

IV

(Notices)

NOTICES FROM EUROPEAN UNION INSTITUTIONS AND BODIES

COURT OF AUDITORS

SPECIAL REPORT No 4/2007

**on physical and substitution checks on export refund consignments
together with the Commission's replies***(pursuant to Article 248(4), second subparagraph, EC)*

(2007/C 252/01)

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EXECUTIVE SUMMARY

I. Export refunds are subsidies paid to exporters of agricultural products to compensate them for the difference between EU internal market prices and the lower world market price. Whilst the amount of refunds paid has been decreasing in recent years it is still significant, amounting to some 3 000 million euro in 2005. This trend continued with 2 500 million euro being paid in 2006.

II. In order to ensure that refunds are paid only for eligible goods and to deter false claims, checks are required to be made on export consignments. They are made both at the point of departure from the Member State where the goods originate, and at the point of exit from the EU territory. These checks comprise a physical examination of at least 5 % of all export declarations at the point of departure and subsequent visual substitution checks at the EU frontier to ensure that the goods declared and claimed for are indeed those effectively exported.

III. The Court's audit examined this system of checks and sought to ascertain whether they are carried out in the Member States as required by the Community legislation. Furthermore the audit examined whether the Commission properly monitors the implementation of these checks and takes appropriate action where their implementation is found to be deficient.

IV. In respect of the physical checks the Court found that whilst the Member States had respected the requirement to physically check 5 % of the export declarations, as required, there were weaknesses in the methodologies applied which reduced, significantly in some cases, the effectiveness of these physical checks. Specifically:

- (a) Physical checks carried out at the place of loading (often the exporters own premises) were systematically carried out at the start of loading and had become predictable to the extent that they no longer fulfilled the requirement to be without tacit prior warning. This reduces the effectiveness of the check as an unannounced inspection designed to discover and deter false declaration and increases the risk that refunds are unduly paid.
- (b) The method of selection of export consignments for checking used in the Member States resulted in a relatively high number of low value and low risk exports being checked. This did not make the most efficient and effective use of scarce and expensive Customs resources.
- (c) The method used to check bulk shipments of goods, which often carry a high value of refund, did not ensure that the entire shipment was verified through a combination of physical and documentary checks with the attendant risk that refunds are unduly paid.

V. The audit of the substitution checks found that:

- (a) Checks were in some cases not detailed enough and that the interpretation of the number of checks to be made varied between Member States.
- (b) At the EU frontiers the officials charged with carrying out the checks faced difficulties in identifying which consignments to check. For this purpose they should eliminate those already subject to a physical check and properly sealed by Customs and identify high value, high risk consignments from the remaining population that should be checked.

VI. The monitoring of the checks by the Commission and its remedial action in respect of weaknesses found leads the Court to conclude that:

- (a) The Commission monitors the operation of the checks by audits in Member States and by reviewing the reports Member States are required to submit in respect of the export refund checks carried out. The Commission takes assurance from the physical and substitution checks as part of its overall assurance that agricultural subsidies are paid in a legal and regular manner.
- (b) The Court's findings are largely mirrored by those of the Commission's own audit services which were found to provide adequate coverage of key controls. Despite the Commission being aware of these weaknesses for some considerable time it has not reacted, with legislative changes or timely financial corrections.

VII. Based on the above the Court recommends:

- (a) That the Commission proposes legislative changes to strengthen the physical and substitution checks and to ensure the harmonious and effective application of such checks.
- (b) That the Commission particularly reviews the findings of the Court's audit in terms of the validity of the checks carried out prior to the loading of goods to determine whether these checks can be considered as fulfilling the criteria needed to count toward the minimum number required by the Community legislation.

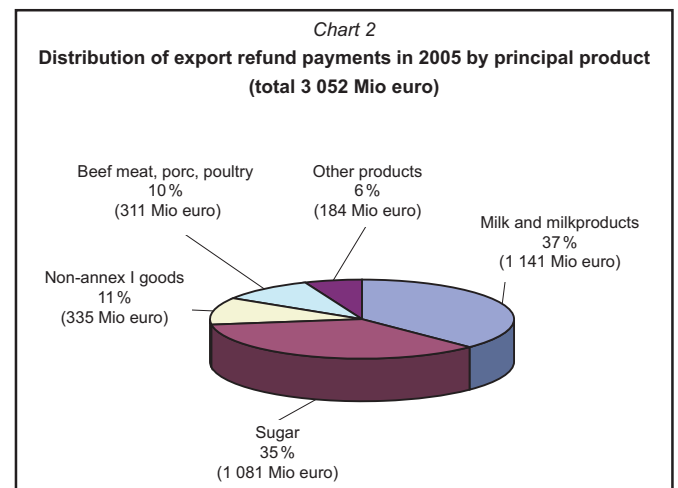
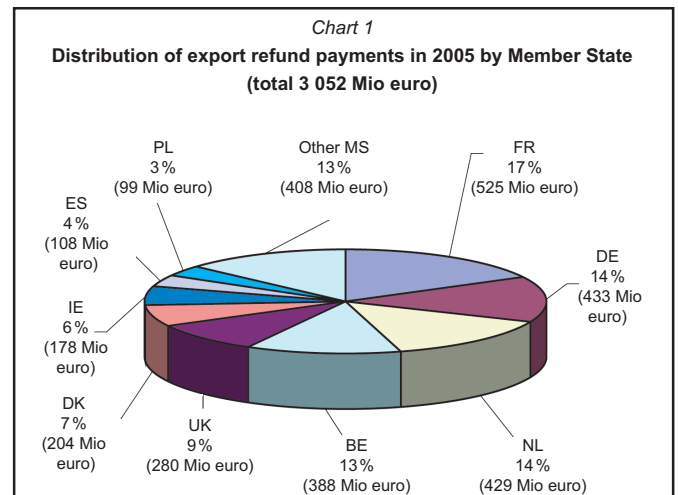
INTRODUCTION

What are export refunds?

1. Export refunds are subsidies paid to exporters of agricultural products to countries outside the EU to stimulate exports by compensating for the difference between the EU internal market price and the lower world market price. Refunds are paid on the quantities of goods exported and the rates vary according to the nature and characteristics of those goods. In certain instances they also vary according to the country of destination. Products exported to countries outside the EU are normally transported in containers, on trucks/trailers and in bulk by shipload.

What is the value of export refund subsidies?

2. Expenditure on export refunds in 2005 amounted to 3 000 million euro, this was down from 9 800 million euro in 1988. *Chart 1* shows the distribution of payments by Member State and *Chart 2* by principal product for 2005. In 2006, export refunds amounted to 2 500 million euro.



3. The decline in expenditure on export refunds — as illustrated by *Table 1* — is partly attributable to a narrowing of the gap between EU and world market prices due both to the successive reforms of the CAP and to the consequent results of the GATT/WTO international trade negotiations. At the end of 2005, during the Doha round of these negotiations it was expected that export subsidies would be abolished by end of 2013. However, the talks are ongoing and the final result is not yet known.

Table 1

Annual expenditure on export refunds compared to the agricultural budget

(million euro)

	Export refunds payments	Total agriculture and rural development payments ⁽¹⁾	Export refunds as a % of total agricultural payments
1988	9 786	27 687	35,3 %
1992	9 470	31 276	30,3 %
1996	5 702	39 108	14,6 %
2000	5 646	40 467	14,0 %
2004	3 384	44 761	7,6 %
2005	3 052	48 928	6,2 %

⁽¹⁾ EAGGF Guarantee Section Expenditure.

Source: DG AGRI 35th Financial Report on the EAGGF — Guarantee Section.

What are physical and substitution checks?

4. In order to safeguard Community finances a control system — a combination of physical and substitution checks (under Council Regulation (EEC) No 386/90) and scrutiny of payment application files ⁽¹⁾ — was created.

5. Physical checks, carried out by the Customs services, are designed to verify that the goods correspond in description, quality and quantity with the export declaration. Where this cannot be done visually (as in the case of dairy or meat products, or processed products, for example) the goods are sampled for subsequent laboratory analysis. Physical checks can be carried out at inland loading places (usually commercial premises), at inland Customs offices or at points of exit from the EU territory.

6. In addition, substitution checks comprise a visual check that goods certified as leaving the EU are the same as those originally loaded and declared. They are carried out at the points of exit from the EU. *Annex* provides a general overview of how the system works.

⁽¹⁾ OJ L 42, 16.2.1990, p. 6.

