact.

6. Best practice example

This chapter deals with the implementation of the Human Resource Development Operational Programme thus the ESF administration in Denmark and Hungary as a best practice example of an EU fund administration. The focus is on the legal framework and best practice on preventing irregularities and fraud.

6.1 ESF administration in Denmark

The implementation structure of the ESF in Denmark has not been stable across time, but changes have not been caused by the EU, but by changes in national political-administrative priorities².

The ESF has traditionally belonged to the Labour Ministry, but in 2004 the Trade Ministry consolidated its position and the ESF was transferred to its jurisdiction.

In the programming period 2000 – 2006 Denmark receives approximately 67 MEURO every year under ESF.

The Law 254 of 12th April 2000 concerning administration of funding from the ESF is the legal base for the administration in Denmark and corresponds to the EU Regulation no. 1260/1999 concerning the Structural Funds and Regulation no. 1784/1999 concerning the ESF.

The responsible Danish minister for the administration of the ESF is the Minister of Trade. However, the minister's competence is delegated to the National Agency for Enterprise and Construction (Decree 858/2004). This agency is thus the overall responsible body for the ESF's activities in Denmark, both for objective 2 and 3 (the 'managing authority' cf. Council Regulation 1260/1999, article 9n). However, this does not mean that the administration of the ESF is a central government prerogative.

First, the Danish ESF means are divided into a central and decentralised part. Only the central part is administered by the National Agency for Enterprise and Construction. The decentralised – and largest - part is administered by Regional ESF Committees in each of Denmark's 14 counties. These committees decide individual applications for grants to regional projects and are the final beneficiaries (cf. Council Regulation 1260/1999, article 9l). Secretarial assistance is provided by the county administration.

Second, the EU's 'partnership' principle (Council Regulation 1260/1999, article 8) requires that sub-national authorities and interest organizations are consulted. At the central level, the National Agency for Enterprise and Construction decides the central ESF grants in a committee with representatives from a number of ministries, employers' and employees' organizations and the associations of local and regional authorities (Decree 1327/2004, § 9). At the regional level, the ESF Committees are composed of representatives of the county, local authorities, employers' and employees' organizations and the de-concentrated state labour market region (Decree 1327/2004, § 10).

² Further details of the Danish ESF administration can be found in annex 4.

Third, as required by the EU rules, there are monitoring committees supervising all ESF activities. They are composed of the above partners and the European Commission (Decree 1327/2004, § 3).

In sum, the Danish administration of the ESF is characterized by considerable corporate consultation and decentralization anchored at the county level.

After the introduction of the programming principle, the Danish central government decided that most applications to the ESF were to be decided at the regional level by Regional ESF Committees with broad functional and geographical interest representation. This principle was endorsed by the Danish Parliament when the implementation structure was formalized in the mid-1990s (Law 191/1995-96).

Law 254 and the decrees (no. 132/2001 and 133/2001) contain this supplementary administration rules for the administration of the ESF in Denmark.

The decrees, no. 132 and 133, state that the Managing Authority can develop more detailed guidelines in relation to the administration of the ESF-projects.

Following this, general rules of assessment of the programme and general guidelines for the administration of the projects has been developed.

This includes very detailed and clear guidelines for the regional ESF project administrator's control visits to the projects.

EU has by the regulation 438/01 concerning rule for implementation of Regulation no. 1260/99 has as far as the administration and control systems on SF projects laid down rules for how the MS has to organise the control of the projects and what kind of controls have to be implemented.

In Denmark the control and audit of the allocation of ESF means further regulated by the decree nr. 132 of 2001 concerning the responsibility and division of competences in relation to administration of ESF.

It is stated that an independent controller function has to report about the interventions. The controller shall implement control of both the administration, the PA and sample check of the projects. The controller shall send information about irregularities to the Commission according to regulation 1681/94. Thus every quarter the controller has to send a report on irregularities above 4.000 EUR.

Projects must find co-funding for at least 50 per cent of the approved project expenditures. Funds from the State, private enterprises, and/or institutions may be included in the co-funding.

Experience tells that the concept of co-funding is one of the most difficult ones in the ESF set of rules. This is how it works: Danish financial legislation does not include any separate provisions on funding of ESF projects. However, allowances for participants are included as expenditure in project budgets. This means the course participant's social benefit, salary or unemployment benefit is part of the project expenditures, even though, in reality, the project is not paying the participants.

