

Official Journal

of the European Communities

ISSN 0378-6986

C 101

Volume 35

22 April 1992

English edition

Information and Notices

Notice No

Contents

Page

I *Information*

Court of Auditors

92/C 101/01

Special Report No 2/92 on the audit of export refunds paid to selected major traders in the milk products sector accompanied by the replies of the Commission

1

I

(Information)

COURT OF AUDITORS

SPECIAL REPORT No 2/92

on

the audit of export refunds paid to selected major traders in the milk products sector accompanied by the replies of the Commission

(92/C 101/01)

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

TABLE OF CONTENTS

	Paragraph reference
1. The Enquiry	1.1 — 1.9
2. The Audit Work	2.1 — 2.11
Preparation	2.1 — 2.2
Selection Procedure	2.3 — 2.8
Previous audit coverage	2.9 — 2.10
Cooperation	2.11
3. Summary of Audit findings	3.1 — 3.2
4. Conclusion and Recommendation	4.1 — 4.8
	page
Commission's reply	7 — 8

1. THE ENQUIRY

Community budget of export refund payments in these markets since 1987 is shown in *Table 1*.

Table 1: Export refund expenditure 1987 — 1990

(mio ECU)

	1987	1988	1989	1990
Milk products	2 257	3 013	2 868	1 930
Beefmeat	877	768	1 343	1 110
Cereals	3 070	2 924	2 597	2 443
Other	3 171	2 981	2 900	2 239
Total	9 375	9 686	9 708	7 722

1.1. In 1987 the Court began an enquiry into the payments, known as export refunds, which the Community offers to exporters of agricultural products in order to bridge the gap between Community prices and the lower level of prices which normally prevails on world markets. The focus of the enquiry was the three major markets of milk products, beefmeat and cereals. The cost to the

1.2. In reports already published ⁽¹⁾ ⁽²⁾ the Court has examined the role of public authorities (Commission, national, regional and local) and the central management of refunds and determination of rates by the Commission; it has also looked at the physical and documentary controls operated by national customs authorities and paying agencies over export consignments.

1.3. In 1989 the Court began to audit selected export transactions at traders' premises by examination of claimants' records. Many of these traders operate internationally and this phase of the audit involves enquiries in the majority of Community countries, and some non-Community countries.

1.4. Scrutinizing the commercial documents of undertakings which are receiving EAGGF Guarantee payments is an effective way of checking the regularity of transactions. That is why the Council introduced Directive 77/435/EEC ⁽³⁾, making it compulsory for Member States to audit such undertakings.

1.5. These provisions were reinforced by Council Regulation (EEC) No 4045/89 ⁽⁴⁾, which imposes much stricter obligations on Member States and specifies the methods to be used. The Regulation is innovatory in that it requires the Member States to provide mutual assistance in scrutinizing undertakings established in a Member State other than that in which payment is effected. A list of such undertakings and of undertakings established in non-member countries must be sent to the Commission. Traders are required to preserve all relevant commercial records for at least three years.

1.6. During its earlier audit work in connection with export refunds, the Court had been forcibly impressed by the problems encountered by national administrations in attempting to fulfil their control obligations under Directive 77/435/EEC ⁽³⁾. The Court's Special Report No 2/90 ⁽²⁾ (and its Annual Report of 1987 ⁽¹⁾) drew attention to the ineffectiveness of some of these controls and identified transnational operations as an area of particular weakness (paragraphs 3.67 and 3.68, of Special Report No 2/90). The objectives of the latest audit work are twofold:

- (i) to evaluate the impact of the system weaknesses on the payments to the beneficiaries and hence the effective-

ness of the Member States' control under Directive 77/435/EEC ⁽³⁾ and Regulation (EEC) No 4045/89 ⁽⁴⁾;

- (ii) to develop a coherent package of working methods for a posteriori controls, which could also be applied for scrutiny purposes by Member States under Regulation (EEC) No 4045/89 ⁽⁴⁾.

