

THE EFFECTIVENESS OF EU FINANCIAL INTERESTS PROTECTION – THE CASE OF TRADITIONAL OWN RESOURCES

Katarzyna Stabryła-Chudzio

Cracow University of Economics, 27 Rakowicka Street, 31-510 Cracow, Poland

Abstract

The system of own revenues in the EU budget requires changes associated with greater emphasis on transparency and comprehensibility for citizens. It is also necessary to counteract smuggling, which leads to a reduction in customs revenues constituting 75% of the third largest source of revenue for the EU. Construction of a comprehensive information system and the exchange of information between customs services should still be a priority in the policy of the EU institutions, which entails additional spending to the EU budget. The need for new regulations concerning fight against fraud primarily is the effect of the insufficient coordination between Member States (in terms of the police, courts and prosecutor's office cooperation) and the EU services (OLAF, Europol, Eurojust). This is due to the absence or existence of inadequate legal instruments and procedures. The purpose of the article is to analyze fraud and financial irregularities relating to the traditional own resources as one of the EU budget revenue in the 2007-2014 period, to present the activities of the European Union and Member States services limiting the phenomenon of abuse and the European Commission's strategy on the protection of EU financial interests. Additionally, the paper includes the European Commission's proposals to limit the phenomenon of abuse.

Key words: *financial fraud, anti-fraud policy, protection of the EU financial interests, traditional own resources*

1. INTRODUCTION

The agreement concluded between the European Commission and the European Parliament within the multiannual financial framework for 2014-2020 has not led to any considerable changes to the structure of EU own budget resources. It is due to the lack of a political consensus over the European Commission's proposals concerning two new taxes – a financial transaction tax and new VAT rules, as well as changes to correction mechanisms. Consequently, the problems of counteracting irregularities and financial frauds remain unresolved, which results from the lack of cooperation among member states and coordinated activities (leading to the discontinuance of court proceedings), the existence of loopholes and diversified penal codes with respect to the forms of punishment, and, finally, different and inadequate criminal sanctions.

Traditional own resources are the oldest source of revenue for the EU budget (appeared in 1971) after the decision of the Member States of the change in the financing of common activities, i.e. the gradual move away from national contributions to revenues enrolling in financial autonomy of the European Community. The traditional own resources include customs duties, agricultural duties¹ retrieved from third countries and imposed on products imported into the European Union and sugar levies as contributions paid by producers of sugar, isoglucose and inulin syrup (Table 1 and 2). Premiums sugar are purposeful, since the revenue derived from them are used to grant export, subsidies for storage of sugar and for the sugar used in the chemical industry (Cieślukowski 2013, p. 115).

Customs duties can be divided into the following types (Cieślukowski 2013, pp. 116-117):

- conventional relating to goods from countries that do not benefit from the preferences of the EU,
- autonomous in relation to non-WTO countries,

¹ Member states could retain 25% of the established amounts of traditional own resources as collection costs. In the future it could be reduced to 20% retroactively from 2014,

- provisional imposed on products exported to the EU at a price lower than the price offered in the country of origin,
- countervailing (anti-subsidy) on products benefiting from state aid in the country of origin.

Table 1. Traditional own resources in 2015 (Part I)

Member State	In EUR	As percentage of total contribution of a MS	As percentage of total TOR
Belgium	1 509 400 000	28,33	8,97
Bulgaria	63 300 000	13,71	0,38
Czech Republic	179 600 000	11,90	1,07
Denmark	328 400 000	11,42	1,95
Germany	3 551 800 000	11,74	21,11
Estonia	24 500 000	11,43	0,15
Ireland	237 400 000	14,38	1,41
Greece	113 200 000	6,18	0,67
Spain	1 104 200 000	9,90	6,56
France	1 519 400 000	6,77	9,03
Croatia	37 800 000	8,35	0,22
Italy	1 486 600 000	9,01	8,84
Cyprus	15 100 000	9,01	0,09
Latvia	23 500 000	8,83	0,14

Source: Author's own calculations based on European Commission's data (<http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:L:2015:069:FULL> viewed 10 January 2015).