In this way, allowances for participants are the most substantial source of Danish co-funding. The participants, therefore, provide money for the project. So the project needs to recruit, nurture, and retain the participants, as well as register their attendance. This is because unemployed course participants, and the remaining project participants, by virtue of their allowances contribute extensively to the project's co-funding. In the overall calculation, the participants make up the financial basis and the core of by far the majority of ESF projects in Denmark.

In the beginning of 2000 especially this co-financing principle caused cases of fraud and irregularities in ESF projects. These cases led risk assessment of the control system and improvement of administrative procedures.

The control system can after new improvements in 2004 be characterised as transparent and the various guidelines secures a high degree of homogenous administration of the projects in the regional as well as the national ESF administration.

The audit function is outsourced to one single private firm for accountancy, which implement the control and audit visits to all projects. This facility has proven to secure a uniform and homogenous use of the rules and regulation for the ESF.

In 2004 the administration system was further improved in order to make it more user friendly for projects. This means electronic application forms, clear guidelines for the budget and financing management.

In addition to this, a support homepage has been developed which give online access to a project implementation handbook and quick response to frequently asked questions.

An assessment by the Danish State Audit in 2004 concluded that there has been a degrees of uncertainty in relation to the reporting of irregularities and that the National Agency for Enterprise and Construction did not use a clear definition on when a irregularity should be reported to the Commission.

In a revision report of September 2003 the Commission has strongly suggested that specific guidelines and follow-up on irregularity are improved.

This was done in October 2004 where the National Agency for Enterprise and Construction developed guidelines on reporting of irregularities which was sent out to the administrations at the regional level. In these guidelines it has been made more when an irregularity is of such a character that it has to be reported to the Commission.

6.2 ESF administration in Hungary

The first MA for the Human Resource Development Operational Programme (HRD OP) was set up under the Ministry of Employment and Labour (MoEL) and had the full responsibility for the efficiency and correctness of management and implementation of the operational programme in accordance with the provisions of Article 34 of Council Regulation 1260/1999/EC.

The National Development Agency was set up as a new organisation in the summer this year as the MA for the HRD OP. This new Agency contains the old National Development Office, the Community Support Framework MA, and all the OP MAs. The administrative set-up and implementation of the OP follow the EU regulations and is supported by more than 25 national laws or government decrees. As for example the Government decree on the unlawful, irregular use of SF funds and on the procedure of reclaiming funds 55/2005 (III. 26.), Government decree on the institutions responsible for the utilization of grant deriving from the Structural Funds and the Cohesion Fund of the European Union 1/2004 (I. 5.) and Government decree on the rules and procedures of the utilization of grants deriving from the Structural Funds, the Cohesion Fund and ISPA program of the European Union 1/2004.(II.16.)

Article 2 of Regulation 438/2001/EC defines intermediary bodies as follows: 'For the purposes of this Regulation, "intermediary bodies" shall mean all public or private bodies or services acting under the responsibility of managing or paying authorities or performing tasks on their behalf in relation to final beneficiaries or the bodies or firms carrying out operations.'

In accordance with this Article, and in line with the provisions of the General Regulation 1260/1999/EC, responsibility for the implementation of the operational programme lies fundamentally with the MA. To this end, the MA in Hungary has delegated certain implementation tasks to intermediary bodies participating in the implementation of the programme.

The delegated Intermediary bodies are the following:

- National Employment Office (NEO);
- European Social Fund National Implementing Agency Public Company (ESF NIA);
- Ministry of Education Fund Management Directorate;
- The Ministry of Health, Social and Family Affairs' intermediary body, the Structural Fund Programme Office;
- Hungarian State Treasury (HST).

In relation to the National Employment Office (NEO), the European Social Fund National Implementing Agency Public Company (ESF NIA), the Ministry of Education Fund Management Directorate, the Ministry of Health, Social and Family Affairs' intermediary body, and the Structural Fund Programme Office, their main tasks are the following: project generation, project selection, preparing the grant contract as well as technical monitoring in cooperation with the NEO.

