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**REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND  
THE COUNCIL**

**Protection of the Communities' financial interests – Fight against fraud – Annual report  
2005**

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## INTRODUCTION

Protection of the Communities' financial interests and the fight against fraud is an area in which responsibility is shared between the Community and the Member States. Each year the Commission, in cooperation with the Member States, produces a report setting out the new measures taken to satisfy these obligations, in accordance with Article 280 of the EC Treaty. This report is sent to the European Parliament and the Council and is published.

In the **first section** of the report, the Commission provides an **assessment of its five-year (2001-05) overall strategic approach** for the protection of the Communities' financial interests. Despite the many obstacles, the overall result of the implementation of the objectives and actions programmed is satisfactory.

The **second section** contains a **statistical summary of the cases of irregularities reported** under the sectoral regulations.

The **third section** contains an illustrative selection of the **measures taken in 2005** by the Member States and, for the Commission, a description of the efforts made to improve the effectiveness of the European Anti-Fraud Office (OLAF).

It was agreed with the Member States to present two specific themes in the fourth and fifth sections of the report. The **fourth section** sets out the measures taken to **improve recovery** of sums not collected or paid unduly. This is the organised financial monitoring that is the only way of remedying the damage caused to the European budget by fraud and other irregularities.

The **fifth and final section** deals with the question of the **certification of Member States' accounts**. The majority of the European budget is managed in cooperation with the Member States. This point includes a brief comparison of the control principles and standards and of the certification systems (where they exist) applied by the Member States.

The report provides only a summary and overview of the measures taken and the results achieved by the twenty-five Member States. The Commission is also simultaneously publishing two working documents<sup>1</sup>, one listing the Member States' contributions and the other on statistics for the irregularities notified by the Member States.

Past years' reports and the associated Commission staff working documents are available on the OLAF website<sup>2</sup>.

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<sup>1</sup> "List of measures taken by the Member States" and "Statistical analysis of irregularities".  
<sup>2</sup> [http://europa.eu.int/comm/anti\\_fraud/reports/index\\_en.html](http://europa.eu.int/comm/anti_fraud/reports/index_en.html).

## **1. ASSESSMENT OF THE 2001-05 OVERALL STRATEGIC APPROACH FOR THE PROTECTION OF THE EUROPEAN COMMUNITIES' FINANCIAL INTERESTS**

The protection of the European Communities' financial interests depends on a culture of strong cooperation between the national and Community levels. The Commission's aim was to put in place an overall strategic approach in this field that includes all actions contributing to this common objective, in order to ensure convergence between the efforts of the national authorities and the institutions involved in prevention. This includes operational activity, financial follow-up, the application of sanctions, prevention and the preparation of legislation providing a framework for these activities, whether for the first or third pillar.

In its Overall Strategic Approach, adopted on 28 June 2000<sup>3</sup> in the context of the inclusion of Article 280 EC in the Amsterdam Treaty and the creation in 1999 of the European Anti-Fraud Office (OLAF), the Commission adopted its political and general objectives for the period 2001-05. It identified four main strategic guidelines for the protection of the European Communities' financial interests:

- an overall legislative anti-fraud policy;
- a new culture of operational cooperation;
- an inter-institutional approach to prevent and combat corruption;
- enhancement of the penal judicial dimension.

The implementation of this overall strategic approach was given practical shape in the 2001-03<sup>4</sup> and 2004-05<sup>5</sup> Action Plans.

### **1.1. An overall legislative anti-fraud policy**

The Commission has endeavoured to follow a horizontal and cross-pillar approach to anti-fraud policy, integrating all sectors in which fraud and corruption may appear. Anti-fraud legislation must make provision for follow-up and cooperation, as well as prevention and detection.

In 2001 the Commission announced that it was putting in place an internal Commission "fraud-proofing" mechanism<sup>6</sup> to improve the quality of legislation and the management of contracts in order to make them more "resistant to fraud". Since 2003 an inter-departmental group has been identifying each year legislative initiatives and model contracts in the process of being drawn up that could present a major risk to the Communities' financial interests. The European Anti-Fraud Office

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<sup>3</sup> Communication from the Commission - Protecting the Communities' financial interests - Fight against fraud – For an overall strategic approach (COM(2000) 358 final).

<sup>4</sup> Communication from the Commission - Protecting the Communities' financial interests - Fight against fraud - Action Plan for 2001-2003 (COM(2001) 254 final).

<sup>5</sup> Communication from the Commission - Protecting the Communities' financial interests - Fight against fraud - Action Plan for 2004-2005 (COM(2004)544 final).

<sup>6</sup> Communication from the Commission concerning the fraud-proofing of legislation and contract management 7 November 2001 (SEC(2001)2029 final).

is consulted ahead of the drafting of such documents. During the period 2004-05 the Office has examined in all 28 initiatives.

The introduction of the euro was accompanied throughout the programming period in question by numerous measures to combat the counterfeiting of euro coins and notes. Among the measures adopted, the Commission enhanced the legal framework for action and intervention, as well as the framework for international cooperation on specific matters.

In a 2002 Communication<sup>7</sup> focusing on improving the recovery of unduly paid agricultural funds prior to 1999, the Commission announced the establishment of a Recovery Task Force (RTF) to clarify the situation of unrecovered debts and to draw up decisions on financial liability under the formal accounts-clearance procedure in the EAGGF Guarantee Section (see point 4.2).

The new Financial Regulation<sup>8</sup>, which came into force in 2003, enhanced considerably the protection of the Communities' financial interests:

- It makes for more effective recovery.
- It makes provision for a move from cash-based to accrual accounting. Since 2005 the Commission has therefore been in compliance with the strictest international accounting standards, has improved its day-to-day management of funds and has reduced to a minimum the risk of errors or irregularities.
- It provides for an information system that makes it possible to exclude from public contracts by means of an administrative decision unreliable candidates and tenderers with criminal convictions or who provide misleading or fraudulent information. A similar mechanism was adopted under the Directive on the coordination of procedures for the award of public works contracts<sup>9</sup>. In the context of its Communication on Transparency<sup>10</sup>, the Commission intends to study the possibility of making greater use of the exclusion system and to produce proposals in this respect in the amended proposal concerning the Financial Regulation<sup>11</sup>.

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<sup>7</sup> Communication of the Commission – Improving the recovery of Community entitlements arising from direct and shared management of Community expenditure (COM(2002) 671 final).

<sup>8</sup> Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities (OJ L 248, 16.9.2002).

<sup>9</sup> Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts (OJ L 134, 30.4.2004) put into place an information system that makes it possible to exclude tenderers with criminal convictions from public contracts.

<sup>10</sup> Communication to the Commission from the President, Ms Wallström, Mr Kallas, Ms Hübner and Ms Fischer Boel: Proposing the launch of a European Transparency Initiative (SEC(2005)1300).

<sup>11</sup> The Commission adopted on 18 May 2006 an amended proposal for a Council Regulation amending Regulation (EC, Euratom) No 1605/2002 on the Financial Regulation applicable to the General Budget of the European Communities (COM(2006) 213 final).

In 2004 the Commission adopted proposals amending the basic regulations governing investigations by OLAF<sup>12</sup>. The aim of these proposals was, among other things, to clarify the rules on information exchanges between the Office and Community institutions, agencies and organisations, and to allow the Office to concentrate on its operational priorities and to speed up its investigations, thereby enhancing its effectiveness. The proposals also aimed at strengthening the procedural rights of those under investigation. On the basis of these proposals, the European Parliament and the Council called for a complementary assessment of the performance of the Office, which the Commission presented in October 2004<sup>13</sup>. The Court of Auditors produced a special report on the management of the Office<sup>14</sup>, accompanied by several recommendations. In July 2005<sup>15</sup> the European Parliament organised a public hearing on strengthening OLAF. On this occasion, it was noted that the Office's organisational structure, independent in its investigations while being integrated into the Commission from an administrative point of view, does indeed work.

In the light of these developments, the Commission adopted in May 2006 a proposal supplementing the progress made in its proposal of February 2004, which it has replaced and which has been withdrawn. This proposal deals in particular with governance and the cooperation between the institutions and the Supervisory Committee via the latter's meetings with the representatives of the European Parliament, the Council and the Commission under the structured dialogue. It also makes provision for the establishment of a Review Adviser to formulate opinions for a certain number of cases and is designed to clarify the mandate of the Director-General of OLAF.

**Events in 2005.** In 2005 the Commission adopted its second report<sup>16</sup> on the application by the Member States of the Black List Regulation<sup>17</sup>. This Regulation provides for the identification of economic operators that present a risk to the Community budget in the field of the EAGGF Guarantee Section, the notification of the Commission and the Member States, and the implementation of preventive measures. The report found that the results of the application of the Regulation had been modest. Via this report, the Commission hopes to provoke a wide-ranging debate with the institutions on the need and possible guidelines for a potential reform of the exclusion mechanism.

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<sup>12</sup> Proposals for a Regulation amending Regulations (EC) No 1073/1999 and (Euratom) No 1074/1999 relating to the investigations carried out by the European Anti-Fraud Office (OLAF) (COM(2004) 103 and 104).

<sup>13</sup> Commission staff working document, Complementary evaluation of the activities of the European Anti-Fraud Office (OLAF) (SEC(2004) 1370). See also Commission Report, "Evaluation of the activities of the European Anti-Fraud Office (OLAF)" (COM(2003) 154 final).

<sup>14</sup> Court of Auditors' Special Report No 1/2005 concerning the management of the European Anti-Fraud Office (OLAF), together with the Commission's replies (OJ C 202, 8.8.2005).

<sup>15</sup> Hearing of 12 and 13 July 2005 entitled "Strengthening OLAF: revision of the Regulation on the European Anti-Fraud Office".

