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I

(Information)

COURT OF AUDITORS

SPECIAL REPORT No 7/93

concerning

controls of irregularities and frauds in the agricultural area (implementation of Council Regulation (EEC) No 4045/89 and Council Regulation (EEC) No 595/91) accompanied by the replies of the Commission

(94/C 53/01)

(Observations pursuant to Article 188c (4) second alinea of the EC Treaty)

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0. GENERAL INTRODUCTION

0.1. Community expenditure on the common agricultural policy during the European Agricultural Guidance and Guarantee Fund (EAGGF) budget year 1992 amounted to 30 billion ECU. A total of 10,6 billion ECU was spent on export refunds. The complexity of the relevant commodity measures and the size of export refund rates compared with world market prices create an environment which is vulnerable to irregularities and facilitates fraud. The Community must ensure, therefore, that sound, cost effective instruments for the early detection of irregularities and fraud exist. Once an irregularity or fraud has been detected, the recovery of Community funds should be swift and appropriate penalties should be applied.

0.2. This report considers:

(a) the effectiveness of one of the Community's main instruments in the fight against irregularity and fraud in the area of the EAGGF, namely the *a posteriori* control of commercial records (Council Regulation (EEC) No 4045/89);

(b) the communication system on irregularities and frauds against the EAGGF (Council Regulation (EEC) No 595/91); and

(c) the Commission's role in coordinating the fight against fraud.

1. COUNCIL REGULATION (EEC) No 4045/89

1.1. Council Regulation (EEC) No 4045/89 [1] (hereafter called 'the Regulation') was introduced with effect from

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

1.1.90 and replaced and reinforced the obligations of Council Directive 77/435/EEC (1). It provides for the scrutiny of the commercial documents of entities receiving or making payments relating directly or indirectly to the Guarantee Section of the EAGGF. The expenditure covered by this Regulation in the European Agricultural Guidance and Guarantee Fund (EAGGF-Guarantee) year 1990, amounted to 23 000 Mio ECU (85 % of total Guarantee expenditure). *Table 1* gives a breakdown of the amounts by Member State.

1.2. The Regulation stipulates that the selection of undertakings to be scrutinized should take into account their financial importance and other risk factors. It further provides for a minimum number of scrutinies to be carried out annually. The scope and methodology of the scrutinies are outlined in general terms in Article 3 of the Regulation (2).

1.3. Member States are responsible for the preparation of annual programmes of undertakings to be scrutinized; for the execution of the scrutinies; and for the preparation of annual reports on the application of the Regulation.

1.4. Provision is made in Article 7 for mutual assistance between Member States in the control of undertakings established in a Member State other than that in which the payment was made and for the regular notification of such payments.

1.5. Part of the Commission's supervisory and coordinating role under the Regulation is to ensure that the annual scrutiny programmes are adopted on the basis of appropriate criteria. (See Chapters 2 and 3)

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

(2) *Article 3*

1.The accuracy of primary data under scrutiny shall be verified in appropriate cases by an adequate number of cross-checks, including, inter alia:

— comparisons with the commercial documents of suppliers, customers, carriers and other third parties directly or indirectly connected with transactions carried out within the financing system by the EAGGF Guarantee section,

— physical checks upon the quantity and nature of stocks, and

— comparison with the records of financial flows leading to or consequent upon the transactions carried out within the financing system by the EAGGF Guarantee section.

2.In particular, where undertakings are required to keep particular book records of stock in accordance with Community or national provisions, scrutiny of these records shall, in appropriate cases include a comparison with the commercial documents and, where appropriate, with the actual quantities in stock.

Table 1 — EAGGF-Guarantee expenditure subject to Regulation (EEC) No 4045/89 scrutiny in 1990

Member State	Expenditure EAGGF-Guarantee (Billion ECU)
Belgium	0,75
Denmark	0,94
Germany	4,12
Greece	1,47
Spain	1,82
France	5,05
Ireland	0,53
Italy	3,97
Luxembourg	0,00
Netherlands	2,74
Portugal	0,25
United Kingdom	1,67
Total	23,31

Source: Commission report on the implementation of Regulation (EEC) No 4045/89. (VI/5202/92)

1.6. The Court has audited the implementation of Regulation (EEC) No 4045/89, which had reached its third annual programme by late 1992.

1.7. The objective of the Court's audit was to evaluate the effectiveness of the Regulation and of the controls carried out thereunder by Member States, with particular reference to export refunds on milk products. The issues examined by the Court were:

(a) the effectiveness of the Regulation as a framework for the a posteriori control of EAGGF income and expenditure;

(b) the effectiveness of the Commission in its supervisory and coordinating role; and

(c) the extent to which Member States have fulfilled their responsibilities under the Regulation in the planning and execution of the required scrutinies.

1.8. The Court carried out its audit at the Commission and in Denmark, France, Germany, Ireland, Italy, the Netherlands and the United Kingdom, these Member States being the most significant in the whole area of export refund payments. The Court's audit was announced in July 1992. It was completed at the Commission on the 14 September 1992 and in the Member States by February 1993.

1.9. The audit focused on:

(a) in the Member States:

— information available to the unit responsible for preparing the annual scrutiny programme;

— the criteria used for the selection of undertakings to audit;

— the coordination of audits including the use of mutual assistance;

— the audit methodology;

— the audit scope;

— the follow up of audit results;

— the information and tools available to auditors.

(b) at the Commission

— the evaluation of Member States' annual programmes;

— the coordination of control of supra-national undertakings;

— the evaluation of the application of the regulation;

— the follow up of audit results.

1.10. As well as evaluating Member States' implementation of the Regulation and the Commission's role in the monitoring thereof, this report also takes into account the findings of the Court's audit of major beneficiaries of export refunds on milk products.

1.11. In its Annual Report 1987 [1] and in two Special Reports No 2/90 [2] and No 2/92 [3] the Court has made observations on export refunds. These observations identified many weaknesses on the part of Member States in relation to:

— auditee selection;

— audit frequency;

— audit scope;

— audit methodology;

— selection of transactions for audit;

— control of large/supra national claimants;

— information & tools available to auditors;

— training & qualifications of auditors;

— follow up of results;

— coordination of audits;

— sanctions;

— powers of scrutineers.

2. AUDIT FINDINGS: MEMBER STATES

Selection of undertakings for scrutiny programmes

Procedure

2.1. Article 2.2 of the Regulation stipulates that undertakings whose total receipts or payments exceeded 200 000 ECU in the year preceding the year of scrutiny should be scrutinized not less frequently than once every two years. It further provides for a minimum number of undertakings to be scrutinized each year. For the reasons explained below, the application of this rule leads to inadequate audit coverage of the larger concerns as illustrated in ***Table 2*** which gives a breakdown, for the United Kingdom, of the distribution of payments of export refunds by undertaking.

(1) Annual Report on the 1987 Financial Year (OJ C 316 of 12.12.1988).
(2) Special Report No 2/90, OJ C 133 of 31.5.1990.
(3) Special Report No 2/92, OJ C 101 of 22.4.1992.

Table 2 — Dairy products Export Refund payments by undertaking in the United Kingdom

Undertaking No	Refunds ECU (*) Received	Percentage of Total Refunds	Cumulative Percentage
1	40 370 793	41,01	41,01
2	22 283 641	22,64	63,64
3	4 720 339	4,79	68,44
4	3 662 921	3,72	72,16
5	3 275 623	3,33	75,49
6	2 232 017	2,27	77,75
7	2 114 664	2,15	79,90
8	2 107 067	2,14	82,04
9	1 505 988	1,53	83,57
10	1 275 700	1,30	84,87
11	1 267 504	1,29	86,16
12	1 205 664	1,22	87,38
13	1 057 004	1,07	88,45
14	942 024	0,96	89,41
15	853 438	0,87	90,28
16	811 184	0,82	91,10
17	615 319	0,63	91,73
18	485 325	0,49	92,22
19	408 770	0,42	92,63
20	404 054	0,41	93,05
21	371 041	0,38	93,42
22	328 782	0,33	93,76
23	326 102	0,33	94,09
24	306 044	0,31	94,40
25	263 662	0,27	94,67
26	228 040	0,23	94,90
27	214 310	0,22	95,12
28	201 330	0,20	95,32
29	178 768	0,18	95,50
30	171 546	0,17	95,68
31	168 283	0,17	95,85
32	156 099	0,16	96,01

Source: United Kingdom Export Refund data 1990/1991. Analysis by the Court of Auditors.

(*) Listed in descending order of size of refund amounts.

2.2. The Table shows that 90 % of total expenditure was accounted for by the top 15 undertakings, whereas the next 17 undertakings in order of importance acounted for only 6 % of the total. Because of the requirement to comply with Article 2.2, all of these 32 undertakings, being above the 'compulsory' threshold, were treated as of equal importance in terms of scrutiny coverage.

2.3. The effect of Article 2.2 has also been counter-productive in terms of scrutiny quality. In the United Kingdom the normal duration of a scrutiny was found to be only one day. The audit effort on the spot accorded to the two main recipients accounting for 41 % and 22 % respectively of milk refunds paid in the 1990/91 EAGGF year was only 6 man days each whereas that devoted to undertakings in receipt of a total of less than 1 % was 14 man days.

2.4. The distribution of refund payments among beneficiaries as illustrated by the United Kingdom example is representative of the pattern in all market sectors across all Member States.

2.5. Article 2.1 provides for the financial importance of an undertaking and other risk factors to be taken into account selection procedures. In recent years, the use of risk analysis in audit techniques has been widely developed in both the private and public sectors. It has now become an essential tool in the selection of activities and undertakings for audit coverage and has been used with increasing effectiveness in auditing areas such as tax administration, particularly in relation to Value Added Tax.

2.6. Risk analysis applies a weighting to the expenditure in accordance with the risks identified. An illustration of the importance of selecting products where small variations in composition can have considerable financial consequences is given in ***Table 3*** below which shows, in relation to the most important milk products exported from a Member State during the EAGGF year 1989, the percentage reduction in refunds which would have resulted had there been a failure, even a minor one, to meet classification requirements.

2.7. There are also risks attendant on the fact that certain export refunds are differentiated by destination. For example refunds paid in respect of an export of Provolone cheese to the USA, where the refund rate is 160 ECU per 100 kg, present a higher risk than refunds paid on the same cheese exported to Canada for which the refund rate is 120 ECU per 100 kg, particularly where the goods destined for the USA are routed via the St Lawrence Seaway which gives easy access to both Canada and the USA.