In addition, the National Employment Office (NEO) is the co-ordinating body of the overall monitoring process – including site visits (concerning ESF funded measures). In this context, the NEO will co-ordinate the activities of all Intermediary Bodies in relation to monitoring tasks. To this end, units of the NEO will be located in each county and will be responsible for registering and receiving progress reports and claims for payment.

At the same time, the Hungarian State Treasury (HST) is responsible for the overall financing aspects of the implementation, as well as for control tasks (in particular, public debt examination, grant-accumulation monitoring, examination of availability of grant limit, financial monitoring of transfers following inspection of submitted invoices and settlements, financial monitoring during and at the

closing of the payment period), and recovery tasks for funds used irregularly or deemed as repayable.

In its capacity as an intermediate body, the HST receives the progress report from the relevant intermediate body in question. In this context, the HST will be responsible for the verification of the financial part of the progress report (including payment claims) submitted by the final beneficiary/recipient of the aid.

The intermediary bodies are responsible in particular for:

- ensuring the verification of the expenditure reported to the Managing Authority in the format set by the Paying Authority;
- the compilation of verification reports on all expenditure co-financed by the relevant Fund, on the basis of which the transfers can be claimed through the Managing Authority;
- ensuring that payment claims forwarded by the final beneficiaries have approved invoices and verified documentation attached, and that an appropriate audit trail exists;
- the correctness of expenditure incurred by the final beneficiaries against assistance from the Funds concerned and forwarded to the Managing Authority.

Additional delegated tasks include:

- assistance in the development drawing up and publication of calls for proposals and centralised programmes for the relevant measures concerned;
- checking the project proposals for formal requirements and eligibility (completeness and eligibility) and drafting the grant contracts with the beneficiaries;
- receiving applications, checking formal and content based requirements, as well as organising their assessment;
- assisting in the selection of projects and operating the professional body/evaluation committee responsible for the selection of projects;
- processing progress reports and payment claims of beneficiaries;
- ensuring the project-level compliance with Community policies and horizontal guidelines (including public procurement), as well as with information and publicity obligations;
- providing up-to-date project-level financial and statistical data to the centralised monitoring information system and preparing regular and ad-hoc reports for the Managing Authority and the Paying Authority in a set format and content.

Final beneficiaries are the bodies and public or private firms responsible for commissioning operations. In the case of aid schemes, pursuant to Article 87 of the Treaty and in the case of aid granted by bodies designated by the Member States, the final beneficiaries are the bodies, which grant the aid (Article 9 1260/1999 EC Regulation).

The Human Resource Development Operational Programme Monitoring Committee (MC) is the body which monitor the implementation of the Operational Programme under its independent rules of procedure and in accordance with the provisions of Article 35 of the General Regulation 1260/1999/EC.

Selection procedures are strictly formalised, basic principles of selection procedure, like transparency, justification, insuring independence and application of four eyes principles are set in various international procedure regulations.

The Programming Complement fixes the selection matrix, which is approved by the Monitoring Committee. These evaluation criteria's are elaborated by working groups where the contact of the application package is made. All applications have a special working group like a task force to elaborate the documents chaired by the MA or the IB. The selection criteria's are public from the launch of the call for applications and can not be changed.

The involved ministries are asked by the MA to give their proposals to the project Selection Committee, the MA chairs the SC. There are two levels of evaluation or assessment. The pre-assessors are selected by a public call; the second filter is the Selection Committee.

Members of the selection committees must declare their properties, as well as all civil servants involved in decision making and property declaration is compulsory for those who approve payments. Strict selection criteria are applied for involving external expertise in evaluation assessment and monitoring phases.

Applications have the right to read all related assessment documents which also will give them knowledge of the evaluators. All applicants – both the winning and the loosing project – receive a written explanation of the decision in a official letter, which is mostly a summery of the assessment report and the assessors opinions.

Irregularity is treated at government decree level, as well as reclaiming procedures if irregular payment was made is also very clear and leads to reclaiming as if the amounts were taxes. In short, these are the basic elements of excluding bribery. Almost all elements of the above are described in the legislation.

The project monitoring system consists of three components: professional, financial, and procedural related (performance) monitoring activities. To this end, the Managing Authority has established the monitoring responsibilities of the Intermediate Bodies in accordance with their functions, with special attention to making the process transparent and traceable. In developing the system, a key objective was the development of a 'single-window' system for Beneficiaries in order to simplify the order of communication and intervention.

