

III

(Preparatory acts)

COURT OF AUDITORS

OPINION No 3/2012*(pursuant to the second subparagraph of Article 287(4) of the Treaty on the Functioning of the European Union)***on a proposal for a Regulation of the European Parliament and of the Council on the Hercule III programme to promote activities in the field of the protection of the European Union's financial interests***(2012/C 201/01)*

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THE COURT OF AUDITORS OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 325(4) thereof,

Having regard to the previous opinions given by the Court of Auditors on decisions regarding a Community action programme to promote activities in the field of the protection of the Community's financial interests, *Hercule I* (No 8/2003 ⁽¹⁾) and *Hercule II* (No 6/2006 ⁽²⁾),

Having regard to the Court of Auditors' Special Reports No 1/2005 ⁽³⁾ and No 2/2011 ⁽⁴⁾ concerning the management of the European Anti-Fraud Office (OLAF) and the follow-up of Special Report No 1/2005,

Having regard to the request of the Council of the European Union of 26 January 2012,

Whereas the proposed Regulation is based on Article 325(4) of the Treaty on the Functioning of the European Union (TFEU), which provides that: 'The European Parliament and the Council ... after consulting the Court of Auditors, shall adopt the necessary measures in the fields of the prevention of and fight against fraud affecting the financial interests of the Union with a view to affording effective and equivalent protection in the Member States and in all the Union's institutions, bodies, offices and agencies.:'

Whereas the main purpose of the Commission's proposal ⁽⁵⁾ is to replace the *Hercule II* programme ⁽⁶⁾ when it expires in 2013 with *Hercule III* for a period of seven years (2014 to 2020),

HAS ADOPTED THE FOLLOWING OPINION:

INTRODUCTION

1. The *Hercule I* programme started on 1 January 2004 and *Hercule II* covers the period 2007-2013. *Hercule III* is a continuation of the programme to promote activities in the field of the protection of the European Union's financial interests. Its proposed budgetary envelope is to be 110 million euro for the period 2014-2020. This would take total expenditure for the three *Hercule* programmes up to 220,3 million euro ⁽⁷⁾.

2. The proposal continues to place specific emphasis on the fight against cigarette smuggling and counterfeiting to reflect legal obligations ⁽⁸⁾ of the Commission stemming from the

agreements with four international cigarette manufacturers ⁽⁹⁾. An amount of approximately USD 2 billion is payable under the agreements into Member States' budgets (90,3 %) and into the European Union's budget (9,7 %), after deduction of legal fees, over the period 2004-2030.

3. The programmes are managed by OLAF. The main objective of the programme is to protect the financial interest of the Union by preventing and combating fraud, corruption and any other illegal activities. There are five operational objectives (see *Annex I*).

4. According to the legislative financial statement attached to the proposal, 79 % of the envelope would be allocated to 'technical assistance' to Member States, 19 % to 'specialised training' and 2 % to the 'European Lawyers Associations (ELAs)'.

5. 'Technical assistance' comprises the acquisition of technical equipment, training and cooperation between the services using the equipment and the procurement of commercially available databases for Member State and OLAF investigations.

6. The objective of the 'specialised training' is to provide adequate knowledge of the protection of EU financial interests' to Member States' officials and to promote 'best practice' and networking between Member States via seminars and conferences.

7. The 'ELA' budget is for academic and professional groups undertaking research and discussion on legal issues and also serves as a forum for the dissemination of developments in the area of EU law.

8. The explanatory memorandum to the proposal states that the Commission considered four options for the *Hercule III* programme. These are evaluated in the impact assessment ⁽¹⁰⁾: (1) Continuation of the *Hercule II* programme with the same level of funding; (2) Renewal of the *Hercule II* programme with improved objectives, better methodology and a higher rate of co-financing ⁽¹¹⁾; (3) Significant alteration of the objectives with much greater support for operation and law enforcement activities; (4) Discontinuation of the *Hercule II* programme, with the possibility of continuing some actions under other Union co-financing programmes and/or leave other actions to Member States. The Commission based its proposal on option (2).

9. This opinion is based on the proposal, the impact assessment and the intermediate review ⁽¹²⁾ of the achievement of the objectives of the *Hercule II* programme. It is divided in two parts: general and specific observations. An assessment of the other three options considered has not been undertaken.

⁽¹⁾ OJ C 318, 30.12.2003, p. 5.

⁽²⁾ OJ C 302, 12.12.2006, p. 41.

