

SPECIAL REPORT No 20/98
on the audit of physical checks of agricultural products receiving export refunds accompanied
by the replies of the Commission

(pursuant to Article 188c (4)(2), of the EC Treaty)

(98/C 375/03)

CONTENTS

	<i>Paragraph reference</i>	<i>Page</i>
EXECUTIVE SUMMARY		18
1. INTRODUCTION	1.1 – 1.7	19
General	1.1 – 1.3	19
Control provisions	1.4 – 1.5	19
Audit scope	1.6 – 1.7	20
2. OBSERVATIONS RELATING TO THE COMMISSION'S INSPECTIONS	2.1 – 2.6	20
Scope and objectives	2.1 – 2.4	20
Deficiencies in Member States' checks identified by the Commission	2.5	21
Follow up action on deficiencies	2.6	21
3. FINDINGS OF THE COURT'S AUDIT IN MEMBER STATES	3.1 – 3.35	21
Risk analysis	3.1 – 3.13	21
Use of databases for risk analysis	3.14 – 3.19	23
Monitoring and evaluation	3.20 – 3.22	24
Effectiveness of checks	3.23	24
Irregularities detected by Regulation (EEC) No 386/90 checks	3.24 – 3.28	25
Coordination with Regulation (EEC) No 4045/89 verifications	3.29 – 3.30	26
Laboratory testing	3.31 – 3.35	27
4. CONCLUSION	4.1 – 4.5	27
Annex		29
Replies of the Commission		30

EXECUTIVE SUMMARY

Context of the audit

In the 1996 EAGGF year, export refunds paid to exporters of agricultural products to compensate them for the difference between the internal European Union price and the lower world market price amounted to some ECU 5 600 million, (13 % of European Union expenditure on agriculture). The rates of export refund vary according to the nature of the products concerned and are applied to the quantities exported. Though financed by the European Union budget, Member States are responsible both for making the payments, and for carrying out the checks to confirm the legality and regularity of the export refunds.

Member States' customs authorities are faced with the difficult problem of protecting the European Union budget by means of physical checks without creating undue obstacles to the flow of trade. In the 1996 EAGGF year, and across the whole of the European Union, Member States' customs authorities carried out 100 000 physical checks, in implementing the 5% minimum rate of physical verification fixed by legislation. For a substantial proportion of these checks laboratory tests were also compulsory. The administrative costs of these checks both to customs authorities and to traders are significant. It is therefore imperative that checks are well targeted and effectively executed. In 1994, Regulation (EEC) No 386/90 was amended principally to introduce the possibility of risk analysis for the selection of consignments for physical checks. The Court's audit in Member States concentrated on the use of risk analysis and the evaluation of the effectiveness of procedures for the selection of consignments for physical checks.

Main observations

In the general context, physical checks are an essential tool for customs services, but, depending on the measure, they may not always be the most effective and appropriate method of control. Because risk analysis is not obligatory there are considerable differences between Member States in the procedures for selection of consignments for physical control. Optimum use of risk analysis is hampered by the mandatory requirement set out in the legislation to carry out fixed rates of physical control at every customs office and by inadequate information databases in Member States. There has been no evaluation of the effectiveness of the procedures for selection of consignments for control either by Member States or the Commission. There is a lack of coordination with *a posteriori* controls carried out by the Member States under Regulation (EEC) No 4045/89.

Main recommendations

The Commission should consider creating a legal framework which provides for a balanced combination of physical controls (at the point of export) and *a posteriori* controls.

Member States should be encouraged to place more emphasis on the quality and effectiveness of physical checks rather than just ensuring that the rates of checking fixed by regulation are met. To improve the effectiveness of the procedures for the selection of consignments for physical check, the Commission is encouraged to consider a number of recommendations. Above all, the Court suggests that the use of risk analysis by Member States should be made obligatory. The legislative requirements relating to physical checks should be made more flexible while at the same time making Member States more accountable for the effectiveness of those checks.

In more general terms, risk analysis is an effective resource management tool. To limit it to export refunds is too restrictive. To manage effectively their resources Member States need a broader legislative framework for risk analysis which would permit them not just to target transactions within measures but to allocate resources to measures on the basis of the comparative risks to the EU budget.

1. INTRODUCTION

Table 2

Export refund expenditure by Member State 1996

*General**(million ECU)*

1.1. Export refunds are amounts paid to exporters of agricultural products to compensate them for the difference between the internal European Union price and the lower world market price. The rates vary according to the product description and are applied to the quantities exported. Though financed by the European Union budget, Member States are responsible, through their appointed paying agencies, for making the payments. Member States are also responsible for checks over the legality and regularity of those payments which are primarily carried out by their customs services.

1.2. Although they are to be gradually phased out under the General Agreement on Tariffs and Trade/World Trade Organisation (GATT/WTO) agreements, export refunds still account for some 13 % of European Union expenditure on agriculture. In the 1996 EAGGF year this amounted to some ECU 5 600 million. *Table 1* shows the distribution of expenditure by product group and *Table 2* by Member State for that year.

Member State	Amount
Belgium	631,9
Denmark	454,0
Germany	943,1
Greece	33,6
Spain	177,1
France	1 136,6
Ireland	618,0
Italy	300,5
Luxembourg	0,3
Netherlands	808,4
Austria	69,9
Portugal	22,1
Finland	81,6
Sweden	35,3
United Kingdom	335,2
Grand total	5 647,5

Source: Sincom 1996.

Table 1

1996 appropriations for export refunds by budget line

(million ECU)

Article	Description	Amount
B1-1 0 0	Cereals	312,6
B1-1 1	Sugar	1 230,0
B1-1 2 0	Olive oil	59,3
B1-1 5	Fruit and vegetables	73,4
B1-1 6 0	Products from vine growing sector	40,8
B1-1 7 0	Tobacco	2,4
B1-1 8 5 0	Rice	33,3
B1-2 0 0	Milk products	1 605,2
B1-2 1 0	Beef and veal	1 559,0
B1-2 3 0	Pigmeat	101,4
B1-2 4 0	Eggs	12,1
B1-2 4 1	Poultry	127,0
B1-3 0	NA II	490,9
Grand Total		5 647,5

Source: Sincom 1996.