The relevant Intermediary Body (ME FMD, MHSFA SFPO) is responsible for the projects' procedural (performance) monitoring, formal, completeness and content check of progress reports, certification of invoices, verifying that tender procedures are conducted according to regulations. They are also charged with conducting on-site project inspections.

The Ministry of Finance is designated as the single Paying Authority (PA) for all Structural Funds and the Cohesion Fund, and will therefore have responsibility for drawing up and submitting payment applications supported by certified statements of expenditure and receiving payments from the Commission
The legal framework for financial implementation is set down in a government regulation on financial management, accounting and control of EU Structural Funds and the Cohesion Funds. Besides the clear definition and separation of

functions of the different bodies under the implementation system, the payment process follows the requirements of transparency in Article 32.1 of the General Regulation 1260/1999/EC.

All organisations and institutions involved in the implementation of the Operational Programme has established and operate their own internal audit units, under the direct supervision of the head of the organisation concerned. The unit is entitled to carry out checks related to any aspect the implementation of the HRDOP, including the intermediate bodies and the final beneficiaries. The internal audit unit is functionally separated from the day-to-day operations of the MA, and from the built-in ex ante and ex post managerial supervisory systems. The main task of the internal audit unit is to evaluate these systems of the organisation.

The 5% audits specified in Article 10 of Regulation 438/2001 are conducted by the supervisory audit unit of the National Development Agency and the Government Control Office. The supervisory control unit is functionally independent from the OP Managing Authority. In accordance with the provisions of Government Resolution No. 2213/2002 (VII. 24), the Minister of Finance co-ordinates the planning and implementation of site audit functions. The International Support Control Inter-ministerial Committee, established within the Ministry of Finance, ensures co-ordination.

The National Development Agency and Government Control Office send the audit reports to the Ministry of Finance. An annual report is prepared from the individual reports, which is then examined by the International Support Control Inter-ministerial Committee. Thereafter, the Ministry of Finance sends it to the European Commission. The Government Control Office is responsible for issuing the declarations on winding-up of the assistance under Article 38(1) (f) of Regulation 1260/1999 and in accordance with Article 15 of Regulation 438/2001.

7. Final remarks and recommendations

It was Metcalfe who first coined the term "management deficit" and posed the questions of whether the Commission in particular could "manage Europe".

The same question can be applied for member states and their ability to manage the Structural Funds, which they are responsible for.

It is difficult to talk about a single management process in the context of the multi-level and multi-agency system like the Structural Funds management systems in the different EU countries.

In implementing the system, the EC has observed the following problems: Inadequate separation of functions, insufficient staff both in terms of quality and in terms of quantity, as well as lack of powers transferred to the institutions concerned.

In the system of SF management there are risk zones of bribery, conflicts of interests, favouritism, nepotism and fraud³ as in all parts of the public administration which are part of the institutional complex.

These risk zones can be reduced by good governance principles and by an effective implementation of SF regulations, a coherent interpretation of the regulations, effective co-ordination of the bodies involved, and adequate training of authorities.

Conflict of interest helps create corruption friendly environment. Conflict of interest is a wide problem and it should be approached and solved on the general level with the view to selected situations in the context of the SF. Codes of Ethics for the single Operational Programmes could be introduced as anti-corruption measures.

It is in the specific part of the SF administration - the selection of projects - where there is a special need to improve the legislation and administrative procedures of both the selection process as well as the preparation activities of the tenders and calls which comes before the selection of projects.

As described in section 4.2, there are based on research and information from Transparency International, Latvia - Delna several recent cases which show that there are severe problems in the administration of the selection procedures of SF projects in Latvia.

In general there is need to secure transparency and openness in the SF tendering and project selection system in order to secure equal opportunities of the applicants. Until now attempt to improve the system has not been sufficient and the tools has not been effective enough change the system.

A specific unit in KNAB should specifically focus on the SF in Latvia and it should be strengthened in order to influence and monitor these organisations which are responsible for the development and implementation of the selection procedures

³ For description of these concepts please refer to annex 3.

(relevant ministries and Intermediary Bodies). KNAB should be empowered to monitor what takes place in the Selection Committees of the various SF programmes.