<sup>16</sup> Report from the Commission to the European Parliament and the Council on the application of Regulation (EC) No 1469/95 (COM(2005) 520).

<sup>17</sup> Council Regulation (EC) No 1469/95 of 22 June 1995 on measures to be taken with regard to certain beneficiaries of operations financed by the Guarantee Section of the EAGGF (OJ L145, 29.6.1995).

## 1.2. A new culture of operational cooperation

Since 2001 the Commission has made efforts to help the ten new Member States and the candidate countries adopt the *acquis* in terms of the protection of the European Communities' financial interests. The ten new Member States, Romania and Bulgaria established national anti-fraud coordination services (AFCOS) to take responsibility for all of the legislative, administrative and operational aspects of protecting the Communities' financial interests, which have proved very useful. Ten new Member States were brought into the fold without any particular difficulties and took adequate steps to prepare for their new task of protecting the Communities' financial interests. In order to provide better support for Romania's and Bulgaria's accession process, OLAF has reinforced its activities and operational effectiveness by detaching a liaison officer to each of the two countries.

In 2004 the European Community and its Member States signed a Cooperation Agreement<sup>18</sup> with the Swiss Confederation on fraud prevention and all other illegal activities detrimental to their financial interests.

Also in 2004 the Commission proposed the adoption of a regulation concerning mutual administrative assistance<sup>19</sup> that would provide a detailed legal basis and would be horizontal in the sense that it covers all the areas involved in the fight against Community fraud and not yet addressed by sectoral legislation.

**Events in 2005.** Some international trade transactions carried out in violation of customs rules, including the rules relating to intellectual property, adversely affect the economy and the fiscal interests of the Member States and the customs revenues of the EU budget. Trade with China has given rise to a number of problems in recent years. A cooperation agreement negotiated and signed in 2004 entered into force in 2005, with the aim of improving mutual assistance between the European Community and China in the customs field. The operational side is managed by OLAF.

A permanent technical support infrastructure (POCU), with better cooperation and support for joint customs operations by the Member States, was launched at OLAF. POCU will allow better cooperation for joint customs operations, enabling them to proceed rapidly at a lower cost. The first operation based on the new infrastructure was "Operation Fake" concerning counterfeit goods from China. The operation took place in May 2005 and produced very satisfactory results (see point 3.2).

The regulations in the field of the Structural Funds and the Cohesion Fund requiring the Member States to inform the Commission of cases where there is suspicion that an irregularity has been committed under the sectoral regulations were amended and

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<sup>18</sup> Council Decision concerning the signature of the Agreement between the European Community and its Member States, of the one part, and the Swiss Confederation, of the other part, to counter fraud and all other illegal activities affecting their financial interests (COM(2004)559 final and OJ C 244, 1.10.2004).

<sup>19</sup> Proposal for a Regulation of the European Parliament and of the Council on mutual administrative assistance for the protection of the Community's financial interests against fraud and any other illegal activities (COM(2004)509 final).

modernised<sup>20</sup> so as to ensure harmonised implementation. This harmonisation will continue with the amendment of the regulation applicable in the agricultural sector.

The basic rules governing the Advisory Committee for the Coordination of Fraud Prevention were amended by Commission decision<sup>21</sup> so as to adapt them to the changes that had occurred since its establishment in 1994, such as the insertion of Article 280 into the EC Treaty, the establishment of OLAF in 1999, and even the introduction of the euro. The Committee, made up of representatives of the Member States and the Commission, assists the Commission in all matters relating to the protection of the Communities' financial interests.

### **1.3. Preventing and combating corruption in the institutions**

In accordance with the mission entrusted to it by the Community legislature in 1999, OLAF continued to perform the task of preventing and combating corruption. The European Court of Justice has confirmed on a number of occasions the legality and coherence of the inter-institutional framework for internal investigations, which applies generally to all the institutions, agencies and organisations<sup>22</sup>.

The memoranda of understanding concluded by OLAF with the Internal Audit Service (IAS)<sup>23</sup> in 2001 and with IDOC<sup>24</sup> in 2004, describing their respective areas of activity, created the conditions for fruitful cooperation between these bodies. Frequent contacts between OLAF and IDOC in 2005 enabled them to coordinate their activities in specific cases.

In the context of the administrative reform, measures were taken to make Commission officials and other servants aware of the principles of sound project management, conflicts of interest and the correct conduct to adopt in cases where there is suspicion of serious wrongdoing likely to be detrimental to the interests of the Communities.

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<sup>20</sup> Commission Regulation (EC) No 2035/2005 of 12 December 2005 amending Regulation (EC) No 1681/94 concerning irregularities and the recovery of sums wrongly paid in connection with the financing of the structural policies and the organisation of an information system in this field (OJ L 328, 15 December 2005), and Commission Regulation (EC) No 2168/2005 of 23 December 2005 amending Regulation (EC) No 1831/94 concerning irregularities and the recovery of sums wrongly paid in connection with the financing of the Cohesion Fund and the organisation of an information system in this field (OJ L 345, 28.12.2005).

<sup>21</sup> Commission Decision of 25 February 2005 amending Decision 94/140/EC setting up an advisory committee for the coordination of fraud prevention (OJ L 71, 17.3.2005).

<sup>22</sup> The European Court of Justice, in its decision in Case C-167/02 P, confirmed on 30 March 2004 the judgment of the Court of First Instance in Case T-17/00 of 26 February 2002 declaring the appeal by 71 members of the European Parliament inadmissible. The appeal sought to annul the Decision of the Parliament of 18 November 1999 amending its rules of procedure, which authorised the European Anti-Fraud Office (OLAF) to carry out its internal investigations also within the European Parliament. In 2003, in Cases C-11/00 and C-15/00, the Court ruled that OLAF could investigate cases of suspected fraud and irregularities within the European Central Bank (ECB) and the European Investment Bank (EIB) on the grounds that Regulation (EC) No 1073/1999 was applicable. The Court also annulled the decisions of the ECB and the EIB aimed at reserving the right for such investigations to be carried out internally.

<sup>23</sup> OLAF-IAS Memorandum of Understanding of 25 July 2001 (SEC(2003) 884/2).

<sup>24</sup> Commission Decision C (2004) 1588 final/4 of 28 April 2004.

The Commission proposal amending the legal framework for investigations carried out by OLAF, which was adopted on 24 May 2006, covers, among other things, improvements in the information provided to the institutions and the possibility, for internal investigations, of not transmitting the final report to the competent judicial authorities if the offences are not serious enough, if the financial loss is minor and if internal measures may be taken to ensure appropriate follow-up, the report being transmitted to the institution, body or agency concerned.

#### 1.4. Enhancement of the criminal judicial dimension

The Commission included this fourth guideline in its overall strategic approach in order to address the difficulties linked to the incompatibility of the national legal systems and the need to handle complex and often transnational legal matters.

In 2001 the Commission presented to the European Parliament and to the Council a proposal for a directive on the criminal-law protection of the Community's financial interests<sup>25</sup>. This proposal aims to bring together in a Community instrument a number of criminal-law provisions (including the definition of illegal behaviour, liabilities and sanctions, and cooperation with the Commission) that are present in the Convention on the protection of the European Communities' financial interests<sup>26</sup> and its protocols<sup>27</sup>.

The said Convention, its first protocol and the protocol on the jurisdiction of the Court of Justice entered into force in 2002, improving judicial cooperation in various areas. The Commission recommended that the Council invite the Member States to intensify their efforts to strengthen national criminal legislation, reconsider their reservations with regard to the instruments of the Convention and ratify without delay the second protocol. It is currently preparing a second report<sup>28</sup> on the implementation of the Convention and the protocols already in force, which should be adopted late in 2007 and will cover the 25 Member States.

The EU's desire to advance the principle of mutual recognition, which has become the cornerstone of criminal judicial cooperation, led to intensive legislative activity in the areas covered by Title VI of the EU Treaty. This activity had a positive effect in particular on the protection of the Community's financial interests. For example, the adoption of the framework decision on the European arrest warrant<sup>29</sup> in 2002

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<sup>25</sup> COM(2001) 272 final (OJ C 240E, 28.8.2001), amended in 2002 as a result of the comments of the Court of Auditors and the European Parliament (COM (2002) 577 final).

<sup>26</sup> Convention, drawn up on the basis of Article K.3 of the Treaty on European Union, on the protection of the European Communities' financial interests, signed in Brussels on 26 July 1995 (OJ C 316, 27.11.1995).

<sup>27</sup> First Protocol to the Convention on the protection of the European Communities' financial interests (OJ C 313, 23.10.1996). Protocol on the interpretation, by way of preliminary rulings, by the Court of Justice of the European Communities of the Convention on the protection of the European Communities' financial interests, (OJ C 151, 20.5.1997). Second Protocol to the Convention on the protection of the European Communities' financial interests, Joint Declaration concerning Article 13(2) – Commission Declaration concerning Article 7 (OJ C 221, 19.7.1997).

<sup>28</sup> Report from the Commission - Implementation by Member States of the Convention on the Protection of the European Communities' financial interests and its protocols, COM(2004) 709.

<sup>29</sup> Council Framework Decision 2002/584/JHA on the European arrest warrant and the surrender procedures between Member States (OJ L 190, 18.7.2002).

makes it considerably easier to arrest an individual and surrender him to another Member State for the purposes of conducting a criminal prosecution or executing a custodial sentence or detention order.

The memorandum of understanding signed by OLAF and Eurojust in 2003 makes provision for mutual exchanges of information and cooperation with a view to protecting the Community's financial interests. The practical implementing arrangements were adopted by OLAF and Eurojust in 2004. An OLAF-Eurojust liaison group has been set up to put the memorandum into effect. The group held regular meetings in 2005. In this context, Eurojust cooperated with OLAF and national authorities in a number of OLAF cases, taking part in the relevant investigations and prosecutions.

