

CHALLENGES TO THE ENHANCEMENT OF THE EFFICIENCY OF THE PROTECTION AND FIGHT AGAINST FRAUD WITH THE EU FUNDS – BULGARIA'S EXPERIENCE SINCE 2007

*Prof. Tatyana Hubenova, PhD
Bulgarian Academy of Sciences*

Abstract

The goal of the paper is to discuss the improvement of the prevention, detection and fight against irregularities and fraud with European and own budget funds in Bulgaria during the first decade of Bulgaria's EU membership. The focus is on increasing the institutional capacity of the financial control and management system for the achievement of a higher degree of prevention or in case of irregularities and fraud – the recovery of unduly spent funds from the general budget of the European Union and the Central Republican Budget of Bulgaria. Based on the identified problematic areas and risks, the paper discusses the challenges to attaining the strategic objectives that have been set in the National Strategy for Prevention and Fight against Irregularities and Fraud, affecting the financial interest of the European Union for the period 2014 – 2020.

Key words

financial control and management system, prevention, detection and fight against fraud and irregularities, EU law.

Introduction

The present state of the functioning of the Bulgarian public management and control system for the fight against fraud and corruption is an outcome of an ongoing process of restructuring for more than a decade since Bulgaria has joined the EU in 2007. The main trends of the fight against

corruption may be presented on the basis of the analysis of Bulgaria's fiscal policy implementation of the EU requirements for compliance with the EU law and the implementation of the strategic and operational goals of the fight against fraud and corruption. Compliance with EU law has been the main trend of changes in Bulgarian's policy in favour of increasing prevention and imposing proportionate and dissuasive penalties in cases of fraud and irregularities with the state budget and EU funds. The paper discusses the problems of enhancement of the efficiency of the protection and fight against fraud and corruption as follows: 1) Corruption, fraud, irregularities: conceptual framework and evaluation; 2) Improving the institutional capacity of the fight against corruption and fraud; 3) The changing framework of the EU policy against fraud in the last decade. Conclusion is drawn to summarise the lessons learned.

Corruption, fraud, irregularities: conceptual framework and evaluation

Since its accession to the EU Bulgaria has not only pledged, but also has transposed the EU legislation in the field of public finances and public accountability in a timely manner, including a comprehensive reform of the system for management and control of public funds (de Koning 2008). Bulgaria has a fully harmonised with the EU system of management and control over its own public funds and the European Union funds. The fiscal policy assessment over the last two decades has shown that substantial progress has been achieved in fiscal discipline and in the overall Europeanisation of macroeconomic policy. The issues of financial and public accountability as well as political and electoral accountability have gained priority in the public sector and public finances. The sustainability of government finances is supported by the lawfulness of fiscal rules in line with the European requirements.

Fraud prevention and detection are important for Bulgaria's public and EU funds' financial management. In spite of the fact that Bulgaria has become a EU Member since 2007, the European Commission has applied a *Mechanism for cooperation and verification* (CVM) in order to help to overcome the shortcomings and problems in the area of judicial reform, the fight against corruption and organised crime as failures which undoubtedly may hinder the integration process as well as the overall economic development. Both Bulgaria and Romania were placed under close EU scrutiny after joining the EU to encourage judiciary reforms to apply the EU standards. The

initial intention was that these deficiencies could be overcome in a couple of years. However, implementation of the Mechanism for Cooperation and Verification is expected to proceed further for some time onwards. In spite of the progress made in implementing judicial reforms, the fight against corruption in Bulgaria has to continue at present, as there is a need still more work to be done.

At the present stage of Bulgaria's economic development, the government and the official institutions have encountered problems with the occurrence of varieties of forms of corruptions and irregularities with public funds (both national and EU funds). The overall social impact of the corruption and the modalities of its contagion at a macro, sectoral and micro level is negative due to the public losses sustained not only financially, but morally. The cases of high political level corruption and the corruption in local municipalities have raised the public discontent and stress the need to improve the efficiency of the fight against fraud and corruption. The official policies have become better focused on the improvement of the financial and control system and the prevention of corruption and fraud. But still the modernisation of the penalty law is to be improved further in compliance with the EU legislation and international good practices.