Audit scope and approach

7. The audit sought to conclude on the extent to which:
- (a) Member States carry out physical and substitution checks of export refund consignments as required by the Regulations.
 - (b) The Commission's arrangements for monitoring the execution of these checks are satisfactory and whether it reacted to the results of these checks or weaknesses with appropriate measures.
8. The Court:
- (a) evaluated the systems set up by the Member States visited for the execution of physical and substitution checks and for confirmation of the exit of goods from the EU territory. Checks were evaluated against Community legislation and national instructions;
 - (b) evaluated the performance of those checks by reference to a sample of inspection reports for each Member State visited and, wherever possible, witnessed physical and/or substitution checks carried out by Customs;
 - (c) reviewed the audits of these systems carried out by the Commission's Clearance of Accounts services. Checks were carried out against work programmes, reports and clearance/conformity decisions of the Commission;
 - (d) reviewed the monitoring and follow-up action taken by the Commission in respect of the annual reports presented by Member States on the performance of these checks;
 - (e) carried out analytical reviews of data relating to physical and substitution checks and irregularities detected, using the Commission's CATS ⁽²⁾ data and OLAF's database.

⁽²⁾ The Commission's database, CATS, Clearance Audit Trail System, provides data in respect of export refund amounts paid per declaration and EAGGF year and additional data related to export refund declarations.

CATS data is related to the EAGGF year that runs from mid-October to mid-October whereas data provided in Member States annual reports refer to the calendar year.

9. The audit was carried out from 2004 to 2006 at the Commission and in 11 Member States: Belgium, Denmark, Germany, France, Italy, Latvia ⁽¹⁾, Hungary ⁽¹⁾, the Netherlands, Poland ⁽¹⁾, Slovenia ⁽¹⁾ and the United Kingdom.

OBSERVATIONS

Do Member States carry out physical and substitution checks of export refund consignments as required by the Regulations?

Numbers of physical checks carried out and means of selection

10. Member States are required to carry out physical checks on 5 % of all export declarations by product sector, excluding those of low value or quantity (of less than 200 euro or less than a specified weight depending on the product). They can vary the percentages per product sector if they select the consignments for physical checks by means of a risk analysis. However, the overall rate of 5 % of declarations to be checked should still be maintained.

11. The Commission has defined a wide range of criteria to be taken into account in the risk analysis including i.a. the characteristics and value of the products, nature of the trade, reliability of exporters etc ⁽²⁾. Risk analysis is officially applied as laid down in the regulations in seven Member States (Denmark, Germany, Ireland, France, Austria, Sweden and the United Kingdom). The other Member States apply the rule that 5 % of the declarations are to be checked for each product sector, the declarations being then chosen either by reference to risk criteria not recognised under the regulation or on random basis.

12. In the period covered by the Court's audit, Member States had respected the requirements relating to the 5 % requirement of physical checks to be carried out. In the Member States visited where risk analysis had been formally adopted, the criteria defined by the Commission had largely been followed.

⁽¹⁾ Audits only in relation to substitution checks.

⁽²⁾ Commission Regulation (EC) No 3122/94 of 20 December 1994 laying down criteria for risk analysis as regards agricultural products receiving refunds (OJ L 330, 21.12.1994, p. 31).

13. In France and Germany, the final decision as to which export declaration is selected lies in the hands of the local Customs office. In the United Kingdom, the risk analysis is managed centrally for the whole country. The declarations chosen by the risk analysis system for checking had to be frequently overridden and changed by the local offices due to systems problems and to the fact that the system was selecting too many similar consignments. The need for overrides and the systems problems encountered calls into question the functioning of the risk analysis in the United Kingdom.

14. Where risk analysis is applied the Commission provides that for Non-Annex I (processed products) ⁽³⁾, Member States may reduce checks to a level of 0,5 % of the declarations, as these represent a lower risk. Where no risk analysis is applied (i.e. in the other 18 Member States), 5 % of all these low risk declarations continued to be checked.

15. However, for both options (risk analysis or 5 % per product sector) the review of data concerning physical checks revealed a high incidence of checks on low export refund value declarations (of less than 200 euro). To make better use of the inspection possibilities, export declarations involving small quantities of products or a low amount of refund should be disregarded when calculating the minimum rates of checks unless there is a risk of fraud or abuse. The Court found that low value items were not always selected on this basis. *Table 2* shows the incidence of checks on low value declarations reported by Member States in the CATS database ⁽⁴⁾, for the 2005 calendar year. Between 6 % and 13 % of all checks carried out were for such low value items. Further analysis shows that these checks represent only 0,1 % of the value of exports checked.

⁽³⁾ Non-Annex I goods. Export refunds are paid on basic products such as cereals, sugar, milk and butter when they are used in the manufacture of products such as spirit drinks, dairy preparations, pastry, cakes and other sugar confectionery.

⁽⁴⁾ The Court's analysis of the CATS database shows between 26 760 and 29 953 checks for the calendar year 2005, whilst Article 11 reports by Member States gave the number of physical checks as: EU-15: 31 003, EU-25: 36 249.

Table 2

The incidence of checks on low value declarations by Member State for 2005

Calendar year 2005 (1.1.2005-31.12.2005)

Minimum level: Analysis based upon totals per Single Administrative Document

Member State	Total number of physical checks	Total number of checks < 200 euro	Number of checks < 200 euro in % of total number of physical check	Total value of declarations physically checked in euro	Total value of declarations checked in < 200 euro	Percentage of amounts checked < 200 euro
BE	858	25	3 %	17 795 108	2 398	
DK	727	19	3 %	5 698 179	2 589	
DE	4 906	239	5 %	37 689 281	20 213	
IE	483	15	3 %	4 856 449	798	
EL ⁽¹⁾	0	0	—	0	0	
ES	1 325	204	15 %	7 282 634	23 647	
FR	1 006	113	11 %	15 238 061	6 248	
IT	2 211	105	5 %	6 933 376	12 262	
LU	0	0	—	0	0	
NL	7 851	444	6 %	28 648 158	53 979	
AT	405	25	6 %	1 738 292	2 941	
PT	370	80	22 %	1 826 201	7 804	
FI	424	41	10 %	5 054 184	3 422	
SE	388	9	2 %	6 514 754	1 132	
UK	402	35	9 %	4 222 519	3 172	
Total EU-15	21 356	1 354	6 %	143 497 195	140 605	
CZ	1 320	24	2 %	10 018 787	3 057	
EE	28	1	4 %	341 922	58	
CY	44	3	7 %	336 423	246	
LV	81	31	38 %	162 312	2 672	
LT	213	2	1 %	4 538 449	203	
HU	559	42	8 %	2 823 611	5 524	
MT	0	0	—	0	0	
PL	2 252	20	1 %	21 338 773	2 781	
SI	249	8	3 %	678 726	1 039	
SK	658	54	8 %	12 604 960	4 912	
Total EU-10	5 404	185	3 %	52 843 963	20 492	
Total EU-25	26 760	1 539	6 %	196 341 157	161 097	0,08 %

Maximum level: Analysis based upon totals per position in the Single Administrative Document

Member State	Total number of physical checks	Total number of checks < 200 euro	Number of checks < 200 euro in % of total number of physical check	Total value of declarations physically checked in euro	Total value of declarations checked in < 200 euro	Percentage of amounts checked < 200 euro
BE	884	62	7 %	17 795 108	4 406	
DK	1 081	131	12 %	5 698 179	13 208	
DE	5 186	415	8 %	37 689 281	31 931	
IE	483	15	3 %	4 856 449	798	
EL ⁽¹⁾	0	0	—	0	0	
ES	1 328	374	28 %	7 282 634	28 535	
FR	1 193	204	17 %	15 238 061	14 487	
IT	2 919	592	20 %	6 933 376	49 113	
LU	0	0	—	0	0	
NL	8 328	894	11 %	28 648 158	87 185	
AT	508	113	22 %	1 738 292	10 215	
PT	477	147	31 %	1 826 201	12 814	
FI	957	235	25 %	5 054 184	16 057	
SE	391	17	4 %	6 514 754	1 725	
UK	474	150	32 %	4 222 519	12 957	
Total EU-15	24 209	3 349	14 %	143 497 195	283 433	
CZ	1 330	29	2 %	10 018 787	3 428	
EE	51	14	27 %	341 922	803	
CY	48	5	10 %	336 423	541	
LV	138	77	56 %	162 312	4 505	
LT	218	4	2 %	4 538 449	463	
HU	612	81	13 %	2 823 611	9 533	
MT	0	0	—	0	0	
PL	2 328	114	5 %	21 338 773	13 022	
SI	270	33	12 %	678 726	2 876	
SK	749	92	12 %	12 604 960	9 103	
Total EU-10	5 744	449	8 %	52 843 963	44 274	
Total EU-25	29 953	3 798	13 %	196 341 157	327 707	0,17 %

⁽¹⁾ Greece did not provide data on physical checks for the EAGGF year 2005, therefore the data is not presented.