The memorandum signed by OLAF and Europol in 2004 makes provision for the enhancement of exchanges of strategic and technical information, and information exchanges on risk assessment and analysis in areas of common interest. In 2005 OLAF and Europol stepped up their collaboration, particularly on smuggling and euro counterfeiting. The Office also maintains contacts with international authorities such as Interpol and the World Customs Organisation (WCO).

In 2001 the Commission adopted a Green Paper<sup>30</sup> intended to launch debate on the establishment of a European Prosecutor in the interests of combating more effectively criminal activity detrimental to the financial interests of the European Communities. Article III-274 of the Treaty establishing a Constitution for Europe, adopted by the European Council in June 2004 but not yet ratified by the Member States, stipulates that the Council, acting unanimously and after approval by the European Parliament, may establish a European Prosecutor's Office on the basis of Eurojust in order to combat offences detrimental to the Union's financial interests. The Prosecutor's Office would be empowered to investigate, pursue and send for prosecution the authors of such offences and their accomplices.

**Events in 2005.** The Commission noted in a communication<sup>31</sup> the consequences of the landmark ruling of the Court of Justice on criminal-law provisions concerning the first and third pillars<sup>32</sup>, particularly on the proposal for a directive on criminal-law protection of the financial interests of the Communities. In accordance with this judgment, when recourse to a specific criminal-law provision for the matter in question is necessary to guarantee the effectiveness of Community law, it must be adopted exclusively under the first pillar. This system puts an end to the dual-text mechanism (directive or regulation and framework decision).

## 1.5. Conclusion

Five years after the launch of the overall strategic approach, a positive assessment can be made of the actions undertaken. As shown in the summary above, significant progress has been achieved in each of the main strategic guidelines for the protection

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<sup>30</sup> Green Paper on criminal-law protection of the financial interests of the Community and the establishment of a European Prosecutor (COM(2001) 715).

<sup>31</sup> Communication from the Commission on the implications of the Court's judgment of 13 September 2005 (COM(2005) 583 final).

<sup>32</sup> Judgment C-176/03 *Council v Commission*.

of the European Communities' financial interests. However, the enhancement of the criminal judicial dimension has slowed down. For example, preparation for the establishment of a European Prosecutor has slowed down temporarily pending ratification of the Constitutional Treaty.

Of all the actions planned for the whole of the programming period, 75% were carried out in full prior to 31 December 2005, while 9% were partially carried out within the stipulated timeframe and are ongoing, 14% were postponed to 2006, and 10% have been provisionally or definitively suspended, largely for reasons outside the Commission's control.

## 2. RESULTS OF THE FIGHT AGAINST FRAUD: STATISTICS CONCERNING FRAUD AND OTHER IRREGULARITIES REPORTED BY THE MEMBER STATES UNDER SECTORAL REGULATIONS

Community law requires Member States to notify the Commission of cases of fraud and other irregularities that are detrimental to financial interests in all areas of Community activity<sup>33</sup>. The statistics given in this chapter relate to suspicions of fraud and other irregularities reported by the Member States, as defined by the sectoral regulations. Direct Community expenditure is not concerned<sup>34</sup>. The paper published by the Commission at the same time as this report contains a detailed analysis of the statistics obtained from these communications<sup>35</sup>. The following table provides a sectoral breakdown of irregularities reported in 2005 and the amounts concerned<sup>36</sup>.

*Table - Number of irregularities and the amounts - 2005*

<b>TOTAL 2005</b>		
<b>Field</b>	<b>Number of irregularities reported</b>	<b>Total financial impact (in € million)</b>
Own resources	4 982	322
EAGGF Guarantee	3 193	102
Structural Funds and Cohesion Fund	3 570	601

<sup>33</sup> See in particular Article 3(1) of Council Regulation (EEC) No 595/91 of 4 March 1991 (OJ L 67, 14.3.1991), Commission Regulation (EC) No 1681/94 of 11 July 1994 (OJ L 178, 12.7.1994) and Commission Regulation (EC) No 1831/94 of 26 July 1994 (OJ L 191, 27.7.1994) as regards expenditure and Article 6(5) of Council Regulation (EC, Euratom) No 1150/2000 of 22 May 2000 (OJ L 130, 31.5.2000) as regards traditional own resources. A similar obligation exists for countries eligible for pre-accession funds.

<sup>34</sup> The OLAF Operational Activity Report deals with this matter. It can be consulted at the Office's website: [http://ec.europa.eu/comm/anti\\_fraud/reports/index\\_en.html](http://ec.europa.eu/comm/anti_fraud/reports/index_en.html).

<sup>35</sup> SEC (2006)...

<sup>36</sup> The statistics given in this chapter relate to expenditure in respect of which the Member States have reported fraud and other irregularities.

Pre-accession funds	331	17
Total	12 076	1 042

It is important to distinguish between fraud and irregularities. Fraud is defined as an irregularity that is committed intentionally and constitutes a criminal act that only a judge may define as such<sup>37</sup>. The real financial impact of fraud can be measured only at the end of legal proceedings. As regards own resources, suspicions of fraud account for approximately 20% of the cases of irregularities notified in 2005 and involve an amount of some €95.2 million. For agricultural expenditure, suspicions of fraud account for approximately 13% of the cases of irregularities notified and involving an amount of some €21.5 million, equivalent to 0.05% of the total EAGGF Guarantee Section appropriations. For the Structural Funds, approximately 15% of the irregularities notified and involving an amount of €205 million were attributed to fraud and accounted for some 0.53% of the total appropriations for the Structural Funds and the Cohesion Fund. For pre-accession funds, fraud accounted for approximately 18% of the irregularities notified and involving an amount of some €1.77 million, equivalent to 0.06% of the total appropriations under the PHARE<sup>38</sup>, SAPARD<sup>39</sup> and ISPA<sup>40</sup> funds. This estimate is based on the information reported by the Member States, but must be treated with caution.

## 2.1. Traditional own resources

The number of cases of detected fraud and irregularities communicated (cases > €10 000) increased by 55 % compared with 2004 (4 982 cases in 2005)<sup>41</sup>. The amount affected by irregularities in 2005 is around €322 million, as compared with €212 million in 2004, an increase of 52%.

This increase could be explained, in particular, by better communication by some Member States and by the fact that some Member States have entered into the OWNRES system cases of undischarged transit operations that were subsequently, although belatedly, discharged. The bald increase of 55% does not therefore justify any conclusion as to the actual situation regarding fraud and other irregularities.

Cigarettes are still among the products most affected by irregularities, with most cases reported concerning cigarette smuggling. In 2005 the number of cases relating to the sugar sector also increased. These were essentially cases of non-exportation of sugar exceeding the quantity approved by the Community system. There was also an increase in the number of cases relating to the textile sector, particularly concerning declaration of origin.

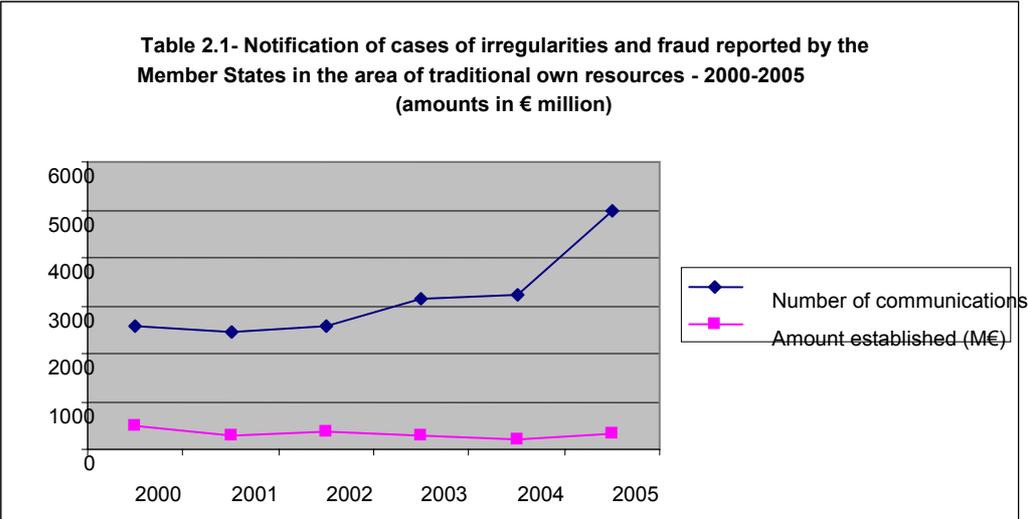
<sup>37</sup> See the definition in Article 1 of the Convention on the protection of the European Communities' financial interests of 26 July 1995 (OJ C 316, 27.11.1995).

<sup>38</sup> Poland-Hungary: assistance for economic restructuring, Regulation (EC) No 3906/89, OJ L 375, 23.12.1989.

<sup>39</sup> SAPARD (Agricultural Pre-accession Instrument), Regulation (EC) No 1268/1999, OJ L 161, 26.6.1999.