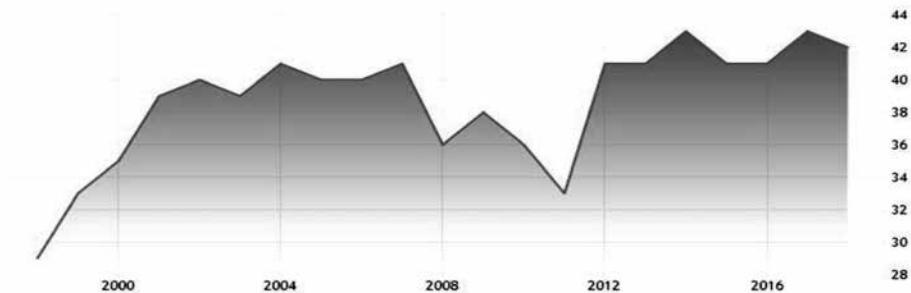
It is to be acknowledged that the Bulgarian experience with the fight of corruption and fraud has evolved essentially during the period of transition from a centrally planned to a market economy. The notion of corruption has changed as a consequence of the alterations of the types of fraud and corruption at the beginning of the transition to a market economy in the first half of the 1990s as compared to the corruption and fraud by the end of year 2010 and at present. In mid-1990s, the corruption was understood as the fraud to privatise at low cost state-owned entities and it has been related to a high level of corruption and abuse of power. The next broad view of corruption reflects its understanding as "rent seeking" by public officials and their private sector counterparts.

The administrative and institutional view of the corruption may be considered predominant for the present times, as the corruption is observed in a variety of forms as a result of the crisis of institutions and democratic deficit, such as the abuse of property rights, market failures, conflict of interests and nepotism. D. Acemoglu and J. Robinson describe the lack of proper institutions as the main reason for the economic underdevelopment and a barrier to growth (Acemoglu & Robinson 2012). This concept makes the need to fight corruption more acute and pending on the agenda of reforms in Bulgaria to

improve public accountability, legal justice and efficient financial control of public funds.

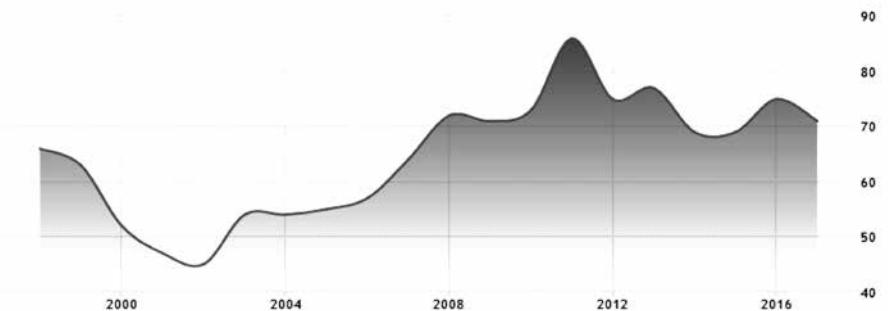
As shown on Figure 1, Bulgaria scored 42 points out of 100 in 2018, taking into consideration Corruption Perceptions Index reported by Transparency International. Corruption Index in Bulgaria averaged 38.67 points from 1998 until 2018, reaching an all-time high of 43 points in 2014 and a record low of 29 points in 1998.

Figure 1. Bulgaria: Corruption Perception Index for 2017 by Transparency International



Source: Transparency international, 2019.

Figure 2. Bulgaria: Corruption Rank in 2018 by Transparency International



Source: Transparency international, 2019.

As seen on Figure 2, the 2018 Corruption rank reported by Transparency International has ranked Bulgaria as the 77th least corrupt nation out of 175

countries. The Corruption Rank of Bulgaria averaged 65.33 from 1998 until 2018, reaching an all-time high of 86 in 2011 and a record low of 45 in 2002.¹³⁷

Bulgaria applies the requirements for the protection of the European Union's financial interests under Article 325 of the Treaty on the Functioning of the European Union (TFEU). The indicators of reporting fraud and irregularities are strictly reported and confirm the progress achieved (COM(2018) 553).