⁽³⁾ OJ C 202, 18.8.2005, p. 1.

⁽⁴⁾ OJ C 124, 27.4.2011, p. 9.

⁽⁵⁾ COM(2011) 914 final of 19 December 2011.

⁽⁶⁾ Decision No 878/2007/EC of the European Parliament and of the Council (OJ L 193, 25.7.2007, p. 18), amending and extending the *Hercule I* programme: Decision No 804/2004/EC of the European Parliament and of the Council (OJ L 143, 30.4.2004, p. 9).

⁽⁷⁾ *Hercule I*: 2004-2006: 11,775 million euro; *Hercule II*: 2007-2013: 98,525 million euro; *Hercule III*: 2014-2020: 110 million euro.

⁽⁸⁾ Explanatory Memorandum, paragraph 1, of the proposal: COM(2011) 914 final of 19 December 2011.

⁽⁹⁾ Philip Morris International (PMI), Japan Tobacco Int. (JTI), Imperial Tobacco Ltd (ITL), British American Tobacco (BAT).

⁽¹⁰⁾ Commission Staff Working Paper — Impact Assessment — accompanying document to the proposal on the *Hercule III* programme: SEC(2011) 1610 final of 19 December 2011.

⁽¹¹⁾ See paragraph 16.

⁽¹²⁾ Intermediate review of the achievement of the objectives of the *Hercule II* programme, updated on 18 March 2011.

SUMMARY

I. According to the proposal approximately 40 % of the Hercule III programme (44,8 million euro) is to be allocated to the fight against cigarette smuggling and counterfeiting. This reflects the commitment of the Commission stemming from the agreements with four international cigarette manufacturers. Under the agreements, 90,3 % of more than USD 2 billion are paid to national budgets of Member States. As one agreement expires in 2016, it should be noted that the EU budget will receive approximately 10 million euro less than the funds the Commission plans to devote to the fight against cigarette smuggling and counterfeiting.

II. More information concerning the use by Member States of the revenue they receive from the agreements should be available at Commission level in order to ensure an efficient and coordinated approach in administering the resources dedicated to the fight against cigarette smuggling and counterfeiting.

III. An important change under the Hercule III programme is the proposed increase in the maximum co-financing rate for grants for technical support from 50 % to 80 % (and 90 % in exceptional and duly justified cases). In the Court's opinion 80 % should be the maximum rate and should only be necessary in such exceptional, and duly justified, cases.

IV. Measurable indicators for Hercule III need to be refined.

V. The Commission has not yet measured the impact of Hercule II. The assessment merely reports the inputs and outputs of the programme.

VI. By 31 December 2014 the Commission (OLAF) shall present a report on the achievement of the objectives of the Hercule II programme. Lessons learned should be used to modify the Hercule III programme.

VII. The simplified procedure envisaged for grants under 50 000 euro depends on the adoption of the new Financial Regulation and its implementing rules.

VIII. In its follow-up to Special Report No 1/2005 (Special Report No 2/2011) the Court maintained its view that OLAF should transfer the responsibility for managing the Hercule programme to other Commission services and refocus its activities on the investigative function.

GENERAL OBSERVATIONS

Financial implications under the agreements between the Commission and international tobacco manufacturers

10. Between 2004 and 2010, in the context of the fight against cigarette smuggling and cigarette counterfeiting, the Commission signed agreements with four international tobacco manufacturers. Under these agreements more than USD 2 billion are paid by the latter to national budgets and

to the EU budget. The agreements have varying periods of validity over the years from 2004 until 2030.

11. Over this period 90,3 % of the proceeds from the agreements are paid to Member States and 9,7 % to the EU budget. For example, in 2010, Member States received approximately 65,7 million euro and the EU budget received 7,1 million euro from this source. The Court estimates that Member States received similar amounts in 2011. OLAF did not provide any figures in respect of 2011 for confidentiality reasons.

12. In its proposal for Hercule III, the Commission allocates an amount of 44,8 million euro (40,7 % of the total envelope of 110 million euro) to the fight against organised fraud, smuggling and counterfeiting of cigarettes⁽¹⁾. This includes financing technical equipment to the amount of 27,4 million euro (see paragraphs 30 and 31).

13. Under Hercule II expenditure on this fight was approximately equal to the Commission share of the revenue from the agreements. The estimated revenue resulting from the agreements is calculated by the Court to be 34,9 million euro⁽²⁾ over the Hercule III period. This is approximately 10 million euro less than the funds the Commission plans to devote to the fight against cigarette smuggling and counterfeiting under Hercule III over the same period. This is due to the fact that the agreement with Philip Morris International will expire at the end of 2016, if not extended.