1.3. Member States' customs services are faced with the difficult problem of protecting the European Union budget by means of physical checks and at the same time presenting as few obstacles as possible to legitimate international trade. In the 1996 EAGGF year European Union customs services dealt with some 2 000 000 declarations involving agricultural products which benefit from export refunds. Respecting the minimum rate of 5 % fixed by legislation results in 100 000 physical checks. In a substantial proportion of those checks laboratory tests are compulsory. The costs both to customs administrations and trade are significant. It is therefore imperative that checks are well targeted and effectively executed.

Control provisions

1.4. The system of control of export refunds is three tiered. The first tier is provided for by Council Regulation (EEC) No 386/90⁽¹⁾ on the monitoring carried out at the time of export of agricultural products receiving refunds or other amounts. It provides for the physical check of consignments at the time of export with the objective of verifying that goods and quantities are correctly declared. The second tier, foreseen by the same

⁽¹⁾ OJ L 42, 16.2.1990, p. 6.

Regulation, provides for documentary checks to be carried out by the paying agencies. The third, set out in Council Regulation (EEC) No 4045/89 ⁽²⁾, provides for the *a posteriori* verification, *inter alia*, of export refund transactions on the basis of beneficiaries' commercial information. This regulation was the subject of Special Report No 7/93 ⁽³⁾.

1.5. Regulation (EEC) No 386/90 has been amended by Council Regulation (EC) No 163/94 ⁽⁴⁾ principally to introduce the possibility of risk analysis for the selection of consignments for physical check. Commission Regulation (EC) No 2221/95 ⁽⁵⁾ lays down detailed rules for its application. Commission Regulation (EC) No 3122/94 ⁽⁶⁾ lays down optional criteria for risk analysis. The annex summarises the principal provisions.

Audit scope

1.6. The Commission had carried out inspections in Member States of the implementation of Regulation (EEC) No 386/90. As part of its audit the Court has therefore carried out an evaluation of those inspections. The Court's audit in Member States concentrated on aspects other than those covered by the Commission's inspections, in particular, the use of risk analysis and evaluation of the effectiveness of procedures for the selection of consignments for physical check.

1.7. The Court's audit was carried at the Commission and in the following Member States; Belgium, Denmark, France, Germany, Ireland, Italy, Netherlands, Spain and the United Kingdom. These Member States were selected because they account for some 95 % of export refund expenditure.

2. OBSERVATIONS RELATING TO THE COMMISSION'S INSPECTIONS

Scope and objectives

2.1. The principal objectives of the Commission's inspections in Member States were to verify that the required rates for physical checks had been respected and

to evaluate the quality of the execution of physical checks by Member States' customs services.

2.2. The Commission has been unable to evaluate either the effectiveness of the procedures for the selection of consignments for physical check or of the results in terms of irregularities detected, since neither the majority of Member States nor the Commission itself have any record identifying the number and value of irregularities detected by Regulation (EEC) No 386/90 checks. Nor has it, in common with Member States, assessed the reliability and relevance of the risk criteria defined in Regulation (EC) No 3122/94 in order to make physical checks more effective and to improve targeting as required by Article 3 of the same Regulation.

2.3. To ensure coherence in the overall control strategy over export refunds Article 5 of Regulation (EEC) No 386/90 requires Member States to take steps to coordinate and combine checks imposed on individual operators with verifications carried out under Regulation (EEC) No 4045/89. The Court considers that this coherence has not been achieved and recommends that the Commission pay particular attention to this aspect in its clearance of accounts inspections.

2.4. Article 5(4) of Regulation (EC) No 2221/95 requires customs services to take representative samples for laboratory analysis as part of the physical check if the rate of refund of the product concerned depends on a particular content. *Table 3* based on statistics obtained by the Court from the Member States compares the number of physical checks which, according to the Regulation, should have led to a test in a laboratory with the number of tests actually performed. In Belgium, France, Germany and Spain the requirement was not respected in a substantial number of physical checks of milk products and olive oil. Although national statistics were not available in Ireland, the internal audit unit of the Irish customs service had found instances of non-compliance with this requirement. The Commission's inspection reports for these Member States did not indicate that this compliance failure had been addressed.

⁽²⁾ OJ L 388, 30.12.1989, p. 18

⁽³⁾ OJ C 53, 19.2.1994, p. 1

⁽⁴⁾ OJ L 24, 29.1.1994, p. 2.

⁽⁵⁾ OJ L 224, 21.9.1995, p. 13.

⁽⁶⁾ OJ L 330, 21.12.1994, p. 31.

Table 3

Number of physical checks and laboratory tests

Member State	France	Germany	Belgium	Spain	
				Milk products	Olive oil
Number of declarations	24 146	51 265	8 577	4 835	3 194
Number of physical controls to be submitted for analysis	3 401	4 089	1 461	1 357	798
Number of analyses carried out	1 516	3 359	666	120	678

Source: Member States' statistics 1996.

Deficiencies in Member States' checks identified by the Commission

2.5. The principal deficiencies identified by the Commission's inspection of the implementation of Regulation (EEC) No 386/90 are as follows;

- inaccurate statistics for rates of physical checks (B, F, EL, IT, L, P, E, UK),
- inadequate quality of physical checks (B, IT),
- lack of appropriate examination and weighing facilities (B, NL, E),
- the Customs services had given prior notice to exporters of checks which should be unannounced if they are to count under Regulation (EEC) No 386/90 (F, IT).

Follow up action on deficiencies

2.6. The Commission has addressed letters to Member States detailing the deficiencies found. The letters, for inspections carried out between February 1996 and July 1997, were sent out between December 1996 and October 1997. The replies were received by the Commission between February 1997 and December 1997. At the date of the Court's final audit visit in April 1998 the Commission had taken no action to evaluate the replies, which in many instances contest the Commission's findings, nor had it taken any other follow up action.

