COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 9.1.2007
COM(2006) 874 final

REPORT FROM THE COMMISSION

Fifth report from the Commission on the operation of the inspection arrangements for traditional own resources (2003-2005)

(Article 18(5) of Council Regulation (EC, Euratom) No 1150/2000 of 22 May 2000)

1. INTRODUCTION

***Traditional own resources**: customs and agricultural duties on products imported from third countries, plus sugar levies.*

Every three years the Commission compiles a report for the European Parliament and the Council on the operation of the inspection system for traditional own resources.[1]

The inspection of traditional own resources is based on Council Decision 2000/597/EC, Euratom of 29 September 2000,[2] Council Regulation No 1150/2000 of 22 May 2000[3] and Council Regulation No 1026/1999 of 10 May 1999.[4]

This report, the fifth of this type,[5] describes and analyses the operation of the inspection system for traditional own resources for the period covering **2003 to 2005**. It describes the Commission's inspection measures over this period, assesses the measures carried out and draws conclusions.[6] The report also outlines the financial, legal and regulatory follow-up to these inspections.

Finally, this report gives an account of the outcome of other Commission measures over the period in question to improve recovery and prepare the acceding countries.

The annex to this report describes the objectives of the inspections and how the inspection system operates at Community level.

2. INSPECTIONS BY THE COMMISSION IN 2003-2005

The Commission's on-the-spot inspections are based on a precise methodology to check that procedures are consistent with Community standards. They are planned as part of an annual inspection programme containing a number of subjects to be inspected in one or more Member States. They are carried out on the basis of identical procedures for all inspections and involve the use of questionnaires sent to the Member States in advance, the use of check-lists employed on the spot to ensure that the inspection is consistent and the drafting of a report at the end of the inspection.

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1 Article 18(5) of Regulation No 1150/2000.

2 OJ L 253, 7.10.2000, pp. 42-46

3 OJ L 130, 31.5.2000, p. 1-9, as amended by Council Regulation (EC, Euratom) No 2028/2004 of 16 November 2004 (OJ L 352, 27.11.2004, p. 1.

4 OJ L126, 20.5.1999, p. 1.

5 COM (93) 691 of 4.1.1994 (first report, covering the period 1989-1992), COM (97) 673 of 1.12.1997 (second report covering the period 1993-1996), COM (01) 32 of 5.2.2001 (third report covering the period 1997-1999), COM(03)345 of 11.6.2003 (fourth report covering the period 2000-2002).

6 The report focuses on the checks made by the Community institutions (the Commission and the Court of Auditors). It does not cover the checks made by the Member States, the detailed results of which are set out in the annual report drawn up under Article 280 of the Treaty.

2.1. Main results of inspections

The Commission carried out ***73 inspections*** under Article 18(2) and (3) of Regulation No 1150/2000 during the period 2003-2005 (as against 65 during the period 2000-2002) - 70 joint inspections and 3 autonomous inspections. Nine of these inspections were carried out under the Joint Audit Arrangement.[7]

73 ***inspections*** *revealing 297 anomalies with a financial impact of* ***€127 million*** *(not including interest on late payment).*

Joint Audit Arrangements: *Special type of joint inspection under which a Member State's internal audit departments conduct an audit in accordance with a method approved by the Commission.*

Of the ***297 anomalies*** noted (as against 304 anomalies during the period 2000-2002), 130 had a financial impact (43.80% of the anomalies), 101 a regulatory impact (34%) and 66 fell into the category "other" (22.20%). The Commission has taken appropriate measures to resolve the financial consequences of the anomalies observed.

2.1.1. Management of customs procedures

The following customs procedures were inspected on the spot
- electronic customs declarations,
- inward processing,
- Community air transit,
- imports of fishery products,
- customs warehouses and
- a number of very specific subjects.

In 2003 and 2004 the Commission initiated an inspection operation on the management of "**electronic customs declarations**". This was conducted in all the Member States which belonged to the EU in 2003, with the exception of the Netherlands and Luxembourg. A number of anomalies were noted, but the systems installed in the Member States were on the whole satisfactory. The Commission recommended that computerisation should be extended with a view to improving the management of customs clearance and the collection of own resources.