14. The Court notes that Member States have a particular interest in the fight against cigarette smuggling and counterfeiting. Import duties evaded on cigarette smuggling and counterfeiting constitute a loss to the EU budget (traditional own resources). However, the excise duties and value added tax foregone, in addition to the share of import duties the Member States would normally retain as collection costs, constitute losses to Member States' budgets well in excess of any loss to the EU budget.

15. OLAF does not have information on what each Member State does with its share of the annual payments received from the tobacco manufacturers. In the opinion of the Court such information should be available at Commission level in order to ensure an efficient and coordinated approach in administering the resources devoted to the fight against cigarette smuggling and counterfeiting, at both EU and national level.

Increase in co-financing rates

16. Article 9 of the proposal stipulates that for eligible actions as defined under Article 7, the co-financing rate shall not exceed 80 % of the eligible costs⁽³⁾ (and 90 % in exceptional and duly justified cases). Under Hercule II the maximum co-financing rate for technical support was 50 % of the eligible costs.

⁽¹⁾ Operational objective No 4 annexed to the legislative statement.

⁽²⁾ Revenue expected and converted in euro using the exchange rate of 1 euro/USD 1,31: 360,1 million euro * 9,7 % (Commission's share) = 34,9 million euro.

⁽³⁾ Eligible costs: (a) technical assistance for national authorities, (b) organisation of specialised training, and risk analysis workshops, conferences, (c) any other action provided by the annual work programmes for attaining the general and specific objectives of the proposed regulation.

17. In the Court's opinion the maximum co-financing rate should remain at 50 % for the technical equipment component in order to ensure that EU and national interests in the purchase of equipment are evenly balanced. This is especially justified for the 27,4 million euro to be devoted to co-financing technical equipment related to the fight against cigarette smuggling, in view of the importance to Member States of this fight. This maximum co-financing rate could be increased to 80 % in exceptional and duly justified cases to ensure that account is taken of particular EU-wide and national circumstances ⁽¹⁾.

Objectives and performance indicators

18. The general and specific objectives of the programme are laid down in the draft Regulation. The programme seeks to protect the financial interest of the Union by preventing and combating fraud, corruption and any other illegal activities. The Annex to the proposal lists the operational objectives which are then broken-down into 'actions' and 'outputs' in the legislative financial statement.

19. Although the explanatory memorandum states that the objectives have been set using SMART criteria ⁽²⁾, the performance indicators need to be improved to be able to demonstrate the measurable impact attributable to the programme. In respect of recoveries, for example, the proposed performance indicator shows an amount of 67,9 million euro recovered ⁽³⁾ in 2010 with a target to increase this amount by 5-10 %. There is no proven link between the achievement of these objectives and the Hercule programme.

20. The legislative financial statement includes four main indicators to monitor the implementation of the five operational objectives, but there is no link between the two to facilitate the evaluation of the objectives.

Monitoring and evaluation of the programme

21. In the Court's opinion, the 'Intermediate review of the achievement of the objectives of the Hercule II programme' ⁽⁴⁾ and the impact assessment are limited in terms of measuring the achievement of the objectives. They merely report the inputs and outputs of the programme over the period 2007-2010. This is partly due to the lengthy procurement procedures and projects whose impact cannot be immediately measured.

22. By 31 December 2014 the Commission (OLAF) will present a report on the achievement of the objectives of the

⁽¹⁾ Financial constraints and/or exposure to risk of cigarette smuggling to markets of the Member State in question or the markets of other Member States because of external borders, for example.

⁽²⁾ Specific, measurable, achievable, realistic and timely.

⁽³⁾ Recoveries in the structural funds sector (32,9 million euro), in agriculture (11,9 million euro), direct expenditure (10,6 million euro), and other (customs, external aid ...: 12,5 million euro). Source: Eleventh operational report of the European Anti-Fraud Office, 1 January to 31 December 2010, p. 40.

⁽⁴⁾ The document, updated on 18.3.2011, covers the period 1.1.2007-31.12.2010.

Hercule II programme. In the Court's opinion this should be an independent and thorough evaluation, clearly assessing the added value of the programme. Lessons learned should be used to modify the Hercule III programme.