The approach adopted combines risk analysis with scrutiny of exporters' records relating to production, quality control, sales, freight costs, insurance, accounts, etc.

1.7. Although the audit is ongoing, the Court considers it appropriate to report on the results of its audit at an intermediate stage of the enquiry, since

- (a) the results obtained to date lead the Court to believe that it has developed a valid package of audit techniques, which ought to be more widely known;

- (b) the Court has also arrived at the conclusion that structurally the Member States' control systems are not designed to cope effectively with the transnational character of much agricultural export business, and in the final chapter of this report the Court recommends the creation of a Community unit for ad hoc control.

1.8. It was clear to the Court from the outset that the audit would require full and prompt compliance by Member States with their obligation under Article 206a of the EEC Treaty to make available to the Court all information necessary for the carrying out of the enquiry. National paying agencies' computerized information concerning payments and beneficiaries is of crucial importance in this context. Full cooperation in this respect was received from most of the Member States concerned before the end of 1989 and the audit work commenced early in 1990. However, France has not yet provided the degree of cooperation requested by the Court, since it finds the Court's request incompatible with the requirements of national law with regard to privacy of computerized information. The Court intends to continue its consultations with the French authorities in the hope of finding a solution to a difficulty which could jeopardize the satisfactory continuation of the audit not only in the Member State directly concerned, but in other Member States, given the transnational character of the export refund arrangements.

1.9. At this stage of the enquiry the Court is presenting its findings in summary form and without disclosure of the identities of the various beneficiaries involved. Full details

⁽¹⁾ Annual Report on the 1987 financial year, OJ C 316 of 12.12.1988, paragraphs 4.20 to 4.59.

⁽²⁾ Special Report No 2/90, OJ C 133 of 31.5.1990.

⁽³⁾ Council Directive 77/435/EEC of 27 June 1977 (OJ L 172 of 12.7.1977).

⁽⁴⁾ Council Regulation (EEC) No 4045/89 of 21st December 1989 (OJ L 388 of 30.12.1989).

of the findings, including the identities of the beneficiaries, have been communicated to the Commission and the Member States concerned.

— complexity of trading structure.

2. THE AUDIT WORK

Preparation

2.1. The Court requested computerized data in the form of magnetic tapes from national paying agencies covering refund payments in respect of the three major product groups Milk, Cereals and Beef. Interrogation of this data permitted analysis by claimant, product description, destination, value and date.

2.2. As a result of the interrogation of this data the Court identified a limited number of companies falling in the risk category in respect of which information was requested concerning previous audit coverage, company structure and trading activities, and the results of previous controls by national authorities under Council Directive 77/435/EEC ⁽¹⁾.

Selection Procedure

2.3. The Court has already published evidence ⁽²⁾ which suggests that the importance of export refunds in relation to the total value of the export contracts is most pronounced in the milk products sector, and this sector was selected as the field for the first enquiries. Within the sector a selection of beneficiaries was made on the basis of a weighted analysis of the following risk factors:

— value of refunds

— product

— destination

— results of previous EC controls

2.4. The present report is based on the Court's findings at two beneficiaries selected for examination, referred to here as Company A (resident in Member State A) and Company B (resident in Member State B). The value of refunds paid to Company A in the EAGGF budget year 1989 was ± 206 Mio ECU, (7,2 % of all export refunds on milk products) of which ± 119 Mio ECU was paid by the paying agencies of Member States other than Member State A. The value of refunds paid to Company B in the EAGGF budget year 1990 was ± 75,5 mio ECU, of which ± 68 mio ECU were paid by Member State B's paying agency and ± 7,5 mio ECU by another paying agency.

2.5. A selection was made of refund claims presented by the two companies in 1989. The claims audited were selected according to risk analysis factors of value, product and destination. The audit work was carried out at the Head offices of both companies where the principal commercial records are maintained and at the premises of some of the suppliers, producers and customers connected with the contracts which had given rise to the claims selected for audit. Certain export contracts of suppliers and producers were also examined. Where necessary, the Court followed the audit trail across Member State frontiers and to third countries where essential documentation was located.

