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(Information)

COURT OF AUDITORS

SPECIAL REPORT No 12/2003

on the sound financial management of the common organisation of the market in dried fodder together with the Commission's replies*(pursuant to Article 248(4), second subparagraph of the EC Treaty)**(2003/C 298/01)*

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SUMMARY

I. Protein is important for animal feeding and is present to varying degrees in a wide range of feeding material. Dried fodder is one source but is relatively low in protein. It provides only 1,2 % ⁽¹⁾ of the total crude protein fed to EU livestock.

II. A common market organisation (CMO) for dried fodder was first established in 1974 with a view to improving the supply by granting aid for processing. Aid is paid for the production of fodder which has been dried naturally and by artificial means. The CMO has been reformed twice in 1978 and 1995, the second time, to cap the cost, which was increasing. A system of maximum guaranteed quantities (MGQ) was introduced to achieve this. The present budget is some 317 million euro. In 2000, the Court commented in its Special Report on 'Greening the CAP' that the dried fodder CMO showed the limited extent to which environmental considerations were taken into account in some markets.

III. Aid is payable to processors who dry permitted plants grown on integrated accounting and control system (IACS) ⁽²⁾ registered land. Aid is paid for quantities that meet the required criteria for protein and moisture content and leave the premises of the processing undertaking. Two rates of aid exist, one for artificially dried material of 68,83 euro/tonne and another for sun dried of 38,64 euro/tonne.

IV. The aid rates set by the Council in 1995 were higher than those recommended by the Commission. Setting the aid rate for artificially dried fodder at nearly twice that for sun-dried fodder, encouraged some processors to switch from sun-drying and to produce to the maximum extent possible. Nearly all Member States produce dried fodder but the major producers are Spain, France and Italy. EU production has continued to increase since 1995. The MGQ has been exceeded since 1998/99. Development of the market has been uneven as some Member States have been able to exceed their MGQ by as much as 60 % whereas others have consistently produced less than their MGQ.

V. Lack of clarity in regulations has created opportunities for different interpretations and practices. Some checks are not being carried out in Member States including, cross-checking with the IACS system, reconciliation of financial accounts of processors and aid claims and verification of plants entering the drying process. In one Member State marketing companies have been created to facilitate claims for aid. This has enabled them to claim aid sooner than if they were transferring ownership to a third party.

VI. Member States are required to produce information for the Commission and the Management Committee. But no information is provided regularly concerning prices for fodder products, or the level of imports or production of competing protein crops and products.

⁽¹⁾ COM(2001) 148 final 2.

⁽²⁾ The reform of the common agricultural policy in 1992 increased significantly the number of aid beneficiaries and the potential for irregularity and fraud.

The IACS system was introduced to meet these risks. It consists of five elements, a computerised database; an identification system for agricultural land parcels, a system of identification and registration of animals; aid applications; and an integrated system for administrative controls and field inspections. Member States are responsible for the implementation of IACS. Within the Directorate-General for Agriculture, supervision, coordination and checking of the implementation of IACS in Member States is carried out by the 'Clearance-of-Accounts Directorate'.

VII. The regulations governing the CMO do not specify any requirement for an evaluation. Although the market was programmed for evaluation by the evaluation unit of the Directorate-General for Agriculture in 2001 this was postponed twice in favour of evaluations of other markets. No evaluation has therefore been done.

VIII. Although no evaluation has been done, two major reviews of the market occurred for other purposes and provided an opportunity for the Commission to examine the market and its development. The first was a review in 2001 devoted to examining the options for replacing the processed animal proteins banned as a result of the BSE epidemic. It concluded that it would be more justifiable to increase imports of soya rather than pursue other more costly options such as increasing production of dried fodder. Farmers would remain free to decide how to satisfy their protein needs.

IX. The most significant review occurred however in relation to the Commission's mid-term review of the CAP in July 2002. This proposed a fundamental change in agricultural support, in particular, a move away from product to producer support. As part of a proposal to introduce a decoupled single payment per farm, changes were proposed in specific markets including dried fodder. Accordingly, the Commission has proposed an income support scheme for growers along with a simplified single rate support scheme to facilitate the transition for processors. The latter would be phased out by 2009.

X. The Court welcomes the current efforts to reform the CMO and recommends that the Commission takes this opportunity to ensure that existing weaknesses are not perpetuated.

INTRODUCTION

Protein needs for animal feeding and the role of dried fodder

1. Protein crops are an essential component of the feeding of farm animals. Protein is present to varying degrees in a wide variety of feeding material. It comes from what are considered to be generally 'non-traded' and 'tradable' sources. The first category comprises material such as grass, hay, silage and other roughages and is largely EU-sourced. The second comprises cereals, energy-rich crops (e.g. manioc, corn gluten, brans and molasses) and protein-rich crops (e.g. soya, other oilseeds meal, peas and beans and dried fodder). The largest single source in this category is soya meal which contributes some 20 % of total needs. Most soya meal is imported. *Table 1* shows those most commonly used according to the level of protein they contain. Dried fodder falls into the lowest category.

2. Dried fodder is obtained by drying approved plants either by the application of artificial heat or by other means, mostly sun-drying.

3. *Table 2* shows estimates of the sources of the 64 million tonnes of crude protein in the nearly 400 million tonnes of material fed to EU livestock in 1999/2000. *Table 3* shows that the protein-rich group accounts for around 33 % of total crude protein fed to livestock but dried fodder contributes only 1,2 % of the total.

The objectives of the CMO and how it has evolved

4. EU produced dried fodder is in direct competition with other protein products, in particular, imported soya products. Because EU dried fodder was more expensive than imports, the Council decided to introduce some form of support. Aid for dried fodder production in the EU was first provided in 1974 when a common organisation of the market (CMO) was established by the Council ⁽¹⁾.

⁽¹⁾ Council Regulation (EEC) No 1067/74 (OJ L 120, 1.5.1974).

Table 1

Protein content of most commonly used protein crops

	Crude protein, %
High protein content	
Fishmeal	60
Meat and bonemeal	55
Soya meal (high pro)	48- 50
Medium protein content	
Skimmed milk powder	35
Rape meal	32
Sunflower meal	28
Palmist/copra/etc.	23
Peas and beans	22
Corn gluten feed	22
Low protein content	
Dried fodder	15- 20
Cereal	9- 12
Tapioca	>2
Vegetable oil	0

NB: This table shows that dried fodder is in the low protein category.