23. Article 11 of the proposal provides for an evaluation of the Hercule III programme by the Commission not later than 31 December 2017. This mid-term evaluation should be independent. The final evaluation, scheduled for 2021, should also be independent, demonstrate the added value of the programme and quantify the achievement of the objectives.

Simplification of administrative procedures

24. The Commission proposes to simplify the administration of grants under Hercule III. A simplified procedure for grants under 50 000 euro is to be introduced in line with the requirements of the Financial Regulation ⁽⁵⁾.

25. This simplification depends on the Commission's proposal for the revision of the Financial Regulation and the implementing rules being adopted.

The programme manager

26. In its follow-up to Special Report No 1/2005 (Special Report No 2/2011) the Court maintained its view that OLAF should transfer the responsibility for managing funding programmes (such as Hercule) to other Commission services and refocus its activities on the investigative function. OLAF states that it has since allocated more resources to its investigation activities. The management of the Hercule programme has been concentrated in one single policy Unit within the Policy Directorate separate from the Investigation Directorates.

SPECIFIC OBSERVATIONS

27. Hercule III is essentially a continuation of Hercule II, made up of three components:

— Technical assistance

— Anti-fraud training

— the European Lawyers Association.

Annex II shows the estimated allocation of resources planned for these components under Hercule III.

⁽⁵⁾ Page 22 of the Legislative financial statement attached to the proposal.

Technical assistance

Purchase of equipment not related to cigarette smuggling

28. For measures in the fight against fraud the resources allocated for co-financing the purchase of technical hardware to be used in investigations would be 27,9 million euro under the Hercule III programme. For the period 2007-2010, approximately 12,2 million euro has been allocated to law enforcement agencies (national criminal/police authorities/customs) ⁽¹⁾. The equipment co-financed is not necessarily exclusively used for the protection of the EU financial interest, but also for operations related to drugs, weapons, prison escapes, human trade, fiscal fraud, credit card fraud, money counterfeiting and corruption in national law enforcement agencies ⁽²⁾.

29. Neither the intermediate review nor the impact assessment, with one exception ⁽³⁾, provide details of the type of equipment financed under Hercule II. It is stated that a systematic programme of on-the-spot controls is carried out by OLAF. However, the results of these controls and an assessment of the achievement of the objectives of the purchases were not included in the intermediate review.

Purchase of equipment related to the fight against cigarette smuggling

30. For measures in the fight against cigarette smuggling the purchase of X-ray scanners has been a preferred instrument under Hercule II. For the period 2007-2010 commitments have been made of approximately 12,5 million euro and allocated to customs authorities in 16 Member States for the purchase of 21 scanners.

31. Except for two examples ⁽⁴⁾, neither the intermediate review nor the impact assessment provide any final evaluation concerning the purchase of the scanner equipment.

Development and procurement of IT tools

Special agreements with the EU Joint Research Centre

32. Two projects were agreed between OLAF and the EU Joint Research Centre under the Hercule II programme:

- **Project AMT** ⁽⁵⁾: a system principally used by Member States and OLAF. According to the intermediate review the expected or achieved benefits include 'the systematic exhaustive analysis on high volume trade data' and 'signals regarding significant changes in trade patterns',

⁽¹⁾ Example: Grants awarded (657 000 euro for 2007-2009) to the GSG 9 (Federal Police) in Germany, in charge of counter-terrorism and special operations under the control of the Federal Ministry of the Interior.

⁽²⁾ Report on the achievement of the objectives of the Hercule I programme prepared by OLAF's Internal Audit Capability (1.1.2004-31.12.2006).

⁽³⁾ Exception: The impact assessment, p. 4, quotes as examples of financing 'vehicle and container number plate reading equipment at the external frontier ...'.

⁽⁴⁾ Impact assessment, pp. 24-25. Two mobile scanners co-financed under Hercule II for Ireland and Malta.

⁽⁵⁾ Costs: 517 000 euro for the period December 2008 to November 2010.

- **Project CONTRAFFIC** ⁽⁶⁾: a system mainly used by Member States to complement national risk analysis. The intermediate review lists the following expected or achieved benefits:

- Operational: support for investigations (container movements),
- Tactical: more realistic and effective scenarios for joint customs operations,
- Strategic: effective risk analysis for sea transportation.

Procured access to external databases

33. Under Hercule II, OLAF and Member States have been given access to external databases in order to help them in their fight against fraud, including:

- Global Trade Atlas database (GTA),
- China Trade information (CTI) and Tips Software Services,
- Maritime transportation and manifest data and companies search tool.