The government, the public institutions and the non-governmental organisations in Bulgaria have undertaken the fight against corruption and fraud on the basis of their engagements to improve the prevention and to enhance the efficiency of the fight against fraud and corruption. A focus of the discussion undertaken by Bulgarian Govermental and non-governmental organisations in the last decade has become the issue of identification of two types of gaps in anticorruption policies/measures: an implementation gap and a policy design gap.

Since 2011, profound work has been undertaken to tackle the most acute issues of fighting fraud and corruption. The focus of the changes has been placed on design and implementation of adequate policies to investigate, prosecute and bring to judgement the crimes against the Bulgarian Republican Budget and the local public budget and the funds of the EU budget, such as fraud, corruption, serious cross-border VAT fraud, etc.

From a conceptual point of view Bulgaria's progress in the protection and fight against fraud and corruption has taken into account the modern complexities of the understanding and better design of more adequate policies for the fight of corruption and fraud, as achieved in the EU and under the auspices of other international official organisations.¹³⁸ The process of

¹³⁷ The different approach in evaluating the corruption should be taken into consideration. Transparency International's **Corruption Perception Index (CPI)** ranks countries by their perceived levels of corruption, as determined by expert assessments and opinion surveys. Ranking is on a scale from 100 (very clean) to 0 (highly corrupt). The **index of public integrity (IPI)** is a composite index consisting of six components: judicial independence, administrative burden, trade openness, budget transparency, e-citizenship and press freedom. It aims to give an objective and comprehensive picture of the state of control of corruption in 109 countries. Ranking is on a scale from 1 (low control of corruption) to 10 (high control of corruption). The **2015 Eurobarometer** measures the perception of the EU citizens. Q1_B. Defrauding the EU budget: The scale of the problem is rather frequent? See: ECA (2019) *Special Report 1/2019: Fighting fraud in EU spending: action needed*.

¹³⁸ The Directive on the fight against fraud to the Union's financial interests by means of criminal law (PIF Directive), which is to be transposed in all Member States since 5th

creating the institutional capacity and improving compliance with the EU recommendations has been carried out in close co-operation with the EU institutions and in partnership with other EU Member States institutions under specific projects on different areas of improving legal framework and administrative capacities.

The fight against fraud has been a focus of empirical research and theoretical analysis at official institutions' and non-governmental level in Bulgaria.¹³⁹ Changes have become necessary due to the fact that the modalities of the corruption and fraud in Bulgaria have reflected the trend of increased varieties of corruption as observed in a European and global context. Thus, the fight against them has become more diversified in the areas such as public procurement, cross-border free movement of goods, labour and capital in the EU, global cybercrimes and fight against global terrorism.

Corruption is a cause and a prerequisite for underdevelopment. It reduces the economic growth and causes economic instability. The evaluation of the direct and indirect costs of corruption is related to the need of risk assessments and adequate policy designs. The Chair of Transparency international D. Ferreira Rubio underlines: "Corruption is much more likely to flourish where democratic foundations are weak and, as we have seen in many countries, where undemocratic and populist politicians can use it to their advantage" (Ferreira Rubio 2018). Recent empirical studies in less developed countries have evaluated evidence that corruption exercises pressure even on the shadow economy and reduces its scope. Through monopolism, corruption raises the risks of organised crime and causes repression of the economy.

July 2019, contributes to harmonise the definition of four criminal offences (fraud, corruption, money laundering and misappropriation), as well as sanctions and limitation periods.

¹³⁹ As examples, the following reports and projects undertaken may be pointed out: 1) Reports of the The Centre for Prevention and Countering Corruption and Organized Crime (CPCCOC) in 2011-2016 like: Report on Analysis of the Concessions Act, Subsurface Resources Act, Black Sea Coast Development Act, Water Act and Proposals for Measures for Prevention of Corruption (see <http://borkor.government.bg/en/page/482>); 2) Reports of the non-government organisation Centre for the Study of Democracy in Bulgaria (see Stefanov, R. S. Karaboev, Dr. T. Yalamov: Edited by Dr. O. Shentov, A. Stoyanov, Dr. T. Galev (2017) Evaluating Governance and Corruption Risk in Bulgaria