3. FINDINGS OF THE COURT'S AUDIT IN MEMBER STATES

Risk analysis

3.1. Risk analysis can be defined as the use of pertinent data to identify transactions presenting the highest risk of

potential material irregularity. It can be used to target scarce and costly resources so that transactions presenting the highest risk of irregularity are checked to a greater degree than where the risk of irregularity is lower. It does not mean that checks should not be performed on potentially low risk transactions. There must always be a degree of random checking both to maintain a deterrent factor and to identify new risks.

3.2. Rates of export refund are differentiated according to product descriptions. Some of these descriptions are complex involving precise chemical composition requirements. Sometimes minor differences between the actual product composition and that required by the export refund nomenclature (ERN) result in the complete loss of refunds whereas in other cases the loss is graduated. For example, Cheddar cheese with a fat content in dry matter (FCDM) of 48 % or more attracts the full rate of refund of ECU 101,68⁽⁷⁾ per 100 kg. If the FCDM is 47,9 % no refund is payable. In contrast full milk powder of a fat content (FC) of 25,1 % or more attracts ECU 102,6 per 100 kg, at 24,9 % FC the rate is ECU 95,38. The degree of compliance of export refund claimants also naturally varies. Therefore, regardless of whether or not Member States have opted to carry out the global rate for checks where risk analysis is applied, there is a sound argument for targeting physical checks on products and/or claimants presenting the highest risk of significant irregularities.

⁽⁷⁾ Rates quoted are those in force for December 1997.

3.3. Although the option has been provided for by legislation since 1 January 1995, at the time of the Court's audit only four Member States, Denmark, France, Germany and United Kingdom were applying the 5 % rate of physical check covering all product sectors by customs office associated with risk analysis. Apart from Italy, the remaining Member States visited all claim to use, to some extent, risk criteria for the selection of consignments for physical check.

3.4. Current legislation provides for the use of risk analysis as an option. Thus, Member States use markedly different approaches for the selection of consignments for physical checks. The use of risk analysis should be made obligatory.

3.5. Whether or not Member States have opted for risk analysis, the imposition by legislation of minimum rates for physical checks means that some selections are made simply to comply with the legislative requirements regardless of the risks presented. To be sure of achieving a fixed annual rate, administrative procedures are aimed at maintaining a regular rhythm of checks throughout the

year. A prime motive for this is to avoid disallowance under the clearance of accounts procedure⁽⁸⁾ for failure to meet the prescribed levels.

3.6. The value of refunds claimed is one of the key risk criteria identified by Regulation (EC) No 3122/94. Yet the Regulation requires the rate of checking to be based upon the numbers of declarations presented, not on the value of refunds claimed. This leads to distortion of control effort. The majority of export declarations are presented in respect of non-Annex II (NA II) goods⁽⁹⁾ which attract much lower rates of refund in relation to their weight than basic products. For example about 10 % of refunds paid in the Netherlands in the 1996 EAGGF year were in respect of NA II goods yet they accounted for some 53 % of the checks. In contrast refunds on beef in the same year accounted for some 21 % of refunds but only 6 % of checks. As demonstrated in *Table 4* a similar distortion can be seen in the pattern of checks in other Member States.

Table 4

Distribution of control effort for NA II⁽⁹⁾ and milk products

Member State	Percentage share of refunds		Percentage share of checks	
	NA II	Milk	NA II	Milk
Germany	9	20	46	15
Netherlands	10	59	53	17
Spain	15	12	28	13
United Kingdom	20	33	57	17
Ireland	8	12	34	10
Belgium	7	24	31	10
France	4	23	29	16

Source: Member States' paying agency and customs service data 1996.

⁽⁸⁾ Member States finance payments to beneficiaries under the EAGGF initially from their own budgets and are subsequently reimbursed by the EC Commission. The Commission's audit of this expenditure is called 'Clearance of accounts'. As a result of this audit the Commission may disallow expenditure where, for example, it considers that the payments have been irregular or that the Member State has failed to fulfil its control obligations. In such instances the charge is to the national not the EU budget.

⁽⁹⁾ Goods not included in Annex II to the Treaty establishing the EEC as referred to in Article 38 and which are in fact processed products.

3.7. Where a Member State opts for the use of risk analysis the rate for physical checks is a minimum of 5 % per customs office per calendar year with a minimum of 2 % per product sector. Goods are taken into customs control not only at the major ports but also at inland customs offices responsible for the premises where they are packed for export. The nature of trade differs considerably between major ports where a wide variety of products from a wide range of exporters is taken under customs control and inland customs offices where often a limited range of products from a few exporters is involved. For such customs offices, the selection of consignments for physical check on the basis of a smaller statistically representative sample is an alternative to the obligatory 5 % rate which might be considered.

3.8. Under the legislation, risk analysis should form an integral part of the selection procedure but it is sometimes used only as background information. However, the extent to which risk analyses are integrated into the procedure for selection for physical check varies. In the UK and to a partial extent in Denmark, the risk criteria used are recorded for each consignment and the risk analysis leads directly to the recommendation for physical check of individual consignments. In Spain there is no formal risk analysis but if a risk is identified, for example, on the basis of an irregularity detected by laboratory analysis, a filter is set which leads to the automatic selection of export declarations for physical check for the product and/or exporter in question. In Germany risk analysis has led to the fixing of rates of checking at the level of product sectors. i.e. beef, milk etc., the selection of the individual consignments being left to the local customs offices. Such a system is too general to be effective on its own. In Belgium and the Netherlands risk analyses have only been drawn up for a limited number of products and at best they serve as an information note to customs offices. Thus all of these Member States could claim to use risk analysis in some way although the methodology used by the UK, and partially by Denmark, is both more transparent and accountable.

3.9. Ideally, to ensure consistent treatment, the selection procedures should be centralised within each Member State, with provision for some local input, since the same products from the same exporter can be presented for customs control at more than one customs office of export. This particular system is in operation only in Spain (but see paragraph 3.20).