2.6. Export refunds are paid on the export of agricultural products from the Community to non-Community countries. In order to qualify for refund, the products must be of sound and fair marketable quality and be placed on the market in an unaltered state. For all products the rates of refund (normally expressed in ECU per 100 kgs.) vary according to their description which gives rise to an export refund classification. It is the responsibility of the exporter to declare the correct description and classification.

2.7. The Court's audit tested the key criteria of origin, weight, quality, identity and destination by reference to a wide variety of commercial documentation including accounting, production, stock, quality control and despatch records; contract, correspondence and insurance files.

2.8. Physical inspections were carried out at the manufacturing and storage premises, including independent cold stores and agents' premises. Test weighing was carried out on a selection of products in production or in store.

⁽¹⁾ Council Directive 77/435/EEC of 27 June 1977 (OJ L 172 of 12.7.1977).

⁽²⁾ Special Report No 2/90, OJ C 133 of 31.5.1990.

Previous audit coverage

2.9. Prior to the Court's visit in 1990, the last occasion on which Member State A's authorities carried out an audit of payments to Company A under Directive 77/435/EEC ⁽¹⁾ was 1986. The audit was concerned solely with payments authorized by the national paying agency. No material irregularities were found. As regards the greater quantity of payments authorized by the paying agencies of other Member States a selective audit of these payments could have been conducted either on their own initiative by Member State A's authorities (who were notified of the amounts involved by the other national paying agencies) or at the request of one of the paying agencies concerned. On 10 June 1986, following a visit to a firm which handles Company A's export business in another Member State, the auditors of that Member State reported to their authorities that an effective audit could only be carried out in Member State A. However, this report was not brought to the attention of the authorities of Member State A, and in the event no audit of any of these payments was carried out by those authorities.

2.10. The last audit of Company B's refund payments was carried out by the national authorities of Member State B in 1985. No irregularities giving rise to reclaim of refunds were found. No audit has ever been proposed or carried out of payments made by other national paying agencies to Company B.

Cooperation

2.11. Constraints of time and resources made it impracticable for the Court to quantify all consequences of the problems identified and evidenced in its audits. Problem areas were therefore drawn to the attention of the relevant national authorities who were invited to follow up the Court's findings with a view to arriving at a comprehensive and definitive view of the facts (including quantification of the costs to Community funds) in each case. The Court acknowledges the generally high level of cooperation received from, in particular, the customs services of national administrations.

⁽¹⁾ Council Directive 77/435/EEC of 27 June 1977 (OJ L 172 of 12.7.1977).

3. SUMMARY OF AUDIT FINDINGS

- 3.1. (a) A cheese, not entitled to any descriptive name, was misdescribed for refund purposes as Provolone. An ordinary cheese does not attract as high a rate of refund as Provolone. Refunds overclaimed in the period covered by the Court's audit are estimated at $\pm 500\ 000$ ECU.
- (b) Steppenkäse cheese was misdescribed as Edam, thus invalidating prefixation certificates. The resulting possible overclaim in the period covered by the Court's audit is $\pm 105\ 000$ ECU.
- (c) Cheese for processing, which attracts no refund, was misdescribed as Gouda. Refunds overclaimed amounted to $\pm 30\ 000$ ECU.
- (d) Buttermilk powder was misdescribed as semi-fat milk powder, attracting a higher rate of refund. The irregular claim to refunds amounted to $\pm 1,15$ Mio ECU. ⁽²⁾
- (e) Refunds were claimed for skimmed milk powder, which was destined for use as food aid and was wrongly declared as not containing added whey. Added whey does not attract refund and is not in accordance with food aid product specifications. The total of overpayments was $\pm 500\ 000$ ECU.
- (f) Refunds were claimed for Cheddar cheese not all of which satisfied the minimum fat content requirement prescribed by Community legislation. The refunds involved are estimated by the Court at $40\ 000$ ECU.
- (g) There are differences in Member States' interpretation of the rules about water content of Cheddar cheese. In the Member State which has adopted the least rigorous interpretation one beneficiary claimed refunds to the value of ± 11 Mio ECU in

⁽²⁾ The Court is continuing its enquiries into exports of this product and has already identified a further consignment supplied to the same customer by other producers.

respect of this cheese in the EAGGF year 1989. The Commission should ensure that all Member States interpret the rules in the same way.