Source: CATS database Commission.

16. Even though Member States complied with the 5 % minimum checks, many undertook a greater number of checks on low value items mainly due to different interpretations of the legislation. These low value items were included in the calculation of the 5 % minimum population for checking when they should have properly been excluded. This resulted in a greater number of checks being carried out than the minimum laid down in the regulations. Table 2 shows that between 1 500 and 3 800 checks were carried out on consignments that should have been excluded.

17. In order to promote a more efficient and effective use of Customs resources an option could be to increase the *de minimis* value of consignments required to be considered for the minimum population and subsequently checked (see paragraphs 19 to 21 on Cost Benefit). Increasing the minimum value for which declarations are considered for physical checks could result in a significant reduction in the number of items to be

checked. Evidently, if the threshold is raised then lower value exports, under the threshold, should continue to be checked if there was an indication of fraud or abuse.

18. The same scenario is true of substitution checks. Table 3 presents an analysis of the value of consignments subjected to substitution checks on the eastern frontiers of the EU. In this context it should be noted that there is no requirement to indicate the value of refunds claimed on the documentation accompanying the goods (either the export declaration or the T5 control copy) and there is no readily available information regarding the rate of refund applicable, in particular for rates fixed by tendering procedures and for Non-Annex I goods. It is therefore difficult for officials to identify the most suitable consignments for checking.

Table 3

Analysis of the value of consignments subjected to substitution checks on the eastern frontiers of the EU audited by the Court between 1 May 2004 and 30 September 2005

Member State	Hungary		Latvia		Poland		Slovenia	
	Number	%	Number	%	Number	%	Number	%
Export refunds value (euro)								
0-200	25	46	0	0	1	3	17	35
NAI or similar	11	20	11	34	15	43	16	33
201-4 000	9	17	7	22	7	20	7	14
> 4 000	9	17	14	44	12	34	9	18
Total	54	100	32	100	35	100	49	100

NAI: Non Annex I.

NB: The Hungarian authorities carried out 100 % checks on all vessels passing the Hungarian — Serbian border. It changes the relative weight of checks performed under euro 200 significantly.

Cost of checks carried out

19. Where consignments are presented for export at Customs offices of exit (a situation mainly seen in the United Kingdom and at certain French ports), the cost to the trade for the execution of physical checks may vary between 120 and 400 euro depending on local circumstances. These costs comprise the movement of containers in, or from, the port area to appropriate unloading places and the labour involved in unloading and reloading the containers (see Box 1).

Box 1

A United Kingdom exporter decided to forgo his export refund claim for 293,28 euro, as it would have required 51 container moves to make the container available for physical check, chargeable to the exporter, which would, in addition, have delayed the departure of the vessel by 5 hours.

20. Where consignments are presented for export at inland loading places, no cost to the trade occurs as consignments are generally presented before loading at the exporters' premises. Two of the Member States visited, Germany and Italy ⁽¹⁾, charge the exporter for the physical check. The cost for a one hour intervention at the loading place is approximately 180 euro.

21. As can be seen above the cost of the check may exceed the value of refunds paid, providing evidence that checks on declarations attracting a low value of refunds are not cost effective.

⁽¹⁾ French Customs charge the exporter if clearance of the goods is requested outside official opening hours of the Customs office.

Prior warning of checks

22. Community Regulations clearly stipulate that physical checks should be conducted frequently and without prior warning and that physical checks for which the exporter has received express or tacit prior warning shall not count toward the minimum required number of checks. Failure to comply with these requirements would normally be regarded by the Commission as a failure in carrying out a key control and be subject to a potential correction for the Member State concerned.

23. Physical checks, when carried out at the place of loading, which are often the exporters own premises- were judged by the Court to be predictable to a significant extent in several Member States: Belgium, Denmark, Germany, France, Italy, Netherlands, and the United Kingdom. The Court observed that the arrival of the officials before loading of the goods commenced was standard practice. Checks that commence systematically before the start of loading are tantamount to a tacit warning of the check in that, if the customs officer does not arrive prior to commencement of loading the trader will know that the consignment will not then be physically checked. The risk is that non-eligible products or insufficient products will then be loaded and a refund claimed to which the trader is not entitled. This effectively negates the purpose and effectiveness of the check.

High value bulk consignments

24. Bulk goods, mainly cereals and sugar, are usually exported by shipload to a single destination. Each shipload can represent a very high value in terms of export refunds (Example: 6 700 tonnes of white sugar to Tunisia was worth 3,4 million euro as at end of 2003). However, for administrative reasons, linked to export licences, the exporter frequently has to submit a number of export declarations covering the whole consignment. The practice observed during the audit, was that for a physical check only one declaration from the entire shipload is checked. Whilst this approach is not in contravention of current legislation, the physical checks currently carried out have a diluted effect as they only cover a part of the whole shipload, thereby reducing the effectiveness of the check (see Box 2).

Box 2

An exporter submitted six export declarations for 1 147 tonnes of white sugar to be loaded on one ship for export to Libya in July 2006 (total export refund value: 268 600 euro). One declaration of 200 tonnes was selected for a physical check (export refund value: 46 840 euro). United Kingdom Customs observed part of the 200 tonnes being loaded onto the vessel. The physical examination started at 06:20 h and finished at 07:10 h.

Sealing of means of transport and substitution checks

25. Where a physical check has been carried out, the means of transport are usually required to be Customs sealed. Such consignments are normally not considered for a further

substitution check, unless the seals have been broken or removed in which case a specific substitution check as foreseen in the regulations should be carried out. Given the value this confers to the seal, a virtual 'laissez passer' for the consignment, then their use and meaning must be clear and unambiguous.

26. As part of the normal administrative procedure for validating export declarations, Customs may also affix customs seals to containers, trailers or trucks without having carried out a physical check. This practice was noted in particular, in Belgium, Germany, Spain, France and Italy. Further, consignments under the T.I.R. procedure ⁽¹⁾ are also customs sealed, again without a physical check necessarily having been carried out (see Box 3 and *Illustration 1*).

Box 3

In 2001, a consignment consisting of 20 tonnes of beef was cleared for export at Customs in Spain with destination Russia. The consignment, sealed by Spanish Customs, was presented for interim storage at a coldstore in Hamburg (unloading and intake under Customs control). The goods were then removed from the coldstore under customs control for transport by truck to Russia. German Customs, despite the goods being sealed, took a sample and the analysis resulted in goods being classified as edible offal of bovine animals for which no refunds were payable. Based on these results, further investigations in Spain led to the detection of more irregularities, amounting to some 497 000 euro — including 56 000 euro of interest — committed by the same exporter. A recovery notification was issued by the paying agency end of 2006 finalising the administrative procedures. The case is currently pending final decision before a national court. Approximately 80 % of the control copies T5 showed that consignments were Customs sealed at departure without physical checks and were then — by definition — excluded from the population for possible substitution checks at various exit points of the Community.

27. The Court's audit found that seals affixed by Danish and Dutch consignors/exporters, authorised to affix seals themselves, gave rise to doubt at Customs offices of exit of the EU as these 'company seals' could not be clearly distinguished from 'Customs seals'.

28. As a result, many consignments are legitimately or inadvertently excluded from the population of consignments considered for substitution checks as the real value of the seal attached is unclear and may lead to the assumption that a physical check has already taken place. The Danish Customs authorities amended their rules of the use of seals from 1 February 2006 onwards to prevent any misunderstanding.

⁽¹⁾ 'Transports internationaux routiers'.

Minimum number of substitution checks and their scope

29. Legislation provides ⁽¹⁾, as a general rule, that Customs offices of exit shall carry out at least one substitution check for each day on which consignments leave from the various exit points within the EU. The selection of consignments for checking should be carried out wherever possible in the light of a risk analysis.

30. Different interpretations have been made of this 'one per day rule'. If consignments arrive every day for seven days for loading a ship departing on the seventh day, then in the United Kingdom, only one consignment will be checked. In contrast, if consignments leave the EU via a customs office on the border between Latvia and Russia every day for seven days, then seven substitution checks will be carried out. This latter rule is also applied at ports in Belgium, Germany, France, Italy and the Netherlands.

31. A further problem of interpretation concerns consignments (truck/trailer or container) which consist of many export declarations, in certain rare cases of up to 30. Unclear legislation and differences in interpretation has led to situations where some Member States (e.g. Latvia, Hungary, and Slovenia) check the whole consignment whereas the majority of the other Member States selected only one of the declarations to check.

Specific substitution checks

32. Specific substitution checks have to be carried out by the Customs offices of exit from the EU territory if it is found that seals affixed at departure had been removed, broken or that a dispensation ⁽²⁾ from sealing had not been granted. Specific substitution checks may entail a full physical check.