Table 2. Traditional own resources in 2015 (Part II)

Member State	In EUR	As percentage of total contribution of a MS	As percentage of total TOR
Lithuania	58 400 000	14,41	0,35
Luxemburg	12 300 000	3,68	0,07
Hungary	91 400 000	8,94	0,54
Malta	9 200 000	11,44	0,05
The Netherlands	2 061 400 000	26,55	12,25
Austria	183 800 000	5,78	1,09
Poland	411 100 000	9,57	2,44
Portugal	131 800 000	7,57	0,78
Romania	112 000 000	7,30	0,67
Slovenia	62 600 000	15,39	0,37

Slovakia	98 200 000	12,49	0,58
Finland	125 000 000	6,04	0,74
Sweden	481 300 000	10,73	2,86
Great Britain	2 793 200 000	17,00	16,60
Total	16 825 900 000	12,05	100,00

Source: Author's own calculations based on European Commission's data (<http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:L:2015:069:FULL> viewed 10 January 2015).

The paper presents an analysis of the cases of financial fraud and irregularities related to the EU budget in 2007-2014 (to the traditional own resources especially), the activities undertaken by EU bodies and member states aimed to counteract such irregularities, and the strategy adopted by the European Commission to protect community financial interests. The work refers to 2008-2015 European Commission reports, EU legal acts and proposals for changes in legislation.

2. TOWARDS CHANGING THE POLICIES FOR COUNTERACTING FINANCIAL IRREGULARITIES AT THE EU LEVEL

In 2011, the European Commission started implementing a multiannual strategy for counteracting financial irregularities. The adopted measures aim to tighten up legislation at EU and national levels, increasing the effectiveness of activities carried out in this area by EU bodies and national state institutions (Table 3 and 4).

Table 3. The European Commission's current activities aimed to protect EU financial interests (Part I)

Year	Legal act	Expected results
01/07/12	Proposal for a directive on counteracting financial irregularities by means of criminal law	Elimination of loopholes in national legislation related to counteracting financial fraud, establishment of common principles with regard to defining crimes and determining minimum and maximum punishment, the amount of financial damage to EU budget, organised crime activities, and the determination of the duration of legal proceedings until the court's final verdict.
01/07/13	Proposal for establishing the European Public Prosecutor's Office	Legal proceedings related to the EU budget, making entities committing EU budget-related financial crimes liable for their activities, and taking such cases to national courts. A two-level structure will be introduced – the European Public Prosecutor's Office at the central level, and at the decentralised level – European prosecutors from member states (investigations will be mainly carried out at the decentralised level). Responsibility for passing verdicts will be held by national courts.

Source: *Proposal to protect...*2012; European Commission 2014; European Commission 2015a.

Table 4. The European Commission's current activities aimed to protect EU financial interests (Part II)

Year	Legal act	Expected results
2013	Amended regulation on the European Anti-Fraud Office	Implementing tools aimed to facilitate the flow of information between OLAF and other EU and national entities. It became effective on 1 October 2013.
01/06/14	Proposal for partial reviews of the financial regulation – adjustment to the amended public procurement directive	The main objective is to establish a system for the needs of the European Commission, facilitating an early detection of risk to EU financial interests. It should lead to the exclusion of a business entity from applying for EU funds and/or the imposing of a financial fine on such an entity The said changes are to become effective as of 1 January 2016.

Source: *Proposal to protect...* 2012; European Commission 2014; European Commission 2015a.

In accordance with the report of July 2015 on the fight against irregularities on the EU budget's revenue side, the European Commission adopted the following measures (European Commission 2015a):

- revised Regulation 515/97 on mutual administrative assistance in the customs area, which should become effective in 2015, leading to the development of a data base of goods which enter or leave the EU territory, or are in transit through the EU territory,
- proposal for a directive on a rapid response mechanism in the area of VAT fraud and a reversed charge mechanism²,
- as of 2014, the Plan of action for fighting cigarette smuggling and illicit trade in tobacco products (activities aimed to increase supply chain security, including control of the supplies of tobacco products and, in particular, the monitoring of the movement and origin of goods, tightened cooperation of tax, customs, police and border guard authorities, as well as more severe punishment for smuggling activities)³,
- in 2014 – the adoption of Hercule III Programme aimed to intensify the activities and increase the administrative effectiveness of customs authorities and police forces in member states (the purchase of appropriate equipment and devices for detecting smuggled goods, organising seminars and conferences to exchange experience and good practices, specialised trainings aimed to broaden relevant knowledge and skills, international cooperation, and developing common data bases).