Inward processing: *customs procedure allowing third-country products to be imported without import duty and re-exported after processing.*

The inspection measures concerning **inward processing** carried out in 2003 (NL), 2004 (FR, IE, IT, AT) and 2005 (DE, UK) revealed a number of shortcomings as regards the management of control of this customs procedure, some with financial consequences. The Member States concerned have informed the Commission that they have taken the measures necessary.

Simplified Community air transit*: transit based on airlines' use of air manifests instead of transit declarations.*

In 2004 inspections of **simplified procedures in Community air transit** in Germany, Luxembourg and the United Kingdom revealed major shortcomings in the management and control of these procedures. The three Member States concerned have since taken strict measures to improve the situation.

Customs warehousing*: customs procedure allowing third-country goods to be stored without import duty.*

Inspections of the entry and import of **fishery products** into the Community[8] in 2004 and **customs warehousing**[9] in 2005 did not, however, reveal any serious anomalies. Only a few shortcomings were noted in connection with the monitoring of specific customs procedures for fishery products (inward processing, release for free circulation with a specific end-use) and the control of customs warehouses.

Finally, there was an autonomous inspection of **exports of C sugar from the Canary Islands** in Spain in 2004**,** an inspection of **preferential**

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7 Inspections in Denmark, the Netherlands and Austria.
8 BE, DE, GR, ES, FR, IT, PT, UK, FI, SE.
9 BE, DK, DE, GR, ES, FR, IE, IT, PT, NL, UK, FI, SE

arrangements in Austria in 2005 and an inspection of **release for free circulation** in the Netherlands in 2004. The management of procedures in the Member States inspected did not give rise to any special comment on the part of the Commission.

2.1.2. Inspections relating to accounting matters

Management of the separate account is a recurrent subject of inspection for the Commission in all the Member States.[10] This account represents a rich source of information on how administrations carry out their responsibilities as regards the management of traditional own resources (establishment of entitlements, management of guarantees, monitoring of recovery, cancellations, writing-off of irrecoverable debts). Inspections in this field over the period 2003-2005 confirmed that most errors were one-off. However, systematic errors persist in a number of Member States, leading to infringement procedures (see point 2.2.2 below).

The Member States book traditional own resources to one of two accounts:
*- the **A account** for amounts recovered or guaranteed (these amounts are paid into the EU budget)*
*- the **B account** for amounts which have not been recovered or guaranteed amounts which have been contested.*

A specific inspection for the Member States which acceded to the EU in 2004 was carried out in 2004 and 2005. In practice, it consisted of evaluating these States' **traditional own resources collection systems**. The inspection findings led to the general conclusion that the Member States concerned were well prepared and that they had installed appropriate collection systems although they revealed a number of structural and one-off errors, particularly as regards the time taken to enter the duty in the accounts, enter customs debts in the A and B accounts and make some amounts available to the Commission. However, most of these errors occurred in the early months of accession; since then, the States concerned have made a number of adjustments to their procedures, computerised clearance systems or accounting systems in order to remedy these errors.

Traditional own resources collection system*: all the systems and procedures introduced by the Member States to ensure that traditional own resources are established, entered in the accounts, recovered and paid.*

Entry of duties in the accounts: *entry of the amount of duty in the customs accounting registers.*

An **autonomous inspection** was also carried out in the **Netherlands** in 2004 to check on the spot the data forwarded in support of requests to be released from the obligation to make irrecoverable entitlements available after they had been written off. This inspection enabled the Commission to substantiate its refusal of two of the three requests for a waiver. Finally, an **autonomous inspection** was carried out in **Denmark** in 2005 to check the reasons for, and accuracy of its repeated adjustments to the amounts of traditional own resources to be paid to the Commission since December 2001.

Request to be released from the obligation to make irrecoverable entitlements available after they had been written off*: procedure allowing the Commission to check whether or not the entitlement is irrecoverable for reasons attributable to the Member State. If the request is refused, the amount has to be paid to the Commission.*

[10] Every inspection visit covers this subject in addition to the main subject.

