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Court of Auditors

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Special report of the Court of Auditors on the system for the payment of refunds on agricultural exports (Audit of the export of agricultural products) 1

I

*(Information)***COURT OF AUDITORS**

SPECIAL REPORT OF THE COURT OF AUDITORS
on the system for the payment of refunds on agricultural exports
(Audit of the export of agricultural products)

(Observations submitted in accordance with Article 206a (4) of the EEC Treaty)

(85/C 215/01)

This report was adopted by the Court of Auditors at its meeting of 26 June 1985, in compliance with Article 206a (4) of the EEC Treaty. On 22 March 1985 it was sent for comment to the Commission whose replies are attached.

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CHAPTER I

INTRODUCTION

1.1. Each year 'refunds' on exports of agricultural products account for a considerable proportion of Community expenditure. In 1984, out of a total expenditure on financing the EAGGF-Guarantee of 18 346,5 Mio ECU, 6 203,6 Mio ECU (34 %) were spent on export refunds. In 1980 this rate had reached almost 50 %.

1.2. Refunds are sums paid to traders when the latter export agricultural produce outside the Community. In principle, these subsidies are intended to make up for the differences between the prices of agricultural produce produced in the Community and the prices of agricultural produce traded on the world market.

1.3. The Court first of all looked at the procedures adopted for export refunds and the central management of the export refund system. It examined the system according to which refund rates are established, which is what induces traders to undertake the transactions on which the exports are based. The Court noted the fact that the Commission plays the main role in this central system.

1.4. However, if the aim is to examine the conditions under which the system as a whole functions, such an examination must also include the control systems which operate in the Member States, in implementation of the Commission's management decisions, for the purpose of authorising and checking the exports which give rise to the payment of refunds.

1.5. According to the principle of division of labour which is common to all the transactions financed by the EAGGF-Guarantee, the Member States are responsible for the functioning of the system at the periphery, where, in the case of refunds, the three processes leading up to the expenditure take place:

- (a) the issuing, for certain products, of export licences;
- (b) the export of agricultural products;
- (c) the calculation and the payment of the refund.

1.6. The system of Community regulations governing the financing mechanisms for refunds appears to be both voluminous (more than one thousand articles applicable on a permanent basis to all markets), and complex (involving, in particular, the implementation of special procedures and systems), and in some cases very detailed. In addition to this, there is also a plethora of regulations formalising the decisions taken by the Commission as part of the day-to-day management of refunds (the level of the refunds is established by regulation). All the same, an analysis of this system of regulations shows that, though, in essence, it covers almost the entire system of management and centralised and peripheral control with regard to refunds, it leaves a fairly

wide margin of manoeuvre to the Member States as far as the organisation of export procedures and the task of inspecting exports are concerned.

1.7. The aim of this report, therefore, is to look in some detail at the way in which, in practice, export transactions are organised and inspected in cases where they are eligible for the payment of refunds chargeable to the EAGGF-Guarantee.

1.8. The study carried out for this purpose dealt with refund expenditure for the export of butter and skimmed-milk powder to non-Member States in cases where the goods did not pass through any other Community Member State. From the beginning the study concerned four Member States, which were selected because they had paid out either the largest cumulative amounts over a full year (the Netherlands and France) or the smallest amounts which were still of some significance (Ireland and the United Kingdom). The departments visited by the Court were those of the customs administration and the paying agencies. The findings of these visits, moreover, were backed up (in particular because they are applicable to other Member States) by the results of various surveys carried out by the Court during the execution of checks on agricultural products not covered by the scope of this report, or during analysis of the results of checks carried out by the Commission during the clearing of the accounts of the EAGGF-Guarantee.

1.9. This approach meant that it was possible to investigate practical mechanisms which are applied in a very similar manner whatever the products in question. These same mechanisms, which all the evidence suggests have not been modified in practice, are also brought into play in cases where the exports constitute the prime cause of an item of expenditure or revenue chargeable to the budget of the Community, such as monetary compensation amounts (MCAs) and, where applicable, export levies (as in the case of sugar in 1980).

1.10. In order to carry out its appraisal of the system of inspection of expenditure on export refunds in the Member States, in this present report the Court has:

- (a) analysed the Community rules governing inspection of agricultural exports and the ways in which the Member States have organised themselves under the terms of these regulations;
- (b) examined, in addition, certain practical aspects of the inspection mechanisms which may have a considerable effect on the financing of refund expenditure.

1.11. The report is, by its nature, limited to an analysis of the systems implemented at the level of the Member States, and, within these limits, the Court has taken particular care to bring out the risks inherent in the various options selected from the point of view of Community finances.

CHAPTER II

THE SYSTEMS FOR ORGANISING THE INSPECTIONS

THE MARGIN OF MANOEUVRE WITHIN THE COMMUNITY REGULATIONS

2.1. The procedures for inspecting exports of agricultural products could have been directly regulated at the Community level, as is the case for all the other stages in the process leading up to the payment of refunds (determination of the rates of the refunds, issuing the export licences, award procedures, rules differentiating refunds according to the zone of destination, pre-calculation of refunds, etc.). Articles 43 (agricultural matters) and 235 (attainment of one of the objectives of the Community without the treaties having provided the necessary powers) of the EEC Treaty allowed for this. Failing that, the national rules governing such matters could have been subjected to a process of approximation by means of directives based on the provisions of Article 100 of the Treaty. Such legislation or harmonisation could have been drawn up with the aim of determining the minimum control procedures for declarations made with a view to obtaining export refunds and guaranteeing the equality of treatment of all exporters, bearing in mind the requirements of the Common Agricultural Policy.

