

Official Journal

of the European Communities

ISSN 0378-6986

C 274

Volume 31

24 October 1988

English edition

Information and Notices

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I

(Information)

COURT OF AUDITORS

SPECIAL REPORT No 5/88

on

management and control of public storage together with the Commission's replies
(88/C 274/01)

(Observations pursuant to Article 206a (4) of the EEC Treaty)

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1. INTRODUCTION

1.1. Intervention storage of agricultural produce, as a policy instrument under the Common Agricultural Policy (CAP), has received a great deal of attention in recent years in political circles, in the press and in public opinion. The principal reason for this wide interest is no doubt the spectacular rise, over the last five years, in the volume of intervention activity and in the resulting expenditure. Another reason is probably the physical aspect of the activity which, with its impressive dimensions, readily fires the imagination and inspires descriptions of the phenomena in scenic terms like lakes and mountains. Intervention stocks are a very explicit illustration of the difficulties experienced in controlling the relationship between demand and supply in agricultural Europe.

1.2. Intervention storage is one of the key-stones of the price guarantee system under the CAP. The objective of the instrument is, in principle, to stabilize the market price near a certain level by regulating quantities, i.e. by taking produce out of the market at times when, as a result of seasonal, climatic or commercial factors, supply is high in relation to demand and prices consequently fall, and by putting it back on the market when market conditions allow. Thus, a climate of economic security is created for producers and a contribution is made to several objectives of the CAP, notably the stability of markets, the availability of supplies, a fair income for persons engaged in agriculture and the development of agricultural productivity.

1.3. Most of the Common Market Organizations under the CAP provide for storage measures. Broadly speaking,

two basic forms of intervention storage can be distinguished. On the one hand, there is public storage: the produce is bought by the intervention agencies, ownership is acquired with all the economic consequences that that implies for the total cost, which is borne by the Community budget. On the other hand, there are private storage measures, based on the conclusion of contracts with owners of produce, by which they undertake to keep their produce stored during a certain period against reimbursement for technical and financial costs of storage.

1.4. For certain products (e.g. butter, beefmeat), public and private storage can be open to the potential users at the same time, so that they have a choice, to be decided in the light of their assessment of the economic risk on later disposal. On other occasions, only one of the two types of measures is legally open or economically relevant. Mixed forms do exist in certain markets, whereby private storage contracts are concluded, but market conditions at the end of the storage period can entail Community financing of losses on sales.

1.5. The present report is about public storage. *Tables 1-3* show how budgetary expenditure on public storage developed over the last eight years and *Table 4* gives the book values of public stocks as at the end of those years. The figures clearly demonstrate that at the beginning of the period the situation was relatively stable: the book value of the stocks was of the order of 2 000 Mio ECU and the annual expenditure charged to the budget just over 1 000 Mio ECU. Then, during 1982, the amount invested in public intervention stocks started to increase significantly. By the end of 1982 the book value had doubled and by the end of 1986, i.e. within a period of five years, it had more than quintupled. Expenditure charged to the budget doubled in 1983 and by 1986 had reached a level almost five times what it was in the years before 1983. Over the same

period, 1982-1986, private storage expenditure remained practically stable at a level of just over 800 Mio ECU, to which level it had gradually developed since 1979, when it was 400 Mio ECU. In the overall context of EAGGF-Guarantee expenditure, the relative part taken by intervention storage rose from 15 to 25 %, the increase being wholly attributable to public storage. It should be noted that both the expenditure figures and the book values are strongly affected by the Commission's accounting policy in the matter, notably by an insufficient and inconsistent depreciation.

1.6. The operational costs of public storage (legally incurred and declared to EAGGF) are borne by the Community budget. This expenditure is of three main sorts: technical costs, financial costs and other costs, essentially losses on sales. In the Community's annual revenue and expenditure account this expenditure is broken down by these three categories and also by product or market. The reimbursement to Member States of their expenditure on technical and financial costs is effected on a flat rate basis. A more detailed description of the national and Community financing arrangements for public storage will be found at Annex I.

1.7. *Tables 1 and 4* make clear that more than 95 % of the financial volume of public storage transactions lies within three market areas: milk products, beefmeat and cereals.

The milk product stocks made an explosive growth in the period 1982-1984 and their book value by the end of 1986 was exactly ten times the book value at the end of 1980. Since 1983, milk products have represented about half of the total value of the Community's public intervention stocks. On the expenditure side, milk products are competing with beefmeat which has shown a strong growth since 1983. Cereals stocks, and related expenditure, made two big leaps, in 1982/83 and in 1985/86, respectively.

1.8. The report concentrates on the above three market areas and the six Member States concerned, viz. FR of Germany, France, Ireland, Italy, Netherlands, United Kingdom.

1.9. The responsibility for the practical implementation of intervention storage is shared between the Commission and the Member States. The Commission carries out functions of a typically central nature, notably matters concerning market management and central budgeting, financing, accounting and control. The Member States are entrusted with the daily execution of the administrative tasks related to the intervention transactions as they occur on the local level. Under the basic regulation on the financing of the CAP, the national governments have designated national bodies or services as the official intervention agencies, charged with the technical, administrative and financial aspects of transactions with sellers,

Table 1 — Absolute and relative evolution of budgetary expenditure on public storage

	1979	1980	1981	1982	1983 (1)	1984	1985	1986	1987 (1)
Total expenditure FEOGA - Guarantee	10 441	11 315	11 141	12 406	15 920	18 372	19 707	22 079	23 176
Of which storage (%)	1 654 (16)	1 617 (14)	1 631 (15)	1 818 (15)	2 893 (18)	3 540 (19)	4 428 (22)	5 555 (25)	3 684 (16)
Of which public storage (%)	1 260 (76)	1 133 (70)	1 052 (65)	1 031 (57)	2 007 (69)	2 710 (77)	3 542 (80)	4 747 (85)	2 934 (80)
Of which									
— milk products (%)	758 (60)	407 (36)	215 (20)	238 (23)	875 (44)	1 498 (55)	1 807 (51)	1 360 (29)	919 (31)
— beefmeat (%)	378 (30)	465 (41)	380 (36)	327 (32)	618 (31)	800 (30)	934 (27)	1 928 (41)	984 (34)
— cereals (%)	89 (7)	202 (18)	342 (33)	380 (37)	477 (24)	314 (12)	752 (21)	1 342 (28)	934 (32)
— olive oil and oilseeds (%)	23 (2)	30 (3)	46 (4)	56 (5)	9 (0)	69 (2)	5 (0)	49 (1)	61 (2)
— tobacco (%)	12 (1)	29 (2)	69 (7)	30 (3)	28 (1)	28 (1)	12 (0)	16 (0)	27 (1)
— other products (%)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	1 (0)	32 (1)	52 (1)	9 (0)

Source: 9th - 16th Financial Reports on EAGGF, Commission.

(1) In comparing the expenditure figures of the different years, it should be borne in mind that, as a result of changes in the reference periods, the expenditure figures for public storage in 1983 represents 11 months' expenditure and the figures for 1987 represent 10 months' expenditure.

Table 2 — Break-down of public storage expenditure by type of expenditure

	(Mio ECU)								
	1979	1980	1981	1982	1983	1984	1985	1986	1987
Total public storage expenditure	1 260	1 133	1 052	1 031	2 007	2 710	3 542	4 747	2 934
Technical cost	184	235	238	262	436	542	733	701	508
(%)	(15)	(21)	(23)	(25)	(22)	(20)	(21)	(15)	(17)
Financial cost	186	180	190	205	420	515	615	658	537
(%)	(15)	(16)	(18)	(20)	(21)	(19)	(17)	(14)	(18)
Other costs	890	718 ⁽¹⁾	624 ⁽²⁾	564	1 151	1 654	2 194 ⁽³⁾	3 388 ⁽⁴⁾	1 889
(%)	(70)	(63)	(59)	(55)	(57)	(61)	(62)	(71)	(65)

⁽¹⁾ Of which 66 Mio depreciation.

⁽²⁾ Of which 105 Mio depreciation.

⁽³⁾ Of which 439 Mio depreciation.

⁽⁴⁾ Of which 468 Mio depreciation.

Table 3 — Public storage expenditure broken down by Member State (*)

	(Mio ECU)								
	1979	1980	1981	1982	1983	1984	1985	1986	1987
Total EEC ⁽¹⁾	1 255	1 133	1 052	1 031	2 077	2 672	3 543	4 705	2 934
Belgium	44	7	4	3	24	38	42	37	31
(%)	(4)	(1)	(0)	(0)	(1)	(1)	(1)	(1)	(1)
Denmark	48	21	20	34	94	92	130	213	100
(%)	(4)	(2)	(2)	(3)	(4)	(3)	(4)	(4)	(3)
FR of Germany	769	600	370	331	955	1 038	1 275	1 600	1 000
(%)	(61)	(53)	(35)	(32)	(46)	(39)	(36)	(34)	(34)
Greece			26	112	5	12	11	12	16
(%)			(3)	(11)	(0)	(0)	(0)	(0)	(1)
Spain								53	64
(%)								(1)	(2)
France	88	209	301	181	471	415	698	1 097	578
(%)	(7)	(19)	(29)	(18)	(23)	(16)	(20)	(23)	(20)
Ireland	106	107	48	76	83	191	307	413	237
(%)	(8)	(9)	(5)	(7)	(4)	(7)	(8)	(9)	(8)
Italy	98	50	161	150	185	293	313	262	229
(%)	(8)	(4)	(15)	(15)	(9)	(11)	(9)	(6)	(8)
Luxembourg	6	2	1	0	0	1	1	0	0
(%)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)
Netherlands	36	58	22	27	78	192	338	319	203
(%)	(3)	(5)	(2)	(3)	(4)	(7)	(9)	(7)	(7)
Portugal								3	9
(%)								(0)	(0)
United Kingdom	60	79	99	117	182	424	450	696	467
(%)	(5)	(7)	(9)	(11)	(9)	(16)	(13)	(15)	(16)

(*) Source: Financial Reports concerning the EAGGF, Commission.

⁽¹⁾ The differences between the totals in this table and the amounts of public storage expenditure presented in tables 1 and 2 are a result of certain combinations of expenditure in the presentation of the detailed budget accounts.

Table 4 — Absolute and relative evolution of the book-value of public stocks at the end of the financial year

	(Mio ECU)								
	1979 ⁽¹⁾	1980 ⁽¹⁾	1981 ⁽¹⁾	1982 ⁽¹⁾	1983 ⁽²⁾	1984 ⁽²⁾	1985 ⁽²⁾	1986 ⁽²⁾	1987 ⁽³⁾
Total book-value of year-end stocks	2 142	2 583	1 874	4 010	7 034	8 751	10 580	11 360	10 575
of which									
— milk products	954	585	381	1 321	3 932	4 779	4 282	5 847	4 904
(%)	(44)	(23)	(20)	(33)	(56)	(55)	(41)	(51)	(46)
— beefmeat	595	682	449	504	1 042	1 732	2 270	1 996	2 117
(%)	(28)	(26)	(24)	(13)	(15)	(20)	(21)	(18)	(20)
— cereals	471	1 135	770	1 840	1 854	1 902	3 821	2 977	2 937
(%)	(23)	(44)	(41)	(46)	(26)	(22)	(36)	(26)	(28)
— olive oil and oilseeds	66	119	227	302	175	299	116	436	491
(%)	(3)	(5)	(12)	(7)	(3)	(3)	(1)	(4)	(5)
— tobacco	56	62	47	43	31	13	15	30	24
(%)	(2)	(2)	(3)	(1)	(0)	(0)	(0)	(0)	(0)
— other products	0	0	0	0	0	26	76	74	102
(%)	(0)	(0)	(0)	(0)	(0)	(0)	(1)	(1)	(1)

Source: 9th — 16th Financial Reports on EAGGF, Commission.

⁽¹⁾ As at 31.12.

⁽²⁾ As at 30.11.

⁽³⁾ As at 30.9.

buyers and storekeepers. Annex II explains in more detail the administrative and technical responsibilities of the national intervention agencies and of the Commission with regard to purchases, storage and sales.

1.10. The fact that daily management is done by the Member States means that the administrative organization is set up within each Member State according to national rules, structures and traditions of both the national public sector and the agro-commercial sector. This introduces a significant element of heterogeneity in the practical arrangements, from a central point of view, and entails the necessity of a considerable effort on the part of the Community services, to ascertain and supervise the various systems. In order to make that possible, Member States are obliged to inform the Commission about their administrative arrangements and about their control measures ⁽¹⁾.

1.11. The figures for Community expenditure in respect of public storage, presented in the Community's annual revenue and expenditure account, are built up from the annual accounts of public storage expenditure presented by each Member State for each product on which public storage has taken place in its territory during the year. These annual accounts each conclude a series of monthly accounts, presented in the context of the monthly Community funding arrangements, and, like these, are drawn from the intervention agencies' accounting systems. These in their turn reproduce and summarize the primary recordings relative to the individual storage transactions made on a local level. The accounting methods and

arrangements are explained in detail in Annex III. For the most recent financial years, the number of annual accounts presented to EAGGF was of the order of 70 to 80 per year.

1.12. Public storage is essentially a standard operation. Goods are bought, stored and sold. Costs are incurred on capital, on fixed assets and on handling. The cycle is concluded at the moment of sale, with the main difference from a normal commercial activity being that the most frequent result is a loss. In the light of the characteristics indicated above, the systems run to implement the public storage scheme will have to satisfy at least the following requirements:

- (a) systems of management and of accounting must be adequate to deal with this type of activity (commodity trade);
- (b) the system in total must be sufficiently flexible to cope with significantly and rapidly changing volumes of activity;
- (c) central management must express its requirements in simple and straightforward language, in order to ensure conformity of transactions with the relevant market legislation in a uniform manner throughout the Community;

⁽¹⁾ The footnotes appear together at the end of the report.

- (d) central accounting rules must be sufficiently simple and straightforward to ensure that the national accounting networks generate accounting reports which reflect adequately the physical reality including its value aspects in a uniform manner between countries and markets;
- (e) all systems must be sufficiently documented to allow easy ascertainment;
- (f) all systems elements must be readily accessible for audit review and verification.

1.13. The audit of the regularity and the accounting aspects of the implementation of the public storage scheme and of the resulting expenditure comes down to the execution of a full audit exercise on each of the 70 to 80 annual accounts presented in connection with this activity. This audit responsibility is shared between the audit services of the Commission and of the Member States and since the national audit arrangements, i.e. the external and the internal audit of the intervention agencies, vary between Member States, the overall control structure, seen from a Community point of view, is a very complex one. Apart from the usual systems assessment and verifications of transaction files and financial accounts, such audit will have to cover the material aspect which is characteristic of the subject and will consequently need to include verifications of the physical presence and the condition of the commodities in relation to their presentation in the accounts, in order to ensure:

- (a) that intervention quality criteria have been correctly applied to the commodities entered into stock;
- (b) that the produce, withdrawn from the market for market regulation purposes, is not brought back on to the market except by an officially decided sales transaction and/or that it is not replaced by commodities of the same or a lower quality;
- (c) that the intervention commodities have not undergone an abnormal quality deterioration due to bad storage conditions;
- (d) that the accounts at all levels of aggregation correctly reflect the real stock positions, in respect of both quantity and value;
- (e) that funds movements recorded in respect of purchase and sales transactions and physical incoming or outgoing stock movements mutually correspond.