33. The practice observed during the audit was that every truck/trailer at Customs offices of exit at the eastern border of the EU (Hungary, Latvia, Poland, Slovenia) is examined which allows the integrity of seals to be verified. In contrast, consignments (mainly containers) making their final exit from Community ports in France, Italy, the Netherlands and the United Kingdom are not subject to such strict checking. This is because, in these Member States, Customs officials do not systematically examine seals when the consignments arrive at the point of physical exit

⁽¹⁾ Article 10(2) of Commission Regulation (EC) No 2090/2002 (OJ L 322, 27.11.2002, p. 4) stipulates that 'The number of substitution checks carried out each year shall be not less than the number of days on which consignments of export refund products, not sealed according to the first subparagraph, leave the Community's customs territory through the customs office of exit concerned.'

⁽²⁾ Dispensation from sealing may be granted due to the characteristics of the goods exported (eg hatching eggs).

from the EU. Therefore consignments with broken, damaged or missing seals are not always identified and thus may escape specific substitution checks. Precisely to address this problem, French Customs have imposed a 2 % additional national check rate on sealing of consignments.

Quality of substitution checks

34. In principle, substitution checks are visual checks that goods correspond to the accompanying documents. The approach often found at the customs offices in the ports visited consisted of opening container doors and identifying only those goods which are immediately visible, so called 'tail-gate' checks. This was often due to the fact that no adequate facilities to unload are readily available particularly in small ports (e.g. Trieste, Dunkerque). Best practice was found at Customs offices on the eastern borders of the EU where checks on consignments in canvas topped trucks were thorough.

Follow-up of irregularities detected during substitution and specific substitution checks

35. Customs offices of exit must inform the paying agencies in the Member States concerned of irregularities detected by substitution checks and may request details of follow up action taken.

36. Irregularities have been communicated by Danish, Latvian, Polish and Slovenian Customs of exit to the responsible paying agencies in other Member States. However, in the majority of cases they have received no feedback on follow up action despite requesting such information.

37. A particular problem was found at the Danish Customs office of Aalborg. Checks carried out by this office revealed a high incidence of missing seals at the point of exit from the EU. However, instead of carrying out the required specific substitution checks, the office refused to certify that the goods had left the EU territory on the grounds that it was unable to establish the identity of the goods because the seals were missing. Between August 2004 and February 2006 this office informed paying agencies in the other Member States that it could not certify exit from the EU of 280 ⁽³⁾ consignments because the seals had been

⁽³⁾ For 2005, the total population eligible for a substitution check was '1 482'. The number of irregularities detected in carrying out specific substitution checks was '263'.

removed. Replies were only received in two cases ⁽¹⁾ out of the 280 communicated. According to Danish Customs, paying agencies in France, Greece, Italy and Spain have not replied to any communication sent by the Danish authorities. In 17 similar cases relating to exports originating in Denmark, Customs Aalborg sent the information to the Danish paying agency and export refunds were subsequently withdrawn.

38. The problem can be illustrated by a case where a set of 30 authorised company seals was found by Danish Customs in the cabin of a truck. The seals should have only been affixed at the point of loading in France, as security against substitution in transit, but were clearly freely available.

Confirmation of exit from the EU

39. One of the key elements for proving the entitlement to export refunds is the confirmation that the goods have left the customs territory of the Community. For all goods exported, either the export declaration itself or a document which accompanies the consignment in transit (T5 control copy) must be stamped and signed by national authorities (Customs) confirming the exit of the goods.

40. In the United Kingdom, the responsibility for the confirmation of the exit of the goods, for goods exported in containers by sea, has been given to shipping agents and/or port operators. Legislation requires that such confirmation is made by the 'competent authorities' ⁽²⁾. Shipping agents and port operators cannot be considered as such. Checks carried out by the United Kingdom Customs on this system revealed that 21 % of the 913 claims checked contained incorrect data in respect of date of exit. The procedures seen in the United Kingdom give rise to the risk

⁽¹⁾ Danish Customs did not confirm the exit and informed the Belgium paying agency (BIRB) about the results of the substitution check in October 2004. However, BIRB paid the export refund of some 3 200 euro for sugar, based on a proof of arrival from Norway and informed Danish Customs about the decision taken in August 2005. In June 2005, Danish Customs refused to certify the exit of the goods as they were not able to establish the identity because of the seal missing affixed at departure in Germany. In September 2005, the German paying agency (HZA Hamburg-Jonas) refused to pay export refunds of some 21 800 euro for the container of butter to Norway. The Dutch exporter lodged an appeal against that decision. The case is still pending before the Finanzgericht Hamburg as per end of January 2007.

⁽²⁾ Commission Regulation (EC) No 800/1999 (OJ L 102, 17.4.1999, p. 11), Article 9(1)(a): 'Where the T5 control copy or the national document proving that the products have left the customs territory of the Community has been endorsed by the competent authorities, the products ...'.

that the wrong date of exit is confirmed and further, given the lack of cross checks to commercial documentation, that exit is confirmed for goods that do not correspond to those declared.

41. Where goods are exported by sea, Community provisions foresee a complicated range of possibilities as to which Customs office is responsible for confirming the exit from the EU and for the substitution check depending on whether or not the sea transport (shipping service) is authorised by Customs as a 'regular' or recognised as a 'non-regular' one. Goods shipped on regular shipping lines are those on vessels which ply only between ports within the customs territory of the Community.

42. The audit found that certain consignments may escape substitution checks at the final point of exit from the EU. For example, where they are transported by sea between Member States using 'regular' shipping lines prior to being subsequently transported overland to an EU frontier point. This may lead to exit being confirmed at a point that is not the actual point of exit from the customs territory of the Community giving rise to the risk that incorrect exit dates are confirmed and that goods for which entitlement to refunds has been certified could be then reintroduced to EU territory (see *Illustrations 2 and 3*).

Results of physical checks and their context

43. Member States are required to report the incidence of irregularities detected by physical checks on export refunds. *Table 4* shows the values of irregularities detected by physical checks and reported to OLAF ⁽³⁾ from 2000 to 2005. The total was 3,5 million euro. In this context it should be noted that irregularities related to export refunds, detected by all methods over the last five years, amounted to 98,6 million euro. This represented some 16 % of the total of all irregularities related to agriculture reported to OLAF during that period whilst the export refund share of all agricultural spending was 8,6 %. Therefore, although Member States carry out the physical checks in the required numbers, the results in terms of value of irregularities detected is relatively small.

⁽³⁾ European Anti-Fraud Office.

Table 4

Values of irregularities detected by physical checks and reported to OLAF

Amounts of reported irregularities based upon a physical check under Regulation (EEC) No 386/90

Member State	2000	2001	2002	2003	2004	2005	Total
BE		66 723	40 875	64 191		57 129	228 918
DK	173 999	91 724	152 451	7 309	63 088	63 309	551 880
DE	272 941	99 239	89 706	212 440			674 326
IE		14 347	62 974	0	28 378		105 699
EL							0
ES	447 637	120 226					567 863
FR		93 026	55 887	135 144	311 035	80 443	675 535
IT				13 258	8 351	23 800	45 409
LU							0
NL				108 139			108 139
AT	165 748	4 300	13 931	4 662	90 616	41 685	320 942
PT		4 031	22 481	4 021	22 982	25 246	78 761
FI							0
SE							0
UK							0
EU-15	1 060 325	493 616	438 305	549 164	524 450	291 612	3 357 472
CZ							0
EE							0
CY						18 327	18 327
LV							0
LT						18 576	18 576
HU							0
MT							0
PL					8 671	50 914	59 585
SI							0
SK							0
EU-10					8 671	87 817	96 488
Total	1 060 325	493 616	438 305	549 164	533 121	379 429	3 453 960

Source: OLAF irregularities database as per December 2006.

44. The rate of reported irregularities expressed as a percentage of the value of the declarations checked (where this information has been supplied by Member States) is also relatively small. According to the Member States annual reports 2005 the overall rate of reported irregularity found by physical checks is 0,2 % of the export refund amounts checked ⁽¹⁾.

45. If the value of irregularities detected by physical checks are compared to those found by other methods then the relatively low rate of detection may be demonstrated. Table 5 is a comparison

of the value of irregularities, as reported to OLAF, detected by physical checks and those detected by *ex post* checks ⁽²⁾ of commercial records. The result (a ratio of 11 to 1 in favour of *ex post* checks) suggests that *ex post* checks, carried out after the physical export has taken place, have to date proved the more effective instrument in the detection of irregularities. Whilst only some types of irregularities detected by physical checks can be found by *ex-post* checks, both of which are indispensable to the overall control process, these figures nevertheless may suggest that the physical and substitution checks could be better targeted.