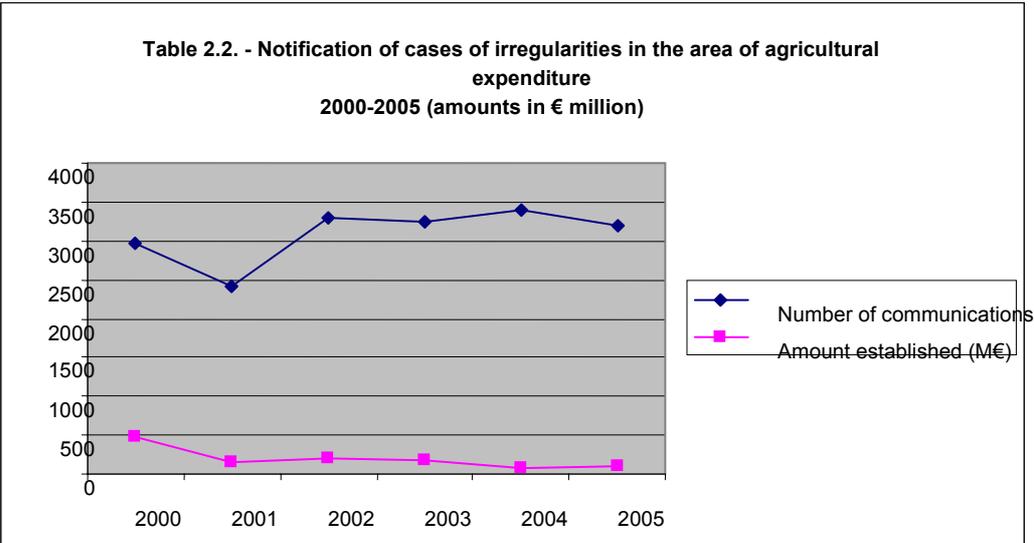
<sup>40</sup> ISPA (Structural Pre-accession Instrument), Regulation (EC) No 1267/1999, OJ L 161, 26.6.1999.

<sup>41</sup> The figures published in the 2004 report have been updated.



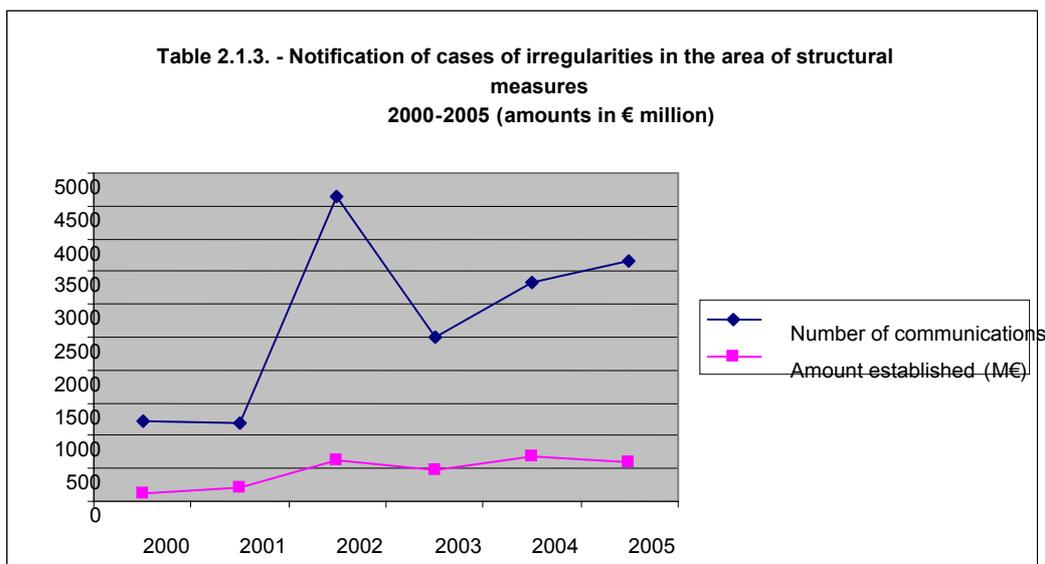
### 2.2. Agricultural expenditure (EAGGF Guarantee)

In 2005 the number of notified irregularities decreased slightly compared with the previous years (3 193 cases in 2005, 3 401 cases in 2004). On the other hand, their financial impact increased (€102 million in 2005, €82 million in 2004), representing around 0.21% of total EAGGF Guarantee appropriations (€47 819 million for 2005).



### 2.3. Structural measures

In 2005 the number of irregularities notified (3 570 cases, including the Cohesion Fund) increased over the previous year (3 339 cases), whereas their financial impact decreased (€601 million in 2005, €696 million in 2004). The financial impact of the irregularities notified in 2005 accounts for around 1.56% of the Structural and Cohesion Fund appropriations (€38 430 million) for 2005. The final impact will not be known until the programmes have been wound up.



## 2.4. Pre-accession funds

A notification system for irregularities similar to that for the Structural Funds was established by the Multi-Annual Financing Agreement for PHARE, SAPARD and ISPA funds and for the funds granted to Cyprus and Malta<sup>42</sup>.

*Table 2.4.: Irregularities and amounts notified by the Member States and the accession countries<sup>43</sup> concerning pre-accession funds – 2002-2005<sup>44</sup>.*

Year	PHARE <sup>45</sup>		SAPARD		ISPA		TOTAL	
	Cases	EU financing affected by irregularities (€'000)	Cases	EU financing affected by irregularities (€'000)	Cases	EU financing affected by irregularities (€'000)	Cases	EU financing affected by irregularities (€'000)
<b>2002</b>	1	21.6	0	0	6	14.9	7	36.5
<b>2003</b>	52	544.1	34	4 121	18	835.9	104	5 501
<b>2004</b>	68	1 845	134	5 533.5	25	251.7	227	7 630.2
<b>2005</b>	139	6 106	167	3 754.4	25	6 938.7	331	16 799.1
<b>Total</b>	<b>260</b>	<b>8 516.7</b>	<b>335</b>	<b>13 408.9</b>	<b>74</b>	<b>8 041.2</b>	<b>669</b>	<b>29 966.8</b>

<sup>42</sup> Regulation (EC) No 555/2000 (OJ L 68, 16.3.2000).

<sup>43</sup> Bulgaria and Romania.

<sup>44</sup> The figures published in the 2004 report have been updated (the allocation of cases per year was corrected and ten new cases concerning the years 2002 to 2004 were notified in 2005).

<sup>45</sup> This column includes reports from Cyprus and Malta under Regulation (EC) No 555/2000.

The quality of notifications concerning irregularities has improved slightly in comparison with 2004, particularly with regard to the estimation of the irregular amounts by the national authorities. Nevertheless, this effort must be maintained in order to permit a more detailed analysis.

The number of irregularities concerning PHARE and SAPARD funds for 2005 is markedly higher than the number of cases notified for the previous years. On the other hand, the number of irregularities concerning ISPA has not changed; an explanation for this could be the transformation of ISPA into a Structural Fund for the new Member States upon their accession to the Union in 2004. The presumed financial impact of the irregularities increased for ISPA and PHARE but fell for SAPARD. For 2005, the total amount of irregularities notified amounts to €16 799 703, or some 0.55% of the total amounts allocated (€3 015.9 million).

### **3. MEASURES TAKEN BY THE MEMBER STATES AND THE COMMISSION IN 2005**

#### **3.1. Measures taken by the Member States**

The provisions set out below are a representative sample. A separate Commission paper itemises all the new measures reported by the Member States in 2005<sup>46</sup>.

##### *3.1.1. New horizontal measures*

The Member States have reported the adoption of many horizontal measures, i.e. measures that help protect the Communities' financial interests but are not confined to a specific sector. These measures are very diverse: some concern prevention or recovery, but most relate to criminal law.

Greece has taken measures to prevent breaches of the rules governing the conclusion and execution of *public contracts*, and to ensure transparency and healthy competition. A law has been passed amending the provisions on *money laundering*, focusing particularly on protecting the Communities' financial interests.

In Hungary the provisions governing the *recovery* of Community resources and the associated Hungarian budget resources have been improved. The new rules facilitate the use of financial guarantees in the event of the irregular use of funds. The act in question is retroactive: it covers all Community funds – including pre-accession funds – for which financing agreements have been concluded since 1 January 2003 and Community own resources.

A Portuguese act provides for *banking secrecy to be lifted* where there is proof that a *tax offence* has been committed and the perpetrator has made false declarations.

In France an amendment to the code of criminal procedure means that the rules on *repeat offenders* now apply to offences committed by someone previously convicted

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<sup>46</sup> SEC (2006)... The Member States were asked to provide information only on measures that are more than a mere implementation of Community law. Since the Commission's report comes out annually, the lack of any new measures in 2005 in certain Member States cannot be interpreted as reflecting the general level of protection of financial interests in those countries. On the contrary, it may be the result of a higher level of activity in the preceding period.

by a court in another Member State. This makes it easier to combat those committing offences (including offences detrimental to the Community's financial interests) in several Member States.

*Harm to the financial interests of the European Communities* is now a *specific offence* in the Slovak Republic's criminal code. It is punishable by prison sentences ranging from six months to 12 years.

Latvia has amended its criminal code to include a new offence: *fraud in an automated data-processing system* has been added to the existing offences of fraud and insurance fraud.

### 3.1.2. *New measures relating to Community own resources*

A wide-ranging reform of the Lithuanian criminal code has introduced two new offences aimed at tackling *smuggling* and the *receiving of smuggled goods* in Lithuania or any other EU Member State.

Spain has amended the implementing provisions for its tax act in order to improve the *recovery* of amounts unpaid by importers.

Italy has taken steps to improve the *recovery* of taxes and amounts due to the authorities.

In Ireland a new act considerably expands the scope for customs officers to *seize money suspected to be the instrument or product of an offence* anywhere on its territory.

The fight against *VAT fraud* is basically governed by national provisions. A number of Member States (Belgium, Latvia, Hungary, Slovenia, and Italy) have reported the adoption of measures aimed at strengthening action against such infringements, be it in terms of offences or procedures. For instance, Belgium has adopted two new acts in the matter: one introducing a provision aimed at preventing abuses in the area of VAT and another aimed at countering bankruptcy fraud through the fraudulent conveyance of assets, such as the transfer of a business without settling VAT debts. Ireland has declared that it maintains its reservations concerning the inclusion of VAT in the Article 280 report<sup>47</sup>.