3.10. Regulation (EC) No 3122/94 provides for optional criteria to be used in the procedure for the selection of

consignments for physical check. They relate to the products, trade, export refund nomenclature, exporters, irregularities, customs arrangements and the arrangements for the granting of export refunds. The Regulation does not however make any recommendations on the relative importance of these criteria.

3.11. The degree of sophistication of the procedures for the selection of consignments varies considerably between Member States. Some are well documented where the use of the criteria can be readily identified (Spain, Denmark partially and the United Kingdom), others are informal with no record of the criteria used for the selection of particular consignments (Belgium, France, Ireland and the Netherlands).

3.12. There are also differences between customs offices within particular Member States. For example, in Denmark, Vejle has a transparent computerised system which takes account of criteria such as trader and product risk, value of refunds, etc. The system leads to an automatic risk rating on the basis of points allocated for each of the criteria. In other customs offices in Denmark, such as Esbjerg and Aalborg, the risk analyses were based on fewer criteria and less information. Disparities were also noted between customs offices in Ireland.

3.13. Each customs office of export must ensure that the achievement of the 5 % check rate can be verified at any time. There is no legislative provision for recording the risk associated with the individual consignment. Without this information it is impossible to judge the effectiveness of selections for deterring or detecting irregularities. Spain, Denmark in part and the United Kingdom are the only Member States to record the risk associated with each export declaration by means of a code or weighting factor.

Use of databases for risk analysis

3.14. Information on export refund irregularities, whether they are detected by Regulation (EEC) No 386/90 checks or by other means, is used for risk analysis in the following ways; as a direct element of the calculation of a risk factor for individual consignments, as in the United Kingdom system; in the form of a database which can be consulted (Ireland, the Netherlands, Spain); or in the form of information notes (Belgium, Denmark, France).

3.15. Where the information is available for consultation in the form of a database or an information bulletin, there is no record that it has been taken into account in the selection of consignments for physical check.

3.16. In the United Kingdom ⁽¹⁰⁾, where the incidence of irregularity in the database is taken into account but not the value, at least 20 % of the irregularities concerned late presentation of export documents and there were many instances where the irregularity was of a purely clerical nature with no financial impact. Of the misdescription irregularities, 25 % were voluntary declarations, 8 % were annotated as having no financial impact and in some 50 % the value of the irregularity had not been recorded. Taking account of irregularities which have no relevance for physical checks or those with no financial impact leads to unnecessarily high rates of checking for both the products and traders concerned with the associated costs for both customs and trade.

3.17. Similarly in the Netherlands, where the irregularity database is available for consultation by customs offices, around 14 % of the irregularities were in respect of minor weight differences (less than 50 kg). Further the declared and found export refund nomenclature codes were not recorded in a consistent manner nor was the nature of the irregularity always clear. This detracts from the usefulness of the database as a tool in the selection of consignments for physical check.

3.18. Irregularities detected by laboratory analysis of customs samples are recorded in Member States' irregularity databases. They are therefore available for consideration within risk analysis procedures. In contrast, the incidence of testing of products which are found to meet the export refund requirements is not. Risk analyses therefore cannot take account of the positive assurance achieved by repeated satisfactory results.

3.19. In most of the Member States visited the customs laboratories maintained databases of details and results of all tests carried out which should be made available to customs services for risk analysis purposes.

Monitoring and evaluation

3.20. All Member States have records of the numbers of physical checks carried out at the customs offices. Where however there are recommendations for physical checks which are made centrally or based on centrally fixed criteria and weightings, such as in Spain and the United Kingdom, there are no systems in place to ensure that the recommended check is in fact carried out, or, if not, that

the reasons are documented. For example, in one customs office in Spain in the period 1 March to 30 June 1997, 75 % of the recommended checks on olive oil exportations were not carried out and yet there was no documented reason for not so doing nor was there any feedback to the central office responsible for setting the parameters which resulted in the recommendations. Similarly in the United Kingdom in 1995, 37 % of physical checks were carried out in the not-recommended category, 34 % in the optional and 29 % in the recommended ⁽¹¹⁾. In fact, the 29 % represented only 3,8 % of the declaration lines recommended for examination. There had been no documented justification for non-adherence to the recommendations and no management feedback.

3.21. In Germany, the centralised system for risk analysis results in a high, medium or low risk being allocated to each product group with an associated rate of minimum check. The system was introduced in 1997 but did not provide for monitoring the results. A comparison of the rates of checking for 1996 and 1997 for one customs office in Germany showed that the risk recommendations, high for beef and medium for milk products, had not significantly altered the pattern of checks in the desired direction.

3.22. None of the Member States visited had evaluated the effectiveness of the selections made for physical check. Even had the Member States wished to carry out evaluations they could not have done so because none of them had management information systems giving details of export declarations, risk categories, controls carried out and results of checks in terms of the values of irregularities detected.

Effectiveness of checks

3.23. In the absence of the necessary data the Court was also unable to carry out an evaluation on the effectiveness of physical checks. Nevertheless, for those Member States where information was available for product groups at the national level, a comparison of the rates of check with rates of detection of irregularities brings into question the effectiveness of Member States targeting. Even at this level there is evidence that substantially more checks are being directed at product sectors where the value of irregularities detected is

⁽¹⁰⁾ The United Kingdom risk-analysis system is detailed and transparent and therefore attracts more comment than those Member States where there is no use of, or no transparent risk analysis.

⁽¹¹⁾ The United Kingdom does not contest the figures but points out that a flaw in the computer system may have caused a number the 'recommended' lines to default to 'not recommended'.

considerably lower than other product sectors. For example in the United Kingdom, in 1996, 57 % of all checks were in respect of NA II goods with irregularities detected accounting for some 16 % of the total value of irregularities; whereas 17 % of the checks were on milk products with irregularities detected accounting for 43 %.

Irregularities detected by Regulation (EEC) No 386/90 checks

3.24. Details of irregularities detected by Regulation (EEC) No 386/90 checks in each product sector in the EAGGF year ending 15 October 1996 were requested from each of the Member States visited. Only Ireland and the United Kingdom provided the information as requested and, as referred to in paragraph 3.16, the

United Kingdom's figures were taken from a database which included irregularities which were in fact voluntary declarations. The Netherlands authorities supplied a global figure being unable to attribute the irregularities to product sectors. The other Member States were unable to supply any figures.