1.14. In the past, the Court of Auditors has examined systems in respect of public storage, on the central

Commission level and on the central and local national level, in the market areas of milk products (1981/82 for the purpose of an internal study), olive oil (enquiry conducted in 1983, results included in a special report published in 1985 ⁽²⁾) and cereals (audit examinations completed early 1986, results included in the Court's annual report on financial year 1985, published in 1986 ⁽³⁾).

1.15. Furthermore, observations on the financial and accounting aspects of public storage expenditure as reported in the Commission's annual accounts, have been included in practically all of the Annual Reports published by the Court since its creation. These observations are to a large extent about the applied principles of accounting and financial reporting and their consequences for the soundness of financial management. One of the central themes has been depreciation policy.

1.16. The enquiry of which the present report is a result, is a logical continuation and extension of the work done in the past. In particular it includes and updates the results of a fundamental study into the central definitions of the accounting system producing the expenditure figures. The provisional outcome of this study was discussed with the competent Commission services at a previous stage (1985) and has in the meantime led to some adaptations of the system.

1.17. The enquiry has focused on the accounting and control arrangements operated by the Commission and the Member States to implement the public storage intervention schemes. The main issues considered are whether:

- (a) appropriate controls are foreseen and in operation to ensure the legality and regularity of all Community expenditure in relation to intervention;
- (b) intervention transactions are accurately recorded by Member States' accounting systems, properly reflected in the monthly and annual accounts presented by them to the Commission and calculated on a basis compatible with principles of sound financial management;
- (c) appropriate independent controls are provided for and effectively performed on the intervention operations.

1.18. In addition, the report brings to attention significant weaknesses of a general nature which are inherent in the system and impair Community control of financial management and market management. It also develops proposals with a view to remedying these shortcomings.

1.19. The cooperation received from Member States and Commission services in carrying out this enquiry was excellent and certainly represents a positive contribution to the comparative element in this enquiry. Only one regrettable exception to this constructive reception by Member States must be reported: one Member State (D) refused access to documentation concerning the scope and methodology of audit work done. In the post-audit exchange of correspondence the German authorities indicated their willingness to revise this attitude in the future.

1.20. Chapters 2 to 5 present the key observations of the enquiry. Chapter 6 sets out the conclusions arising and develops proposals with a view to remedying the shortcomings brought to light.

2. PHYSICAL CONTROL ASPECTS

The central philosophy

2.1. The Community regulations governing intervention storage contain very few rules on the physical control of intervention stocks. The reason for this is that the system is supposed to be self-controlling, from the Community point of view. The theory is that the Community's financial interest in the stocks is adequately safeguarded as to quantity and quality, by the fact that the prices at which transactions take place are determined by the opposed interests which exist at points of entry and release between storekeeper and seller and buyer respectively, and that the Member States are financially responsible to the EAGGF for any quantity or quality losses that exceed natural tolerances. There is also the (naive) argument that what has gone into intervention storage will eventually also have to come out.

2.2. This reasoning, however, does not adequately take into account the risks inherent in public storage operations. The main risks are:

- (a) that the quality of the product accepted into intervention storage may be overstated, and may even be sub-standard;
- (b) deterioration of the quality of the product as a result of inadequate care taken during storage;
- (c) substitution of the product accepted into intervention, which may be brought to the market, with a similar

product of a lower quality at some stage during storage;

- (d) manipulative discrepancies between ingoing and outgoing qualities can pass unnoticed, because even for an important deterioration of quality it is difficult to distinguish the effects of time and weather from other factors which lead to a deterioration of the product being stored.

2.3. In all of these cases the EAGGF may finance unjustified amounts of sales losses, as the difference between purchase and sales value is a charge to the Community budget. Moreover, when irregularity or negligence cannot be proved, it is the EAGGF that pays the extra loss. In the case of (c) the intervention operation is frustrated in its main objective of withdrawing produce from the market and the technical and financing costs paid are for products which are not being stored.

2.4. The risks outlined above are accentuated in any one or more of the following situations:

- (a) a combination or an association of interests on the intake side. The obvious case is an intervention centre run by a producers' cooperative, but it can also be a matter of local business structures and relationships that render the storekeeper more or less dependent and impair his objectivity;
- (b) a combination or an association of interests on the sales side. Strong commercial relationships, or even identity, can exist between the storekeeper organization and a buyer organization. The obvious case is when the storage company is part of a trading or an industrial enterprise. In one Member State (I), the Court's auditors found a case where a member of a storekeeper's staff, who was in charge of intervention stocks and as such responsible for authorizing and reporting stock entries and releases, also acted as a business agent for companies involved in the purchase of products from the same intervention stocks. This is a very concrete but not an exceptional case of the independence of the storekeeper's function being compromised (see also paragraph 4.4);
- (c) disposal measures involving the low grade end use of a product, in the processing industry, for example, or in the manufacture of animal feed, provide no incentive for the buyer to obtain the quality he would require were the product intended for direct human consumption;
- (d) food aid deliveries and the free food distribution scheme provide outlets for the direct human consumption;

tion of products. Recipients are not, of course, in a position to compare the quality of the product received with the theoretical quality shown in the records of the intervention agency, and they are, in practice, unlikely to complain;

- (e) intervention products are often offered for sale at a price that corresponds to their theoretical quality. Only when after a while it is discovered that they fail to find buyers, the question of their real quality may arise and it will be too late to identify the real cause of the discrepancy. The storekeepers may hardly be expected to signal the problem, because their objective business interest is to earn their storage fee on the products in stock.

Control over quantities

2.5. The value of any quantities lost over a tolerance limit is charged to the Member State (and is calculated at the highest intervention price of the year). It is therefore up to Member States to organize their own quantity control system, in which they usually apply the same principle to their storekeepers. The determination of the real quantity is dealt with in an aide-mémoire issued by the Commission as a guideline for the presentation by Member States of the clearance accounts. It specifies that a physical stock-taking of all intervention stocks is to be carried out on the last day of the year. This is clearly impractical. At the same time however, the aide-mémoire provides that, failing such an operation, stock statements delivered by the storekeepers themselves can be accepted instead. Whatever the administrative convenience of this procedure, it does not provide the necessary independent verification.

2.6. As to the Member States' arrangements for stock quantity control, full annual stock-takings by intervention agency staff are formally provided for in certain cases notably for butter in two Member States (IRL and UK) and butter and skimmed milk powder in one other (D). These stock-takings are either carried out as close as possible to the year-end date (IRL) or are spread over the year (D, UK). While these cases represent positive exceptions in relation to standard practice followed by other Member States, it may be asked why these Member States limit the application of this procedure to milk products and do not apply it to notably beefmeat. The answer forwarded by the Member States invariably is, that for beefmeat, with its great variety of types, cuts, qualities and variable weights, this would become too costly and that the EAGGF does not reimburse the cost of such control operations (4).

2.7. In other cases, year-end stock statements issued by the storekeepers, are filed as an alternative. Sometimes this is backed up by a certain amount of surveillance by technical inspection staff establishing regular reports on storage conditions in general. However a systematic practice of formal spot checks, reconciling stock record figures with physical lots, is rarely provided for and formal reports of such verifications are hard to find. In one country (I), the system not only does not provide for formal physical stock-takings, not even on a spot-check basis, but also fails to apply the alternative procedure, offered by the aide-mémoire, of the explicit submission by storekeepers of year-end stock statements.

2.8. The audit tests carried out by the Court's auditors included physical verifications of lots of intervention products, selected from the detailed stock records, after these had been reconciled with the global data entered into the declarations submitted to the EAGGF. It was found that:

- (a) in a number of cases it was difficult to reconcile figures in the central stock records, on the one hand with the data reported to the EAGGF and on the other hand with the physical stock quantities. This was either because the central stock data were so far from up-to-date that reconciliation with actual stock positions was not feasible or because the central stock records are kept on a free stock basis, and therefore by definition do not reconcile with physical stocks (because purchase and sales transactions are included that have not yet resulted in a physical movement). In a number of cases, the only way to obtain up-to-date and pertinent information on actual stock positions was to contact the storehouses in question, (D, I cereals, NL, UK);
- (b) in particular with products kept in coldstores (butter and beefmeat) but sometimes also with skimmed milk powder, there are generally problems of physical access to selected lots. This is because the storekeepers, with a view to optimal utilization of space, place the stacks of pallets as closely to one another as possible, leaving no path-ways in between. The relevant regulations prescribe that the lots of intervention products must be stored in such a way that they are individually accessible and countable. The interpretation of this rule in practice is that the storekeepers staple them immediately next to and on top of each other, but, on request, will move around the pallet-loads as much as is necessary to make individual lots required for inspection accessible and countable. Having regard however to practical constraints (no room left in the store-rooms to manoeuvre the stocks, selected lots so far behind other lots that time becomes prohibitive, control operations to be carried out under severe

freezing temperatures), physical controls are seriously impeded by this practice. A number of test checks envisaged by the Court's auditors, had to be called off for these reasons, in practically all countries visited;

(c) in addition, some of these physical verifications failed because:

(i) the lots selected from the stock records could not be physically located in the store rooms within a reasonable time (IRL, NL);

(ii) the lots selected were mixed with other lots in the storage containers, without sufficient identification to allow separate checking (I);

(iii) pallet labelling was insufficient to constitute a link between the lot weight and number of pieces on the one hand and the identifications of the individual pieces on the other (IRL);

(d) in general, there is a lack of evidence that this kind of spot checks are regularly carried out by national control services;

(e) there is only one country (D) in which volumetric assessment of the quantities of cereals kept in flat storage is feasible. This is done by recording the ground surface of each storage compartment, levelling the top level into a completely flat surface, installing height indicators and multiplying the volume calculated on this basis by the specific weight of the grain stored, which gives a reasonably accurate figure for the quantity. In other countries such an assessment is impossible because the cereals are stored in irregular heaps;

(f) in one country (I) stock movements of cereals are in certain cases (notably identity between seller and storekeeper and/or between storekeeper and buyer) reported in such round figures that they cannot be based on weighing, but can only represent global and approximative estimations;

(g) while procedures followed to deal with damaged intervention products after their discovery were generally found to be correct, inspection and reporting practices quite often do not allow the timely inclusion in the EAGGF declarations that the regulation requires. The Court's auditors noted on their audit visits cases of damage that had not been declared. In

one country this was clearly because of a lack of compliance by local staff with central instructions (IRL, butter and beef). One case of damage due to inadequate storage technique was observed, the risk of which national audit services had drawn attention to in one of their reports but apparently without follow-up (IRL, butter).

Control over quality

2.9. No action is taken by the Commission services in respect of quality control unless Member States report abnormal quality deteriorations or complaints are received from dissatisfied buyers of intervention commodities.

2.10. As to the Member States' arrangements for quality control of intervention stocks, important differences in nature and intensity exist between Member States and between products. Quality control at entry, i.e. sample-taking and physical-chemical analysis, is in practice carried out by the intervention agency's own technical staff, officers of specialized technical government services including state laboratories, experts of specialized commercial firms, including private laboratories, or the storekeepers' technical and laboratory staff. Some illustrative examples of existing arrangements are:

(a) intervention agency's technical staff are permanently present on the premises. Samples taken by them are analyzed in State laboratories (IRL);

(b) intervention agency's technical staff visit the store-houses after each (series of) intake(s), take samples and send them for analysis to a private laboratory (D, milk products);

(c) offerer and storekeeper proceed to a joint sample-taking, usually done by an independent expert on their behalf, have the sample analyzed by a jointly agreed laboratory and declare the quality so established to the intervention agency which records this as the entry quality (F, cereals);

(d) storekeepers sample the incoming transport loads of produce, analyze each of these samples in their own laboratory facility on the premises, calculate a weighted average quality for a whole lot constituted by a number of transport loads and declare this to the intervention agency which records this as the entry quality (UK, cereals).

2.11. During the period of storage, it is very rare for samples to be taken by or on behalf of the intervention agency, and analyzed with a view to verifying the state of preservation of the product. Olive oil is the only case where, since 1984, there has been a legal obligation to sample and analyze the lots of edible oil each year. Occasionally storekeepers themselves take samples and have them analyzed at regular intervals as a matter of standard business practice to satisfy themselves as to the state of preservation of the product. The intervention agencies may or may not have access to the results. For the rest, control over the state of preservation of intervention products is indirect, by means of checks at the point of release and monitoring of storage conditions.

2.12. Control at the point of release is to a large extent based on the supposed opposition of interests between buyer and storekeeper. Sales regulations normally provide for the possibility that potential buyers sample the products put on sale before making their offer, i.e. the caveat emptor rule applies. Intervention agencies rarely sample or analyze on release, except in special cases, e.g. special sales and distributions to consumers (D, butter and beefmeat). Sometimes they participate in a joint sample-taking with the buyer and the storekeeper, or a sample is kept available to the agency from a joint sample-taking between buyer and storekeeper, which may happen in part of the cereals releases (D, F, NL, I). In one country, cereals storekeepers are obliged to compose representative samples of cereals releases of a day's discharging or of 500 tonnes, whichever is the smaller, and keep these available to the intervention agency (UK). There is only one country (IRL), where intervention agency's staff systematically supervise all release operations, on account of their permanent presence on the storage premises. They do not however sample the outgoing produce.

2.13. The systems of surveillance of storage conditions put into practice by the Member States, show, for the same product, important technical differences from one Member State to another. Some striking examples are:

(a) the great variety in technical instructions issued by the intervention agency to the storekeepers in respect of the

quality surveillance of intervention cereals. They vary in practice between one extreme of very precise rules as to how to monitor internal temperature (how many temperature probes, at which height and at which distance, how often to be recorded on obligatory temperature control sheets), how to monitor humidity, under which conditions to ventilate, how to watch for the presence of insects, how to prevent access of other animals (D), to another extreme where it is stipulated that the storekeeper is to look after the stocks 'as a good family father' and no precise technical instructions on quality control are imposed at all (F, I);

(b) differences in the minimum freezing temperature for butter, prescribed by national regulations (as opposed to the case of beefmeat, the Community regulations give no standard for butter). While in most Member States -16°C is the norm, there are countries which allow less, one country even up to -10°C (IRL);

(c) while in most countries sample boxes of butter (the entry quality test of which is done in two stages and some intervention agencies do periodic, e.g. annual, spot tests) are systematically kept in the same coldstore room with the lots they represent, this is not obligatory. There is one country where the sample boxes are kept together in one room, for reasons of convenience but with the result that they are kept under different conditions than the lots they represent (IRL);

(d) sample-taking procedures on butter are in some countries surrounded by more professional ritual than in others, quality rating systems are more elaborate in some countries than in others, and the quality testing in general differs by definition, because there exists no common definition of butter in the Community;

(e) sample-taking practice in general, but especially for cereals, differs widely between Member States, in all respects: procedurally, statistically and technically.