### 3.1.3. *New measures relating to agricultural expenditure*

Spain has reported new measures taken to improve the system of *on-the-spot controls* in the dairy and fruit-and-vegetable sectors.

In Italy a series of measures have been decided on to improve the *recovery* of sums unduly paid by the EAGGF Guarantee Section paying agencies.

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<sup>47</sup> Ireland, unlike the Commission, considers that "all measures concerning taxes must be taken under the appropriate article of the Treaty, i.e. unanimously". Consequently, it continues to maintain its reservation concerning the inclusion of VAT in the Article 280 report as, in its view, this is not the appropriate article for the notification of measures for combating VAT fraud.

A number of new offences relating to *breaches of accounting obligations* have been introduced into Hungarian law. These offences result from a failure to comply with procedures governing the granting of agricultural aid are breached and may be committed involuntarily. In some cases, legal persons may incur criminal penalties.

Poland has reported the adoption of a *cooperation agreement between customs and the agricultural market agency* designed to facilitate the flow of documents and information between the two authorities.

In Portugal, two ministerial decrees have amended the implementing arrangements for *controlling cross-compliance*.

#### 3.1.4. *New measures relating to structural measures*

Estonia now has a regulation enabling the paying authorities to *suspend payments* when they learn that the control system in place does not meet certain conditions.<sup>48</sup> Another regulation provides for the Finance Ministry's financial control department (AFCOS – department for cooperation with OLAF) to be notified of suspected fraud or irregularities within two weeks. This measure, which speeds up the involvement of the competent authorities, is intended to *prevent irregularities* where this is still possible and to improve recovery where sums have already been unduly paid out.

In Greece a ministerial decision lays down the procedure for *recovering* sums paid illegally or unduly from the national budget to final recipients for the implementation of programmes financed by the ESF under the third Community Support Framework.<sup>49</sup> The decision to recover amounts is taken by the special department of the Ministry of Employment and Social Security responsible for implementing ESF co-financing, which acts in its capacity as final beneficiary of the "Promotion of Employment and Continuous Training" operational programme.

The Lithuanian authorities have taken measures to develop and improve the system for *analysing and managing risks* relating to the Structural Funds (Objective 1 programmes) and the Cohesion Fund and to national part-financing.

### 3.2. **Operational measures adopted by the Commission to fight fraud**

Since the policy and legislative measures have been set out in Chapter 1, this chapter basically covers the operational measures adopted by the Commission to fight fraud, and in particular to enhance the operational effectiveness of OLAF, the European Anti-Fraud Office.

Following the recommendations issued by the Court of Auditors, certain improvements have been made in order to carry out day-to-day work more

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<sup>48</sup> And in particular those of Commission Regulation (EC) No 438/2001 of 2 March 2001 laying down detailed rules for the implementation of Council Regulation (EC) No 1260/1999 as regards the management and control systems for assistance granted under the Structural Funds (OJ L 63, 3.3.2001) and of Council Regulation (EC, Euratom) No 2988/95 of 18 December 1995 on the protection of the European Communities' financial interests (OJ L 312, 23.12.1995).

<sup>49</sup> Joint Ministerial Decision No 190622/16.12.2005.

effectively. In particular, OLAF has taken steps to assess incoming information more efficiently.

In 2005 OLAF opened 257 cases (including monitoring cases, for which OLAF essentially monitors the investigations carried out by the authorities in the Member States). It closed 233 cases, of which 133 were sent for follow-up. The proportion of closed investigations requiring follow-up is continuing to increase, which is indicative of an improvement in quality and the increased importance of the cases investigated by OLAF.

Furthermore, OLAF has improved its coordinating and support capacity in the field of mutual assistance by organising “Joint Customs Surveillance Operations” and by providing the Member States with logistical resources (permanent technical infrastructure – POCU) and with technical resources (the Virtual Operational Customs Unit V-OCU) on OLAF premises. Since mid-2005, the Office has coordinated two joint customs operations and provided logistical and/or technical support for four joint customs operations organised by the Member States.

### **3.3. Complementary measures for the protection of the Communities’ financial interests**

#### *3.3.1. State of play with the ratification by Member States of the Convention of 26 July 1995 on the protection of the European Communities’ financial interests<sup>50</sup> and its protocols*

The Convention of 26 July 1995 on the protection of the European Communities’ financial interests, together with the First Protocol, which defines active and passive corruption, and the Protocol of 29 November 1996 concerning the interpretation of the Convention by the Court of Justice, entered into force on 17 October 2002 in all the old Member States.

Following its ratification by Luxembourg in 2005, the Second Protocol, which makes provision for sanctions to be imposed on legal persons and expands the scope of incriminations for money laundering connected with fraud, has now been ratified by 13 old Member States. Austria and Italy have still not ratified it. Austria has announced the adoption of a new law which figures among the most important measures adopted in 2005 to protect Community’s financial interests more effectively. The new law establishes in Austrian law the criminal liability of legal persons (under public or private law) and commercial law associations for offences detrimental to the Community’s financial interests. The ratification process for the Second Protocol is under way in Austria.

Following the accession of the ten new Member States, Lithuania and Slovakia ratified the Convention and its protocols in 2004. In 2005 Cyprus, Estonia and Latvia also deposited their instruments of ratification.

By end of 2005, however, five of the ten new Member States (Czech Republic, Hungary, Malta, Poland, and Slovenia) had still not ratified the Convention. A

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<sup>50</sup> See references to point 1.4.

summary table showing the state of play with regard to ratification can be found in the Commission staff working document published at the same time as this Report.<sup>51</sup>

3.3.2. *The Customs Information System (CIS) and the ratification of the Convention on the use of information technology for customs purposes<sup>52</sup> and of its protocol<sup>53</sup> creating a Customs File Identification Database (FIDE)*

The Commission (OLAF) is responsible for, runs and provides technical support for the Customs Information System (CIS)<sup>54</sup>.

The CIS was created to store information on goods, transport means, individuals and companies, thereby contributing to the prevention, investigation and prosecution of breaches of customs and agricultural legislation (first pillar) and serious offences under national legislation (third pillar). Its aim is to create a warning system for the fight against fraud and to enable a Member State participating in the system to ask another Member State to carry out one of the following actions: sighting and reporting, discreet surveillance or a specific check.

As regards the third pillar, access to the CIS system is subject to ratification by the Member States of the Convention of 26 July 2005 on the use of information technology for customs purposes. Among the old Member States the CIS Convention was provisionally applied on 1 November 2000 and entered into force on 25 December 2005 with its ratification by Belgium.

Since 1 May 2004 the new Member States, basing themselves on Article 3(4) of the Accession Treaty, can accede to the Agreement on the provisional application of the CIS Convention.

Consequently, following ratification by the Czech Republic, Estonia, Belgium and Poland, the Convention entered into force on 25 December 2005 in almost all the Member States. Poland notified its ratification in November 2005, and the Convention entered into force there 90 days later, namely in 2006. At present, Malta is the only Member State that has not started the Convention ratification process.

The Commission (OLAF) is also responsible for the Customs File Identification Database (FIDE)<sup>55</sup>, which contains all customs investigation references. The aim of this database is threefold: (i) to simplify the exchange of information between European services investigating the same object (person or business); (ii) to enable

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<sup>51</sup> SEC(2006)...

<sup>52</sup> Convention on the use of information technology for customs purposes, drawn up on the basis of Article K.3 of the Treaty on European Union (Official Journal C 316, 27.11.1995).

<sup>53</sup> Council Act of 8 May 2003 drawing up a Protocol amending, as regards the creation of a customs file identification database, the Convention on the use of information technology for customs purposes (OJ C 139, 13.6.2003).

<sup>54</sup> The CIS is based, on the one hand, on Council Regulation (EC) No 515/97 of 13 March 1997 on mutual assistance between the administrative authorities of the Member States and their cooperation with the Commission to ensure the correct application of law on customs and agricultural matters (OJ L 82, 22.3.1997) and, on the other, on the Convention of 26 July 1995 on the use of information technology for customs purposes, drawn up on the basis of Article K.3 of the Treaty.

<sup>55</sup> For more information, see also the OLAF website at [http://europa.eu.int/comm/anti\\_fraud/fide/i\\_en.html](http://europa.eu.int/comm/anti_fraud/fide/i_en.html).

coordinated actions; and (iii) to increase the level of cooperation among European services dealing with customs investigations.

FIDE is based on the Protocol amending the Convention on the use of information technology for customs purposes. In 2005 the Czech Republic, Estonia, Spain, Luxembourg, the Netherlands and Poland joined the six Member States that had already ratified the protocol<sup>56</sup> but it has not yet entered into force. A summary table of the state of play with regard to ratification can be found in the Commission staff working document published at the same time as this Report.<sup>57</sup>

### 3.3.3. *The Philip Morris International Agreement*

In 2005 nine Member States (Denmark, Ireland, Cyprus, Lithuania, Malta, Austria, Poland, Slovenia, and Slovakia) joined the Anti-Contraband and Anti-Counterfeit Agreement signed in 2004 between the Commission, ten Member States<sup>58</sup> and Philip Morris International. The Agreement improved the exchange of information between the parties on seizures of suspect cigarette consignments (bearing Philip Morris trademarks) and their day-to-day contacts on operations covered by the Agreement.

## 4. RECOVERY

In matters of Community expenditure, recovery involves recovering amounts unduly paid out owing to errors, irregularities (whether of form or substance) and, albeit less frequently, fraud. It helps remedy the injury to the Communities' financial interests in so far as it is possible to do so. This chapter is aimed at outlining – very broadly – some features of the recovery procedures applied in the Member States and at providing information on the main results of the work of the agricultural “Recovery Task Force”, set up to examine the serious backlog affecting recovery files from before 1999.