(h) The fat content of whole milk powder was in some cases misdeclared from below to above 28 % thus attracting a higher rate of refund. The refunds involved have not been notified by the Member State concerned.

(i) In the following instances refunds were claimed on goods which were not of sound and fair marketable quality and therefore not entitled to any refund:

(i) A consignment of cheese found to be unfit for human consumption on arrival in Poland. Refunds involved $\pm 450\ 000$ ECU.

(ii) Another consignment of a different sort of cheese was rejected on arrival in the U.S.A. because it contained animal hairs and failed to comply with the applicable health standards. The cheese concerned was returned to the EEC and for the most part re-exported with the benefit of refunds under a different description. The amount of refunds involved is $\pm 150\ 000$ ECU.

(iii) 1700 cases of butter exported to Egypt were found to be 'completely and severely damaged' in transit according to the insurance survey report. Some of the damaged goods were destroyed, the remainder not being fit for human consumption was sold for industrial use. They were therefore not entitled to refunds which in this case amount to $\pm 90\ 000$ ECU.

(j) Quantities of Cheshire cheese were declared for refund purposes and certified by the customs authorities of one Member State before their date of production.

(k) Plastic wrapping was included in the weight of the cheese for refund purposes. Refunds overclaimed total $\pm 40\ 000$ ECU.

(l) A prefixation certificate, issued at a high rate of refund, and with a preferential period of validity, for use only in connection with contracts within

the framework of the 3rd country call for tender cited thereon, was found to have been irregularly issued and subsequently irregularly used. The prefixation certificate holder had not obtained the required contract and had transferred the certificate to other exporters for irregular use. The refunds overclaimed amount to ± 2 Mio ECU ⁽¹⁾.

3.2. The earliest of the findings summarized above were brought to the attention of the relevant national authorities over two years ago. In some cases prompt and effective remedial action has been taken by the relevant national authorities. In other cases the Court has yet to see evidence of adequate follow-up action. The Court will keep these cases under review and will present further observations to the discharge authority if it is not satisfied with the measures adopted by the Commission and the Member States.

4. CONCLUSION AND RECOMMENDATION

4.1. Despite being in receipt during the period covered by the audit of approximately 10 % of all refunds on milk products, the two companies, which are the focus of this report, had not been audited by their national authorities since 1986 and those audits had revealed little or nothing in findings leading to recovery of refunds overpaid.

4.2. The scope of those audits was much narrower than the Court's audit. In one Member State no audit work had been carried out at producers; in neither case had payments made in other Member States been audited; in neither case had audit work been carried out in other Member States.

4.3. The Court believes that the findings in this report have demonstrated that much useful work could be achieved under Council Regulation (EEC) No 4045/89 ⁽²⁾, although Article 2 of that Regulation is an obstacle to the use of risk analysis, because of the method which it prescribes for calculating the number of undertakings to be scrutinized and because of the obligation it imposes on Member States to scrutinize all undertakings in receipt of more than 200 000 ECU. The findings in this report have

⁽¹⁾ The problem is not necessarily confined to this certificate. In 1987 the same Member State issued similar prefixation certificates for the export of milk products to the same destination. The Court is continuing its enquiries.

⁽²⁾ Council Regulation (EEC) No 4045/89 of 21st December 1989 (OJ L 388 of 30.12.1989).

also demonstrated the need for auditors to have access to better information and for the audit methodology to be improved both in terms of selection of transactions to be audited and in the scope of the audits.