Source: Commission working paper SEC(2001) 431 dated 16.3.2001.

Supply and demand of protein-rich crops in the EU following the BSE crisis.

Table 2

Crude protein use in animal feed broken down by type of feedstuff, EU-15, 1999/2000

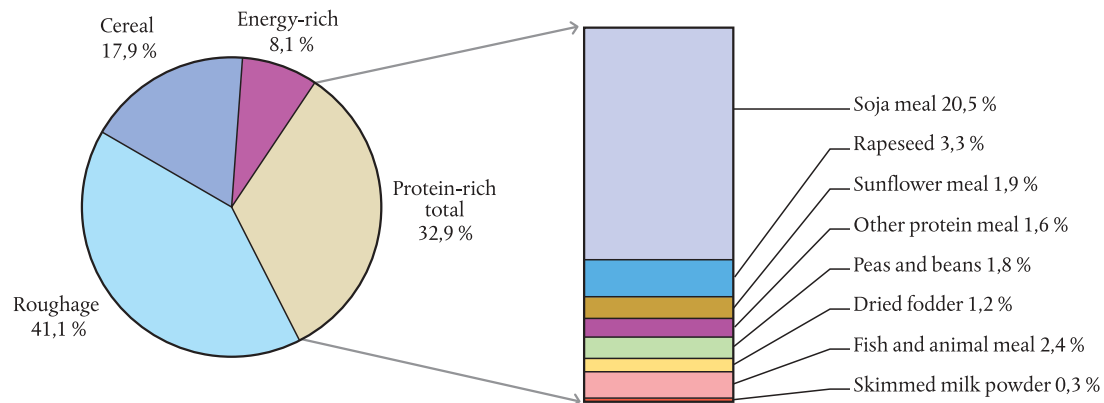
	Total quantity fed million t	Total crude protein	
		million t	%
TOTAL TRADABLE	206	37,7	59
Of which:			
Cereals	110	11	18
Energy-rich	40	5	8
Protein	56	21	33
TOTAL GENERALLY NON-TRADED			
Roughage - 85 % dry matter	188	26,3	41
TOTAL FEED	394	64,0	100

NB: This table shows that protein tradables, which include dried fodder, provided 33 % of the total crude protein.

Source: Commission internal working paper DG Agriculture 'Possible developments regarding protein-rich crops following the BSE crisis.'

Table 3

Sources of crude protein in total animal feed in EU-15, 1999/2000



NB: This table shows the sources of the 64 million tonnes of crude protein referred to in Table 2.

Source: Commission's working paper SEC(2001) 431 dated 16.3.2001

'Supply and demand of protein-rich crops in the EU following the BSE crisis'.

5. It was decided to grant aid to fodder drying/processing facilities to increase the levels of EU production. To ensure that green plants for drying were regularly supplied and to enable growers to benefit, aid was made conditional on processors concluding contracts with growers. A uniform level of aid was introduced with the marketing year running from 1 April. To qualify for aid the dried fodder produced had to meet quality standards as regards moisture and protein content.

6. Following the review of 1978, the Council decided that, to guarantee producers a fair return, a guide price should be set. Because EU fodder was, in general, more expensive than imported products, aid would be granted to dried fodder processors on the basis of a percentage of the difference between the guide price and world market price. It was also agreed that, because sun-dried fodder was also subject to competition from outside the EU and it should also qualify for aid, but at a lower level than that for dehydrated fodder.

7. Production rose continually throughout the 1980s. This resulted in increases in total aid expenditure which could not be controlled as no limit had been placed on the quantities for which

aid would be paid. As part of the 1991 review of the common agricultural policy (CAP) the Commission considered proposing the phasing-out of the support for dried fodder. The Council did not support the idea and asked the Commission to seek alternative ways of limiting total expenditure.

8. The Commission eventually proposed a return to a flat-rate system while maintaining the differential between artificially dehydrated and sun-dried fodder. The rates were set by the Council at 68,83 euro/tonne for artificially dried and 38,64 euro/tonne for sun-dried ⁽¹⁾.

9. In an effort to limit costs and influence the levels of EU production, the new regulation introduced a maximum guaranteed quantity (MGQ) of 4 412 400 tonnes for artificially dried and 443 500 tonnes for sun-dried fodder, above which, aid would be reduced. *Table 4* shows how the MGQ was attributed between Member States. This was determined on the basis of their production/aid claims in relation to 1992/93 and 1993/94 marketing years.

Table 4

Maximum guaranteed quantities by Member States

Member State	Artificially dried fodder tonnes	Sun-dried fodder tonnes
BLEU (Belgium/Luxembourg)	8 000	0
Denmark	334 000	0
Germany	421 000	0
Greece	32 000	5 500
Spain	1 224 000	101 000
France	1 455 000	150 000
Ireland	5 000	0
Italy	523 000	162 000
Netherlands	285 000	0
Austria	4 400	0
Portugal	5 000	25 000
Finland	3 000	0
Sweden	11 000	0
United Kingdom	102 000	0
EU - 15	4 412 400	443 500

NB: This table shows the attribution of maximum guaranteed quantity. It also shows that most EU production comes from three Member States namely Spain, France and Italy.

Source: Article 4 of Council Regulation (EC) No 603/95.

⁽¹⁾ New regime introduced by Council Regulation (EC) No 603/95 by which detailed rules for the application of the new regulation were introduced via Commission Regulation (EC) No 785/95.

The characteristics of dried fodder production in the EU and how the present aid system works

10. Aid is payable to processors who transform permitted green protein-yielding plants into dried fodder either by drying them by the application of artificial heat or by other means, usually sun-drying. The plants supplied must be grown on registered agricultural land and references provided to permit cross-checking through the integrated administrative and control system (IACS) that the same land has not been the source of claims made in respect of other EU area-based aid schemes.

11. Benefit from the aid does not usually accrue directly to growers but is achieved indirectly through contracts for supply to the processing industry. The aid influences on the prices which the processors are prepared to pay to suppliers. But, in those cases where the grower is providing green material for the production of dried fodder for his own use, processors are required to pass the aid on to the grower either in cash or, as is more usual, by adjusting the prices they charge the growers for drying the fodder.

12. In summary, aid is paid under the following conditions:

- (a) the plants used qualify for drying;
- (b) they have been grown on registered land;
- (c) the dried fodder produced meets quality criteria for protein and moisture content;
- (d) processing undertakings claiming the aid have been duly approved by the Member State and fulfil the requirements of the regulations;
- (e) the product has left the premises of the processing undertaking or approved external storage.