The need for implementing new regulations mainly results from the insufficient coordination of activities among member states (police forces, courts of law and prosecutor's offices) and EU services (OLAF, Europol and Eurojust). This state of affairs is due to the lack or insufficient legal instruments and procedures. Consequently, conviction rates for crimes against the EU budget in particular member

² The introduction of this mechanism aims to reduce the number of tax frauds by entities which operate only temporarily (following the sales of products, a company is liquidated without meeting its tax obligations). In accordance with the reverse charge mechanism, the buyer pays the seller only net amounts, settling their own tax payments. However, cases occur in which buyers report on their invoices other VAT payers' details (not their own).

³ In 2013, the UE and member states entered into agreements with the major tobacco manufacturers, requiring them to engage in controlling delivery chain systems for the purpose of preventing the illicit distribution of products.

states range from a dozen to several dozen per cent⁴. Some problematic issues include the following: the scope of authority applies to a given country, restrictions on the use of evidence from abroad, and different regulations on counteracting financial irregularities and related crimes. As a result, a large number of cases are closed before they are taken to court (*European Commission...2011*).

Simultaneously, common customs operations are being undertaken, which include coordinated operational activities carried out by member states and third country customs authorities as well as by Europol, Interpol and the World Customs Organization, aimed to fight against illicit transborder trade. In 2014, the European Anti-Fraud Office – in cooperation with member states - conducted seven common customs operations, offering technical and financial assistance, and providing secure access to exchanged information (Table 5 and 6).

Table 5. The characteristics of common customs operations in 2014 (Part I)

Operation	Description	Effects
REPLICA	The import of goods infringing upon intellectual property rights – special attention given to hazardous materials posing a threat to the environment or citizens' health.	Recovered amount: 1.2m in counterfeit goods (including perfume, car and bicycle spare parts, toys, handbags and electronic devices); 130m in cigarettes. The prevention of cigarette smuggling alone led to the savings of EUR 25m (customs duties and taxes).
SNAKE	Understating of the value of imported textiles and footwear from China.	Detection of more than 1,500 containers with understated value (prevention of EUR 80m worth of customs-duty losses).

Source: European Commission 2015a.

Table 6. The characteristics of common customs operations in 2014 (Part II)

Operation	Description	Effects
ERMIS	Shipping of small consignments to the EU territory.	More than 70,000 articles sized (mobile phones, pairs of glasses, car accessories and medications).
ATHENA IV	Unregistered cash transfers and money laundering in the EU territory.	EUR 1.2m seized.
WAREHOUSE II	Smuggling and fraud related to excise taxes on tobacco products and alcohol.	Final results unknown.
ICARE	Maritime monitoring in the area of the Atlantic, coordinated by French customs services, aimed to detect illicit trade in sensitive products.	
ISIS 2014	Maritime operations coordinated by Spanish customs services, aimed to fight against illicit trade in sensitive products in the Mediterranean.	Seizure of 39.3 kg of Indian hemp.

Source: European Commission 2015a.

⁴ Punishment for EU budget financial irregularities in member states ranges from the lack of penalty to a dozen or so years imprisonment, and from one to a dozen or so years imprisonment in the case of investigation and prosecution procedures.

3. DETECTED IRREGULARITIES AND FRAUD CONCERNING TRADITIONAL OWN RESOURCES

In its reports on the protection of EU financial interests the European Commission differentiates between fraud (financial fraud), suspected fraud and financial irregularities not reported as fraud.

Fraud is referred to as an intentional act of committing criminal irregularities. In accordance with Art. 3 of a proposed directive on the fight against financial irregularities by means of criminal law, the cases of fraud on the revenue side of the EU budget include the following (*Proposal for a Directive...2012*):

- a) the use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the illegal diminution of the resources of the Union budget or budgets managed by the Union, or on its behalf,
- b) non-disclosure of information in violation of a specific obligation, with the same effect, or
- c) misapplication of a legally obtained benefit, with the same effect.

Suspected fraud means an irregularity giving rise to the initiation of administrative and/or judicial proceedings at national level in order to establish the presence of intentional behaviour, in particular fraud (Commission Regulation (EC) No 2035/2005).

On the other hand, according to article 2 of Council Regulation (EC) No 2988/95 irregularities means any infringement of a provision of European law resulting from an act or omission by an economic operator which has, or would have, the effect of prejudicing the general budget of the European Union or budgets managed by it, either by reducing or losing revenue accruing from own resources collected directly on behalf of the Union.