4.4. The Court further believes that there is a need to improve the structure of the Community's mechanisms for *a posteriori* control of EAGGF funds. Useful improvements have been made in recent legislation, in particular Regulation (EEC) No 4045/89 ⁽¹⁾, with a view to facilitating cooperation between control services of different Member States. These changes were a logical response to the fact that many companies receive EAGGF funds in Member States other than those in which they have a physical presence. But no amount of cooperation between different national control services, whether under Regulation (EEC) No 4045/89 ⁽¹⁾ or in the context of the Community's arrangements for mutual assistance between Customs authorities, has much chance of unravelling the audit trail of operations which are organized not only internationally but on an intra-company basis. To be effective, that sort of enquiry must be entrusted to a single audit team from start to finish.

4.5. There is at present no organization in existence corresponding to a Community *a posteriori* control unit. The Commission (which some might see as an appropriate candidate for such a role) has consistently emphasized that the front-line role in combatting fraud must lie with the Member States, and that its own role should not exceed the central one of collating and disseminating information and coordinating Community action. The role of the Commission's anti-fraud unit, which was created three years ago, is confined largely to the coordination of the Commission's own services and the Community-wide collection and dissemination of information on fraud cases and anti-fraud legislation.

4.6. The Court recommends the creation of an independent Community unit for ad hoc controls. The responsibilities of such a unit would be to undertake controls of the major beneficiaries of EEC subsidies, particularly where those beneficiaries are international in their production and trading structures. This task is virtually beyond the reasonable capabilities of national control authorities. The targeting of such controls depends on analysis of data provided by several Member States, and this is work which can best be done on a Community basis. Such a unit could usefully include national experts on temporary contracts — a formula which has been adopted by the Commission's anti-fraud unit.

4.7. The controls would be carried out in liaison and cooperation with the responsible Member State bodies. They would be the equivalent at Community level to the controls carried out by the Member States under Regulation (EEC) No 4045/89 ⁽¹⁾ and would need a comparable legal basis. They would not replace national controls but would complement them in the areas where individual Member States are unable to carry out complete controls. Their cost effectiveness can be gauged from the fact that the direct costs (i.e. salaries and travel) of the operational work underlying the present report amount to approximately 200 000 ECU.

4.8. The Court recognizes that the decision to create such a unit could raise questions for the Community's legislative and budgetary authorities, in particular about resources and powers, and about the optimum location for the unit within the institutional framework. The Court has no wish to usurp the prerogatives of the Commission by making specific proposals on such matters. In the hope that its recommendation will lead to early action by the competent authorities the Court intends to continue its investigation of selected recipients of export refunds with the resources currently available.

The present report was adopted by the Court of Auditors in Luxembourg at its meeting of 12th March, 1992.

For the Court of Auditors
Aldo ANGIOI
President

⁽¹⁾ Council Regulation (EEC) No 4045/89 of 21st December 1989 (OJ L 388 of 30.12.1989).

COMMISSION'S REPLY

1. This Court report is based on enquiries made at the premises of a limited number of traders which the Court identified as potentially falling within a high-risk category. The selection was made on the basis of a weighted analysis of the following risk factors: value of refunds, product, destination, results of previous controls and complexity of trading structure.
2. The Commission would point out, firstly, that the Court's enquiries were made prior to the adoption of a number of measures (cf. point 4) and before the Member States became aware through the clearance of accounts of the need to audit refunds. It would also stress that export refunds will assume a smaller budget share with the proposed reform of the common agricultural policy.
3. The Court's findings identify two types of problems, due to shortcomings either in the rules or in the application of the rules.
4. In this context, the Commission notes the steps taken to introduce improvements in the past two years, in particular following the Court's special report on the management and audit of refunds, with regard both to the rules on refunds and to control.

The measures in question are as follows:

(a) on refunds:

- reduction in the number of headings concerning export refunds for beef and for fruit and vegetables;
- Regulation (EEC) No 386/90 and its Commission implementing Regulation (EEC) No 2030/90 laying down detailed rules for the application of a minimum number of physical checks to be carried out at the time of export of agricultural products attracting a refund;
- Commission Regulation (EEC) No 354/90 deleting Annex II for purposes of proof of release for consumption in a third country of exported

agricultural products qualifying for payment of a refund of variable rate according to destination.