2.14. Inspections of intervention storehouses by intervention agencies' technical staff in order to verify storage conditions, compliance with technical, administrative and bookkeeping procedures and to examine the stocks for visible damage are provided for with a frequency that varies, according to Member State and product, from permanent supervision on the spot, via once every two

months, to once a year or only occasionally, when there is suspicion of a problem. These inspection visits usually result in formal reports, often of a standardized format.

2.15. The comparison between the quality characteristics of products delivered out of intervention with the quality characteristics of the same products as they came into intervention is of paramount importance as a check on both the reliability of the entry quality test and of the state of preservation while held in storage. This is particularly the case for products of which the purchase and the sales price are dependent upon quality, e.g. cereals, olive oil, tobacco. The organization of the material storage operations (separation/combination of lots) and of the stock registers (records: linkage between lots entered, lots stored and lots released, which can all be different) is practically nowhere geared towards the objective of systematic confrontation of qualities in and qualities out. There are only a few cases where such comparisons are in principle possible, there are even fewer where they are actually made (but on a very global scale, i.e. the content of a whole storehouse over a whole harvest year), and there is only one case known (F, cereals) where examples are found of storekeepers being financially sanctioned for excessive quality differences.

2.16. In previous enquiries, which concentrated on the storage of a particular product (olive oil ⁽⁵⁾, cereals ⁽⁶⁾), the Court had samples taken and analyzed, by way of substantive test on the reliability of stock quality information. These tests revealed serious problems, both as regards minimum intervention quality criteria which were not met in a number of cases, and as regards the comparison of the real quality established to the theoretical quality recorded in the books. Investigations conducted by the Commission services in the same two product areas, but limited to the aspect of minimum quality fulfilment only, seem to confirm the existence of basic quality control weaknesses in the Member States' systems.

2.17. The audit tests carried out by the Court's auditors in the context of this horizontal enquiry included inspection visits on the spot with a view to assess storage conditions and quality control measures. In spite of the relatively limited number of inspections made, the following findings can be considered sufficiently indicative:

- (a) there are important differences between Member States in the technical treatment and preservation of the cereals stocks. In some countries, the cereals are under systematic surveillance in respect of the presence of certain insects, in other countries surveillance is inadequate. While in one country (F) traces of frequentation by animals were found on several occasions, such presence is in another country (D) almost unthinkable;
- (b) a case was found in which a lot of wheat offered into intervention presented a humidity rate of 15,9 % according to the analysis made by an expert firm on behalf of the offerer and the storekeeper. Although this was clearly outside the intervention limit of 15,5 %, the storekeeper accepted the lot into intervention and declared it at 15,5 % to the intervention agency (F);
- (c) examination of quality control procedures and of quality analysis sheets for cereals in one particular country (I) raised serious doubts on the reliability of the quality determination. In certain cases, there was no doubt that instead of the pretended sampling and analysis of each lorry-load constituting a transaction, either only one lorry-load had been analyzed or a theoretical quality had been declared;
- (d) in practically all countries, the frequency of inspection visits carried out by the technical staff of the intervention agency to verify storage conditions and compliance with the official procedures, turned out to be lower than intended, and in certain cases, supervision was less tight than the theoretical description or even the formal instructions prescribed (IRL, I);
- (e) a case was found of intervention beefmeat stored immediately next to a load of unwrapped fish, although the specific storage contract excluded such a combination (F), and rightly so.

3. FINANCE AND BUDGETARY ASPECTS

The cumulative declaration method

3.1. The method by which Member States intervention expenditure is funded by the Commission on the basis of monthly declarations, and subsequently charged to the Community budget, is explained in detail in Annexes I (paragraphs 10-13) and III. The essence of the method is that cumulative amounts of expenditure are calculated on the basis of a new average price each month, and monthly expenditure is determined by subtracting the previous amount. It has three important consequences:

- (a) since under current arrangements there exists no stable valuation basis for the recording of stock movements and their consequences for the Community budget in the financial accounts, it is impossible for intervention agencies to record the value of the stocks and the losses on sales in their normal accounts. Consequently, the declarations of expenditure presented to EAGGF are not derived from accounts supported by the in-built safeguards of the double entry system, but have to be compiled by purely ad hoc procedures. The agencies are of course not to blame for this state of affairs, which is an inevitable result of the accounting and reporting requirements of the Community regulations;
- (b) an equally serious consequence of the cumulative averaging system is that it risks creating a lax attitude on the part of the people who have to work in it, because all data declared are perceived as 'provisional'. This has a negative influence on the control attitude in general, and particularly tends to postpone specific control action until a moment when the data are 'final', i.e. when the year is over. Since the accounting data are thought of as provisional in nature and open for completion and correction, they are widely considered to be excused from internal or external control;
- (c) another consequence is that profits and losses cannot be attributed to individual transactions. While the specific sales price for a particular disposal action may be known, the cost price is, under this system, set at either the global average purchase price which is only definitively known by the end of the year or the current intervention price. In neither case does the calculated loss correspond to the specific age and quality of the commodities sold.
- (a) in the absence of any rules at Community level, the intervention agencies take different attitudes vis-à-vis the stock records kept by the storekeepers. Some Member States issue no rules at all (F, NL, UK). An extreme case was met where a body acting as an agent to the intervention agency did not transmit sales transaction files until all detailed physical and administrative aspects had been completely cleared, many months after the relevant transaction date, without being obliged to provide any intermediate or substitute information (UK, Intervention Board for Agricultural Produce/Home Grown Cereals Authority);
- (b) the service within the intervention agency, that draws up the declaration, i.e. usually the finance and accounts department, more often than not depends for its input information on the market services. For the latter, timeliness of accounting entries is a lesser priority than completion of their technical and administrative controls on the related transaction files. An extreme case was found where an accounting service had the basic, but unverified information available in good time, in the form of reported stock movements and positions accompanying storage fee invoices, but preferred to base its EAGGF declaration on estimated stock movements, thereby achieving a high degree of inaccuracy (F, Office National Interprofessionnel des Céréales). Another case was found, however, where provisional data were reported as soon as they became available, but were systematically replaced by the definitive data in the following period. The result here was an acceptable degree of accuracy (I, beefmeat);
- (c) the Member States have an interest in the earliest possible declarations of expenditure because the declaration has to have been submitted before funds can be withdrawn from the EAGGF Treasury account. It was established that the great majority of the intervention agencies draw up their second category declarations in the first week of the month following the month in which the physical operations took place. Cases were found in which the previous month's accounts were closed before the end of the month. It will be clear that at such an early moment in time, it is hardly likely that the centrally recorded data in respect of intervention transactions can be complete.

Accuracy of declarations

3.2. The declarations of intervention expenditure submitted by Member States to the EAGGF are built up from the basic level where the operations take place, i.e. the individual storehouse level. Almost invariably the Court found that the stock records of the storekeepers were up-to-date. But delays and errors occur during the process by which these basic data are transmitted to the intervention agencies' central stock records from which the monthly declarations are derived. In particular:

3.3. The combined effect of the above-mentioned factors is that the monthly declarations submitted by Member States to the EAGGF bear only a tenuous relationship to the real level of the underlying expenditure. For the Member States and the intervention products covered by this enquiry, the Court has examined all the monthly declar-

ations and year-end accounts submitted in 1984 and 1985 and has measured their accuracy in terms of the variations between:

- (a) monthly quantity movements and positions as they result from the cumulative monthly statements (by subtraction), and;
- (b) monthly quantity movements and positions as they are finally indicated in a detailed annex to the annual account.

3.4. The analysis established that the overall average inaccuracy for the monthly entry figures is of the order of 25 %, the monthly releases are misstated by 45 % on the average, and the error level for declared stock positions is about 10 %. The figures for releases are determinant for losses on sales, and these latter represent, typically, about two thirds of total public storage expenditure which in recent years has accounted for about 20 % of total EAGGF Guarantee expenditure (cf. *Table 1*). An error rate of 45 % for figures of this magnitude calls in question the continuation of the EAGGF system of advances, in so far as it is based on the belief that it is possible to estimate the cost of implementing CAP measures with an acceptable degree of accuracy in advance of the presentation of annual accounts. Another consequence of this state of affairs is that it invalidates in-year decisions about budgetary management. There are however positive exceptions in the sense of variations in the order of a few percentage points or less, notably in one country for all products (NL) and in two countries for just one single product case (beefmeat in D, butter in IRL). The results in these cases show that it is possible to run a system that achieves a satisfactory degree of accuracy of the monthly declared data.

COMPLETENESS PROBLEMS OF ANNUAL ACCOUNTS

3.5. A systematic tendency of monthly declarations to be inaccurate can equally affect the twelfth, i.e. the year-end declaration, which is submitted in the format prescribed for the annual account. The particular importance of this declaration lies in the fact that the expenditure resulting from it is the final amount to be charged to the financial year concerned. Corrections following the methodological-arithmetical check carried out by the EAGGF accounting service (cf. paragraph 5.11) are charged to the budget in the month of their financial settlement. All other changes in the expenditure figures are automatically brought under the clearance procedure and hence charged to the budget of the

financial year in which the clearance decision is published. This is unavoidable in the case of corrections established by the Commission's clearance auditors, notably in respect of the regularity aspects of the operations declared. But it is not acceptable for changes which result from the inadequacy of Member States' systems to produce complete, timely and accurate information. The clearance procedure is not designed to deal with the Member States accounting back-logs and systems' errors and its use for that purpose constitutes an inadmissible violation of the annuality of the Community budget.

3.6. That these breaches of annuality represent a real and a serious problem is proved by a number of cases that was identified in the accounts examined in the context of this enquiry:

- (a) about 300 000 tonnes of cereals sold and released in 1983 were not included in the 1983 account presented by a Member State (UK) so that losses on sales were understated by 6,8 Mio ECU. This was a result of the problem described in paragraph 3.2, point (a). There were also corrections made to other expenditure figures of that year, which had a compensating effect on the global amount of correction to be brought to that Member State's overall expenditure for that year;
- (b) the same country however arrived at a global understatement of expenditure of 8,6 Mio ECU for 1984 and of 4,3 Mio ECU in 1985;
- (c) another Member State understated expenditure on public storage of one single product (beefmeat) by 23,7 Mio ECU in 1984 and by 11,9 Mio ECU in 1985 (F);
- (d) in another case involving a very sophisticated and very powerful computer system, there were too few staff to cope with the additional preparation of input which was generated by high sales activity. This resulted in an understatement of losses on sales of beefmeat of 1 Mio ECU (Ireland, beefmeat).

4. MANAGEMENT AND ACCOUNTING CONTROL

The organization of intervention at national level

4.1. The organization of intervention varies between Member States. The main types of system are described in Annex IV.

4.2. When the national central intervention agency contracts out the daily implementation of public intervention storage to professional and commercial organizations, the structure becomes a conglomerate of very different entities. Not only is a separate structure set up for each intervention product, but there can be a number of contractors admitted, as many as several dozens, for each intervention product and each one of those is further subdivided into a great number of regional and local entities. The diversity aspect can be partially extenuated by imposing standard accounting and reporting formats, which it has indeed been established is normally the case. But what is also required are strong structural control measures, like a heavy internal audit function and a specialized technical inspection service. These elements were in practice found to be very weakly developed.

4.3. In addition, this construction presents a fundamental difficulty in that the organizations which carry out the administrative tasks for the implementation of intervention are producers cooperatives, trade companies or industrial companies, or storage companies controlled by one of these, in other words, organizations that are also commercially active in the market. There is a conflict of interest between the intervention and the commercial functions. Different combinations of the following capacities can be found in practice:

- (a) intervention administrator;
- (b) intervention storekeeper;
- (c) seller into intervention;
- (d) buyer from intervention.

In fact, it must be considered that combinations of (a) and/ or (b) with (c) or (d) are undesirable because they create a position in which advantage can be taken vis-à-vis other

market parties or even abuse can occur through manipulation.

4.4. The problem has been signalled in the special report on the organization of the olive oil market, published by the Court in 1985 (2). It was clearly established that there was a fundamental problem in this respect, in the two Member States involved in that enquiry (GR, I). It has also been clearly established by the enquiry conducted in 1987 that in the one country (I) included in that enquiry and applying the contractors model of organization (cf. Annex IV, point 1 (c)), the problem also exists, and seriously so, in the beefmeat and cereals market areas. Examination of the formal arrangements made it clear that many possibilities are open and a very limited systems test revealed a number of practical cases of unacceptable function combinations (cf. paragraphs 2.4 (b) and 2.8 (f)). The problem has been recognized in recent years by the responsible national audit authorities and remedial action has been taken, but only to a limited extent, i.e. the combination of seller into intervention and intervention storekeeper of cereals has been excluded, but only for commercial companies and not for producers cooperatives, which constitute the majority of cases.

4.5. A similar sort of risk arises when organizations involved in intervention transactions combine several duties. The Court found a case of a professional-commercial organization controlling the quasi-totality of offers into intervention, acting as a storage agent of the intervention agency and intervening on the disposal side, e.g. as an intermediary in export sales (IRL: Irish Dairy Board). This involvement in all stages of intervention represents certain risks of exploitation that ought to be kept under control by the intervention agency. The situation would become totally unacceptable if the physical storage activity were included in the combination of functions. As the national authorities ensure that this is not allowed to happen and that in other respects they keep the matter under strict surveillance, the situation is theoretically not irregular.

Systems management and documentation

4.6. As regards the monitoring by the central level of a correct and uniform reflection of the various basic and implementing regulations in the administrative rules issued by Member States, there is no evidence that national regulations and communications in respect of intervention storage are systematically obtained by the Commission services and fully checked for their conformity with the Community legislation. On Member State level there is however evidence, that some of the national audit instances include this type of check in their audit programme when

examining certain intervention measures (D, IRL, NL, UK).

4.7. In 1987, when this enquiry was conducted, the Commission services had not established a complete and systematic documentation of the intervention agencies' accounting systems and procedures. Member States have in reality transmitted little or no information on their practical accounting arrangements, nor have they been solicited to do so. It must be recognized that the legal provision prescribing the supply of information is formulated in extremely superficial terms: Member States are to communicate 'particulars' concerning 'the accounting conditions in accordance with which payment is made', without any further specification (7). In order to obtain a systems documentation which could serve as a basis for accounting coordination, monitoring and control, it should at least be specified what basic information requirements are to be met, e.g.:

- (a) chart of accounts and booking schemes for the entering of the financial transactions;
- (b) stock record formats and stock reporting procedures on the local, intermediate and central level;
- (c) description of methods and procedures of valuation of reported stock movements;
- (d) description of methods, procedures, information sources and auxiliary work sheet formats for drawing up the declarations to the EAGGF.