⁽¹⁾ Article 11 reports under Regulation (EC) No 2090/2002 by Member States and summary report by the Commission as per 17 November 2006.

⁽²⁾ Under Council Regulation (EEC) No 4045/89 of 21 December 1989 on scrutiny by Member States of transactions forming part of the system of financing by the Guarantee Section of the European Agricultural Guidance and Guarantee Fund (OJ L 388, 30.12.1989, p. 18).

Table 5

Value of irregularities reported to OLAF discovered by *ex-post* administrative checks (Regulation (EEC) No 4045/89)

Irregularities detected on basis of Regulation 4045/89 audits (amounts in euro)						
	2001	2002	2003	2004	2005	Total
Total	7 711 833	4 655 655	5 638 791	8 044 471	1 695 640	27 746 390

Amounts of reported irregularities based upon a physical check under Regulation 386/90 (in euro)

	2001	2002	2003	2004	2005	Total
Total	493 616	438 305	549 164	533 121	379 429	2 393 635

Comparison of amounts of irregularities reported based upon Regulation 4045/89 and Regulation 386/90

(amounts 4045/89 divided by amounts 386/90)

Ratio 4045/89 vs 386/90	2001	2002	2003	2004	2005	Total
	15,6	10,6	10,3	15,1	4,5	11,6

Source: Irregularity database of OLAF as of December 1st 2006.

Are the Commission's arrangements for monitoring the execution of these checks satisfactory and has the Commission reacted to the results of these checks or to weaknesses with appropriate measures?

46. The Commission carries out audits on a regular basis in Member States on export refund control procedures. Desk checks are also carried out on Member States' annual reports. The Court evaluated reports of these audits for the period 2001 to 2004 and concluded that there was adequate coverage of key controls in the system of physical and substitution checks. The Commission's audits covered the main areas of Regulation (EEC) No 386/90 as to the application of risk analysis schemes, sufficient number of checks, proper documentation of checks, exit certification, sealing procedures, origin of goods. In addition checks were made on pre-financing and also on the methodology of controls under Regulation (EEC) No 4045/89 in relation to export refunds.

47. The Commission's action in respect of Member States annual reports under Regulation (EEC) No 386/90 covers any obvious non-compliance with numbers of checks to be carried out (i.e. self reporting of deficiencies by Member States). Although the issues raised by Member States have been discussed at Trade Mechanisms Committee meetings, further action still has to be taken as regards the predictability of checks (raised by Italy in April 2003) and the potential avoidance of substitution checks (raised by Denmark in May 2004). In order to check the accuracy of Member States' annual reports, the Court checked the values of irregularities reported for 2004 and found that the Dutch authorities reported a total amount of 1,4 million euro. Following the Court's enquiries, this was subsequently reduced to 78 000 euro.

48. As a result of the Commission's audits in Member States, financial corrections have been imposed for weaknesses in Member States' control systems as shown in Table 6. 67 % or 34 million euro relate to corrections stemming from shortcomings in substitution, physical and documentary checks (Belgium, Denmark, Netherlands, United Kingdom) whilst 33 % or 16,5 million euro are linked to deficiencies in respect of animal welfare (Germany, France, Netherlands).

Table 6

Export refunds — Financial corrections 2002 to 2007 (in euro)

	Animal Welfare	Scheduling regime ⁽¹⁾	Physical checks ⁽²⁾	Substitution checks	Mission dates	Delays in year
Netherlands ⁽³⁾ ⁽⁷⁾	1 064 627				27-29/11/2000 8-10/1/2001	3,0
				26 664 623	14-18/5/2001	5,7
Germany ⁽⁴⁾	13 823 822				13-17/11/2000 23-26/1/2001	3,6
France ⁽⁴⁾	1 649 756				23-25/10/2000 5-9/2/2001	3,8
Belgium ⁽⁵⁾			225 713		3-7/12/2001	3,4
United Kingdom ⁽⁶⁾		369 440	10 772		June 2001 November 2001	4,3
Denmark				6 616 032	24-28/9/2001 21/6/2002	
Total	16 538 205	369 440	236 485	33 280 655		
Grand total				50 424 785		
Percentage of the total amount of corrections	32,8 %	0,7 %	0,5 %	66,0 %		

⁽¹⁾ Deficiencies in the design of the scheduling system.

⁽²⁾ Failure to carry out minimum inspection rates.

⁽³⁾ Decision No 17 (2004/561/EC); OJ L 250, 24.7.2004, p. 21.

⁽⁴⁾ Decision No 18 (2005/354/EC); OJ L 112, 3.5.2005, p. 14.

⁽⁵⁾ Decision No 20 (2005/579/EC); OJ L 199, 29.7.2005, p. 84.

⁽⁶⁾ Decision No 22 (2006/554/EC); OJ L 218, 9.8.2006, p. 12.

⁽⁷⁾ Decision No 24 (2007/243/EC); OJ L 106, 24.4.2007, p. 55.

NB: Exchange rate used:

1 euro = 0,6791GBP (27.7.2006).

49. However, cases concerning compliance failures relating to substitution checks in Italy and the Netherlands, where audit missions were carried out in 2001/2002, are still pending. This also applies to audits carried out in 2004 where clearance of accounts procedures may result in financial corrections for Germany, Ireland, Spain, France, Italy, the Netherlands and the United Kingdom. The Commission's auditors detected shortcomings related to the quality of physical and substitution checks, exports of sugar, application of penalties, quality of risk analysis systems and the compliance with inspection rates.

50. The Commission has not yet taken effective action to clarify and/or to tighten legislation as a result of its Clearance audit findings. The problem of the predictability of checks was noted in audit reports on the Netherlands in June 2004, Spain in May 2004 and in Belgium in March 2005 without any clear proposals being made to date.

51. Whilst the Commission's own internal standards set a period of between 16 months (without conciliation) and 24 months (with conciliation) as being the time required

between audit visit and final decision, for the audit of physical and substitution checks these periods have not been fully complied with.

52. The main subjects/observations of this report which were raised by the Court in its preliminary findings to Member States and also made available to the Commission in April 2005. They were further discussed at the meetings of the Trade Mechanisms Committee, most recently in mid 2006. However, no concrete measures by the Commission have yet been taken to address these findings.

CONCLUSIONS AND RECOMMENDATIONS

53. In relation to physical checks the Court found that the interpretation by the Member States of the regulatory framework had led to many checks at the exporters' premises being carried out systematically at the start of the loading process. This has the effect of rendering the check predictable to the exporter thereby negating their effectiveness. The regulations clearly state checks must be frequent, without prior warning and that checks for which the exporter has received express or tacit prior warning do not count as checks towards the minimum requirements.

Recommendation 1

The Commission should ensure the regulation is applied properly to guarantee that checks at exporters' premises are being carried out in an unpredictable manner and without tacit prior warning. It should ensure an effective follow up of the Court's and its own observations in this regard with a view to determining whether such checks not meeting this criteria should be counted towards the 5 % minimum requirement.

54. Physical checks were carried out on a significant number of low value declarations in contradiction with the legislation. Between 6 % and 13 % of physical checks carried out in 2005 covered only 0,1 % of the total refund value subject to those checks. This was especially so where Member States did not apply a risk analysis to the selection of the declarations but even in the three Member States visited by the Court which applied risk analysis low value consignments were regularly checked.

Recommendation 2

The Commission should review the method by which Member States select declarations subject to physical checks; it should consider making the use of a risk analysis obligatory and consider increasing the minimum value of refund for which a declaration is subject to physical checks. This would make physical checks more cost effective and help to ensure a more efficient use of customs resources by the selection of higher value, higher risk consignments.

55. Physical checks on bulk shipments may result in only a small part of the shipload being subject to a physical check. Where this is done in isolation without further verification that the entire consignment is in accordance with the declarations and eligible for refund there is a risk that the value of the check is eroded.

Recommendation 3

The Commission should consider clarifying that, where part of a bulk shipment is selected for a physical check, the national authorities are required to verify the entire shipment through, for example, cross checks with other records and ensuring that not only one part of the shipment is checked in isolation.

56. In relation to substitution checks the Court found that:

- (a) Certain checks carried out were only cursory visual examinations of a part of the consignment that did not fulfil the intended purpose of the checks.