2.2. In practice, however, each of the Member States has its own long-standing administrative traditions regarding the monitoring of movements of goods. For this reason none of them wished to see the Community enact legislation likely to call the organisation of their own customs services seriously into question, in spite of the fact that such customs services are usually more concerned with carrying out checks on revenue arising from imports. As a result, the only Community legislation which concerns the inspection of exports of agricultural products is not specifically concerned with such operations and is set out in the form of general objectives.

Application to agricultural products of the regulations on customs export procedures

2.3. The various customs export procedures have been subjected to a process of general harmonisation, concerning all exported goods, whether agricultural or not, (see Council Directive 81/177/EEC of 24 February 1981⁽¹⁾ and the Commission's Implementing Directive 82/347/EEC of 23 April 1982⁽²⁾). The purpose of these texts was to harmonise national export procedures, with effect from 1 February 1983, by laying down:

- (a) minimum requirements, such as the obligation to lodge an export declaration and to present the goods to the customs;
- (b) a fairly broad range of possible variants resulting from:
 - (i) the option for the customs services of examining the goods (or not);
 - (ii) the proposal of various outlines of simplified procedures.

2.4. The question is whether these texts, which do not apply specifically to agricultural products, might be inadequate, given that the act of exporting an agricultural product is the prime cause of an item of budgetary expenditure which, in the aggregate, is a large one (almost a quarter of the entire Community budget for 1984). The fact is that there is no other legislation which, as regards agricultural matters, could provide the means of ensuring uniformity in the customs procedures for inspecting agricultural exports and which could ensure with equal certainty in all particulars that the transactions in question have actually been carried out.

The agricultural regulations and checks on exports

2.5. If we except Commission Regulation (EEC) No 2730/79 of 29 November 1979⁽³⁾ governing the administrative procedures for allocating export refunds, the only Community legislation with any bearing on the inspection of agricultural exports, to the extent that such exports constitute the prime cause of an item of Community expenditure, are Council Regulation (EEC) No 729/70 of 21 April 1970⁽⁴⁾ and Council Directive 77/435/EEC of 27 June 1977⁽⁵⁾.

Regulation No 729/70

2.6. Regulation No 729/70 (Article 8, paragraph 1, indent 1) provides in an extremely general way for the need to ensure that all transactions financed by the EAGGF are actually carried out and are executed correctly, which therefore includes exports eligible for refunds. It assigns the responsibility for these checks to the Member States 'in accordance with national provisions'.

2.7. It is clear that this very general basic legislation, which has not been supplemented by any other text relating specifically to the inspection of agricultural exports, provides

⁽¹⁾ OJ L 83, 30. 3. 1981, p. 40.

⁽²⁾ OJ L 156, 7. 6. 1982, p. 1.

⁽³⁾ OJ L 317, 12. 12. 1979, p. 1.

⁽⁴⁾ OJ L 94, 28. 4. 1970, p. 13.

⁽⁵⁾ OJ L 172, 12. 7. 1977, p. 17.

no information regarding the characteristics of an optimum, harmonised system of inspection of such exports.

Directive 77/435/EEC

2.8. Directive 77/435 is also a very general piece of legislation. It concerns explicitly the task of ensuring that 'transactions financed by the Guarantee section of the EAGGF are actually carried out and are executed correctly'. The minimum inspection requirements laid down in this directive (*ex post facto* scrutiny by sampling of accounting and commercial documents of undertakings receiving payments from the EAGGF-Guarantee) concern exporters, amongst other companies, but do not include any specific provisions regarding inspections of exports and, more generally, the inspection of external trade. In its second recital, the directive specifies that this minimum scrutiny of accounting and commercial documents supplements other kinds of inspection already carried out by the Member States. It lays down no guidelines for the other kinds of inspection, which, in the case of exports, consist mainly of direct inspections of goods and the scrutiny of administrative and commercial documents accompanying the goods. These inspections continue to come within the exclusive preserve of the Member States.

2.9. By setting up a system of *ex post facto* inspections, on a limited number of traders, and by leaving direct and administrative inspections out of account, Directive 77/435 does not restrict the freedom of the Member States with regard to the organisation of inspections directly connected with the payment of refunds.

THE VARIOUS SYSTEMS IN USE IN THE MEMBER STATES

2.10. Having established that Community legislation leaves the Member States a fairly free hand in the

organisation of their inspections of refund expenditure, we must now look at the practical consequences of this freedom of manoeuvre. It can then be seen that the existence of differing administrative traditions and approaches, based on either a direct examination of movements of goods or on *ex post facto* checks on companies, has not induced the Member States to make any fundamental changes to their established systems of supervising trade with non-Member countries. It therefore comes as no surprise to find that the simple adjustments made by the Member States in order to manage refunds and supervise the exports that give rise to them have resulted in the emergence of several different systems, each affording guarantees which are not necessarily complementary.