(b) on auditing in general:

- Council Regulation (EEC) No 4045/89 and its Commission implementing Regulation (EEC) No 1863/90 providing for a reinforcement of a *posteriori* scrutiny of commercial documents of undertakings receiving or making EAGGF payments;
- Council Regulation (EEC) No 595/91 amending Regulation (EEC) No 283/72 providing for the communication by the Member States of detailed information on irregularities and for a flat-rate contribution by the Community to detection and recovery costs and, in certain circumstances, to the legal costs of the Member States;
- Council Regulation (EEC) No 307/91 and its Commission implementing Regulation providing for the reinforcement of national monitoring services, with a financial contribution by the Community at the request of the Member States;
- Proposal for a Council Regulation concerning the CAP and fisheries sanctions applicable, adopted by the Commission on 7 May 1990 and sent to the Council.

The Commission has, furthermore, set up a working party of experts chosen on the basis of their qualifications, with the task of examining the scope for simplifying the market organization mechanisms and the rules governing them.

5. Aware of the need for further improvement of the regulations, the Commission has undertaken a study of refunds paid in the milk products sector, with the aim of simplification and clarification.

It intends to rationalize the nomenclature, in particular of cheeses, by:

- deleting headings containing refunds which do not apply, through duplication or zero value;

— equalizing refunds paid in respect of comparable products; in this connection, for certain products, higher standards (notably in the case of oils and fats) will be proposed; differentials between refund levels will also be reduced as far as possible.

In addition, in the case of high-refund typical cheeses, the possibility of improving the definition of the product will be examined.

6. With regard to application of the export refund system by the Member States concerned, the Commission has taken note of the Court's comments. It will discuss the Court's findings with the Member States concerned with a view to achieving management improvements in the relevant national departments and ensuring smooth application of the Community rules (cf. 3.1. (g)).
7. According to the Court, the Member States in which it carried out its audits had taken steps to improve their management and monitoring of the refund system. Procedures and instructions had been adopted. The Commission will check on the extent of the action taken.
8. The Court recommends 'the creation of a Community unit for ad hoc controls ... to undertake audits of the major beneficiaries of EEC subsidies, particularly where those beneficiaries are international in their production and trading structures'.

With regard to Regulation (EEC) No 4045/89 on scrutiny by Member States of transactions forming part of the system of financing by the EAGGF Guarantee Section, to which the Court refers and which has been in force since 1 July 1990, the Commission considers that longer experience is needed in order to be able to judge its effectiveness.

The Commission would point out, moreover, that Article 2 of Regulation No 4045/89 states explicitly that the selection of undertakings for scrutiny must take account 'of the financial importance of the undertakings ... and other risk factors' (end of first paragraph). This Regulation places emphasis on risk analysis at the time of the selection of undertakings, in contrast to the earlier Directive 77/435 which merely specified a 'representative' selection of undertakings 'according to their financial importance'. This risk analysis also forms part of the scrutiny programmes drawn up each year by the Member States on the basis of Article 10 of the Regulation in which the Member States indicate 'the criteria adopted for drawing up the programme' (Art. 10(2), final indent).

The Commission will study the reports to be drawn up by the Member States on the application of the Regulation and will re-examine, where appropriate, the procedure specified by the Regulation, taking into account the Court's comments.

The Commission is aware of the importance of scrutiny and is constantly seeking to improve it. It is accordingly ready to engage in discussion with the Court on whether or not to introduce a control unit and on how this would be done. The Commission notes the problems involved, of which the Court itself is not unaware, since in its report it refers to the many problems in setting up such a unit and has reached no decision on the framework within which the unit should be established.

The Commission notes, however, that the work undertaken by the Court, on which this report is based, has required a considerable input in terms of human resources. The Commission would therefore point out that any steps taken to increase control will first require a policy commitment by the budget authorities to make available the necessary resources for such a measure.