13. The rate of aid to be applied is assessed ultimately on the basis of the actual production recognised as eligible by Member States. When production stays within the MGQ the full rate is paid. When it exceeds MGQ, the rate payable is calculated on the basis of either a standard or specific reduction.

14. Assuring compliance with these conditions falls primarily to Member States who are required to implement the detailed rules. The Commission remains responsible for ensuring compliance with all market requirements and for monitoring and evaluating the implementation and impact of the market's measures. Annex A shows that EU production of artificially dried fodder has

increased steadily since 1995 eventually exceeding the total MGQ in 1998/99. In contrast the production of sun-dried has fallen by some 60 % over the same period. Production in Spain has consistently exceeded their MGQ reaching 150 % in 2002/03. Italy and Greece have also exceeded their MGQ in most years. The remaining Member States have consistently produced far less than their MGQ.

15. Nearly all Member States produce artificially dried fodder but the major producers are Spain, France and Italy who, between them, produce around 80 % of total EU production. Although Spain and Italy together produce nearly all the EU's sun-dried fodder they have decreased their production of it over the last few years but increased production of artificially dried fodder. In other Member States the production of dried fodder is at a lower level, either because animals have more access to natural grazing, or other protein sources or drying is less viable.

The budget

16. The annual budget has remained at around 300 million euro since the last reform introduced in 1995. The budget for 2003 is 317 million euro.

Previous audit by the Court

17. The CMO featured in the Court's Special Report No 14/2000 'Greening the CAP'. The Court commented in that report that the dried fodder CMO showed the limited extent to which environmental considerations had been taken into account in some markets. It drew particular attention to the higher rate paid for artificial drying which was inconsistent with the EU's energy policy and had encouraged a major switch from sun-drying to artificial methods. As well as criticising the extent of the energy required to dry fodder artificially, the Court also commented on the environmental impact of the resulting carbon dioxide emissions.

18. In its reply the Commission undertook to follow up the Court's comments and to ascertain whether a further reform of the sector should be proposed to the Council, not excluding the possibility of abandoning the scheme. This has been incorporated in the reforms to the dried fodder CMO proposed as a result of the Commission's mid-term review of the CAP discussed later in this report.

The Court's present audit

19. The Court's objectives were to examine whether in modifying the regime in 1995:

- (a) alternative ways of achieving increased production of proteins had been considered;
- (b) the differential aid rates established for the present system had been determined on a sound basis;
- (c) the detailed rules and procedures introduced ensured effective control over the market and the aid measures adopted;
- (d) appropriate monitoring had been carried out and the impact of the measures evaluated.

20. The audit focused on the main producer States of Spain, France and Italy and used transactions of the 2000/01 marketing year to examine how the aid system was managed. Germany was also visited to provide a contrast as a less important producing Member State. The audit included visits to individual processors, their representative organisations, national and regional administrations and the Commission services responsible. It also took account of the work of national certifying bodies and the Commission service responsible for clearance of EAGGF accounts as well as other work done by the Court in this area.

MANAGEMENT OF AID

The aid rates established by the 1995 reform were higher than those proposed by the Commission but were subject to the introduction of a budget limit

21. When reviewing the evolution of the market in 1993, the Commission expressed their concern that the aid in this sector did not represent a cost-effective means of supporting farm incomes and that, despite the reductions in aid which had been applied, production had continued to increase with the usual consequences for the budget. On the basis of Commission costings for 1994 and 1993 production levels, the average aid for dehydrated fodder, expressed in per hectare terms, represented some 600 ecu/hectare compared with the aid for other protein crops, actually paid on a per hectare basis, of 390 ecu/hectare. While production costs and selling prices also have to be taken into account in assessing the relative attractiveness of dried fodder production, the aid level contributed to an increase in production in certain Member States.

22. The Commission's proposals on prices for agricultural products for 1994/95 ⁽¹⁾ recognised that, despite the Commission's suggestion in 1991 that the support for dried fodder should be phased out, the Council had asked for other proposals based on either continuing the specific aid or including the products in the general framework of aid for arable crops. The latter option was rejected as unsuitable and the Commission eventually proposed a simple flat-rate payment of 40 ecu/tonne for artificially dehydrated fodder and half that for sun-dried, coupled with an increase in the minimum protein content. The difference between the rates was supposed to reflect the higher energy costs required for artificial drying.

23. This received a mixed reception at the Management Committee. During discussions at the Council working group other levels of aid and production limits were discussed. Accordingly, the rates finally adopted by the Council increased to 57 and 32 ecu/tonne respectively, which, after taking account of the special exchange rates which apply to agricultural spending (green ecu) became 68,83 euro and 38,64 euro.

24. The rates originally proposed of 40/20 ecu (see paragraph 22) were intended to permit processors to produce fodder at a price similar to those products with which it was in competition. Examination of the various documents associated with the consideration of the proposal did not explain the increase between the rates proposed and those finally adopted by the Council.

Total aid expenditure has been contained within the budget limits independently of the levels of production in Member States

25. If total EU production exceeds the MGQ the regulations prescribe that, in order to limit expenditure to the budget provided for, a reduction in aid will be applied equally to all Member States provided the excess was no greater than 5 %. If the excess is greater than 5 % a specific additional reduction is applied individually to those Member States who have exceeded their national MGQ.

26. Since 1998/99, the Commission has had to reduce the amount of aid finally paid to beneficiaries as a result of total production exceeding total MGQ. Even though some countries exceeded their national MGQ by substantially more than 5 % the second level of reduction was not triggered because others had produced less than their MGQ. It was not until 2000/01 that production exceeded 105 % of MGQ and the second level of reduction was applied to Greece, Spain and Italy (see Annex B).

⁽¹⁾ COM(94) 10 final of 30 January 1994.

DG AGRI identified the key controls to be applied but has not amended the detailed rules to be applied by Member States

27. Communication of controls, which the Commission considers as being required to ensure the proper operation of the market in Member States, are laid down in the detailed rules published as Commission regulations. In general, CMO regulations do not rank the rules/controls to be applied in order of their relative priority, since these regulations regard all controls to be of equal importance.