THE MAIN FEATURES OF THE VARIOUS SYSTEMS

The separation of duties

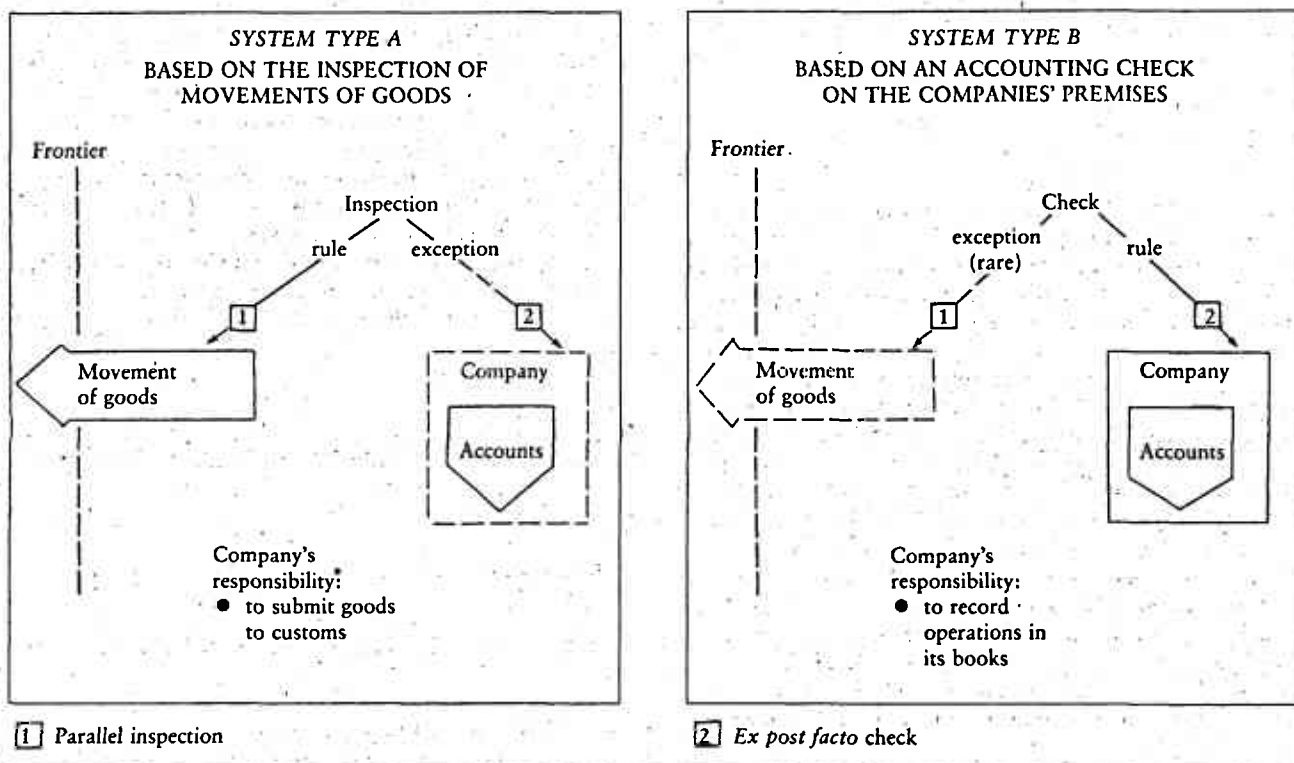
2.11. In all the Member States visited it was observed that:

- (a) administrative duties relating to export operations and the supervision of such operations are entrusted to the customs authorities;
- (b) duties relating to export licences and the payment of refunds are entrusted to the paying agencies.

The two main types of system concerning the supervision of export operations

2.12. There are two systems of supervision in use: the direct inspection of movements of goods and *ex post facto* checks carried out on exporting firms (cf. Table 1). The Member States apply one or the other of these systems, to varying degrees.

Table 1: The two main types of system concerning the supervision of agricultural exports

*Direct inspection of movements of goods*

2.13. Under this system (type A) the exported goods:

- (a) are submitted physically for inspection by the customs authorities at the time of the export operation;
- (b) give rise to the lodging by the firm of an export declaration which is recorded by the customs authorities;
- (c) may form the subject of a specific check:
 - (i) physical (i.e. on presentation of the goods);
 - (ii) and/or documentary (i.e. on presentation of the commercial documents submitted in support of the declaration);
- (d) may also not be subject to any check.

Ex post facto checks on exporters

2.14. Under this system (type B) the exported goods:

- (a) are recorded by the exporters in their own books (rules have been issued laying down the procedure for keeping and compiling these records);

- (b) are sent directly abroad under cover of commercial accompanying documents (in some cases, customs export documents⁽¹⁾);
- (c) are set out in summary and periodic export declarations drawn up by the exporters and sent to the customs authorities;
- (d) undergo *ex post facto* controls by the customs authorities which take the form of cross-checking the declarations received from the company with the records, account books and commercial documents;
- (e) may, in exceptional cases, be subject to inspection at the moment of export.

The various systems for the management of licences and the payment of refunds

2.15. In some Member States, the paying agency (or agencies) responsible for the management of licences and the payment of refunds has its own inspection facilities, whereas in other Member States this is not the case.

Agencies with their own inspection department

2.16. In the above agencies, which initially issue and manage the export licences, the payment of refunds is made on the basis of files consisting of the supporting documents

⁽¹⁾ In cases where there are certain differences in procedure.

and, in particular, the export declarations inspected by the customs. An inspection in the full sense of the term is carried out simultaneously on the beneficiaries' premises in order to ensure, by means of an *ex post facto* check of the companies' accounts, that the produce for which the refunds have been calculated actually exists.

Agencies with no inspection department

2.17. These agencies consider the calculation and payment of refunds, and similarly the issue and management of export licences, as administrative and accounting tasks, which do not call for supplementary checks on the beneficiaries' premises. They are effected on the basis of supporting documents, including the export declaration bearing the customs authorities' stamp, which guarantees the accuracy of the information declared.