2.8. Risk analysis should apply to all EAGGF measures, taking account of such factors as:

— previous scrutiny coverage and results;

Table 3 — Percentage reduction in Refund rates resulting from classification requirement failures

Product	Refund value (Mio ECU)	Percentage of total refunds	Cumulative percentage	Reduction in Refund rate
Butter	147	30	30	f/c failure = 2.5 % reduction in rate
Skimmed milk powder	143	29	59	Added whey etc. = reduction based on quantity added
Whole milk powder 28 % f/c	47	9	68	f/c fallure = 1 % reduction in rate
Whole milk powder 26 % f/c	37	7	75	f/c failure = 10 % reduction in rate
Evaporated milk 7.4 % f/c	15	3	78	f/c failure = 20 % reduction in rate
Processed cheese	14	3	81	f/c failure = 20 % reduction in rate
Gouda	13	3	84	f/c failure = 30 % reduction in rate
Cheddar	12	2	86	f/c failure = 100 % reduction in rate

key: f/c = fat content
fcdm = fat content in dry matter
Source: Analysis by the Court of Auditors of Export Refund data supplied by a Member State 1989/1990.

— product risk;

— destination risk;

— financial importance;

— complexity of the undertaking's business structure and activities; and

— history of known or suspected irregularities.

2.9. The main purpose of using risk analysis is to provide the most effective basis possible on which to select the most interesting undertakings for scrutiny having regard to the overriding need to prevent and deal with irregularities. Analysis is also helpful in determining the audit effort required to carry out an adequate scrutiny of each undertaking and the desirable frequency of scrutiny.

2.10. No Member State had set up a procedure to include all the above elements. In Denmark, France, Ireland, Italy and the United Kingdom, apart from the obligatory scrutinies of undertakings in receipt of more than 200 000 ECU, the only additional criteria taken into account systematically in the selection procedure, were financial importance and previous audit coverage. In no Member State was there any advance calculation by undertaking of the audit effort required. The only advance planning was in respect of the quantitive obligations contained in article 2.2.

2.11. Only in Germany and the Netherlands, is a certain amount of risk analysis carried out:

— In Germany, for export refunds, data is interrogated in order to identify undertakings dealing in 'risk' products for consideration in the annual scrutiny programme. The authorities, however, were unable to supply an explanation of their risk criteria.

— In the Netherlands, there is an exercise in its third year, whereby a limited range of export refund classifications is analysed. The analysis takes account of the risks presented by the export refund classification, known risk destinations, known fraud methods, Customs' laboratory analysis results, trading patterns and company links. The companies identified by this analysis are included in the annual scrutiny programme.

An explanation of the risks and the records needed to detect irregularities associated with these risks, are communicated to the scrutineers.

2.12. Notwithstanding the German and Netherlands' effort, the Court considers that general lack of effective risk analysis in the Member States constitutes a serious weakness in scrutiny procedures.

Information used in the selection of undertakings

Export Refund Payment Data

2.13. Payment information must be available in an easily accessible form to permit the identification of undertakings dealing in risk products and exporting to risk destinations so that the undertakings to be scrutinized can be most efficiently selected. The Court has received and used such data on magnetic tapes from all of the abovementioned Member States, except Ireland, annually since 1989. There are thus no valid technical reasons why Member States should not have made swifter progress in using such data in planning scrutinies of undertakings.

2.14. In the Member States audited (see paragraph 1.8) the Court found the following:

(a) in Denmark, France, Italy and the United Kingdom, the payment data is captured but not interrogated by the unit responsible for drawing up the annual scrutiny programme;

(b) in Germany and the Netherlands, the key payment data is available and used, albeit to a limited extent and;

(c) Ireland does not at present capture key data by refund claim but the feasibility of doing so is being examined by the authorities.

2.15. The basic data concerning export refund payments, which the Court considers should be captured by paying agencies and made available to the departments responsible for the planning of scrutinies for use by them in selecting undertakings and transactions, is identified in annex 1 to this report.

Information on Irregularities and Frauds

2.16. The history of a trader's compliance with the rules of the EAGGF regimes, is an important criterion in the selection of undertakings for scrutiny. Such information is frequently held by administrations or divisions not responsible for scrutiny. For example, Customs will hold details of irregularities arising from physical controls carried out under Commission Regulation (EEC) No 386/90 [1]; Customs or state laboratories will hold information on laboratory analyses of products subject to export refund claims; paying agencies will have information on irregularities discovered during their prepayment documentary controls or by their internal auditors; Customs or Ministry of Agriculture fraud investigation services will have knowledge of established and/or suspected fraudulent undertakings as well as details of how frauds have been perpetrated; Ministry of Agriculture officials responsible for food and hygiene standards in production plants will have information on an undertaking's record of compliance.

2.17. To gather all such intelligence within the department responsible for the selection of undertakings for scrutiny may be difficult. Nevertheless, it is possible as evidenced by the United Kingdom database which includes most of the abovementioned information. However, there was no evidence to demonstrate that it had been used during the selection procedure. In Italy and France, in contrast, none of the information was available. In other Member States, the information available in scrutiny departments was very limited. In any event, the only example of the use of appropriate intelligence for risk analysis was that found in the Netherlands which is referred to in paragraph 2.11.

Scrutineers' Risk Assessment

2.18. Risks arising from the complexity of the business structure of an undertaking and the adequacy of its records, as well as the results of former scrutinies are all essential elements for the selection of undertakings to be scrutinized. Such information should be available as a result of previous scrutinies. However, apart from the United Kingdom, no

[1] Commission Regulation (EEC) No 386/90 of 12.2.1990 (OJ L 42 of 16.2.1990).

Member State has set up procedures to ensure that this information is evaluated by scrutineers and subsequently exploited.

Performance measurement

2.19. The evaluation of the execution of a scrutiny programme is an integral part of risk analysis. It is important to ascertain whether or not the risk elements identified have resulted in the detection of irregularities so as to use this knowledge in the preparation of succeeding programmes.

2.20. Only the Netherlands had made this type of evaluation and even this, at the time of the Court's audit, was limited to the pilot risk analysis (referred to in paragraph 2.11). The evaluation demonstrated impressive results in that more than 25 % of the scrutinies resulting from the risk analysis gave rise to the discovery of irregularities amounting in value to 1,2 Mio ECU.

2.21. All Member States should evaluate the results of their annual scrutiny programmes against their selection criteria and such evaluations should be included in the annual reports submitted to the Commission under Article 9 of the Regulation.

Control of supra-national undertakings

2.22. The distribution of export refund payments in the dairy sector illustrates how a limited number of undertakings account for the greater part of the refund payments. There is a similar pattern in other product sectors. Computerized information received by the Court from 8 Member States, shows that in the dairy sector some 25 undertakings or groups of undertakings account for 60 % of the refunds. Most of these undertakings operate in more than one Member State. The following scenarios exist:

— undertakings receive payments in a Member State other than the one in which they are established;

— they receive such payments via 'brass plate' [1] companies;

— they have their own separate registered companies within the Member State making the payments but some, if not all, of their commercial records are maintained outside that state;

— the production takes place in a Member State other than that where payment is received;

— some of their commercial records are maintained outside the Community.

2.23. Article 7 of the Regulation provides for:

— mutual assistance between Member States for scrutiny purposes, on request, where an undertaking is established in a Member State other than the one in which the payments are made;

— the notification of such payments annually from the Member State making the payment to the one in which the undertaking is established, with a copy being sent to the Commission; and

— the communication to the Commission of the names of undertakings in receipt of EAGGF funds which are established in third countries.

2.24. There is a need to strengthen Article 7 to provide for the following:

— mutual assistance covering all the scenarios described at paragraph 2.22;

— coordination of scrutinies of undertakings concerned;

— an obligation on a Member State receiving a mutual assistance notification without a request for scrutiny, nevertheless to consider the undertaking and transactions concerned for scrutiny.

2.25. The succeeding paragraphs detail the Court's observations on the implementation by Member States of Article 7. (See also paragraphs 3.12 and 3.13)

Inclusion of payments notified in the scrutiny population

2.26. In all Member States, unless there has been a specific request for a scrutiny, the notifications are filed

[1] A company with no genuine trading activities set up in this context only in order to claim refunds on behalf of other related companies.

without action, even when the undertakings concerned have been included in the annual scrutiny programme. This has led to lack of control as illustrated by the following cases:

— Italy received a notification from Germany in respect of payments to an Italian undertaking totalling 5 Mio ECU. The undertaking was included in the Italian programme in respect of payments in Italy totalling 500 000 ECU but the records in Italy relating to the product for which payments were made in Germany were not audited by the Italian administration;

— France received a notification from Belgium concerning a French undertaking which had received 3 Mio ECU in 1991. Because this undertaking did not claim any EAGGF funds in France, it was not registered with the French Customs administration. The notification was filed with the comment 'unknown' and no further action was taken. The undertaking concerned was the principle actor in the irregularity described in paragraphs 2.33 to 2.38 of this report [1];

— Ireland received notifications from the Netherlands in respect of an Irish undertaking in receipt of amounts of 130 Mio ECU and 12 Mio ECU but neither amount was included in Ireland's scrutiny;

— a notification to Germany by France concerning payments of 15 Mio ECU was ignored. These payments were also the subject of the request by the Commission referred to in paragraph 3.12 below;

— the United Kingdom received a communication from Germany to scrutinize payments of 1,5 Mio ECU to an undertaking already in the United Kingdom's annual scrutiny programme. The German payments were omitted from the scrutiny. A request from Italy to scrutinize payments of 1 Mio ECU was similarly filed without action;

— the Netherlands received a notification from Germany in respect of payments of 22 Mio ECU to one undertaking. But again, despite the fact that the undertaking was included in the annual scrutiny programme, these payments were not examined;

— Denmark was notified by the Netherlands of export refund payments to one company of 600 000 ECU for the year 1990 and for approximately the same amount in 1991. The amounts were not considered for the scrutiny of that company which was, and still is, in progress.

2.27. Notifications only advise the total payments to an undertaking for the year in question. In cases where scrutinies have also been requested, the only Member State seeking details of the payments was the United Kingdom. Such payments cannot, of course, be properly scrutinized without knowledge of the underlying transactions.

