

EUROPEAN COURT
OF AUDITORS

Special Report No 11

2008

THE MANAGEMENT OF THE EU SUPPORT
FOR THE PUBLIC STORAGE OPERATIONS
OF CEREALS



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(pursuant to the second subparagraph of Article 248(4) of the EC Treaty)

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Special Report No 11 // 2008

More information on the European Union is available on the Internet (<http://europa.eu>).

Cataloguing data can be found at the end of this publication.

Luxembourg: Office for Official Publications of the European Communities, 2009

ISBN 978-92-9207-027-4

DOI 10.2865/57636

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Printed in Belgium

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EXECUTIVE SUMMARY

I.

The objective of public storage of agricultural products is to stabilise the markets and ensure a fair standard of living for the agricultural community. Member States buy in the products at the intervention price set by the Council based on a proposal from the Commission and keep them in storage until they can be sold without undermining prices on the EU markets.

II.

The stocks of cereals in storage have been decreasing recently due to a significant increase in market prices. Future levels also depend upon many other factors, such as climatic conditions and the policy decisions taken in the context of the Commission's 2008 'health check'.

III.

The Court audited the economy of the European Union support for the public storage operations of cereals, and in particular the extent to which costs have been minimised and revenue maximised. This was based on a review of the data at the Commission and the two Member States with the largest stocks. The conditions and quality of a sample of 18 cereal lots in 11 stores were checked on-the-spot.

EXECUTIVE SUMMARY

IV.

The Court found that the procedures that ensure that cereals bought in are of the required quality and stored appropriately are correctly applied.

V.

The procedures followed for the disposal of stocks in storage do not always ensure that the net costs of intervention are minimised or that stocks remain in storage no longer than necessary. The Court recommends that:

- (a) the minimum sales price set should take the quality and location of the cereals into account;
- (b) when market conditions allow:
 - (i) cereals should not be offered for export if a higher price can be obtained on the internal market; and
 - (ii) marginally lower offers should be accepted if this is more than offset by their future storage costs.

VI.

The transparency of the budgetary process could be improved by identifying all the cost elements of any activities which are not directly related to the objectives of the intervention storage of cereals, such as the support of the most deprived persons or of the bioethanol industry.

VII.

Payments to Member States for the storage of cereals are based on data communicated to the Commission. Given the significance of the amounts involved, the Commission should strengthen its review procedures and introduce on-the-spot checks of the data.

VIII.

The method of calculation of reimbursements to Member States generally ensures that they do not exceed the underlying costs and that Member States have an incentive to maintain costs low. However, the Commission should review its standard costs for operations without movement. Furthermore, the rates used for the calculation of financing costs should be reviewed to encourage Member States to provide their actual financing costs and reduce the risk of overcompensation to a minimum.

IX.

While the improvements recommended by the Court have limited financial impact in the current strong market situation, potentially they could have a significant impact on the EU budget if cereal stocks increase again in the future. Furthermore, they could impact on other intervention storage measures. Therefore, the Court strongly recommends implementing these improvements at the earliest possible date.

INTRODUCTION

BACKGROUND

1. The objective of public storage of agricultural products is to stabilise the related markets and ensure a fair standard of living for the agricultural community¹. When market prices are low, Member States buy in the products (subject to certain conditions) offered by producers or intermediaries at the intervention price that is set by the Council based on a proposal from the Commission. They are kept in storage until disposal either to the internal market when prices rise or for export.
2. The Commission refunds to Member States the cost of storage (warehousing and financing costs) and part of the initial purchase cost of bought-in produce through so-called 'depreciation'. Net proceeds (proceeds less initial cost, adjusted for depreciation) on disposal are credited to the Community budget.
3. By protecting producers from reduced prices, the intervention measure acts as a safety net. However, it should not distort markets by encouraging consistent over-production or cause a structural build-up of stocks.
4. The intervention policy for cereals dates back to 1962, when the Council established it as an instrument of the common organisation of the market. **Annexes I and II** show the quantities and cost of cereals in public storage since 2000. The quantity of rye in storage declined following the abolition of its intervention in 2003. The quantity of other cereals increased sharply in 2005 following a good harvest and the entry of the 10 new Member States, but the steadily increasing market prices have negated the need for intervention and allowed existing stocks to be sold. As a result, stocks were virtually nil by June 2008. The cost of public storage has followed a similar pattern.

¹ Council Regulation (EC) No 1784/2003 (OJ L 270, 21.10.2003, p. 78), since repealed by Regulation (EC) No 1234/2007 (OJ L 299, 16.11.2007, p. 1).

- 5.** Future trends of market prices and intervention stocks depend upon numerous factors, such as climatic conditions and world demand, which are difficult to forecast. While the stocks are not expected to increase again in the short term, this remains a possibility for the future. In this respect the ongoing 'health check' on agricultural policy includes proposals by the Commission to maintain public intervention for at least the major cereal (bread wheat) and certain other products in order to maintain a safety-net support in case of market disruptions². Another issue discussed by the Council was the constitution of "strategic stocks" in the interest of food security³.
- 6.** Certain of the Court's findings on disposal policy and costs may apply to other products (such as butter, skimmed milk powder, alcohol, beef and veal, bulk sugar and packaged sugar), as they are subject to the same regulation⁴ and management systems.
- 7.** The Court has previously reported on public storage of agricultural products in a special report in 1988⁵ that focused on the accounting of public storage expenditure as well as checks on the quantity and quality of stocks. A special report in 1999⁶ dealt with the impact of the 1992 CAP reform on the cereals sector.
- ² COM(2007) 722 final of 20 November 2007, followed by COM(2008) 306 final of 20 May 2008.
- ³ Agriculture and Fisheries Council, 2834th Council meeting, Brussels 26-27 November 2007 (15333/07 (Presse 264)).
- ⁴ Commission Regulation (EC) No 884/2006 (OJ L 171, 23.6.2006, p. 35).
- ⁵ Court of Auditors — Special Report No 5/88 on management and control of public storage (OJ C 274, 24.10.1988).
- ⁶ Court of Auditors — Special Report No 2/99 on the effects of the CAP reform in the cereals sector (OJ C 192, 8.7.1999).