2.18. Inspections which differ from those carried out by the customs authorities may sometimes be effected. In that

case they are carried out by a department external to the paying agency.

The various possible permutations of the above systems

2.19. The two systems of supervision (cf. Table 1) may be combined in various ways with those functioning in the field of management and, in reality, the situations encountered vary greatly in detail on account of the existence of one or more paying agencies (some of which are public sector agencies connected with the trade, whilst others are public services) and, in some cases, audit authorities acting *ex post facto* under the authority of a third body. However, an examination of the main features once again reveals the existence of two fairly representative systems (cf. Table 2):

Table 2: Synoptic table of the two main systems used by the Member States for the management and supervision of agricultural exports

PARTY ACTION	UNDERTAKING	CUSTOMS	PAYING AGENCY
<p>ORGANISATION OF THE SYSTEM BASED ON INSPECTIONS OF MOVEMENTS OF GOODS (TYPE A)</p> <p>Application for licence</p> <p>Issue of licence</p> <p>Export declaration</p> <p>Inspection of the movement of goods at the moment of export</p> <p>Calculation and payment of the refund</p>	<p>Application</p> <p>Export declaration</p>	<p>(V)</p>	<p>Export licence</p> <p>Payment</p>
<p>ORGANISATION OF THE SYSTEM BASED ON ACCOUNTING CHECKS ON THE PREMISES OF THE UNDERTAKING (TYPE B)</p> <p>Application for licence</p> <p>Issue of licence</p> <p>Recording in the books of the undertaking of the products to be exported</p> <p>Export (with the option, which is very rarely taken up, of inspecting the movement of goods)</p> <p>Ex post facto check of the exporter's accounts</p> <p>Possibility of ex post facto checks of the exporter's accounts</p> <p>Calculation and payment of the refund</p>	<p>Application</p> <p>Recording of exports</p>	<p>(V)</p> <p>(V)</p>	<p>Export licence</p> <p>Payment</p>

(V) = approval/check.

- (a) The first involves the on-the-spot recording and direct supervision of export operations by the customs authorities, leaving the paying agencies with only the management of licences and payments.
- (b) The second brings together the recording of exports by exporters, the *ex post facto* checks carried out on them by first the customs authorities and then the paying agencies' inspection departments, and the management of licences and payments by these same paying agencies.

THE RISKS INHERENT IN THESE TWO SYSTEMS

The risk of 'roundabout' operations

2.20. In the first system (type A), where direct inspection of all exported goods is possible, there is a certain measure of security regarding the material bases of the payments. This security obviously varies according to the procedures used for selecting the operations that are to be inspected.

2.21. There is, on the other hand, a risk that artificial movements of goods may be invented, or relevant facts may be concealed, without any commercial justification, with the sole aim of increasing the amount of refunds. For example, traders may set up fraudulent 'roundabout' operations (cf. Annex I) by making goods cross the same frontier several times after smuggling them back into the country from which they were exported. Such practices should be prevented or detected so as to avoid the irregular payment of refunds or the evasion of levies. Similarly, improper 'roundabout' operations may take place when goods cross a frontier several times, taking advantage of legislative loopholes arising, for example, from considerable differences in the rates of the refund for adjacent tariff headings (cf. Annex II). These 'roundabout' operations should also be detected so that the Commission may identify and eliminate the legal loopholes, in particular by adjusting the rates.

2.22. Checks carried out on physical data are intended to pin-point characteristic features of each operation, considered in isolation from others. They do not give an overall view of the flows of goods, such as would highlight abnormal commercial practices of the type mentioned above, and they leave the field wide open to all the practices that do not come within their scope. As this conventional approach by the customs authorities is not generally combined with systematic *ex post facto* accounting checks at the level of the paying agencies, it is clear that there is no compensatory control during the management stage.

The risk of false declarations

2.23. In the second system (type B) it is clear that when the exporter collects, records and subsequently declares the physical data (quantity, quality, value, dates, etc.) to be used as a basis for calculating the refunds he may give false information in order to obtain higher refunds (cf. Annex III).

2.24. Of course, the accuracy of most of the data supplied may be corroborated by an examination of the company's accounts and commercial documents (e.g. accounts stipulated by the legislation governing exports, stock accounts, general accounts, contracts, invoices, etc.) which are subject to *ex post facto* checks.

2.25. Where the accounts have been completely falsified (with false invoices, etc.), however, or where there are not enough *ex post facto* checks, such frauds are either undetectable or are uncovered too late. And direct inspections, if carried out only randomly, do not compensate satisfactorily for the inadequacy of the checks. All that they can do is ensure that the physical data relating to exports inspected in this way have not been falsified.

2.26. In the final analysis, this procedure does not provide an overview of the real flow of goods: the declared flow may be different. On the other hand, two authorities are involved, operating one after the other and independently of each other, and the advantage of the checks that they carry out is that they are comprehensive and cover all the exports of a given undertaking for a given period.

The risk of complete absence of compensatory controls

2.27. All of the systems studied contain other control mechanisms, such as special surveys where there are grounds for suspecting fraud and the controls laid down under Directive 77/435⁽¹⁾, which may curb the two types of risk which have been discussed in the preceding paragraphs.

2.28. Where fraud is suspected checks are usually carried out at a later stage, on the premises of the undertakings. They may be implemented by the customs authorities or the paying agencies. But the fact that they are the exception, rather than the rule, limits their effectiveness as far as safeguarding the whole system is concerned.