- (b) The way in which the minimum required number of substitution checks was established varied between Member States.
- (c) The regulations provide that goods that have been subject to a physical check and sealed by customs are then exempt from further substitution checks (except in exceptional circumstances). The audit found that certain consignments customs sealed (for other purposes), but not having been physically checked, were then exempted from the possibility of substitution checks at the point of exit from the EU territory.
- (d) Specific checks on seals are carried out by the Customs offices of exit where seals affixed earlier are broken or tampered with. As no explicit rules for checking seals exist, they were found to be performed in an inconsistent way.
- (e) Where consignments of goods are transported between Member States by sea prior to their exit from the EU by road or rail there is a possibility that they avoid being selected for substitution checks at the point of final exit from the territory of the Community.
- (f) Consignments arriving at the point of exit from EU territory are not accompanied by documentation clearly stating the value of refund, or even whether or not a refund is payable, making it difficult for the officials charged with carrying out such checks to identify which consignments should be checked.
- (g) Where substitution checks detect irregularities these must be communicated back to the Member State where the goods originate, a request for information on any follow-up made may also be included. The Court found that this system was not operating as foreseen and that follow-up information was not returned to the authorities carrying out the checks.

Recommendation 4

The Court recommends that:

The regulatory requirements for substitution checks should ensure that the entire consignment selected for checking can be visually identified.

Consideration should be given to requiring that the number of substitution checks to be made should be established on the basis of a minimum percentage of declarations rather than the 'one per day rule'.

The Commission should take steps to ensure that the value of the seals attached to consignments of goods eligible for export refunds is clear and unambiguous. Thus ensuring that substitution checks apply to all exports other than those which have been physically checked and sealed by Customs at departure.

The Commission reviews the regulations governing substitution checks — including specific substitution checks — to ensure that their application is harmonised between Member States and so that it is clear to the officials charged with these checks at the EU frontiers which consignments should be considered for checking.

The Commission should ensure that the procedures for the communication and follow-up of reported irregularities discovered by substitution checks are adhered to and that the required follow-up action is carried out efficiently by the Member States concerned.

57. As regards the Commission's monitoring of the application of the regulatory framework and its actions to remedy known deficiencies in its operation:

- (a) The Courts findings are largely mirrored by those of the Commission's own audit services. Despite the Commission being aware of these weaknesses for some considerable time it has not reacted, with legislative changes or timely financial corrections.
- (b) The fact that *ex-post* checks on refunds, carried out on records after the export process is completed, show a significantly higher number of irregularities than the physical

checks, may suggest that physical and substitution checks could be better targeted.

- (c) The Commission monitors the operation of the checks by audits in Member States and by reviewing the reports Member States are required to submit in respect of the export refund checks carried out. The Commission takes assurance from the operation of such checks as part of its overall assurance that agricultural subsidies are paid in a legal and regular manner.

The weaknesses identified by the Court need to be effectively addressed in order to ensure that the system of physical and substitution checks provide the Commission with a greater level of assurance on export refund expenditure.

Recommendation 5

The Court recommends that:

The Commission proposes legislative changes to strengthen the physical and substitution checks and to ensure the harmonious and effective application of such checks. This would include ensuring that checks are not predictable, making selection of checks by risk analysis obligatory and ensuring that substitution checks are applied to those exports where no physical check has previously been made.

That the Commission particularly reviews the validity of the checks carried out prior to the loading of goods to determine whether these checks can be considered as fulfilling the criteria needed to count toward the minimum number required by the regulation.

This Report was adopted by the Court of Auditors in Luxembourg at its meeting of 21 June 2007.

For the Court of Auditors
Hubert WEBER
President

ILLUSTRATIONS

Illustration 1

Beef from Spain to Russia via Germany and Latvia, by truck

Export refund value for a consignment of beef: 9 000 euro. Goods on the way to the final destination may be kept in a cold-store (e.g. Hamburg/Germany) under Customs supervision for a given period before a decision is made by the exporter concerning the final transport means (ship or truck).

Illustration 2

Frozen chicken (poultry) from Morlaix (France) to Saudi Arabia (Saudi Arabia) via Brest (France) and Rotterdam (Netherlands) by feeder and ocean going vessel in containers of 24 tonnes

Export refund value for a 24 tonne container: 10 800 euro in November 2004.

Office of departure: Morlaix

Office of exit: Brest (transhipment Rotterdam)

The feeder vessel Brest/Rotterdam (although a regular shipping line in commercial terms) has the customs status of a 'non-regular' shipping line in the meaning of the Customs code. The exit of the goods from the EU is therefore correctly confirmed by Brest Customs on the day when the vessel is leaving the port of Brest.

*Illustration 3***Full Cream Milk Powder from Cookstown (United Kingdom) to Moscow (Russia) via Rotterdam (Netherlands), Riga (Latvia) and Grebneva (Latvia) by vessel and truck**

Export refund value for a 25 tonne container: 13 650 euro in June 2005.

Office of departure: Belfast (inland clearance at Cookstown)

Office of (first) exit: Belfast

Office of (final) exit: Grebneva/Latvia

Depending on 'regular' or 'non-regular' shipping lines used, the Customs office of exit, responsible for substitution checks and confirmation of the exit of the goods from customs territory of the Community, may be Belfast/United Kingdom, Rotterdam/Netherlands or Grebneva/Latvia.

ANNEX

HOW THE SYSTEM WORKS

The following is a brief outline of the system of physical and substitution checks of export refund consignments and confirmation of exit from the EU.

- (a) exporters may present their export refund consignments inland at the place of loading (at commercial premises), or at customs offices either inland or at the place of exit from the EU;
- (b) the goods must be accompanied by an export declaration which gives *i.a.* the description and the quantity;
- (c) where the goods are presented at an inland loading place, the exporter must, as a general rule, give 24 hours notice of start and finish of loading times (pre-announcement) ⁽¹⁾;
- (d) not less than 5 % of export declarations submitted per product sector should be physically checked per annum ⁽²⁾;
- (e) reduced rates of checks per product sector ⁽³⁾ are permitted when risk analysis is used to select declarations to be checked, however, the overall rate of 5 % of declarations must still be respected. Physical checks in 'high risk' product sectors would compensate for checks at a rate of less than 5 % in 'low risk' product sectors;
- (f) low export refund value and low quantity declarations (<200 euro and <500 kg) should not be considered for physical checks unless there are suspicions of fraud or abuse ⁽⁴⁾;
- (g) physical checks shall not count as checks where the exporter has received express or tacit warning ⁽⁵⁾;
- (h) where the goods physically leave the EU at a different point to where the goods and export declaration were presented, the means of transport or the packaging must be sealed. Seals are affixed by customs authorities or by exporters themselves having been authorised by customs to use company seals ⁽⁶⁾;
- (i) substitution checks ⁽⁷⁾ should be carried out on at least as many declarations as the number of days on which unsealed ⁽⁸⁾ export refund goods leave the EU through the office concerned (in principle one 'declaration' per day as a minimum);
- (j) in addition, specific checks should be carried out when the seals have been removed or have been broken or dispensation from sealing has not been granted;
- (k) substitution checks are visual checks to ensure that the goods correspond to the customs document accompanying them;
- (l) export refunds are payable, *i.a.*, on confirmation by customs that the goods have left the territory of the EU ⁽⁹⁾.

⁽¹⁾ Article 5(7) of Regulation (EC) No 800/1999.

⁽²⁾ Article 3 of Regulation (EEC) No 386/90.

⁽³⁾ '... a minimum rate of 2 % shall be compulsory per product sector.'

⁽⁴⁾ Article 2 of Regulation (EC) No 2090/2002.

⁽⁵⁾ Article 3 of Regulation (EEC) No 386/90 and Article 5 of Regulation (EC) No 2090/2002.

⁽⁶⁾ Article 7 of Regulation (EC) No 2090/2002.

⁽⁷⁾ Article 10 of Regulation (EC) No 2090/2002.

⁽⁸⁾ Substitution checks should not normally be carried out when consignments have been Customs sealed at departure as they are considered as having been physically checked and in accordance with the declaration.

⁽⁹⁾ Where rates of refund vary according to the country of destination proof is required that the goods have been placed on the market in the declared country of destination.

THE COMMISSION'S REPLIES

EXECUTIVE SUMMARY

I. Export refunds used to be a major pillar of the CAP until the 1992 CAP reforms and have lost importance with successive CAP reforms. The figures in Table 1 illustrate this: from 9,8 billion euro in 1988 to 2,5 billion euro in 2006. Only 1,4 billion euro is budgeted for export refunds in 2007. Most importantly, the Commission has made a political commitment in the context of WTO to abolish all export refunds by 2013.

However, until the last export refund is paid, a fully operational control system must remain in place. That is why the Commission welcomes most of the recommendations, which will be followed up. But any substantial modification of the control system should not lead to unnecessary complication of the legislation or increase administrative burdens in a disproportionate manner for the administrations and the stakeholders in order to counter potential risks. That would be unjustifiable considering that the export refunds regime is being phased out now and will be abolished.