OVERVIEW OF THE MANAGEMENT SYSTEMS

- 8.** The paying agencies of the Member States are responsible for the management of public storage operations⁷. This includes the purchase and disposal of the cereals, contracting of the storage facilities, carrying out various checks and maintaining the required physical and accounting records. The paying agencies input their physical and financial data into a Commission-maintained computer database. The Commission uses this information to monitor the situation and calculate the amounts due to or from Member States.
- 9.** Producers or intermediaries are given the opportunity to sell cereals to intervention at the intervention price. Before acceptance by the paying agency, the cereals are weighed and analysed to ensure that their quality satisfies the minimum conditions for intervention. The paying agencies adjust the intervention price to take account of certain quality characteristics, such as the moisture content, impurities and specific weight.
- 10.** The cereals are kept in Member State-contracted storage facilities (stores, such as warehouses and silos) which are required to meet minimum standards. Member State paying agencies are required to ensure that cereals in storage are properly conserved. This includes conducting an annual stock take as well as ad hoc checks at stores.
- 11.** The paying agencies inform the Commission whenever a loss or degradation occurs. When this results in the cereals no longer fulfilling the conditions for intervention, the paying agencies or storekeepers — rather than the Community budget — bear the financial responsibility. Any depreciation and other costs previously received for the degraded stock is reimbursed to the Commission.

⁷ Commission Regulation (EC) No 884/2006 (OJ L 171, 23.6.2006, p. 35).

12. The Commission determines its approach to disposals of stored cereals on the basis of its market forecasts. Tenders for the disposal of cereals are then organised by the Member States. The Commission decides upon which offers to accept, after consultation with the Management Committee for Cereals, comprised of representatives from the Member States. The committee can reject any proposed decision by a qualified majority. The paying agencies are responsible for the implementation of the approved disposal operations.



Source: ECA

AUDIT SCOPE AND APPROACH

13. The Court audited the economy of the European Union support for the public storage operations of cereals, and in particular the extent to which costs have been minimised and revenue maximised.

⁸ This untypical concentration of stocks in these Member States is explained by the fact that disposals were carried out sooner in other Member States for logistical reasons (transport to the markets) and the high volumes involved.

14. The questions set for this audit were the following:

- (a) Have the physical operations of the public storage of cereals been well managed?
- (b) Do the Commission's procedures ensure that the costs incurred by the EU are minimised?

15. The audit approach consisted of:

- (a) assessing the procedures established by the Commission and the Member States for implementing the policy and providing data;
- (b) testing the compliance of storage operations in the two Member States visited; and
- (c) checking the conditions of storage and quality of cereals in a sample of stores.

16. The audit covered the storage operations during the financial year that ended on 30 October 2006 and the first five months of the following financial year. The fieldwork undertaken in 2007 included the audit of the paying agencies in Germany and Hungary, which together accounted for 91 % of stocks in public storage at the time of the audit⁸. The Court checked the storage conditions and quality of a sample of 18 cereal lots in 11 stores located in these Member States. The sample was selected on the basis of the quantities remaining in storage and logistical criteria.

OBSERVATIONS

HAVE THE PHYSICAL OPERATIONS OF THE PUBLIC STORAGE OF CEREALS BEEN WELL MANAGED?

- 17.** In approaching the audit question, the Court examined the extent to which:
- (a) the cereals bought in are of the required quality;
 - (b) the conditions of storage are appropriate;
 - (c) the cereals are disposed of efficiently as soon as conditions permit;
 - (d) the Commission acts in a way to avoid structural storage.

⁹ Commission Regulation (EC) No 824/2000 (OJ L 100, 20.4.2000, p. 31), codified by Regulation (EC) No 687/2008 (OJ L 192, 19.7.2008, p. 20).

¹⁰The Member States visited were the Czech Republic, Germany, France, Hungary and Slovakia. The report of the visit in November 2006 to Hungary noted that although some problems were found, considerable improvements had been made since the previous visit in 2005.

THE ACCEPTANCE OF CEREALS INTO STORAGE

- 18.** The Court checked the compliance of the paying agencies' acceptance procedures with the regulation in force at the time⁹. The documentation of a sample of 31 purchases was audited to verify their compliance and the correctness of the related payments. No errors were detected in the sample and the documentation provided sufficient evidence that the paying agencies' procedures had been carried out in accordance with the requirements of the same regulation.

THE PHYSICAL SAFEGUARD OF CEREALS IN STORAGE

- 19.** The Commission carried out checks in five Member States in 2005 and 2006, concluding that there were no major problems regarding the storage conditions of cereals in those countries¹⁰. The Court checked the appropriateness of the conditions of 18 cereal lots stored in 11 stores in Germany and Hungary. Nine stores were found to be satisfactory. However, unsatisfactory storage conditions were identified in two stores, although the paying agencies had already taken appropriate remedial action and the quality of the cereals was not compromised.

THE DISPOSAL OF CEREALS IN STORAGE

- 20.** The Court did not detect any weaknesses in the system for disposal operations at the paying agencies in Germany and Hungary. The Court also reviewed the documentation of a sample of 44 disposals. This provided sufficient evidence that the transactions had been properly carried out.