2.28. On the basis of these observations, there was no assurance at the time of the audit that all of the amounts defined by article 1 of the Regulation had been duly included in the payments considered for scrutiny.

Mutual Assistance Requests

2.29. On 9.10.1990, the Netherlands asked France for mutual assistance under Article 7 in respect of an undertaking established in the Netherlands, but having some of the relevant commercial documentation in France. The French administration responsible for coordinating such requests sent it to the Customs service responsible for executing the requested scrutiny only on 3.9.1991. Customs transmitted the request internally to the responsible scrutiny team on 29.10.1991 and to date no reply has been issued by France.

2.30. International trade frequently involves undertakings in the supply chain between producers and the final customers, which are established in different Member States. Despite this, the Court found only one instance (referred to in paragraph 2.29 above) of mutual assistance requests where suppliers and/or producers and/or the commercial records of undertakings in the chain between the claimant and final customer, were in a different Member State to that making the payment.

2.31. The Court considers this to be a major gap in *a posteriori* controls. This has already been referred to in the Special Report No 2/92. The following details of a typical case illustrate the nature of international trade and the need to improve the structure of controls.

[1] Also referred to in paragraph 3.1(l) of Special Report No 2/92 (OJ C 101 of 22.4.1992).

2.32. Article 43 of Commission Regulation (EEC) No 3183/80 [1] permitted exporters to fix the rate of refund in advance for a period of 13 months, provided they had been awarded a contract as a result of a call for tender in a third country. The use of the advance fixing certificate was restricted to deliveries within the framework of the call for the tender in question. The normal period of validity for advance fixing certificates was 6 months.

2.33. In June 1987, an undertaking in France applied for, and received such a certificate for the export of 10 000 tonnes of skimmed-milk powder to Algeria. The quantity covered by the certificate was divided and the related rights were transferred to three undertakings, one in the Netherlands and two in Germany. The milk powder was for the most part (9 000 tonnes) produced by 3 undertakings in the United Kingdom at 10 different dairies. The remaining 1 000 tonnes were produced at 4 dairies in Germany. The powder produced in the United Kingdom was shipped to the Netherlands and stored in warehouses there prior to onward shipment.

2.34. Between January and June 1988, the powder stored in the Netherlands was loaded onto 7 ships for export to Algeria. On leaving the Dutch ports, the ships did not sail westwards as one would expect, but eastwards. They claim to have reported at the German port of Emden where, in order to satisfy the advance fixing conditions, the powder was declared for importation into Germany and for export with the benefit of refunds simultaneously, without the goods having left the ships. Lloyds Register of Shipping has no record of one of the ships concerned having reported at Emden.

2.35. The export refund claims were made by the two undertakings in Germany. The purchase of the powder was arranged by the Dutch company. The powder was sold in part directly by the latter to Algeria (2 000 tonnes). The balance of 8 000 tonnes was sold FOB, to two undertakings, one established in Switzerland, the other in the United Kingdom.

2.36. In order to check whether the goods were declared in the correct quantity, under the correct export refund classification and that they were delivered to Algeria and placed on the market there, within the framework of the call for tender on the advance fixing certificate, an audit had to be carried out by the Court in Germany, Netherlands, France, the United Kingdom and Switzerland. The audit revealed that the managing director of the undertaking in France was also the beneficial owner of the undertakings in the United Kingdom and Switzerland; that none of the deliveries had been made within the framework of the call for tender on the advance fixing certificate; and that of the 15 Mio ECU refunds involved more than 2 Mio ECU had been irregularly paid.

2.37. When the Court reported the case to the Member States concerned, Germany replied that it could take no action because it was a matter of the irregular issue of the certificate in France, and France replied that it was entirely a matter for Germany because it was a case of misuse of the certificate. The Commission has since requested the recovery of the amount involved in the misuse of the licence in question from the German undertaking. However, the Commission has not sought to extend its follow up action to other licences issued to the same undertaking.

2.38. The Court invited the French authorities on 12 February 1992 to extend the enquiry to cover other certificates issued to the French undertaking. A reply was received on 25 March 1992 indicating that the enquiry was under way. In fact, this enquiry did not commence until March 1993 as a result of further contacts between the Court and the French authorities.

Communication of background to scrutiny requests

2.39. No Member State gives any background information on the undertakings when making requests. It is particularly important when specific information is available concerning suspected frauds or known risks, that all relevant information be communicated to those who have to carry out the scrutiny.

2.40. Only the Netherlands, had identified certain undertakings for scrutiny as a result of its pilot risk analysis but where such undertakings had to be scrutinized in other Member States, the perceived risks were not communicated.

Reporting and follow up

2.41. Any request for a scrutiny should naturally receive a reply, preferably in the form of a written report. The United

[1] Commission Regulation (EEC) No 3183/80 of 3 December 1980 (OJ No L 338 of 13.12.1980).

Kingdom and Ireland were the only Member States systematically providing copies of the relevant scrutiny reports.

2.42. No Member State had set up a follow up procedure to ensure that their requests were satisfactorily dealt with.

2.43. The Court considers that Member States have taken a rather minimal approach with regard to the application of Article 7 of the Regulation. For it to be fully effective a more dynamic approach on the part of Member States is needed.

Undertakings with commercial records outside the EC

2.44. The Regulation is silent in respect of the production of the records of undertakings who maintain part or all of the commercial records necessary for scrutiny outside the geographical territory of the EC.

2.45. One of the biggest recipients of export refunds in respect of milk products, operating in all Member States sells 80 % of its exports of EC produce to third countries, via a central company established outside the EC. This company maintains at its location outside the EC the records of settlement by third country customers, the records of complaints concerning goods claimed to be not sound fair and marketable and records of shipping and insurance claims. This fact had been noted in several Member State scrutiny reports.

2.46. In view of the location outside the Community of this central selling company a full scrutiny of all required commercial records relating to refund claims was not made by the Member States concerned.

2.47. The Court sought to undertake an audit of this company with the aim of examining, in particular, commercial evidence relating to the criteria of the sound and fair marketable quality and the placing on the market, of the goods in question. After negotiation, the company accepted the reasonableness of the Court's request and, an authorization for the audit having been obtained from the Government of the third country concerned, the Court conducted an audit. Some findings from this audit are set out in paragraph 2.72.

2.48. Existing legislation is defective in that it does not specifically oblige beneficiaries, as a condition of payment of EAGGF funds, to allow full access to Member States and Community Institutions to relevant commercial records, wherever they may be located. This weakness needs to be remedied so as to avoid any doubts concerning rights of audit.

Scrutiny preparation

Payment information

2.49. The scrutineers need to have the details underlying the transactions they are to scrutinize, in a form easy to interrogate for the purposes of selecting transactions. They should also be available for consultation on the undertakings' premises.

2.50. In all Member States except Denmark and partly in Germany, the payment details such as claim number, date, product, quantity, destination, rate, and amount were not available to scrutineers in such a form. The Court found that:

— in Italy, the scrutineers were advised by the scrutiny central unit, of the total annual amount paid to the undertaking. They then had to reconstruct the claim details by requesting the undertaking to provide a summary identifying all the export declarations and then requesting the Customs offices where they had been lodged to forward copies;

— in Ireland, the scrutineers had to examine and, where necessary, copy details manually from the claim documents at the paying agency;

— in the Netherlands, the United Kingdom and for most part of Germany, details were available only in the form of computer listings, which are very difficult to use for the purpose of risk analysis; and

— in France, claim details were not obtained from the paying agencies by the Customs but from their own export statistics database in the form of a computer listing based on only the 8 digits of the Combined Customs Nomenclature in spite of the fact that refunds are differentiated by 3 additional digits under the export refund nomenclature (see also paragraph 2.62). Further-

more, the rate and amount of the refund were unavailable within the Customs data base.

Background information

2.51. The preparation for any scrutiny should always include researching the information held by other official entities involved in the control of EAGGF funds such as that described in paragraph 2.16 above. It should cover paying agencies' correspondence with undertakings concerning the regularity of claims, problems over proofs of arrival, refund classification and other issues. Details of analysis results held by Customs laboratories should be studied as should the reports of fraud investigation services on known and/or suspected frauds.

2.52. The Court found that:

— in the scrutiny preparation process the above information was not obtained by the scrutiny unit from the paying agencies in any Member State; and

— in no Member State was the Customs laboratory systematically consulted for test results on products exported by the undertakings concerned.

2.53. Even where there is provision for consultation, such as in Italy, where the scrutineers consult the Guardia di Finanza to ascertain details on fraud investigations of the undertakings to be scrutinized, it does not always lead to a prompt investigation as the following case illustrates.

2.54. On 31.8.1989, the Court informed the Italian Corte dei Conti of a potential irregularity case involving exports of Pecorino cheese. On 22.12.1989 the Court discussed the case with the Guardia di Finanza in Rome who had no progress to report. A scrutiny was carried out under Regulation (EEC) No 4045/89 by Italian Customs on the undertaking and some of the transactions concerned on 25.3.1991. The scrutineers had no knowledge of the suspected irregularity and, without examining production records, found all claims to be legal and regular. Only on 31.7.1991 did the Guardia di Finanza in Rome send a request to the Guardia unit responsible for the control of the undertaking concerned asking them to effect an investigation. The Guardia found the claims to be irregular and the refunds of 15 000 ECU unduly paid in the period 1986 to 1989 were recovered on 4.9.1992.

2.55. It is also interesting to note that the undertaking concerned exported the same type of cheese, produced in Italy, via the Netherlands and claimed refunds there. The Netherlands Customs laboratory tests indicated that the water content was higher than that declared in the refund claim. However there was no contact between the Dutch and Italian services on this and the Dutch did not investigate other export refund claims made by that undertaking in respect of the same product which amounted to 500 000 ECU in 1991.

Selection of transactions

2.56. The Regulation does not stipulate that transactions as such should be selected for scrutiny according to the risk they present. If the selection of undertakings must take into account not only the financial importance of the undertaking in the EAGGF system but also other risk factors, the selection of transactions should also take account of risk factors. In the Court's opinion, the other risk factors to be taken into account for export refund transactions, should at least be the same as those used for the selection of undertakings, as described at paragraph 2.8 above.

2.57. The Court found that:

— in Ireland, the Netherlands and the United Kingdom, the transactions were selected by the Member States scrutineers taking account of value and representativity of period and product;

— in Italy, since all claims were scrutinized, there was no need for a selection by risk factor. (But see comments on the audit scope in paragraph 2.61 et seq); and

— in Germany and Denmark, there was no evidence to indicate systematic use of risk criteria in the transaction selection process.