Irregularities not reported as fraud include such cases as unintentional errors in customs and tax forms, or unintentional non-compliance with competitive bidding procedures. On the other hand, the cases of financial fraud affecting the EU budget are as follows:

- customs fraud, i.e. failure to pay import duties (falsified documents concerning the origin, description, value or quantity of goods, and the smuggling of goods),
- VAT fraud,
- shadow economy activities.

The data on financial irregularities collected by the European Commission (80%) is based on information provided by member states, which are responsible for preventing, detecting and responding to financial irregularities and fraud. This data, along with OLAF's own observations and investigations, enable the European Commission to prepare annual reports submitted to the European Parliament and the Council of the European Union. Such reports include information on the adopted measures and their effects, in compliance with a strategy for a transparent management of community finances, allowing for identifying further steps aimed to prevent financial fraud in the EU.

Tables 7 and 8 present the data which only represents traditional own resources obligatorily submitted by member states to the European Commission on a quarterly basis. Such reports include information on amounts recovered as well as the cases of suspected financial irregularities (if they justify administrative and/or legal proceedings at national level, aimed to confirm intentional activities), irregularities not reported as fraud, and intentional irregularities regarded as a criminal act (European Commission 2015)⁵.

⁵ Member state are obligated to report the cases of irregularities in excess of EUR 10 thousand EUR. However, under Article 17 (2) of the Regulation No 1150/2000, section 17, Member States shall be free from the obligation to place at the disposal of the Commission the amounts corresponding to established entitlements solely if, for reasons of force majeure, these amounts have not been collected. In addition, Member States may disregard this obligation to make such amounts available to the Commission in specific cases if, after thorough assessment of all the relevant circumstances of the individual case, it appears that recovery is impossible in the long term for

In 2014, 710 cases of financial fraud were reported to the European Commission, including suspected and established fraud. The number of cases reported in 2014, related to traditional own revenues (5,185), is lower than the respective number for 2007-2014 by 8% (5 631,5)⁶, with the value of irregularities (EUR 957.1m) exceeding the established amount for this period by 104.1% (EUR 468.95m - Table 7 and 8). In 2014, 14 major types of fraud were reported (in excess of EUR 10m), totalling EUR 516m, which represents a considerable difference as compared with the previous year, in which two major cases were reported, totalling EUR 29m (see: European Commission 2015b)⁷.

An explicit assessment of the increase in the value of the detected cases of fraud and irregularities is not easy, especially with regard to the revenue side. Over the past 5 years, the European Commission as well as member states have changed the way in which they report financial irregularities. Improvements have been made in two platforms for data transfers, improving the quality of, and increasing the volumes of information.

With regard to the expenditure side of the EU budget, problems are caused by the following factors: the cumulation of financial settlements from the previous programming period of 2007-2013, an increase in the amount of funds at the disposal of member states since 2014, and the increased effectiveness of controlling the use of EU funds by community and national institutions. An increase in the number of irregularities related to traditional own resources can be only attributed to stricter control mechanisms and international cooperation and/or higher rates of criminal activity.

Comparisons of the number of cases reported by member states are not reliable due to their different interpretations of applied legislation. In the situation when a member state does not report any cases of fraud in a given year, the European Commission considers four hypotheses (European Commission 2015):

1. No fraud was committed in this country.
2. This country is not capable of detecting fraud.
3. This country is not willing to detect fraud.
4. The combination of 2 and 3.

Table 7. Detected irregularities and fraud on the side of EU budget traditional own resources (Part I)

	2007	2008	2009	2010	2011	2012	2013	2014
Financial irregularities (not reported as fraud)								
Number	4866	4960	4288	4612	4450	4386	4523	4475
Value (million EUR)	269.9	244.1	245.4	264.2	268.8	377.4	357.4	800.5
Gross amount of TOR collected	1.17	0.98	1.27	1.4	1.2	1.69	1.57	3.66
Recovery rate (%)	49.67*	40.7	44*	51*	52*	50.95	68	24

*all cases of financial irregularities and fraud resulting from the lack of information by two categories

Source: author's own research based on: European Commission 2008; European Commission 2009; European Commission 2010; European Commission 2011a; European Commission 2012; European Commission 2013a; European Commission 2014; European Commission 2015b.

reasons which cannot be attributed to them. These cases must be mentioned in the report (...) if the amounts exceed EUR 10 000, converted into national currency at the rate applying on the first working day of October of the previous calendar year; this report must contain an indication of the reasons why the Member State was unable to make available the amounts in question. The Commission has six months in which to forward, if appropriate, its comments to the Member State concerned (Council Regulation (EC, Euratom) No 1150/2000).