3.25. On the basis of the figures which were supplied by the three Member States, the value of irregularities detected is low, ranging between 0,003 % and 0,06 % of refunds paid with a total value of ECU 1,4 million against refunds paid of some ECU 1 934 million. *Table 5* details the refunds paid, numbers of checks and irregularities detected in those Member States.

Table 5

Number of Regulation (EEC) No 386/90 checks reported by Member States in 1996

	Refunds million ECU	Number of declarations	Number of checks	Value of irregularities (in ECU)
Belgium	478,8	16 497	1 642	
Germany	893,8	306 847	24 370	
Netherlands	774,6	377 353	17 152	475 380
Ireland	839,6	28 221	2 391	29 020
Spain	166,4	76 882	9 193	
United Kingdom	375,8	121 997	4 162	926 532
Italy	264,6	122 134	National total not available	
France	1 119,6	298 578	22 706	
Total	4 913,2	1 348 509	81 616	

Source: Member States paying agency and customs data.

3.26. Under Council Regulation (EEC) No 595/91⁽¹²⁾ Member States are required to notify to the Commission all irregularities in excess of ECU 4 000. The notifications are also required to identify the method of detection. These are defined as *a posteriori* control, customs controls, fiscal controls, Commission initiative, controls other than customs controls and other controls. Member States are inconsistent in determining the methods of detection and the Commission does not verify their accuracy. For example, some Member States classify irregularities detected by laboratory analysis of samples taken by customs as inter-service controls, others as customs controls. It is therefore not possible to identify

from the Commission's database (IRENE) irregularities detected by Regulation (EEC) No 386/90 checks.

3.27. Nevertheless, even taking the maximum possible figure from the Commission's database the level of irregularities detected by Regulation (EEC) No 386/90 checks is low in comparison to other methods of detection. In 1997, out of a total of 563 cases with a total value of ECU 34 million, the maximum possible was 121 cases (21,5 %) with a value of some ECU 2 million (5,9 %). Irregularities detected by *a posteriori* controls account also for around 20 % of the number of cases but 33 % of their value. *Table 6* shows the details of refund irregularities detected by each Member State according to the method of detection.

⁽¹²⁾ OJ L 67, 14.3.1991, p. 11.

Table 6

Export refund irregularities reported under Regulation (EEC) No 595/91 in 1997

Detection methods	Total		B		DK		D		EL		E		F	
	A	B	A	B	A	B	A	B	A	B	A	B	A	B
Other methods of detection	27	456					21	187						
Operational checking	51	1 174					51	1 174						
Fiscal checking	3	2 355												
Customs checking	43	2 548	3	87					2	0			30	266
Commission initiative/inquiry	118	7 098					115	5 688	1	18	2	1 392		
Checking other than customs	211	8 759	7	199	10	296	118	5 431	1	18	18	1 749	4	52
<i>A posteriori</i> accounting checks	110	11 668	7	796	2	29	18	1 692	2	52	7	1 305	2	17
Total	563	34 058	17	1 082	12	325	323	14 172	6	88	27	4 446	36	335

Detection methods	I		NL		A		P		FIN		S		UK	
	A	B	A	B	A	B	A	B	A	B	A	B	A	B
Other methods of detection			2	61									4	208
Operational checking														
Fiscal checking	3	2 355												
Customs checking	2	2 166			1	0							5	29
Commission initiative/inquiry														
Checking other than customs	1	0	4	50	21	8	4	472					23	484
<i>A posteriori</i> accounting checks	14	3 441	16	1 382	11	14	8	2 513	1	32	5	33	13	245
Total	20	7 962	22	1 493	33	22	12	2 985	1	32	5	33	45	966

A = Number of cases.

B = Sum in thousands ECU.

Source: UCLAF.

3.28. This low level of irregularity detection by physical control can be read in different ways. It could imply that, generally speaking, operators do comply with Community legislation or that the controls are an effective deterrent. Conversely, it could also suggest that physical checks are inadequately targeted or executed and, as a result, ineffective. The level of export refund irregularities detected by other means, the Commission's findings on the adequacy of Members States checks and the findings of this report in respect of targeting of checks, all point to the latter.

Coordination with Regulation (EEC) No 4045/89 verifications

3.29. The provision for coordination and combination of Regulation (EEC) No 386/90 and Regulation (EEC)

No 4045/89 *a posteriori* controls is insufficiently defined. It is mostly interpreted by Member States restrictively as the exchange of results between the responsible officials. Even this is not done on a systematic basis. In some Member States not even the risk categories accorded to exporters under the two Regulations are exchanged (Denmark, France, Ireland, the Netherlands, the United Kingdom).

3.30. What could be more effective is a planned control strategy designed to ensure that controls under the two Regulations are complementary; to determine for particular export refund criteria which method of control is the more effective; to determine the extent to which one control can compensate for the other and to avoid duplication. This approach would be particularly appropriate to large exporters with a regular trade, for the most part, in the same goods.

Laboratory testing

3.31. Physical checks of all products where the rate of refund applicable to those products is dependent upon composition must include laboratory analysis. Most products are not manufactured specifically to meet export refund compositional requirements. They are manufactured to commercial specifications designed to ensure that the customer receives what he orders. They are for the most part subject to quality control procedures by the producers covering both quantity and composition on a scale which far exceeds that which can be achieved by customs controls. The Commission should consider introducing a provision for customs laboratory testing of products to be reduced subject to accreditation by Customs services of the producer's laboratory, testing methods and records coupled with periodic unannounced compliance tests. This system would be particularly appropriate for NA II and milk products.

3.32. The Commission should also consider reducing the requirement for obligatory laboratory testing where positive assurance is available on the basis of repeated satisfactory results on the same product from the same exporter. For example, in the United Kingdom over a period of two years 6,6 % of all laboratory tests in that period, all of which were satisfactory, were on one exporter's range of six products. Similarly, in the Netherlands, tests on one exporter's limited range of NA II products accounted for 2,5 % of all tests with an irregularity detection rate of 0,7 %.