2.2. Follow-up to Commission inspection measures

2.2.1 Regulatory aspects

Where flaws or loopholes are detected in national regulations or administrative provisions in the course of the inspections, the Member States are asked to take the necessary measures, including legislative and regulatory measures, to bring them into line with Community requirements. Such adjustments, made in both customs law and the financial field, are an important spin-off from the Commission's inspections. The anomalies detected are also an essential source of information on the problems encountered by the Member States in applying customs regulations and their impact in terms of own resources.

2.2.2 Outcome of disputes

25 disputes outstanding at 31.12.2005.

Some points in the rules are a source of disagreement between the Member States and the Commission, whose only option is to resolve outstanding cases by using the ***infringement procedure*** provided for in Article 226 of the EC Treaty. At 31 December 2005 a total of 25 cases involving 10 Member States were at various stages of the procedure (formal notice, reasoned opinion, referral). The conclusions resulting from the Court of Justice's examination of the infringement procedures will clarify the questions in dispute and finally clear up the differences of interpretation.

In 2005 *three Court judgments upheld the Commission's position as regards Community transit and the financial consequences of errors by the Member States.*

In 2005, the European Court of Justice delivered a number of important judgments following infringement procedures brought by the Commission.

Undischarged transit: *transit operations under which goods subject to a suspension of duties and taxes have not reached their destination. The duties and taxes must then be entered in the accounts and recovered.*

In two judgments delivered on 14 April 2005[11] against Germany and the Netherlands, it upheld the Commission's position and ruled that the two countries had been late in entering in the accounts and making available duty that was owed after transit operations had not been discharged in the regulation time-limits. The interest on late payment claimed by the Commission as a result of these judgments amount to some €2.4 million from the Netherlands and €11.4 million from Germany.

In its judgment of 15 November 2005[12] the Court upheld the Commission's position that Member States should be held accountable to the Community budget for errors they commit when establishing duties. Member States must therefore pay the Commission any amounts which cannot be established (and thus recovered) as a result of an error on the part of the national authorities responsible.

In 2006 *a judgment upheld the Commission's position concerning the time limit for entering duties in the accounts.*

In 2006, in its judgment of 23 February,[13] the Court also upheld the Commission's position concerning the time limit for entering duties in the accounts when Member States carry out *ex post* inspections. These duties

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11 Case C-460/01 "Commission v the Netherlands" and Case C-104/02 "Commission v Germany".

12 Case C- 392/02 "Commission v Denmark".

must be entered in the accounts within 14 days of when the customs authorities are able to calculate the amount of duty and not later (in particular after a procedure to guarantee the debtor's right of defence); assertion of this right of defence is by no means hindered by the entry in the accounts.

***Ex post inspections**: customs inspections by the Member States which are not carried out when goods are cleared but later.*

On 5 October 2006 the Court upheld the Commission's position when it ruled that certain Member States were wrong to refuse to pay certain categories of resources into the Community budget, in this case instalments of traditional own resources recovered under a payment plan (Belgium)[14] and guaranteed and uncontested duties resulting from undischarged transit operations conducted in the form of Community transit (Belgium)[15] or under a TIR carnet (Germany[16] and Belgium).[17] On the same day the Court rejected a case brought against the Netherlands in connection with the burden of proof, but agreed that Member States must report infringements or irregularities as soon as they are aware of them and thus before expiry of the time limits (Article 11(1) of the TIR Convention); this applies *mutatis mutandis* to payment demands (Article 11(2) of the TIR Convention). The Court considers that this is to be regarded as "notification" within the meaning of Article 2 of Regulation No 1150/2000.[18] The Court also agrees that Member States must keep supporting documents concerning establishment for a period which will allow them to be corrected and checked.[19]

***TIR carnets** allow goods to be moved without payment of duty or taxes between the various countries which are party to the TIR Convention (international road transport).*

On 5 October 2006 the Court upheld the Commission's position in a number of cases concerning amounts that had been guaranteed or recovered but not paid to the EU budget.

2.2.3 Financial aspects

Over the reference period (2003-2005) additional entitlements totalling more than **€127 million** ***(not including interest for late payment)*** were paid to the Commission following observations it made in reports on joint or autonomous inspections, following inspections by the Court of Auditors or following the Commission's other inspection activities.