4.8. The accounting systems documentation existing on the premises of the intervention agencies and the quality of systems management that such documentation normally is a reflection of, were found to vary in practice between very wide extremes. On the one hand, there was the case of an accounting system that is very well designed, with contributions made by all national services involved, to meet the information output requirements with a high degree of timeliness and accuracy, which incorporates adequate measures of internal control and constitutes a very suitable object for external audit. Systems documentation is systematically set up to meet both management and control requirements and is well-kept and well-presented (NL). In intermediate cases, some form of systems documentation can be put together from available material like office manuals, work instructions, procedure outlines, occasional diagrams or flowcharts made for specific purposes (reorganization, edp development, training courses) and reflect a certain ongoing activity of keeping systems in line with perceived requirements (Community regulations, aide-mémoire instructions) and conditions (staff situation, data-processing equipment). In such cases, the internal and external control functions

usually have their own ways of ascertaining the systems and exert little influence on internal systems management and documentation (D, F, IRL). At the other end, cases were found, where practically no documentation exists on the accounting aspects and/or where systems management is a too insufficiently developed activity to guarantee coherent and reliable results (I, UK).

4.9. Without exception, but in some countries and for some products to a different degree than for others, the intervention agencies are engaged in great efforts of systems development in order to cope with two major classes of problems:

- (a) conversion from a manual or mechanical to an electronic data-processing system or from one edp application to a more sophisticated one;
- (b) the growing complexity and instability of the Community accounting requirements.

In all cases it was clearly understood that a minimum of coordination, guidance and support from the central Community level and the creation of a basis for exchange of knowledge and experience would be extremely helpful to the development of adequate and efficient systems. It was also clearly established that there is, in general, insufficient pressure from the outside (Commission, national audit services) to improve the performance and the security of the accounting systems in order to meet Community objectives of financial reporting, especially as regards the monthly declarations and the year-end account.

Reconciliation aspects

4.10. As regards the overall control features of the accounting systems run by the intervention agencies, it was established that an important control measure for this kind of activity, i.e. periodic reconciliations between total stock movements and total funds movements are not feasible in any of the Member States.

4.11. Cases where stock figures included in the EAGGF declarations systematically reconcile not only with the intervention agency's central stock records but also with

the storehouse stock records of that moment are very hard to find. In fact the Court's auditors found only one country (NL) where this was sufficiently the case. Elsewhere there were real reconciliation difficulties. In particular one case of several non-reconciling total quantities (UK, butter) and one case of frequently non-reconciling sub-quantities within totals that did reconcile (I, beefmeat). In practically all cases, it was manifest that this type of reconciliation test was not a standard control procedure.

4.12. In reconciling monthly data declared to EAGGF with the intervention agencies' accounts, a first problem results from the cumulative system: when the underlying system builds up totals continuously, in fact overwriting a previous figure with a next one, there is little or no audit trail left of the monthly declared data (F, IRL, NL, UK).

4.13. A second problem encountered in almost all cases is that the working papers underlying the statements submitted and constituting the link between the data reported and the source data generated by the accounting system, are so intricate and/or informal that without the assistance of the person(s) who established them, they are practically unintelligible.

4.14. Intervention agencies have the possibility of making a cross-check between their central stock records (underlying the EAGGF declarations), on the one hand, and the storage fee invoices received from storekeepers, on the other. In principle the stock positions figuring in the central stock records should, once updated so with some data processing delays, be consistent with the positions over which storage fees are paid to the storekeepers. In practice, most intervention agencies seem to be unaware of the importance of this safeguard, and do not attempt such cross-checks.

4.15. In one country, three cases were identified on a test check basis where the transaction quantities figuring in the financial documentation and as such accounted for and reported to the EAGGF, varied (in either direction) from the quantities figuring in the documentary evidence of the physical movements. As these differences could not be explained by the responsible authorities, it has to be assumed that these are errors resulting in misstatements in the accounts. The implications as to the reliability of national controls are quite serious as is the fact that in one case the probable, but not verifiable, consequence is a misallocation of a transaction between two financial years.

5. THE AUDIT OF INTERVENTION STORAGE

National internal audit

5.1. The legal and administrative framework in respect of the control of intervention operations is explained in Annex V.

5.2. Internal audit, in the sense of a specialized internal control function, reporting to management and with an independent status vis-à-vis the operational departments, exists in some form in all intervention agencies. Two types can, broadly speaking, be distinguished: one where this control function is also independent from the finance and accounts department and one where it is associated with that service, even to the extent of a combination in the person of one official.

5.3. The first type of internal audit function happens to coincide with the single-agency model of national organization (cf. Annex IV). The intervention agencies of FR of Germany, Ireland, the Netherlands and the United Kingdom all have an internal audit department, led by a Chief Internal Auditor and varying in number of staff between 2 (NL) and 20 (UK). These services strive to work to professional audit standards when auditing both national and Community aspects of the tasks performed by their agency. In the latter context, their usual objective is to audit all Community measures implemented by the agency on a cyclical basis, about once every four years. They review national implementing rules, systems and procedures and carry out spot checks on files, accounts and in certain countries (IRL, UK) also on stocks. They work in conjunction with the external auditors with whom they coordinate their work programme and to whom they make the results of their audit work available.

5.4. The other type is found in countries like France and Italy, where according to the traditions of the public sector, the accountant is personally responsible (and financially liable) for the legality and regularity of the payments and receipts effected by the finance and accounts department. Consequently, in his control capacity, he is obliged to proceed to full formal verifications of the transaction files presented for payment or receipt, which he effects in his financial capacity and records in his accounting capacity. In order to carry out these tasks, the accountants have a relatively important number of staff available. In France, the accountants of the intervention agencies have also an external status in that they are appointed by decree of the Minister of Finance and are responsible to him for the lawful and regular performance of their duties.

5.5. The examination made by the Court's agents of the organization and procedures of internal audit in the intervention agencies gives rise to the following comments:

- (a) the specialized internal audit departments (paragraph 5.3) spend part of their available capacity on the audit of the public storage measures. The actual audit effort lies in practice between 1 (UK) and 6 (D) man-years per year;
- (b) the audit work that is done on intervention measures by these audit departments is organized, prepared and documented in a competent and professional way;
- (c) the scope of the audits is limited to the extent that the objectives are geared towards what is seen as the national responsibility rather than to an interpretation of the Community interests;
- (d) in the cases where the internal control function is performed by the accounting agency, the basic strength of their *modus operandi*, a 100 % check on transactions, represents at the same time its fundamental weakness: because of its concentration on the financial dimension and on the regularity aspects of the individual transactions, this control system tends to pay insufficient attention to precisely those elements that are characteristic of the Community financing system for second category, i.e. global accounting totals, representing physical movements;
- (e) no audit is performed by any of the internal audit departments, of the monthly declarations nor of the annual accounts of public storage expenditure, submitted to EAGGF. Even the accounts presented for clearance are covered only partly and indirectly by internal audit;
- (f) in the case where the accountant, who combines the accounting and the control function, certifies the declarations or accounts presented by him, he certifies in fact his own accounting work. The significance of his signature is that he attaches his personal responsibility to the correct representation of the state of the financial accounts and to the legality and regularity of the financial transactions included therein.

National external audit

5.6. In the different Member States, different arrangements exist for the external audit of the intervention agencies:

- (a) FR of Germany: a state-owned private audit firm, specialized in the audit of public and semi-public bodies, is charged with the audit of the intervention agency by the Minister of Agriculture to whom the intervention agency reports. They work together with the intervention agency's internal audit department. The German national Supreme Audit Institution, Bundesrechnungshof, receives the reports of both, has a global responsibility of its own to Parliament and regularly carries out special audit enquiries on selected topics;
- (b) France: the external control element is represented by the external status of the intervention agencies' accountants, combined with their personal and financial responsibility. The legality and regularity of the accountants' financial and accounting management is furthermore controlled by the agencies' State Controllers and by the General Inspection Service of the Ministry of Finance. These authorities also have a wider responsibility for the audit of sound financial management. The central paying agency coordinates and scrutinizes the declarations to EAGGF. The national Supreme Audit Institution, Cour des Comptes, has a global responsibility and conducts from time to time an audit enquiry in a selected area;
- (c) Ireland: the national S.A.I., the Comptroller and Auditor General's Office, performs the external audit of the national intervention agency, working in conjunction with the agency's (i.e. the Department of Agriculture's) internal audit service, and reports to the Public Accounts Committee of Parliament;
- (d) Italy: the national S.A.I., Corte dei Conti, has an audit office on the premises of the central national intervention agency, where a limited number of audit staff prepare contributions on the agency's organization, general performance and financial situation, for inclusion in Corte dei Conti's annual report to Parliament;
- (e) Netherlands: the external audit of the national intervention agency is carried out by the internal audit service of the Ministry of Agriculture, working in conjunction with the internal audit service of the agency. The national S.A.I., Algemene Rekenkamer, has the global responsibility to Parliament, reviews the

audit results and can conduct audit enquiries of its own;

- (f) United Kingdom: the national S.A.I., National Audit Office, performs the external audit, taking account of work done by the intervention agency's internal audit branch, and presents an audit certificate annually to the Public Accounts Committee of Parliament.

5.7. In four of the six cases listed above, the external audit work results in some sort of an audit opinion on the intervention agency's accounts, presented directly or indirectly in a national discharge context. The auditors are obliged to make explicitly exception, in their opinions, for the accounting methods imposed by the Community regulations which do not comply with generally accepted accounting principles, notably in respect of the valuation of stocks and the calculation of the loss figure for the year. In one case, exception is also made in respect of generally accepted audit standards: the audit coverage is determined by the commissioning authority and physical stocktakings are explicitly excluded from the audit programme (D).

5.8. The principal audit objectives of the six national external auditors referred to above, in relation to public storage, are to a large extent determined by the national context. Inevitably therefore their first priority is the examination of those financial aspects that are relevant from a national point of view, i.e.:

- (a) the financing of the intervention purchases and the funds tied up in the stock position of the moment;
- (b) the financial risks, inherent to the stock position (losses, damages);
- (c) the net national cost of handling, storing and financing;
- (d) the risk of disallowances for lack of conformity with Community regulations.

5.9. None of the national external audit instances has to date ever looked into the accuracy aspects of monthly declarations. As to the year-end accounts, one national S.A.I. has made a severe observation in a published report on cases of incompleteness of these annual accounts in relation to the accounts submitted for clearance. The point of the observation was however that it was a case of under-declaration leading to under-reimbursement at that stage, to be made up at the much later stage of clearance, so clearly a national treasury problem. To the extent that the audit verifications themselves have a bearing on the

Community accounts, they are oriented towards the accounts presented for clearance. However, no formal statements of assurance are delivered with these accounts.

5.10. In the past, the communication by Member States of particulars concerning their control arrangements and of the results of their audit activities, as provided by the basic regulation on the financing of the common agricultural policy, has in practice always been a problem. This was the result of a contradiction in the situation: on the one hand Member States are designated as the first responsible for the control of the decentralized implementation of CAP measures; on the other hand transactions that are not entirely in conformity with the Community legislation are disallowed for Community financing and are charged to the Member State. In other words, the more effective their own control, the higher the financial risk for the Member States. With the adoption of regulation 295/88⁽⁸⁾, the obligation is introduced for Member States to present, with the clearance accounts (starting with those concerning 1987), detailed information on the audit arrangements relevant to those accounts, and on the global results of those controls.

Commission control

5.11. The EAGGF accounting service effects a scrutiny of the monthly declarations and annual accounts submitted by the Member States, before posting the resulting amounts of expenditure to the budget accounts. This scrutiny is necessarily limited to the formal, methodological aspects, i.e. the correct application of the declaration rules and formulae, the use of the correct standard amounts and exchange rates, arithmetical correctness. Until 1986, only the cumulative global figures were reported each month, so the Commission services were unable to assess the accuracy of the key elements declared in the successive monthly declarations. Their accuracy could only be determined at the end of the year, on the basis of the table annexed to the annual account, presenting the definitive monthly quantitative stock movements and positions. At that stage the comparison obviously would no longer serve any purpose. With the introduction, since 1986, of this same table as an annex to the monthly declarations, it has become possible to assess the accuracy of the quantitative basis of the declarations throughout the year, by following the importance of the corrections, which now become visible. Thus, the risk of year-end surprises, or of infringements upon annuality, can be ascertained at an early stage and Member States can be spurred into corrective action. The importance of these risks has been demonstrated in paragraphs 3.3 — 3.4. Examination of 1987 practice has

revealed that the Commission services still do not carry out these verifications in any systematic way.

5.12. The special declarations that the Member States send in of their real technical costs and their real interest rates, in the context of the periodic general revisions of the standard rates, are in practice not subject to real audit verification. The Commission services assess the submissions for consistency and plausibility and make comparisons between cost levels of Member States, but do not carry out audits in a proper sense of accounts recording real expenditure, nor do they request any form of audit assurance to be procured by Member State audit authorities. Having regard to the significance of these data (on the basis of which standard amounts are established that, once they are fixed, become an automatic pricing basis for reimbursements) and to the reality of the risk of misstatement (as demonstrated by an investigation made by the Court in a particular market case ⁽⁹⁾), this control must be considered too weak at present.

5.13. The audits carried out by the EAGGF audit service in the context of the clearance of accounts, are in fact the culminating point in the control structure. They are the basis for the final decision on the acceptance of the financial consequences of Member States' management of CAP measures. They cover the totality of CAP expenditure charged to the budget and they are comprehensive in that they cover the financial, accounting, administrative and technical aspects. At the time of this enquiry (1987) in the area of public intervention storage, the following shortcomings must still be noted ⁽¹⁰⁾:

- (a) the coverage of these audits is extremely limited, both because the audit programs are selective and on account of the small number of concrete audit verifications that can be carried out in the short spaces of time available to the auditors as a result of a situation of understaffing;
- (b) while some remarkable professional achievements can be noted within the limitations, the audit methodology varies considerably between the various audit teams;
- (c) systems audits are still not being applied as a working basis in this area;
- (d) the audits are not sufficiently extended and followed up to cover the systematic weaknesses detected in the Member States' systems;

- (e) there is an obvious lack of consultation and coordination between the clearance service and the market services in the Commission, especially on technical matters and on matters of market management (e.g. application of tolerance limits, interpretation of deboning yield criteria, justification of reimbursements for technical treatment of produce stored, acceptable methods of quality analysis, etc.);
- (f) while, in view of the limitations of the clearance audits, there is an important reliance on national internal and external control, there is no coordination effort being made to bring national controls under an integrated approach and to render the whole of the control measures and activities of the different parts of the control pyramid as efficient and effective as possible.

5.14. In addition, as set out in Chapter 6 of the Court's Annual Report for the financial year 1986, the action taken by the Commission in the fight against fraud and irregularities is limited in its scope and approach. Although in the specific area of public storage the responsible Commission services have recently conducted several enquiries into the observance of minimum intervention quality criteria, it has not been possible to draw conclusive results due to certain limitations in the method followed.