28. Within the DG AGRI a 'Clearance-of-EAGGF Accounts Directorate' is responsible for on-the-spot examinations of how controls and checks required by these regulations are carried out in Member States in support of aid claims. When they find instances where controls have not been carried out or have not been carried out correctly they propose financial corrections. In its Annual Report for 2001 the Court noted that, in order to make the relationship between systematic weaknesses identified as a result of financial clearance of EAGGF accounts and the corrections proposed clearer, the 'Clearance-of-Accounts Directorate' had developed definitions of key and ancillary controls for various markets and measures including the CMO for dried fodder.

29. The market unit responsible for the overall management of the CMO was not involved in this analysis. There has been no proposal to amend the detailed rules to reflect the resulting identification of the key and ancillary controls which should help focus efforts and facilitate risk analysis.

Lack of clarity in Commission regulations has contributed to different interpretations and practices

The criteria for claiming aid for sun-dried fodder

30. The Council regulation and the detailed rules promulgated by the Commission define those products which are regarded as dried fodder products qualifying for aid.

31. Sun-dried fodder has to be dried otherwise than by the application of artificial heat and also ground before it can qualify for aid. In the case of one Spanish processor audited, fodder was being dried other than by the application of artificial heat but had not been milled as it was produced as long fibre. The authorities informed the Court that, to ensure correct treatment, all the autonomous communities had been reminded in 2001 that, for a product to be defined as sun-dried, it had to be subjected to a process of milling regardless of the manner in which it was finally

presented. The Spanish authorities informed the Court that recognition had been withdrawn from the previous operator of the site in question. The authorities are pursuing reimbursement of aid from the operator and have initiated legal proceedings.

Checks on the financial accounts of processors and checks of suppliers and operators

32. The checks of financial accounts play an important role in ensuring the compatibility of the financial information maintained by processors for producing their financial and management accounts and the quantities claimed for aid.

33. The 'Clearance-of-Accounts Directorate' of DG Agriculture had observed that the German text of the detailed rules concerning checks of accounts of processors required such checks only 'in case of doubt' whereas the other language versions contain no such limitation. They had also observed that the checks on suppliers provided for in the other language versions of the regulation did not feature in the German text or the national regulations. The competent authorities consider that the official German text of the regulations has exclusive validity. The Commission has not yet addressed the differences in the German text.

34. In Italy the authorities responsible for the checking of dried fodder aid claims were not themselves carrying out the required checks of financial records of processors. They relied, instead, on inspections carried out by two other services and undertaken for different purposes. As a result, these checks were limited in scope and did not respond to the specific requirements of the dried fodder regulations.

35. The Commission's detailed rules ⁽¹⁾ also provide that authorities will make checks on suppliers and operators to whom processed fodder is supplied. This was not being done in all Member States visited and, in certain cases, relied on seeking written confirmation rather than a visit to verify trading activity.

36. Failure to operate such controls coherently and consistently reduces the assurance that the quantities claimed for aid are acceptable.

⁽¹⁾ Article 14(3) of Commission Regulation (EC) No 785/95.

The absence of checks on plants entering the drying process

37. The Council regulation ⁽¹⁾ specifies the green plants which are permitted to be transformed into dried fodder and thus qualify for aid. The Commission's detailed rules do not include any requirement to verify that only permitted plants are used. In practice, national authorities usually achieve some verification indirectly by means of the contracts for supply. Inspectors also obtain some assurance through physical observations made during their periodic visits to processors though this is not done systematically.

Definition of criteria for leaving the precincts

38. To qualify for aid or advances of aid the fodder must leave the premises of the processor. Fodder products are considered to have left the processing undertaking where they leave in an unaltered state either ⁽²⁾:

- (a) the precincts of the undertaking; or
- (b) where the products cannot be stored in those precincts, any storage place outside them which has been approved in advance by the competent authority.

The criteria that processed fodder must leave the premises of the processor to qualify for aid is open to different interpretations.

39. The instructions for processors issued by the competent authority in France, in relation to 1998/99, recognised that one of the main criteria governing the right to claim aid was for processed fodder to have left the processing undertaking. They also stated that, what generated this condition was usually fulfilled by actual sale supported by an invoice. It went on to advise that the processor could transfer the product to storage external to the main installations without making a sale and that this was, by association, equivalent to the product leaving the premises. A later instruction however, confirmed that products must leave the processor's premises or approved external storage in order to qualify for aid.

⁽¹⁾ Article 1 of Council Regulation (EC) No 603/95 and Article 2 of Commission Regulation (EC) No 785/95.

⁽²⁾ Article 3(1) of Commission Regulation (EC) No 785/95.

40. For one of the processors visited during the audit, output delivered to a common silo as well as to other external storage, qualified for aid. The competent authorities considered that this was consistent with the requirements of the regulations as the fodder had, in both cases, left the precincts of the processing undertaking.

41. In 2001, France abandoned the concept of approved external storage altogether and now regards all storage facilities outside the precincts of the processing facility as being not approved. On this basis they regard all flows to external storage as fulfilling the criteria of leaving the premises and therefore qualifying for aid. This is within the letter but not the spirit of the regulations which the Court considers should require the product to be transferred to a third party.

Processors in one Member State have created their own marketing companies to facilitate aid claims

42. In Italy the authorities have extended interpretation of the leaving the premises conditions to mean that the fodder has to have been sold. To ensure that they can meet this criteria and claim the aid, processors have established marketing companies to whom they 'sell' their production. The system is a device for ensuring that the processors can claim aid sooner than if they had to wait for a sale to a true third party. The marketing companies of two of the processors visited in Italy were legally physically separate entities but remained virtually inseparable from their parent processing companies. The administration and bookkeeping of the marketing companies was provided by the systems and personnel of the processing companies.

43. The 'sale' criteria adopted can, in one sense, be viewed as stricter than just 'leaving the premises', but the creation of such companies can also be seen as exposing the system to the risk of fictitious sales.

44. The Italian authorities carried out sample checks on financial documents (bills and payments) for dried fodder, including the final user of the products. The Court carried out specific tests, during the audit of the processors, relating to stock records of both parties, including clearance of the payments for 'sales', in order to ensure that the transactions between the processors

visited and their marketing companies were genuine. Although the results of the tests were satisfactory in this instance, they required extensive reconciliation which the national authorities were not carrying out. Such tests are essential to ensure that complex beneficiary structures are controlled effectively.