2.29. The value of the checks which are made subsequent to the management stage and are implemented in accordance with the directive varies considerably, according to the system in which they are incorporated:

- (a) They are likely to improve the first system (type A). In fact, even if, under the terms of the directive, the Member States are only required to effect a limited

⁽¹⁾ Cf. paragraph 2.9 above.

number of checks, the checks they carry out are by their nature accounting checks and thus complement those related to management. They allow the observer to distance himself from events and provide the kind of overall view of the flow of goods which is not possible in the case of direct inspection.

(b) On the other hand, these checks may appear less effective when included in the second system (type B), since the latter is already, and almost solely, based on the same type of accounting checks. All the directive does is add another layer of controls similar to those included in the management, whereas the weaknesses of the two systems lie in the absence of any direct inspection of physical exports ⁽¹⁾.

IDENTIFICATION OF AN OPTIMUM SYSTEM

2.30. In order to reduce the total number of risks noted above, it looks as if the form of organisation which, in principle, would offer the best guarantees, without, however, involving excessively burdensome economic constraints or administrative costs compared with the expected benefits for Community finances, would be one which combined elements of the two systems in the following way:

- (a) direct inspection of the movement of goods by the customs departments;
- (b) administrative management of refunds by the paying agency on the basis of:

⁽¹⁾ Cf. Special Report of the Court of Auditors on the implementation of Directive 77/435/EEC of 27 June 1977 on scrutiny by the Member States of transactions forming part of the system of financing by the EAGGF (Guarantee Section), OJ C 336, 17. 12. 1984.

(i) the supporting documents supplied by the customs authorities;

(ii) the results of a proper *ex post facto* audit of the exporters' accounts;

(c) *ex post facto* checks on the basis of sampling outside the scope of normal management, as part of the implementation of Directive 77/435.

2.31. Such a system, bearing in mind the financial stakes, ought not be beyond the resources of the exporting countries, especially if it mainly involves reorganisation of the methods of inspection implemented by the existing inspection authorities. Moreover, an organisation of this type has been in operation for some time now in the FR of Germany.

THE NEED FOR A COMMUNITY REACTION

2.32. It may be noted, however, that with this significant exception, no such organisation is implemented exactly in the way described above in any of the Community's main exporting countries. The room for manoeuvre which the Member States have been given thus appears to have allowed the continuing use of mechanisms which involve risks for the Community's finances, and one may wonder at the fact that the Community authorities have not so far taken any steps (such as a proposal for a regulation or a directive, or even the organisation of information seminars) to set up, in the long term, a monitoring mechanism which will eliminate the main risks in the field of exports, namely, 'roundabouts' and fictitious export transactions.

CHAPTER III

THE ADDITIONAL RISKS CONNECTED WITH CERTAIN PRACTICAL ASPECTS OF THE INSPECTION OF EXPORTS

3.1. In addition to the risks relating to physical data and to actual movements of goods, as well as those relating to compensatory controls, which have just been described in connection with the design and organisation of export supervision systems, there may be other kinds of risk connected with certain practical aspects of the controls which lead to the payment of the refunds.

THE RISKS OF REFUNDS AND DOMESTIC SUBSIDIES BEING COMBINED

The risk of aids being combined

3.2. One of the risks run by the Community finances is that of disbursing, in respect of one and the same product, a

form of aid laid down for cases where the product's final use is on the territory of the Community, as well as a refund, in the event that the product should be exported. This has been the case, for example, for:

(a) butter for which a permanent subsidy for direct consumption is paid pursuant to Council Regulation (EEC) No 1269/79 of 25 June 1979 ⁽¹⁾;

(b) and for skimmed-milk powder which has been denatured for use as animal feed (feed for calves: Commission Regulation (EEC) No 1725/79 ⁽²⁾); feed

⁽¹⁾ OJ L 161, 29. 6. 1979, p. 8.

⁽²⁾ OJ L 199, 7. 8. 1979, p. 1.

for pigs and poultry: Commission Regulation (EEC) Nos 1844/77 ⁽¹⁾, 368/77 ⁽²⁾ and 443/77 ⁽³⁾).

Responses to the risk of aids being combined

3.3. In order to forestall this risk, it is laid down, in principle, that, in the event of export, products shall not be eligible for refunds unless the aid which has already been received is repaid prior to export.

3.4. The measures designed to prevent such combinations of aid may vary considerably, as may the actual situations encountered in the field.

Direct recourse to the Member States

3.5. In certain cases (for example, the consumer subsidy for butter), the Commission has left it to the Member States to take 'appropriate measures'. It has thus been found that in two Member States:

- (a) the departments managing the two types of expenditure – subsidies and refunds – are independent of each other;
- (b) the consumer subsidy is paid at the production stage, prior to the marketing of the goods, without there being any system (for example, provision of a security) to ensure that the product is used for the purpose intended;
- (c) no check is made when butter is being exported to ascertain that the product has not already received a consumer subsidy;
- (d) the *ex post facto* checks made on the recipients of the consumer subsidy concentrate mainly on whether the subsidy is being applied in a regular manner and only incidentally on whether the butter is being exported and a refund obtained in addition to the subsidy;
- (e) in one of the two Member States, the responsibility for recording and declaring exports of butter that has already been subsidised lies with the firms receiving the subsidy;
- (f) when cases of combination of aids have been discovered, no follow-up legal action has ever been taken;
- (g) in one Member State, attempts have been made to match up the data on refunds paid with those on subsidies paid, but these did not result in any systematic controls on the refunds disbursed, even when the cross-checks cast doubt on whether the rules prohibiting the combination of aids were being observed;

- (h) in the case of butter supplied for the victualling of ships, one Member State neglected for a certain period of time to take action to recover the consumer subsidy.