¹¹ Article 5 of Commission Regulation (EEC) No 2131/93 (OJ L 191, 31.7.1993, p. 76).

¹² Represents revenue foregone.

- 21.** The Commission's stock disposal policy — which is to support producers when market prices fall below the intervention price and to avoid undermining the market price¹¹ — reflects its interpretation of the objectives of public storage (see paragraph 1). The disposal policy does not aim to stabilise markets when prices are rising. Until recently, this did not have any impact because the market price of cereals was below the intervention price.

- 22.** In its disposal decisions, the Commission sells either on the EU market, where it does not wish to undermine the internal market price, or on the export market, where it will accept lower prices to remove the excess stocks from the EU market. When the EU market price exceeds the intervention price, this policy sometimes results in higher value internal market sales being forgone in order not to undermine the EU market prices. However, the risk of disrupting the market is lower when markets are strong (characterised by rising prices).

- 23.** For example, in early 2007, 112 800 tonnes of German rye were sold for export at prices ranging between EUR 106 and EUR 113 per tonne, while on the same dates, offers of EUR 140 per tonne on the internal market were rejected because they were below the corresponding market price. This had an opportunity cost¹² of approximately EUR 3,3 million. Furthermore, in the case of exports the EU reimburses the costs of transport to the nearest point of export, whereas sales on the internal market do not give rise to any such reimbursement. In this example, the export rather than internal sale resulted in additional costs of EUR 1,9 million.

24. In the first six months of 2006, sales of German rye were made to the bioethanol sector at lower prices than could have been obtained on the market. According to the Commission, these sales were part of a programme of experimental support for the energy sector. This choice had no direct relationship with the economic management of intervention stocks, and resulted in an opportunity cost of approximately EUR 5 million¹³.

¹³ 183 000 tonnes sold between January and June 2006 at approximately 81 euro/tonne, while an average price of above 108 euro/tonne was being obtained on the market during this period.

25. Since 1987, cereals have been withdrawn from EU public intervention stocks for the support of a Community programme to contribute to the well-being of the most deprived persons. This policy is funded through the budget line for the intervention storage of cereals. Due to the recent rise in the market price of cereals, the opportunity cost (representing a subsidy for the most deprived persons' budget) can be estimated at EUR 26 million¹⁴ for 2007. In the past the opportunity cost was lower than currently because the only alternative outlet for cereals was the export market.

¹⁴ In 2007, 667 000 tonnes of cereals were withdrawn for the programme at an approximate potential loss of revenue of 40 euro/tonne which would have been earned if the cereals had been disposed of on the market.

26. Disposing of stored cereals at below market price for bioethanol production, or withdrawing them for the benefit of the most deprived people in the EU, represents a cost to the EU budget (in the form of sales income forgone). However, the 'subsidy' element of such programmes is not allocated to the activities concerned. This leads to a lack of transparency in budgeting and reporting.

¹⁵ Commission Regulation (EEC) No 2273/93 (OJ L 207, 18.8.1993, p. 1) only states that intervention centres should have, inter alia, an "advantageous geographical location".

27. The centralisation of the decision to sell products makes it difficult, in practice, to take into account the differences in characteristics between lots. At each management committee meeting, the Commission sets a minimum disposal price for each Member State and product type, with no distinction made for geographical location of the store. All offers above the set price are accepted and all those below are rejected. However:

- (a) in a Member State, all else being equal (such as the quality of the cereals), a lot in a less convenient location will receive lower offers than a similar lot in a more convenient location¹⁵;
- (b) likewise, differences in the quality of the cereals in storage (in particular the levels of protein) could affect the value of the offers received. While the intervention price is adjusted to reflect such criteria (see paragraph 9), this principle is not applied on disposal.

- 28.** In practice, cereal lots of lower quality or stored in less accessible locations will attract lower offers. When such offers, even if economically sound, are below the minimum disposal price set by the Commission, the lot will remain in storage. Keeping cereals in storage incurs continuing technical and financial costs charged to the Community budget.
- 29.** For example, representatives of the paying agency in Germany indicated to the Court that the cereals remaining in storage at the time of the audit visit were mainly in less favourably situated regions or stores. The offers received for those lots had been lower than for the other lots sold, as they reflected the additional transport costs involved, but were not accepted by the Commission.

THE AVOIDANCE OF STRUCTURAL STORAGE

- 30.** As mentioned in paragraph 3, structural storage occurs when the intervention policy results in a persistent imbalance between supply and demand for the stored cereal. The result is a build-up of stocks over time caused by a level of production which reacts to the intervention price rather than market conditions. The Court examined the extent to which the Commission managed cereal storage to reduce the risk of structural storage.
- 31.** The Commission monitors the medium term prospects for the agricultural markets by means of historical data and projections, updated every six months. The impact of specific events, such as the accession of new Member States or planned changes to public storage, is evaluated either by the Commission itself or external consultants. The state of the cereals market is regularly discussed between representatives of the Commission and Member States at the cereal management committee meetings.

- 32.** The data on which the Commission assesses the market is necessarily based on a number of assumptions and forecasts that can only be used as a guide to market trends. It is especially difficult to make accurate long-term forecasts about supply and demand because of the variables involved, such as the effect of climatic conditions on forthcoming harvests and the demand for cereals for the production of biofuel. Action to reverse the negative effect of intervention on certain products was only taken when a risk had actually materialised and was forecast to worsen.
- 33.** For example, the Commission proposal to abolish intervention in rye was made in the context of the 2002 CAP reform, although it had already been apparent for a number of years that whereas the supply of rye was relatively stable, demand was declining. Except in urgent cases such as for maize in 2007, the pace of the Commission's responses to structural storage is in practice dependent upon the timetable of larger reforms, rather than representing a quick and flexible reaction to market conditions. However, at the end of 2007 the stocks of most cereals were either non-existent or very low indicating little or no current risk of structural storage.