3.33. Export refunds for Pecorino cheese from Italy in the 1996 EAGGF year amounted to some ECU 14 million. The rate of refund depends in part on whether or not the cheese is made exclusively from sheep's milk. If the cheese is made wholly or in part from cow's milk the refund rate is reduced by some 30 %. The presence of cow's milk can be detected by laboratory analysis. Routine laboratory analysis methods are allowed by Commission Regulations (EEC) No 690/92⁽¹³⁾ and (EC) No 1081/96⁽¹⁴⁾ provided the detection limit is 0,5 % or lower. The routine method used by the Customs laboratory in Sardinia from 1992 to mid-1997 had a detection limit of 1,25 % and was therefore inappropriate. As a result, there can be no assurance that

refunds paid on exports of Pecorino between 1992 and mid-1997 have been regular. The maximum amount at risk based on payments in the 1996 EAGGF year is in the order of ECU 4 million p.a.

3.34. Article 13 of Commission Regulation (EEC) No 3665/87⁽¹⁵⁾ 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(1) of Regulation (EC) No 2221/95 requires the customs office of export to be mindful of this requirement.

3.35. The conformity of products with legal health requirements can be controlled by laboratory tests. Yet apart from one customs laboratory in Germany, such tests were neither systematically requested by Member States' customs services nor systematically carried out.

4. CONCLUSION

4.1. In the general context, physical checks are an essential tool for customs services, but, depending on the measure, they may not always be the most effective and appropriate method of control. Given the volume of exports and the difficulty of obtaining representative samples from containerised consignments the task of customs offices in performing effective controls without creating undue obstacles to the flow of trade is a very difficult one. There is also a need to improve coordination between these controls and those carried out under Regulation (EEC) No 4045/89. The Commission should therefore consider creating a legal framework which provides for a balanced combination of physical and *a posteriori* controls.

4.2. Member States are encouraged to place more emphasis on the quality and effectiveness of physical checks rather than just ensuring that the rates of checking fixed by regulation are met.

4.3. The Commission's inspections in Member States have concentrated on the number and quality of physical checks. However the effectiveness of the procedures for the selection of consignments for physical check has not been addressed. The Commission should carry out such evaluations periodically.

4.4. The Commission is encouraged to consider a number of recommendations aimed at improving the effectiveness of the procedures for the selection of consignments for physical check. Above all the Court suggests that the legislative requirements relating to

⁽¹³⁾ OJ L 74, 20.3.1992, p. 23.

⁽¹⁴⁾ OJ L 142, 15.6.1996, p. 15.

⁽¹⁵⁾ OJ L 351, 14.12.1987, p. 1.

physical checks be made more flexible while at the same time making Member States more accountable for the effectiveness of those checks. The principal recommendations relating to Regulation (EEC) No 386/90 are as follows:

- the use of risk analysis by Member States should be made obligatory. Where the nature of the trade is unsuitable for risk analysis, provision should be made for physical checking to be based on statistically representative samples,
- the necessity for rates of physical checks to be fixed by legislation should be re-examined. Member States should be required to submit to the Commission for approval annual strategic control plans including risk analysis and target rates of checks by risk category,
- the Commission should give guidance to Member States on the meaning of the use of risk analysis,
- a simple but uniform system of recording the risk associated with each consignment should be provided for by legislation,
- Member States should introduce monitoring and feedback systems to ensure that targeted checks are carried out or satisfactory explanations for not doing so are recorded,
- Member States should be required to submit annual evaluations of the execution and effectiveness of Regulation (EEC) No 386/90 checks ⁽¹⁶⁾,

- the method of detection of export refund irregularities should be recorded in Member State databases and should identify, where appropriate, the pertinent control regulation. The same information should be included for irregularities notified to the Commission under Regulation (EEC) No 595/91,
- Article 5(1) of Regulation (EC) No 2221/95 should be strengthened to require routine testing of the sound and fair marketable quality on all samples submitted for laboratory analysis,
- customs services should be able to reduce the level of laboratory testing where reliance can be placed on manufacturer's accredited quality control procedures and records or where positive assurance is available from repeated satisfactory results.

4.5. In more general terms, risk analysis is an effective resource management tool. To limit it to export refunds is too restrictive. Member States customs services are the control bodies for other European Union measures with financial implications particularly in the area of traditional own resources. In some Member States they also control some internal measures such as production aids. To effectively manage their resources Member States need a broader legislative framework for risk analysis which would permit them not just to target transactions within measures but to allocate resources to measures on the basis of the comparative risks to the EU budget.

This report was adopted by the Court of Auditors in Luxembourg at its meeting of 14 and 15 October 1998.

For the Court of Auditors

Bernhard FRIEDMANN

President

⁽¹⁶⁾ Annual plans are required for other control measures such as those carried out for agricultural expenditure in general under Regulation (EEC) No 4045/89 and for olive oil in particular under Commission Regulation (EEC) No 27/85.

ANNEX

PRINCIPAL PROVISIONS OF THE CONTROL REGULATIONS

The principal provisions of these Regulations are as follows:

(a) *Unannounced physical checks — Article 3 of Regulation (EEC) No 386/90*

Member States shall carry out unannounced physical checks at the time the goods are taken into customs control at the rate of 5 % per product sector per customs office. This rate may be replaced by 5 % per customs office covering all sectors with a minimum of 2 % by product sector provided the transactions are selected for inspection on the basis of risk analysis. The rate shall apply to a representative choice of export declarations.

(b) *Sampling for laboratory analysis — Article 5(4) of Regulation (EC) No 2221/95*

If the rate of refund depends on a particular content Member States shall, as part of the physical check, take samples of the exported products for laboratory analysis to determine whether or not they correspond to the description in the export refund nomenclature.

