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PARLIAMENT, THE COUNCIL AND THE COURT OF AUDITORS**

**PROTECTION OF THE EU BUDGET TO END 2014**

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## EXECUTIVE SUMMARY AND CONCLUSIONS

President Juncker has strongly stressed the need to ensure the sound financial management of European Union (EU) programmes and insisted that all necessary measures be put in place to protect the EU budget. This Communication describes the functioning of the preventive and corrective mechanisms foreseen in the legislation and the actions taken by the Commission services to protect the EU budget from illegal or irregular expenditure. It also provides a best estimate of the figures resulting from their use and indicates how Member States are involved and impacted.

This Communication is prepared annually following a specific request by the European Parliament in the context of the 2011 discharge procedure and is therefore addressed to this institution, as well as to the Council and to the European Court of Auditors (ECA). It complements the information included in the 2014 EU annual accounts, the 2014 Commission's Synthesis Report, and the relevant parts of the Annual Activity Reports of the Directorates General concerned.

The ECA provides in its annual report a statement of assurance on the legality and regularity of transactions underlying the EU annual accounts, as well as observations and statistics on the material level of error in the payments underlying the accounts. The importance of financial corrections and recoveries is particularly highlighted when considering their multi-annual character. This is duly reflected in the Annual Activity Reports which provide detailed information on both error rates and financial corrections and recoveries. A complementary assessment of both gives an indication of the final impact on the EU financial interests as regards irregular payments to beneficiaries and represents a key indicator for assessing how supervisory and control systems manage the risks relating to the legality and regularity of operations financed by the EU budget (see the 2014 Commission's Synthesis Report).

The significant work of both the Commission and the Member States to manage the risks relating to the legality and regularity of operations financed by the EU budget is performed in accordance with the Treaty on the Functioning of the European Union (TFEU)<sup>1</sup>, the Financial Regulation<sup>2</sup>, its Rules of Application<sup>3</sup> and the various sector-specific legal texts. The Commission protects the EU budget, i.e. EU spending, from undue or irregular expenditure via two main methods:

- (1) Preventive actions; and
- (2) Corrective mechanisms (primarily financial corrections imposed on Member States but also recoveries from recipients of EU payments).

The primary objective of financial corrections and recoveries is to ensure that EU funds are used in accordance with the legal framework i.e. they exclude from Union financing expenditure in breach of applicable law. Under shared management, Member States (and not the Commission) are primarily responsible for identifying and recovering from beneficiaries amounts unduly paid. Given the control framework, the complexity of the corrective mechanisms and procedures, as well as the multi-annual character of programmes, the results (i.e. financial corrections and recoveries) are generally

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<sup>1</sup> OJ C 326, 26.10.2012, p. 47.

<sup>2</sup> Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002 (OJ L 298, 26.10.2012, p. 1).

<sup>3</sup> Commission Delegated Regulation (EU) No 1268/2012 of 29 October 2012 on the rules of application of Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council on the financial rules applicable to the general budget of the Union (OJ L 362, 31.12.2012, p. 1).

implemented after the related weaknesses or irregularities are identified and payments are made.

In order to ensure the cost-effectiveness of control systems, one of the main work streams on which the services of the Commission will work during the mandate of the College is to rationalise and streamline controls and reallocate resources to controls deemed most appropriate for managing legality and regularity risks within the regulatory framework. For shared management, the main objective is to improve the effectiveness of Member States' control systems.

This Communication focuses primarily on the results of the Commission's supervisory role, but also provides information on Member States' controls.

### Financial corrections & Recoveries: 2014 Results

Regarding the impact of corrective measures taken by the Commission, the key figures for the financial year 2014 are as follows:

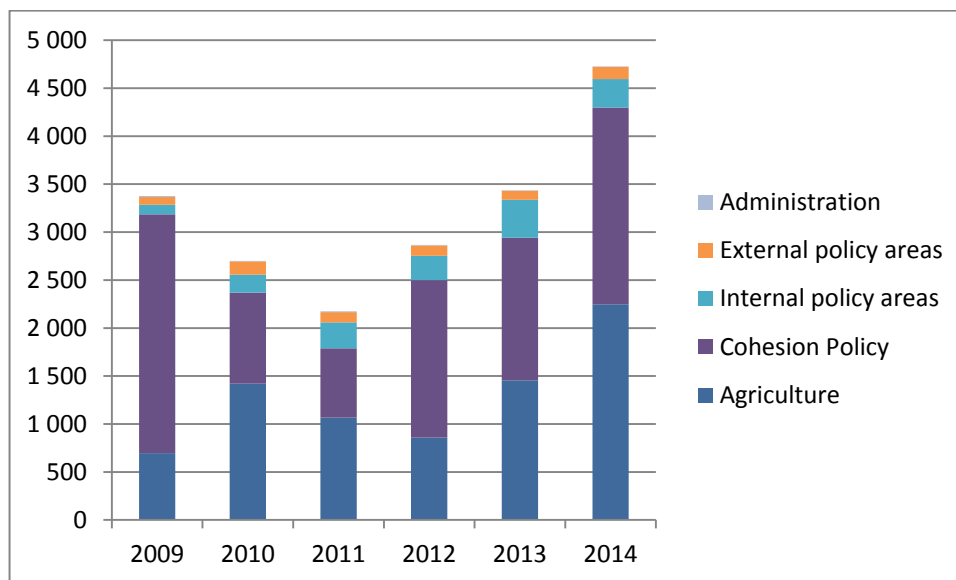
Policy Areas	EUR millions	
	Total financial corrections and recoveries confirmed in 2014	Total financial corrections and recoveries implemented in 2014
<b>Agriculture</b>	<b>2 247</b>	<b>1 198</b>
EAGF	1 862	946
Rural development	385	252
<b>Cohesion Policy</b>	<b>2 050</b>	<b>1 694</b>
ERDF	1 330	1 083
Cohesion Fund	292	236
ESF	343	290
FIFG/EFF	67	66
EAGGF Guidance	18	19
<b>Shared management</b>	<b>4 297</b>	<b>2 892</b>
Internal policies	297	279
External policies	127	108
Administration	5	5
<b>TOTAL</b>	<b>4 728</b>	<b>3 285</b>

Financial corrections confirmed and implemented represent **3.3 % (confirmed)** and **2.3 % (implemented)** of budgetary payments in 2014.

## Financial corrections & Recoveries: Cumulative Results

Cumulative figures provide more useful information on the significance of corrective mechanisms used by the Commission because they take into account the multi-annual character of most EU spending and neutralise the impact of one-off events.

*Financial corrections and recoveries confirmed 2009-2014 (EUR millions):*



- During the **period 2009-2014** the amounts confirmed show an **increasing trend**. The **average amount confirmed** was EUR 3.2 billion or **2.4 % of the average amount of payments** made from the EU budget, while the **average amount implemented** in this period was EUR 2.8 billion or **2.1 % of payments** - see graph 4.1;
- For **EAGF**, the average correction rate for Commission financial corrections for the **period 1999 to end 2014** was **1.7 % of expenditure** (all of which are net financial corrections) - see section 4.2.2;
- For **ERDF and ESF 2000-2006 funds** (where the closure is almost complete), at the end of 2014 the combined rate of financial corrections, based on Commission supervision work only, was **4.1 % of the allocations made** - see section 4.2.3;
- The average amount confirmed of under direct and indirect management for the **period 2009-2014** was EUR 366 million or **1.2 % of the average amount of payments**.
- During 2015, the **Court of Justice** ruled against the Commission for a number of financial corrections relating to regional policy spending in 1994-1999, totalling almost EUR 500 million. This concerned procedural issues and the Commission is currently analysing the impact - see section 4.1.2.

## Protection of the EU budget: Main Conclusions

- The figures demonstrate the **positive results of the multiannual preventive and corrective activities** undertaken by both the Commission and Member States;
- The significance of the amounts reported should be viewed as an **affirmation of the commitment** of the Commission and the Member States to ensuring that European taxpayers' money is being used in accordance with legal requirements;

- The Commission is striving to **further improve the management and control systems at Member States level** by proposing appropriate Member States specific action plans, by organising seminars on error rates, by sharing good practices and guidance, by organising training courses for Managing Authorities and by holding annual and ad-hoc meetings;
- **Corrective measures** are intended to correct the past, **preventive measures** are intended to avoid that such irregularities reoccur in the future;
- Financial corrections can be net (e.g. under Agricultural Policy), which implies that the amounts concerned are actually reimbursed to the EU budget, or may be compensated against additional new eligible expenditure (in Cohesion Policy). In both cases, there is a **real impact** since, even in the case of compensation, the Member State concerned bears with its own resources (from the national budget) the financial consequences of ineligible expenditure;
- When precise quantification of the irregularities is either not possible or not cost effective, or concern serious management and control deficiencies, the Commission applies the so called **flat rate corrections**, for example at the overall operational programme level, as set out in the relevant regulations. Both project and programme level financial corrections have a deterrent effect for the future.

#### **Protection of the EU budget: ongoing improvements for the period 2014-2020**

- **Agriculture:** this includes an increased focus on more risky expenditure, a shorter conformity procedure, better definition of the criteria and methodology for applying net financial corrections, simplified payment schemes, a new opinion by national Certification Bodies on the legality and regularity of declared expenditure and a reinforcement of interruptions and suspensions in line with the successful practices in Cohesion.
- **Cohesion:** this includes the application of net financial corrections, which introduces an additional incentive for Member States to improve their controls risk based audits taking into consideration strengthened assurance packages encompassing audit opinions on the functioning of systems and legality and regularity and Annual Control Reports (ACRs) reporting residual error rates, reinforced legal basis for flat rate corrections and an increased level of correction for repeated deficiencies.

## 2. PROCESSES



### 2.1. Preventive actions

The Commission uses a number of preventive mechanisms to protect the EU budget.

Under the **shared management mode** (i.e. Agricultural and Cohesion policy expenditure), Member States are primarily responsible throughout the expenditure life cycle for ensuring that expenditure paid out from the EU budget is legal and regular. The Commission provides timely and close supervision, based on EU audit results, national audit results received throughout the years, results of OLAF investigations, and any other information coming to the services knowledge that points to a system deficiency or serious uncorrected irregularities. Key elements pointing to the effective functioning of the monitoring and control system are re-assessed on a continuous basis to prevent payments in case of ineffective systems at programme/part of programme level.

**Agriculture:** Under the new Common Agricultural Policy (CAP) Horizontal Regulation, a new legal framework for interruptions and suspensions of CAP funds entered into force in 2014, which will strengthen the Commission's powers to suspend EU financing in cases where risks of irregular payments have been identified. Accordingly, the Commission may reduce or suspend monthly (European Agricultural Guarantee Fund (EAGF)) or interim (European Agricultural Fund for Rural Development (EAFRD)) payments where *"one or more of the key components of the national control system in question do not exist or are not effective due the gravity or persistence of the deficiencies found"* (or there are similar serious deficiencies in the system for the recovery of irregular payments) and:

- either the deficiencies are of a continuous nature and have already been the reasons for at least two financial correction decisions,
- or*
- the Commission concludes that the Member State concerned is not in a position to implement the necessary remedial measures in the immediate future, in accordance with an action plan with clear progress indicators to be established in consultation with the Commission.

For EAFRD, the new Common Provisions Regulation (CPR) also provides for the interruption of interim payments by the Authorising Officer by Delegation (i.e. the Director-General) as an additional, quick and reactive tool in case of concerns about the legality and regularity of payments. For EAGF, the rhythm of the monthly payments would not allow for using such an interruption procedure.

**Cohesion:** Preventive mechanisms exist at the level of the Commission in its role of supervising body allowing it to:

- interrupt the payment deadline for a maximum period of 6 months if:
  - (a) There is evidence to suggest a significant deficiency in the functioning of the management and control systems of the Member State concerned; or
  - (b) The Commission services have to carry out additional verifications following information that expenditure in a certified statement of expenditure is linked to a serious irregularity which has not been corrected.

Once a case is closed (after a lifting letter is sent), the interrupted amount can be processed and paid out to the Member State authorities under the condition that

sufficient credits are available and that there are no other issues affecting the programme.

- suspend all or part of an interim payment to a Member State in the following cases:
  - (a) Where there is evidence of serious deficiency in the management and control system of the programme and the Member State has not taken the necessary corrective measures; or
  - (b) Where expenditure in a certified statement of expenditure is linked to a serious irregularity which has not been corrected; or
  - (c) If there has been a serious breach by a Member State of its management and control obligations.

Where the required measures are not taken by the Member State, the Commission may decide to impose a financial correction.

Both procedures provide a mechanism for rapid agreement with the Member State on the complementary verifications to be carried out and, if need be, implementation of appropriate remedial actions. Whenever necessary, in case of serious weaknesses and where the Commission services consider that no or insufficient action has been taken by the concerned authorities within the regulatory time frame of the interruption (maximum period of 6 months), the Commission also launches a formal suspension procedure starting with a pre-suspension letter addressed to the Member State.

Under **direct and indirect management**, preventive actions include checks made by the responsible services on eligibility of expenditure being claimed by beneficiaries. These ex-ante controls are embedded in the programmes' management processes and are intended to provide reasonable assurance on the legality and regularity of expenditure being paid. The Commission services can also provide guidance, particularly on contractual issues, with the aim of ensuring a sound and efficient management of funding and therefore a lower risk of irregularities.

## **2.2. Corrective actions**

It is important to underline that for a significant portion of EU expenditure, e.g. Cohesion, Research and Rural Development policies, the programmes concerned are of a multi-annual nature. In line with Article 32(2)(e) of the Financial Regulation, this is taken into account when designing and implementing corrective measures, as well as when assessing the results of these actions. Financial corrections and recoveries are made at all stages of a programme's life-cycle, once expenditure has been incurred and/or a payment has been made.

### *2.2.1. Financial corrections*

Financial corrections **in progress** are those proposed but not yet accepted by the Member States or not yet decided by the Commission.

A financial correction is reported as **confirmed** as soon as it is accepted by the Member State or decided by a Commission Decision.

A financial correction is considered **implemented** when the correction has been applied and recorded in the Commission accounts, which means the financial transaction was validated by the responsible Authorising Officer in the following cases: deduction from the interim or final payment claim, recovery order and/or a de-commitment transaction.