⁶ The declining trend refers mainly to the cases of financial fraud.

⁷ Attention should be given to a time difference between detection and reporting.

Table 8. Detected irregularities and fraud on the side of EU budget traditional own resources (Part II)

	2007	2008	2009	2010	2011	2012	2013	2014
Financial fraud								
Number	1538	1377	1101	1158	902	894	812	710
Value (million EUR)	135	115.5	102.8	184.5	74	87.5	68	156.6
Gross amount of TOR collected	58	0.46	0.53	0.97	0.33	0.35	0.29	0.8
Recovery rate (%)	17.3	25.9	44*	51*	52*	27.87	24	24

*all cases of financial irregularities and fraud resulting from the lack of information by two categories

Source: author's own research based on: European Commission 2008; European Commission 2009; European Commission 2010; European Commission 2011a; European Commission 2012; European Commission 2013a; European Commission 2014; European Commission 2015b.

In 2007-2014, approx. 2% of EU budget revenues from customs duties and sugar charges were attributed to irregularities and fraud (member states are obligated to recover these amounts). In 2014, the total amount of EUR 203 was recovered in connection with cases reported in 1990-2013, and in 2014 alone the amount of EUR 191m was recovered in connection with irregularities, and EUR 38m in connection with the cases of fraud.

The RR-recovery rate represents a percentage of the total recovered amount in relation to established amounts. Current corrections are deducted in the denominator, which results in more recent data being different from previous reports. The year 2014 records a considerable decrease in recovered amounts, especially for financial irregularities, which can be explained by a larger number of appeals and closed cases.

$$RR = \frac{\text{Recovered amount because of payments obtained (all cases)}}{\text{Established amount (all cases) minus processed corrections (all cases)}} \times 100$$

Also, the European Commission has introduced the historical recovery rate (HRR), which accounts only for cases regarded as closed. In 1989-2011, HRR was at the average level of 79.71% (including 51.08% for the cases of fraud, and 88.97% for irregularities not reported as fraud).

$$HRR = \frac{\text{Recovered amount because of payments obtained (closed cases)}}{\text{Established amount (closed cases) minus processed corrections (closed cases)}} \times 100$$

4. CONCLUDING REMARKS

The effectiveness of counteracting EU budget irregularities should be determined by the specific plans of action and cooperation among community and national services, as well as third countries (mainly those neighbouring the EU territory). This strategy was adopted by the European Commission in 2011, and it is aimed to implement a comprehensive system for eliminating community budget losses, based on the following measures: preventive activities and early detection of irregularities, investigation procedures, a system of penalties, and the recovery of misappropriated funds. The necessity of introducing changes and new directives⁸ resulted from the development of the updated forms of cooperation in the enlarged EU, as well as the occurrence of new types of crimes⁹ and counterfeit techniques (euro banknotes and coins). Moreover, it was necessary to take into account new technological solutions which facilitated the activities of community and national services, allowing for the development of detailed data bases for recording the detected cases (European Commission 2011).

The above discussed measures, including organizational and legal changes, are expected to achieve the following goals (see: European Commission 2013):

- improved coordination of activities carried out by community and national services (cases and results of investigations transferred to national services should lead to a larger number of court verdicts instead of closing a case),
- commitment of national enforcement agencies to attribute the same significance to EU budget-related cases (as compared with national public finance irregularities),
- recognition of lawful evidence collected in one member state as valid in court proceedings in other member states,
- increased effectiveness of recovering funds lost as a result of financial irregularities,
- gradual reduction in crime rates.

The EU own budget revenue system requires changes in terms of its transparency from the perspective of community citizens. Assuming that the existing sources of financing are retained, the presented measures and expected changes lead to positive results in terms of counteracting fraud related to both EU and national budget contributions. Further measures should be taken against smuggling activities, which reduce customs duty revenues – the EU's third largest source of revenues. The development of a comprehensive IT system and the exchange of information between EU and national services should be given priority in the policies of community institutions, necessitating, however, additional outlays.

⁸ In the preceding periods the European Commission followed the 2000 strategy.

⁹ The interpretation of EU budget crimes is made complicated by criminal activities carried out in several countries which apply various legislation systems. As a result, procedures are time-consuming, requiring the engagement of appropriate HR resources as well as the knowledge of foreign languages and foreign regulations for the purpose of assessing the impact of transnational crimes (*Proposal for a Council regulation ... 2013*).

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