Recourse to the regulations

3.6. In other cases (denaturing of milk), the Commission introduces technical devices into the regulations designed to prevent the combination of aids:

- (a) for example, skimmed-milk powder denatured for use as feed for pigs and poultry is specifically excluded from the tariff nomenclature that is used for refunds relating to skimmed-milk powder during periods when the regulations authorising the denaturing are being applied. Denatured milk exported during these periods is not therefore eligible for refunds;
- (b) skimmed-milk powder denatured for use as feed for calves, however, is not excluded from the tariff heading relating to skimmed-milk powder. It is eligible for the refund. Nevertheless, Commission Regulation (EEC) No 532/75 of 28 February 1975 ⁽⁴⁾ makes the completion of customs formalities subject to the production of a certificate, issued by the competent agency, stating either that the aid has been recovered or that no such repayment is due in respect of the product in question.

3.7. Applying these different measures, one of which is applied differently at different times, requires a very detailed knowledge of these specific regulations, which the customs authorities inevitably have trouble implementing.

Limited value of the solutions adopted

3.8. The checks to ensure that domestic subsidies and refunds are not combined leave something to be desired.

- (a) Where this task is left entirely up to the Member States, the latter appear to be negligent. Even when they do attempt to organise checks, the result proves to be inadequate. For example, when they cross-check data, they do so by comparing the financial data on refunds on the one hand with those on domestic subsidies on the other; the only way of detecting an irregularity, however, would be to cross-check the data which identify the subsidised goods and the exported goods, so as to ascertain that they are not the same ones.

⁽¹⁾ OJ L 205, 11. 8. 1977, p. 11.

⁽²⁾ OJ L 52, 24. 2. 1977, p. 19.

⁽³⁾ OJ L 58, 3. 3. 1977, p. 16.

⁽⁴⁾ OJ L 56, 3. 3. 1975, p. 20.

(b) Where the checks result directly from the Community regulations, the measures adopted are imperfect and complex:

- (i) either they contain loopholes (as in the case of the ban introduced by means of a temporary, restrictive tariff definition, which, when abolished, makes it possible to pay a refund on the export of products that have already been granted domestic aid and have remained on the market);
- (ii) or else it is difficult to check up on them because they are contained in disparate texts which may not always attract the attention of the customs authorities, especially those at the Community's external frontiers.

PRACTICE REGARDING PHYSICAL CHECKS

Limitation of the risk relating to physical data

3.9. One of the methods of reducing the likelihood of the risk relating to physical data mentioned above is to check the nature (tariff heading) and weight of the goods which are being exported by physically inspecting them.

Scope of the different types of physical check

3.10. Less and less use is being made of this method. Traditionally it involved visually identifying the goods, weighing and/or counting them, by whole batches or by samples, and, sometimes, making chemical analyses.

3.11. The rates of physical checks vary according to the Member States:

- (a) The checking standards stipulate rates of 4 %, 10 %, etc.
- (b) In practice, rates of 0,8 %, 1 % or 2 % were noted.
- (c) The chemical analyses are performed on between one per mil and three per mil of the goods inspected.

3.12. In some Member States, goods are physically identified solely by chemical analyses, carried out not on the exported batches but during the production stages. This method offers no assurances as to the exact composition of the products exported. Moreover, there are no precise criteria for selecting the products to be inspected (value of the products, amount of refunds at stake, risk of fraud, etc.), thus further reducing the effectiveness of the physical checks.

Technical aspects of the chemical analyses

3.13. The factors that determine the nature and composition of a product and on which the level of refund payable often depends (for example, for milk products, the fat content or the dried milk content), are in principle isolated and quantified by means of the chemical analyses.

Determining the contents

3.14. The regulations fixing the refunds refer to products whose fat content, for example, is sometimes defined to within 0,1 %. The chemical analyses are carried out allowing for margins of error that roughly correspond to the same percentage. It is thus difficult, once the chemical analyses have been completed, to define the exact tariff classification of a product whose composition is close to the threshold laid down by the regulations. The financial impact may, however, be considerable.

Determining the nature of the products

3.15. Some laboratories said that it could sometimes prove difficult, especially in the case of oils and fats, to distinguish whether substances are original or added, and whether they are of animal or vegetable origin.

3.16. The financial risk regarding the amount of the refunds is a real one. For example, butter enriched with vegetable or animal fat in order to justify a higher rate of refund, could, after analysis, be classified in the desired tariff heading and receive an overvalued refund.

3.17. Moreover, tariff heading 23.07 B and its subdivisions, which are devoted to sweetened forage and other preparations of a kind used in animal feeding and containing milk products, give entitlement to refunds that vary according to the milk-powder content. A footnote to the scale of refunds stipulates that the exporter must declare the product's content as regards milk powder and added lactose and whey; this latter substance is not eligible for the refund.

3.18. Chemical analysis, however, does not – or at least did not at a recent date – make it possible to distinguish between milk powder and added whey.