The Commission applies the following types of financial corrections on the expenditure declared by the Member States ("**ex-post**" corrections):

- Financial corrections on individual cases, based on a precise identification of amounts unduly spent, and the financial implications for the budget;
- Extrapolated financial corrections if the related amount can be quantified on the basis of a representative statistical sample with a sufficient level of confidence;
- Flat rate corrections, if the related amount cannot be quantified on the basis of a representative statistical sample or when the impact on expenditure of individual errors cannot be quantified precisely (e.g. financial corrections of individual public contracts based on agreed flat rates) – see tables **3.3.2** & **3.4.2**.

Under shared management, all financial corrections, no matter what type, have an impact on national budgets – even if no reimbursement to the EU budget is made, the impact of financial corrections is always negative at Member States' level.

**"At source"** financial corrections are used to effect financial corrections before an EU reimbursement has been made. These occur when the correction is applied by the Member State when certifying new expenditure to the Commission following and as a result of the remedial action plan agreed with the Commission. It should be highlighted that the difference between "ex-post" and "at source" financial corrections is a timing one.

#### *2.2.2. Recoveries*

For the **EAGF**, amounts recovered from the beneficiaries are credited to the EU budget as assigned revenue, after deduction applied by Member States of 20 % to cover administrative costs. In order to address delays by some Member States in recovering undue payments, a legal clearing mechanism provides that 50 % of any undue payments which the Member States have not recovered from the beneficiaries within 4 years or, for cases involving legal proceedings, 8 years, would be charged to their national budgets (50/50 rule). Even then, Member States are still obliged to pursue their recovery procedures and, if they fail to do so with the necessary diligence, the Commission may decide, following the conformity clearance procedure, to charge the entire outstanding amounts to the Member States concerned. Moreover, Member States are required to off-set any outstanding debts against future payments to the debtor (compulsory compensation). This system encourages Member States in their efforts to actually recover irregular payments without unjustified delays.

For **EAFRD** recoveries are taken into consideration in a future reimbursement claim received by the Commission and therefore can be reused for the programme within the programming period – after the end of the eligibility period it is credited to the EU budget as assigned revenue.

Under **Cohesion policy**, recoveries are mainly issued at or after closure of the programmes and result in revenue for the EU budget. Under the current programming period (2014-2020), in the framework of the acceptance of the accounts recoveries can be off-set with future reimbursement claims (and re-used for the programme).

Under **direct and indirect management**, and in accordance with the Financial Regulation, recovery orders should be established by the authorising officer for amounts unduly paid. Recoveries are then implemented by direct bank transfer from the debtor (and constitutes revenue for the EU budget that can be re-used for the same programme) or by offsetting from other amounts that the Commission owes to the debtor. Commission services implement recoveries also "at source" by deducting ineligible expenditure (which has been identified in previous or current cost claims) from payments made.

## 2.3. Agriculture

### 2.3.1. How does the Commission protect the CAP expenditure ?

According to the CAP legal framework, financial corrections imposed by the Commission on Member States have always been net corrections<sup>4</sup>. The amounts are actually reimbursed by the Member States and are treated as assigned revenue in the EU budget. They are used to finance CAP expenditure as a whole without being earmarked for any particular Member State.

Every year the Commission adopts between 2 and 4 conformity clearance decisions covering a package of individual financial corrections. The actual execution of the reimbursement to the EU budget may be delayed via instalment or deferral decisions. Implementation by instalments was so far accepted for Bulgaria, France, Greece, Lithuania, Portugal, Romania and Spain. Additionally, in 2012, the Commission introduced a new provision<sup>5</sup> which permitted deferral of reimbursement of financial corrections for Member States under EU financial assistance and under the conditions that the deficiencies at the origin of the financial correction are remedied. After the expiry of the deferral period the corrections are executed in annual instalments. To date, deferrals were granted to Portugal and Greece. Up to end of 2014, instalment decisions had been adopted in respect of EUR 1.1 billion while such decisions were also adopted in January 2015 in respect of a further EUR 1.3 billion (EUR 2.4 billion in total).

### 2.3.2. Ongoing improvements for the period 2014-2020

#### (A) Focus on more risky expenditure

As a result of the higher error rates reported by the ECA in its recent audit exercise, the number of EAFRD audits were increased significantly in 2013 (to 35) and again in 2014 (to 45), thus double the 2012 amount (23). Another consequence is that some Member States are audited every year, until all serious deficiencies are remedied. The audit strategy for the period is based on a reinforced risk analysis and a rolling three-year programme which will ensure a better coverage of the overall expenditure, notably to achieve a better audit coverage, and targeting mainly the serious and/or systemic deficiencies in the Member States' management and control systems. More intensive audit activities will continue in the most risky areas with a system-based approach.

#### (B) No discretion and a ranking of financial corrections

Any identified risk to the EU budget will systematically trigger a net financial correction since the Commission is legally bound to exclude any identified illegal expenditure from EU financing. Both EAGF and EAFRD net financial corrections are governed by the new CAP Horizontal Regulation which tightens the procedure even more, to the extent that the method and the criteria for fixing the amount of financial corrections is now set out in the delegated act. Both the Financial Regulation and the new CAP Horizontal Regulation provide for a ranking of types of net financial corrections where flat-rate corrections may only be used if calculated or extrapolated corrections cannot be established with proportionate efforts.

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<sup>4</sup> The procedure by which the Commission accepts the accounts of the Member States and thereby the expenditure made by the paying agencies to farmers and beneficiaries. Firstly the accounts of paying agencies are checked for accuracy by certification bodies in the Member States and are then subject to an annual financial clearance decision by the Commission. Secondly, the Commission itself then carries out the conformity clearance procedure based on audits which permit it to identify and exclude (in later years) payments not complying with the rules.

<sup>5</sup> Commission Implementing Regulation (EU) No 375/2012 of 2 May 2012 amending Regulation (EC) No 885/2006 laying down detailed rules for the application of Council Regulation (EC) No 1290/2005 as regards the accreditation of paying agencies and other bodies and the clearance of the accounts of the EAGF and EAFRD (OJ L 118, 3.5.2012, p. 4–5).

### *(C) Shorter conformity procedure*

The Commission will continue with actions aimed at streamlining the whole procedure. Firstly, the new CAP Horizontal Regulation describes precisely the nature, scope and sequence of the successive steps, as well as the different types of financial corrections. Secondly, provisions in the delegated act (method and criteria for calculating the financial correction) and implementing acts (details of the conformity procedure, with mandatory deadlines) are intended to further streamline the legal framework and limit the risk of unnecessary delays. Thirdly, the Commission will intensify its monitoring of the progress of the conformity procedures to ensure a strict respect of the deadlines.

### *(D) Reinforcement of the Commission's supervisory role*

The CAP regulatory tools have been reinforced for the period 2014-2020, including: having a single system of monitoring and evaluation for both pillars, streamlining/speeding up of the conformity clearance procedure, better definition of the criteria and methodology for applying net financial corrections, introducing a new model for assurance by the Certification Body (CB) on the legality and regularity of declared expenditure based on representative samples.

### *(E) Simplification*

Notably for EAFRD, the Commission will continue its efforts to identify the root causes of errors (an ad-hoc task force was set-up), and to propose and encourage the widest possible use of the simplified payment schemes that are less prone to errors. More globally, the Commission, together with the stakeholders, is engaged in a simplification process where all legal acts and guidelines are assessed with a view to identify all possible simplifications and make the necessary changes as soon as possible: in the short term for delegated and implementing acts and guidelines, in the mid-term for the basic acts.

### *(F) Interruptions and suspension for CAP as prompt and effective instruments for the Commission to protect the EU budget*

These preventive actions (interruptions for EAFRD, suspensions or reductions for both EAGF and EAFRD) will allow the Commission to act promptly and effectively and protect the EU budget: no new payments will be made or they will be reduced up to the level of the estimated risk during the suspension. In addition, and as has always been the case in the previous programming periods, any identified irregular payments will be fully covered via net financial corrections. See section **2.1** above for more details.

## **2.4. Cohesion**

### *2.4.1. Situation up to 2007-2013 programming period*

Funds released following financial corrections in the Cohesion area were available for reuse and replacement by regular expenditure during the life-cycle of the programme. Due to the legal framework, net financial corrections leading to the return of previously paid amounts to the EU budget were generally the exception during programme implementation.

### *2.4.2. Improvements planned for period 2014-2020*

#### *(A) Net financial corrections*

A significant change was introduced for the 2014-2020 programming period: under certain conditions laid down in Article 145(7) of the Common Provisions Regulation (CPR), the Commission has the obligation to apply a net financial correction. In such cases the current possibility for the Member State to accept the correction and to re-use the EU funds in question is removed.

Net financial corrections in the 2014-2020 period therefore introduce an additional incentive on the side of the Member States to further improve their management and control systems since these corrections will reduce the funds earmarked for a particular Member State when serious deficiencies not previously detected, reported nor corrected at Member State level are discovered by EU audits.

*(B) Incentives for Member States to improve their controls*

When drawing up the accounts, the management declaration and the audit opinion, the programme authorities should obtain reasonable assurance through such control procedures that all material irregularities have been corrected and that possible serious deficiencies, at any level of the management and control system, have been addressed, or are being addressed. Audit authorities will play a reinforced role in presenting audit opinions every year for each programme: their audit opinions will be based on annual residual risks of error. Residual error rates reported by Member States will be assessed and validated by the Commission's DGs when preparing their Annual Activity Reports (AARs).

Within the new financial management cycle, 15 February following each accounting year<sup>6</sup> is the cut-off date. By that date, Member States must submit to the Commission the programme's accounts, management declaration, audit opinion and corresponding reports. Member States shall certify the legality and regularity of expenditure included in their annual accounts.

*(C) Financial corrections for irregularities/deficiencies identified before 15 February each year*

The rules of the 2014-2020 programming period concerning financial corrections for irregularities identified before 15 February each year are similar to those of the 2007-2013 programming period. The objective is to maintain the incentive for Member States to detect and correct irregularities themselves. Irregular expenditure detected through national verifications or audits has to be deducted from the accounts to be submitted to the Commission by 15 February each year. Having done so, the Member State will be able to re-use the amounts thus corrected for new eligible operations under the programme, just as in the 2007-2013 programming period.

In the case of EU audits carried out on expenditure before the certified accounts are submitted to the Commission and which detect irregularities requiring financial corrections, two scenarios are possible, as in the 2007-2013 period:

- (1) If the Member State agrees on the financial correction to be made and takes action, it will be able to re-use the corrected amounts for new eligible operations (Article 145(5) of the CPR);
- (2) If the Member State does not agree, the Commission will adopt a financial correction decision, following the contradictory procedure provided for in Article 145 of the CPR. This financial correction will always be net and the programme and Member State allocation will be reduced proportionally.

*(D) Commission assessment of legality and regularity on the basis of the accounts, audit opinion and accompanying documents submitted by 15 February each year*

The Commission will assess and review the audit opinions (elements relating to the functioning of systems and legality and regularity) and Annual Control Reports (ACRs), including the reported residual error rates, as well as the management declarations and annual summaries, within three months of reception of the documents provided by 15

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<sup>6</sup> This date can be extended to 1st March in exceptional cases at the request of the Member State, (Art. 59(5)).

February. The Commission will, on this basis, make its risk-assessment and establish its audit plan determining the required risk-based audits targeted to the selected high-risk programmes.

The Commission will carry out its risk-based audits until the submission of the next assurance package. It will examine, through desk and on-the-spot audit work and re-performance of samples of national audits including at the level of operations, whether reported information is reliable and therefore constitutes an adequate basis for assurance on legality and regularity. Priority will be given to auditing programmes that have a material impact on the Commission's payments for the corresponding fund in the accounting year. The past performance of Member States authorities will also be taken into account in the risk-based criteria for the definition of audit priorities.

*(E) Identification by EU audits of irregularities indicating a serious deficiency after 15 February each year*

If EU (Commission including OLAF and ECA) audits carried out after 15 February each year detect irregularities demonstrating a serious deficiency affecting the corresponding accounting year, the Commission has the obligation to apply a net financial correction, if the conditions defined in the regulation are fulfilled. The resulting financial correction will always be net because the allocation to the programme and the total allocation of the Member State in question will be automatically reduced by the amount of the correction, even if the Member State accepts the financial correction.

*(F) Reinforced legal basis*

Under the CPR, the Commission is empowered to lay down in a delegated act detailed rules concerning the criteria for the assessment of the functioning of management and control systems, including the main types of serious deficiencies, the criteria for establishing the level of financial correction to be applied and the criteria for applying flat-rates or extrapolated financial corrections. The delegated act was adopted on 3 March 2014 (Commission Delegated Regulation (EU) 480/2014)<sup>7</sup>. The Commission therefore has a stronger legal basis compared to the 2007-2013 programming period which included similar elements under a non-legally binding guidance note. Moreover, the criteria for the assessment and the levels of flat-rate corrections will be well-known in advance to all programme stakeholders.

*(G) Flat rate correction rates maintained*

Flat-rate correction percentages already applied during previous programming periods are maintained, i.e. 5 %, 10 %, 25 % and 100 %. This approach has been confirmed by the case law of the Court of Justice. Nonetheless the decision to apply any level of financial correction must take account of proportionality and of the residual risk to the EU budget, as required in the CPR. Therefore, where the application of a fixed flat-rate correction in accordance with the delegated act would be disproportionate, the Commission shall apply a reduced level of flat-rate correction.

*(H) Increased level of correction for repeated deficiencies*

When the same deficiencies have been detected by EU audits despite a previous financial correction, the Commission has included a provision in the delegated act allowing for a higher rate of correction than in the case of the first correction. This is a clear message to

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<sup>7</sup> Commission Delegated Regulation (EU) No 480/2014 of 3 March 2014 supplementing Regulation (EU) No 1303/2013 of the European Parliament and of the Council laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund (OJ L 138, 13.5.2014, p. 5-44).

Member States that they need to ensure a rapid and permanent adjustment of their management and control systems once a serious deficiency has been detected.

*(I) Other measures already in force will continue to be applied*

The new possibilities, i.e. the possibility to impose net financial corrections, and the introduction of the annual assurance package, will be coupled with the continuation of the existing strict policy on interruptions and suspensions, and the strong encouragement of the utilisation of all simplification opportunities. This should result in a further improvement of the implementation of the Cohesion policy in the new programming period.