6. CONCLUSIONS AND RECOMMENDATIONS

Physical control aspects

Quantitative control

6.1. The general conclusion on the control arrangements in respect of the quantitative aspect of intervention stocks, can only be that these leave much to be desired both at the regulations level and in practice. A basic weakness lies already in the lack of direction provided by the central rules, which indicate in fact two extreme measures that are both equally unsatisfactory, one because it is unrealistic (i.e. to expect that a full physical stock-taking can be carried out at year-end date) and the other because it is insufficient (i.e. that storekeepers themselves provide a paper assurance). Having regard to the necessity to verify the physical presence of the stock quantities declared on the one hand, and to legitimate requirements of practicality and efficiency on the other, the central rules should provide

for an obligatory physical stock-taking per year, but allowing that it be broken down into partial stock-takings which can be spread over the year. This would need to be supplemented by a minimum of random spot checks on individual lots selected from the stock records underlying the declarations. At the same time, the supervision of release operations needs to be reinforced, at least on a spot-check basis. There is no reason to grant extra reimbursements to Member States for such control efforts, since under article 1 of the basic regulation on the financing of the common agricultural policy (4), expenditure relating to administrative costs and personnel is to be borne by the Member States.

Qualitative control

6.2. The conclusion on the control arrangements in respect of the qualitative aspect of intervention stocks, can only be, firstly, that the system is founded on a number of invalid assumptions and, secondly, that a limited number of visits on the spot suffices to identify important weaknesses in the daily practice of quality control. The overall system clearly needs to be reinforced by an impulse from the central level aiming at a specification of minimum requirements to be met by national quality control measures and at the same time a minimum of harmonization in control practices. The procedural aspects of this can be elaborated in the relevant Community regulations or in special guidelines. Bearing in mind the differences in technical conceptions and traditions, it would be advisable to treat the technical aspects in working parties set up according to the apparently very fruitful example of the committee for the application of the common classification scheme for beefmeat. A key standard to be introduced in all national storage systems is the organization and recording of stock movements and positions in such a way that a systematical confrontation of outgoing qualities with the corresponding qualities at intake becomes possible and is effectively implemented. This is then to be connected with the financial responsibility of the storekeepers which up till now has remained mainly a theoretical feature of the system, in spite of its key significance for the control structure.

The flat rate basis

6.3. The standard rate basis for reimbursement of technical and financial costs carries an inherent tendency to

cause distortions in both the way expenditure is shared between Member States and in the overall level of expenditure financed by the Community vis-à-vis the national funding (cf. Annex I, paragraphs 3-7).

6.4. The choice of this system has been motivated by two principal arguments:

- (a) in relation to technical costs, reimbursement at a fixed rate is supposed to be cheaper than a system of full reimbursement of real costs, because it gives Member States an incentive to prevent their real costs exceeding the reimbursement level or, when their real costs are lower, to try and maintain their advantage;
- (b) administrative simplicity.

6.5. But it does not follow from the argument at (a) above that the fixed rate for technical costs should be a uniform one. An inevitable disadvantage of a uniform rate is that in relation to the real costs of most Member States it is either too high or too low. In addition, as with any Community-wide norm, there is an inherent tendency for a uniform rate to be set at an unnecessarily high level, since all Member States stand to gain if costs are overstated by any of their number in the context of the periodic declarations to the Commission referred to in paragraph 5.12. There would be fewer disadvantages in a standard rate system which differentiated between Member States. Such a system would preserve some of the simplicity of the uniform rate system, while it would permit the elimination of the arbitrary distribution of cost advantages between Member States which is an inevitable consequence of the present uniform rate. It would also make it easier to take account of special situations e.g. the substantial EAGGF (Guidance) contributions paid to beneficiaries in certain Member States towards the capital cost of storage facilities.

6.6. Another disparity in the distribution of charges between Member States stems from an anomaly, viz. the fact that green exchange rates are used for the calculation and the application of the standard amounts for the reimbursement of the cost of technical operations. The use of the green rate in this context, while stemming from a general rule laid down in the CAP legislation, is in the particular case irrelevant to the objective of the agri-monetary system, which is to mitigate the immediate effects of exchange rate adjustments on intra-Community trade flows and national rates of inflation. It would be preferable therefore to make an exception and to apply market exchange rates to avoid the unjustified side-effects.

6.7. What makes the uniform rate system especially difficult to justify is the lack of any serious verification of

Member States' costs on the part of the Commission (cf. paragraph 5.12). Under any of the possible systems of reimbursement the Commission should define and put into practice a system of accounting for the real costs, particularly technical costs, with underlying documents. It was established by the Court's auditors that all Member States do already some sort of accounting for the real costs and draw the annual balance of real costs and Community reimbursements, because they need this information for national accounting purposes.

Year-end stock valuation method and depreciation

6.8. The fixing of uniform carry-forward prices for the year-end stocks, as weighted averages of the national book-values (see Annex III, paragraphs 15 — 18), and the replacement of the national average accounting prices by these uniform valuation prices, result in a depreciation of the stocks of some products in some Member States and a revaluation of the stocks of other products and in other Member States. Through the process of declaration and settlement of expenditure under the heading 'other costs of public storage', this results in extra reimbursements to some and in subtractions included in the reimbursements to others. This effect of treasury advantages and disadvantages is unnecessary, because the regulation in no way stipulates that the carry-forward prices to be fixed 'on the basis of the purchase prices paid by the intervention agencies' ⁽¹¹⁾ are to be interpreted as one uniform price for a given product for all Member States. They could as well be fixed Member State by Member State. This would simplify the procedure, and facilitate the fixing of carry forward prices at levels which reflected the end-year conditions rather than the conditions of August or September. This result would be achieved if the Fund Committee would use its consultative influence to fix an objective method entailing no cash advantages or disadvantages to individual Member States, and then leave it to the responsible control authorities to verify the correct and consistent application of the rule in what should be nothing else than a bookkeeping exercise.

6.9. One of the main problems of the presentation in the accounts of the annual valuation of stocks concerns depreciation policy. Past practice has been characterized by inconsistent application leading to an arbitrary allocation of expenditure to financial years and insufficient depreciation leading to increasing latent losses which had built up to in excess of 8 000 Mio ECU by the end of 1986. Under prevailing budgetary constraints this cannot be written off until several years' time. As long as this burden of the past interferes with the annual loss accounting and as long as no fixed, objective criteria are consistently applied to account for the loss of stock value from year to year, the

Community revenue and expenditure account will continue to fail to comply with generally accepted accounting principles, and materially so.

Conclusion on the accounts

6.10. As regards the principal audit question on the Community level, i.e. whether the Community revenue and expenditure account adequately presents the expenditure of the year, the main conclusions in respect of the accounting and control arrangements for public storage can be summarized as follows:

- (a) significant weaknesses exist in the measures of physical and accounting control, both as conceived by the system and as implemented in practice (cf. paragraphs 6.1, 6.2, 3.1 and 4.10 — 4.15);
- (b) the methods applied for the valuation of the stocks and the resulting determination of the loss expenditure of the year are not in conformity with generally accepted accounting principles (cf. paragraphs 6.9 and 5.7);
- (c) inaccuracies in the accounts are more or less provoked by the system, not only in the course of the year, but also at year-end, which is determinant for the charge of the year, so for annuality (cf. paragraphs 3.2 — 3.6);
- (d) both on the national and on the Community levels audit coverage is generally insufficient to provide a reasonable assurance as to the correctness of the whole of the accounts and coordination between the two levels is practically non-existent (cf. paragraphs 5.5 and 5.8 — 5.14).

The conclusion that inevitably results from these findings is that it is technically impossible to arrive at any audit opinion whatever on the view presented by the EAGGF budget accounts of public storage expenditure.

Overall systems management

6.11. The most striking underlying cause of the uncertainty that surrounds the published expenditure figures is a disquieting lack of coordination both on the level of systems conception and management and in the control. There is a clear need for more exchange, consultation and guidance in these fields and a more active role for the Commission is called for.

Overall audit organization

6.12. It would be desirable for national audit bodies to offer some statement of assurance in relation to each of the accounts submitted for clearance. In order to arrive at a satisfactory overall result, it will obviously be necessary to establish common minimum criteria. While national audit activities are mainly oriented towards national preoccupations, this is to a large extent also attributable to a lack of understanding of Community needs and to a lack of guidance from the central level. It is advisable to organize consultations between national and Community audit authorities in order to elaborate common definitions of scope and objectives of the respective audit efforts and to develop common minimum formulae for statements of audit assurance.

Preparation of monthly declarations

6.13. The process of drawing up the monthly EAGGF declarations is almost unverifiable because of the form and the presentation of the underlying working papers. These papers nevertheless constitute the link between the source data and the declaration as it is presented in its standard format. It is not only imperative from a Community control point of view, but it would no doubt also be very useful for the national control authorities, if the preparation of the declarations to be submitted to EAGGF was based on standardized auxiliary sheets, which could also provide for systematical cross-referencing to the source data (accounts, registers, records, ledgers, listings).

Complexity of the accounting scheme

6.14. Notably on the national level, the accounting has become more and more laborious as a result of the successive introduction of a number of additional complications. The most significant ones are:

- (a) the introduction and subsequently the frequent change of payment delays for intervention purchases and sales;
- (b) the introduction and subsequent change of take-over delays for purchases into intervention;
- (c) the introduction of partial depreciations i.e. concerning only certain parts of the stock of a given products;
- (d) the special disposals of butter, decided in 1987 and to be financed in the first instance by Member States and subsequently reimbursed by the EAGGF over a period of 4 years.

Generally speaking, the intervention agencies see themselves obliged every so often, to adapt their systems, which they developed with sometimes very considerable effort including the development of special edp-applications, to significant alterations of the central system's specifications within a very short time. A very good example is the financial costs which are now to be calculated on a basis so far removed from the original, simple calculation scheme, that the amounts charged to a month and on occasion even the annual amounts, consist more of all kinds of complicated adjustments than of their main component. Another strong example lies in the fact that stocks of the same product are to be accounted for as different stocks as a result of selective depreciation and/or disposal measures (points (c) and (d) above). The time has come to wonder whether the whole system has not become too complex and in fact practically unmanageable and therefore requires a fundamental rethinking.

An alternative accounting method

6.15. Because of their cumulative nature, the monthly declarations of expenditure can conceal important retrospective adjustments to earlier declarations. Successive

adjustment of the average purchase and sales value (and thus of the loss on sales) is endemic in the system. Errors and delays also lead to frequent retrospective adjustment of previous figures for quantity movements and stock positions. Intervention agencies have to improvise ad hoc accounting procedures in order to keep track of stock values and sales losses. Normal accounting procedures and safeguards are of no help with this Byzantine system. Since all data declared are perceived as provisional, there is little incentive for the agencies to improve the accuracy of figures. These problems could however be overcome quite easily by a relatively simple change of the accounting method, which on the one hand would leave the existing scheme basically intact (monthly declaration, valuation of stocks and losses on purchase price basis) but on the other hand would eliminate all the adverse effects of the cumulative averages formula. All that is needed is to replace the cumulative average purchase and sales prices by monthly average prices which are specific to each month, i.e. calculated on the basis of the transactions of the month (global value of transactions divided by global quantity) and remain constant once all transactions of the month have been included in the calculation. Each month would have its own lot of purchases in quantities and value, its own lot of sales and its own opening and closing stock position, equally in quantities and, this time, stable values.

6.16. The crucial element in the system is then the rule to be applied for the valuation of the cost of sales and the resulting valuation of quantities remaining in stock. Here, several possibilities are open: apply the specific purchase price of the month of entry when at the central level it is known (by regulation or decision) which months' lots are being released; or on a hypothetical basis, e.g. the first-in, first-out rule; or a combination, e.g. in cases where sales regulations specify a maximum age, so that one can apply the fifo rule as from the oldest month within that specification. The remaining stock is then automatically valued at the values of the remaining months' lots and there will be absolutely no need to fix global carry-forward

prices at the end of the year, let alone uniform ones for all countries (cf. paragraph 6.8). The need for the EAGGF Committee to be engaged in discussions about carry-forward prices in the light of their consequences for the treasury positions of individual Member States, becomes obsolete.

6.17. The advantages of a system on such a basis are obvious, if it were only for the fact that the disadvantages of the present method are disposed of: accounting adjustments are limited to corrections of the most recent months' figures; sales losses are based on the relevant sales prices, globalized into a month's average, and can equally be based on a relevant cost price if the commodities sold are stemming from a specific period; in any case sales losses for a given month are established once and for all, they don't change in subsequent months as a result of new transactions that have no relation to them; the stock value follows automatically and can serve as a stable basis for the calculation of financing costs, for which it is a more relevant basis than the present one because it comes closer to the amount really invested at the various points in time; stocks and sales losses and storage costs are easier to calculate and can be accounted for within the system of double-entry bookkeeping which brings them under the automatic controls inherent to that system; intermediate financial statements drawn from such a system make sense; the risk of bad surprises at year-end is significantly reduced. Depreciations can still be applied, even partial ones if desired, by simply reducing a number of monthly prices, provided that the regulation be adapted to allow for such partial depreciations.

6.18. It goes without saying that this is not the place to elaborate an alternative system in all its details with a view to proposing it to the Commission and the Member States. These explanations are only meant to serve the purpose of demonstrating that the serious drawbacks of the present system can be eliminated by relatively simple measures.

This report was adopted by the Court of Auditors in Luxemburg on 8 September 1988.

By the Court of Auditors
Marcel MART
President

- (1) Council Regulation (EEC) No 729/70, on the financing of the common agricultural policy, OJ L 94 of 28.4.1970, articles 4(1) and 8(1).
- (2) Special report 1/85 on the common organization of the market in olive oil, OJ C 134 of 3.6.1985, chapter 6.
- (3) Annual report concerning the financial year 1985, OJ C 321 of 15.12.1986, paragraphs 4.27 to 4.39.
- (4) Council Regulation (EEC) No 729/70, on the financing of the common agricultural policy, OJ L 94 of 28.4.1970, article 1(4).
- (5) Special report on olive oil (see footnote 2), paragraphs 6.25 and 6.43.
- (6) Annual report on 1985 (see footnote 3), paragraph 4.35.
- (7) Council Regulation (EEC) No 729/70, on the financing of the common agricultural policy, OJ L 94 of 28.4.1970, article 4 (1).
- (8) Commission Regulation (EEC) No 295/88, amending Commission Regulation (EEC) No 1723/72 on making up accounts for the EAGGF, Guarantee Section, OJ L 30 of 2.2.1988, p. 7.
- (9) Special report on olive oil (see footnote 2), paragraph 6.50(e), p. 39.
- (10) See also the Court of Auditors' annual report concerning the financial year 1986, OJ C 336 of 15.12.1987, paragraphs 5.26 to 5.44, pages 53 to 56.
- (11) Council Regulation (EEC) No 1883/78, laying down general rules for the financing of interventions by the EAGGF, Guarantee Section, OJ L 216 of 5.8.1978, article 8 (1).

ANNEX I

*National and Community financing arrangements**National funding of stocks*

1. The money invested in public intervention stocks does not represent own capital of the Community. The funds required for the purchase of agricultural produce offered into intervention are made available to the intervention agencies on a national basis. The Member States' authorities procure themselves these funds in any way that suits them: bank loans, short or long term capital market loans, bills of exchange, intervention body's own capital or funds allocated from the national budget.