Effective cross-checking with IACS is not being achieved in one Member State

45. In Italy declarations relating to parcels growing green fodder are included in those made for all arable products and recorded for checking to the Land Register database. The areas declared as the source of green fodder under supply contracts to processors are also recorded but in another database. There was however, no cross-checking between these databases thereby creating a risk that inconsistencies would not be detected. New procedures were adopted in 2000 with the aim of making the fodder scheme more compatible with IACS. But the above cross-checks were still not being done at the time of our audit.

MONITORING AND EVALUATION BY THE COMMISSION

Monitoring

46. The market is managed and monitored by a market unit in the Commission and the Management Committee for Dried Fodder set up to assist the Commission ⁽¹⁾.

47. The Commission requires Member States to provide limited information to them consisting of:

- (a) the average level of humidity of the green fodder to be dehydrated;
- (b) the quantities of dried fodder for which aid has been requested and the quantities accepted;
- (c) stocks of dried fodder.

48. The Commission provides this information to the Committee along with the calculations of the reduction in aid to be applied in cases where production has exceeded MGQ. Although the primary objective of the CMO was initially to increase protein supply through the aid for processing dried fodder, no information is required to be provided by Member States on total protein supply market prices of protein products or prices and production/imports of other competing protein crops and products.

There has been no evaluation of the CMO

49. The regulations governing the operation of the dried fodder market do not specify that any evaluation of the market is required.

50. Under its evaluation programme for 2001 however, the 'Evaluation' unit of DG AGRI had planned an evaluation of the dried fodder sector but this was postponed in favour of a higher priority project on the wine sector. The fodder project would have been reprogrammed for 2002 but further changes in Commission priorities resulted in it being replaced by one on cereals. To date therefore, the CMO has not been the subject of an evaluation.

OTHER REVIEWS OF THE MARKET AND SECTOR

51. Although there has been no evaluation of the market two major reviews of the sector, for other purposes, provided an opportunity for the Commission and the Council to examine the market.

Supply and demand of protein rich material in the EU following the BSE crisis

52. Following the BSE crisis, the Commission was asked by the 'Agriculture' Council in December 2000 to examine the supply and demand situation of protein-rich crops in the context of the need to find alternative supplies to replace banned processed animal protein. The terms of reference were: '...to analyse the issue (of the production of protein rich plants) in greater detail

⁽¹⁾ Article 17 of Council Regulation (EC) No 603/95 of 21 February 1995.

and to draw its consequences for the policy currently being prepared in this sector...’.

53. The results of this review were set out in a formal communication from the Commission to the Council and the European Parliament ⁽¹⁾ ‘Options to promote the cultivation of plant proteins in the EU’. This assessed the protein market, likely future scenarios and the options available, including:

- (a) increasing production of oilseeds by increasing aid;
- (b) promoting increased production of aid supported protein crops;
- (c) authorising the cultivation of protein rich crops on set aside land;
- (d) promoting increased production of dried fodder by increasing the MGQ;
- (e) importing more soya.

54. The best option was to increase soya imports as the other options were considered to be too costly or too difficult to reconcile with other objectives. Each option would, however, satisfy additional needs only to a limited extent. Market forces would come into play: the feed industry and farmers would not react to the replacement problem just by using soya meal. They were likely to reduce protein-rich ingredients in feed and increase cereal content, any remaining deficit being covered by additional use of soya via increased imports.

55. Also, increasing the production of dried fodder would increase aid costs by nearly 14 million euro but not necessarily lead to ‘real’ increases in production rather than just cover for existing production in excess of MGQ.

Changes proposed to the CMO as a result of the CAP mid-term review

56. Following the CAP review published in July 2002 ⁽²⁾, the Commission proposed a number of fundamental changes in agricultural support with the objective of achieving more market-orientated sustainable agriculture. The most significant elements

were a shift from product to producer support with the introduction of a decoupled system of single payments per farm, based on historical references and conditional upon compliance with environmental, animal welfare and food quality criteria. Adjustments to the dried fodder sector were envisaged as part of this process, in particular to consider the need for further reform of the market or even its abandonment, following the comments made by the Court in its Report ‘Greening the CAP’.

57. The Commission proposed replacing the current regime in the dried fodder sector with an income support envelope for growers of up to 132 million euro of the existing budget for aid paid to processors. This would be distributed between Member States in proportion to the national shares of the existing MGQ. Grower entitlements would be based on the quantities of green fodder delivered to processors in a historical reference period. In order to facilitate the transition for the fodder processing industry, a simplified and degressive single-rate support scheme, of 33 euro per tonne of dried fodder produced, would be maintained and the individual national MGQs would be merged.

58. In addition to the Court’s environmental arguments on fodder, the Commission also drew attention to the fact that aid now represented up to 70 % of the market price of dehydrated lucerne. They also indicated that they had not excluded the possibility of abandoning the current regime if the reform proposals were not accepted.

59. In January 2003, the Commission brought forward legislative proposals to the Council ⁽³⁾ which make clear that, in addition to transferring funds (now some 133 million euro) from the present fodder aid budget to growers via the single farm payment scheme, the revised single rate payable to processors would be phased out by 2009 thus removing all aid for processing. The Commission confirmed to the Court that the money saved would not be transferred to growers and would be a real saving for the budget.

⁽¹⁾ COM(2001) 148 final 2 16.3.2001.

⁽²⁾ Commission Communication to the Council and to the Parliament, COM (2002) 394 final 10.7.2002.

⁽³⁾ COM(2003) 23 final of 21.1.2003.

CONCLUSIONS

60. The market was introduced to encourage the production of proteins in the form of dried fodder. Although production has increased, the EU still only produces less than 2 % of its protein requirements in the form of dried fodder. Dried fodder remains of limited economic significance for animal protein consumption in the EU. The MGQ introduced to limit total expenditure has been successful. It has however, influenced production to only a limited extent as some Member States have consistently exceeded their MGQ (see paragraphs 4, and 7 to 9).

61. The Commission has argued against increasing production limits even to the limited extent necessary to make up the deficit in protein supply caused by the ban on processed animal proteins (see paragraphs 52 to 55).

62. There has been a major shift in production from sun-dried to artificially dried fodder. The rates of aid themselves were set by the Council at higher levels than those recommended by the Commission and with an increased differential between the two levels of aid. The existence of the higher rate of aid for artificially dried fodder encouraged processors to produce this form of the product to the maximum extent possible. The production of artificially dried fodder rose by 11 % between 1995 and 2002 whereas the production of sun-dried fell by 50 %. Of the total aid expenditure on dried fodder 87,5 % relates to artificially dried. Development of production has been uneven with some Member States consistently exceeding MGQ and others continually producing less than their entitlement (see paragraphs 14 and 25 and 26).