## **2.5. Direct Management**

For direct management expenditure, the Commission has control frameworks in place to prevent, detect and deter irregularities at the different stages of the grant management process in order to achieve both operational and financial objectives. An overview of the controls made in two key areas of direct management expenditure, research and international aid, are given below.

For **Research** expenditure, the control framework starts with the development of a work programme, which goes through a wide-ranging consultation process to ensure that it best meets the expectations of all stakeholders and will maximise the research outcome. Following the evaluation of proposals, further controls are then carried out as the selected proposals are translated into legally binding contracts.

Project implementation is monitored throughout the lifetime of the project. Payments against cost claims are all subject to ex-ante checks according to standard procedures, which include (for payments above EUR 375 000) an audit certificate given by a qualified auditor. As well as standard controls, additional, targeted, controls can also be carried out according to the information received and the risk of the transaction.

A main source of assurance comes from in-depth checks carried out at a sample of the beneficiaries' premises after costs have been incurred and declared. A large number of these in-depth checks are carried out over the lifetime of the programme. Any amounts paid in excess of what is due are recovered, and systemic errors are extended to all ongoing participations of a beneficiary.

In the field of **International Cooperation and Development**, the Commission has established a control framework to prevent, detect and deter irregularities at the different stages of the implementation of funding, applicable to the all management modes (direct and indirect) used for this implementation. This strategy starts from the choice of the most appropriate tool when drafting the planning documents and the financial decisions, and translates into the actual checks carried out at all stages of the implementation.

From the point of view of financial control, the system is made up of a number of instruments systematically applied to the implementation of contracts and grants for all management modes: ex-ante checks on payments, audits carried out by the Commission and foreseen in an audit plan, expenditure verifications carried out prior to payments by beneficiaries of grants, verification missions to international organisations and an overall ex-post control on the basis of the Residual Error Rate study carried out every year.

The EU financial interests are therefore safeguarded, in addition to all the other possible means offered by the Financial Regulation, by the Commission's ex-ante control of individual transactions as well as subsequent controls or audits, and by the resulting recovery of any unduly disbursed funds where the agreed procedures have not been respected, or where the activities were not eligible for EU financing.

## 2.6. Cost-effectiveness of management and control systems

In line with the requirement of the Financial Regulation, an important objective of the Commission's "budget focused on results strategy" is to ensure cost-effectiveness when designing and implementing management and control systems which prevent or identify and correct errors. Control strategies should therefore consider a higher level of scrutiny and frequency in riskier areas and ensure that controls add value. This is important because controls impose a significant administrative burden on beneficiaries and may even discourage participation in programmes. Furthermore, inefficient and ineffective controls absorb resources which could otherwise contribute to the achievement of results.

Reporting on cost-effectiveness improved in 2014 annual activity reports. All Commission services which reached a conclusion on the cost-effectiveness of their management and control systems stated that quantifiable and/or non-quantifiable benefits exceed costs and/or show a stable or a positive trend of relevant indicators.

The Commission instructed its services to develop a common methodology for calculating their costs and benefits of control so as to improve consistency and produce reliable results which can be used to determine the relative cost-effectiveness of the control systems in place (see the Commission's Synthesis Report for 2014). For expenditure under shared management, the calculation of the costs and cost-effectiveness of controls needs to take into account in the management and control activities of the Member States.

## 3. FINANCIAL CORRECTIONS AND RECOVERIES IN 2014

### 3.1. OVERVIEW

**Table 3.1: Financial corrections and recoveries overview for 2014**

EUR millions

MFF Heading	Total EU budget payments in 2014	Total financial corrections in progress at end 2014	Total financial corrections and recoveries confirmed in 2014	% of payments of the EU budget	Total financial corrections and recoveries implemented in 2014	% of payments of the EU budget
<b>Smart &amp; inclusive growth</b>	<b>67 683</b>	<b>1 018</b>	<b>2 198</b>	<b>3.2 %</b>	<b>1 828</b>	<b>2.7%</b>
ERDF <sup>8</sup>	29 841	360	1 330	4.5%	1 084	3.6%
Cohesion Fund <sup>8</sup>	13 464	22	292	2.2%	236	1.8%
ESF	10 623	636	343	3.2%	290	2.7%
Internal policies	13 755	-	232	1.7%	218	1.6%
<b>Sustainable growth: natural resources</b>	<b>56 584</b>	<b>4 892</b>	<b>2 355</b>	<b>4.2%</b>	<b>1 302</b>	<b>2.3%</b>
EAGF	44 287	3 789	1 862	4.2%	946	2.1%
Rural Development	11 191	960	385	3.4%	252	2.3%
FIFG/EFF	689	47	67	9.8%	66	9.6%
EAGGF Guidance	6	95	18	294.2%	18	294.2%
Internal policies	411	-	23	5.6%	19	4.6%
<b>Security &amp; citizenship</b>	<b>1 711</b>	<b>-</b>	<b>42</b>	<b>2.5%</b>	<b>42</b>	<b>2.5%</b>
Migration and home affairs	400	-	5	1.3%	5	1.3%
Internal policies	1 311	-	37	2.8%	37	2.8%
<b>Global Europe</b>	<b>7 206</b>	<b>N/A</b>	<b>127</b>	<b>1.8%</b>	<b>108</b>	<b>1.5%</b>
External policies	7 206	-	127	1.8%	108	1.5%
<b>Administration</b>	<b>8 819</b>	<b>N/A</b>	<b>5</b>	<b>0.1%</b>	<b>5</b>	<b>0.1%</b>
Administration	8 819	-	5	0.1%	5	0.1%
<b>TOTAL</b>	<b>142 003*</b>	<b>5 909</b>	<b>4 728</b>	<b>3.3%</b>	<b>3 285</b>	<b>2.3%</b>

\* Excludes EUR 29 million paid to Croatia under the Compensation heading and EUR 465 million paid out under the Special Instruments heading.

Please note that the figures above differ from the ones shown in the PIF report of OLAF since the OLAF report was published earlier, at a stage where only provisional figures were available.

<sup>8</sup> ERDF and Cohesion Fund amounts include, for the first time in 2014, financial corrections "at source".

## **Agriculture:**

In 2014 the Commission adopted 3 conformity clearance decisions<sup>9</sup>, covering 56 individual net financial corrections for a total amount of EUR 443 million (0.8 % of the CAP expenditure budgeted for 2014). A further, financially significant, conformity clearance decision was prepared at the end of 2014 and the Member States were formally consulted in the Agricultural Funds Committee before year-end. That decision, which was for the amount of EUR 1.4 billion (covering 56 individual corrections), was adopted by the Commission in January 2015<sup>10</sup>. Based on internationally accepted accounting standards for the public sector, this amount was included as "confirmed" in the financial year 2014.

## **Cohesion:**

### *2000-2006 programming period:*

The advanced stage of the closure process of ERDF programmes and Cohesion Fund projects led to total additional financial corrections of an amount of EUR 543 million being imposed and accepted by Member States in 2014:

- EUR 451 million of financial corrections for the closure of **ERDF** programmes in 9 Member States, the most significant being for Italy (EUR 231 million) and Spain (EUR 119 million);
- EUR 92 million accepted by 11 Member States for **Cohesion Fund** projects, the largest being for Slovakia (EUR 70 million).

For **ESF**, in the context of the closure process, all 239 programmes have been closed (209 fully and 30 partially). In 2014, the amount of financial corrections confirmed and implemented was EUR 133 million. The Member States with the highest level of financial corrections confirmed and implemented were, respectively, Spain (EUR 99 million) and Italy (EUR 20 million). The other countries for which the closure process has been finalised were Belgium, Germany, Greece, France, Austria, Slovakia and UK. Italy and Spain did not accept yet some closure proposals and the pre-correction procedure has been initiated – see section **4.2.3** for more details.

Significant progress was made in 2014 in relation to the closure of the Financial Instrument for Fisheries Guidance (**FIFG**). At the end of 2014, 53 programmes out of 60 were closed. Most financial corrections concerned were implemented via recovery orders.

### *2007-2013 programming period:*

Confirmed financial corrections in 2014 for **ERDF and Cohesion Fund** were EUR 294 million<sup>11</sup>. This is the result of the strict supervision and interruption policy of the Commission and growing number of action plans including financial corrections decided by Member States and implemented as a result of interruption or pre-suspension letters sent by the Commission's Authorising Officers by Delegation.

Under **ESF**, EUR 209 million has been confirmed and EUR 156 million has been implemented, out of which EUR 95 million were confirmed in 2014 and EUR 61 million in the previous years. 89 % of financial corrections confirmed during the year 2014 and previous years have been implemented, leaving an amount of EUR 118 million still to be implemented. Member States with the highest level of corrections are Spain (EUR 56 million), Romania (EUR 43 million); Poland (EUR 32 million) and France

<sup>9</sup> Decision 2014/191/EU of 4 April 2014, OJ L104 (ad hoc decision no. 44),  
Decision 2014/458/EU of 9 April 2014, OJ L204 (ad hoc decision no. 45),  
Decision 2014/950/EU of 24 December 2014, OJ L369 (ad hoc decision no. 46).

<sup>10</sup> Decision 2015/103/EU of 16 January 2015, OJ L16 (ad hoc decision no. 47).

<sup>11</sup> In addition to this amount, EUR 782 million of financial correction "at source" have been reported for the first time in 2014 for ERDF/CF – see section 3.3.3.



(EUR 20 million). Among the financial corrections implemented in 2014, EUR 64 million are at source financial corrections, meaning that these financial corrections are applied by the Member State authorities at the same time the expenditure is declared to the Commission by application of flat rate corrections following Commission audits.

Financial corrections confirmed for European Fisheries Fund (**EFF**) increased by more than 80 % from 2013, mainly resulting from Commission audits and desk reviews. The withdrawal of ineligible expenditure from the subsequent payment claim allows such financial corrections to be implemented rapidly.

*2014-2020 programming period:*

The first accounting period was ongoing in the course of 2014 and the designation of authorities has not yet taken place for almost all the operational programmes, therefore no audit activity related to the declaration of expenditure has yet been processed.

### **3.2. FINANCIAL CORRECTIONS IN PROGRESS AT 31 DECEMBER 2014**

Financial corrections in progress are the preliminary stage where procedures for a financial correction have been opened but the contradictory procedure with the Member State concerned is still on-going. The indicated amounts are only initial estimates by the Commission services, subject to change until the final decision by the Commission.

### **3.3. FINANCIAL CORRECTIONS CONFIRMED IN 2014**

This section provides different views of the financial corrections amounts confirmed in 2014. Attention is drawn to the fact that the data and maps presented below relate to one year only, 2014. The level of both the global corrections amount and the split by Member State can change significantly depending on the year. Therefore, a meaningful assessment of the corrective capacity of supervisory and control systems has to be based, in line with the nature of this expenditure, on a multi-annual perspective (see section 4).

### 3.3.1. Breakdown by Member State

**Map and Table 3.3.1: Financial corrections confirmed in 2014 as compared to EU payments received; Breakdown by Member State**



The map above takes into account the relative weight of the financial corrections confirmed for each Member State compared to the payments received from the EU budget in the year 2014.

Light grey shows Member States that are below the average percentage of 3.5 %.  
Red highlights Member States that are above the average percentage of 3.5 %.

Member State	Payments received from the EU budget in 2014 (EUR million)	Financial corrections confirmed in 2014 (EUR million)	Financial corrections confirmed in 2014 % as compared to payments received from the EU budget in 2014
Belgium	1 028	25	2.4%
Bulgaria	2 096	148	7.1%
Czech Rep.	4 152	441	10.6%
Denmark	1 212	9	0.7%
Germany	9 712	39	0.4%
Estonia	610	2	0.3%
Ireland	1 376	18	1.3%
Greece	6 829	187	2.7%
Spain	10 219	379	3.7%
France	11 159	1 383	12.4%
Croatia	407	-	N/A
Italy	9 450	401	4.2%
Cyprus	237	-	N/A
Latvia	1 005	5	0.5%
Lithuania	1 774	9	0.5%
Luxembourg	79	0	0.0%
Hungary	6 342	189	3.0%
Malta	221	0	0.2%
Netherlands	1 285	(30)*	(2.3%)
Austria	1 301	15	1.2%
Poland	17 088	49	0.3%
Portugal	4 772	50	1.0%
Romania	5 775	295	5.1%
Slovenia	1 078	15	1.4%
Slovakia	1 577	142	9.0%
Finland	866	7	0.8%
Sweden	1 338	4	0.3%
UK	5 685	62	1.1%
INTERREG	1 866	44	2.4%
<b>TOTAL</b>	<b>110 537</b>	<b>3 890</b>	<b>3.5%</b>

\* The negative amount for Netherlands above arises following a judgement of the Court of Justice where the Commission needs to reimburse the Netherlands.

### 3.3.2. Breakdown of flat-rate corrections confirmed in 2014

**Table 3.3.2: Breakdown of flat-rate corrections confirmed in 2014**

	<b>Total financial corrections (EUR million)</b>	<b>Flat-rate financial corrections* confirmed in 2014 (EUR million)</b>
<b>Agriculture</b>		
EAGF	1 649	644**
EAFRD	220	168**
<b>Cohesion</b>		
ERDF & CF	1 622	890
ESF	342	223
EAGGF guidance	13	0
EFF/FIFG	39	3
Internal policies	5	5
<b>TOTAL</b>	<b>3 890</b>	<b>1 933</b>

\* Includes extrapolated corrections

\*\* This represents a best estimate. The majority of financial corrections integrate amounts based on precise calculations and flat rates.

Flat rate corrections are a valuable tool that is used when the related amount cannot be quantified on the basis of a representative statistical sample or when the impact on expenditure of individual errors cannot be quantified precisely. However, this means that the Member State subject to the flat correction bears the financial consequences as the corrections are not directly linked to individual irregularities at project level, i.e. there is no individual final beneficiary to recover monies from.

### 3.3.3. Breakdown of financial corrections made at source

**Table 3.3.3: Breakdown of financial corrections at source confirmed in 2014**

<b>Member State</b>	<b>At source financial corrections confirmed in 2014 (EUR million)</b>
Bulgaria	28
Czech Rep.	407
Ireland	0
Greece	88
Spain	0
France	20
Italy	4
Lithuania	0
Hungary	152
Poland	14
Portugal	0
Romania	133
Slovakia	56
UK	0
<b>TOTAL</b>	<b>903</b>

At source corrections for 2007-2013 **ERDF/CF** programmes have been reported for the first time in 2014. They relate to amounts reported by the Member States<sup>12</sup> in 2014, following a specific request from the Commission services (requests targeted on the main cases in which flat rates corrections have been applied for problems linked to public procurement procedures or deficiencies in the Member States' management and control systems). As a result of this exercise, EUR 782 million of financial corrections at source have been identified in 6 Member States cumulatively since 2012 and up to the end of 2014. Being the first year of reporting such information, the full amount of at source corrections have been attributed to 2014, even though some of the amounts were included in payment claims sent to the Commission in 2012 and 2013.