DO THE COMMISSION'S PROCEDURES ENSURE THAT THE COSTS INCURRED BY THE EU ARE MINIMISED?

- 34.** There are three types of storage costs that the Commission refunds to paying agencies, which are described in more detail in **Annex III**:
- (a) the technical costs for the entry, monthly storage and removal from storage of cereals;
 - (b) the 'depreciation' costs to compensate for potential losses in the value of stored cereals; and
 - (c) the financing costs of the capital used in holding the stocks.
- 35.** Total expenditure on intervention storage comprises the costs described above as well as the accounting profit or loss on sale of stored cereals (representing sale proceeds less written down value — original cost net of depreciation); see **Annex II**.

TECHNICAL COSTS

- 36.** The Court reviewed the Commission's system for ensuring the accuracy of data from Member States and the use of this data to calculate the costs to be refunded to the paying agencies.
- 37.** The Court's audit revealed inconsistencies and inaccuracies in the data used to calculate the standard technical costs.
- (a) In a sample of four Member States whose real cost data differed from the norm or varied significantly between 2005 and 2006, only one Member State had provided the Commission with adequate explanatory documentation to support the figures provided.
 - (b) In 1999 the Commission carried out detailed on-the-spot checks which identified a number of issues that had the potential to affect the accuracy of the data provided by the paying agencies. No further on-the-spot checks have been undertaken.

- 38.** In 2005/06, 61 % of purchases and 11 % of disposals did not involve the cereals being physically moved into or from the stores in which they were located and were therefore at lower cost to the paying agency. The Commission calculates the standard costs of such take-overs or disposals of cereals without movement by reducing the equivalent standard cost with movement by 32 %. The Commission could not provide sufficient justification to support this figure. This adjusted standard cost has almost certainly resulted in Member States having been reimbursed more than would have been the case if the Commission had used the same standard rate calculation which better reflected the actual costs incurred as is done for transactions with movement. For example, Germany, which accounted for 27 % of cereals taken over without movement, was paid EUR 2,3 million during the marketing year 2005/06 on such transactions, even though no costs were actually incurred by the agency.

¹⁶ Once stocks are sold the amount of depreciation has no net effect on the Community budget, other than through the time value of money.

DEPRECIATION COSTS

- 39.** The depreciation cost is not an accounting depreciation — which involves the writing off of the cost of an asset without movement of funds — but compensation paid to Member States for the estimated unrealised loss in the value of cereal stocks. The higher the rate that stocks are depreciated, the greater is the cash flow advantage to the Member States until the cereals are sold¹⁶. The Court examined the methods and approach used by the Commission in calculating depreciation and the extent to which they ensure that depreciation of stocks is appropriate and reasonable.
- 40.** As explained in *Annex III*, depreciation is calculated using estimates of the future realisable value of stocks. These values are established by the Commission, but there is an insufficient record of the background to the assumptions made for the market forecasts on which these estimates are based. It is thus not possible for the Court to audit whether the method is realistic and has been consistently applied. *Annex II* shows that the depreciation paid to Member States has almost always resulted in an excess of proceeds over net book value when cereals have been disposed of, indicating that depreciation — and therefore advance payments from the Community budget — was at a higher rate than necessary to protect Member States but prevented the build-up of Community liabilities.

FINANCING COSTS

41. The Court examined the Commission's approach to calculating and reimbursing the financing costs (based on the cost of capital), and the extent to which the process ensures that such reimbursements do not overcompensate Member States.
42. Every year the Commission requests each Member State to calculate and declare their cost of capital. If no reply is received, the rate used by the Commission for the reimbursement of the Member State's financing cost is the lower of the inter-bank borrowing rate plus one percentage point and the uniform rate (see *Annex III*).
43. In practice, not all Member States reply, perhaps because of the complexity of the calculations involved. For 2006, only 15 Member States declared their cost of capital, out of which nine were reimbursed a total of EUR 6 million less than if they had not provided the information. For the remaining 10 Member States that did not declare their cost of capital, the Court has no basis to estimate whether the reimbursements exceeded their real financing costs.



CONCLUSIONS AND RECOMMENDATIONS

- 44.** The Court found that the physical operations of the public storage, including the taking in, storing and disposing of cereals have been well managed. The Court's audits to Germany and Hungary indicated that the procedures that ensure that cereals bought in are of the required quality and stored appropriately are correctly applied.
- 45.** The Commission's disposal policy generally minimises the cost of intervention. However, the Court identified cases where higher value internal market sales were forgone in favour of export sales in order not to undermine the EU market prices (see paragraph 22).
- 46.** The transparency of the EU budget and accounts is affected by charging the cereal storage budget line with the cost of disposal at lower than market price in support of the bioethanol industry or the most deprived people (see paragraph 26).
- 47.** A lack of flexibility in the disposal policy — resulting from the fact that the quality and physical location of the product is not taken into account, together with the cost of maintaining it in storage — means that some stocks remain longer than necessary, so incurring additional financing and technical costs (see paragraphs 27 and 28).
- 48.** The pace of the response to structural storage is often slowed down to coincide with the timetable of larger reforms. However, the urgent case of maize in 2007 was dealt with promptly (see paragraph 33).