This unit should be strengthened in order to develop suggestions for general laws, regulations and internal administrative procedures for the selection of SF projects – thus how the SF are being allocated.

Furthermore, the unit should inspire and put forward recommendations to the relevant ministries of the various SF and especially their connected Intermediary Bodies in the development of good governance administrative procedures which can minimise corruption, bribery, pressure and lobby influence.

In relation to experience from other EU countries the following are all features of good governance in SF management and project implementation which should be built into clear guidelines for the administration as well as for the applicants. Each of these features can help prevent possible risks of corruption, fraud or irregularities – on both sides: the administration side and the application side. The underlying principle is to secure equal opportunities and transparency of the allocation and use of the SF resources.

Complete information

Full information on tender regulation, guidelines, basis information should be available on the day when the project tender is announced and is not changed during the tender process.

During the tender process the responsible institution should provide written and binding answers to clarification questions. The answers should be transparent, open and available for all applicants for example through the internet.

Evaluation criteria

Project evaluation criteria and evaluation procedures should be defined before the tender is open. The criteria are clear and available for the applicants.

Specific deadline

Within a reasonable period of time the applications can be prepared. All applications submitted before the deadline should be evaluated based on the same evaluation criteria.

Clear calls for proposals

Clear requirements in specific calls under a specific measure in a SF programme can prevent possible fraud and prevent that very vague formulated projects receive funding for activities which are not intended under the programme of the policy. This is for example the case in Hungary in relation to the ESF, where the programme document is divided into a large number of measures and where specific calls define the projects.

Information on selection of projects

All applicants should be informed about the reasons for which their application has been successful or has failed to receive funding. The justification of this should relate to the selection criteria which have been public to the applicants. Furthermore evaluation committees' minutes and individual evaluator sheets could be made public.

Support in relation to project implementation

Support from administration to SF projects in relation to both the content of the projects as well as the financial management.

Procurement

Clear rules for procurement and national laws on procurement correspond with the EU rules for procurement and tendering.

Control of project implementation

Most effective controls are those that exist inside institutions – honest and effective supervisors, good auditing offices, and clear rules on ethical behaviour should be able to discourage or uncover corrupt behaviour.

Complaints

Procedures for complaints should be clear and be informed to the applicants in advance of a call or a tender procedure.

SF Ombudsman

It could be considered to establish a SF Ombudsman function to take care of complaints from the public on the management and implementation of the SF. This institution could be an important watch dog for correct implementation and allocation of the funds.

With view to training of civil servants involved in the implementation of SF the experience has shown that especially the creation of human resources is a timely process and that most programmes were thus handled better at the end of a programming period than in the beginning. This should especially be kept in mind when analysing the management of SF in the new member states.

It can be argued that the three main indicators for efficient management of the Structural funds are:

- Structures
(Clear allocation of responsibilities, competences and tasks to institutions, including coordination arrangements between, as well as within, institutions.)
- Human resources
(The ability to detail responsibilities, competences, and tasks not only at institutional level but also at the level of individual employees.)
- System and tools.
The availability of procedures, forms, guidance, manuals. etc.

The most important aspect for an efficient management is the clear division of responsibilities and tasks.

The management structure combined with the 3 main indicators above forms the SF management grid which is summarised below:

INDICATORS	DESIGN		
	Structure	HRD	System & Tools
Management	Designation of MA	Staffing of MAs	Arrangements for delegating tasks
Programming	Clear objectives, measures and calls	Capacity to carry out programming	Clear Guidelines/Manuals for programming
Implementation	Assignment of IB	Staffing of IB and training	Administrative and electronic support for project implementation
Evaluation & Monitoring	Designation of monitoring and evaluation responsibilities	Availability of independent evaluation expertise	User friendly computerised monitoring and evaluation system
Financial Management & Control	Designation of PA and functions	Accounting and auditing expertise	Existence of uniform accounting system and financing procedures

An important and possible strategy to combat fraud and irregularities in the SF administration system is to secure - through structure & tools, HRD and systems - that the conditions in the matrixes are in place and continuously assessed and improved.