The main at source financial corrections for ERDF/CF concern the Czech Republic (EUR 398 million), Hungary (EUR 136 million), Romania (EUR 92 million), Greece (EUR 72 million) and Slovakia (EUR 56 million).

For **ESF**, the main Member States concerned by flat rate corrections applied at the same time as the declaration of the expenditure to the Commission, and consequently correcting new expenditure are: Romania (EUR 41 million), France (EUR 20 million), Hungary (EUR 16 million) and Poland (EUR 14 million), with a total of EUR 100 million of at source financial corrections confirmed in 2014.

Concerning Romania, in order to address the root causes of the recurring problems identified under ESF, the Commission is working with national authorities in order to strengthen their management and control systems and is closely following-up on the implementation of the agreed action plan. In addition, the national audit authority has checked procurement issues for a number of high risk projects and the errors detected are being corrected through financial corrections at the level of the projects concerned (replacing the 25 % flat rate correction). The Commission is also supporting the Romanian authorities in improving simplification and the use of the fraud prevention and detection tool, Arachne.

### **3.4. FINANCIAL CORRECTIONS IMPLEMENTED IN 2014**

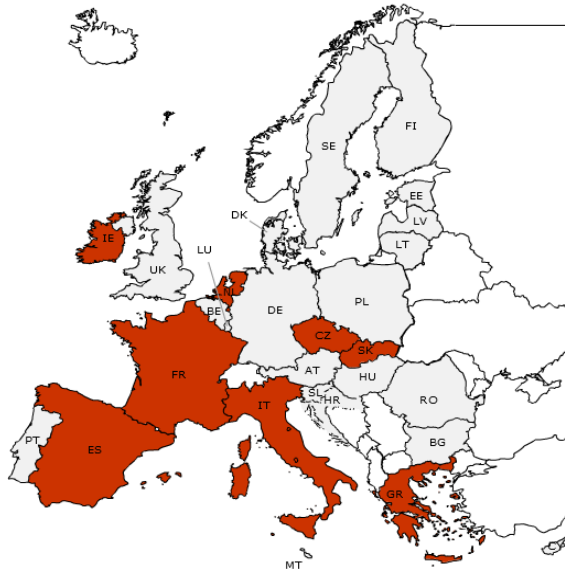
This section provides different views of the financial corrections amounts implemented in 2014. Attention is drawn to the fact that the data and maps presented below relate to one year only, 2014. The level of the global corrections amount and the split by Member State change significantly depending on the year – see section 4 for the multi-annual picture.

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<sup>12</sup> Since there is no legal requirement for Member States to report on such amounts, nor a structured reporting since the beginning of the programming period, this section presents a prudent and non-exhaustive amount of additional financial corrections for cases for which the Commission could reconstitute a clear audit trail at the level of the certifying authority.

### 3.4.1. Breakdown by Member State

**Map and Table 3.4.1: Financial corrections implemented in 2014 as compared to EU payments received; Breakdown by Member State**



The map above takes into account the relative weight of the financial corrections implemented for each Member State compared to the payments received from the EU budget in the year 2014.

Light grey shows Member States that are below the average percentage of 2.3 %.

Red highlights Member States that are above the average percentage of 2.3 %.

Member State	Payments received from the EU budget in 2014 (EUR million)	Financial corrections implemented in 2014 (EUR million)	Financial corrections implemented in 2014 as % of payments received from the EU budget in 2014
Belgium	1 028	17	1.7%
Bulgaria	2 096	31	1.5%
Czech Rep.	4 152	336	8.1%
Denmark	1 212	9	0.7%
Germany	9 712	28	0.3%
Estonia	610	1	0.2%
Ireland	1 376	37	2.7%
Greece	6 829	321	4.7%
Spain	10 219	391	3.8%
France	11 159	462	4.1%
Croatia	407	-	N/A
Italy	9 450	324	3.4%
Cyprus	237	-	N/A
Latvia	1 005	5	0.5%
Lithuania	1 774	0	0.0%
Luxembourg	79	0	0.2%
Hungary	6 342	25	0.4%
Malta	221	0	0.0%
Netherlands	1 285	34	2.7%
Austria	1 301	7	0.5%
Poland	17 088	65	0.4%
Portugal	4 772	73	1.5%
Romania	5 775	93	1.6%
Slovenia	1 078	7	0.6%
Slovakia	1 577	137	8.7%
Finland	866	8	0.9%
Sweden	1 338	4	0.3%
UK	5 685	89	1.6%
INTERREG	1 866	43	2.3%
<b>TOTAL</b>	<b>110 537</b>	<b>2 549</b>	<b>2.3%</b>

### 3.4.2. Breakdown of flat-rate corrections implemented in 2014

**Table 3.4.2: Breakdown of flat-rate corrections implemented in 2014**

	Total financial corrections (EUR million)	Flat-rate financial corrections* implemented in 2014 (EUR million)
<b>Cohesion</b>		
ERDF & CF	1 319	520
ESF	289	185
EFF/FIFG	41	4
EAGGF	13	0
Internal policies	5	5
<b>TOTAL</b>	<b>1 667</b>	<b>714</b>

\* Includes extrapolated corrections

Figures for Agriculture are not available.

### 3.4.3. Breakdown of financial corrections made at source

**Table 3.4.3: Breakdown of Cohesion corrections at source implemented in 2014**

Member State	At source financial corrections implemented in 2014 (EUR million)
Czech Republic	274
Ireland	0
Greece	60
Spain	0
France	20
Italy	4
Lithuania	0
Hungary	21
Poland	13
Portugal	0
Romania	50
Slovakia	56
United Kingdom	0
<b>TOTAL</b>	<b>499</b>

For **ERDF/CF**, out of EUR 782 million of financial corrections at source reported in 2014 EUR 430 million (55 %) can be considered as already implemented. The main Member States concerned are Czech Republic (EUR 271 million), Greece (EUR 60 million) and Slovakia (EUR 56 million). For **ESF**, in the context of at source corrections, the Member States concerned by flat rate corrections applied at the same time as the declaration of the expenditure to the Commission and consequently correcting new expenditure are: France (EUR 20 million), Hungary (EUR 16 million), Poland (EUR 13 million) and Romania (EUR 11 million).

### 3.5. RECOVERIES

**Table 3.5: Recoveries confirmed and implemented in 2014**

EUR millions		
MFF Heading	Total recoveries <u>confirmed</u> in 2014	Total recoveries <u>implemented</u> in 2014
<b>Smart &amp; inclusive growth</b>	<b>233</b>	<b>220</b>
ERDF	0	1
Cohesion Fund	0	0
ESF	1	1
Internal policies	232	218
<b>Sustainable growth: natural resources</b>	<b>435</b>	<b>366</b>
EAGF	213	150
Rural Development	165	167
FIFG/EFF	29	25
EAGGF Guidance	5	5
Internal policies	23	19
<b>Security &amp; citizenship</b>	<b>37</b>	<b>37</b>
Internal policies	37	37
<b>Global Europe</b>	<b>127</b>	<b>108</b>
External policies	127	108
<b>Administration</b>	<b>5</b>	<b>5</b>
<b>TOTAL</b>	<b>838</b>	<b>736</b>

**Agriculture:**

During the period 2008-2014, the Commission audited the correct application of the rules on recoveries through 32 audit missions in 19 Member States (including all EU-15 Member States with a low recovery rate for the cases detected since 2007). Deficiencies found during these audits are being followed up in the context of conformity clearance procedures. Except for two cases, (Italy and Ireland), in general the Member States' authorities have adequate procedures in place to protect the financial interest of the EU.

The diligence of the Member States' authorities in the recovery of the most significant individual irregularity cases is assessed in the context of a further 25 on-going conformity clearance procedures (desk audits).

In 2012, an OLAF investigation revealed some serious issues for the Italian Paying Agency regarding the completeness of the debtors' ledger, the prescription of certain debts, and some national schemes allegedly funded by the EU budget. In addition, the ECA, in the framework of the 2013 audit exercise, also raised serious concerns regarding the debt management systems implemented in Italy (AGEA), and Ireland (DAFF). The Commission took this into account in its risk analysis and carried out an audit mission in Italy in September 2014, while an audit to Ireland will take place in the 2015-2016 audit year.

### **3.6. DEFICIENCIES IN MEMBER STATES' MANAGEMENT AND CONTROL IDENTIFIED IN 2014 AND MEASURES UNDERTAKEN**

#### **3.6.1. *Agriculture and Rural Development***

Material deficiencies noted in Member States' management and control systems, as identified by them, the Commission, the ECA, and/or OLAF (fraud investigations) are closely followed up by the Commission until it has obtained reliable evidence that the weaknesses have been remedied through the implementation of appropriate actions by the Member State, the irregular expenditure declared in the past has been corrected, and the new system has proved its reliability in practice.

For direct payments, DG AGRI in its 2013 AAR made reservations in respect of 15 Spanish Paying Agencies, France, UK (England), Hungary, Greece and Portugal. For France, Spain and England, remedial action plans established by the national authorities continue to be monitored by the Commission. For Portugal, the action plan has been implemented. For Greece, although the situation had significantly improved, the action plan was found not to have been fully implemented according to the set milestones and deadlines which led the Commission to adopt an implementing decision to reduce the claim year 2014 monthly payments for expenditure concerned by the deficiencies. For Hungary it was not considered necessary to establish a formal action plan for the specific problems which existed for 2013 and 2014. These relate to the control set up which is to be overhauled in the context of the new direct payments regime as of claim year 2015. For France, the action plan finalised on 15 November 2013 is being followed-up by quarterly reporting and, where necessary, audit missions.

For the 2013 AAR, DG AGRI adjusted Member States' control statistics to reflect undetected and thus unreported error and calculated an error rate of 5.2 %. As this work was carried out at Paying Agency level, a targeted approach was possible with regard to reservations and this resulted in the Director General being able to issue reservations for 31 Paying Agencies instead of for the entire ABB activity.

In 2014, the Commission further reinforced the existing action plans to address the above mentioned reservations, on the basis of improved cooperation and analysis within Commission services and intensive dialogue with Member States. Following this approach, the ad-hoc AGRI Task Force created in 2012 continued to meet and develop analysis and strategy within the Commission, while an improved system of reporting by all Member States on their national action plans for the reduction of error rates was put in place. This

includes a reinforced focus on regular follow-up on audit findings, as well as improved indicators and milestones for monitoring purposes. In 2014, the Commission also developed a new IT tool which enables it to collect and handle the information extracted from the national action plans in a more efficient and consistent manner.

Since 2013, four seminars on error rates have been organised, two of which took place in 2014, to present the state of play regarding the implementation of the action plans, to share good practices and to provide guidance. These biannual seminars are organised jointly in the framework of the Rural Development Committee and the Agricultural Funds Committee, in order to ensure the involvement of both Managing Authorities and Paying Agencies. Therefore, a stock taking of the closely monitored follow up process is conducted every semester. In the meantime, the geographical desks ensured the follow up of the issue with Member States in annual and ad-hoc meetings, monitoring committees and if relevant in the context of programme amendments.

In parallel, the relevant audit capacity in the Commission was reinforced. The number of audit missions was increased and the audits target specific issues related to error rates.

Furthermore, the legal framework allows for interruption and suspension of payments in case of serious deficiencies in the management and control systems for the expenditure committed under EAFRD during the 2007-2013 or the 2014-2020 periods. As for the new legal framework (Regulation 1305/2013), Article 62 ensures that both Managing Authorities and Paying Agency undertake an ex-ante assessment of each programme proposal, stating that the measures programmed are verifiable and controllable. Commission services thoroughly analyse this assessment before approving programmes.

Finally, the European Network for Rural Development will play an enhanced role in disseminating good practices related to the reduction of error rates. In the first semester of 2015, training for Managing Authorities was arranged on the following topics: simplified cost options, reasonableness or costs, public procurement and result-oriented agro-environment payments: a collective approach.

### *3.6.2. Cohesion*

For **ERDF and Cohesion Fund** 2007-2013, the Commission's audit work focused in 2014 on five audit enquiries, as well as specific fact finding missions to validate selected ACR error rates. In order to be able to validate the audit results of the audit authorities, on-the-spot audits are carried out at the level of programmes authorities and/or intermediate bodies, and usually include verifications of audit evidence down to the source, on the spot, at the level of beneficiaries/projects. The result of this audit work is that the Commission can generally rely on the work of 42 out of the 47 audit authorities audited, in charge of auditing 91 % of ERDF/CF allocations for 2007-2013 programming period.

The audit work carried out from 2010 to 2014 confirms that the management verifications (first level controls) conducted by Member States continue to be a key issue. In fact, the management verification audits performed in 2014 by the Commission confirmed that weaknesses in the execution of these controls have been identified in 66 % of the missions performed, in particular in the area of public procurement (issues identified in 58 % of the missions).

Other issues were identified in areas such as eligibility of operations (audits carried out on selection of operations in Hungary, Romania, Greece, Italy and Slovenia) and State Aid (addressed in audits on competitiveness programmes in Slovenia, Hungary, Greece, Romania, Italy and in the mission to Spain at the level of the two intermediate bodies). In these three areas (public procurement, eligibility, State Aid) problems are also reported in audits by the ECA.



A detailed analysis of the reservations issued by the Director General and the related action plans at programme level is disclosed in the DG REGIO 2014 AAR.

For **ESF**, the main findings in system audits concern: selection of operations, inadequate management verifications, lack of audit trail, unreliable IT systems, flaws in the certification process, insufficient reliability of the national system audit reports, breaches in public procurement and ineligibility of expenditure.

Management verifications conducted by Member States continue to be a key issue. The management verification audits performed in 2014 by the Commission confirmed the following main weaknesses in the execution of these controls, already identified in 2013: the formal nature of management verifications, insufficient verifications of public procurement procedures, insufficient structure/organisation of the managing authority or intermediate body, lack of training and supervision in case of delegation of responsibilities, management verifications carried out after the certification of expenditure and insufficient guidance and training for beneficiaries.