PRACTICE REGARDING PENALTIES

The system of penalties

3.19. The administrative or legal sanctions imposed on traders who do not abide by the rules on refunds, or who submit false declarations, have been found to vary from one

Member State to another, depending on whether the fraud constitutes the main purpose of the operation carried out or is incidental to it (increase in the refunds normally payable):

- (a) In the first case (detected fairly infrequently), when the fraud involves large sums of money, legal action is taken, resulting in penalties that are usually severe;
- (b) In the second case, penalties are imposed provided it can be proved – and this is rare – that there was intent to commit fraud. The penalties are, by contrast, light and sometimes even non-existent where intent to commit fraud is not proved, even though the amounts that have been wrongly paid may be high. This approach constitutes an encouragement to commit fraud. For example, it was found that, where there existed a well-established pattern of trade, the habitual

declaration of an erroneous and more advantageous tariff heading, which had been detected as a result of a chemical analysis, had given rise merely to a warning in respect of the future; no steps were taken to investigate or rectify past events.

The risk of non-deterrence

3.20. The risk remains in both cases that this system, which is supposed to be repressive, may involve some degree of encouragement to 'bend' the rules, to the detriment of Community finances. The only true deterrent would be to bring into general use a system of rules whereby traders give their word of honour in respect of the data they declare, at the risk of incurring quite heavy legal penalties.

CHAPTER IV

CONCLUSION

4.1. This survey by the Court of supervision within the Member States of exports of agricultural products which benefit from Community finance through the granting of refunds has established the following two facts:

- (a) The margin of manoeuvre left to the Member States by the virtual absence of Community regulations on specific procedures for the supervision of agricultural exports has enabled the Member States to amend, and thus retain, their own checking procedures and systems, which have traditionally been applicable to movements of goods in general.
- (b) In practice, these systems operate in different ways, according to whether they are based on traditions which give priority to one of the following aspects:
 - (i) physical and administrative inspections;
 - (ii) scrutiny of the exporting firms' accounts.

4.2. The Court notes that:

- (a) The former types of inspection system have a weak point, in so far as they are liable not to detect possible 'roundabout'-type frauds – i.e. the exportation of a product on which a refund has been paid followed by re-importation without the imposition of a levy, and even the re-exportation of the same product.
- (b) There is a risk that the latter type of inspection system may not detect the existence of fictitious commercial transactions not corresponding to any actual movement of goods.

4.3. The Court considers that, as the value of the type of compensatory controls provided for in Directive 77/435 is still limited, an optimum monitoring system ought to adopt a combination of the positive aspects of the inspection methods used in each of the systems studied.

4.4. Furthermore, the way in which certain control procedures for refunds are dealt with in practice leads to additional risks for Community finances with regard to refunds:

- (a) The confidence placed in the Member States, or in certain regulations, to ensure that agricultural products do not receive both domestic aid and refunds is not such as to eliminate completely the risk that these benefits may be combined.
- (b) Increasingly less frequent recourse to physical identification, along with regulations which do not take sufficient account of the technical limits inherent in the chemical analyses that are carried out intensify the risks concerning the physical data on which the payment of refunds is based.
- (c) In the absence of clear and deterrent rules regarding the penalties for proven irregularities, the existing control systems do not appear to be capable of guaranteeing full protection for Community funds.

4.5. Under these circumstances, the inescapable conclusion is that the overall system implemented in the Member States for inspecting agricultural exports suffers from a series of shortcomings such that it is reasonable to

conclude that connected with export transactions is generally effected in an acceptable manner from the point of view of the interests of Community finances.

4.6. . All that can be done is to ask the Community authorities to decide by what means the series of risks identified in this report might be reduced in future through the implementation of appropriate measures either at Community level or at national level. In any case, the national authorities, which, in pursuance of Community law, are directly responsible for checking 'that transactions financed by the Fund are actually carried out and are executed correctly', should be asked without delay to look at ways of strengthening, in the immediate future, their

procedures for checking expenditure on refunds, if only to protect themselves from any financial consequences of the clearance of the accounts.

These observations were adopted by the Court of Auditors at its meeting of 26 June 1985.

Done at Luxembourg, 5 July 1985.

For the Court of Auditors
Marcel MART
President

ANNEXES

The following pages set out some typical cases of irregular practices observed in connection with the export of agricultural products in order to give a real-life illustration of the situations mentioned in this report, particularly in paragraph 2.21.

For the purpose of protecting confidentiality, the typical cases quoted correspond to transpositions of actual practices and situations which have occurred over the past financial years, and have in many cases been simplified. In real life, the irregular practices which traders indulge in are generally more complex.

ANNEX I

Description of a typical fraudulent 'roundabout' operation (cf. paragraph 2.21).

Description

A trader exports a cargo of goods in order to qualify for the refund and then reimports it fraudulently by smuggling it back in (via a road without a check-point, by concealing the goods or by making a false declaration of the tariff heading). He may then take one of the following steps:

- either sell the goods on the domestic market, thus benefiting both from the Community price, which is higher than the export market price, and from the export refund;
- or repeat the export transaction, thus qualifying for a second export refund payment.

Effectiveness of the various types of inspection

(a) An inspection carried out at the place of exportation to check the specifications of the goods (weight, quality, tariff heading) and the carrier's documents provides guarantees regarding these specifications and documents but does not enable the movement of goods to be followed after they cross the frontier. Furthermore, even if the product is re-exported via the same frontier crossing-point, the physical and administrative inspections are carried out all over again, as if an additional amount of the product is being exported.

(b) On the other hand, an *ex post facto* scrutiny of the firm's books provides material for an analysis of the commercial specifications of the transaction. These inspections, which involve the examination of invoices (suppliers, customers) or other commercial documents, reveal either that:

- the firm has never had a customer outside the Community;

or that

- the firm has never had in its possession (through purchase or production) all the quantities allegedly exported.