63. The lack of clarity of the regulations has permitted different interpretations by Member States and exposed the system to the risk of incoherence of approach. In one Member State, marketing companies have been created by processors to facilitate claims for production aid. This permitted them to claim aid sooner than would otherwise be possible (see paragraphs 30 to 45).

64. Some Member States have failed to operate important controls provided for in the regulations which may expose the system to risks that unjustified claims might go undetected (see paragraphs 32 to 36).

65. The Commission has identified key controls in order to focus proposals for corrections to the aid paid in cases of non-compliance with regulations. But the managers of the CMO were not involved in this process and the information has not resulted

in amendments to regulations (see paragraphs 27 to 28). The results of the definition of controls work have been communicated to Member States by the 'Clearance-of-Accounts Directorate' through presentations made to the EAGGF Committee.

66. Monitoring of the CMO by the Commission does not cover protein supply or prices of protein products and imports. There is no formal requirement for evaluation in the regulations. Although an evaluation was planned it has been postponed twice in favour of other markets. Other reviews of the market have been made but were initiated for other purposes (see paragraphs 46 to 50).

67. The recent reform proposals are in part intended to address the uneven development which has occurred in the market and continuing concerns about efficiency. The Commission has indicated to the Council that it has not excluded the possibility of abandoning the current regime if the overall CAP reform proposals are not accepted by the Council. Any new scheme would still involve redirecting funds to the growers rather than the processing industry (see paragraphs 56 to 59).

68. The major changes proposed by the Commission following the mid-term review of the CAP would, if approved by Parliament and the Council, eliminate many of the risks associated with aid to processors although some may remain in the interim. The continuance of aid to processors, albeit at a single reduced rate, will still require the application of effective controls. The new system of paying farmers for growing plants has yet to be defined and controls devised.

RECOMMENDATIONS

69. The Court welcomes the Commission's current efforts to reform the market. The Court recommends that the Commission address the following points when implementing the reform and notes the compromise reached by the Council:

- (a) emphasise the importance of prioritising checks on the basis of formal risk assessment;
- (b) define more specifically what it is prepared to accept as meeting the key criteria of fodder 'leaving the premises' in order to qualify for aid;

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- (c) introduce checks on the plants actually used to produce the fodder to ensure compliance with those specified;
- (d) specify the nature and extent of checks on suppliers and operators to whom fodder is supplied;
- (e) specify and define the inspections of stock records and financial records of processors that are required in order to ensure reconciliation of the information as far as possible with the quantities being claimed for aid.

This report was adopted by the Court of Auditors in Luxembourg at its meeting of 24 and 25 September 2003.

For the Court of Auditors

Juan Manuel FABRA VALLÉS

President

ANNEX A

DEVELOPMENT OF EU PRODUCTION OF DRIED FODDER

Quantities recognised as being entitled to aid

(1 000 t)

1. DEHYDRATED FODDER	MGQ	1995/96		1996/97		1997/98		1998/99		1999/2000		2000/01		2001/02		2002/03		Difference		
		production	% MGQ	production	% MGQ	production	% MGQ	production	% MGQ	production	% MGQ	production	% MGQ	production	% MGQ	production	% MGQ	02/03-01/02	02/03-MGQ	02/03-95/96
BLEU	8	4	51 %	4	54 %	4	53 %	3	35 %	2	24 %	2	22 %	1	14 %	2	20 %	1	- 6	- 2
Denmark	334	271	81 %	207	62 %	225	67 %	266	80 %	186	56 %	168	50 %	147	44 %	147	44 %	0	- 187	- 123
Germany	421	343	81 %	300	71 %	308	73 %	321	76 %	334	79 %	357	85 %	334	79 %	348	83 %	14	- 73	5
Greece	32	46	145 %	30	94 %	38	120 %	46	144 %	52	161 %	44	136 %	51	160 %	58	181 %	7	26	12
Spain	1 224	1 262	103 %	1 414	115 %	1 571	128 %	1 668	136 %	1 769	145 %	1 955	160 %	1 812	148 %	1 882	154 %	70	658	621
France	1 455	1 307	90 %	1 091	75 %	1 264	87 %	1 346	93 %	1 304	90 %	1 225	84 %	1 167	80 %	1 094	75 %	- 73	- 361	- 213
Ireland	5	5	94 %	6	117 %	6	126 %	5	109 %	5	99 %	5	95 %	5	98 %	4	87 %	- 1	- 1	0
Italy	523	526	101 %	499	95 %	561	107 %	638	122 %	674	129 %	677	129 %	659	126 %	716	137 %	57	193	189
Netherlands	285	221	77 %	176	62 %	210	74 %	223	78 %	194	68 %	214	75 %	181	64 %	203	71 %	22	- 82	- 17
Austria	4	2	50 %	2	45 %	2	48 %	2	42 %	2	45 %	2	47 %	2	45 %	3	61 %	1	- 2	0
Portugal	5	1	16 %	2	39 %	4	71 %	3	50 %	1	19 %	2	44 %	4	74 %	0	2 %	- 4	- 5	- 1
Finland	3	2	60 %	1	44 %	1	35 %	1	40 %	0	17 %	1	19 %	1	17 %	1	21 %	0	- 2	- 1
Sweden	11	9	86 %	7	65 %	5	48 %	7	60 %	6	59 %	6	55 %	8	68 %	9	79 %	1	- 2	- 1
United Kingdom	102	72	70 %	79	77 %	84	82 %	81	80 %	70	68 %	63	62 %	50	49 %	48	47 %	- 2	- 54	- 23
TOTAL EU	4 412	4 070	92,2 %	3 818	86,5 %	4 283	97,1 %	4 610	104,5 %	4 599	104,2 %	4 720	107,0 %	4 421	100,2 %	4 515	102,3 %	94	103	445
																				11 %

(1 000 t)