2.58. There have been some cases where the scrutineer has used his own initiative in the selection of transactions and in so doing proved the validity of risk analysis. For example, a scrutineer in Germany examined an undertaking which exported, amongst other products, Feta cheese. If the product contained added casein, no refunds were due. Having identified this as the highest risk, the scrutineer made a detailed examination of the raw materials used in the production of this cheese. The result was that he proved casein had been added and the undue refunds amounting to 45 000 ECU were subsequently recovered. Thus, initiative on the part of audit staff should be encouraged and should complement detailed criteria for risk analysis.

Audit scope

Definition of Commercial Documents

2.59. Article 1 of the Regulation stipulates that commercial documents of undertakings shall be scrutinized to ascertain whether or not the transactions have been executed correctly. It defines 'commercial documents' as 'all books, registers, vouchers, supporting documents, accounts and correspondence relating to the undertaking's business activity, as well as commercial data, in so far as these documents relate directly or indirectly to the EAGGF transactions'. Article 3 provides for the extension of the scrutiny to the commercial documents of suppliers, customers, carriers and other third parties directly or indirectly connected with the EAGGF transactions.

2.60. These articles provide a sound base for the scope of scrutinies. However, during the course of the Court's audits, some doubts were raised by Member States and enterprises as to whether commercial documentation included production and quality control records. In the Court's view they are included. This matter should be clarified by the Commission and the Trade Mechanism Committee and, if necessary, the text should be revised to put the matter beyond doubt.

Scope

2.61. Contrary to the broad audit scope defined by the Regulation, the Court found that in practice the Member States' approach was unduly limited. Examples of weaknesses in audit scope are cited in the following paragraphs. They are grouped according to the refund criterion which should be tested, with a brief explanation as to the importance of the test.

Export refund classification

2.62. Export refund rates are differentiated according to composition and description as defined in the export refund nomenclature. These compositional requirements relate to the raw materials and to the chemical characteristics of the finished product such as water content or fat content in dry matter. For example, a cheddar cheese with a fat content in dry matter of 48 % or more attracts a refund of 150 ECU maximum per 100 kg whereas if the fat content in dry matter is 47.9 % or less it attracts no refund at all. Rate differentiation on the basis of description and/or composition is common to milk, beef and cereals export refunds.

2.63. Commercial documentation in the limited sense of orders, contracts, delivery notes,freight documents and invoices certainly gives some assurance as to the correct description of the product declared. However, none of those sources will provide adequate assurance as to the raw materials used in its manufacture or of the chemical composition in terms of water content, fat content etc. In order to verify these elements the scrutiny has to include the undertaking's production records and the results of quality control tests on the finished product.

2.64. The Court found that the scrutiny of production and quality control records was carried out systematically in only two Member States, France and Ireland. In Italy, the Netherlands and the United Kingdom, these records were never examined by the scrutiny unit. In Germany and Denmark, they were rarely examined. In these circumstances there can be no assurance that the scrutiny of export refund transactions has adequately covered crucial elements relating to export refund classifications.

2.65. The importance of examining production and quality control records has been illustrated in Special Report No 2/92 (1) and the following example is a further illustration of the importance of such examinations or scrutinies:

a Customs laboratory test on a sample of Mozzarella cheese exported from the United Kingdom with refunds, showed that the product had an excessive water content and should be reclassified, thus attracting a lower rate of refund. The case was treated as a fraud investigation by United Kingdom Customs. The investigation unit responsible obtained the undertaking's own laboratory test results on the product in question which supported the Customs test results and also established that the misdeclaration related to many other transactions. The irregularity amounted to 900 000 ECU which was recovered along with a penalty.

2.66. Article 3 of the Regulation provides for physical checks on the quantity and nature of stocks. Physical inspections are important for the following reasons:

— it is a basic check as to whether or not the undertaking has the capacity to manufacture the goods in question;

— it enables the scrutineer to identify key control documents which indicate and quantify ingredients;

— it enables the scrutineer to check key control procedures such as the method of establishing quantity and

— it enables the scrutineer to identify, and therefore follow up the use of, raw materials.

2.67. The Court found that physical inspections of production, storage and despatch premises were not systematically considered for inclusion in any of the Member State scrutinies. The Court's own audit of export refund beneficiaries has proved the usefulness of such checks.

— plastic wrapping included in the weight for refund purposes (40 000 ECU per year overpaid to one refund claimant);

— buttermilk used instead of skimmed milk resulting in overpayments of 1,2 Mio ECU;

— additives such as casein and whey not deducted from the weight for refund purposes with corresponding overpayments of 800 000 ECU. This case, which had not been detected by national audits in 4 Member States (F, UK, NL and D), was the subject of voluntary disclosure by the undertaking concerned.

Sound and fair marketable quality and placing of goods on the market

2.68. Article 13 of Commission Regulation (EEC) No 3665/87 (2) states that no refund shall be granted on products which are not of sound and fair marketable quality, or on products intended for human consumption whose characteristics or condition exclude or substantially impair their use for that purpose. Article 5 of the same Regulation stipulates that the payment of the refund shall be conditional not only on the product having left the customs territory of the Community but also on its having been imported into a non-member country. Member States may also require that additional evidence be provided such as to satisfy them that the product has actually been placed on the market in the non-member country of import in an unaltered state.

2.69. The purpose of these articles is to ensure that the Community does not subsidize damaged goods, goods which no longer possess the qualities of conservation inherent in the concept of merchantable quality, goods unfit for human consumption and goods for which there is no genuine commercial market.

2.70. Auditing in this context can be difficult in that some of the related evidence may be available only in the commercial records of the third country customer. The usual audit method has been to ensure that the goods have been paid for in full by examining the customer's account and settlement records. There are, however, a number of other useful sources of audit evidence such as:

— customer complaint records;

(1) Paragraph 3.1.

(2) Commission Regulation (EEC) No 3665/87 of 27 November 1987 (OJ L 351 of 14.12.1987).

— provisions and write-offs in the accounts in respect of non-marketable or non-marketed goods;

— credit notes;

— insurance claims and

— quality control reports on customer complaints.

2.71. In this context the Court found that:

— in Denmark, Germany, Italy, the Netherlands and the United Kingdom scrutinies did not take account of any of these records;

— French scrutinies took account of provisions and write-offs but none of the other sources;

— in Ireland, the scrutiny included examination of insurance claims and credit notes but not the other records.

2.72. The importance of auditing these records can be judged from the following examples found by the Court during a recent audit of one beneficiary. All resulted from an examination of the records referred to in paragraph 2.70 above:

— 250 tonnes of whole milk powder found to be 'simply not fit for direct sale on account of its rancid taste';

— 85 tonnes of whole milk powder destroyed by public health authorities in the third country, because the goods were unfit for human consumption resulting from inadequate sealing of cans;

— 617 tonnes of sweetened condensed milk sold for industrial use at 50 % reduction because the viscosity was too thick for the market as a result of a manufacturing fault;

— 42 tonnes of cream seized and destroyed by the public health authority because the goods were unfit for human consumption as a result of bitter taste caused by inadequate sterilization;

— 9,5 tonnes of cream completely destroyed during a storm at sea and

— 1 690 tonnes of whole milk deemed by the customer to be of abnormal quality as a result of its mouldy flavour and therefore not marketable in its existing condition.

The refunds at stake in the abovementioned cases amount to 2,65 Mio ECU.

3. THE ROLE OF THE COMMISSION

Introductory remarks

3.1. The Commission's reply indicates that, subsequent to the start of the Court's audit, it has undertaken its own exercise to monitor the implementation of Regulation (EEC) No 4045/89. The Court notes with satisfaction that account has been taken of the Court's observations and recommendations in Special Report No 2/92, as well as of the observation which arose during the Courts audit on the implementation of Regulation (EEC) No 4045/89.

Annual programmes

3.2. Article 10.2 of the Regulation obliges Member States to send to the Commission their annual programmes identifying the numbers of undertakings to be scrutinized and their breakdown by sector on the basis of the amounts received and the criteria adopted for drawing up the programme. The Commission must make known its comments within 6 weeks and if there are none, the programmes are to be implemented as established.

3.3. At the time of the Court's audit at the Commission, the Member States' annual programmes for the years 1990/91,1991/92, 1992/93 had been received. The Commission's action on receipt of the programmes has been limited to an arithmetical check on the calculation of the numbers of undertakings to be scrutinized. The only query raised was in respect of the United Kingdom 1990/91 programme. There has been no evaluation of the programmes in terms of the risk criteria used for the selection of undertakings.

3.4. Article 10.5 allows the Commission to request the inclusion of a particular category of undertaking in the

Member States' programmes. The Commission has made two such requests, addressed to all Member States, to include export refunds on beef and export refunds and production aid for olive oil in the 1992/93 programme. However, there was no evidence of follow up at the Commission to ensure that these requests were respected.

3.5. Within the Commission, the Directorate-General for Agriculture (DG VI) is responsible for administering the Regulation. Despite the fact that other Commission services, such as the 'Unité de Coordination de la Lutte Anti Fraude' (UCLAF), the Financial Controller (DG XX) and the Customs Directorate (DG XXI), hold information on irregularities and fraud trends none of these services is consulted by DG VI when considering the Member States' scrutiny programmes.

Annual report

3.6. Article 9 of the Regulation obliges Member States to send the Commission a detailed report each year on the application of the Regulation.

3.7. The first annual programme under Regulation (EEC) No 4045/89 ran from 1.7.1990 to 30.6.1991. Member States were obliged under article 9(1) of the Regulation to submit their reports on the application of the Regulation by 1 January 1992. Under article 9(5), the Commission was obliged to submit its report on the application of the Regulation by 31 December 1991. There is moreover no provision in the Regulation which makes the Commission's report dependent on the prior receipt of Member States' reports. At the time of the audit in September 1992, the Commission had not submitted the required report. It was later submitted in December 1992 [1].

3.8. At the time of the audit, no internal Commission documentation was made available to the Court to indicate that Member States' reports had been evaluated other than tables comparing the numbers of scrutinies required by Article 2.2 with those executed.

3.9. The Commission is obliged in its annual report to evaluate the progress achieved on the administration of funds referred to in Article 10 of Council Regulation (EEC) No 729/70 [2].