49. The Court **recommends** that:

- (a) the following factors should be taken into account when evaluating offers received for the disposal of cereals in storage:
 - (i) setting a sales price which varies based on product quality and physical location;
 - (ii) minimising the period, and thus the costs, of storage by accepting marginally lower offers when the market is considered sufficiently buoyant;
 - (iii) optimising revenue (which is credited to the cereal intervention budget line to offset other costs of intervention) by accepting an offer above the intervention price on the internal market rather than one for export at a considerably lower price;
- (b) in order to improve the budgetary process, the costs of any activities which are not directly related to the intervention storage of cereals, such as for the support of the most deprived persons or as a subsidy of the bioethanol industry, should be more transparent;
- (c) action should be taken more promptly to react to potential or actual risks of market distortion (structural surpluses).

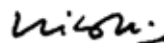
50. The Commission's method of calculating costs generally ensures that the EU minimises the costs of storage and that Member States have an incentive to minimise their costs. However, few checks are carried out on the data that is used for the cost calculations, with the risk that wrong data may be used (see paragraph 37).

51. Amounts reimbursed to Member States for storage of cereals are mostly reasonable, but may exceed the underlying costs in the case of the financing costs and the standard cost of taking cereals into storage without movement (see paragraphs 38 and 43).

- 52.** The Commission insufficiently records the background to the assumptions made for the market forecasts on which the future realisable values of cereals are based. The Court cannot therefore verify whether these values, used for the calculation of depreciation, are realistic and consistent (see paragraph 40).
- 53.** The Court **recommends** that:
- (a) the Commission should strengthen its review of the costs notified by the paying agencies by systematically following up any unusual data or trends; on-the-spot inspections should include checks of the data used;
 - (b) the Commission should review its standard costs for operations without movement to ensure that they do not exceed the actual costs;
 - (c) the background to the assumptions made by the Commission for the depreciation of cereal stocks should be more clearly documented;
 - (d) the Commission should ensure that the rates are set at levels that act as an incentive for Member States to provide their actual financing costs and reduce any risk of overcompensation to a minimum.
- 54.** The Court recommends a simplification of procedures in the context of the 'health check', particularly as public intervention for at least the major cereal (bread wheat), in order to provide a safety-net support, will continue.

This report was adopted by the Court of Auditors in Luxembourg at its meeting of 19 November 2008.

For the Court of Auditors



Vítor Manuel da Silva Caldeira
President

ANNEX I

QUANTITIES OF CEREALS IN PUBLIC STORAGE AT THE FINANCIAL YEAR END (30 SEPTEMBER)

(1 000 tonnes)

	2000	2001	2002	2003	2004	2005 ¹	2006	2007
Wheat	2 770	666	431	1 179	173	8 592	4 218	152
Maize	23	12	3	17	-	2 608	5 357	1 218
Rye	3 218	3 792	5 054	4 715	3 196	2 307	546	-
Barley	1 798	2 210	2 382	800	109	1 129	2 061	-
Sorghum	5	5	4	11	-	2	3	-
Total	7 814	6 685	7 874	6 722	3 478	14 638	12 185	1 370

¹ The figures from 2005 include the cereals stored in the 10 Member States that joined the EU in 2004.

Source: Annual financial reports of the EAGGF-Guarantee Section (2000-2006) and of the EAGF (2007).

ANNEX II

EXPENDITURE FOR THE INTERVENTION STORAGE OF CEREALS BY TYPE OF COST

(million EUR)

	2000	2001	2002	2003	2004	2005 ¹	2006	2007
Technical costs (a)	325	198	160	177	106	222	353	192
Financial costs (b)	30	25	27	23	9	30	47	25
Book value — proceeds (c)	(130)	(74)	(14)	58	(97)	(10)	(130)	(443)
Depreciation (d)	239	36	46	10	27	200	68	-
Total expenditure² (a) + (b) + (c) + (d)	464	185	219	268	45	442	338	(226)

¹ The figures from 2005 include the cereals stored in the 10 Member States that joined the EU in 2004.

² Budget line 05 02 01 02 "Intervention storage of cereals".

Source: Annual financial reports of the EAGGF-Guarantee Section (2000-2006) and of the EAGF (2007).

DETAILS OF THE COMPUTATION OF THE EXPENDITURE INCURRED IN THE CONTEXT OF PUBLIC STORAGE OPERATIONS

STANDARD AMOUNTS FOR PHYSICAL OPERATIONS

1. The standard rates for the three storage operations (entry, monthly storage and removal) are calculated every year on the basis of the real costs provided by the Member States for the previous year. Each standard rate is calculated as the weighted average of the real costs of at least four Member States with the lowest costs of the operation. The real costs used must correspond to at least 33 % of the average stored quantities. The following example illustrates this:

Member State	A	B	C	D	E	F
Real cost of entry (EUR/tonne)	1,5	1,7	1,9	2,0	2,5	5,0
Average stored quantities (tonnes)	200	500	300	100	4 000	6 000

2. Since the Member States with the lowest four real costs represent less than 33 % of the total average stored quantities (= 3 663 tonnes), the fifth must be partially included in the weighted average calculation. The standard rate per tonne for the entry into storage in this example is thus:

$$(1,5 \times 200 + 1,7 \times 500 + 1,9 \times 300 + 2 \times 100 + 2,5 \times 2 563) / 3 663 = 2,27 \text{ euro.}$$

3. It should be noted that this method ensures that the Commission always reimburses less than the total real costs declared by all Member States taken together, although the Member States declaring the least costs will be compensated for more than the actual costs they incur. In the above example, the overall average would have been EUR 3,78 per tonne. Member States have an incentive to minimise their costs because costs exceeding those reimbursed by the Commission will be borne out of their own funds.