2. SUN-DRIED FODDER	MGQ	1995/96		1996/97		1997/98		1998/99		1999/2000		2000/01		2001/02		2002/03		Difference		
		production	% MGQ	production	% MGQ	production	% MGQ	production	% MGQ	production	% MGQ	production	% MGQ	production	% MGQ	production	% MGQ	02/03-01/02	02/03-MGQ	02/03-95/96
Greece	6	3	46 %	2	30 %	0	2 %	0	0 %	0	0 %	0	0 %	0	0 %	0	0 %	0	- 6	- 3
Spain	101	41	40 %	37	36 %	53	52 %	93	92 %	85	84 %	108	107 %	227	225 %	105	104 %	- 122	4	64
France	150	166	111 %	86	57 %	14	10 %	4	2 %	3	2 %	3	2 %	4	3 %	3	2 %	- 2	- 147	- 163
Italy	162	190	117 %	125	77 %	87	54 %	53	33 %	73	45 %	90	56 %	74	46 %	107	66 %	33	- 55	- 83
Portugal	25	3	13 %	4	16 %	3	10 %	1	5 %	2	6 %	2	6 %	1	2 %	1	4 %	0	- 24	- 2
TOTAL EU	443,5	402	90,7 %	253	57,0 %	156	35,3 %	151	34,1 %	162	36,5 %	203	45,7 %	306	69,0 %	216	48,7 %	- 90	- 228	- 187
																				- 46 %

Sources: Information supplied by Member States (Article 15(a), second indent of Regulation (EC) No 785/95).

Working document submitted by the Commission to the Dried Fodder Management Committee in respect of the 2002/03 marketing year.

ANNEX B

ARTIFICIALLY HEAT-DRIED (DEHYDRATED) FODDER — REDUCTIONS IN AID WHEN EU PRODUCTION EXCEEDS MGQ

Table a

General amount to achieve budget neutrality when EU production < MGQ + 5 %

	Production	Quantity 1 000 tonne	Rate of aid euro/tonne	Budget Million euro
Aid payable if EU excess = 0	MGQ	4 412,4	68,83	303,705
Aid payable if EU excess = MGQ + 5 %	MGQ + 5 %	4 633,0	65,55	303,705

Table b

Specific reduction when EU production > MGQ + 5 %

Marketing year 2000/ 2001	PRODUCTION quantities recognised as being entitled to aid 1 000 t	NGQ ⁽¹⁾			Distribution of Quantities exceeding the NGQ + 5 %		RATE OF AID to be paid by Member States Euro/t
		NGQ 1 000 t	Production/ NGQ ratio	NGQ + 5 % 1 000 t	quantity produced over and above the NGQ + 5 % 1 000 t	% of total	
Greece	43,6	32	136 %	33,6	10,0	1 %	63,94
Spain	1 954,6	1 224,0	160 %	1 285,2	669,4	83 %	63,15
Italy	676,8	523	129 %	549,2	127,7	16 %	64,23
Total					807,1	100 %	

⁽¹⁾ NGQ = national guaranteed quantity share of maximum guaranteed quantity for EU as a whole.

NB: Legal basis: Article 5 of Regulation (EC) No 603/95.

The full aid provided for in Article 3 of Regulation (EC) No 603/95 is payable, if the EU production recognised for aid of the marketing year does not exceed the MGQ. If the EU production exceeds the MGQ, two cases are foreseen under Article 5 of Regulation (EC) No 603/95, in order to keep total EU expenditure within the budget limit:

(a) EU production exceeds the MGQ between 0 and 5 %: the aid is reduced in all Member States by an amount which is proportionate to that excess

(b) EU production exceeds the MGQ more than 5 %: all Member States support a 5 % aid reduction and for the Member States in which production exceeds the NGQ increased by 5 %, additional reductions is made proportionate to this excess.

In 2000/01, it was the first time when the EU dehydrated production overshot the MGQ by more than 5 % and therefore the rule (b) applied;

Table b presents a detailed calculation of this situation.

Source: Information supplied by Member States to the Commission and submitted to the Dried Fodder Management Committee.

THE COMMISSION'S REPLIES

SUMMARY

IV. In March 1994, in the framework of the price package proposal for the 1994/95 marketing year, the Commission proposed aid rates without limits on production. In February 1995, the Council agreed in an overall compromise on a level of aid higher than initially proposed by the Commission, but with an effective upper limit on EU budget expenditure by the introduction of maximum guaranteed quantities (MGQs).

The Commission acknowledges that uneven developments in production occurred after the reform of the sector in 1995, in terms of dried fodder type and as between Member States.

V. The Commission's staff also pay great attention to differences of interpretation when conducting audits as part of the clearance of accounts.

For example, in 1999 Commission staff carried out a series of audits of agricultural expenditure relating to dried fodder in the main producing Member States. In the course of these investigations, shortcomings similar to those raised by the Court were identified. However, after taking into account the other elements of the control systems in the Member States, it was concluded that the financial risk for the EAGGF was small, except for specific cases where financial corrections were applied.

The Commission notes the Court's remarks concerning the persistence of these shortcomings and will take account of them in its forthcoming audits.

Specifically concerning the procedures to accelerate the payment of aid, the Commission considers that they are not questionable per se. The criterion of 'leaving the premises' is meant to promote effectiveness of the physical checks and is mainly designed to guarantee that aid on dried fodder is not paid twice.

VI. In order to minimise the administrative burden, the Commission Regulation requires Member States to report the information needed to manage the aid regime. Information on the items raised by the Court is available through other sources such as Eurostat and industry data.

VII. An evaluation of the dried fodder scheme is foreseen in the Council decision and is to be completed in time for the Commission's report to the Council by 30 September 2008. As the Court indicates, it should be noted that the sector was included in the analysis presented in the report on protein supply.

IX. In its proposal on a long-term policy perspective for sustainable agriculture, the Commission took account of the Court of Auditors' report on 'Greening the CAP' as regards the negative effect of the fodder dehydrating process on the environment.

INTRODUCTION

3. Even if the level of protein content as such in feeds is an important element, the protein composition and other qualities required by the different types of livestock must be considered as well.

MANAGEMENT OF AID

21. Since 1995, the budget stabiliser system has ensured that an overshoot of the MGQ does not create any additional expenditure from the Community budget.

24. In March 1994, in the framework of the price package proposal for the 1994/95 marketing year, the Commission proposed aid rates without limits on production. In February 1995, the Council agreed in an overall compromise on a level of aid higher than initially proposed by the Commission, but with an effective upper limit on EU budget expenditure by the introduction of the MGQ.

27 to 29. In the Commission's view, ranking the controls by order of importance in the Community legislation is not desirable.