8. Annexes

Annex 1

Structural Funds

Irregularities communicated by MS under regulation no. 1681/94

2004 – Number of cases

Member state	ERDF	ESF	EAGGF	FIFG	Total
Austria	25	8	5		38
Belgium	38	4		3	45
Denmark	31	15	1		47
Estonia		6	1		7
Finland	14	21	2		37
France	37	66	4	3	110
Germany	736	185	56	8	985
Greece	79	26	42	3	150
Hungary		1			1
Ireland	43				43
Italy	423	125	77	13	638
Netherlands	6	46	4	2	58
Latvia			2		2
Luxemburg	1	2			3
Poland		2	1		3
Portugal	52	34	165	5	256
Spain	59	164	28	12	263
Sweden	67	47	4	1	119
United Kingdom	160	66	11	7	244
Total	1.771	818	403	57	3.049

Annex 2

Structural Funds

Irregularities communicated by MS under regulation no. 1681/94

2004 – Amounts in MEUR

Member state	ERDF	ESF	EAGGF	FIFG	Total
Austria	2.813	302	309		3.424
Belgium	14.375	63		504	14.942
Denmark	1.456	1.009	10		2.475
Estonia		31	74		105
Finland	974	457	60		1.491
France	1.774	1.227	52	51	3.104
Germany	107.783	12.052	6.013	1.624	127.472
Greece	104.027	4.834	2.992	486	112.339
Hungary		6			6
Ireland	3.451				3.451
Italy	175.478	12.003	5.225	2.212	194.918
Netherlands	2.083	3.472	1.281	17	6.853
Latvia			361	361	
Luxemburg	3	107			110
Poland		12			12
Portugal	4.172	1.888	4.318	710	11.088
Spain	19.904	4.728	866	377	25.875
Sweden	1.969	641	90	40	2.740
United Kingdom	18.282	3.203	102	466	22.053
Total	458.544	46.035	21.753	6.487	532.819

Annex 3

In the following various forms of corruption and related actions are described. These descriptions which are commonly used are sampled by Rambøll Management. In this report they serve as an explanatory purpose and are not analysed up against terms and definitions used in Latvian laws.

Bribery

Bribery is the act of offering someone money or other valuables in order to persuade him/her to do something for you; or the act of demanding a payment for more or less concrete returns. Bribery is the payment of a fixed sum, a certain percentage of a contract, or any other monetary favours in money or kind to (in most cases) a state official. To pay or receive a bribe is corruption per se. There are many equivalent terms to bribery, like kickbacks, baksheesh, sweeteners and pay-offs, which are all notions of corruption seen "from below", from the corrupters point of view. These are all payments needed or required to make things pass swifter, smoother or more favourably through a bureaucracy, or to avoid a certain burden.

Bribery, however, is indeed also extraction from "above". It is a kind of "informal" taxation when public officials charge extra under-the-table payments or "gifts" from clients. It is an extractive form of bribery when police officers stop you and search your car for possible offences, not so much to prevent a crime as to get an opportunity to demand a bribe.

Facilitation Payment

A facilitation payment, also called "speed" or "grease payments", is a small payment made to secure or expedite the performance of a *routine, legal or necessary action*.

Facilitation payment is a debated topic. Some consider such payments tolerable as an acceptable necessity to "grease the wheels" of trade, in the absence of which international business cannot function effectively and expediently. Others, such as for instance Transparency International, consider facilitation payment to be not far removed from bribery.

Fraud

Fraud is an economic crime that involves some kind of trickery, swindle or deceit. It is fraud when for instance state agencies and state representatives are engaged in the black and grey (informal) markets, and when networks of forgery, trade in illegal goods and smuggling are propped up by "official" sanction and involvement. While serious fraud is generally treated as cases of individual enrichment, fraud can also be "collective" when it is used by the ruling group to increase the benefits for the rulers, and as such may be labelled extractive corruption.

Favouritism

Favouritism or cronyism is to grant offices or benefits to friends and relatives, regardless of merit. It is the mechanism of power abuse, which leads to the "privatisation" and a highly biased distribution of state resources. Clientelism is a basic characteristic of the neo-patrimonial societies, but in most societies it is a common feature – and even expected – to favour one's kinship members (family, clan, tribe, ethnic, religious or regional group).