3.10. The evaluation of progress achieved is limited to the statement that the 1990 programmes had been received and implemented; that the Commission had proposed a standard format for communication of the programmes and that 2,4 Mio ECU had been contributed to Member States under the financing provisions in Articles 12 to 20, linked to improving the quality and scope of Member States' scrutiny.

3.11. Like the Member States, the Commission at the time of the audit had taken the least possible view of its role in evaluating and reporting on the application of Regulation (EEC) No 4045/89.

Article 7 Notifications to the Commission

3.12. As stated in paragraph 2.23 above, under Article 7.2 Member States have to send to the Commission annually a copy of the lists which they send to each other of undertakings established in a Member State other than that in which the payment is made or received. With one exception, the notifications copied to the Commission under this article have been filed without action. In the one exception which resulted in a request by the Commission to Germany to include the payments in its annual programme for 1991, there was no follow up action by the Commission and the Court found that the amounts concerned were not even scrutinized in Germany. As the objective of Article 7 is to ensure that the amounts notified are considered for scrutiny, both the Commission and Member States should use communicated information for this purpose.

3.13. Article 7 on its own is not adequate for the control of traders whose commercial records or whose suppliers' or customers' commercial records are maintained, in part or wholly, in a Member State other than that in which the payment was made or received. This shortcoming needs to be rectified. (See also paragraphs 2.24, 2.48 and 2.55).

(1) VI/5202/92 refers.

(2) Council Regulation (EEC) No 729/70 of 21 April 1970 (OJ L 94 of 28.4.1970).

4. THE COMMUNICATION SYSTEM ON FRAUDS AND IRREGULARITIES AND THE FIGHT AGAINST FRAUD

Introduction

4.1. Chapters 1 to 3 of this report have dealt with the one of the Community's main instruments in the detection of fraud and irregularities against the EAGGF. This chapter deals with the communication of frauds and irregularities after discovery and the role of the Commission in coordinating the fight against fraud. The audit started in January 1991 and finished in February 1992.

Notification and Recovery under Regulation (EEC) No 595/91

4.2. In its Annual and several Special Reports the Court has criticized the ineffectiveness of the actions taken by the Commission and the Member States to combat fraud and irregularities, mainly in relation to Own Resources and to the EAGGF. In early 1991, the Court started a comprehensive enquiry with the aim of assessing some of the Community's defences against fraud and irregularities which could affect the Guarantee Sector of the EAGGF. For this purpose the Court visited the Commission and 6 Member States: the United Kingdom, Spain, Germany, Italy, Greece and Luxembourg. The remaining countries (France, Belgium, the Netherlands, Denmark, Portugal and Ireland) were also included in the audit by using questionnaires, but they were not visited.

4.3. In order to monitor not only the cases detected but also the follow up actions by the Member States, including prosecution, sanctions, recovery of sums unduly paid, an information system between the Member States and the Commission was created by Council Regulation (EEC) No 283/72 [1]. This was subsequently replaced by Council Regulation (EEC) No 595/91 [2]. Its chief objective is to ensure that the Member States and the Commission are fully informed of irregular practices so that they can be tracked down and prevented more effectively [3].

4.4. Under Council Regulation (EEC) No 595/91 [4] Member States are required to notify:

(a) the Commission of the application of the national provisions to implement the Regulation including a list and description of the roles of the authorities and bodies responsible for doing so (Article 2);

(b) the Commission once a quarter of any irregularities, the proceedings instituted and subsequent significant developments (Articles 3 and 5);

(c) the other Member States concerned and the Commission of any irregularities discovered or that are suspected which it is feared may have effects outside the reporting Member State's territory (Article 4);

4.5. The Commission is required to:

(a) assess the Member States' notification system (Article 2).

(b) inform the Member States concerned where it considers that irregularities have taken place and to request them to hold an enquiry (Article 6);

(c) maintain appropriate contact with Member States to supplement the information received and to organize information meetings for the Member States (Article 8);

(d) put before the EAGGF Committee [5] cases where the nature of the irregularity is such as to suggest that identical or similar practices could occur in other Member States (Article 8);

(e) provide the EAGGF Committee with overall summary information every quarter (Article 9);

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(1) Council Regulation (EEC) No 283/72 of 7 February 1972 (OJ L 36 of 10.2.1972).

(2) Council Regulation (EEC) No 595/91 of 4 March 1991 (OJ L 67 of 14.3.1991).

(3) Doc. DG VI/680/89, paragraph 5.

(4) Article numbers between brackets in this part of the Report are those of Regulation (EEC) No 595/91.

(5) The EAGGF Committee, established by Council Regulation (EEC) No 729/70 of 21 April 1970 is an advisory body on EAGGF affairs. It is composed of representatives of the Member States and the Commission.

(f) include in the annual EAGGF Report the number of cases notified, those closed and sums recovered and written off (Article 9).

4.6. Regulation (EEC) No 595/91 also contains provisions concerning:

(a) the Community financing of part of the costs of the inquiries, legal proceedings and recovery of sums unduly paid (Article 7);

(b) the Commission officials' rights and constraints when participating in national inquiries (Article 6);

(c) the upgrading of the quality of the information to be provided to the Commission (Article 8) and

(d) the confidentiality of the information (Article 10).

Coordination of the Fight against Fraud

4.7. In response to demands from Parliament, the Council and the Court, an anti-fraud coordinating unit, UCLAF, was created by the Commission in 1988 to coordinate the Commission's resources and activities for combatting fraud and irregularities. The unit, within the Secretariat General of the Commission, was placed under the direct responsibility of the President.

4.8. The European Council of Madrid in June 1989 adopted a workplan for the anti-fraud campaign, to be managed by UCLAF. This plan did not include target dates for the implementation of the actions. It remained in force until the Commission in its 1992 Report and Action Programme for 1993 on the fight against fraud has set out a more detailed statement of its mission (1). Because it is, as yet, too soon to assess its impact, that Action Programme was not examined in the context of this audit. However, the role of UCLAF in relation to the EAGGF is further discussed in paragraphs 4.20 and 4.23.

(1) COM(93)141 final of 20 April 1993.

The notification system

General

4.9. Neither Regulation (EEC) No 595/91 nor any other Community instrument defines the concept of fraud or irregularity. In an attempt to define 'irregularity' and 'primary administrative or judicial finding of fact' and to lay down some basic rules concerning the notification of attempted fraud, a working document was prepared by the Commission and communicated to the Member States in 1989 (2). In this document 'irregularity' is defined as 'any infringement of a Community or national rule as a result of an act or omission by an economic operator, whether deliberate or not...'. 'Primary administrative or judicial finding of fact' should be understood as meaning 'the first report (even internal) by an administrative or judicial body concluding that an irregularity exists, irrespective of whether that conclusion must subsequently be revised or withdrawn in the light of developments in the administrative or judicial proceedings'. However, these definitions have no legal standing. Agreed definitions should be included in a revision of the Regulation.

4.10. Financial irregularities and frauds involve breaches of the law and result in losses to the Community budget which perpetrators are under an obligation to refund. They should not be confused, however, with exploitation of loopholes in the law which result in material advantages to their perpetrators not intended by the legislator. Nonetheless, Member States should accept an obligation to report to the Commission the existence of exploitable weaknesses in Community legislation so that the Commission can initiate action to revise the law and thus relieve the budget in future of the cost of conferring unwarranted rewards on unintended beneficiaries.

Role of the Communicating units in Member States

4.11. Article 2 obliges the Member States to communicate to the Commission 'the list of authorities and bodies responsible... (for notifications)... and the main provisions relating to the role and fuctioning of those authorities and bodies and to the procedures which they are

(2) Document VI/680/89: the concept of 'irregularity' within the meaning of Article 3 of Council Regulation (EEC) No 283/72.

reponsible for applying'. In the majority of the Member States visited the responsible units receive summaries from the paying agencies or Customs authorities and pass them on to the Commission. Except in the United Kingdom and Portugal these services rarely compile statistics on frauds and irregularities. They have no central follow up procedures nor do they conduct any comparative analyses of frauds and irregularities detected for the purpose of targeting enquiries and setting priorities for the future.

4.12. As indicated in the earlier part of this report, in each Member State there are several different services involved with the control of the EAGGF expenditure. Coordination at national and regional level is clearly essential.

Reliability of information

4.13. The period of two months after each quarter within which the Commission must be notified (Articles 3 and 5) has not been consistently respected for the notification of cases (Article 3) by the United Kingdom, Greece and Italy.

4.14. Belgium sends its communications irregularly. Two of the six cases notified by Belgium in 1989 were mistakenly reported as relating to EAGGF expenditure whereas in fact they related to Own Resources income. Portugal and Belgium sent the communications for only one quarter in 1990.

4.15. Although Greece joined the Communities in 1981 it did not send any notifications until 1989. In addition, because of the deficiencies in the notification procedures in Greece, the Court's auditors were unable to determine whether all irregularities and frauds were correctly communicated to the Commission.

4.16. Italy sends few notifications on the follow up of cases. The length of time it takes in Italy to complete the due legal process hampers prompt notification.

4.17. Notifications are not always made promptly even within Member States. One of the reasons given by Member States is the need to maintain confidentiality. In one case in Italy the paying agency had continued to make payments after facts were detected which gave rise to suspicions of fraud. Notwithstanding the need to maintain secrecy in such cases so as not to jeopardize investigations or legal procedures, at least the paying agency should have been alerted in order to prevent further payments being made pending completion of enquiries.

4.18. The information contained in the communications is frequently incomplete and vague. They do not always include all the data required such as financial and recovery information.

4.19. In respect of Article 5 notifications by Member States of subsequent action, the Commission reported in 1990 [1], that in 161 cases it had been more than ten years since the last communication had been received. In 684 cases, it had been more than two years since the last communication had been received. In most instances the cases were already closed, but the outcome had not been communicated to the Commission nor had the Commission taken action to find out what had happened.

4.20. The Commission should have a mechanism for reminding the Member States wherever Article 5 communications are in arrears. Furthermore, all cases of undue delay should be systematically reported to the EAGGF Committee.

4.21. The information on EAGGF is sent by the Member States to the Commission's Agricultural Directorate-General (DG VI). This Directorate-General passes the information to UCLAF on a selective basis. UCLAF does not receive any information on EAGGF matters directly from Member States. The Court noted that cooperation between the two units had not been good as a consequence of which UCLAF was hindered in fulfilling its role of managing and coordinating the information passed to it.