Such ranking is carried out by Commission staff solely as part of the clearance of accounts process in order to help assess the financial risk to the EAGGF if one or more controls are not applied or are applied wrongly. The division into key controls and secondary controls is based on some general principles adopted by the Commission. It is the responsibility of the departments in charge of auditing agricultural expenditure, independently of the departments responsible for market management.

31. Detailed definitions, particularly of eligible fodder and approved undertakings, have been included through the management committee procedure in the Commission regulation, which must be applied by Member States.

33. At the time of its audit for the clearance of accounts, the Commission found that the German authorities had introduced the other controls required in the rules and that additional controls not required by the rules had also been used to settle cases of doubt. In this context, the Commission judged the control system as a whole to be capable of controlling the financial risks to the EAGGF.

Nevertheless, in the framework of the reform of the sector, the Commission will rectify the problem in the German text.

34. The fact that controls on financial records are delegated to specialised control bodies cannot in itself be regarded as a shortcoming.

Except for specific financial corrections, the Commission judged at the time of its 1999 controls that the Italian system did not present financial risks to the EAGGF. This point will however be analysed again during the next investigations to be carried out in the context of the clearance of accounts.

36. Regarding the differences noted by the Court of Auditors in the detailed rules for applying the controls provided for in the legislation, the Commission considers that this is the result of the differences among the various national organisations. However, the Commission always pays great attention to these aspects during its investigations.

37. Given the broad range of fodder species for dehydration, this issue mainly concerns fodder dried in the sun. The rate of aid is lower by almost half than aid for dehydrated fodder and the level of production is small within the total of dried fodder.

Furthermore, the areas intended for producing dried fodder are covered by the area declaration under IACS and the use must be indicated (dehydrated or sun-dried fodder).

In this connection, the nature of the crops is usually checked during the on-the-spot controls carried out by the Member States.

39 to 41. The criterion of 'leaving the premises' used in the legislation is designed to prevent aid for dried fodder being paid twice. During the 1999 audit by Commission staff, the characteristics of the French system, in particular the non-approved stores, were subjected to thorough analysis; this concluded that the practice is in conformity with the current rules.

42 and 43. The Commission considers that the practice of using firms specialised in marketing dried fodder to assist operators to receive aid more quickly is not objectionable.

44. During their 1999 audit for the clearance of accounts, Commission staff identified weaknesses similar to those raised by the Court. However, taking into account the other elements of the control systems of the Member States, it was concluded that the financial risk to the EAGGF was small, except for specific cases where financial corrections were applied.

As the Court indicates, its tests did not reveal any anomalies. However, the Commission notes the remarks of the Court concerning the persistence of these weaknesses and will take account of them in its forthcoming audits.

45. The audit carried out by Commission staff in Italy in 1999 showed that cross-checking of the plots declared under IACS was carried out but was not documented.

This point will be examined again during the next investigation.

MONITORING AND EVALUATION BY THE COMMISSION

48. The objectives of the scheme are based on the EC Treaty, in particular Articles 36 and 37. Since 1995, a particular focus has been on managing the aid within the MGQ adopted by the Council and thus on respecting the budget limits. The primary aim is no longer to increase protein production.

In order to minimise the administrative burden, the Commission regulation requires Member States to report the information needed to manage the aid regime. Information on the items raised by the Court is available through other sources.

49 and 50. An evaluation of the dried fodder scheme is foreseen in the Council Decision of 26 June 2003 and is to be completed in time for the Commission's report to the Council by 30 September 2008. As the Court indicates, it should be noted that the sector was included in the analysis presented in the report on protein supply.

OTHER REVIEWS OF THE MARKET AND SECTOR

53. The Commission's Communication was the response to a mandate from the European Council in December 2000 requesting analyses in strict compliance with the financial perspective.

56 to 59. The Council compromise of 26 June 2003 adopted the Commission proposal on dried fodder with two amendments.

1. Suppression of the phasing-out of processing aid, but maintenance of the single rate of aid at EUR 33 per tonne.
2. By 30 September 2008, the Commission is to present a report on the dried fodder sector based on an evaluation of the common market organisation, dealing in particular with the growth of areas under leguminous and other green fodder, the production of dried fodder and the savings on fossil fuels. The report is to be accompanied, if necessary, by appropriate proposals.

CONCLUSIONS

62. The recent Council Decision will improve the regime by decoupling the aid and establishing a single aid rate for both dehydrated and sun-dried fodder, while the MGQs will be merged (see paragraphs 56 to 59).

63. During the clearance-of-accounts procedure, the Commission concluded that the national implementing rules cited by the Court did not involve financial risks to the EAGGF.

In particular, the fact that operators implemented procedures enabling them to receive the aid more quickly cannot be considered per se as questionable.

64. The Court's criticisms mainly concern Italy and Germany. These two Member States were the subject of an investigation by Commission staff in 1999 in the context of the clearance of accounts.

After an analysis of their control systems as a whole, it was judged that they were capable of controlling the risks to the EAGGF.

However, the Commission takes note of the Court's remarks and will take account of them when conducting its next investigations.

65. In the Commission's view, ranking controls by order of importance in the Community legislation is not desirable.

Such ranking is carried out by Commission staff solely as part of the clearance of accounts process in order to help assess the financial risk to the EAGGF if one or more controls are not applied or are applied wrongly. The division into key controls and secondary controls is based on a number of general principles adopted by the Commission. It is the responsibility of the departments in charge of auditing agricultural expenditure, independently of the departments responsible for market management.

66. An evaluation of the dried fodder scheme is foreseen in the Council Decision of 26 June 2003 and is to be completed in time for the Commission's report to the Council by 30 September 2008.

68. In the context of the reform of this market organisation, the definition of appropriate controls will be given proper attention by the Commission.

RECOMMENDATIONS

69. The Commission's proposal is largely driven by the Court of Auditors' comments in its report on 'Greening the CAP' about the environmental effects of the drying process.

- (a) The need for a formalised risk analysis system was stressed in the documents distributed to Member States in February 2001.
- (b) and (c) In the context of the reform, the Commission will continue to pay attention to the criterion of 'leaving the premises' as well as the plant criteria, with the objective of effectiveness in terms of cost/benefit.
- (d) and (e) Obviously not all the possible controls can be defined and listed in an exhaustive way, but the Commission will continue to pay attention to the quality and suitability of controls in the context of the clearance of accounts.
- However the Commission will re-evaluate all these controls in the context of the forthcoming reform.
-