Interest for late payment was also charged, pursuant to Article 11 of Regulation No 1150/00, for delays in making available own resources detected during inspections by the Commission or by the Court of Auditors. Over the period 2003-2005 ***interest for late payment*** paid by the Member States totalled more than €**77 million.**[20]

2.3. Commission measures to improve recovery of traditional own resources

Apart from its on-the-spot inspections in the Member States, the Commission has several other means of monitoring the recovery of traditional own

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13 Case C-546/03 "Commission v Spain".
14 Case C-378/03 "Commission v Belgium"
15 Case C-275/04 "Commission v Belgium"
16 Case C-105/02 "Commission v Germany"
17 Case C-377/03 "Commission v Belgium"
18 Case C-312/04 "Commission v the Netherlands"
19 Case C-275/04 "Commission v Belgium"
20 The figures are still incomplete, especially for 2002, since the recovery of entitlements established as a result of Commission inspections depends on national procedures for collecting the accounting information needed to issue recovery orders.

resources. Appropriate use of these means effectively improves recovery.

Before 2005 Community measures to monitor recovery were based in particular on one-off examinations in response to information provided by the Member States under Article 6(5) of Regulation No 1150/2000 on cases of fraud and irregularities involving amounts exceeding €10 000. The Commission monitored recovery on the basis of this information and followed up recovery operations for a representative number of cases ("B sample")[21] in a report until they were finally discharged. The Commission's last report on this subject was submitted to the budgetary authority on 7 January 2005.[22] However, as it stated, this type of report will no longer be drawn up. With the amendment of Regulation No 1150/2000 in 2004, Member States are asked to notify the Commission of all unrecovered amounts over €50,000, at the latest five years after the moment that debt (following assessment, review or appeal) was confirmed as irrecoverable. All Member States therefore have to report such cases, providing the Commission with a better view of the overall recovery performance of Member States.

Over the period 2003-2005, the Commission was able to improve its monitoring of recovery in the Member States through the introduction of the new OWNRES data base, amendment of the rules on the writing-off of irrecoverable entitlements, the Court's case law on the financial consequences of errors by the Member States and monitoring activities geared to the acceding countries.

2.3.1 Examination of irrecoverable entitlements which have been written off

Member States must take the measures necessary to make traditional own resources available to the EU, except where recovery proves impossible (*amounts which are definitively irrecoverable)* for reasons of *force majeure* or for reasons which cannot be attributed to it.

Over the period 2003-2005 thirteen Member States reported 176 cases to the Commission involving an amount of almost **€39 million**. Over the same period the Commission examined **309 requests** (outstanding cases and newly presented cases) involving more than **€166 million**. The Commission refused 62 cases involving more than **€41 million** which must now be made available to the EU budget.

One objective of adopting Regulation No 2028/2004 of 16 November 2004 was to give Member States a better understanding of the meaning of *amounts which are definitively irrecoverable*.

The purpose of the Commission's examination of the cases reported is to assess the degree of diligence shown by the State in carrying out its recovery operations. This acts as an incentive for them to carry out their operations properly. If the Commission refuses, the amount in question must be paid into the EU budget. At first, this examination was limited to cases involving more than €10 000. This threshold was raised to €50 000 with the adoption of Regulation No 2028/2004 of 16 November 2004.

2.3.2 Treatment of errors of establishment leading to a loss of traditional own resources

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21 Some recovery cases (referred to as "non-sample cases") are also given specific monitoring outside the B representative sample.

22 COM(2004) 850 of 7.1.2005.

Since Member States are supposed to collect traditional own resources as effectively as possible, the Commission considered that they should be liable for losses of traditional own resources resulting from errors on their part and should compensate the EU budget accordingly.

The Court has confirmed that Member States must assume the financial consequences of errors they make when establishing entitlements.

This view was upheld by the Court of Justice in its abovementioned judgment of 15 November 2005 (*Commission v Denmark*). It expressly recognises that the obligation of the Member States to establish the Communities' entitlement to traditional own resources (and then make them available to the EU budget) arises as soon as the conditions laid down in the customs regulations are met. It is not therefore necessary for establishment actually to take place. Only when the conditions laid down in Article 17(2) of Regulation No 1150/2000 are met (i.e. *force majeure* or if the Member State can demonstrate to the Commission that it is impossible for it to recover the amounts for reasons which cannot be attributed to it) is the Member State released from its obligation to make available the own resources in question. This judgment clearly shows that the Member States must assume the financial consequences of errors they make.