### 4.1. National recovery procedures involving civil or administrative proceedings

In matters of indirect expenditure, namely funds administered by the Member States on behalf of the Communities, basically the Structural Funds, the Cohesion Fund and the EAGGF Guarantee Section, the Member States are responsible for recovery. It is their responsibility to pursue recovery claims against final beneficiaries and to transfer the sums in question to the Commission.

The Member States agreed to report on the rules governing administrative and civil recovery procedures. The Commission collected this information using a questionnaire. The Member States' responses gave the Commission an overview of national recovery procedures and the judicial and administrative obstacles (both provisional and permanent) that they may encounter.

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<sup>56</sup> Cyprus, Germany, Hungary, Lithuania, Slovenia and Slovakia.

<sup>57</sup> SEC (2006) ...

<sup>58</sup> Belgium, Germany, Greece, Spain, France, Italy, Luxembourg, the Netherlands, Portugal and Finland.

Further details of each Member State's recovery procedures can be found in the Commission working paper published at the same time as this report.<sup>59</sup> The presentation below is no more than a brief summary.

**Obstacles to recovery. Irregularity attributable to administrative error - "legitimate expectations".** In most Member States,<sup>60</sup> domestic law stipulates that, when action for recovery is taken against a debtor acting in good faith on the basis of instructions from an administrative authority that was in error, the debtor can oppose recovery invoking the "legitimate expectations" placed in the instructions. In one Member State,<sup>61</sup> though the concept of legitimate expectations does not exist, debtors can invoke the fact that they acted in good faith. Most Member States report that this exception can be invoked only where the administration issued erroneous instructions<sup>62</sup> which the debtor followed in good faith.<sup>63</sup> Some Member States also lay down other conditions, for instance the lack of serious grounds for withdrawing the benefit received,<sup>64</sup> the use of funds in the specified manner,<sup>65</sup> the fact that the debtor has adapted his situation to the ownership of the sum to be recovered (by investing it)<sup>66</sup> or the existence of a public official responsible for having created the legitimate expectations on the part of the debtor.<sup>67</sup> Only four Member States<sup>68</sup> reported that legitimate expectations could be invoked in the case of serious or deliberate negligence, in which case it is for the judge to assess whether circumstances warrant the granting of this exception. Most of the judicial systems that do not recognise the concept of legitimate expectations allow the debtor to sue the administration that issued the erroneous instructions for compensation.<sup>69</sup>

**Bona fide third parties.** National legal systems often allow *bona fide third parties* injured by recovery to oppose it on certain conditions.<sup>70</sup> In Member States where this right does not exist, third parties can sue persons who caused them injury, including public administrations that issued erroneous instructions, for damages.

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<sup>59</sup> SEC (2006) ...

<sup>60</sup> Belgium, Germany, Estonia, Greece, France, Ireland, Italy, Cyprus, Latvia, Austria, Portugal, Finland and Sweden. In Poland, this is possible in tax cases; in the United Kingdom, in agricultural cases.

<sup>61</sup> Slovakia.

<sup>62</sup> Belgium, Czech Republic, Estonia, Greece, France, Ireland, Latvia, Lithuania, Austria and Poland.

<sup>63</sup> Germany, Estonia, Cyprus, Italy, Austria, Portugal, Sweden and the United Kingdom. In France and Finland, the law and case law demand more than just good faith and require the change of situation to have been unforeseeable by the debtor.

<sup>64</sup> Belgium.

<sup>65</sup> Austria.

<sup>66</sup> Sweden.

<sup>67</sup> Portugal. Portuguese law, however, does not require that all these conditions be fulfilled; where one of the factors giving rise to a legitimate expectation is particularly telling, this can offset the fact that another condition has not been met.

<sup>68</sup> Denmark, Cyprus, Poland, Sweden.

<sup>69</sup> Czech Republic, Lithuania, Hungary, Netherlands and Slovakia.

<sup>70</sup> In Sweden a debt cannot be recovered from a bona fide third party. In France, Italy, Finland, Scotland and Slovenia, bona fide third parties can oppose recovery that would injure them, though this is subject to certain conditions. In Spain they can do so if they were unaware of Community law because it had not been transposed into Spanish law. In Belgium they can oppose recovery in the agricultural sphere. In Poland and Slovakia they can do so where they have a claim to goods to be seized. In Austrian law the amount recovered may be reduced if necessary to protect a bona fide third party (e.g. for wages paid).

As regards the concepts of legitimate expectations and bona fide third parties, it should be stated that when recovering amounts paid unduly by the Communities, the Member States must interpret these concepts without prejudice to Community law, as results in particular from the case law of the Court of Justice.

**Coordination of recovery procedures.** In cases of multiple co-financing, the lack of an inter-agency system for coordinating recovery procedures can constitute a serious obstacle to the recovery of funds. Seven Member States said they had set up a system for coordinating recovery,<sup>71</sup> and two allowed the authorities to cooperate on a case-by-case basis.<sup>72</sup> In Denmark a single administrative authority is responsible for recovery of all claims collected or recovered by the public authorities. Two Member States also reported that information could be exchanged by consulting various databases.<sup>73</sup>

**Administrative recovery procedure.** In the 25 Member States the administrative recovery procedure takes different and specific forms. After the establishment of a claim in an administrative recovery procedure, the first step is usually to call upon the beneficiary to pay the amount received unduly. The nomenclature used for the administrative measures varies considerably from one Member State to another. Whether in the form of a debit note, a recovery decision issued by an administrative body, a written reminder, an invoice or an invitation to pay, each State has its own particular administrative procedure to induce the beneficiary to **pay back the amount voluntarily** before enforcement measures are taken. In some Member States<sup>74</sup> the law stipulates that the beneficiary must first be heard before any recovery action is launched.

When called upon to pay voluntarily, the debtor is given a **deadline** by which he has to return the amount due. The deadline can be set by law, by an administrative decision of the competent body or by administrative practice. The average deadline for voluntary payment is 30 days (deadlines range from 15 days to two months), although some legal systems do not set any specific time limit. France and Finland refer to a “reasonable deadline”.

Almost all Member States report that administrative **coercive measures** are then taken if debtors do not pay voluntarily by the deadline set. These measures take different forms and have different names among the 25 Member States. Recovery orders, final payment orders and execution orders are among the most common terms. In general the deadline for the issuance of a formal notice is one month, although some Member States apply shorter deadlines. The deadlines are usually stipulated by law but can also be set on a case-by-case basis<sup>75</sup>.

**Enforcement.** When the debtor fails to pay, there are two possibilities: enforcement measures can be taken on the basis of a court decision or on another legal basis. Most of the Member States report that such measures can be decided without the need for

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<sup>71</sup> Belgium (Walloon Region), Estonia, Greece, Latvia (in the area of the Structural Funds), Austria and Poland (for agriculture), and Slovakia.

<sup>72</sup> Cyprus and the United Kingdom.

<sup>73</sup> Finland and the United Kingdom.

<sup>74</sup> Greece, Portugal and Finland.

<sup>75</sup> Ireland, Hungary and Finland.

court action, especially in cases concerning tax recovery debts. In such cases the financial or tax administration authority is usually the body responsible for enforcement. In most cases, the coercive measures can be authorised on the basis of a court order from the competent jurisdiction (administrative courts<sup>76</sup> or civil courts<sup>77</sup>).

**Administrative contentious procedure.** After a court enforcement action has been launched, the debtor may **bring proceedings before a court** in order to challenge the recovery order. In almost all Member States the competent court for challenging a recovery order is an administrative court. In just a few Member States, the debtor may bring an action before the civil courts<sup>78</sup>.

If the debtor considers the decision of the court to be unsatisfactory, he may appeal against it. An **appeal** against a court decision has a suspensory effect in some legal systems<sup>79</sup>. In some Member States the court may suspend enforcement only if the debtor explicitly requests this<sup>80</sup>.

During the court proceedings, **interim and precautionary measures** can be taken by the court in order to ensure the effectiveness of recovery after the final judgment. Such measures may include attachments, mortgages, the lodging of bank guarantees, the prohibition of some actions on the assets of the debtor, seizure and confiscation, to give only a few examples.

**Precedence given to public claims.** Some public claims, and in particular tax and customs claims, can be given precedence<sup>81</sup> – for instance in collective proceedings – enabling the holder of the claim to have the claim met even where the total debts exceed the value of the assets. Examination of the Member States’ contributions suggests that public claims connected with aid (national and Community) do not take precedence and are dealt with exactly like other claims, unless there are contractual guarantees.

**Recovery by offsetting.** Offsetting – the definition of which varies from one legal system to another – generally consists of cancelling two debts by setting them off against each other. It is a highly effective means of recovering public money, provided that it is permitted under national law and that the debtor has a credit or claim (or a combination of the two) on the public authorities that lends itself to offsetting.

As regards the **public funds of the Member States** in general, all legal systems bar two<sup>82</sup> recognise offsetting, though its definition and scope vary from one country to another. Most Member States say they apply offsetting for all public funds,

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<sup>76</sup> Estonia, Greece, Netherlands, Portugal and Finland.

<sup>77</sup> Czech Republic, Italy, Cyprus, Latvia, Austria, Poland, Slovakia and Sweden.

<sup>78</sup> Belgium, Spain, Ireland, Italy and Austria (in some cases).

<sup>79</sup> Belgium, Germany, Cyprus, Ireland, Latvia, Lithuania, Austria, Finland, Sweden and United Kingdom. No suspensory effect: Czech Republic, Greece, Spain, France, Italy, Netherlands, Poland, Portugal and Slovakia.