In 2014, AAR reservations were made due to deficiencies in the management and control systems of the following **EFF** operational programmes: Germany (Mecklenburg-Vorpommern), Italy, the Netherlands, Poland and Romania. The 5 operational programmes concerned were all affected by material error, as reported in the ACRs. Letters with clear action plans were sent to all affected Member States, specifying the necessary corrective action to be taken to allow payments to resume.

## **4. CUMULATIVE FINANCIAL CORRECTIONS & RECOVERIES TO END 2014**

### **4.1. Overview**

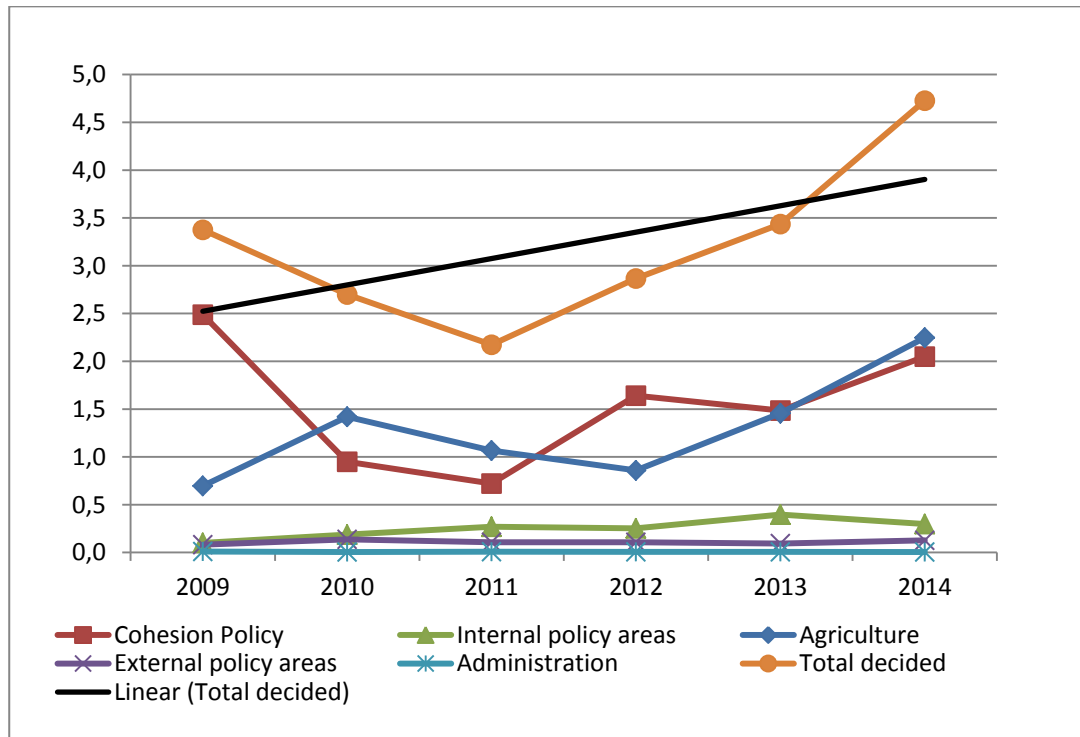
Cumulative figures provide useful information on the significance of the corrective mechanisms used by the Commission, in particular as they take into account the multi-annual character of programmes and projects and neutralise the impact of one-off events.

#### 4.1.1. Period 2009-2014

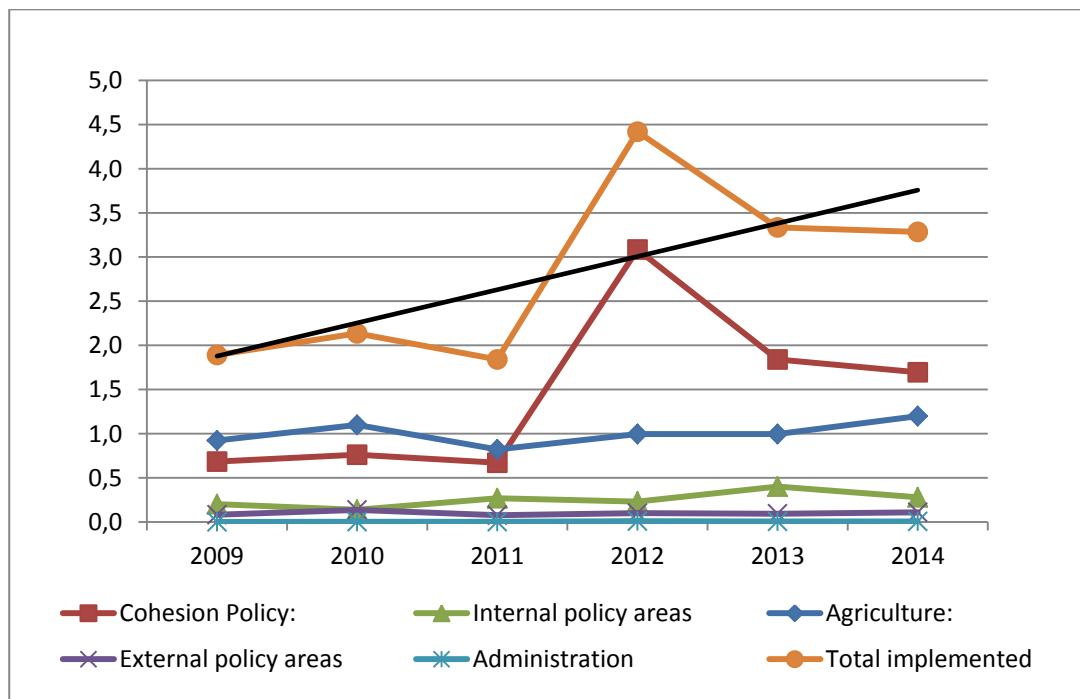
The graphs below show the evolution of financial corrections and recoveries confirmed and implemented during the last 6 years:

#### **Graphs 4.1: Financial corrections and recoveries 2009-2014 (EUR billions)**

Financial corrections and recoveries **confirmed** 2009-2014 (EUR billions)



Financial corrections and recoveries **implemented** 2009-2014 (EUR billions)



The average amount of financial corrections and recoveries **confirmed** per year during the period 2009 to 2014 was EUR 3.2 billion or 2.4 % of the average amount of payments from the EU budget of EUR 133 billion (shared management: EUR 2.8 billion or 2.8 % of the average amount of payments of EUR 102 billion; all other types of management: EUR 366 million or 1.2 % of the average amount of payments of EUR 30.5 billion.) The trend for confirmed amounts is slightly increasing, which demonstrates that the multi-annual control framework is successfully protecting the EU budget over time.

The average amount of financial corrections and recoveries **implemented** for 2009-2014 was EUR 2.8 billion, which represents 2.1 % of the average amount of payments from the EU budget in that period (shared management: EUR 2.5 billion or 2.4 % of the average amount of payments; all other types of management: EUR 356 million or 1.2 % of the average amount of payments). The increasing trend shown above can be explained by the closure of the programming period 2000-2006, as a significant number of financial corrections and recoveries are only implemented at that stage (see below). For Agriculture, the impact of executing some net financial corrections via three annual instalment payments is reflected in a lower increase of the amounts actually implemented compared to the amounts decided by the Commission.

#### 4.1.2. Decisions of the Court of Justice concerning Regional policy financial corrections

During 2015, Court of Justice judgements were issued annulling a number of regional policy financial corrections' decisions taken between 2008 and 2010. These corrections totalled almost EUR 0.5 billion and related to the programming period 1994-1999. The judgements reflect procedural issues arising from Regulation 1083/2006. The Commission is analysing the impact.

## 4.2. Financial corrections

### 4.2.1. Overview

**Table 4.2.1: Cumulative financial corrections confirmed & implementation percentage to end 2014**

EUR millions

	Programming Period			Cumulated EAGF decisions	Total financial corrections confirmed at end 2014	Implementation % end 2014	Financial corrections confirmed at end 2013	Implementation % end 2013
	1994-1999 Period	2000-2006 Period	2007-2013 Period					
<b>Agriculture</b>	-	<b>126</b>	<b>580</b>	<b>10 808</b>	<b>11 514</b>	<b>82.8%</b>	<b>9 634</b>	<b>89.6%</b>
EAGF	-	-	-	10 808	10 808	83.7%	9 148	90.0%
Rural Development	-	126	580	N/A	706	69.3%	486	83.2%
<b>Cohesion Policy</b>	<b>2 723</b>	<b>8 437</b>	<b>3 043</b>	<b>N/A</b>	<b>14 203</b>	<b>92.2%</b>	<b>12 189</b>	<b>93.8%</b>
ERDF	1 794*	5 638	1 541	N/A	8 973	91.9%	7 643	93.8%
Cohesion Fund	268	780	448	N/A	1 496	88.7%	1 204	90.7%
ESF	560	1 811	1 029	N/A	3 399	96.5%	3 057	97.9%
FIFG/EFF	100	125	25	N/A	250	60.4%	211	51.8%
EAGGF Guidance	2	83	-	N/A	85	100.0%	73	100%
<b>Other</b>	-	-	-	N/A	<b>9</b>	<b>100.0%</b>	<b>4</b>	<b>100%</b>
<b>Total</b>	<b>2 723</b>	<b>8 563</b>	<b>3 623</b>	<b>10 808</b>	<b>25 726</b>	<b>88.0%</b>	<b>21 827</b>	<b>91.9%</b>

\* In 2015 the Court of Justice decided in favour of the beneficiary Member States for a number of legal cases (EUR 0.5 billion) relating to ERDF financial corrections implemented in 2008/10 (see section 4.1.2.).

The different programming periods in Cohesion policy clearly show the multi-annual nature of the EU budget cycle. Since the 2000-2006 period is approaching the end of the closure process, the amount of financial corrections is considerably higher, especially when compared to the 2007-2013 period. Financial corrections for this more recent period are

expected to continue to increase in the coming years as its programmes start to close (some are reaching the 95 % payment threshold) but should be of a lower significance compared to the previous programming period due to the success of preventive measures.

#### 4.2.2. Agriculture – EAGF: financial corrections under the conformity clearance procedure

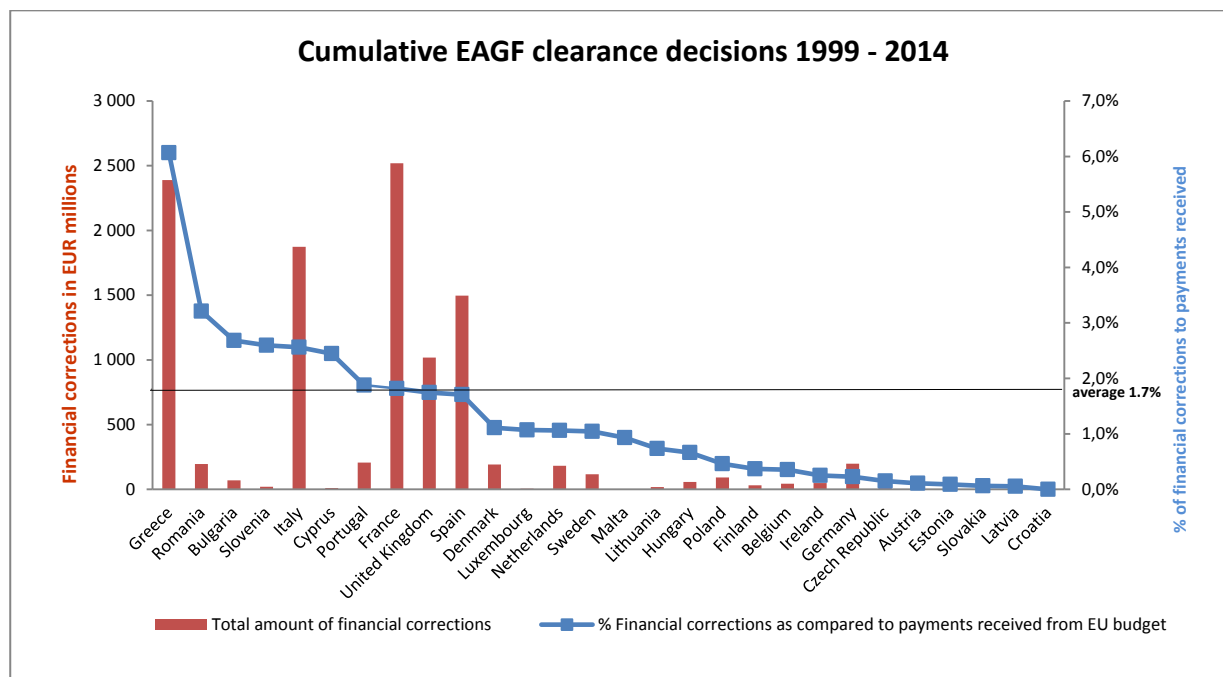
Concerning **EAGF**, the amount of financial corrections decided by the Commission since 1999 totals EUR 10 808 million (from 47 decisions adopted). The average correction rate per financial year for the period 1999-2014 has been **1.7 %** of expenditure. Once decided by the Commission, the corrections are automatically implemented unless a Member State has been granted the possibility of paying in three annual instalments.