4. The paying agencies of the Member States are responsible for contracting storage space, including determining the individual costs for entry into storage, storage and removal from storage. In Hungary, an annual standard contract is negotiated between the national authorities and the representatives of the storekeepers. In Germany, although a standard cost for entry and removal from storage is set by the paying agency, twice a year storekeepers submit offers for providing storage space. The paying agency then selects the cheapest when needed on the basis of minimising the combined transport and storage costs.
5. In Germany, individual storekeepers have to compete for the service of storing the cereals. This ensures that costs are kept in line with the market, which in turn has a beneficial effect on the standard costs reimbursed by the EU.

DEPRECIATION OF STORED CEREALS

6. Depreciation is determined by the Commission and reimbursed to Member States:
 - (a) when the cereals are bought at least 70 % (the so-called K coefficient, fixed by the Commission at the beginning of each year) of the difference between the buying-in price and the estimated disposal price for each cereal concerned;
 - (b) at the end of each subsequent accounting year by multiplying the quantities of each cereal in stock in each Member State by the difference between their carry-over value and estimated selling price.
7. The carrying value of cereals may be reduced by depreciation but cannot be increased. Thus, even if at the end of an accounting year, the estimated disposal price of the cereals has increased, the carrying value is not increased by reversing part of the depreciation cost already reimbursed to the Member States.

8. The following example shows that the depreciation rate does not change the overall cash flow of public storage of cereals, but has an effect on the timing of the flow of funds and how the payments are allocated to the budgetary years. In the example, the same lot of cereals is bought in year x at 100 and sold in year x+1 for 90, the only difference being the depreciation cost in year x:

	Take-over cost	Depreciation in year x	Carry-over value	Disposal proceeds in year x + 1	Carrying value less proceeds	Total paid by the EU
	(a)	(b)	(c) = (a) — (b)	(d)	(e) = (c) — (d)	(b) + (e)
A	100	100	-	90	-90	10
B	100	50	50	90	-40	10
C	100	0	100	90	10	10

¹ The rate to be notified by the Member States is the average interest rate actually borne during the six months preceding the request.

² The uniform interest rate corresponds to the average of the 3-month and 12-month forward Euribor rates of the six months preceding the request.

³ The interest rate level is one percent plus the average of the Member States interbank borrowing offered rate three months for the six month preceding the request.

9. The example illustrates the fact that the depreciation cost affects the cash flow of payments (or refunds) from the EU budget to the Member States in year x (column b) and year x+1 (column e), but that the overall amount paid by the EU is the same.

FINANCING COSTS FOR FUNDS MOBILISED

10. The financing costs reimbursed to Member States are calculated by the Commission by multiplying the applicable interest rate by the average value of the cereals in storage during the accounting year. Every year the Commission requests every Member State to declare their cost of capital:

- if a reply is received, the interest rate applicable to the Member State is the lower of the one declared¹ and the uniform interest rate²;
- if no reply is received, the interest rate applicable to the Member State is the lower of the Member State's interest rate level³ plus one percent and the uniform interest rate.



THE COMMISSION'S REPLIES

EXECUTIVE SUMMARY

V.

Under the current system the resale price of each batch is determined without taking into consideration either its quality or its geographical location. Doing otherwise would make the system very difficult to manage in practice. The Commission finds that the current system has the advantage of being straightforward, objective and more efficient.

When market conditions allow, the Commission applies these recommendations.

VI.

The Commission will examine how to respond to this observation.

VII.

The Commission currently carries out a thorough analysis of the cost information received from the Member States concerned. On the basis of the Commission's risk analysis and the limited quantities in store, on-the-spot inspections of this information cannot be justified at this point in time.

VIII.

The Commission is examining the situation and it will decide on the most appropriate method to follow for the calculation of entry and removal standard costs without stock movement. However, the current public storage situation does not allow the Commission to establish a method whereby intakes and removals costs with no movement can be efficiently accounted for and used in devising a new calculation method.

The Commission is also working on the most appropriate method to follow in the cases where certain Member States do not declare their interest costs, in the framework of the Commission's calculation of the specific interest rate to be used for the reimbursement of the financing costs for public storage operations.

IX.

The Commission's proposals put forward in May 2008, in the framework of the so-called health check, include several measures aimed at adapting the cereals intervention system to the new market situation and reinforce the role of public intervention as a safety-net mechanism.

There are currently no public stocks for butter and skimmed milk powder and for many years not for beef and veal either. Furthermore, there have been no intakes for sugar while outtakes are expected to limit sugar stocks in store. For alcohol, the reformed wine market has abolished all new intakes into public storage as of 1 August 2008.

A new Commission regulation is foreseen by end of 2009 establishing common rules as regards buying-in under public intervention.

OBSERVATIONS

22.

Export is the main outlet for stocks of intervention cereals. It is essential to avoid a situation where massive resales on the internal market would lead to a sharp drop in prices, which would in turn trigger intervention offers. Resales on the internal market have therefore taken place only during marketing years with high price levels. Care has been taken not to upset the market, which required cautious management of the changeovers from reselling for export to reselling on the internal market.

23.

Over time, rye became a structural stock. In spite of the Commission's efforts to find outlets, the final stocks could not be cleared until the summer of 2007, although rye had not been eligible for intervention since 2003.

During the year 2006/07 the market experienced an unexpected turnaround. Internal prices rose sharply.

The situation referred to by the Court, where two tenders were open simultaneously, lasted for only five weeks. The export tender, with lower sales prices, was closed in favour of the internal market tender.

24.

Two prices existed, a higher one for regular rye and a lower one for rye used to produce bioethanol.

The pilot project conducted in 2005/06 concerned 200 000 tonnes harvested in 2003 and earlier. In spite of the additional opportunity cost, past and potential storage expenses (EUR 2 per tonne per month) were sufficient reason put this new outlet to the test.