4.22. Information on frauds and irregularities is recorded by the Commission in a computerized database (called COMA35) which should serve as the basis for the follow up of irregularities. It should also facilitate analyses and be used to highlight particular problems by market or by Member State for further investigation.

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[1] Communication by the Commission to Member States following the meeting of the experts group on irregularities and mutal assistance (EAGGF) on 19 June 1990.

4.23. Substantial delays occurred in the Commission's entering of information in COMA35. Therefore, the information base was incomplete at the time of the audit. For example, information communicated by Greece in the second, third and fourth quarters of 1990 and the first quarter of 1991 was not recorded in COMA35 until the end of 1991.

4.24. On the basis of the information in the preceeding paragraphs the Court concludes that the Commission's data base is not reliable for producing statistics and is of limited use to the Commission to monitor and follow up irregularities in the Member States. The Commission has never assessed the operation of the notification system by Member States.

4.25. To assist in the detection of frauds and irregularities affecting the Community budget, the Commission has developed a system, called IRENE 3, in which COMA35 will be integrated. It is a database managed by UCLAF which should eventually contain information on all frauds and irregularities communicated by Member States to the Commission. When the system is fully operational the information entered on the COMA35 data base will automatically update IRENE 3 files. By the end of 1992 IRENE 3 was not yet operational despite an original deadline of mid-1991. Although UCLAF is the responsible data base manager, it will not, however, have the supporting information to check the accuracy and the reliability of the data; that information will remain with DG VI.

Recoveries

4.26. In the period 1972-1991, Member States reported 5775 cases of fraud and irregularity involving a total amount of 725,5 Mio ECU (1). As some Member State communications did not include the amounts involved, this figure is probably an understatement. ***Table 4*** gives a summary by Member State.

4.27. At the time of the audit only the figures up to 1991 were available. According to notifications of subsequent action, the amount recovered was 77,7 Mio ECU, just 10,7 % of that communicated. The outstanding amount to be recovered was 639,5 Mio ECU, 88,2 % of the value of cases reported. This consisted of recoverable cases and also

(1) In 1992, 1030 cases were reported with a total value of 118 Mio ECU, including some cases reported in 1992 but relating to previous years.

Table 4 — Cases of Irregularities and Frauds reported 1972-1991

1	2	3	4	5	6	7	8	9
Member States	Number of cases reported	Value Mio ECU	Amount recovered Mio ECU	Amount recovered as a percentage (4/3)	Amount lost Mio ECU	Amount lost as a percentage (6/3)	Amount to be recovered Mio ECU	Amount to be recovered as percentage (8/3)
Belgium	91	17,613	1,251	7,1	0,008	0	16,353	92,9
Denmark	373	18,645	6,359	34,1	0,587	3,1	11,699	62,8
Germany	1 653	146,060	26,685	18,3	2,100	1,4	117,274	80,3
Greece	30	0,816	0,034	4,2	0	0	0,782	95,8
Spain	137	3,578	0,488	13,6	0	0	3,090	86,4
France	751	26,885	14,835	55,2	0,698	2,6	11,351	42,2
Ireland	121	8,055	2,238	27,8	1,102	13,7	4,714	58,5
Italy	783	452,605	11,470	2,5	0,621	0,1	440,514	97,4
Luxembourg	1	0,0	—	—	0	0	0,0	0
Netherlands	554	27,681	7,646	27,6	0,034	0,1	20,000	72,3
Portugal	66	1,274	0,641	50,3	0	0	0,632	49,7
United Kingdom	1 215	22,270	6,038	27,1	3,149	14,1	13,082	58,8
Total (1)	5 775	725,482	77,685	10,7	8,299	1,1	639,491	88,2

Source: Commission's data base (COMA 35) as at 16 March 1992 and Court of Auditors' analysis.
(1) Minor discrepancies in totals due to rounding.

cases where the recoverability was under discussion between the Commission and Member States. The amount considered irrecoverable was 8,3 Mio ECU, 1,1 % of reported cases. In principle, the financial consequences of sums which cannot be recovered have to be borne by the Community unless non recovery is due to a Member State's negligence. However, in a large number of cases dating back over 20 years, the Commission and Member States have not reached agreement on liability. Of the 109 cases deemed as irrecoverable by Member States, the Commission had accepted responsibility for 67; Member States had accepted 7 and the remainder were under consideration at 30.1.1991. The situation was unchanged at the beginning of 1992.

4.28. The acceptance by the Commission that a Member State is blameless for non recovery implies that an amount, which should have been recovered, is written off anticipated Community revenue. By virtue of Article 29 of the Financial Regulation this requires the intervention of the financial controller. In practice the financial controller's intervention consists of an informal personal contact with the authorizing officer on the basis of which the acceptance of financial responsibility by the Commission is approved. This procedure does not include an official communication, or an official stamp. The financial controller does not keep records of the number of approved cases accepted by the Commission, which is not an acceptable practice.

4.29. As indicated in paragraph 4.20 the Commission's recovery statistics do not necessarily reflect reality. The Commission has therefore failed to adequately establish the true amounts not yet recovered and has failed to institute a procedure to satisfy itself that the amounts notified for recovery are recovered within a reasonable period.

Prosecution and sanctions

4.30. Member States are responsible for the detection, and investigation of fraud and irregularities and for the application of legal and other sanctions provided for under national legislation. However, sanctions are not applied in a homogeneous way in the Community. Indeed there is no national code of administrative sanctions in the United Kingdom, Ireland and France in the context of EAGGF Guarantee schemes. These apply administrative sanctions only in rare cases if Community legislation specifically provides them. In the case of improperly paid amounts there is no homogeneous policy to charge interest on outstanding amounts. A contributory factor is that there is no legal definition of 'fraud' or 'irregularity' common to all Member States. The problem was commented upon in the Courts 1986 Annual Report (1). The Commission is also of the view that the autonomy of national law can mean that the same infringement is punished with varying degrees of severity (2).

4.31. The Commission has already acknowledged that Community legislation itself must lay down administrative penalties sufficiently severe to outweigh any economic advantage to be derived from an infringment, thus achieving both a preventive and a dissuasive effect (3). The Commission and the Council should endeavour to put into place the appropriate legislation as a matter of urgency.

4.32. The Member States and the Commission should give maximum priority to the introduction of interest charges and administrative sanctions in respect of frauds and irregularities against the EAGGF and to the establishment of common criteria for the application of comparable penalties.

Cooperation between Member States

4.33. Neither the Commission nor any Member State visited, used a system for monitoring communications between Member States as laid down in article 4 of Regulation (EEC) No 595/91. Accordingly no information was readily available regarding them.

5. CONCLUSION

5.1. The Commission's coordinating action, its dissemination of good practice and its monitoring of the Member States' systems were found to be inadequate. The shortcomings and disparities in risk analysis, information, audit scope, coordination and follow up which the Court found to exist in Member States are now being addressed. The Commission's reply to this Special Report describes a number of initiatives which are welcomed by the Court.

(1) 1986 Court of Auditors' annual report (OJ C 336 of 11.12.1987, paragraph 6.17).
(2) The fight against fraud report on work done and progress achieved in 1990. SEC(91)456 final.
(3) Report on harmonization of controls relating to the CAP and fisheries. SEC(90)1381.

5.2. In view of the incompleteness of the data notified by the Member States, the lack of follow up by the Commission of amounts to be recovered and the insufficient use of the data notified, Regulation (EEC) No 595/91 had at the time of the audit, been of little significance as an instrument in the fight against fraud.

5.3. In respect of the coordination of the fight against fraud in the EAGGF area, the Court found that the division of responsibilities between UCLAF and other Commission anti fraud services was unclear and its informatic tool IRENE 3 was not yet operational.

5.4. The Commission has addressed certain deficiencies in the role and effectiveness of UCLAF in relation to the EAGGF and in particular in relation to the implementation of the Regulations mentioned in this report. The Commission should continue to give priority to concrete action in terms of detection, investigation, analysis and follow up of frauds.

5.5. Having regard to the significance of multi-national enterprises in the marketing of agricultural products, the Commission and Member States need to give more attention to the scrutiny and follow up of transnational transactions involving other Member States or third countries.

5.6. Steps should be taken to ensure that, as a condition of receiving payments, beneficiaries must allow full access, for audit purposes, to all relevant commercial records, including production and quality control records wherever they may be located.

5.7. With a view to strengthening the means of combatting irregularities and fraud in the EAGGF area, the Commission and Council should, as a matter of urgency, take the steps necessary to put in place a system of Community administrative penalties.

This report was adopted by the Court of Auditors in Luxembourg at the Court meeting of 9 December 1993.

For the Court of Auditors
André J. MIDDELHOEK
President

ANNEX 1

KEY EXPORT REFUND DATA
(Referred to in paragraphs 2.13 to 2.15)

Beneficiary identification No
Beneficiary name
Claim No
Payable order No
Payment date
Export declaration No
Date of customs control
Code for office of customs control
Licence or prefixation certificate No
Date of prefixation
Destination code
Origin code
Export Refund code
Quantity
Rate
Code for type of payment
Amount of payment
Beneficiary's claim reference No
FOB value
EEC budget item

REPLY OF THE COMMISSION

0. GENERAL INTRODUCTION

0.1. The general objective of sound financial control set out by the Court is enshrined in Article 8 of Council Regulation (EEC) No 729/70 of 21 April 1970 on the financing of the common agricultural policy, as last amended by Regulation (EEC) No 2048/88. These require Member States to take the measures necessary to satisfy themselves that transactions financed by the European Agricultural Guidance and Guarantee Fund (EAGGF) are actually carried out and are implemented correctly, to prevent and deal with irregularities, and to recover sums lost as a result of irregularities or negligence.

0.2. The a posteriori audit of the commercial documents of undertakings, which is the object of Regulation (EEC) No 4045/89, is an instrument complementary to pre-payment checks. A posteriori audit is not the primary instrument of control and it is not the only one. The importance of routine controls and checks undertaken concurrently as part of Member States' authorization and approval procedures is fundamental to the proper control of EAGGF income and expenditure. It is in this context that the effectiveness of a posteriori audit should be viewed.