2. The Community reimburses the Member States for the losses realized at the moment of sale. On the other hand, in the case of realized profits, Member States have to pay these over to the Community. These reimbursements and the proceeds on sales that the intervention agencies receive from buyers, constitute together the amortization of the Member States' investment. The Community pays the Member States an interest allowance over the investment position.

Standard rate reimbursement of expenditure

3. Expenditure incurred by the Member States in connection with their public storage activities, i.e. the capital cost of financing the stocks and the technical cost of physically moving and keeping the produce, are reimbursed to them on a standard rate basis. As regards financial costs, a uniform standard rate of interest is applied to average stock values. As regards technical costs, standard amounts are fixed for each product and for each type of physical process, (e.g. entering into storage, keeping in storage, releasing from storage) and uniformly applied to the quantities involved at or during the time of the physical process in question.

4. The standard rate system was introduced in the years 1960, as a provisional arrangement. Since the Council could not come to a decision on the system of full reimbursement of the real cost to each Member State that was proposed by the Commission, it was twice decided to prolong the provisional system of standard rate reimbursement, in 1970 and in 1972. In 1978 the Commission, having established that the views of the Member States had not changed, proposed to make the temporary system definitive.

5. The standard rates are fixed periodically, as weighted averages of the real costs, declared by Member States in a questionnaire designed to that effect. The relevant regulation ⁽¹⁾ prescribes the consultation of the EAGGF Fund Committee for the determination of these uniform, representative rates.

6. In 1986, the principle that the standard rates should be fixed uniformly at a representative level has been suspended, with a reference to the 'present circumstances' under which the Community budget had to be implemented. By way of derogation applicable to the financial years 1986, 1987 and 1988, it was decided ⁽²⁾:

- (a) to fix the uniform interest rate at a level below its representative level and, in the case of Member States which pay themselves an interest rate which is lower than the rate fixed, to fix the uniform interest rate at that lower level. (In practice this means a rate of 7 % with the exception of two countries, FR of Germany and the Netherlands, which receive 6 %);
- (b) to fix the uniform standard amounts for the financing of the material operations arising from storage, i.e. technical costs, at a level corresponding to three quarters of the uniform standard amounts established on a normal basis, i.e. reflecting the level of weighted costs in Member States.

⁽¹⁾ The footnotes appear together at the end of the Annex.

7. This decision constitutes both a formalization and a considerable increase of the already existing element of national financing of the intervention policy ⁽³⁾. The charge borne by Member States in respect of technical and financial costs of public storage for the financial year 1986 can be conservatively estimated at about 450 Mio ECU. The result in terms of published financial information is that the official Community accounts do not reflect any more the full cost of the Community's intervention storage policy.

Budget presentation

8. These three budget lines (or 'budget items'):

- (a) technical costs of public storage;
- (b) financial costs of public storage;
- (c) other storage costs, essentially losses on sales;

can be found for: cereals, olive oil, tobacco, skimmed milk powder, butter and beefmeat. The line 'other storage costs' represents essentially losses on sales, but can also include profits on sales or miscellaneous items like forfeited securities. In such cases of inclusion of revenue items, these are absorbed as 'negative expenditure' by the normal expenditure, reducing the amount of the latter or even turning the balance into a negative amount. Since 1986, a fourth line is foreseen, 'depreciation of stocks', to deal with depreciations that are provided for in the budget, as was the case with butter and beefmeat and, since 1988, also with cereals ⁽⁴⁾. For the products involving relatively small amounts of expenditure on public storage, i.e. oilseeds, sugar, cheese, wine-alcohol and pigmeat, no differentiation in cost categories is made in the budget. In those cases, the expenditure is presented in one item, sometimes even combined with other expenditure, e.g. on private storage, under headings like 'public storage', 'storage' or 'intervention'.

9. It is inherent to the nature of second category intervention that the resulting budget expenditure is particularly difficult to forecast. Both the quantity factor and the unit cost are in principle undetermined and vary depending on:

- (a) climatic and technological conditions;
- (b) supply and demand conditions on the world market;
- (c) the level of the internal intervention prices which are fixed in the course of the financial year, i.e. after the budget for that year has been adopted.

It is therefore inevitable that budget forecasts in respect of second category expenditure on frequent occasions need to be revised, so that they figure very often in the rectifying budgets.

Community funding

10. The amounts of reimbursable expenditure to which the public storage transactions carried out by the intervention agencies give rise, are funded by the Commission through the EAGGF advance system. This system has successively been governed by regulations of 1970 ⁽⁵⁾, 1978 ⁽⁶⁾ and 1983 ⁽⁷⁾, and has been specially adapted to the existing budgetary constraints as from 1 November 1987 ⁽⁸⁾. During the period relevant to this enquiry (reference years for accounts analyses and test-checks on accounts: 1984 and 1985, systems examinations and

spot checks on systems and stocks carried out in the period November 1986 — May 1987) the provisions of the 1983 Regulation ⁽⁷⁾ were applicable.

11. This system provided that the Commission made available, from the account held to that effect at the Treasury or another financial institution in the Member State, one global amount per month to each Member State, to finance a month's EAGGF-Guarantee expenditure. It was then up to the Member States themselves to distribute these funds among the paying agencies according to their respective cash needs.

These monthly global advances were based on monthly applications concerning the financial requirements of the paying agencies, submitted by the Member States to the Commission and comprising, for each paying agency:

- (a) a statement of the cash position at the end of the preceding month;
- (b) a statement of expenditure, broken down by budget item and by type of expenditure, in the preceding month;
- (c) an expenditure estimate, following the same break-down, for the current month and for the two following months;

and, for Member States with more than one paying agency, three summary statements grouping the individual cash statements, expenditure statements and estimates.

12. One of the renewals introduced by the 1983 Regulation was that, for second category expenditure, the expenditure in a given month should be interpreted as the expenditure resulting from the operations of the previous month. Thus, the successive monthly declarations of the financial year refer to the operations of the months December to November. The reasons invoked for this provision were that it would help to achieve a higher accuracy of the monthly declarations of expenditure and especially to avoid year-end problems with budget management. The immediate consequence of this change was a year of introduction (1983) counting 11 months, thus reducing the charge to the budget of that year by one month's expenditure on second category.

13. Expenditure in respect of public storage is declared on specific forms, explicitly prescribed by the regulation ⁽²⁾, both for the monthly declarations and for the annual account. The format and the logic of these forms have important implications for the accounting principles and methodology underlying the Community system of financing and accounting for second category interventions.

(1) Council Regulation (EEC) No 1883/78, laying down general rules for the financing of interventions by the EAGGF, Guarantee Section, OJ L 216 of 5.8.1978, articles 5 and 6.
 (2) Council Regulation (EEC) No 1334/86, OJ L 119 of 8.5.1986, p. 18, articles 1 and 2.
 (3) See also Court of Auditors annual report concerning the financial year 1985, OJ C 321 of 15.12.1986, paragraph 4.20, p. 45.
 (4) In the rectifying letter to the preliminary draft budget for 1988, these items are brought under title 8 of the budget.
 (5) Commission Regulation (EEC) No 2697/70 on the procedure for making Community Funds available to Member States under the Guarantee Section of the EAGGF, OJ L 285 of 31.12.1970, p. 63.

(6) Commission Regulation (EEC) No 380/78 on the operation of the system of advances in respect of expenditure financed by the EAGGF Guarantee Section, OJ L 56 of 27.2.1978, p. 1.
 (7) Commission Regulation (EEC) No 3184/83, on the operation of the system of advances in respect of expenditure financed by the EAGGF Guarantee Section, OJ L 320 of 17.11.1983, p. 1.
 (8) Commission Regulation (EEC) No 3188/87, amending Regulation (EEC) No 3184/83 on the operation of the system of advances in respect of expenditure financed by the EAGGF Guarantee Section, OJ L 304 of 27.10.1987, p. 9.
 (9) Commission Regulation (EEC) No 3184/83 (see footnote 7), in particular its Annexes III and VI, and related tables.

ANNEX II

*Administrative and technical organization**Purchase*

1. The administration of intervention offers is done partly on the local, partly on a central level in the Member State. Usually there is a central coordination of the intake, particularly from a point of view of allocation to storehouses, to ensure an economic use of capacity and for the application of rules in respect of transport cost reimbursement (in cases of allocation to other than the nearest intervention centres and/or transport beyond a certain distance). This central coordination is sometimes accompanied by a limitation of the quantity accepted into intervention per time unit, normally the week, as a result of intake capacity problems, e.g. the shock-freezing capacity for beefmeat. Technically, intervention purchases are dealt with at the local level, at the intervention intake points, which may be the end of a production line (slaughterhouse) or the entry of a storehouse. Acceptance procedures in connection with quality (sample-taking) and quantity (counting and weighing) are naturally taking place at that level. There may be a waiting period between physical arrival and definitive acceptance because of the time needed to obtain quality analysis results. These analyses are carried out in the laboratory of the intervention agency itself, or in a State laboratory, an independent commercial laboratory, the storekeeper's own laboratory, or a combination (for different technical aspects or for adjudicating analyses in the case of dispute). Payment is made by the intervention agency, taking into account payment delays prescribed by Community legislation, running into several months in recent years and usually expressed in a minimum and maximum delay, e.g. 90 to 120 days. (The main direct effects of these payment delays are a reduction of the effective price to the seller and a reduction of the interest charges borne by the Community.)

Storage

2. Technical storage arrangements are looked after by the national intervention agencies. They conclude contracts with owners of storage facilities, who can be producer cooperatives, commercial trading or manufacturing companies or specialized storage companies. There are very few examples of State-owned storage facilities. The conclusion of such storage contracts is usually preceded by a screening procedure, in which candidate intervention storekeepers have to prove their seriousness in respect of technical adequacy, financial solidity and commercial standing. The storage fees are negotiated between the intervention agency and the storekeepers, on a collective basis (with storekeepers' associations) or in individual bilateral negotiations, or also by periodic tender procedures. The contracts concluded normally contain provisions on technical requirements (including handling facilities, storage conditions and quality control measures) administrative obligations, accounting formats and procedures and inspection requirements, e.g. that individual lots should be accessible and countable. Most contracts also contain rules specifying the circumstances in which public intervention stocks can be stored together with other, e.g. commercial or private, intervention stocks of the same or different products, in the same store-room. It is equally a normal provision that storekeepers are financially responsible for abnormal losses of quantity and quality, a risk against which they can insure themselves.

Sales

3. Sales procedures are in principle centrally managed by the responsible market service of the Commission, in consultation with the relevant Management Committee, with a view to avoiding disturbance of the market and to ensure equal conditions for all interested parties. In order to carry out this task of central sales management, the Commission market services need to be informed about the actual free stock positions. Arrangements exist in each market, either governed by a regulation or on the basis of an agreement, for a regular (weekly, bi-monthly or monthly, depending on the market area) transmission by Member States of the relevant detailed data (e.g. breakdown by quality, age, geographical area). Sales procedures differ with the type of sale. Broadly speaking, one can distinguish:

- (a) sales on the internal market, at fixed prices or by tender;
- (b) authorization of the intervention agency to sell intervention commodities at the current intervention price, increased by a certain margin;

- (c) export sales at fixed prices or by tender, combined or not with an export restitution. Intervention storage in the case of export has in fact a waiting room function, in the light of developments on the world market or in the budgetary constraints;
- (d) special sales at reduced prices (e.g. Christmas butter);
- (e) sales for processing, for inclusion in animal feed or other low-value uses that should avoid substitution effects in the original market;
- (f) food-aid deliveries or free distribution to poor people in Europe.

In these procedures, the Commission market services play a central information-gathering and decision-making role (in consultation with the Management Committee) and the Member States' intervention agencies inform and carry out. They receive the payments coming from buyers (normally payment must have been made before release of the commodities is authorized) and they also process the securities that are to be lodged by (prospective) buyers in the case of tender, export and processing sales.

ANNEX III

Accounting

Annual account

1. According to the basic regulation on the financing of interventions ⁽¹⁾, the amount of expenditure to be financed by the EAGGF in respect of public storage is determined by the annual accounts drawn up by the payment agencies. The basic regulation on the financing of public storage ⁽²⁾ contains detailed rules for these annual accounts, which are to be drawn up for each product for which a specific intervention price has been fixed and on which intervention operations have taken place in the year.
2. These annual accounts have a trade account format, i.e. expenditure items, like technical costs and financial costs (both on a standard amount basis), are entered on the debit side, revenue items, like forfeited securities, are entered on the credit side, and the loss (or profit) on sales to be borne by the EAGGF follows from the inclusion, on the debit side, of the value of the opening stock and the purchases of the year and, on the credit side, the revenue from sales, the value of quantity losses chargeable to the Member State, and the value of the closing stock.
3. This account format is elaborated in detail in the standard form prescribed for the 12th monthly (i.e. annual) declaration under the regulation laying down rules for the estimation, declaration and funding of public storage expenditure ⁽³⁾. This year-end declaration is to be submitted to the EAGGF by 20 January of the following year. The expenditure declared in it is charged to the budget of the year. The Commission accounting services can, on the basis of a methodological screening, bring corrections to these declarations. Such corrections are then charged to the following financial year ⁽⁴⁾. The rest of the procedure is the same as for all EAGGF-Guarantee expenditure: Member States make their definitive declaration, which can include corrections established by their own services, in the account presented for clearance, in principle not later than 31 March, in practice in June or even later. Further corrections can be decided by the Commission as a result of clearance audits. The clearance corrections are charged to the budget of the year in which the clearance decision is published.

Monthly declarations

4. While the expenditure to be financed by the EAGGF in respect of public storage is defined on an annual basis, the funding of the expenditure must be effected on a monthly basis. The scheme of calculation of the expenditure must therefore be fitted into the pattern of monthly declarations and estimations of expenditure. The method chosen consists essentially in the conception of the monthly account as an intermediate version of the annual account. Each month, a declaration is drawn up which covers the period running from the beginning of the financial year till the end of the month for which the expenditure is to be declared. The expenditure is calculated and presented as a cumulative amount for that whole period. The charge of the month is determined by subtracting the previous cumulative amount from the new one.
5. A direct consequence of this method is that such a monthly amount can include adjustments brought to elements of the calculation of expenditure concerning operations of previous months. Such adjustments are simply absorbed by the system, they are not shown explicitly nor accounted for. This consequence was wanted when the system was established for the first time in 1970, because of the advantage that: 'preceding calculations can be corrected when necessary and only a single figure by column and by product is required for noting second category expenditure in the monthly declaration' ⁽⁵⁾.

⁽¹⁾ The footnotes appear together at the end of the Annex.