Improving the institutional capacity of the fight against corruption and fraud

The Centre for Prevention and Counteracting Corruption and Organised Crime (CPCCOC) was established on 17th June 2011 as a specialised administrative structure for the implementation of state policy in the area of preventing and countering corruption and organised crime.¹⁴⁰ The Centre has carried out the mission to focus on the enhancing the efficiency of the anti-fraud fight on the grounds of the recommendations in the reports of the European Commission (EC) and the Integrated Strategy for Prevention and Counteracting Corruption. The fight against fraud has been a focus of special research and theoretical analysis at the official institutions' and non-governmental level in Bulgaria due to the fact that the modalities of the corruption and fraud have increased substantially in a global context and the fight against them has become more diversified in areas such as public procurement, transborder free movement of goods, labour and capital in the EU, global cybercrimes and global terrorism.

Through an amendment of the Rules of Organisation of the Council of Ministers (CM) and of its administration of 26th November 2013, the CPCCOC was assigned to perform preliminary control on the bills of the executive power bodies according to its functional competence.

By a decree from the CM of 8th May 2015, an amendment to the Rules of Organisation of the CPCCOC was made, through which the long-term seconding of the analysts was discontinued.

At present, the Centre has two main functions:

¹⁴⁰ Initially as a structure at the Council of Ministers (CM), it was created on 29th July 2010 with a decree by the CM under a project headed by the German anti-corruption expert Rolf Schlotterer, an advisor to the Bulgarian government (March 2009 – October 2013), as a structure at the Council of Ministers (CM) funded by the Budget funds. Since October 2012, the analysts have started practical work on the first project of CPCCOC assigned to them by the Consultative Council of the the CPCCOC: "Public Procurement" Solution Model. Training on the specialised complex methodology for assessment of the corruption risk was carried out for experts from some ministries and central government agencies, such as: Ministry of Economy and Energy (MEE), Ministry of Regional Development and Public Works (MRDPW), Ministry of Agriculture and Food (MAF), Ministry of the Interior (MI), State Agency for National Security (SANS), National Customs Agency, National Revenue Agency (NRA) and others. Besides pooling the capacity of the state administration, the project also provided the partnership of the state structures along with the partnership of non-governmental organisations. Respective legislative amendments have been made to the Civil Servants Act, the SANS Act, the Ministry of the Interior Act and the Law on Defense and Armed Forces.

- To exercise preventive control by coordinating every bill prepared by the executive power bodies, i.e. to identify weaknesses, shortcomings, contradictions, obscure definitions in the bills which create conditions for the occurrence of corrupt practices;
- To develop projects by analysing legal acts, rules, administrative procedures and processes running in corruption risk zones; to carry out comparative and legal, legal, organisational and process analyses, analyses of specific cases as well as other kinds of analyses in order to detect conditions and opportunities for corrupt behavior and make proposals for measures and complex solutions with anti-corruption purpose.

The progress in implementing the Cooperation and Verification Mechanism (CVM) has been observed in different areas of economic regulation and judicial reform.

Public procurement is widely recognised as a particular risk area for corruption. Bulgaria has made progress on the implementation of the public procurement strategy since its adoption in 2014, including through the introduction of risk-based, in-depth ex-ante checks. A track record of effective follow-up policy measures has been accomplished and new steps to fight corruption and irregularities have been made.

In February 2018, a new Law for combatting corruption and forfeiture of assets was adopted by the National Assembly, thus creating a powerful anti-corruption Commission, introducing new conflict of interest regulations and regulating the seizure of illegally acquired assets.¹⁴¹ In March 2018, a new Anti-Money Laundering Act was adopted as well, bringing the legal framework in line with the relevant EU directive. Secondary legislation has been introduced later in 2018.

Another area of special interest to improve the efficiency of the fight against fraud and corruption in the present decade has become the public management and control system of local finances at municipalities' level. The problems encountered with corruption at the local municipalities' fi-