1. COUNCIL REGULATION (EEC) No 4045/89

1.6. The Commission notes that the Court audited implementation of Regulation (EEC) No 4045/89 shortly after it had been introduced. While it is important to correct shortcomings, anomalies and errors in implementation from the very outset, it is no less important to reach a judgment after a certain period.

The Commission would stress that the conclusions of its inspection teams relating to the procedures for clearing the accounts reflect the Court's findings.

1.9. The focus of the Court's audit does not take into consideration the day-to-day organizational and management aspects of a posteriori audit, the good quality of which is fundamental to successful application of Regulation (EEC) No 4045/89.

2. AUDIT FINDINGS: MEMBER STATES

As regards the examples chosen by the Court to back up its arguments, the Commission would point out that some of the cases mentioned were already discussed in Special Report No 2/92 on the audit of export refunds paid to selected major traders in the milk products sector. The other cases identified are similar. The findings of the investigations conducted or comments relating to them have already been sent to the Court and to Parliament.

The Commission would make the following comments on certain subjects dealt with in this chapter, such as risk analysis and payment agencies.

2.8. The Commission agrees that risk analysis is an essential tool in the selection of beneficiaries and transactions for a posteriori control (see point 2.12).

2.9. A posteriori control is a second line of control for detecting anomalies which may not have been identified by the first line of routine and concurrent controls. It is not a preventative check.

2.10. Member States plan the implementation of their scrutiny programmes according to the availability of their resources.

2.12. It is true that much can be done to develop the application of risk analysis to both concurrent and a posteriori controls. The Commission has encouraged this:

— a special working group of national Customs experts, chaired by the Commission, has the task of reporting on this subject;

— the Commission made a presentation to the 5th meeting of the 'Experts Group' on Regulation (EEC) No 4045/89, held on 2 March 1993, on the application of risk analysis in the selection of undertakings for a posteriori control, using, amongst others, techniques similar to those adopted by the Court;

— the Commission has also made a similar presentation in all but one Member State (Luxembourg) using national data, with encouraging results. In fact, the German authorities have made their selection of undertakings for the scrutiny programme 1993/1994, in the field of export refunds, using the approach suggested by the Commission;

— the modifications to Regulation (EEC) No 4045/89 proposed by the Commission contain a key provision which enables Member States to determine the whole of their scrutiny programmes on the basis of risk analysis.

Information used in the selection of undertakings

Export Refund Payment Data

2.13. Some Member States appear to have experienced technical difficulties in summarizing, by undertaking, the payment and income data prepared by different national agencies. The preferred solution lies in the allocation of a unique identification reference for each undertaking.

Information on Irregularities and Frauds

2.16 – 2.21. The Commission has accepted that risk factors include the undertakings' record of compliance with the relevant legislation, an appreciation of the complexity of the business structure of an undertaking, the adequacy of its internal control procedures and the results of previous scrutinies, and that the implementation of scrutiny programmes should be evaluated by Member States' special units and their control partners. It has encouraged the Member States to apply this approach in a systematic way.

Control of supra national undertakings

2.24 et 2.43. The Commission agrees that mutual assistance between Member States under Article 7 of Regulation (EEC) No 4045/89 has proved disappointing. This is why the Commission, in its proposed amendment to Regulation (EEC) No 4045/89, seeks changes to the existing arrangements. These proposals address the points identified by the Court. Moreover, after consultation with Member States' special units and their control partners, the Commission has set in motion a demonstration project the objectives of which are to:

— develop cooperation between Member States, and between the Commission and Member States;

— reinforce the audit of undertakings operation within and across national boundaries and in third countries;

— develop the use of risk analysis techniques, particularly in the selection of undertakings and transactions to be scrutinized;

— encourage cross-checking with third party sources upstream and downstream of undertakings, particularly where this involves activities in a place other than in the Member State in which subsidy is received.

Inclusion of payment notified in the scrutiny population

2.26. Under Article 7 of Regulation (EEC) No 4045/89 Member States are obliged to notify the Commission of the results of their scrutiny.

The examples quoted by the Court have been communicated to the Member States, and appropriate action should be taken. The Commission stresses that notification procedures under article 7 are generally applied.

2.28. In the absence of any supporting background information it is not clear how the examples cited in paragraph 2.26 may support the Court's assertion of a lack of assurance that all payments are considered for scrutiny. Indeed, the very fact of notification under Article 7 would appear to indicate the contrary.

Mutual Assistance Requests

2.29 – 2.31. The Commission already replied to the Court in the fifth paragraph of point 8 of its replies to Special Report No 2/92.

2.33 – 2.38. The case mentioned by the Court has been examined in detail by the Commission. It shows that the current situation is unsatisfactory as regards the possibility of initiating recovery procedures in respect of operations involving a number of operators from different countries.

Furthermore, the conditions for the issue of advance-fixing certificates following a call for tenders by a non-Community country are currently being dealt with in a proposal amending the regulation. Under the rules now being discussed with the Member States, issue of these certificates would be conditional on presentation of the contract concluded as a result of this call for tenders. In addition, cooperation between the relevant departments of the Member States must be developed and become a matter of routine.

Undertakings with commercial records outside the EEC

2.44 – 2.48. The Commission recognizes the problem of commercial records being held outside Community territory. This is why the Commission, in its proposed amendment to Regulation (EEC) No 4045/89, seeks changes to the existing arrangements.

Scrutiny preparation

Payment information

2.49 and 2.50. It is clearly desirable for inspectors to have complete details underlying the transactions they are to audit, and this is a form which is easy to interrogate. The Commission is encouraging Member States to make progress in this area. The speed of progress is often determined, however, by factors outside the immediate control of the special units and their control partners, particularly regarding the state of technical advance achieved by national authorities in their bookkeeping.

Background information

Selection of transactions

2.51 – 2.55 and 2.56. Best practice would include all of the points identified by the Court. To a greater or lesser extent best practice is achieved by the special units and their control partners in all Member States.

Audit scope

Definition of Commercial Documents

2.60. It is true that certain special units and their control partners have raised doubts about the definition of the term 'commercial documents'. The Commission has advised that the definition includes production and quality records.

Nonetheless, as already noted by the Court, some Member States have held firm views that the definition of 'commercial documents' does not include production and quality control documents. It is not surprising to learn, therefore, that these records are not examined. The Commission, in its proposed amendment to Regulation (EEC) No 4045/89, seeks to clarify matters with an explicit reference to production records.

Export refund classification

2.67. The physical inspection of production, storage and dispatch premises as part of an a posteriori scrutiny is good practice. It is important such checks should be systematically considered, having due regard to the initiative of the

inspector and his appreciation of the particular circumstances of the control.

The two cases mentioned in the first and second indents were already discussed at point 3.1 (k) and (d) of the Court's Special Report No 2/92.

Sound and fair marketable quality and placing of goods on the market

2.70. The Commission agrees with the list of useful sources of audit evidence presented by the Court. The Commission's advice to Member States has been to examine such sources wherever possible.

2.71. As already explained above, the findings of the Court concern only scrutinies of export refunds and therefore should not be taken as representative of the practices followed by all a posteriori control bodies in the seven Member States cited.

2.72. The cases mentioned by the Court are being examined by the Commission and the Member State concerned. Taking into account the provisions applicable to export refunds it is not yet clear if the total amount mentioned by the Court is correct.

3. THE ROLE OF THE COMMISSION

Introductory Remarks

Any rounded assessment of the implementation by Member States of Regulation (EEC) No 4045/89, such as that undertaken by the Commission beginning in October 1992, will include the following questions:

whether Member States have,

— adequately incorporated Regulation (EEC) No 4045/89 into national legislation and administrative instructions;

— adequate organizational structures and systems to satisfy their scrutiny obligations;

— satisfactory operational arrangements in place for planning, executing, monitoring and reviewing the strategic and practical application of the regulation.

To answer these questions the Commission has focused on a number of general criteria covering the key organizational and management processes for the proper implementation of Regulation (EEC) No 4045/89, which act as general standards against which to assess existing conditions. They equate with good management practices, indicate the scope of the assessment and provide an explicit basis against which to measure the degree of adherence.

The relevant criteria are:

1. The objectives of a posteriori audit under Regulation (EEC) No 4045/89 should be clearly stated in national legislation and administrative notices.

2. The scrutiny programme should be consistent with the requirements of Regulation (EEC) No 4045/89.

3. Special units and their control partners should have available all the information necessary to plan and perform the a posteriori controls.

4. Procedures should be established for ensuring that the planning of a posteriori audits gives priority to targetting high risk undertakings and transactions. In particular, undertakings and transactions should be assessed against documented risk criteria.

5. The human resource commitment to the performance of a posteriori controls should be consistent with the workload.

6. A posteriori control reports should be tailored to the objectives of the control.

7. The performance of planned a posteriori controls should be monitored by the control body responsible and, centrally, by the special unit.

8. Arrangements for the exchange of information between the special unit and the control bodies should provide reliable, relevant, and timely information on progress and findings.

9. The quality and effectiveness of the work performed should be evaluated systematically.

10. All material irregularities identified by inspectors should be made known to the special unit, decisions on the recovery of sums unduly paid should be documented, and the end result notified to the inspectors responsible, the special unit and to the Commission.

Any fair assessment of the strengths and weaknesses of national arrangements will draw on all the available sources of evidence in all the Member States. Full account will be taken of the varied national arrangements established to meet scrutiny obligations; the numerous national, regional and sectoral control bodies charged with the responsibility for a posteriori controls under the surveillance of special units; and the different incidence of EAGGF income and expenditure by product and measure for each Member State.

Although such evaluation represents a major task, the first of two phases was completed by the Commission during 1993, only the third year of implementation of Regulation (EEC) No 4045/89.

In fact the Commission has on file, already, full replies from Member States to a comprehensive and detailed questionnaire about their arrangements for a posteriori controls, which was dispatched in the autumn of 1992.

The aim of the Commission's excercise is to determine objectively the extent to which Member States comply with the requirements of Regulation (EEC) No 4045/89, and to document both strengths and weaknesses. The end result will be the improvement of the quality and effectiveness of a posteriori controls through cost-effective advice from the Commission in the form of recommendations which are practical, address and resolve specific problems, result in benefits commensurate with the costs of implementation, and do not propose solutions which Member States already have in hand.