Nepotism

Nepotism is a special form of favouritism, in which an office holder (ruler) with the right to make appointments tends to prefer to nominate to prominent positions his proper kinfolk and family members (wife, brothers and sisters, children, nephews, cousins, in-laws etc.). When "successful", deeply nepotistic systems are starting to resemble to a "mafia" because of the shared family "values" and loyalties.

Annex 4

The Danish ESF-model

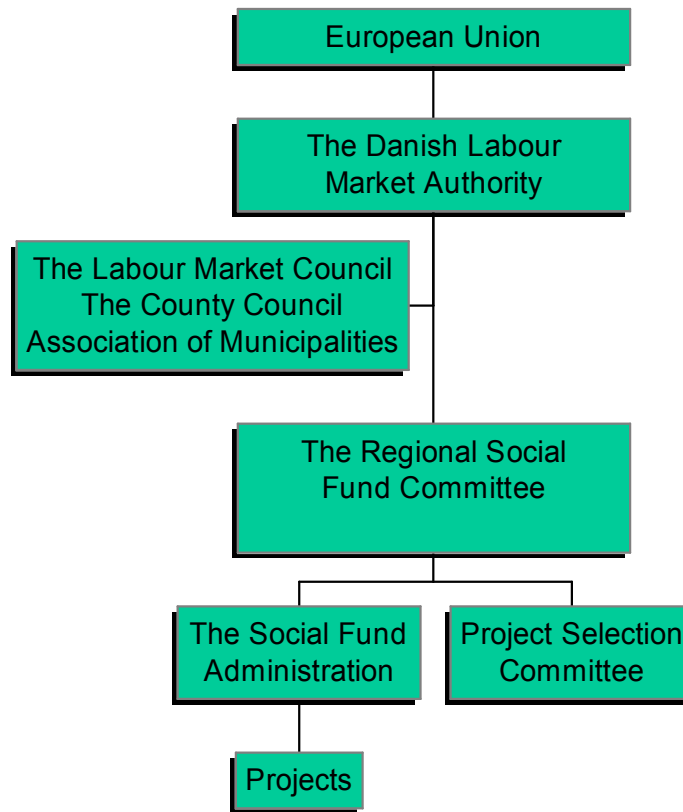
In relation to the administration of the ESF in Denmark, there are three important partners.

Institution	Responsibility
National Agency for Enterprise and Construction	<ul style="list-style-type: none">• Implementation and administration of ESF nationally• Horizontal coordination• Programming• Co-operation and negotiation with the EC• Monitoring committee• Monitoring control, accounting towards the EC• Administrative contact to the other line ministries and regions
Regional Social Fund Committees	<ul style="list-style-type: none">• Play a role in the implementation of measures and projects• Planning, co-ordination and project approval• Secretariat in each region/ESF co-ordinator
Monitoring Committee	<ul style="list-style-type: none">• Oversee implementation of the programme

At the national level, the National Agency for Enterprise and Construction, being a sub-unit of the Ministry of Trade, is responsible for the implementation and co-ordination of the ESF nationally. Further, as listed it undertakes horizontal co-ordination, programming, co-operation and negotiation with the EC. It participates in the monitoring committee, is responsible for monitoring, control and cost statements and final reports to the EC, and is responsible for contact to other line ministries.

At the regional level a regional social fund committee in each of the 15 counties, who is responsible for local planning, co-ordination and project approval. In these committees there are 2 representatives from the County, 3 representatives from the municipalities, and in each region there is a regional Labour Market Council who sends two representatives from the unions, 2 representatives from the employers' associations, and one representative from regional head of the Council. Further, the Regional Social Fund Committee has a secretariat, often located at the County Administration, with one or more ESF co-ordinator.

Finally, we have a monitoring committee whose task is to oversee the implementation of the programme, but we will return to this committee later.



The following figure is a complete list of the actors involved in the Danish ESF programme, and their relationship to each other.

Starting from the bottom, the project promoters consults the Social Fund Administration, usually located at the county level.

Upon submission deadline, the projects are forwarded by the ESF co-ordinator to the Project Selection Committee, who consists of members of the RSFC.

Before passing the selection of the projects to the National Agency for Enterprise and Construction for final approval, the Labour Market council, the County Council, and Association of municipalities are also heard. This is due to the principle of additionality, implying a 50% co-finance from these partners.

Finally, the National Agency for Enterprise and Construction deals directly with the EC.