Losses on sales

6. The calculation of the cumulative loss on sales in each monthly declaration is based on the difference between a global average purchase price and a global average sales price. The global average purchase price is calculated by dividing the sum of the book-value of the opening stock and the total purchase value of the quantities taken in since the beginning of the financial year, by the sum of the quantities of opening stock and entries of that period. The global average sales price is calculated by dividing the total sales value received on quantities released since the beginning of the financial year till the end of the last month included, by the total quantity released in that period. The difference between the two global average prices, the average loss on sales, is multiplied by the total quantity released, to obtain the total cumulative loss on sales for the period covered by the declaration. From the subtraction of the previous cumulative amount follows the amount of loss on sales to be charged to the budget as expenditure of the last month included. This way of determination of the global cumulative loss on sales gives the same result as the application of the trade account scheme in which total opening stock value and total value of purchases are subtracted from the sum of total sales value and total closing stock value, provided that the closing stock is valued at the same global average purchase price referred to above.

7. On the sales side, a number of particular features exist. Free distribution of intervention products is simply accounted for at zero sales price, so that the loss equals the book value. Food aid deliveries are accounted for at the current intervention price, which is normally different from the book-value, so that these transactions give rise to bookkeeping results, sometimes profits, on the intervention budget item 'other costs of storage', with their counterpart on a food-aid budget line. Sales of milk products, butter and skimmed milk powder, are accounted for by a special procedure. In the normal declaration form, sales are valued at current intervention prices. Then, the difference between the intervention price and the sales price is determined and multiplied by the quantity disposed, in a special table which presents a break-down of the losses on sales by disposal measure. These amounts are posted to budgetary sub-items, so that the development of the cost of each disposal measure can be followed. Another particular case are the transfers of intervention produce from one country to another. These operations, which can involve hundred thousands of tonnes of produce, are nowadays usually accounted for as a sale at price zero by the dispatching country and as a purchase at the official opening stock valuation price (see paragraphs 15 and 16 of this Annex) by the receiving country.

Technical and financial costs

8. The basic rule for the accounting for all financial elements of public storage, technical costs, financing costs and losses on sales, is that the time when the various elements of expenditure and revenue are to be entered in the accounts is determined by the time of the physical operation in question. If the physical operation is carried out over a certain time, the time of the end of the operation is taken as the determining factor.

9. The main categories of technical costs are: entry costs, storage costs and withdrawal costs. Entry costs and withdrawal costs are included in the monthly cumulative declarations by multiplying the standard amounts (per tonne entered or withdrawn) by the total quantity physically entered into or released from storage since the beginning of the year. The amounts to be charged for the month are determined by subtracting the cumulative amounts determined in the previous declaration. The cumulative amount of storage costs is determined by multiplying the sum of the average stock positions of all the months included in the declaration, each average monthly position being calculated as the arithmetic mean of the physical stock quantities at the beginning and at the end of the month, by the standard amount for storage (expressed as an amount per tonne per month). The amount of a monthly charge to the budget is again the outcome of a subtraction of two successive cumulative amounts.

10. The financing costs are determined by applying one-twelfth of the annual interest (flat) rate to the sum of the average stock positions of all the months included in the declaration (i.e. the same sum of monthly average quantities as is used for the determination of storage costs), valued at the global average purchase price (the same that is used in the calculation of the loss on sales). The difference between the amount thus calculated after a given month and the amount established after the previous month is charged to the budget as the expenditure of the month.

11. The financial costs are calculated by reference to physical stock positions, as the physical movement criterion prescribes (see paragraph 8 above). However, in very many cases on the purchase side, and in more exceptional cases also on the sales side, payments occur with a significant timing difference in relation to the physical stock movement. Payment delays of several months have been provided for in the regulations governing the general purchase conditions for different products and in regulations on specific sales measures (in both cases lowering the effective price, to the disadvantage of sellers into intervention and to the advantage of buyers from intervention). In such cases, where a payment delay is provided for in a regulation, an adjustment is brought to the calculation of the financial costs. Such an adjustment is calculated over the whole quantity moved (i.e. new cumulative quantity, entered or released, minus the previous cumulative quantity entered or released) and for the whole minimum payment delay. Depending on the proportional relationship between physical stock position and physical movement in a month and on the length of the payment delay, such a deduction can decrease the cumulative amount of financial costs (so that the differential amount becomes negative) and it can even make it drop under zero. But it has been prescribed ⁽⁶⁾ that in that case the amount to be declared must be set at zero.

Implication of the cumulative declaration method

12. A cumulative declaration in respect of a given month not only adds on to the previous cumulative figures, the expenditure resulting from the physical operations of the last month, but also adjustments to entry and release costs for stock movements that took place in previous months, adjustments to storage and financing costs that result from the related changes in previous stock positions and, often the most important element: the sales losses on releases not previously included. These adjustments are basically of two types: quantity adjustments and value adjustments.

13. Quantity adjustments included in a declaration stem from the fact that stock movements, relating to one or more previous months have not been completely or correctly entered in the declarations drawn up by the end of those months. The main reason for these differences is that there are delays in the transmission of stock movement data from the local to the central level and/or processing delays at the central or at an intermediate level. Delays can also be caused by laboratory analyses of samples taken from produce offered into intervention; there is a downward adjustment when entries have been provisionally recorded but are then found to be unacceptable for intervention and a positive adjustment when entries are only recorded on definitive acceptance.

14. Value adjustments stem from the continuous recalculation of price averages, which are established each month on a cumulative intermediate basis, developing towards their final average value for the whole year. This concerns both the average purchase price and the average sales price. The former determines the financial costs and the two combined determine the losses on sales. Thus the expenditure of a month following from the differences between the new and the previous cumulative figures does not only represent the losses on sales and the financial costs for the last month, but also the adjustment resulting from the recalculation of the sales losses on the releases of all previous months, with the new average loss following from the new average purchase and sales prices, and the adjustment to the previously calculated financial costs resulting from the re-evaluation of the previous months' average stock positions with the new average purchase price. Needless to say that, until the end of the year, all these amounts will be the object of readjustments in the following months. Thus, in the case where the only sale transaction (at a loss) takes place in the first month of the year, the result for the year as a whole would be an accounting profit if sufficient purchases were made in subsequent months at prices below the disposal price of the sale transaction.

Stock valuation

15. The basic regulation on the financing of interventions lays down rules for the valuation of the intervention stocks, which could be interpreted as representing the principle of valuation at cost price or realizable market value, whichever is the lowest. The relevant Article (?) provides, in its first subparagraph that 'in the annual accounts (...), the quantities of products in storage to be carried forward to the following financial year shall, as a rule, be valued at their purchase price'. The second subparagraph states that: 'however, if, for a given product, the estimated price on leaving intervention is substantially lower than the value of stocks to be carried forward as determined in accordance with the first subparagraph, a decision may be taken to replace the purchase prices

paid by the intervention agencies by another price'. The Regulation provides further that, in both cases, the EAGGF Fund Committee is to be consulted on the valuation prices to be fixed. It is to be noted that, since 1983, the year-end stocks are those of 30 November (see Annex I, paragraph 12), and since 1987, those of 30 September.

16. The valuation rule that refers to a purchase price basis, is implemented in practice by fixing one common valuation price which is applied to the stocks of the same product in all countries. This uniform price is calculated as a weighted average of the global average purchase prices resulting from the Member States' monthly declarations. These national prices are themselves weighted averages of individual transaction prices which vary as a result of timing differences (monthly increases, change in intervention price, change in green currency rate, inclusion of opening stock) and of quality differences (giving rise to price premiums or reductions), and therefore they differ, for the same product, from month to month and from Member State to Member State. The weighting to establish the Community average is done on the basis of stock quantities and book values at a reference date. Since there is an obligation to consult the Fund Committee and the year-end stock valuation price must be known by the end of the year, this reference date is several months before the end of the year, usually 31 August or 30 September.

17. A depreciation of stocks is in fact an anticipation of an expected future loss on sales and results, under the system of financing for second category, in an immediate reimbursement to Member States of the amount involved. The possibility of depreciation was, until 1986, limited to the moment of drawing up the annual account (year-end valuation) and to a maximum of 50 % of the difference between purchase value and expected disposal value. The practical implementation consisted essentially in using up budget appropriations that had remained available at the end of the financial year.

18. The 1986 change of the regulation ⁽⁸⁾, received with reserved approval in a Court opinion ⁽⁹⁾, abolished the two limitations, which cleared the way for a depreciation provided for in the budget and effected in the course of the financial year. This constituted the start of an attempt to catch up with the enormous amount of unrealized losses built up since 1983, and representing, the last two or three years, more than half of the book value of the stocks. Similar depreciations were carried out in the beginning of 1987 and are proposed for the 1988 budget.

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- (¹) Council Regulation (EEC) No 1883/78, laying down general rules for the financing of intervention by the EAGGF, Guarantee Section, OJ L 216 of 5.8.1978.
- (²) Council Regulation (EEC) No 3247/81, on the financing by the EAGGF, Guarantee Section, of certain intervention measures, particularly those involving the buying in, storage and sale of agricultural products by intervention agencies, OJ L 327 of 14.11.1981.
- (³) Commission Regulation (EEC) No 3184/83, on the operation of the system of advances in respect of expenditure financed by the EAGGF, Guarantee Section, OJ L 320 of 17.11.1983. Recently amended by Commission Regulation (EEC) No 3188/87, OJ L 304 of 27.10.1987, p. 9.
- (⁴) Commission Regulation (EEC) No 3184/83 (see footnote 3), Article 9 (7) provides that corrections made by the Commission to the data declared and which figure in an annex to a decision on advances, give rise to withdrawal or reimbursement by the paying agencies before the end of the month which follows that in which the said decision was taken.
- (⁵) Aide-mémoire on the method to be followed for the declaration of second category expenditure Doc. COM VI/13/73 — Rev. 1.
- (⁶) Aide-mémoire for presentation of clearance accounts, Doc. VI/38/83 Rev. 8 of 1.6.1987, point 5.03.1.b.
- (⁷) Council Regulation (EEC) No 1883/78 (see footnote 1), Article 8.
- (⁸) Council Regulation (EEC) No 964/86, OJ L 89 of 4.4.1986, p. 1.
- (⁹) Opinion 1/86, OJ C 80 of 9.4.1986, p. 9.

ANNEX IV

Organization of intervention in Member States

1. Broadly, national intervention agencies are of three sorts:
 - (a) the single agency model is the most frequent type. It is found in Denmark, the FR of Germany, Ireland, Luxembourg, the Netherlands and the United Kingdom. The intervention agency is in most cases a body with semi-public status, reporting to the national Department of Agriculture (DK, D, NL, UK) or it is the Department itself (IRL, L). Practically all of these agencies have regional services for the on-the-spot supervision, two of them (F, I) have regional offices performing primary administrative and control tasks. For the technical storage capacity, contracts are concluded on a commercial basis with store-owners (i.e. agricultural cooperatives, specialized storage firms, trade or industrial companies with spare storage capacity). For this, Member States usually impose standard contracts with standard conditions, per product. The Court's examination revealed that for historical and other reasons, the management and audit of the single agency systems was more laborious than might have been expected;
 - (b) intervention agencies specialized by market are found in France and Belgium. There are separate intervention bodies for, e.g. milk products, beefmeat and cereals. Their status is a mixed form of a public body and a professional organization. In France, there is a central, coordinating agency which coordinates the legislative activity, centralizes and supervises the financial reporting by the intervention agencies to the EAGGF, distributes the Community funds among the agencies and has a liaison function in the contacts with the Community control authorities. The management and audit of systems of this type is in addition complicated by a vertical differentiation between administrative and financial functions;
 - (c) the case of a central agency, contracting out daily operations is found in Italy and Greece. The central agency is a public body, reporting to the Department of Agriculture. Contracts are concluded under national legislation with professional or commercial organizations, notably producer cooperatives, storage companies or trading and manufacturing companies having storage capacity available. These 'intervention contractors' carry out all daily administrative and technical tasks in respect of buying-in and storage of intervention products. They provide themselves the storage capacity and receive storage and handling fees provided for in the contract. They have accounting and reporting obligations and, in the case of Italy, also play a role in the payment for purchases. As to their number, in Italy the situation is different per market: almost 40 organizations in the cereals market, about 7 for olive oil and about 50 for beefmeat, the latter however coordinated through one national master association. In Greece, contracts are made with national producer cooperatives, one for each market, which each coordinate a large number of relatively autonomous, regional and local member cooperatives which physically carry out the intervention tasks.

ANNEX V

*Control provisions**Member States' control obligations*

1. The control provisions in respect of public storage expenditure are the same as for all EAGGF Guarantee expenditure. The general rules are laid down in the basic regulation on the financing of the common agricultural policy ⁽¹⁾ and are further elaborated in the regulations on the clearance of accounts ⁽²⁾, on irregularities ⁽³⁾ and in the directive on scrutiny by Member States of transactions forming part of the system of financing by the Guarantee Section of the EAGGF ⁽⁴⁾. They provide for supervision to be effected by the Commission over Member States and audits to be carried out by the Commission, including audits on the spot. The Member States are obliged to make these audits possible and are also supposed to carry out their own audits and to make the results available to the Commission.

2. Under the basic regulation on the financing of the common agricultural policy ⁽⁵⁾, Member States are obliged to make available to the Commission all information required for the proper working of the Fund and to take all suitable measures to facilitate the supervision which the Commission may consider it necessary to undertake within the framework of the management of Community financing, including inspections on the spot. It is specified that officials appointed by the Commission to carry out inspections on the spot must have access to the books and all other documents relating to expenditure financed by the Fund, in particular to check:

- (a) whether administrative practices are in accordance with Community rules;
- (b) whether the requisite supporting documents exist and tally with the transactions financed by the Fund;
- (c) the conditions under which transactions financed by the Fund are carried out and checked.

3. The last point implies a reviewing, by the Commission services, of Member States' systems of implementing and controlling the Guarantee measures. Member States are obliged to communicate to the Commission certain particulars concerning the paying agencies, notably their name and statutes and the administrative and accounting conditions in accordance with which payments are made relating to the implementation of Community rules within the framework of the common organization of agricultural markets, as well as any change in those particulars ⁽⁶⁾. They are also obliged to attach to the annual accounts, drawn up by the paying agencies and relating to EAGGF Guarantee expenditure, any report or part of a report drawn up by the competent auditing or supervisory authorities dealing with such expenditure ⁽⁷⁾. As from 1 March 1988, as a result of an amending regulation ⁽⁸⁾ to the regulation on the presentation of the accounts for clearance, Member States are obliged to supply information on the control conditions in a specified format. This provides notably for a description of the organization of the control activities and particulars of the control bodies involved, followed by descriptions of: systems audit work done, controls effected before payment, controls effected after payment, audit work undertaken in respect of bookkeeping, audit of declarations to EAGGF and any other control activities.

4. Furthermore, Member States are obliged by regulation ⁽⁹⁾ to take measures necessary to:

- (a) satisfy themselves that transactions financed by the Fund are actually carried out and are executed correctly;
- (b) prevent and deal with irregularities;
- (c) recover sums lost as a result of irregularities or negligence.

(1) The footnotes appear together at the end of the Annex.

They are to inform the Commission, with the detail and by procedures laid down in an implementing regulation ⁽³⁾, of the measures taken for those purposes and in particular of the state of the administrative and judicial procedures.