<sup>80</sup> Spain, Greece, Luxembourg, Czech Republic.

<sup>81</sup> A number of Member States reported that tax or customs debts take precedence: Czech Republic, Spain, France, Ireland, Cyprus, Lithuania, Hungary, Netherlands and Slovakia.

<sup>82</sup> Malta and Lithuania.

regardless of the field or sector.<sup>83</sup> Others offset public funds within the same field or sector.<sup>84</sup> In some Member States offsetting can be used solely for recovery in the tax sector.<sup>85</sup>

With regard to **Community funds**, all Member States bar two<sup>86</sup> use offsetting where they can to speed up recovery. There are, however, substantial differences in the way it is applied. Sometimes it is possible, for instance, to clear debts and claims for the same programme or project,<sup>87</sup> the same paying agency<sup>88</sup> or the same managing authority.<sup>89</sup> In some Member States offsetting is applied more widely, for instance to the debts and claims of paying agencies that have set up a coordination system.<sup>90</sup> Two Member States<sup>91</sup> stated that a tax claim could be offset by Community funds but there is no detailed information on this subject.

#### 4.2. Recovery by the institutions

In the areas where funds are managed directly by the institutions, amounts unduly paid are recovered directly by them, without the intervention of the Member States.

The Financial Regulation and its implementing rules set out the different stages in the recovery procedure: estimate and establishment of the entitlement by the authorising officer (who must ensure that the claim is certain, of a fixed amount and due), establishment of a recovery order (instruction from the authorising officer to the accounting officer to proceed with recovery) followed by a debit note to the debtor, and finally recovery by the accounting officer. For this the accounting officer will, if possible, recover by offsetting if the debtor has a claim on the Communities that is certain, of a fixed amount and due.

The debtor can be allowed additional time for payment by making a request in writing explaining the reasons and provided he undertakes to pay interest and lodges a financial guarantee.

If, after reminders and letters of formal notice have been sent, the debtor has not paid the debt and the accounting officer has not been able to recover the amount due by offsetting or calling in a bank guarantee, the authorising officer determines, without delay, what method of enforced recovery should be applied to the debt.

There are two mutually exclusive ways of obtaining an enforceable order to seize the debtor's assets:

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<sup>83</sup> Denmark, Greece, Spain, France, Hungary, Netherlands, Austria, Poland, Portugal, Slovenia and Slovakia.

<sup>84</sup> Latvia, Finland and United Kingdom.

<sup>85</sup> Belgium, Czech Republic, Netherlands and Sweden.

<sup>86</sup> Malta and Lithuania, where the mechanism does not exist at all.

<sup>87</sup> Denmark (for the Social Fund), Estonia, Portugal.

<sup>88</sup> Belgium, Austria and Finland.

<sup>89</sup> Czech Republic, Greece, Latvia and Netherlands.

<sup>90</sup> France, Italy, Poland, Slovenia and Slovakia.

<sup>91</sup> Denmark (for agriculture) and Hungary.

- adoption of a decision constituting an enforceable order within the meaning of Article 256 EC (in this case the institution formalises the establishment of the entitlement in a decision which constitutes an enforceable order),
- securing of an order before the national or Community courts.

The authorising officer is not free to choose between these two possibilities. When the Commission's claim falls within the scope of the enforceable decision within the meaning of Article 256 EC (grants satisfying certain criteria), recovery is not possible without such a decision. In this case the overall time between establishment of the claim and actual recovery can be shortened considerably.

#### 4.3. The Recovery Task Force and the EAGGF Guarantee Section

In 2002, the Commission announced the setting-up of a Recovery Task Force (RTF)<sup>92</sup> to examine the considerable backlog of recovery cases concerning the EAGGF Guarantee Section. It is up to the RTF to draw up decisions on financial liability under the formal clearance procedure in the EAGGF Guarantee Section for unrecovered amounts resulting from an irregularity notified to the Commission prior to 1999.

On the basis of the on-the-spot audits by the RTF carried out in 2004, proposals were drawn up on the financial liability for a total non-recovered amount of approximately €765 million resulting from 431 cases of irregularity (each exceeding €500 000). These were discussed in detail with all the Member States concerned in 2005 in formal bilateral meetings under the current legal framework, in particular as regards compliance with the formal recovery obligations of the Member States.

In 2005 the RTF also audited 32 cases of amounts each exceeding €500 000 that had not been audited earlier. Official letters concerning financial liability were sent to the Member States in question, along with the financial corrections proposed by the Commission, for a total amount of approximately €92 million.

For 3 227 cases each with a value of less than €500 000 communicated before 1999, a document audit using SAGE (an automated management and evaluation system) was launched in 2005. For these cases the formal clearance procedure will be carried out in accordance with the mechanism introduced by Council Regulation (EC) 1290/2005, which came into force on 16 October 2006<sup>93</sup>. The following table gives an overview of the work of the RTF and the amounts concerned.

<b>Overview of non-recovered amounts from EAGGF Guarantee irregularities communicated by Member States under Regulation (EC) 595/91</b>			
	<b>Total</b>	<b>Cases &gt;€500 000</b>	<b>Cases &lt;€500 000</b>

<sup>92</sup> See reference at point 1.1.

<sup>93</sup> Council Regulation (EC) No 1290/2005 of 21 June 2005 on the financing of the common agricultural policy (OJ L 209, 11.8.2005). See point 4.3.

	Cases	Amount (€million)	Cases	Amount (€million)	Cases	Amount (€million)
<b>Initial situation end 2002.</b> Non-recovery cases communicated before 1999, subject to Task Force Recovery audits	4 228	1 212	419	1 035	3 809	177
<b>Situation end 2004 after TRF audits</b>	3 690	1 059	463	857	3 227	202

For all 463 cases involving more than €500 000, the audits were completed in the course of 2005. These cases account for non-recovered amounts totalling €857 million.

<b>Progress made in 2005</b>		
	<b>Cases</b>	<b>Amount (€ million)</b>
A. Audits and bilateral meeting finalised with MS in clearance of accounts procedure (cases > €500 000 each)	431	765
B. Audit completed but not yet discussed with MS in clearance of accounts procedure (cases > €500 000 each)	32	92
C. Cases < €500 000 not processed/audited by TRF and no clearance of account procedure started	3 227	202

In 2006 a formal Commission decision will be adopted under the EAGGF Guarantee clearance of accounts procedure for most cases exceeding €500 000.

#### **4.4. Reform of the system of financial monitoring of irregularities in agricultural policy**

By adopting Regulation (EC) No 1290/2005, the Council mapped out the future financing of the common agricultural policy<sup>94</sup>. It decided to set up two separate European agricultural funds, namely the European Agricultural Guarantee Fund (EAGF) to finance, among other things, market measures and direct payments, and the European Agricultural Fund for Rural Development (EAFRD).

The new Regulation reforms the entire system of financial monitoring of irregularities affecting these two new Funds (EAGF and EAFRD) and simplifies the procedure for monitoring recovery in future. Under Articles 32 and 33 of the Regulation, if recovery has not taken place within four years of the primary administrative or judicial finding, or within eight years where recovery action is taken in the national courts (for the EAGF and the EAFRD), or prior to the closure of a rural development programme (for the EAFRD), 50% of the financial consequences will be borne by the Member State concerned and 50% by the Community budget.

### **5. PROCEDURES FOR CERTIFYING THE ACCOUNTS**

#### **5.1. Roadmap for a positive statement of assurance**

Although it acknowledged the progress made by the Commission and the Member States in improving their budgetary control systems, for the eleventh consecutive year the Court of Auditors could only deliver a partially positive statement of assurance for payment appropriations under the Community budget. The main problem, according to the Court's reports, relates to the funds whose management is shared with the Member States. In Opinion No 2/2004,<sup>95</sup> the Court of Auditors proposed a Community internal control framework, based on common standards and principles, which could provide a reasonable assurance that revenue collection and expenditure had been executed in accordance with the legislation in force, while at the same time taking into account the equilibrium between the cost and the advantages of internal control. Obtaining a positive DAS is one of the Barroso Commission's strategic objectives.<sup>96</sup> To that end, following the Court's opinion, the Commission adopted in June 2005 a roadmap which makes a number of proposals for an integrated Community control framework.<sup>97</sup> In this document, the Commission referred to the proposal made by the European Parliament at the time of the 2003 discharge in which it suggested a provision on the ex ante publication in a formal statement, and an ex post annual statement of assurance on the legality and regularity of the underlying transactions from the political authority and highest-ranked manager in each Member State (the Finance Minister). This roadmap

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<sup>94</sup> Council Regulation (EC) No 1290/2005 of 21 June 2005 on the financing of the common agricultural policy (OJ L 209, 11.8.2005).

<sup>95</sup> Opinion No 2/2004 of the Court of Auditors of the European Communities on the "single audit" model (and a proposal for a Community internal control framework) (OJ C 107, 30.4.2004).

<sup>96</sup> Strategic objectives 2005-2009 (COM(2005) 12 of 26 January 2005).

<sup>97</sup> Communication from the Commission to the Council, the European Parliament and the European Court of Auditors on a roadmap to an integrated internal control framework (COM(2005) 252).

was accompanied by a gap assessment between the internal control framework within Commission departments and the control principles set out in Court of Auditors' Opinion No 2/2004<sup>98</sup> ("gap assessment").

On the basis of these Commission documents and the discussions of a group of experts from the national administrations of the Member States, the ECOFIN Council adopted conclusions on 8 November 2005 in which it took the view that "the existing statements at the operational level may constitute a significant level of assurance for the Commission and ultimately for the Court of Auditors and should prove useful and provide a satisfactory cost-effectiveness ratio and be taken into account by the Commission and ultimately by the Court of Auditors in order to obtain a positive statement of assurance". The Council called on the Commission to provide an assessment of the controls and the value of the existing statements.