ANNEX II

Description of a typical 'roundabout' abuse (cf. paragraph 2.21).

Description

A trader imports a product which contains $n - 1$ % of oils and fats and for which the rate of levy is low as the product contains less than n % of oils and fats. He pays the levy at the low rate. Once the product has been imported, he adds 1 % of oils and fats to it. He then re-exports the product and claims the refund, which is more or less equivalent to the levy rate for products containing more than n % of oils and fats (a high refund rate). The

trader has not committed any fraud, but, by adding a very small quantity of oils and fats, he has caused the subsidised product to move into a higher refund bracket and has profited from the considerable difference between the low levy rate and the high refund rate.

The transaction may be repeated with the same goods by adding a small percentage of dry ingredients prior to reimportation, thus reducing the proportion of oils and fats once again.

Effectiveness of the various types of inspection

(a) An inspection carried out at the place of exportation to check the specifications of the goods (weight, quality, tariff heading) and the carrier's documents provides guarantees regarding these specifications and documents but does not enable the details relating to the previous history of the goods to be traced.

(b) An *ex post facto* inspection of the firm's books makes it possible to analyse the process of manufacture of the goods and to record their commercial past (purchase abroad of commercially similar products to those which are exported, purchase and incorporation into the imported products of small quantities of oils and fats. This procedure highlights a commercial activity, which amounts to an abuse of the system, even if nothing unlawful is involved.

Value of the results of the inspection

The inspection does not establish any irregularity, but it does highlight undesirable consequences of the regulatory system and may enable the Commission to amend the regulations, particularly by adjusting the rates of refund or levy.

ANNEX III

Description of a typical false declaration.

Description

An exporter exports goods, for which he makes a false declaration of weight, tariff heading or quality (for example, stating that the goods are of top quality when they are in fact waste) in order to qualify for a higher amount or rate of refund.

Effectiveness of the various types of inspection

(a) Inspections carried out at the places of exportation to check the specifications of the goods normally bring to light false declarations of weight. They also reveal false declarations of tariff headings or quality when the goods are frequently sampled and visually inspected.

(b) An audit of the firm's account would in principle achieve the same results, except in cases where the transactions checked were the subject of fictitious bookkeeping entries or if the false declarations were only marginal. In the latter case, it is in fact hard to detect by this type of inspection small differences in unit weight and small differences in the margin between two closely related tariff headings corresponding to refund levels which sometimes differ quite considerably.

THE COMMISSION'S REPLIES

The Commission has taken note, with interest, of the special report by the Court of Auditors examining in detail the way in which export transactions eligible for payment of refunds chargeable to the EAGGF Guarantee Section are organized and inspected in practice.

As the Court itself notes, Article 8 (1) of Regulation (EEC) No 729/70 leaves it to the Member States to take the necessary measures to monitor such transactions, in accordance with their laws, regulations and administrative provisions, and it is for the Commission to assume a coordinating and supervisory role.

In monitoring exports of agricultural products, the Commission has laid emphasis until now upon specifying the characteristics of the products and any other conditions determining eligibility for a refund, while the Member States determined and established the necessary administrative procedures and structures.

The Commission agrees with certain reservations expressed by the Court as to the effectiveness of the present monitoring system. To increase the effectiveness, it has instructed its staff to explore the possibility of adopting Community provisions specifying how the two main types of supervision described by the Court should be organized and implemented. This should ensure that the work of the various national departments involved in the monitoring of exports and payments of refunds is mutually complementary and hence more effective.

Some of the Court's conclusions were anticipated by the Commission and although it has not yet proposed any amendments to the legislation, it has not been inactive, as far as an improvement in the application of the existing regulations framework is concerned.

Several seminars on monitoring of EAGGF Guarantee expenditure have been organised, and inspection visits to Member States in connection with the clearance of accounts have provided opportunities for talks with the national authorities about actual or potential problems.

Since July 1983, refunds have been subject to the systems audit that should allow a progressive improvement of the present situation, specially in the application of the regulations by the Member States.

With regard to irregularities, the EAGGF Irregularities Group regularly reviews cases of fraud. The Commission examines with the national experts cases which have financial repercussions or which give evidence of a new fraudulent practice; discussions also cover common methods of legal action and prevention. A report on cases of irregularities including about 60 typical cases has been drafted by the concerned Commission's services and sent in a suitable way to the Member States in order to help national departments in their work.

Furthermore, the progress of mutual assistance between Member States in the framework of Council Regulation EEC No 1468 of May 1981 on mutual assistance between the administrative authorities of the Member States and cooperation between the latter and the Commission to ensure the correct application of the laws on customs and agricultural matters, as much as the work in the Committee on Recovery of Claims facilitated or allowed the statement of irregularities in connection with refunds and in the same way the recovery of amounts owed also in the cases where the debtor resides in another Member State than the Member State where the sums are due.

NB: points 3.6 and 3.7

Danger of combinations of aids for the use of products on Community territory with refunds:

The problem mentioned in the draft report at point 3.6 (b) has recently been solved: Regulation (EEC) No 532/75 was repealed on 4 March 1985.

From now on, aid paid in respect of denatured skimmed-milk powder and compound feed for animals is no longer subject to recovery where these products are exported to non-member countries. As a counterpart, the Commission has discontinued the refund which was practically the same in amount as the aid. The solution also simplifies the administrative formalities to be carried out at the time of export, as an aid recovery certificate is no longer required (Regulation (EEC) No 462/85).

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