5. Specifically within the context of public storage, a provision on quality control is laid down in the relevant regulation ⁽¹⁰⁾, prescribing that Member States take all necessary measures to ensure the proper preservation of products which have been the subject of Community intervention. They are obliged to inform the Commission upon its request of all provisions laid down by law, regulation or administrative action governing storage and related operations.

Commission control action

6. The legal basis for control action effected by Commission services on the Member States' systems, activities, documents and accounts relevant to the implementation of EAGGF Guarantee measures, is laid down in the provisions quoted in paragraph 1 of this Annex, combined with the principle that only expenditure incurred in accordance with the Community rules within the framework of the common organization of agricultural markets, is financed by the EAGGF. The following types of control activity can be distinguished:

- (a) screening by EAGGF accounting service of monthly declarations and annual accounts for their methodological and arithmetical correctness;
- (b) audit by the EAGGF clearance audit service of final annual accounts presented for clearance, i.e. to decide on definitive acceptance of expenditure for Community financing;
- (c) investigations conducted by the frauds and irregularities service of EAGGF. As far as public storage is concerned these investigations concern in most cases problems with the quality of intervention products or problems with the destination of disposals;
- (d) special inquiries made by the financial control services into a particular theme (oriented controls). The last thematic study of public storage was made in 1982.

⁽¹⁾ Council Regulation (EEC) No 729/70, on the financing of the common agricultural policy, OJ L 94 of 28.4.1970, p. 13, Articles 4, 8 and 9.

⁽²⁾ Commission Regulation (EEC) No 1723/72 on the clearance of accounts concerning the EAGGF, Guarantee Section, OJ L 186 of 16.8.1972, p. 1.

⁽³⁾ Council Regulation (EEC) No 283/72, concerning irregularities and the recovery of sums wrongly paid in connection with the financing of the common agricultural policy and the organization of an information system in this field, OJ L 36 of 10.2.1972, p. 1.

⁽⁴⁾ Council Directive 77/435/EEC on scrutiny by Member States of transactions forming part of the system of financing by the Guarantee Section of the EAGGF, OJ L 172 of 12.7.1977, p. 17.

⁽⁵⁾ Council Regulation (EEC) No 729/70 (see footnote 1), Article 9.

⁽⁶⁾ Council Regulation (EEC) No 729/70 (see footnote 1), Article 4 (1).

⁽⁷⁾ Council Regulation (EEC) No 729/70 (see footnote 1), Article 4 (3).

⁽⁸⁾ Commission Regulation (EEC) No 295/88, amending Commission Regulation (EEC) No 1723/72 on making up accounts for the EAGGF, Guarantee Section, OJ L 30 of 2.2.1988, p. 7.

⁽⁹⁾ Council Regulation (EEC) No 729/70 (see footnote 1), Article 8.

⁽¹⁰⁾ Council Regulation (EEC) No 3247/81, on the financing by the EAGGF, Guarantee Section, of certain intervention measures, particularly those involving the buying in, storage and sale of agricultural products by intervention agencies, OJ L 327 of 14.11.1981, Article 2.

THE COMMISSION'S REPLIES

General

(a) The Commission is well aware of the problems arising in connection with agricultural products held in public intervention store for a number of years. In fact, it has changed on a number of occasions the storage arrangements to allow for potential losses and to reduce storage costs. Moreover, since 1986, it has stepped up sharply its drive to dispose of stocks more rapidly, despite budgetary constraints.

Action along these lines has includes the following:

— depreciation of the value of products stored at the end of the year on the basis of available appropriations: 86 million ECU in 1981 and 435 million ECU in 1985,

— amendment of Regulation (EEC) No 1883/78 in 1986 by introduction of a facility for depreciating stocks regardless of the budgetary situation at the end of the year; this allowed of a depreciation of 392 million ECU in 1986,

— amendment of Regulation (EEC) No 1883/76 in 1987 to allow of the disposal of about 1 million tonnes of butter, involving expenditure of about 3 200 million ECU in 1987 and 1988, financed in advance by the Member States,

— depreciation in 1988 of the value of stocks held, of 1 240 million ECU in March and of about 700 million ECU in July, to which will be added a third depreciation at the end of the year,

— amendment of Regulation (CEE) No 1883/78 to render depreciation compulsory on buying in, from 1989 onwards,

— supplementary financing of the depreciation and disposal of old stocks by appropriations from Title 8 of the budget of 1 400 million ECU per year between 1989 and 1992,

— reduction in the rate of interest paid to the Member States for the capital invested in stocks from 9 % in 1981 to 7% (5 and 5,5 % respectively for two Member States),

— freezing of flat-rate amounts for the financing of technical storage cost since 1986 and reduction in the relevant financial burden by 25 % until 1992.

In the aggregate, these arrangements have proved useful as regards the volume and value of stocks and storage costs, as the table below shows. The Commission takes the view that pursuit of an active stock reduction policy and improvements in stock financing management will lead to a normal situation in this area by 1992.

Also, since 1984, an inventory of public intervention stocks, their book value and potential cost is annexed to the Community's revenue and expenditure account and financial balance sheet.

(b) As regards Community supervision of public storage, the Commission would recall that the management and financing system chosen is the outcome of protracted negotiations within the Council, which opted for a system under which practical management remains in the hands of the Member States' authorities. Financing

million ECU	1984 (30.11)	1985 (30.11)	1986 (30.11)	1987 (30.9)	1987 (30.12)
Book value of products stored	8 751	10 580	11 360	10 575	9 368
Potential costs	3 391	4 459	6 766	4 777	4 250
Net value	5 360	6 121	4 594	5 798	5 118
Storage cost	542	733	701	508	600
Financing cost	515	615	658	537	649

is covered by the Community on the basis of a flat rate system in view of the differences in storage and administration practices in the various Member States.

Under this Community system, the Member States are responsible, in their national contexts, for the audit and supervision of merchandise bought in and stored and for its proper preservation (Article 2 of Regulation (EEC) No 3247/81).

When clearing the accounts, the Commission not only closes the files but also verifies proper implementation of Community regulations by the Member States (see point 2.2). The introduction of systems audit methods holds out the prospect of a steady improvement in management in this field.

- (c) The Commission shares the Court's concern as regards weaknesses in management and supervision by the Member States' government departments. It will send this report to the Member States, in particular through an appropriate working group, and will consider possible improvements with their representatives (see, in particular, points 4.9, 6.2, 6.11, 6.12 and 6.15).

Comments on certain specific points in the report

1. INTRODUCTION

1.18. The Commission refers the Court to its reply to points (b) and (c) in the general introduction at point 2.2.

2. PHYSICAL CONTROL ASPECTS

The central philosophy

2.2. The Commission is aware of the risks mentioned by the Court. In 1982 it carried out a selective check of 'second-category' expenditure.

Supervision and management of intervention operation are the responsibility of the competent government departments and the Member States must bear the financial consequences of any wrong practice ascertained (Regulations (EEC) No 3247/81 and (EEC) No 729/70).

The Commission has disallowed claims when clearing the accounts, as the examples below show:

- (a) It was found that three Member States had carried out premature tests for preservation of butter held in intervention store. When the 1986 accounts are cleared, it is planned to disallow about 1 500 000 ECU of the relevant claim.

In another Member State, durum wheat not matching the minimum standards set down in the regulations had been bought in. A claim of 21 million ECU was disallowed.

- (b) In two Member States, corrections were made for failure to apply the homogenization process on storage of cereals, which had an effect on the quality of the product. The claim disallowed was about 10 million ECU.

- (c) One Member State had failed to verify final use of skimmed-milk powder from other Member States, and the relevant claim of about 50 million ECU was disallowed.

Control over quantities

2.5 to 2.8. The organization of the control and supervision of stocks is a matter for the Member States, since they are responsible for the practical management of public storage. The methods used are related to the administrative machinery in each Member State. To attempt to prescribe standardized Community methods could well, in some cases, engender real difficulties for the Member States as to the organization of their administrative departments and could only lead to rules acceptable to all and thus to arrangements lacking rational structure.

2.6. Under Community legislation, the cost of organizing control and supervision of stocks is borne by the Member State.

2.8. This question concerns in the first instance the administrative organization of the Member States. The

Commission will submit the Court's criticism to the working group referred to at point (c) in the general note at the beginning of this paper.

Quality control

2.9. The Commission has asked an interdepartmental working group to frame general rules on sampling and sample analysis, and these have now been adopted by the Commission. Also, use of the systems audit method will allow of better monitoring of the procedures in the various Member States, which are responsible for the controls.

2.13. The Commission would refer to point (b) of the general remark at the beginning of this paper.

(b) It is true that the relevant Regulation did not include a minimum temperature for the storage of butter; however, the Member State is required to ensure proper conservation of the product. If there is deterioration of the product which is due to the physical conditions of storage, the loss must be reimbursed to the EAGGF (Regulation (EEC) No 3247/81, Article 4).

3. FINANCE AND BUDGETARY ASPECTS

Accuracy of the cumulative declaration method

3.1 to 3.4. It will be recalled that the Community financing of expenditure incurred in public storage is based on the submission of a document equivalent to an invoice, as indeed for any other EAGGF guarantee financing operation.

This invoice is based on evidential documents prescribed by the Community regulations.

Some of the evidence is drawn from the accounts of the intervention agency and other evidence consists in further calculations made to define the costs of the physical operations to be invoiced.

Also, the nature of the physical operations requiring financing is such that the quantities of products bought in and sold (and, therefore, stored) are provisional, based, for example, on provisional taking-over pending the results of a quality control. However, the accounts, which are used as the basis, are national accounts, which follow appropriate national rules and must neither be provisional nor involve overwriting preceding values (4.12). The Commission believes that it would be possible, in theory, to use an accounting system which would be partly a double entry system, yielding the figures required for the EAGGF claims.

Also, in the Community advance financing system — whether in the form of advance payments proper, or in the form of 'advances against booking' — a method has had to be introduced enabling this expenditure by monthly tranches to be covered while the principle of 'annuality' peculiar to public storage expenditure is properly complied with. Consequently, the regulations are not concerned with the final determination of the expenditure for a given month but with a calculation whereby the monthly accounting of the public storage expenditure to be financed by the EAGGF can be carried out.

These two observations yield, among others, the following conclusions:

— any 'lax attitude' in the accounting is not dependent upon the Community arrangements but on the government departments, which are automatically penalized in financial terms if buying in or sales are recorded late,

— as regards paragraph 3.4, in which the Court mentions the risk of mistakes, the Commission takes the view that the financial implications, which are not quantified by the Court, would form a small proportion, on an annual basis, of total expenditure.

The Commission has noted the points made at 3.2 (c), but has not found that the Member States consistently carry out their calculations early in order to draw the Community funds as quickly as possible: the weekly notifications received by the Commission show that the funds are consistently drawn in most cases in the last few days of the month following that of the operations.

4. MANAGEMENT AND ACCOUNTING CONTROL

Systems management and documentation

4.6. The Commission's staff regularly reviews the procedures used by the Member States to implement Community regulations.

Storage procedures will be examined thoroughly in the near future.

4.7. The EAGFF staff is preparing an inventory of this kind in connection with the systems audit.

4.9. The Memorandum used for the purposes of the monthly claims, which is updated from time to time, is a valuable tool for the Member States. Also, each adjustment is regularly and systematically explained in a working paper laid before the EAGFF Committee.

5. AUDIT OF INTERVENTION STORAGE

National external audit

5.7. The Commission would draw the Court's attention to the changes in the regulations in this field. The questions relating to the depreciation of existing stocks and to buying in have been settled following guidelines approved by the European Council on 11 and 12 February 1986.

Commission control

5.11. Claims sent in during the year are verified to the fullest extent possible.

5.12. The Commission establishes the flat-rate amounts and the interest rates on the basis of regular surveys in the Member States, and the latter notify, in official documents, the real costs of storage operations and of financing the value of products stored. The figures are checked by the Commission staff, in Brussels and on the spot, and adjusted where necessary.

Also, in the period between 1979 and 1981 the Commission asked a private firm to study storage costs and their structure in cold stores and grain stores, to provide comparative information. Also, it is by no means clear that the Commission reimburses more than it should to the Member States.

5.13(b) The relevant staff, working with an external expert bureau, has drafted an operational handbook for the Audit, use of which began in 1988.

(c) The systems audit method is applied on the basis of the verification of 1986 expenditure for certain schemes. It will gradually be extended to all the schemes financed by the EAGFF.

(e) The market management departments must consult the department responsible for accounts clearance for each proposed regulation involving control aspects, but problems do none the less persist in respect of practical application.

5.14 The Commission believes that the establishment of the anti-fraud unit will boost the drive against fraud, notably as regards coordination and the approaches adopted, of which the Court stresses some aspects.

The Commission shares the Court's concern as to the need to tighten up qualitative control of intervention storage. New verification procedures have been established in this connection and the Commission, in any recommendation it makes, will bear in mind the Court's observations.

6. CONCLUSIONS AND RECOMMENDATIONS

Physical control

Quantitative and qualitative control

6.1 and 6.2. The Court feels that there should be uniform rules for both quantitative and qualitative control. The Commission readily understands that such rules are desirable, but must also stress the limits which would arise when it came to practical application.

As the Court itself noted on its visits to the Member States, the storage infrastructures, practical management arrangements and administrative machinery vary very widely and are devised along lines peculiar to each Member State. Moreover, the storage infrastructure constitutes in the first instance a response to commercial needs, and public storage requirements are treated as a secondary matter. More thorough harmonization of administrative procedures could well lead either to higher costs for product storage or prompt store managers to refuse intervention storage altogether (this has happened).

A conceivable alternative — that of setting up a network of public warehouses — would be even more costly and would be an investment of questionable value in view of the Commission's declared aim of scaling down stocks substantially by 1992.

Flat-rate reimbursement

6.3 to 6.7. As described by the Court at 6.4, the flat-rate amount system was chosen for its convenience in a

situation in which the actual costs in the various member countries vary widely and are not easy to verify.

In the mean time, experience gained as regards the storage of agricultural products, financed by a flat-rate system, has confirmed that this is the right approach.

However, the Commission feels that the system could be refined as regards some details, and this is being studied by the relevant staff, working with the Member State's representatives, so that adjustments may well be made in the near future.

Year-end stock valuation method and depreciation

6.8. The system of year-end carryover prices has been altered by Commission Regulation (EEC) No 3189/87. As a result, the anomalies mentioned by the Court no longer occur.

6.9. The rules on depreciation of stock values were changed completely in 1988. Council Regulation (EEC) No 2050/88 provides for the compulsory depreciation from 1989 onwards of products bought in for public storage. Also, on 11 and 12 February 1988, the European Council recommended that the 'weight of the past' should be liquidated by the appropriation of 6 800 million ECU, spread between 1988 and 1992 for stock depreciation purposes.

Taken together, these two changes will suffice to achieve in due course a situation of normal storage in which a threat to the budget will no longer arise.

6.10 to 6.17. The Commission will study the Court's suggestion in connection with the joint examination of the report it will be making with the Member States' representatives in an appropriate working group.

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