¹⁴¹ The Commission is the successor of assets, liabilities, archive information, resource rights and obligations of the Commission for prevention and ascertainment of conflict of interest and the Center for Prevention and Combating of Corruption and Organized Crime at the Council of Ministers, the relevant part of the assets, liabilities, archives, rights and obligations of the Court of Auditors relating to the activities under the Act on publicity of the property owned by senior government and other officials, as well as the respective specialised Directors in the National Security State Agency for combating corruption among senior government positions. <http://www.ciaf.government.bg/pages/view/za-komisijata-3/>

nances in the period 2011 – 2018 have two main aspects: on the one side, there have been serious delays in the decentralisation process of the revenues' management of local finances, thus preserving the central government responsibility for the state of the municipalities' budgets and the moral hazard risk of undervaluation of the responsibility of the municipalities. On the other side, since 2006 the municipalities have been given the responsibility to manage their own resources and to maintain on their own the ex-ante and internal audit functions of the management of public funds and EU funds. This has led to some slowing down in the reform of the local finances decentralisation. Thus, the control on the spending of public funds has remained involved with undervalued risks.

The decentralisation of governance powers to the municipalities makes it necessary to improve further the financial control on local finances and prevention of corruption and irregularities in their management. The role of institutions at all stages of public governance in the field of public finances in Bulgaria may be viewed upon as a very positive one for increasing the efficiency of the public money. Further strengthening of the fight against corruption is on the agenda not only as regards the changes in public procurement law and adoption of new laws against corruption, but also with regard to the improvement of financial management and control at municipalities' level.

The changing framework of the EU policy against fraud in the last decade

It is vital for the European Union to protect its financial interests in order to raise the efficiency of the EU funds and the relevant policies implemented. The work of the European Anti-Fraud Office (OLAF) is most important to combat fraud and irregularities in the implementation of the EU budget. It has the power to carry out administrative investigations independently of the Commission and to make them more effective, efficient and accountable.

In recent years, the number of the EU legislative measures and recommendations dealing with the protection of the Union's financial interests has grown.

Bulgaria has been involved in all changes introduced in the EU fight against corruption and fraud. The new legal measures essentially seek to improve OLAF's governance and strengthen procedural safeguards in investigations – by means of a step-by-step approach to accompany the establishment of the European Public Prosecutor's Office (EPPO) – to reform Euro-

just (COM(2013) 0532 and COM(2013)0533) and to improve the protection of the Union's financial interests, but also to guarantee the protection of those interests by means of criminal law and administrative investigations, through an integrated policy to safeguard taxpayers' money and through the Commission's anti-fraud strategy (COM(2011) 0293 and COM(2011) 0376). Important new EU recommendations in 2012 and 2013 have raised the attention to the anti-fraud fight: „An Action Plan to strengthen the fight against tax fraud and tax evasion” (COM(2012) 0722), the „Protection of the European Union budget to end 2012” (COM(2013) 0682) and the „Application of net financial corrections on Member States for agriculture and cohesion policy” (COM(2013) 0934). Two directives were also adopted in 2013: one on the common system of VAT concerning an optional and temporary application of the reverse charge mechanism in relation to supplies of certain goods and services susceptible to fraud, and the other concerning a quick reaction mechanism against VAT fraud (Directives 2013/43 and 2013/42). In addition to this, there was a proposal for a directive on the fight against fraud to the Union's financial interests by means of criminal law (COM(2012) 0363), the Commission's EU Anti-Corruption Report (COM(2014) 0038) and the Commission communication of 7th April 2016 on an action plan on VAT (COM(2016) 0148). In spring 2018, with a view to the new multiannual financial framework (2021-2027), the Commission adopted a proposal for a new EU anti-fraud programme, which is essentially designed to replicate and improve the Hercule III programme (2014-2020) and combine it with two activities already carried out by OLAF: the Anti-Fraud Information System (AFIS) and the Irregularity Management System (IMS).

The European Parliament has maintained an improvement in OLAF's governance through the continual revision and consolidation of its core investigative processes.

The European Commission has taken major initiatives concerning strategic anti-fraud measures and application of an integrated approach. The EU strategies for fighting fraud and corruption by means of legal and effective measures throughout the Union are to be made more efficient by the implementation of Directive (EU) 2017/1371 of the European Parliament and of the Council of 5th July 2017 on the fight against fraud to the Union's financial interests by means of criminal law (Directive (EU) 2017/1371).¹⁴² The

¹⁴² Directive (EU) 2017/1371 of the European Parliament and of the Council of 5 July 2017 on the fight against fraud to the Union's financial interests by means of criminal law

Member States have two years (until 6th July 2019) to transpose it into their national legislation. It harmonises the definition of four criminal offences (fraud, corruption, money laundering and misappropriation), as well as sanctions and limitation periods. There is a need that the European Commission and the Member States should continue to give absolute priority to this fight, for which a strategy for strengthened and multidimensional cooperation and coordination between Member States themselves and with the Commission should be developed.