25.

The programme to supply food to the poorest was set up in 1987, when intervention stocks held by the Community were very large¹. It provided an outlet for large stocks that would otherwise have remained in public storage and entailed large expenses for the Community.

The accounting value of goods made available from intervention stocks for most deprived persons has been fixed by the Council at the intervention price.

The successive reforms of the CAP led to a drastic reduction in the Community's intervention stocks. This means that the programme to supply food to the poorest has to undergo a thorough review. On 17 September 2008, the Commission adopted a proposal to review the relevant Council regulation.

¹ Council Regulation (EEC) No 3730/87 of 10 December 1987, replaced by the Single CMO, Council Regulation No 1234/2007.

26.

With regard to the most deprived persons support scheme, the cereals outtakes are funded through budget item 05 02 04 01. Furthermore, the public storage accounts clearly identify separately all stock movements involving the free distribution scheme. The implementation of these two separate accounts leads to the transparent presentation of the financial cost of this scheme to the EU budget both from the budgetary and the stock accounting viewpoints.

The tender for the resale of rye in view of its processing into ethanol was a pilot project for a limited quantity of grain (200 000 tonnes, of which 190 505 were sold). The accounts for this one-off tender are included in the budget line for sales of intervention rye, together with the other three tenders opened the same marketing year, for 0,2 million, 0,5 million and 1 million tonnes respectively. The pilot project for bio-ethanol represented less than 11 % of the quantities of intervention rye put on sale during that marketing year. It was therefore not necessary to create a specific budget line. In addition, this tender has not been reopened in subsequent years.

27 and 28.

Under the current system the resale price of each batch of cereals is determined without taking into consideration either its quality or its geographical location. Doing otherwise would make the system very difficult to manage in practice.

The Commission has chosen to adhere to gross prices and let the tender mechanism and its inherent competition element determine the order in which the batches are sold. It would be difficult to take real transport costs into account in any meaningful way, because they are unknown and would have to be estimated on a hypothetical basis. Therefore the Commission finds that the current system has the advantage not only of being straightforward and objective, but also more efficient.

29.

Batches further afield from consumption centres generally fetch less competitive offers and consequently are the last to be sold. An ad-hoc approach is possible in such cases. For instance, in October 2007 the Commission located the last remaining stocks in Hungary, which consisted of small batches spread across different locations, by obtaining information from the national authorities on a case-by-case basis.

The same has been done in the past with Finnish and Swedish stocks stored in difficult locations. On more than one occasion, prices have been accepted on the basis of this consideration. However, as useful as tailor-made approaches may be for the final batches, they would be very difficult to manage if used from the outset, for all batches put on sale.

31.

Market analyses are discussed with representatives from the Member States in the management committee, which meets twice monthly, and in the Standing Group 'Cereals' of the Advisory Committee (with representatives from traders and civil society), which meets four times a year.

32 and 33.

Over the past few years the Commission made several proposals to modify the cereals intervention system, more specifically in connection with Agenda 2000, the 2003 mid-term reform and maize in 2006. Thanks to these proposals the intervention system could be adapted to the changed market conditions.

Given that the stocks' size is no longer a problem, the Commission proposed a number of changes in May 2008 (health check) to adapt the system to present-day market conditions and reinforce its role as a safety net.

37.

The Commission proceeds to an analysis and to a thorough questioning of the information forwarded by the Member States. This is clearly evidenced by the established working files which contain not only the Member States' initial replies to the Commission's questionnaire but also all the additional communications exchanged between the Commission and the Member States as a result of this analysis. There have been many instances where Member States have amended their initially-declared costs following the Commission's analysis and questioning of their declarations. Furthermore, the Commission considers that it has received adequate explanatory information to support the figures provided by the Member States. It, therefore, does not share the analysis of the Court that only one of the four Member States selected provided adequate justification to the Commission.

The on-the-spot checks carried out in 1999 have not been repeated since because the findings were considered by the Commission not to be sufficiently important and, after due consideration under the clearance of accounts procedure, when effect on the fund was established as negligible the enquiries were closed.

38.

According to applicable rules, in cases where there is no movement of stocks, the costs of transport and removal from the warehouse shall be deducted from the intervention price. In the case of Germany, for the period in question, the transport and removal costs entered into the technical costs account leading to the reduction of the technical costs reimbursed to Germany.

The Commission will examine the situation and it will decide on the most appropriate method to follow for the calculation of entry and removal standard costs without stock movement once the public storage situation would allow it.

40.

The Commission considers it has adequate evidence to support the assumptions made for the market forecasts on which the cereal values are based.

The cereals selling price is the one used for establishing the credit appropriations needed in order to fund the cereals' market credit requirements included in the amending letter of each budget. The amending letter does indeed explain the rationale of the retained budget hypotheses which are communicated to the Budgetary Authority which examines, and eventually, adopts the budgetary credits needed.

43.

For 2006, the Council had provided derogation to the applicable rules for the Member States which were incurring very high financing costs. As a result these Member States could be reimbursed on the basis of specific interest rates higher than the applicable uniform interest rate set at 2,2 % for 2006. These specific rates were fixed on the basis of the declared financing costs by the Member States concerned.

The Commission will examine the situation and it will decide on the most appropriate method to follow when Member States do not declare their interest costs, in the framework of the Commission's calculation of the specific interest rate to be used for the reimbursement of the financing costs for public storage operations.

CONCLUSIONS AND RECOMMENDATIONS

46.