II. The physical checks carried out on export consignments are part of the overall comprehensive control system in place. This also includes *ex-ante* administrative controls of 100 % of the export refunds claims, *ex-post* controls under Council Regulation (EEC) No 4045/89 and the Commission's verification within the clearance of accounts.

IV.

- (a) The Commission is aware of the risk of predictability of controls and reminded Member States at the meeting of the Trade Mechanisms Committee held on 10 May 2005 of the need to vary the timing of physical checks in order to maintain an element of surprise.
- (b) According to the annual reports submitted by Member States, 6,08 % of all exports for amounts above de minimis thresholds were physically checked in 2005. These exports accounted for close to 7 % of exports in value terms demonstrating that the controls were not concentrated on the low value exports.
- (c) The method used respects the legislation and policy objectives. Checking a representative sample of a shipment of goods in bulk form is similar to the treatment of other types of goods.

V.

- (a) Substitution checks are a visual check that the identity of the goods presented to customs at the office of exit correspond to those declared to customs at the place of departure ⁽¹⁾.

Regarding the numbers of checks being performed, Member States have largely respected minimum requirements.

VI.

- (a) The Commission welcomes the findings in point 46 of this report, in particular the finding that *'The Court evaluated reports of (the Commission's) audits for the period 2001 to 2004 and concluded that there was adequate coverage of key controls in the system of physical and substitution checks.'*
- (b) The Commission has communicated relevant findings to Member States in a timely manner. Where justified, these findings will result in financial recoveries for the EU budget.

Legal modifications of both Council Regulation (EEC) No 386/90 and Commission Regulation (EC) No 2090/2002 are in preparation in order to address, among other things, the weaknesses pointed out by the Court of Auditors.

⁽¹⁾ Article 10(4) of Regulation (EC) No 2090/2002.

VII.

- (b) Member States were reminded at the Trade Mechanisms Committee meeting of 10 May 2005 of the need to vary the timing of physical checks and are expected to have reacted accordingly.

After thorough consideration and consultations, the Commission will in the near future, submit legal proposals to the opinion of the Member States in the Trade Mechanisms Committee.

INTRODUCTION

1. Export refunds used to be a major pillar of the CAP until the 1992 CAP reforms and have lost importance with successive CAP reforms. The figures in Table 1 illustrate this: from 9,8 billion euro in 1988 to 2,5 billion euro in 2006. Only 1,4 billion euro is budgeted for export refunds in 2007. Most importantly, the Commission has made a political commitment in the context of WTO to abolish all export refunds by 2013.

However, until the last export refund is paid, a fully operational control system must remain in place. That is why the Commission welcomes most of the recommendations, which will be followed up. But any substantial modification of the control system should not lead to unnecessary complication of the legislation or increase administrative burdens in a disproportionate manner for the administrations and the stakeholders in order to counter potential risks. That would be unjustifiable considering that the export refunds regime is being phased out now and will be abolished.

4. In addition to the controls mentioned by the Court, there are 100 % administrative ex-ante checks on all export refund claims as well as a system of ex-post controls under Regulation (EEC) No 4045/89.

OBSERVATIONS

13. Regarding the UK, the problem of overrides referred to by the Court arose from problems with a new computer system introduced in 2004. Since then the number of overrides has fallen substantially.

15. Member States are free to carry out whatever checks they wish on low value exports provided that they do not include them when calculating the minimum rates of checks to be carried out. Furthermore Member States are obliged to adopt appropriate provisions to prevent fraud and abuses ⁽¹⁾. These provisions might well include performing some physical and substitution checks on lower value exports, in which case they may be counted for the purposes of calculating minimum requirements.

Nevertheless, the Commission shares the Court's view that Member States should aim at striking an appropriate balance between low value and high value consignments selected for checks in order to target the risks involved most efficiently.

According to the annual reports submitted by the Member States, 6,08 % of all exports for amounts above de minimis thresholds were physically checked in 2005.

16. The Commission recalls that low value items may be included in the calculation of the minimum rate of controls when they are made to prevent fraud and abuses. See Article 2(3) of Commission Regulation (EC) No 2090/2002.

17. The suggestion will be further examined by the Commission.

18. The Commission underlines that the exporter should mention whether or not an export refund applies. Proposals will be submitted to the opinion of the Trade Mechanisms Committee regarding mandatory information in documents (control copy T5) stating whether a refund is requested and an estimation of the total amount.

19. to 21. The Commission accepts that the cost of control (for the exporter) is considerably higher when done at the customs office of exit than at the premises of the exporter. Condition for the value of this control system is that the export products are isolated or identified ⁽²⁾ before the start of loading mentioned in the notification to customs (Article 5(7) of Regulation (EC) No 800/1999).

Box 1. An exporter is not allowed to withdraw his export refund claim when informed that these goods are selected for a physical check. To do so would be to undermine the purpose of such checks. The Commission services will therefore investigate this finding further.

⁽¹⁾ Article 2 of Regulation (EC) No 2090/2002.

⁽²⁾ As mentioned in Discussion Document D(2005) 12998; TMC 10.5.2005.

23. The Commission shares the Court's view that steady control patterns may in some cases lead to predictability, although this is not necessarily the case. The issue has already been addressed with the Member States in the Trade Mechanisms Committee ⁽¹⁾.

The practice of carrying out checks at exporters' premises has the advantage of being more convenient for exporters and allowing customs services full and easy access to the goods selected for check.

Moreover, if the export products are isolated or identified before the start of loading mentioned in the notification to customs (Article 5(7) of Regulation (EC) No 800/1999) the exporter is already bound to the identity of the products.

Goods dispatched from an exporters' premises without a physical check will later be subject to a selection for a substitution check at the point of exit from the Community territory, and in 2005 about 13 % of such exports do in fact receive such a check.

24. and Box 2. The Commission does not consider it a problem if a complete shipload of one and the same product is covered by several export declarations and customs check the products belonging to only one export declaration. The exporter does not know beforehand which export declaration will be checked.

Moreover, the current approach has the advantage that more shipments are inspected, albeit only partially, than would be the case if an all or nothing approach was to be adopted.

In addition to the physical controls on the spot, shipping documents, together with other commercial documentation covering the whole shipment, should confirm the assurance obtained for the whole cargo. Furthermore, *ex post* controls under (EEC) Regulation No 4045/89 reinforce these assurances.

25. and 26. The Commission agrees that customs should not affix seals without preliminary checking of the cargo.

The Commission is examining possible amendments to the legislation to reinforce the rules on sealing by customs. No customs sealing should be accepted without prior physical check.

Box 3. The Commission is aware of the problem and the case has been reported to OLAF.

⁽¹⁾ Discussion Document D(2005) 12998, discussed in the Trade Mechanisms Committee of 10 May 2005.

27. and 28. The system of authorised consignor ⁽²⁾ does not exclude the affixing of genuine customs seals instead of company seals. The accompanying transit document ⁽³⁾ clarifies that it concerns a consignment of an authorised consignor.

Under correct application of Regulation (EEC) No 2454/93 there should be no in clarity whether a seal is affixed by customs or by an authorised consignor.

30. The Court refers to the practice where customs in some ports execute as many substitution checks as there are days in which consignments qualifying for such a check enter the port at the land side; other Member States limit this to the number of days when such consignments leave the port at sea-side. The legal provision requires a number of substitution checks not less than the number of days on which qualifying products leave the Community's customs territory through the customs office of exit concerned ⁽⁴⁾.

As a sea vessel crossing the sea border carries a higher number of containers than a truck crossing the land border, thus concentrating more the number of qualifying days as described before, the frequency of substitution checks varies accordingly.

31. The Commission will remind Member States in the Trade Mechanisms Committee that goods should be selected for substitution checks wherever possible in the light of a risk analysis and that if consignments covered by multiple declarations are selected, each item selected to count as a separate substitution check must be justified.

The multi checks on one consolidated consignment were executed by the New Member States right after their accession, as they did not take risks on their understanding of the norm at that time. They are comfortably exceeding minimum requirements concerning substitution checks.

33. The system of Article 10 of Regulation (EC) No 2090/2002 provides an obligation to execute substitution checks, and if during such a check anomalies like broken seals are detected, customs has to change over to a specific substitution check. Member States are encouraged to apply risk analysis, and under such rule it may be useful to execute active controls on the integrity of seals. Nevertheless, the Commission is considering proposing the introduction of an obligation for customs offices of exit to actively check the condition of seals.

⁽²⁾ For control copies T5 of Article 912g(4) of Regulation (EC) No 2454/93.

⁽³⁾ Control copy T5, box A and/or box 110; Article 912g(2)(b) or (c) of Regulation (EEC) No 2454/93.