As a result of this precedent, Member States may no longer refuse, as they often did in the past, to make available to the EU budget the duty which they failed to establish because of an error on their part.

2.3.3. The new OWNRES database

***OWNRES database**: database maintained by the Member States and covering all cases of fraud and irregularities established by them when the amounts involved exceed €10 000.*

Under Regulation No 1150/2000 Member States must send the Commission information on cases of fraud and irregularities involving entitlements of more than €10 000. This information is reported via OWNRES. Because of the anomalies observed in submitting reports of fraud and irregularities, the Commission has set up ***a new database (OWNRES)*** based on the internet. The Member States thus have a more functional tool allowing them to send the Commission - and update - information on fraud and irregularities *in real time*. The new application has been operational since July 2003. With the new application, the Member States, as the main managers of the tool, are thus entirely responsible for sound data management.

This database provides the Commission with the information it needs to monitor recovery and prepare the on-the-spot inspections. The data reported is also examined by the Anti-Fraud Office (OLAF).

As the Commission has had its doubts in recent years about the reliability of the data reported by the Member States, it decided to compare the amounts exceeding €10 000 entered in the Member States' B accounts (EUR15) and the corresponding amounts in OWNRES. The findings proved unsatisfactory. With 31 December 2001 and 31 December 2003 as the dates of reference, a match of only 32% and 50% respectively was established. After insisting that the Member States improve the quality of the information supplied via OWNRES, the Commission conducted a further comparison in 2005 (EUR25). This time the results were much more satisfactory, with an average match of 90% and with more than half the Member States having a 100%

match.

2.4. Monitoring measures for the acceding countries

When preparing for the accession of the ten new Member States, the Commission conducted monitoring visits specifically geared to traditional own resources in each of the ten countries in 2003. These monitoring visits and the mock accounting exercises conducted by these States enabled the Commission to obtain a reasonable degree of assurance about their administrative capacity to apply the *acquis communautaire* with respect to traditional own resources. The findings of the on-the-spot inspections in 2004 and 2005 suggested that, on the whole, the Member States concerned were well prepared and that the collection systems introduced were operating properly. The range of technical assistance and monitoring visits by the Commission undeniably contributed to these satisfactory results.

A technical assistance and monitoring programme similar to that employed for the States acceding to the EU in 2004 was continued in 2004 and 2005 to help Romania and Bulgaria prepare for accession as effectively as possible. It will also continue in 2006.

3. ASSESSMENT OF THE INSPECTION ARRANGEMENTS

As in previous years, the anomalies noted in the operation of the inspection arrangements for traditional own resources during the period 2003-2005 confirm the benefit which the Commission can derive from the inspections it carries out. The *traditional tools* which the Commission employs to follow up its inspection activities include the adjustment by Member States of national procedures which are not consistent with Community rules, corrections in the accounts for old cases (before they are time-barred), one-off corrections of the anomalies found, explanation of Community texts and concerted improvement of Community legislation in the case of persistent malfunctions.

The financial impact represents the visible impact of the checks carried out on the spot; However, this is not the only reason for the checks. Specific inspections by the authorising officer based on all the information gathered from the Member States can, on analysis, influence the process for improving the rules so that the financial interests of the Union are taken into account.

4. CONCLUSION

Traditional inspection activities must continue and the monitoring of recovery measures in the Member States must be further strengthened.

The results recorded from 2003 to 2005 show that the Commission's inspections of traditional own resources are necessary. This inspection activity ensures equality of treatment between the Member States as regards both application of the customs and accounting rules and protection of the European Union's financial interests.

In future, the Commission intends:

– **to continue its traditional role as regards on-the-spot inspections**, while improving its inspection methods (audit tools, etc.);

– to continue **strengthening its monitoring of recovery measures** in the Member States by introducing an IT tool allowing user-friendly treatment of cases of irrecoverable entitlements that are written off and reported to the Commission.

– to continue **monitoring** the acceding countries, so as to obtain a reasonable degree of assurance that these countries' systems for collecting traditional own resources meet Community requirements by the time of accession.