The Commission has ensured that the Community budget reflects the cost of public storage in a transparent manner. On one hand, intervention cereals used for the support programme for the poorest are financed under a separate budget heading: 05 02 04 01. On the other, public storage accounts clearly itemise stock movements relating to this programme. Creating these two separate accounts has made it possible to detail the programme's cost transparently, both for the purposes of the Community budget and stock management. The accounting value of goods made available from intervention stocks for most deprived persons has been fixed by the Council at the intervention price.

As regards the resale of rye as a raw material for making ethanol, this was part of a pilot project and happened on a very small scale. The cost of this one-off tender was included under the budget heading for the resale of intervention rye, together with three other public tenders held during the same year. It was therefore not necessary to create a separate budget heading. Moreover, no such tender has been launched since.

47.

Taking on board criteria such as quality and geographical location to determine resale prices for every batch of cereals separately would be very difficult in practice.

48.

The Commission would repeat that over the past few years it made several proposals to adapt the cereals intervention system, more specifically in connection with Agenda 2000, the 2003 mid-term reform and maize in 2006. Thanks to these proposals the intervention system could be adapted to the changed market conditions.

Given that the stocks' size is no longer a problem, the legislative proposals of May 2008 (health check) were designed to adapt the system to present-day market conditions and reinforce the intervention system's role as a safety net.

49. (a)

(i)

Under the current system the resale price of each batch is determined without taking into consideration either its quality or its geographical location. Doing otherwise would make the system very difficult to manage in practice. The Commission finds that the current system has the advantage of being straightforward, objective and more efficient.

An ad-hoc approach can and has been followed on several occasions for the last remaining batches at the end of each exercise.

(ii)

The Commission already follows this approach when it considers it appropriate.

(iii)

The Commission already follows this approach when it considers it appropriate.

49. (b)

The Commission will examine how to respond to this recommendation.

49. (c)

Intervention stocks have disappeared and the proposals made by the Commission in May 2008 (health check) include a number of adjustments to adapt the system to present-day market conditions and reinforce its role as a safety net. A new Commission regulation laying down common rules for public intervention purchases is expected by the end of 2009.

50.

The Commission proceeds to an analysis and to a thorough questioning of the information forwarded by the Member States.

51.

The Commission is examining the situation and it will decide on the most appropriate method to follow for the calculation of entry and removal standard costs without stock movement.

The Commission is also working on the most appropriate method to follow in the cases where certain Member States do not declare their interest costs, in the framework of the Commission's calculation of the specific interest rate to be used for the reimbursement of the financing costs for public storage operations.

52.

The Commission considers it has adequate evidence to support the assumptions made for the market forecasts on which the cereal values are based.

The cereals selling price is the one used for establishing the credit appropriations needed in order to fund the cereals' market credit requirements included in the amending letter of each budget. The amending letter does indeed explain the rationale of the retained budget hypotheses which are communicated to the Budgetary Authority which examines, and eventually, adopts the budgetary credits needed.

53. (a)

The Commission currently carries out a thorough analysis of the cost information received from the Member States concerned. On the basis of the Commission's risk analysis and the limited quantities in store, on-the-spot inspections of this information cannot be justified at this point in time.

53. (b)

The Commission is examining the situation and it will decide on the most appropriate method to follow for the calculation of entry and removal standard costs without stock movement. However, the current public storage situation does not allow the Commission to establish a method whereby intakes and removals costs with no movement can be efficiently accounted for and used in devising a new calculation method.

53. (c)

The Commission's procedure as regards the selling price for cereals determines the amount of the depreciation of cereals stocks to be made. This selling price is thoroughly documented and presented to the Budgetary Authority as part of the amending letter of each year's budget.

53. (d)

The Commission is working on the most appropriate method to follow in the cases where certain Member States do not declare their interest costs, in the framework of the Commission's calculation of the specific interest rate to be used for the reimbursement of the financing costs for public storage operations.

54.

The Commission's proposals put forward in May 2008, in the framework of the so-called health check, include several measures aimed at adapting the cereals intervention system to the new market situation and reinforce the role of public intervention as a safety-net mechanism.

European Court of Auditors

Special Report No 11/2008

The management of the EU support for the public storage operations of cereals

Luxembourg: Office for Official Publications of the European Communities

2009 — 32 pp. — 21 × 29.7 cm

ISBN 978-92-9207-027-4

DOI 10.2865/57636

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IN THIS REPORT, THE EUROPEAN COURT OF AUDITORS ANALYSES THE MANAGEMENT OF EU SUPPORT FOR PUBLIC STORAGE OPERATIONS FOR CEREALS TO ASCERTAIN WHETHER THE COST TO THE EU IS MINIMISED.

THE REPORT FINDS SOME ASPECTS OF THE MANAGEMENT OF THE PHYSICAL STORAGE OPERATIONS AND THE COMMISSION'S PROCEDURES SATISFACTORY, WHILST HIGHLIGHTING OTHER ASPECTS THAT NEED IMPROVING. THESE OBSERVATIONS FOCUS IN PARTICULAR ON IMPROVING BUDGETARY TRANSPARENCY AND, IN CERTAIN CASES, THE POSSIBILITY OF AVOIDING SOME STORAGE COSTS OR SALES INCOME FOREGONE. THE REPORT MAKES A NUMBER OF RECOMMENDATIONS TO THIS EFFECT, WHICH MIGHT HAVE A SIGNIFICANT IMPACT IF CEREAL STOCKS INCREASE AGAIN IN FUTURE. FOR THAT REASON, THE COURT STRONGLY RECOMMENDS IMPLEMENTING THESE IMPROVEMENTS AS SOON AS POSSIBLE.



EUROPEAN COURT OF AUDITORS



Publications Office
Publications.europa.eu

ISBN 978-92-9207-027-4