⁽⁴⁾ Article 10(2) of Regulation (EC) No 2090/2002.

34. The Commission agrees that 'tail-gate checks' are not giving the best possible assurance on non-substitution, but it has not the experience that these types of controls, as the Court describes for relatively small ports with limited activity with goods benefiting from export refunds, are the most common approach.

In major ports, such as Felixstowe, Le Havre and Rotterdam, containers are taken to a dedicated premises and are unloaded to the extent needed to gain access to the entire consignment.

37. The customs office at Aalborg defines all situations where a specific substitution check is required as irregularities *ab initio*.

Denmark notified orally that seals were missing because truck-loads of fruit exports originating in the south of the Community were reloaded on other trucks during their transport to the customs office of exit. The Commission asked Member States in the Trade Mechanisms Committee of 17 November 2006 to pay attention to this and the Belgian authorities reported that their customs supervise such re-loadings.

Given the workload these supervisions of re-loadings cause to the Member States' authorities, the Commission discussed the issue once again in the Trade mechanisms Committee of 17 April 2007 ⁽¹⁾.

38. The presence or absence of company seals has no bearing on the selection of goods for substitution checks or for specific substitution checks. All export consignments sealed or non-sealed by authorised consignors qualify for a substitution check anyway ⁽²⁾.

40. The situation in the UK is under consideration in the clearance of accounts procedure.

42. While there may be risks as indicated by the Court, in such cases the goods in question remain under customs control until they physically exit the Community customs territory. Therefore, the Commission considers that the risks as regards export refunds are properly managed.

43. While the relative share of export refunds in the Commission database may be higher than average, the amount involved comes to less than 0,5 % of total expenditure on export refunds over the period concerned. 21 % of the amounts involved have already been recovered.

The Commission's database contains irregularities above the threshold of 4 000 euro (since 1 January 2007 above 10 000 euro) which implies that the database does not contain all data regarding irregularities.

⁽¹⁾ Working document D(2007) 8083.

⁽²⁾ Article 10(2) first subparagraph of Regulation (EC) No 2090/2002.

44. and 45. The irregularities detectable by physical checks are predominantly concerning aspects like weight and characteristics of the products. The type of irregularities detectable under 4045/89 scrutinies may include these aspects, but also other types of irregularities are revealed. Member States shall coordinate their physical controls and their *ex-post* scrutinies pursuant to Article 5 of Regulation (EEC) No 386/90.

47. The Commission is further examining these issues and will take appropriate action.

49. The final outcome of these cases will only be known once the entire conformity clearance procedure, including a full and exhaustive exchange with the Member States to preserve their right of defence and guarantee fair and equal treatment, has been completed. At this stage, however, it is expected that not all cases will result in financial corrections imposed on the Member States concerned.

50. On numerous occasions the Commission clarified in the Trade Mechanisms Committee the problems the Court mentioned.

Moreover, the Commission prepares a proposal for modification of Council Regulation (EEC) No 386/90. In parallel modification of Commission Regulation (EC) No 2090/2002 is in preparation and it will be discussed and brought for an opinion in the Trade Mechanisms Committee when the Council approves its part.

51. The Commission services accept this finding and will take steps to speed up the processing of the audit enquiries which remain open.

52. Concrete measures are being taken. The issues raised by the Court are adequately followed-up in discussions on best practice in the Trade Mechanisms Committee and by draft legal measures. However, the preparation of legislation requires thorough examination in order to strike a balance between increasing administrative burdens and complicating legislation on the one hand and the added value of the modified controls on the other.

CONCLUSIONS AND RECOMMENDATIONS

Recommendation 1

The opinion that customs should vary their moment of arrival in order to prevent predictability of the controls has been discussed with the Member States ⁽³⁾. The Commission will take initiatives to lay this down formally by modification of Regulation (EC) No 2090/2002.

⁽³⁾ Working document D(2006) 12818 (TMC of 7 June 2006).

54. The current criteria of 5 % minimum is respected even without taking into account the low value exports.

Nevertheless, the Commission shares the Court's view that Member States should aim at striking an appropriate balance between low value and high value consignments selected for checks in order to target the risks involved most efficiently.

However, the Commission considers that some low value exports should continue to be checked.

Recommendation 2

The Commission is considering to introduce obligatory use of risk analysis in line with initiatives already laid down in Regulation (EC) No 1875/2006 (Customs Code Implementing Provisions).

The Commission already provided a considerable incentive to Member States to apply risk analysis by permitting those who do to reduce the rate of checks on non Annex 1 goods (mainly processed goods) from 5 % to 0,5 %.

Furthermore the Commission will propose to the Council to give Member States an option to set the control rate to 5 % per Member State instead of per customs office if risk analysis is applied.

55. Physical controls on the spot, shipping documents, together with other commercial documentation covering the whole shipment, should confirm the assurance obtained for the whole cargo. Furthermore, *ex-post* controls under Regulation (EEC) No 4045/89 reinforce these assurances. The Commission also refers to its reply to paragraph 24.

Recommendation 3

The Commission is considering issuing guidelines on controlling bulk shipments in point 1 of Annex I to Commission Regulation (EC) No 2090/2002.

56.

(a) The Commission agrees with the Court's observation that 'tailgate inspections' (see also the Commission's reply to point 34) as such are not sufficient enough to cover the requirement that a visual check should clarify that the goods are covered by the documents accompanying them. The Commission's services are examining modification of the relevant legislation ⁽¹⁾ to address the issue.

⁽¹⁾ Article 10(2) first subparagraph of Regulation (EC) No 2090/2002.

(b) The Member States concerned were compliant with the legal requirements.

The Court's findings concern:

- Teething problems of the New Member States, which in the meantime have been solved.
- The practice at seaports of exit which all fulfil the legal minimum requirements, but some execute more than the required minimum. The Commission is of the opinion that this should not be discouraged.

(c) The practice identified by the Court is in line with existing legislation, which requires that substitution checks are carried out on goods not sealed by Customs.

However, the Commission is considering proposing the alternative to introduce mandatory customs' pre-clearance checks before seals are affixed by customs authorities, in which case the customs office of exit may treat consignments with sound customs seals with confidence.

(d) The Commission is considering proposing the introduction of an obligation for customs offices of exit to actively check the condition of seals.

(e) While there may be risks as indicated by the Court, in such cases the goods in question remain under customs control until they physically exit the Community customs territory. Therefore, the Commission considers that the risks as regards export refunds are properly managed.

(f) The Commission underlines that the exporter should mention whether or not an export refund applies ⁽²⁾. Proposals will be submitted to the opinion of the Trade Mechanisms Committee regarding mandatory information in documents (control copy T5) stating whether a refund is requested and an estimation of the total amount.

(g) The Court informed the Commission of these findings and the Commission requested Member States in the Trade Mechanism Committee on 11 November 2006 to pay more attention to this aspect.

Recommendation 4

The Commission is preparing a modification of Regulation (EC) No 2090/2002:

- *taking into account the principles of cost-effectiveness of controls*

⁽²⁾ In the third copy of the export declaration accompanying the products to the customs office of exit (Article 793 of Regulation (EEC) No 2454/93), or in the control copy T5.

- with a percentage expressing the norm for substitution checks replacing the 'one per day rule'.
- introducing mandatory pre-clearance checks before customs affixes seals, thus ensuring that other consignments really qualify for selection for substitution checks.

so that the legal provisions express what already has been explained in working documents to Member States in this respect.

The Commission will continue carefully checking the Member States' Annual reports on this issue, as has been provided in point 2.7 of Annex III to Regulation (EC) No 2090/2002.

57.

- (a) The Commission has acted on the findings of the auditors. They were discussed with Member States in the Trade Mechanisms Committee and addressed in different working documents to Member States. In addition, the Commission is preparing changes to the relevant legislation.

Moreover, the relevant findings of the Court have been taken up with the Member States concerned under the clearance of accounts procedure.

- (c) The physical checks under Regulation (EEC) No 386/90 form part of an overall comprehensive system of controls, which, in addition to the physical checks, consist of 100 % ex-ante administrative checks of refund payment claims, of ex-post controls under Regulation (EEC) No 4045/89 and of the Commission's own audits within the clearance of accounts. It is on the basis of this chain of controls that the Commission obtains reasonable assurance on the expenditure concerned.

Recommendation 5

The Commission is preparing a modification of Regulation (EC) No 2090/2002 on the issue of predictability. Initiatives will be taken to introduce mandatory application of risk analysis in conformity with Article 3 of Regulation (EC) No 1875/2006 regarding risk analysis in customs import and export procedures. Regarding the selection for substitution checks, see third part of fourth recommendation.