**Table 4.2.2: EAGF: Cumulative financial corrections decided under conformity clearance of accounts from 1999 to end 2014; Breakdown by Member State**

EUR millions

Member State	EAGF payments received from EU budget	% of payments received as compared to total payments	Cumulated EAGF financial corrections at end 2014	% as compared to payments received from EU budget	% as compared to total amount of financial corrections
Belgium	12 243	1.9%	43	0.4%	0.4%
Bulgaria	2 583	0.4%	69	2.7%	0.6%
Czech Republic	5 636	0.9%	8	0.1%	0.1%
Denmark	17 282	2.7%	192	1.1%	1.8%
Germany	87 523	13.4%	198	0.2%	1.8%
Estonia	624	0.1%	1	0.1%	0.0%
Ireland	19 570	3.0%	49	0.3%	0.5%
Greece	39 372	6.0%	2 389	6.1%	22.1%
Spain	87 622	13.5%	1 496	1.7%	13.8%
France	138 554	21.3%	2 519	1.8%	23.3%
Croatia	7 687	1.2%	-	N/A	N/A
Italy	73 157	11.2%	1 874	2.6%	17.3%
Cyprus	395	0.1%	10	2.4%	0.1%
Latvia	897	0.1%	0	0.1%	0.0%
Lithuania	2 474	0.4%	18	0.7%	0.2%
Luxembourg	471	0.1%	5	1.1%	0.0%
Hungary	8 614	1.3%	57	0.7%	0.5%
Malta	32	0.0%	0	0.9%	0.0%
Netherlands	17 214	2.6%	183	1.1%	1.7%
Austria	11 173	1.7%	12	0.1%	0.1%
Poland	19 972	3.1%	92	0.5%	0.9%
Portugal	11 013	1.7%	207	1.9%	1.9%
Romania	6 117	0.9%	196	3.2%	1.8%
Slovenia	766	0.1%	20	2.6%	0.2%
Slovakia	2 458	0.4%	2	0.1%	0.0%
Finland	8 440	1.3%	31	0.4%	0.3%
Sweden	11 235	1.7%	117	1.0%	1.1%
United Kingdom	58 272	8.9%	1 018	1.7%	9.4%
<b>Total</b>	<b>651 394</b>	<b>100.0%</b>	<b>10 808</b>	<b>1.7%</b>	<b>100.0%</b>

**Graph 4.2.2: EAGF: Member States' cumulative financial corrections under conformity clearance of accounts from 1999 to end 2014 as compared to payments received from the EU Budget**



#### 4.2.3. Cohesion Policy: ERDF & ESF 2000-2006

As the closure of the 2000-2006 period is in the completion stage, a useful comparison of the overall results of the corrective actions with the total monies spent can be made and thus a more complete view of the impact of corrective mechanisms is possible<sup>13</sup>. For the ERDF and ESF funds at the end of 2014, the combined amount of financial corrections, based on Commission supervision work only, was EUR 8.2 billion. This corresponds to about 4.1 % of the allocations (EUR 196.9 billion) at end 2014. The correction rate increases to above 4.6 % when considering the additional financial corrections reported by Member States and related to their own control activities.

<sup>13</sup> For a more exhaustive explanation of the corrective mechanism put in place by the Commission for the closure 2000-2006, see the Report on financial corrections carried out for ERDF and ESF on 2000-2006 programmes (Ares(2013)689652 – 12 April 2013).

**Table 4.2.3: Programming period 2000-2006 - ERDF & ESF Financial corrections confirmed and in progress at 31 December 2014; Breakdown by Member State**

EUR millions

Member State	ERDF+ESF contribution amount	% of contribution amount to total contributions	Financial corrections confirmed	Financial corrections in progress (closure letters sent)	Total financial corrections imposed for 2000-2006	Percentage of financial corrections in relation to the ERDF+ESF contributions	Share of financial corrections imposed compared to total financial corrections
Belgium	1 945	1.0%	20	-	20	1.0%	0.2%
Czech Republic	1 456	0.7%	6	-	6	0.4%	0.1%
Denmark	570	0.3%	1	-	1	0.1%	0.0%
Germany	26 960	13.7%	53	2	54	0.2%	0.7%
Estonia	305	0.2%	2	-	2	0.5%	0.0%
Ireland	3 067	1.6%	36	-	36	1.2%	0.4%
Greece	20 211	10.3%	1 178	13	1 191	5.9%	14.6%
Spain	40 686	20.7%	3 464	58	3 522	8.7%	43.2%
France	14 825	7.5%	333	149	482	3.3%	5.9%
Italy	27 501	14.0%	1 480	479	1 959	7.1%	24.0%
Cyprus	53	0.0%	-	-	-	N/A	N/A
Latvia	518	0.3%	4	-	4	0.8%	0.0%
Lithuania	773	0.4%	3	-	3	0.3%	0.0%
Luxembourg	71	0.0%	2	-	2	2.6%	0.0%
Hungary	1 695	0.9%	12	-	12	0.7%	0.2%
Malta	57	0.0%	-	-	-	N/A	N/A
Netherlands	2 702	1.4%	44	-	44	1.6%	0.5%
Austria	1 647	0.8%	4	0	4	0.2%	0.0%
Poland	7 032	3.6%	180	-	180	2.6%	2.2%
Portugal	18 178	9.2%	190	-	190	1.0%	2.3%
Slovenia	215	0.1%	2	-	2	0.9%	0.0%
Slovakia	1 245	0.6%	45	-	45	3.6%	0.5%
Finland	1 789	0.9%	0	-	0	0.0%	0.0%
Sweden	1 634	0.8%	12	-	12	0.7%	0.1%
United Kingdom	16 129	8.2%	312	-	312	1.9%	3.8%
Interreg	5 645	2.9%	68	2	69	1.2%	0.8%
<b>Total</b>	<b>196 911</b>	<b>100.0%</b>	<b>7 449</b>	<b>702</b>	<b>8 152</b>	<b>4.1%</b>	<b>100.0%</b>

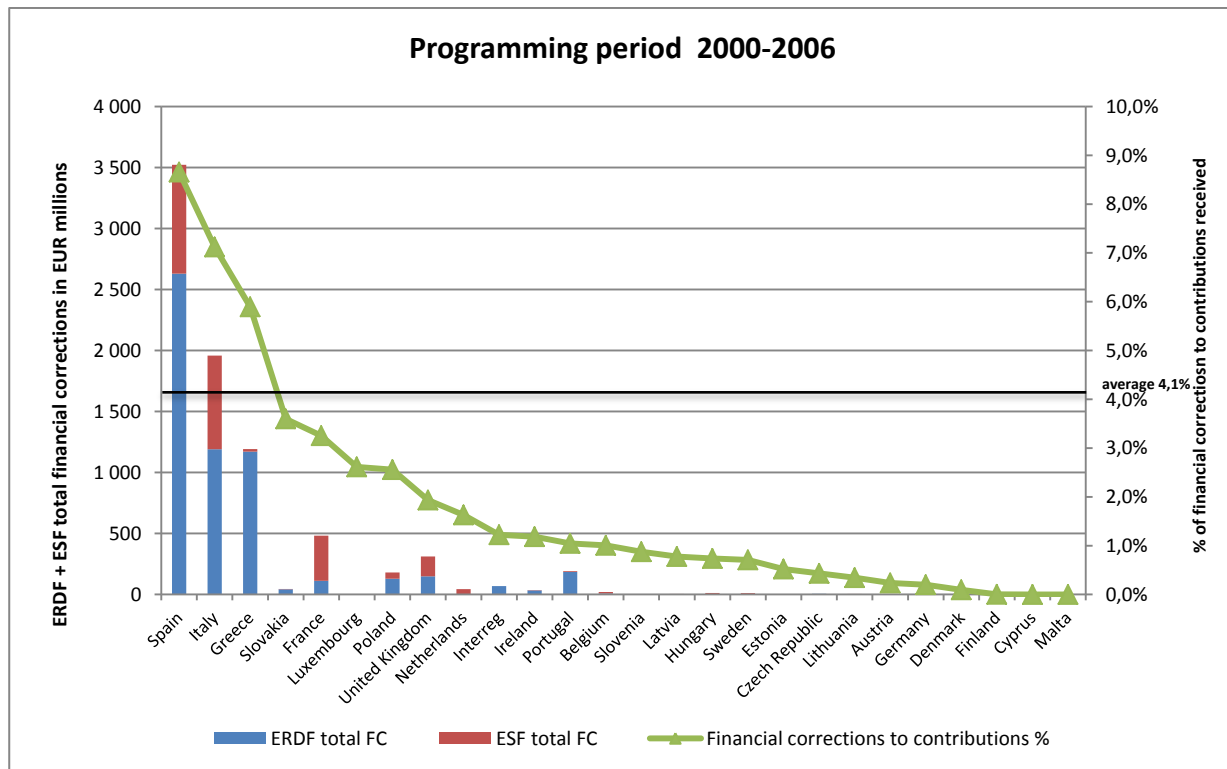
At the end of 2014, the Commission had closed 338 **ERDF** programmes (compared to 316 at end 2013) out of a total of 379 programmes. The remaining 41 programmes represent cases where the Member States contested the financial corrections proposed by the Commission, presented additional information to be considered or requested reimbursement of irrecoverable amounts. These cases are followed up by financial correction procedures (hearings) and decisions on irrecoverable amounts.

For ERDF, financial corrections imposed by the Commission to all Member States cumulatively up to the end of 2014 are EUR 5.8 billion, representing around 4.5 % of the total allocations for all 2000-2006 programmes. This process can be broken down into EUR 4.1 billion of financial corrections during the life cycle of the programmes and another EUR 1.6 billion of financial corrections applied at closure of the programmes. The main Member States concerned are Spain (EUR 2.6 billion), Italy (EUR 1.2 billion) and Greece (EUR 1.2 billion).

For **ESF**, the closure process has been finalised at the end of 2014. The Commission services estimate at 30 June 2015 that the total amount of financial corrections for 2000-2006 programming period - taking into account financial corrections in progress - will amount to EUR 2.4 billion for the ESF programmes, representing 3.6 % of the ESF allocation. This process can be broken down into EUR 1.2 million of financial corrections during the life cycle of the programmes and another EUR 1.2 million applied at closure.

In the context of the closure of the Spanish ESF programmes, for 3 programmes out of 38 the closure proposal was rejected by the Spanish authorities despite a closure analysis of all the arguments and information presented by the Commission. At the end of 2014, the financial corrections in progress for Spain amounted to EUR 59 million and represented a blocked RAL of EUR 34 million. In the course of 2015, 1 closure proposal has been accepted by the local authorities. The pre-correction procedure for other programmes has been initiated.

**Graph 4.2.3: Member States' cumulative financial corrections confirmed and in progress at 31 December 2014 for ERDF & ESF programming period 2000-2006 as compared to contributions received**



#### 4.2.4. Cohesion Policy: ERDF/CF & ESF 2007-2013

At this stage of the programming period, the cumulative amounts corrected to date represent 0.9 % of the budget allocations. While financial corrections for the 2007-2013 period are expected to continue to increase in the coming years as its programmes start to close, figures so far indicate an overall lower volume of financial corrections compared to the previous programming period. This reflects the improved capacity of the management and control systems to detect problems and to correct errors before expenditure is declared to the Commission, as reflected in the lower error rates for cohesion policy in the period 2007-2013 compared to the period 2000-2006. Reference is also made to the corrections made by Member States in this period – see section 7.

**Table 4.2.4: Programming period 2007-2013 – ERDF/CF & ESF Financial corrections confirmed and in progress at 31 December 2014; Breakdown by Member State**

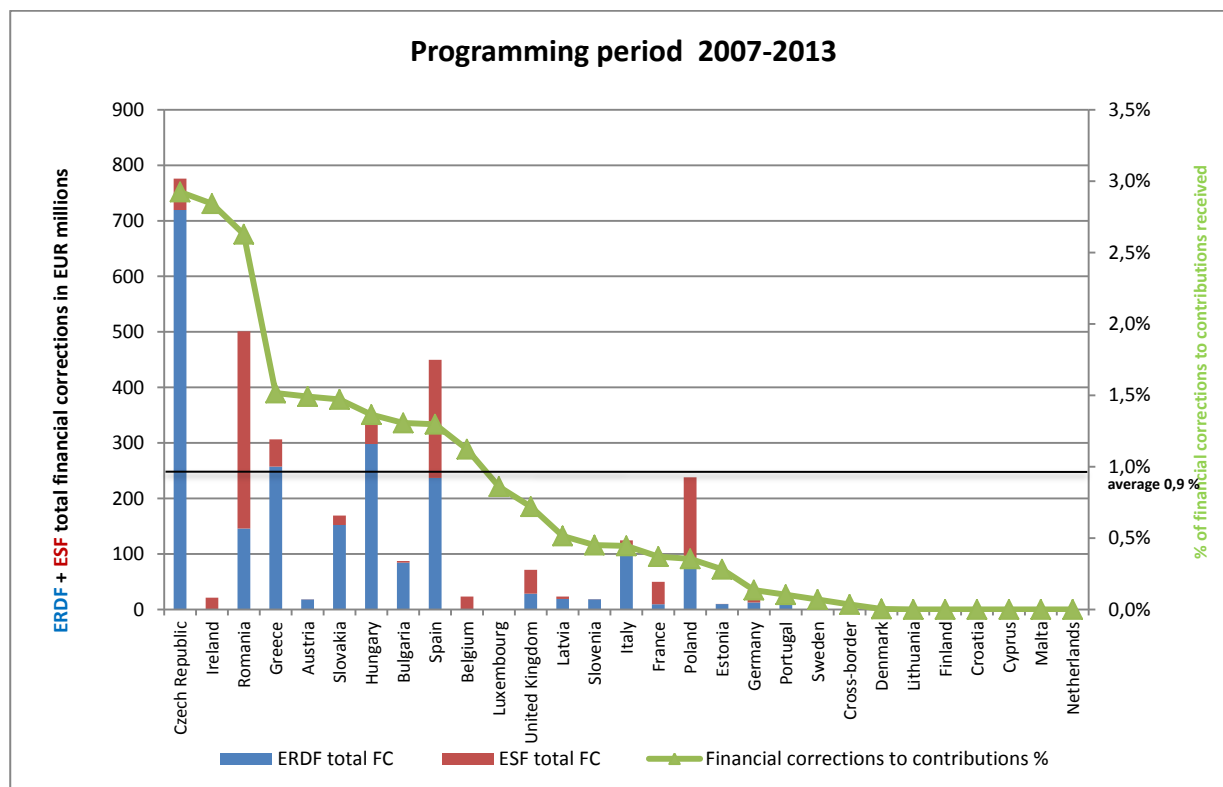
EUR millions

Member State	ERDF/CF+ESF contribution amount for 2007-2013	% of contribution amount to total contributions	Financial corrections confirmed	Financial corrections in progress (closure letters sent)	Total financial corrections imposed for 2007-2013	Percentage of financial corrections in relation to the ERDF/CF+ESF contributions	Share of financial corrections imposed compared to total financial corrections
Belgium	2 063	0.6%	22	1	23	1.1%	0.7%
Bulgaria	6 674	1.9%	87	-	87	1.3%	2.7%
Czech Republic	26 540	7.6%	715	61	776	2.9%	23.6%
Denmark	510	0.1%	0	-	0	0.0%	0.0%
Germany	25 488	7.3%	26	9	35	0.1%	1.1%
Estonia	3 403	1.0%	10	-	10	0.3%	0.3%
Ireland	751	0.2%	21	-	21	2.8%	0.6%
Greece	20 210	5.8%	219	88	306	1.5%	9.3%
Spain	34 649	10.0%	368	82	450	1.3%	13.7%
France	13 449	3.9%	48	2	50	0.4%	1.5%
Croatia	858	0.2%	-	-	-	0.0%	0.0%
Italy	27 923	8.0%	110	15	124	0.4%	3.8%
Cyprus	612	0.2%	-	-	-	N/A	N/A
Latvia	4 530	1.3%	23	-	23	0.5%	0.7%
Lithuania	6 775	2.0%	0	-	0	0.0%	0.0%
Luxembourg	50	0.0%	0	-	0	0.9%	0.0%
Hungary	24 908	7.2%	340	-	340	1.4%	10.3%
Malta	840	0.2%	-	-	-	N/A	N/A
Netherlands	1 660	0.5%	-	-	-	N/A	N/A
Austria	1 204	0.3%	12	6	18	1.5%	0.5%
Poland	67 186	19.3%	238	-	238	0.4%	7.2%
Portugal	21 412	6.2%	22	-	22	0.1%	0.7%
Romania	19 058	5.5%	501	-	501	2.6%	15.2%
Slovenia	4 101	1.2%	19	-	19	0.5%	0.6%
Slovakia	11 496	3.3%	169	0	169	1.5%	5.1%
Finland	1 596	0.5%	0	-	0	0.0%	0.0%
Sweden	1 626	0.5%	1	-	1	0.1%	0.0%
United Kingdom	9 891	2.8%	64	7	71	0.7%	2.2%
Cross-border	7 987	2.3%	3	-	3	0.0%	0.1%
<b>Total</b>	<b>347 450</b>	<b>100.0%</b>	<b>3 018</b>	<b>269</b>	<b>3 287</b>	<b>0.9%</b>	<b>100.0%</b>

As 2007-2013 programmes are multi-funds, no split is given between ERDF and CF in the above table.