Taking into account the conclusions of the Council, in January 2006 the Commission adopted an action plan for an integrated control framework<sup>99</sup> in which it stated that it was important that the Member States "ensure that their management of appropriations in the name of the Commission reduces the risk of irregularities in expenditure to an acceptable level and are in a position to demonstrate this to national and Community auditors". Since the management of 80% of Community expenditure is shared with the Member States, the emphasis is on simplifying legislation for the 2007-2013 programming period, on harmonising the control principles and standards applied by the Commission and the Member States by sharing the results of the control and promoting profitability, and on making use of the existing management declarations of operational agencies in the Member States, which are a major source of assurance for the Commission and, ultimately, for the Court of Auditors too.

## **5.2. Procedure for certifying proper implementation of public expenditure in the Member States**

The Commission and the Member States judged that it was in both their interests to collect information on the existing certification systems for the proper implementation of public expenditure in the Member States in order to extract best practice. Moreover, this exercise could be used to examine application of the principle of equivalent protection enshrined in Article 280 of the Treaty.

On the basis of the replies to the questionnaire sent to the Member States, it was possible to obtain a picture of national practices in this field, which are presented below in the form of a table.

This table provides a summary of the answers given by the Member States. A more comprehensive summary containing the detail of the answers can be consulted in the Commission working paper published at the same time as this report.

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<sup>98</sup> Commission working paper concerning the gap assessment between the internal control framework in the Commission services and the control principles set out in the Court of Auditors' "proposal for a Community internal control framework" Opinion No 2/2004 (SEC(2005) 1152).

<sup>99</sup> Commission Action Plan towards an Integrated Control Framework (COM(2006) 9).

	<b>Certification of national accounts by an internal body<sup>100</sup></b>	<b>Certification of national accounts by an external body<sup>101</sup></b>
<b>BE</b>	No	No <sup>102</sup>
<b>CZ</b>	Yes	No <sup>103</sup>
<b>DK</b>	Yes	Yes
<b>DE</b>	No	Yes
<b>EE</b>	Yes	Yes
<b>EL</b>	No	No
<b>ES</b>	No	No <sup>104</sup>
<b>FR</b>	No	Yes
<b>IE</b>	Yes	Yes
<b>IT</b>	No	Yes
<b>CY</b>	No	Yes
<b>LV</b>	Yes	Yes
<b>LT</b>	Yes	Yes
<b>LU</b>	Yes	Yes
<b>HU</b>	Yes	Yes
<b>MT</b>	No	Yes
<b>NL</b>	Yes	Yes

<sup>100</sup> Internal body: individual, department or service dependent on the management and/or payment service for the budget to be certified.

<sup>101</sup> External body: individual, department or service that is independent of the management and/or payment service for the budget to be certified. The annual reports adopted by external bodies and submitted to the national parliament are regarded as account certification systems.

<sup>102</sup> The certification of accounts by an external body does, however, exist for the budget of certain regions.

<sup>103</sup> There is no obligation for certification, but the Czech Republic's supreme audit institution submits to the Parliament its opinion on the implementation of the budget and the final state of the accounts. However, these opinions do not have the status of an audit.

<sup>104</sup> There is no obligation for certification, but the Court of Auditors taxes the general state account and the other public sector accounts, and also manages the public sector in terms of legality and rationality (efficiency and economy).

<b>AT</b>	No	No <sup>105</sup>
<b>PL</b>	No	Yes
<b>PT</b>	No	Yes
<b>SL</b>	No	Yes
<b>SK</b>	Yes	Yes
<b>FI</b>	Yes	Yes
<b>SE</b>	No	Yes
<b>UK</b>	Yes	Yes

### *Certification by an internal body*

Approximately half of the Member States who replied to the questionnaire possess an internal certification procedure to ensure the legality and regularity of public expenditure<sup>106</sup>. Among them, only Latvia stated explicitly that this certification also concerned funds allocated by the European Community and managed by the national public administration. It should nevertheless be pointed out that, often the certification is delivered at management level and not by an internal auditor proper<sup>107</sup>. In a significant number of cases, the bodies responsible for delivering the certification also issue an opinion on the total amount likely to be recovered by the paying agencies<sup>108</sup>. Certification by an internal body is sometimes delivered at national level<sup>109</sup>; in other cases, it is delivered at the level of the management department or agency<sup>110</sup>. The individual cases of the United Kingdom and Slovakia, where there are several levels of certification (national level, regional level and by fund), should also be noted. These certifications issued by an internal body are submitted to the national parliaments in some cases only<sup>111</sup>.

Some Member States<sup>112</sup> have an internal auditing system to ensure the legality and regularity of the national accounts even in the absence of a legal obligation for

<sup>105</sup> Even if Austria's Court of Auditors is not obliged to provide certification of the reliability of federal and provincial accounts, the Court checks that the utilisation of public funds is in compliance with the principles of reliability, legality, regularity, economy, efficiency and effectiveness.

<sup>106</sup> Denmark, Estonia, Ireland, Latvia, Luxembourg, Hungary, Netherlands, Slovakia, Finland and United Kingdom.

<sup>107</sup> Certification is delivered by an internal auditor in Estonia, Netherlands and Slovakia only.

<sup>108</sup> Denmark, Estonia, Latvia, Lithuania, Luxembourg, Slovakia and United Kingdom.

<sup>109</sup> Czech Republic, Lithuania, Luxembourg, Hungary and Netherlands.

<sup>110</sup> Estonia, Ireland, Latvia and Finland.

<sup>111</sup> Czech Republic, Lithuania, Slovakia and United Kingdom.

<sup>112</sup> France, Italy, Cyprus, Lithuania, Malta, Greece and Portugal.

certification by an internal body. Among them, two indicated that these audits concerned Community funds<sup>113</sup>.

According to the responses of the Member States who possess an internal control and audit system, the most widespread standard appears to be INTOSAI.

#### *Certification by an external body*

A large majority of Member States declared that they had a legal obligation to obtain from an external body an annual certification that ensured the legality and regularity of public expenditure. The only exceptions were Spain, Italy and Austria. However, it should be noted that, in the case of Greece, Spain and Italy, the Court of Auditors delivers an annual report rather than a certification.

In most cases, this external body is a public body corresponding to the highest state auditing body. Certifications are delivered at national level in most countries<sup>114</sup>. They concern the entire budget<sup>115</sup> and, in all cases, are submitted to the national parliaments, particularly to certify the legality and efficiency of the management of national accounts. Only in some Member States do the certifications provide an opinion on the total amounts likely to be recovered<sup>116</sup>.

#### *Control of Community funds (funds in shared management)*

In their replies to the questionnaire the Member States indicated that more than half of the national certification bodies provided for in Article 3 of Regulation (EEC) No 1663/1995 for the EAGGF Guarantee Section fulfil the necessary conditions for recognition by the national authorities as certifiers of national accounts<sup>117</sup>. In cases where they do not fulfil the conditions, the Member States explain this by the absence of a legal basis and by the fact that the bodies were established with the specific objective of managing and controlling Community funds. In all such cases, with the exception of Estonia, the Netherlands and Sweden, these bodies also give their opinion on the amounts likely to be recovered by paying agencies.

In the case of the Structural Funds, only a small proportion of national services responsible for issuing the certificate of validity on the winding-up of a programme, as provided for in Article 38 of Regulation No 1260/1999 and Article 15 of Regulation No 438/2001<sup>118</sup>, are apparently also responsible for the certification of national accounts<sup>119</sup>.

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<sup>113</sup> Lithuania, Greece and Malta.

<sup>114</sup> The only exceptions are Belgium (federal and regional level), Germany (certifications at a federal and regional level), Finland (certifications at the level of the accounting office) and United Kingdom (certifications at national level and at project level).

<sup>115</sup> In the case of Poland, certification by an external body is limited to agricultural expenditure.

<sup>116</sup> Cyprus, Estonia, Hungary, Lithuania, Latvia, Luxembourg, Slovakia and United Kingdom.

<sup>117</sup> Czech Republic, Greece, France, Cyprus, Latvia, Lithuania, Luxembourg, a few Austrian provinces, Poland, Slovenia, Slovakia, Finland and the United Kingdom.

<sup>118</sup> In addition to the certificate issued by an independent person or body when a programme is wound up, the paying authority certifies all the declarations of expenditure that are presented to the Commission several times a year.

<sup>119</sup> Italy (for national co-financing), Lithuania, Netherlands and Slovakia.

Most Member States<sup>120</sup> have indicated that the certification bodies give an opinion on the amounts likely to be recovered.

## **Conclusions**

The majority of national rules make provision for certification on the national accounts to be obtained from an independent external body, almost always the Supreme Auditing Institution (SAI) at national level. In most cases, the audits carried out by the SAI concern the entire budget, and the audit reports or certifications of accounts are submitted to the national parliaments.

The obligation to obtain a certification delivered by an internal body is not so widespread. Around ten Member States only make such provision. As a result, the situation is more diverse than in the case of certifications by an external body. In a few cases the certification is delivered not by an auditor but at the level of the department in charge of management.

The Commission considers that these documents, in cases where they also concern Community funds, could provide an additional degree of assurance demonstrating the correct usage of European funds. The Court of Auditors could also consider the possibility of taking them into consideration to guarantee the legality and regularity of the accounts of the European budget.

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<sup>120</sup> Denmark, Germany, Ireland, Italy, Latvia, Lithuania, Luxembourg, Hungary, Austria, Slovenia, Slovakia, Finland and United Kingdom.