Particular attention should also be paid to the development of mechanisms for prevention, early detection and customs transit monitoring, this being one of the areas still affected by the highest rates of systemic corruption in Europe. Further measures are needed to guarantee total integrity and transparency in public spending.

The major problems identified and measures required in the EU policy against fraud and corruption for the future may be listed as follows:

Better inspections

- ▶ support the Hercule III programme, which is a good example of the ‘best use of every euro’ approach; it is to be expected its post-2020 successor to be even more efficient;
- ▶ the newly planned regulation of the European Parliament and of the Council establishing, as part of the Integrated Border Management Fund, **the instrument for financial support for customs control equipment**, will further improve coordination and enhance cooperation for funding purposes between customs authorities and other law enforcement authorities, through improved EU-level partnership.

Transnational fraud

- ▶ emphasises that a **system enabling the authorities to exchange information would facilitate the cross-checking of accounting records** for transactions between two or more Member States in order to prevent cross-border fraud in respect to the structural and investment funds, hence ensuring a cross-cutting and comprehensive approach to the protection of Member States’ financial interests;
- ▶ **the increasing threat and occurrence of transnational fraud detected by OLAF** as revealed in the EU Parliament’s report of 25th October 2018 on protection of the EU’s financial interests – Recovery of money and assets from third-countries in fraud cases, and the anti-fraud clause

successfully incorporated in the Free Trade Agreement with Japan, as well as generalising the practice of adding anti-fraud clauses to agreements signed between the EU and third countries.

Whistle-blowers

- ▶ the proposal for a directive of the European Parliament and of the Council **on the protection of persons reporting on breaches of Union law** (COM(2018)0218); hopes that it will significantly improve the safety of whistle-blowers in the Union, leading to major improvement of the EU's financial protection and the rule of law;
- ▶ the important role of whistle-blowers in fraud prevention, detection and reporting and the need to protect them.

Investigative journalism

- ▶ investigative journalism plays a key role in fostering the necessary level of transparency in the EU and the Member States, and it must be encouraged and supported both by the Member States and the EU.

Tobacco

- ▶ according to the OLAF estimates, the illicit trade in cigarettes causes annual financial losses of over EUR 10 billion to the budgets of the Union and the Member States. Thus, the further implementation of more efficient customs control requires special attention.

Establishment of the European Public Prosecutor's Office

- ▶ under enhanced cooperation the establishment of the European Public Prosecutor's Office (EPPO) is undertaken on the basis of the Regulation adopted on 12th October 2017 and entered into force on 20th November 2017.¹⁴³ Bulgaria is one of the 22 Member States participating in the enhanced co-operation for the establishment of the EPPO.

The EPPO will be a decentralised European Union prosecution office with exclusive competence for investigating, prosecuting and bringing to judgment crimes against the EU budget. It will have uniform investigative

¹⁴³ Currently, only national authorities can investigate and prosecute fraud against the EU budget. But their powers stop at national borders. Existing EU-bodies such as Eurojust, Europol and the EU's anti-fraud office (OLAF) lack the necessary powers to carry out criminal investigations and prosecutions.

powers throughout the Union based on and integrated into the national law systems of the Member States. It will bring together the European and national law enforcement efforts to counter EU fraud.

Conclusion

The focus in Bulgaria's fight against corruption and fraud has been laid on improving governance and reducing vulnerabilities to corruption, including through better public expenditure control, publication of audited accounts of ministries and government agencies and state enterprises, streamlined and less discretionary revenue administration, greater transparency in the management of natural resources, improving the public tenders legislation to guarantee transparency and public accountability of spending public money, stronger anti-money laundering measures, and more effective anti-corruption legal frameworks.

In all of these areas, the Bulgarian experience has proved the importance of building effective economic institutions and their continuous adjustment to the real economy. The implementation of well-focused and better designed policies will be much in demand in the future and can be strengthened to improve governance and reduce vulnerabilities to corruption.

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