**Graph 4.2.4: Member States' cumulative financial corrections confirmed and in progress at 31 December 2014 for ERDF/CF & ESF programming period 2007-2013 as compared to contributions received**



For **ERDF/CF** programmes, the Commission has imposed around EUR 2 billion of financial corrections cumulatively since the beginning of the 2007-2013 programming period (which includes EUR 782 million of financial corrections applied by the Member States before or at the same time of declaring the expenditure to the Commission as a result of requested remedial actions, see also corrections “at source” above) and EUR 237 million of financial corrections are in progress. The main Member States concerned are Czech Republic (EUR 719 million), Hungary (EUR 298 million), Greece (EUR 257 million), Spain (EUR 237 million), Slovakia (EUR 152 million), Romania (EUR 146 million) and Italy (EUR 105 million).

Concerning **ERDF** and the **Cohesion Fund**, in 2014, the Commission continued to exercise rigorously its supervisory role by interrupting/suspending payments as soon as deficiencies are identified and ensuring that Member States address the identified weaknesses in their management and control systems. The objective was to identify and address any major outstanding material risk so as to ensure an appropriate protection of the EU budget, and to arrive at an acceptable residual risk by the closure of programmes. This resulted in an overall improvement for the 2007-2013 period compared to 2000-2006, and in a positive trend as regards the incidence of errors in Cohesion expenditure over the years thanks to a series of actions taken by the Commission in cooperation with Member States, as described below.

For **ESF**, the Member States with the highest level of cumulative financial correction figures are Romania (EUR 355 million), Spain (EUR 213 million) and Poland (EUR 152 million).

The following improvements were made for the period 2007-2013 for ERDF/CF and ESF programmes:

*(A) Strengthening national controls*

The capacity of national management and control systems to prevent, detect and correct errors before expenditure is declared to the Commission has been strengthened. On one hand, the Commission services invested significant management and audit efforts in improving the functioning of Member States' first level verifications. On the other hand, the 2007-2013 regulations include the obligation for audit authorities to use, as a general rule, statistical samples for audits of operations. This, associated with exhaustive audit supervision and guidance from the Commission leading to considerable capacity building efforts, very much helped to improve the reliability of error rates reported on a yearly basis to the Commission in the Member States' ACRs and used as indicators on the effectiveness of management and control systems in the Commission assurance process. The Commission audit work could thus shift towards obtaining assurance on the work of audit authorities, concentrating on the weakest ones or on those ensuring the highest coverage of EU Funds. In addition, the Commission is continuously following-up identified weaknesses and monitoring that the work quality of the audit authority remains satisfactory when the single audit status has been granted to a programme. The close cooperation with audit authorities ensures a timely detection and solution of problems already at national level. It also contributes to the improvement of the assurance process at Commission level.

*(B) Commission on-the-spot audits*

The Commission also carries out its own on-the-spot risk-based audits, including audits at the level of beneficiaries, if it considers that certain deficiencies (concerning in particular complex issues such as public procurement or State aid issues for ERDF/CF) could remain either undetected or not detected in a timely manner. This includes verifying implementation of remedial actions plans in case of interruptions and financial corrections. These audits contribute to improvements in the management and control systems for programmes put under reservation ensuring that past and future expenditure declared to the Commission is legal and regular. It also provides an additional, more direct source of assurance to the Commission.

*(C) Better problem detection*

The improved capacity to detect problems has been pro-actively used to improve the functioning of Member States' management systems, while implementing the necessary financial corrections. The systematic and consistent use by the Commission of interruptions and/or suspensions of payments to programmes with significant management weaknesses since 2008, or the decision of the Directors General to issue warning letters when no payments are pending, has avoided EU reimbursements of expenditure with a high risk of error, while also providing strong incentives to Member States to rapidly improve their management and control systems. At the same time, the joint work of the EU and Member States' control authorities has allowed for better agreement on, and implementation of, the necessary financial corrections so as to duly protect the EU budget against irregular expenditure, including through flat-rate corrections. Member States were, in turn, able to re-use the EU resources affected by these corrections for other projects. However, such corrections still have a major financial and political impact in the Member States concerned since irregular expenditure has to be funded by national resources unless it is recovered from beneficiaries.

#### (D) Capacity building actions

In order to mitigate the remaining risks and weaknesses identified in Member States and programmes at the level of managing authorities, the Commission has also taken initiatives to implement additional capacity building actions for the 2007-2013 programmes. A new Competence Centre on administrative capacity building was established at the beginning of 2013 in order to support public administrations managing ERDF and the Cohesion Fund. For public procurement, the Competence Centre has established a Public Procurement Action Plan. Actions are also taken to improve the implementation of State aid rules, while an exchange platform between administrations managing the funds is being developed in order to capitalise on existing good practices.

#### (E) Simplified Cost Options

In 2014, the Commission continued to actively promote the use of Simplified Cost Options (SCOs). Seminars took place in Italy, France, Ireland and Malta to promote the use of SCOs, as a way to further reduce the risks of errors in the legality and regularity of the transactions, notably in the context of the preparation of the next 2014-2020 programming period. In addition, an updated guidance note for the Member States on SCOs was finalised in September 2014 and an Italian case study on the implementation of SCOs in the 2007-2013 programming period was published in 2014.

### 4.3. Recoveries

The tables below provide the amounts of recoveries confirmed and implemented for the period 2009-2014. See also table **5.2** below concerning the impact on the EU budget.

**Table 4.3.1: Recoveries confirmed 2009-2014**

EUR millions

Recoveries	Years						Total
	2009	2010	2011	2012	2013	2014	
Agriculture:							
EAGF	163	178	174	162	227	213	<b>1 117</b>
Rural Development	25	114	161	145	139	165	<b>750</b>
Cohesion	102	24	50	22	83	35	<b>315</b>
Internal policy areas	100	188	270	252	393	293	<b>1 495</b>
External policy areas	81	137	107	107	93	127	<b>652</b>
Administration	9	5	8	7	6	5	<b>40</b>
<b>Total</b>	<b>480</b>	<b>646</b>	<b>770</b>	<b>695</b>	<b>941</b>	<b>838</b>	<b>4 368</b>

**Table 4.3.2: Recoveries implemented 2009-2014**

EUR millions

Recoveries	Years						Total
	2009	2010	2011	2012	2013	2014	
Agriculture:							
EAGF	148	172	178	161	155	150	<b>964</b>
Rural Development	25	114	161	166	129	167	<b>763</b>
Cohesion	102	25	48	14	81	32	<b>301</b>
Internal policy areas	100	162	268	229	398	274	<b>1 432</b>
External policy areas	81	136	77	99	93	108	<b>594</b>
Administration	9	5	2	9	6	5	<b>36</b>
<b>Total</b>	<b>464</b>	<b>614</b>	<b>734</b>	<b>678</b>	<b>862</b>	<b>736</b>	<b>4 089</b>

## 5. NET CORRECTIONS

The budget implementation type, the sectorial management and the financial rules of the policy area influence how the EU budget is impacted by the different correction mechanisms. In all cases, the correction mechanisms result in the EU budget being protected from expenditure incurred in breach of law.

### 5.1. Net financial corrections 2014

A net financial correction is a correction that impacts the EU budget, (i.e. the corrected and recovered amounts are reimbursed to the EU budget). As a consequence, the EU funding is decreased for the Member State concerned.

As explained above, under the programming periods 2000-2006 and 2007-2013 net corrections were primarily made under Agricultural policy.

**Table 5.1.1: Breakdown of net financial corrections confirmed in 2014**

EUR millions

MFF Heading	Net financial corrections confirmed in 2014	Financial corrections with replacement of expenditure confirmed in 2014	Total financial corrections confirmed in 2014
<b>Smart &amp; inclusive growth</b>	<b>315</b>	<b>1 649</b>	<b>1 964</b>
ERDF	185	1 145	1 330
Cohesion Fund	31	261	292
ESF	99	243	342
<b>Sustainable growth: natural resources</b>	<b>1 903</b>	<b>17</b>	<b>1 921</b>
EAGF	1 649	-	1 649
Rural Development	220	-	220
FIFG/EFF	21	17	39
EAGGF Guidance	13	-	13
<b>Security &amp; citizenship</b>	<b>5</b>	<b>-</b>	<b>5</b>
Migration and home affairs	5	-	5
<b>TOTAL</b>	<b>2 224</b>	<b>1 666</b>	<b>3 890</b>

A total of EUR 113 million remain to be classified and is treated as non-net corrections in this table.

As shown above, **Agriculture** corrections (EAGF, EAFRD, EAGGF) are always net whereas, due to the legal framework, for **Cohesion Policy**, net financial corrections leading to the return of previously paid amounts to the EU budget were generally the exception – see section **3.1** for more explanation of the amounts.

Under the legal framework applicable for **Cohesion Policy** up to the 2007-2013 programming period, a real cash-flow back to the EU budget occurs only:

- If Member States are unable to present sufficient eligible expenditure;
- After the closure of programmes where replacement of ineligible by eligible expenditure is no longer possible;
- In case of disagreement with the Commission (see section **2.4.1**).

However, a significant change was introduced for the 2014-2020 period: The Commission has the obligation to apply a net financial correction when serious deficiencies not previously detected, reported nor corrected at Member State level are discovered by EU audits. In such cases, the current possibility for the Member State to accept the correction and to re-use the EU funds in question is removed (see section **2.4.2**).

**Table 5.1.2: Breakdown of net financial corrections implemented in 2014**

EUR millions

MFF Heading	Net financial corrections implemented in 2014	Financial corrections with replacement of expenditure implemented in 2014	Total financial corrections implemented in 2014
<b>Smart &amp; inclusive growth</b>	<b>358</b>	<b>1 250</b>	<b>1 608</b>
ERDF	204	879	1 083
Cohesion Fund	55	181	236
ESF	99	190	289
<b>Sustainable growth: natural resources</b>	<b>918</b>	<b>18</b>	<b>936</b>
EAGF	796	-	796
Rural Development	86	-	86
FIFG/EFF	23	18	41
EAGGF Guidance	13	-	13
<b>Security &amp; citizenship</b>	<b>5</b>	<b>-</b>	<b>5</b>
Migration & home affairs	5	-	5
<b>TOTAL</b>	<b>1 281</b>	<b>1 268</b>	<b>2 549</b>

The increased application of implementation by instalment and deferrals explains why in the last three years (2012 to 2014) the amounts implemented for **Agriculture** were lower than the amounts decided. The difference should disappear once cruising speed is reached.

## 5.2. Impact on the EU budget

**Table 5.2: Impact on the EU Budget**

EUR millions

	Total impact on the EU budget
Net financial corrections implemented*	1 281
Recoveries implemented**	736
<b>TOTAL</b>	<b>2 017</b>

\* The main expenditure chapters concerned are 0502, 0503, 0504, 1303, 1304, 0402, 1106 and 1803.

\*\* The main expenditure chapters concerned are 0502, 0503, 1303, 1304, 0402 and 1106. For more information on recoveries see 4.3.

As explained above, revenue arising from net financial corrections (see section 5.1.) and recoveries (see sections 2.2.2. and 4.3.) are treated as assigned revenue<sup>14</sup>, noting that the Commission implements recoveries also "at source" by deducting ineligible expenditure (which has been identified in previous or current cost claims) from payments made. Apart from two exceptions, the Financial Regulation<sup>15</sup> does not include specific provisions on how the assigned revenue generated by a net financial correction or recovery can be used. However, Article 7 of the Rules of Application determines that the budget commentary shall show which budget lines may receive the appropriations corresponding to the assigned revenue. In general, assigned revenue goes back to the budget line or fund from which the expenditure was originally paid and may be spent again but it is not earmarked for specific Member States.

<sup>14</sup> Article 21(3)(c) of the Financial Regulation.

<sup>15</sup> For European Agricultural Guarantee Fund (EAGF) the appropriations are assigned to the "origin of the revenue" (Art. 174(1)) and for financial instruments to the "same financial instrument" (Art.140(6)).

### 5.3. Impact on national budgets

Under shared management, all financial corrections and recoveries have an impact on national budgets regardless of their method of implementation. It has to be underlined that even if no reimbursement to the EU budget is made, the impact of financial corrections is always negative at Member State's level. This is because in order not to lose EU funding, the Member State must replace ineligible expenditure by eligible operations. This means that the Member State bears, with its own resources (from the national budget), the financial consequences of the loss of EU co-financing of expenditure considered ineligible under the EU programme rules (in the form of opportunity cost) unless it recovers the amounts from individual beneficiaries. This is not always possible, for example in the case of flat-rate corrections at programme level (due to deficiencies in the national administration managing the programme) which are not directly linked to individual irregularities at project level.