(c) *Substitution checks — Article 3a of Regulation (EEC) No 386/90*

Where goods have been taken into customs control at a customs office which is not the office of exit from the Community, the customs office of exit shall carry out at least one substitution check per day based on risk analysis if a customs seal has not been applied.

(d) *Sound and fair marketable quality — Article 5(1) of Regulation (EC) No 2221/95*

The Customs office of export must be mindful of the provisions of Article 13 of Commission Regulation (EEC) No 3665/87 concerning the sound and fair marketable quality of the goods;

(e) *Verification of rate of physical checks — Article 7(1) of No (EC) Regulation 2221/95*

Each customs office of export shall ensure that the check rate of 5 % can be verified at any time; each customs office of exit shall ensure that the number of declarations to be taken into account for substitution checks as well as the number of substitution checks carried out can be identified at any time.

(f) *Scrutiny of payment applications — Article 2b of Regulation (EEC) No 386/90*

Member States shall scrutinise the payment applications and supporting documents to justify the payments in question.

(g) *Coordination of controls — Article 5 of Regulation (EEC) No 386/90*

Member States shall take steps to coordinate the controls of individual operators and combine them with those carried out under Council Regulation (EEC) No 4045/89.

(h) *Risk analysis criteria — Article 1 of Regulation (EC) No 3122/94*

Where Member States have opted for the use of risk analysis under Article 3(2) of Regulation (EEC) No 386/90 they may notably rely on the criteria to select export declarations which are listed in Article 1 of Regulation (EC) No 3122/94.

REPLIES OF THE COMMISSION

EXECUTIVE SUMMARY

The Commission considers that rates of control should continue to be fixed by regulation, even when Member States use risk analysis. A minimum rate of 2 % for the physical control of each product has been adopted in order to ensure that a representative number of all exports is checked. Each customs office is required to check at least 5 % of all exports, so a proper application of risk analysis leads each office to check 2 % of low-risk products, and a considerably higher percentage of high-risk products.

Member States have a general requirement to detect and prevent fraud, so the regulations governing physical checks do not preclude other checks which are effective in particular circumstances. There is coordination between customs offices and the services responsible for *a posteriori* controls and the Commission constantly strives to improve this. The Court suggests means of providing the information necessary for an evaluation of the selection procedures. The Commission will consider the suggested means, seeking to avoid any disproportionate administrative burden on Member States.

The Commission considers that a reasonable balance between the different controls cannot be achieved by legislation alone. The Commission is concerned that existing legislation is properly implemented by all Member States, who are already fully accountable for the effectiveness of their checks. It will examine all the Court's recommendations, in particular that of making obligatory the modulation of control percentages according to the risk each product presents and that of the recording of risk factors.

The Commission agrees that the technique of risk analysis should be applied under all control systems and will continue to explore means of extending its use. Legislative frameworks should be envisaged in a prudent manner, as risk analysis must always include elements of flexibility to take into account different conditions and to maintain a level of unpredictability in the selection of operations for control.

1. INTRODUCTION

General remarks

The Commission agrees that risk analysis is a major tool for orienting controls on aid schemes such as export

refunds. Controls, whether physical or administrative, should be carried out in the most effective way.

Audit scope

1.6. The scope of the Commission's enquiry was, under the clearance of accounts procedure, to analyse the implementation of Regulation (EEC) No 386/90 by Member States and concerned customs controls operating during 1996 and 1997. The Court's audit, for which most visits took place at a later date than those of the Commission, was of a more specific nature and focused principally on the different aspects of risk analysis implemented by customs.

A national risk analysis approach in the sense of Regulation (EC) No 3122/94 was applied in the United Kingdom from 1 January 1995. Other Member States introduced their risk assessment system at a later date (such as Germany from 1 January 1997 and Denmark from 1 July 1996).

2. OBSERVATIONS RELATING TO THE COMMISSION'S INSPECTIONS

2.2. There has not yet been an overall evaluation of the effectiveness of the procedures adopted for the selection of exports for checking as there is insufficient information available. However, the assessment of the success in detecting irregularities through physical controls is an important element in analysing risks and, as this success is closely linked with actions in the fight against fraud, specific attention is given to it under the implementation of Regulation (EEC) No 595/91. The Commission has always paid particular attention to risk analysis in its fraud prevention strategy. The Task Force for Fraud Prevention (UCLAF) analyses the risks of fraud and irregularities on the basis of the information available. This analysis is examined with the Member States in special meetings to discuss specific cases and in full session. Specific courses of action, possibly involving tighter physical inspections and controls of documents and sampling, are suggested to the Member States on the basis of these analyses.

2.4. The Commission agrees that regular control on export is based upon a combination of physical control and administrative control. Both types of controls are

complementary and findings in one type of control should trigger a follow-up in the other. The Commission's experiences gained during several missions are that the Member States are already taking initiatives to strengthen their control structures in this respect. In order to improve coherence, the clearance of accounts unit places a great deal of emphasis on the importance of the information flow between the customs and the services responsible for *ex-post* verifications under Regulation (EEC) No 4045/89, in particular given that customs undertake the *ex-post* scrutinies of export refunds in most Member States. This subject is raised in the meetings of expert groups, and examined in the course of audits on the spot.

2.5. The Commission's audit focused on the controls over a sample of export declarations concerning the more significant products from selected customs offices. Its own risk analysis precluded a verification of every single sector. In all customs offices visited by the Commission, full attention was given to verifying that all the elements of the controls (including laboratory analyses) were performed before the controls were considered as eligible to count towards the 5 % requirement.

2.6. to 2.7. The delay in the finalisation of the Commission's audit was caused by other, unforeseen, priorities. The Commission is now in the process of calling bilateral meetings with all of the Member States concerned prior to finalising its conclusions within the clearance of the accounts procedure. It should be noted that some of these conclusions may be modified within this procedure, particularly as regards the seriousness of each deficiency.

3. FINDINGS OF THE COURT'S AUDIT IN THE MEMBER STATES

3.3. Council Regulation (EC) No 163/94 provides for the option to replace the rate of 5 % per sector by a rate of 5 % covering all sectors if the Member State applies a selection system on the basis of risk analysis. Until now the Commission has received notifications from seven Member States that they have adopted the option of a selection system based on risk analysis.