Potential overlap of information between different databases

34. The Commission should avoid any overlap between the different systems and databases financed under the Hercule programme. This also applies to the information tools that are available, for example, at DG TAXUD.

Anti-fraud training

35. This component focuses on anti-fraud training actions and conferences for participants from Member States, candidate countries and non-EU countries. Opportunities are also given for networking, exchange of experience between Member States and the Commission and a wide dissemination of anti-fraud campaigns across the EU.

36. For the period 2007-2010 commitments of approximately 12,6 million euro have been made ⁽⁷⁾.

37. The intermediate review shows the principal results achieved by the beneficiaries ⁽⁸⁾. Evaluation forms were distributed to participants of training events. However, it remains unclear to what extent the surveys support these results. Only results from one question ('Overall impression of the seminar') are presented in the intermediate review.

⁽⁶⁾ Costs: 220 000 euro p.a. for 2007-2010.

⁽⁷⁾ 4 million euro in grants and 8,6 million euro in procurement.

⁽⁸⁾ Specialised anti-fraud training given to the staff of national and regional administrations; the establishment of networks between the anti-fraud organisations in different countries; the exchange of experience and establishment of personal contacts with colleagues in other organisations at national, EU and non-EU level; dissemination of the anti-fraud and anti-corruption campaign across EU through the training activities.

38. The Commission should clearly demonstrate the added value of training activities and conferences in the final report in 2014.

European Lawyers Association

39. The beneficiaries of this sector are national administrations, research and educational institutes. They are all non-profit organisations promoting the protection of the EU's

financial interests. Actions to which grants are attributed are mainly conferences/seminars, periodical publications, the dissemination of expertise and comparative law studies. The intermediate review does not provide any evaluation of these actions and the impact assessment only reports on beneficiary satisfaction.

40. The Commission should clearly demonstrate the added value of this component in the final report in 2014.

This Opinion was adopted by Chamber IV, headed by Mr Louis GALEA, Member of the Court of Auditors, in Luxembourg at its meeting of 15 May 2012.

For the Court of Auditors

Vitor Manuel da SILVA CALDEIRA

President

ANNEX I

Estimated amounts to be allocated to operational objectives under Hercule III

Objective No	Description	Total (million EUR)
1	To improve the prevention and investigation of fraud and other illegal activities beyond its currently reached levels by enhancing transnational and multi-disciplinary cooperation.	34,8
2	To increase the protection of the financial interests of the Union against fraud, facilitating the exchange of information, experiences and best practices, including staff exchanges.	11,835
3	To strengthen the fight against fraud and other illegal activities providing technical and operational support to national investigation and in particular customs and law enforcement authorities.	16,45
4	To limit the exposure of the financial interests of the Union to fraud, corruption and other illegal activities, as compared to the level of exposure known today, with a view to reducing the development of an illegal economy in key risk areas such as organised fraud, smuggling and counterfeiting, especially of cigarettes. (All measures provided for in the legislative financial statement, paragraph 3.2.2, concern cigarettes smuggling only)	44,815
5	To enhance the degree of development of the specific legal and judicial protection of the financial interests against fraud by promoting comparative law analysis.	2,1
Total Hercule III 2014-2020		110

Source: Legislative financial statement, pp. 30-36.

ANNEX II

Estimated allocation of resources to the components under Hercule III

Operational objective No	Sector	Million EUR	%
1	Co-financing the purchase of technical hardware to be used in investigations	27,9	
4	Co-financing technical equipment related to the fight against cigarette smuggling	27,4	
<i>Total co-financing of the purchase of technical equipment</i>		55,3	
1	IT developments	6,9	
3	Technical assistance — subscription to databases, forensic computing	16,45	
4	Cigarette databases and IT developments	2,1	
<i>Total Procurement and development of IT databases</i>		25,45	
4	Exchange of staff in the fight against cigarette smuggling	3,5	
4	Other technical assistance related to the fight against cigarette smuggling	2,85	
<i>Total other technical assistance measures</i>		6,35	
Total Technical assistance		87,1	79
2	Training, seminars, meetings, publications	11,835	
4	Training, conferences, seminars — related to the fight against cigarette smuggling	8,965	
Total Training activities		20,8	19
5	ELA — studies, conferences, meetings	2,1	
Total ELA		2,1	2
Total Hercule III 2014-2020		110	100

Source: Legislative financial statement, pp. 30-36.