## 6. PREVENTIVE MEASURES

### 6.1. Agriculture

#### 6.1.1. Interruptions, suspensions and reductions

In 2014, under the previous legal basis<sup>16</sup>, there were 17 interruptions of payments. In addition, a reduction decision based on Article 41(1) for two quarters for Greece has been adopted at the beginning of 2015. Those interruptions and reductions concerned some investment measures not managed under the Integrated Administration and Control System (IACS) in 6 out of 92 Rural Development Programmes.

For EAGF, the Commission adopted a decision to reduce from claim year 2014 the direct payments in Greece. This decision was based on Article 41(1) of R. 1306/2013 and protects the EU financial interest against remaining, limited and precisely quantified problems with the inclusion of ineligible permanent pasture land in the Land Parcel Identification System (LPIS).

#### 6.1.2. Other preventive measures

A compulsory administrative structure has been set up at the level of Member States (see section **7.1**):

- The management and control of the expenditure is entrusted to dedicated paying agencies, which must be accredited by the Member State prior to their operations on the basis of a comprehensive set of accreditation criteria laid down in EU law. The paying agencies' compliance with these criteria is subject to a detailed review

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<sup>16</sup> Commission Regulation (EC) No 883/2006 of 21 June 2006 laying down detailed rules for the application of Council Regulation (EC) No 1290/2005 as regards the keeping of accounts by the paying agencies, declarations of expenditure and revenue and the conditions for reimbursing expenditure under the EAGF and the EAFRD (OJ L 171, 23.6.2006, p. 1–34).

Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320–469).

Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320–469).

by an external audit body, as well as to a constant supervision by the competent national authority, and clear procedures exist as to how to address and remedy any problem.

- Moreover, the heads of the paying agencies are required to provide an annual statement of assurance which covers the completeness, accuracy and veracity of the paying agency's accounts, as well as a declaration of assurance on the legality and regularity of the underlying transactions. These statements of assurance are verified by independent certification bodies, which are required to provide an opinion thereon. For those Member States with only one paying agency, this statement of assurance received from the director of the paying agency, together with the certificate and opinion of the certification body, constitute by definition the "annual summary".

## 6.2. Cohesion

### 6.2.1. Interruptions and suspensions

**Table 6.2.1: Interruptions**

EUR millions

Fund	Cohesion policy: 2007-2013 programming period							
	Total open cases at 31.12.2013		New cases 2014		Closed cases during 2014		Total open cases at 31.12.2014	
	Number of cases	Amount	Number of cases	Amount	Number of cases	Amount	Number of cases	Amount
<b>ERDF &amp; Cohesion Fund</b>	101	1 608	134	6 227	137	3 998	98	3 837
<b>ESF</b>	20	272	31	1 323	19	625	32	970
<b>EFF</b>	10	97	13	103	15	186	8	14
<b>Total</b>	<b>131</b>	<b>1 977</b>	<b>178</b>	<b>7 653</b>	<b>171</b>	<b>4 809</b>	<b>138</b>	<b>4 821</b>

The table above presents for the ERDF, the Cohesion Fund, the ESF and the EFF, a view on the evolution of the interruption cases both in number and in amount. The opening balance includes all the cases still open at end 2013, irrespective of the year when the interruption was notified to the Member State. The new cases only refer to the interruptions notified in the year 2014. The closed cases represent the cases for which the payment of cost claims resumed in 2014, irrespective of the year when the interruption started. The cases still open at end 2014 represent the interruptions that remain active at 31 December 2014, i.e. the payment deadline of cost claims is still interrupted pending corrective measures to be taken by the Member State concerned.

In 2014, the number of warning letters, interruptions and pre-suspensions for **ERDF/CF** programmes were still at a very high level. 16 new warning letters were sent and 36 new interruptions were decided and communicated to Member States in the year. The Commission initiated 28 pre-suspension procedures. 121 programmes were impacted by either a warning or an interruption. Approximately two third of these interruptions and pre-suspensions are based on audit results reported to the Commission by audit authorities during the year or at year end.

Concerning **ESF**, at end 2013, 20 interruptions remained open. During 2014, 31 interruptions were decided and 19 interruptions were lifted. This meant that 32 payments remained interrupted at end 2014 (Czech Republic (1), Spain (18), France (3) Italy (8) and the United Kingdom (2)), of which 13 were already interrupted at end 2013.

For **EFF**, most of the interruptions relate to issues stemming from the analysis of the ACRs provided by the MS at the beginning of each year (reports not provided, not reliable or showing high error rates). The significant reduction in the interrupted amounts between the two years resulted from the lifting of the interruption for Spain.

## **Suspensions**

Concerning **ERDF** and the **Cohesion Fund**, five<sup>17</sup> suspension decisions were still in force at the end of 2013. Decisions to lift the suspensions for the intermediate bodies AENA in Spain and Social Affairs in Estonia were taken during 2014. The other three suspension decisions for Spain and Italy remained in force at the end of 2014. Four new suspension decisions were adopted in 2014: three related to Spain, and one related to an IPA CBC programme (Adriatic –Technical assistance priority). Two of the suspension decisions related to Spain were still in force and one was lifted before the year-end.

Concerning **ESF**, one suspension decision adopted in 2011 for France was still on-going at 31 December 2014. Seven suspension decisions adopted during 2013 were still ongoing at 31 December 2014: Belgium, Czech Republic, Spain (3), Italy and Slovakia. During 2014, eleven suspension decisions were adopted (Czech Republic, Spain (9) and Italy) and all of them were still ongoing at 31 December 2014.

Interim payments for the **EFF** operational programme for Estonia were suspended in May 2014. Following the suspension decision, a number of exchanges between Estonia and the Commission services took place to analyse and address the measures undertaken by Estonia, which led to the lifting of the suspension in April 2015.

### *6.2.2. Fraud-prevention measures*

Fraud, when it occurs, raises significant attention and damages the reputation of the EU. In this respect, an important initiative taken by the Commission was firstly to hold in December 2013 a conference on anti-fraud measures for all Member States. Secondly, this was followed by a series of conferences in 2014-2015 in Greece, Slovakia, Czech Republic, Bulgaria, Croatia, Romania, Italy, Slovenia and Spain, Poland and Latvia (for the 3 Baltic States). Furthermore the Commission produced specific guidance to support Member States' fraud risk assessment and developed tailor-made IT tools in order to help them target their anti-fraud efforts on high risk projects. These actions are in line with the increased responsibilities at Member State level arising from the new Cohesion Policy regulation (Article 125(4)(c)) which requires Member States to "put in place effective and proportionate anti-fraud measures taking into account the risks identified".

These above-mentioned awareness raising events have provided positive results; for example, the region of Andalucía (Spain) has decided to start using the ARACHNE fraud risk scoring tool already for the 2007-2013 programming period. The Commission is providing the necessary support to set up the system and assisting the regional authorities in creating the relevant data files required. The Andalusian authorities also committed (written communication of December 2014) to have a dedicated anti-fraud agency carrying out detection and prevention activities.

ARACHNE has been presented to 22 Member States. So far, sixteen have sent programme data and the roll out of the system is continuing. Eight Member States already use the ARACHNE tool and the Commission continues to monitor its use. Eight other Member States have access since the first quarter of 2015. Further presentations to the remaining six will take place in 2015. ARACHNE aims at establishing a comprehensive database of financial and operational data on projects and beneficiaries in order to carry out, on the basis of objective criteria, a risk scoring allowing the identification of the most risky projects and the most risky operational programmes.

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<sup>17</sup> The decision for lifting the suspension related to Estonia was taken in 2013 but officially notified in 2014.



## **7. CORRECTIVE ACTIONS MADE BY MEMBER STATES ON THEIR OWN INITIATIVE**

Under shared management, Member States have the primary obligation to prevent and detect irregularities, and thus they make major efforts and commit resources to making financial corrections and recovering undue amounts from beneficiaries. Moreover, they perform management verifications, controls and audits in the first instance, these being in addition to those of the Commission detailed above. The figures below are in addition to the corrections reported by the Commission above.

### **7.1. Agriculture**

Member States are required to put in place systems for ex-ante controls and dissuasive sanctions:

- For each aid support scheme financed by EAGF or EAFRD, ex-ante administrative and on-the-spot checks are performed and dissuasive sanctions are applied in case of non-compliance by the beneficiary. These control systems are to be applied by the paying agencies and encompass common features and special rules tailored to the specificities of each aid regime. They are designed to provide exhaustive ex-ante administrative controls of 100% of aid applications, cross-checks with other databases where appropriate, as well as on-the-spot checks of pre-payments on a sample of transactions ranging between 1 % and 100 % of the population, depending on the risk associated with the regime concerned. If on-the-spot checks reveal a high number of irregularities, additional controls must be carried out.
- In this context, the most important system is the IACS, which covered 94 % of EAGF expenditure in financial year 2014 (92 % in 2013). To the extent possible, the IACS is also used to manage and control Rural Development measures relating to parcels or livestock, which accounted for 40 % of payments under the EAFRD in 2014. For both Funds, the IACS covered 83 % of total expenditure in 2014.
- A detailed reporting from Member States to the Commission on the checks carried out by them and on the sanctions applied is foreseen in the legislation. The reporting system enables a calculation, for the main aid schemes, of the level of error found by Member States at the level of the final beneficiaries. The accuracy of the statistical information reported and the quality of the underlying on-the-spot checks is also verified and validated by the certification bodies for direct aids and Rural Development measures.

The latter reports from the Member States disclose the preventive effect of the ex-ante administrative and on-the-spot controls carried out.

**Table 7.1: Member States' own corrections applied before payments to beneficiaries are executed in 2014 (in addition to Commission reporting)**

EUR millions

Member State	EAGF Market Measures	EAGF Direct Payments	EAFRD	Total 2014
Belgium	1	1	1	3
Bulgaria	0	14	9	24
Czech Republic	0	0	1	2
Denmark	0	1	1	2
Germany	1	6	7	14
Estonia	0	0	1	2
Ireland	1	5	2	8
Greece	0	10	5	14
Spain	12	24	20	56
France	4	3	4	11
Croatia	0	1	-	1
Italy	3	17	9	30
Cyprus	0	1	0	1
Latvia	0	1	1	3
Lithuania	0	1	2	3
Luxembourg	0	0	0	0
Hungary	1	14	5	20
Malta	0	0	0	0
Netherlands	3	1	2	5
Austria	0	1	5	6
Poland	9	11	14	34
Portugal	1	1	4	6
Romania	2	9	18	29
Slovenia	0	0	1	2
Slovakia	0	2	1	4
Finland	0	0	2	2
Sweden	0	1	1	3
United Kingdom	0	3	4	7
<b>Total</b>	<b>39</b>	<b>128</b>	<b>122</b>	<b>289</b>

## 7.2. Cohesion

Under the regulations for the 2007-2013 programming period, Member States have to report annually to the Commission the corrections stemming from all controls performed. The Commission is performing risk-based audits to test the reliability of these figures as part of its assurance process.

It is highlighted that the Commission has taken a prudent approach, due to certain weaknesses in the Member State figures, so as to ensure that the amounts are not overstated – as a result some of them may in reality be higher. This, however, has no impact on the reliability of the Commission's own figures. The amounts in question are very significant and when added to the results of the Commission's work, give a very clear indication of the success of the controls put in place by both parties.

**Table 7.2: Cumulative corrections at end 2014 reported by Member States for Cohesion Policy period 2007-2013**

EUR millions

Member State	ERDF/CF	ESF	EFF	Total
Belgium	4	20	-	<b>24</b>
Bulgaria	14	3	0	<b>17</b>
Czech Republic	364	9	1	<b>374</b>
Denmark	1	0	0	<b>1</b>
Germany	266	78	1	<b>345</b>
Estonia	2	1	0	<b>3</b>
Ireland	0	18	0	<b>19</b>
Greece	301	25	3	<b>329</b>
Spain	466	221	38	<b>725</b>
France	140	71	1	<b>212</b>
Croatia	0	0	-	<b>0</b>
Italy	280	46	3	<b>329</b>
Cyprus	1	1	0	<b>2</b>
Latvia	46	3	1	<b>50</b>
Lithuania	18	0	0	<b>18</b>
Luxembourg	0	1	-	<b>1</b>
Hungary	255	-	0	<b>255</b>
Malta	2	0	0	<b>2</b>
Netherlands	7	3	-	<b>10</b>
Austria	14	2	0	<b>16</b>
Poland	444	-	1	<b>444</b>
Portugal	169	46	2	<b>216</b>
Romania	136	-	-	<b>136</b>
Slovenia	45	6	-	<b>51</b>
Slovakia	34	7	0	<b>41</b>
Finland	2	1	1	<b>3</b>
Sweden	8	1	0	<b>9</b>
United Kingdom	95	8	3	<b>105</b>
Cross-border	31	-	-	<b>31</b>
<b>TOTAL IMPLEMENTED</b>	<b>3 142</b>	<b>570</b>	<b>56</b>	<b>3 769</b>

## 8. RECOVERY OF PRE-FINANCING AMOUNTS

So as to provide a complete picture of all the tools used by the Commission to protect the EU budget, it is also necessary to consider the recoveries made in the areas of pre-financing, that being the recovery of unused (i.e. unspent) pre-financing amounts.

When a beneficiary has not used (spent) the advances received from the EU on eligible expenditure, the Commission issues a recovery order to return the monies to the EU budget. This procedure represents an important step in the control system of the EU to ensure that no excess money is kept by the beneficiary without proper expense justification, thus contributing to the protection of the EU budget. The amounts are the result of the issuance of a recovery order by the Commission, and are recorded in the accounting system as such. The below recovery of unused pre-financing amounts should not be confused with irregular expenditure recovered. Where Commission services identify and recover such expenditure in relation to pre-financing amounts paid out, these are included in the normal financial correction or recovery processes described above.

**Table 8: Recovery of pre-financing amounts**

*EUR millions*

	<b>2014</b>
Cohesion Policy:	
<i>ESF</i>	9
<i>FIFG/EFF</i>	10
<i>EAGGF Guidance</i>	6
Internal policy areas	278
External policy areas	95
Administration	2
<b>Total recovered pre-Financing</b>	<b>400</b>