3.4. The Commission will examine the Court's request to render risk analysis obligatory.

3.5. The experience of the Commission was that the controls aimed to get general assurance on the regularity of the exports as a whole. The Commission agrees that

selection should not be made simply to reach the minimum rate of inspection regardless of the risks presented by different exports.

Obviously, a failure to achieve the regulatory number of checks will lead to disallowance, as will a failure to spread checks throughout the year as Regulation (EEC) No 386/90 requires that controls are representative.

3.6. Under present legislation, even when the risk analysis option is applied, a key element of the control structure is to carry out controls in such a way that they cover a representative selection of all exports (including lesser value operations or lesser risky ones). The requirement to control 5 % of all exports from each customs office, with a minimum of 2 % per sector, leads to a substantial increase in the control efforts for the higher risk products. More than 5 % of the higher risk products should be controlled.

The issue of the control of non-Annex II goods has been addressed by Regulations (EC) No 3122/94 and (EC) No 2221/95, which provide in most cases for a separate, simplified procedure with a control rate of 2 %.

3.7. Even in the cases mentioned by the Court, a certain risk remains because inland offices normally deal with a small number of big exporters who often also benefit from simplified or home procedures and who simultaneously apply different customs regimes for their different activities. There is a risk that they will submit the export declaration to customs after the goods have already been loaded, or have already left the premises. Regular visits by customs to these companies are essential to reduce the risk of abuse of the procedures adopted. The Commission is reluctant to initiate proposals to the Council which could remove the requirement for a minimum number of controls in each customs office.

3.9. to 3.10. Qualifying some elements as less important in the legislation can generate a counter-productive effect on the level of control over those elements.

3.11. to 3.22. The Commission is not in a position to reply to the Court's findings, because this aspect remained outside the scope of its own audit. The answers from the Member States to the Court will be examined once they are received by the Commission.

The Commission will discuss the different points concerning risk analysis raised by the Court of Auditors

with the Member States in the appropriate management committees. Such an exchange of views will enable the Member States to take into account experiences gained by others, and to improve their own systems. At the same time, any necessary changes in legislation will be identified. However, in general, it is not desirable to make systems too cumbersome, or too sophisticated, as this might render them inapplicable or inflexible in practice.

3.24. to 3.28. The Commission is considering how to improve the notification of methods for the detection of irregularities reported by the Member States pursuant to Article 3 of Regulation (EEC) No 595/91 and their incorporation in the IRENE database, particularly with a view to identifying the irregularities detected during the inspections conducted pursuant to Regulation (EEC) No 386/90.

3.29. to 3.30. The Commission agrees that the coordination between physical controls and administrative *ex-post* controls could be improved. Cases of non-compliance found by one control procedure should be followed up under the other. A difference in a fat content found in cheese samples might concern the whole production lot and thus several export transactions. The frequency with which credit notes are issued by a trader for differences in weight should guide customs to intensify controls on quantities at the moment of export. The Commission has insisted on this point many times, most recently during an Experts' Group for *ex-post* control services in June 1998.

3.31. to 3.32. Because of the risks presented by an exporter certifying the nature of his own exports, the Commission does not share the opinion that, in the circumstances described by the Court, official customs laboratory testing could be reduced by a system of accreditation of producers' laboratories. Access to production records, including product control, is already provided for under both Article 8(2) of Regulation (EC) No 2221/95 and Article 1(2) of Regulation (EEC) No 4045/89. Furthermore, the Annex to Regulation (EC) No 2221/95 provides for a flexible verification system for certain non-Annex II goods where sampling is not obligatory (see point 3(a)(bb), third subparagraph).

3.34. to 3.35. The Commission is discussing this difficult and sensitive issue with the Member States in the trade mechanisms Management Committee.

4. CONCLUSION

4.1. The Commission agrees that regular control on export is based upon a combination of physical control and administrative control. Both types of controls are complementary and findings in one type of control should trigger a follow-up in the other. The Commission's experiences gained during several missions are that the Member States are already taking initiatives to strengthen their control structures in this respect.

Controls are implemented by different administrative organisations in each of the countries and obey different public and administrative national legislation (Article 8(1) of Regulation (EEC) No 729/70). The Commission prefers to maintain the existing level of subsidiarity, but will continue to stress the importance of Member States setting up or deepening the coordination between their different control bodies.

4.2. The Commission makes considerable efforts to encourage improvements to physical checks over exports.

4.3. The audit by the Commission aimed to establish how the control requirement for physical control on export was carried out during 1995 and 1996. Applying risk analysis, as defined in the amended version of Regulation (EEC) No 386/90, as a practical tool for selecting the export operations to be physically controlled was, at that time, not an operational system in place in the majority of Member States. In general, the Commission has found that customs services in Member States which had not introduced risk analysis were well aware of risk criteria in their selection and examination of individual export transactions. It will continue to pay close attention to the effectiveness of all customs control procedures in the Member States.

4.4. The Commission will examine carefully the Court's recommendations, in particular those relating to records and reports, whilst avoiding any excessively cumbersome systems as this might render them inapplicable or inflexible in practice — see reply 3.11 to 3.22. The different structures in place in the Member States and the nature of the beneficiaries and exports are such that flexibility in organising and carrying out of controls is essential. For this reason, Regulation (EEC) No 3122/94 mentions a wide range of elements of risk including those which relate to the products, the beneficiaries, the procedures and the previous findings, which should enable the Member States to set up workable systems of risk assessment. Article 3 of the Regulation provides that experience be used to adjust the systems and the selection

of parameters, in order to make physical checks more effective and to improve their targeting.

4.5. The Commission, together with the customs authorities of the Member States, has drawn up guidelines on risk analysis in customs controls. In addition, the Commission has organised various meetings

and seminars to exchange mutual experiences on physical controls and risk analysis issues.

The guidelines include definitions of risk, risk analysis, risk assessment, risk areas, risk indicators and risk profiles.