Annual programmes

3.3. On their receipt from Member States, scrutiny programmes are checked for conformity with the requirements of Regulation (EEC) No 4045/89. It is difficult however, given the formal nature of the document, to envisage what further evaluation may be usefully undertaken centrally. This is why, in the period from October 1992 to September 1993 when the Commission visited the special units and their control partners in each Member State, questions relating to the evaluation of past and future scrutiny programmes were discussed with Member States, including the application of risk criteria.

The number of queries formally raised with Member States in respect of their scrutiny programmes does not appear to be the only indicator of either the quality of the scrutiny programmes or of the quality of the evaluation of those programmes.

3.4. The Commission has pursued the progress of Member States in respect of the requests mentioned by the Court.

3.5. The Commission organizes the work of its departments in the manner it considers responds most appropriately to the various demands imposed by its responsibilities.

Annual reports

3.7. As the Court states in its report of 16 December 1992 [1], Regulation (EEC) No 4045/89 on scrutiny by Member States of transactions forming part of the system of financing by the Guarantee Section of the EAGGF entered into force in 1990.

As a result, each Member State presented to the Commission, for approval, a programme for scrutinies to be carried out in the first year of application (1 July 1990 to 30 June 1991). The first detailed report on the application of this Regulation was also to be sent to the Commission before 1 January 1992.

[1] VI/5205/92 refers.

Article 9(5) of the Regulation states that the Commission must submit before 31 December 1991 a general report summarizing the reports drawn up by the Member States. However, in view of the delays in most Member States, the Commission was not able to fulfil this obligation until the second half of 1992.

3.8. Member States' reports are evaluated by the Commission.

3.11. The Commission and Member States are committed to successful implementation of Regulation (EEC) No 4045/89. The current Commission exercise, now embarking on its second phase, together with the extensive cooperation offered by Member States in the realization of the first phase, is clear evidence of this.

3.12 – 3.13. The Commission refers to its reply to paragraphs 2.25 to 2.39.

4. THE COMMUNICATION SYSTEM ON FRAUDS AND IRREGULARITIES AND THE FIGHT AGAINST FRAUD

The notification system

General

4.9. The Commission shares the Court's view that a recognized definition would make the system more consistent and make work easier. However, uniformity is always difficult to achieve and often leads to a text based on consensus which actually resolves nothing. The Commission has therefore opted for a pragmatic approach.

4.10. The Member States are obliged to ensure that Community legislation is properly applied

During the examination of proposed legislation by the management committees, special attention is given to the prevention of abuses, since distortion in the application of measures is unacceptable for all parties involved.

Role of the Communicating units in Member States

4.11. In meetings of the 'Irregularities and mutual assistance-EAGGF' group, Member States are provided with a detailed comparative analysis of irregularities communicated, which are subsequently discussed. In this way, the Commission tries to demonstrate to Member States the importance of this kind of analysis and the need for follow-up of the irregularities found.

It should be taken into account however that Member States' basic responsibility also includes the organization of national control bodies including definition of their competences and targeting of their work; making use of the information provided by the Commission is emphasized as being as important in risk analysis.

Reliability of information

4.18. On numerous occasions the Commission has requested Member States to provide more detailed and fuller data on cases communicated. In general, Member States reply in good time.

The Commission also insists that Member States should notify it of the procedures initiated and the outcome of these procedures.

4.19 – 4.20. Member States — being formally responsible for recovery of the sums unduly paid — are regularly reminded to inform the Commission about the latest developments in the recovery situation of each individual case.

In meetings of the 'Irregularities and mutual assistance EAGGF' group the Commission has emphasized the necessity for Member States to update their records regularly, to improve the flow of information to the Commission, and to guarantee the reimbursement to the EAGGF of sums recovered.

In February 1992 the Commission launched an updating exercise relating to all open cases in the 'COMA35' system. Since then additional or missing information (in particular concerning 'old' cases dating from before 1989) has been

exchanged between the Commission and Member States and is being processed in 'IRENE 3'. In addition the Commission has announced and discussed with Member States the development of an early warning system, enabling in future closer follow-up of subsequent actions for recovery of sums notified in art. 3 and art. 5 communications on irregularities.

On 2 June 1993 the Commission decided to speed up recovery of sums due as a result of frauds and irregularities and to write off long-term debts which could no longer be recovered.

4.21. The transmission of fraud cases from agriculture's COMA35 base to the Irene 3 database was delayed so that solutions could be found to a number of specific problems such as personal data, access to the base and confidentiality. Interdepartmental coordination is organized to monitor operation of the database.

4.23. The Commission does not share the Court's view on this question. When the 1992 Fraud Report was drafted in March 1993, the EAGGF was the only department which had available full information relating to all cases in all Member States covering the whole of 1992.

4.24. Additional efforts have been made by the EAGGF to facilitate, improve and speed up the introduction of irregularity reports into the 'Irene 3' database by the following initiatives:

— standard forms for 'article 3 communications' and 'article 5 communications' have been established and implemented:

— a system for computerized introduction of 'article 3 communications' supplied on diskette by Member States is being developed and tested.

4.25. The 'COMA35' database has been completely integrated into the UCLAF 'IRENE 3' database on 1 December 1992 and has been fully operational since.

For own resources and the Structural Funds the database has already been operational since the end of 1991. For EAGGF Guarantee the base has been operational since 1 December 1992, for the reasons set out at 4.21.

Recoveries

4.27. Irrecoverable amounts notified by Member States are dealt with in conformity with article 5(2) of Regulation (EEC) No 595/91 and article 8 of Regulation (EEC) No 729/70 (Commission decision after consulting the EAGGF Committee).

At a result of consultations within the Commission in early 1993, 134 cases representing about 3.7 million ECU declared irrecoverable, have been included in the clearance of accounts procedure for 1991, indicating whether the Commission or the Member States will bear the loss.

A new list for the next clearance of accounts procedure is in preparation.

Recovery statistics do reflect reality but have to be updated regularly with the information obtained from Member States in 'article 5 communications', and taking account of the ongoing updating exercise concerning all open cases.

4.28. As regards the Commission covering the irrecoverable EAGGF Guarantee amounts notified by the Member States in accordance with Article 5 of Regulation (EEC) No 595/91, the Commission, in response to the Court's comments, has taken the necessary steps to remedy the situation as part of the procedure for clearing the accounts.

In its memo of 22 February 1993 Financial Control asked DG VI to allow it to examine the 124 files concerning irregularities mentioned in the summary report on the clearance of the EAGGF Guarantee accounts for 1990, concentrating on seven of them.

After examining these cases, Financial Control agreed in its memo of 15 March 1993 to the proposal in the summary report, except in the case UK/91/070 which required clarification.

In the second memo Financial Control also made recommendations to improve the monitoring and control of this type of case.

Prosecution and sanctions

4.30. The Commission has carried out two studies on administrative penalities and the protection under criminal law of the Community's budgetary interests — one on the administrative and criminal sanctions in the Member States and the other on national rules governing fraud affecting the Community budget. The final reports on these studies contained detailed recommendations. The Commission is currently examining these recommendations and is considering what action to take.

4.31. At present, Community legislation lays down percentage-based penalties for fraud in the application of the new common agricultural policy (aid schemes related to area farmed or number of livestock).

4.32. Interest is collected in specific sectors, such as milk quotas, and common criteria are now being drawn up to harmonize penalities.

Cooperation between Member States

4.33. Article 4 communications are applied especially within the export refunds sector, where fraud methods are often identical in the different Member States. There were five communications to Member States in 1991, and six in 1992. Member States receiving these communications are requested by the Commission to make the necessary checks within their own country. In several instances the Commission has been able to act as intermediary between two or more Member States where similar cases had occurred.

These 'article 4 cases' are also discussed on a regular basis in the 'Irregularities and mutual assistance — EAGGF' group. Moreover, the whole system provided for in article 4 has already been the subject of in-dept discussion in order to examine possible improvements.

5. CONCLUSION

5.1. The Commission is actively involved in encouraging Member States to be more sensitive to the introduction and use of selection methods based on risk analysis.

For more than one year now, this subject has been on the agenda of every meeting of the Working Group on 'Irregularities and Mutual Assistance — EAGGF'.

A document on the strategy to be adopted has been proposed and debated.

Specific documents relating to beef and veal and to milk products have been drawn up and distributed. These two documents do not deal with all aspects of the subject. They represent a contribution by the Commission. As specific information concerning operators and certain types of trade are not available to the Commission, this part of the work has still to be carried out nationally or even locally (based on knowledge of the practices followed by operational departments).

A similar document on cereals is in preparation.

At every meeting of the said Working Group the irregularities notified to the Commission every three months are analysed so that the departments concerned can incorporate this information in their own risk analysis.

The Commission also encourages the Member States to use a computer package which it has developed to select high-risk operations, primarily as part of *ex post* administrative controls. By taking a sample of operations weighted according to risk, control activities may be targeted (for example) on an unreliable trader exporting a high-risk product to a destination qualifying for a highly differentiated rate.

A document setting out a points-based method has also been debated.

Finally, it should be noted that risk analysis now forms an essential part of the integrated management and control system of the new CAP.

Work in this sector will continue, in particular under Regulation (EEC) No 386/90 on physical checks and Regulation (EEC) No 4045/89 on checks of the accounts. Other meetings will be arranged with the Member States on this subject in order to refine the method and decide on the components to be used for the various sectors of the CAP.

5.2. Complete data on irregularities are frequently used to make analyses of different kinds, these analyses being distributed and discussed in meetings of the 'Irregularities and mutual assistance EAGGF' group that take place regularly three or four times a year.

From discussions in this working group it has become clear that these analyses are frequently used as a basis for establishing risk analysis in the Member States and have become a significant instrument in the fight against fraud.

Member States appreciate the material the Commission supplies, and support the need to follow-up more thoroughly the recovery of amounts unduly paid.

5.3. and 5.4. The Commission Decision of 4 November 1992 to extend the scope of the UCLAF's task defines the unit's operational powers. It is not up to the UCLAF to control other departments. DG VI is responsible for checking that Regulations (EEC) No 4045/89 and No 595/91 are properly applied. The Commission gives priority to practical measures as the Court wishes; it recently modified the structure and establishment plan of the UCLAF for this purpose by setting up operational units for the main financial sectors.

5.5 – 5.7. The Commission gives more attention to the large-scale operations of multiannual undertakings by following the risk analysis method.

Proposals are now being drawn up to make refunds conditional on access to the trade registers of the place where these companies have their headquarters in order to conduct production and quality controls.

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