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EUROPEAN ANTI-FRAUD OFFICE (OLAF)

The Director General

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REPORT BY THE EUROPEAN ANTI-FRAUD OFFICE (OLAF)

First report on operational activities
1 June 1999 – 31 May 2000

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FOREWORD

The protection of the Community's financial interests, like the corollary topic of the fight against fraud, is being given ever higher political priority. The creation of the European Anti-fraud Office (OLAF) is described by the conclusions of the Helsinki European Council of December 1999 as "an important new step in the fight against fraud". The institutions, following "negotiations" and a series of discussions which were described as "exemplary" by the Cologne European Council of June 1999, thus obtained a unique mechanism which makes it possible to ensure a Community presence on the ground without losing the effects of synergy with the legislative activity that is supposed to draw the lessons of operational activity for the development of existing and future Community policies.

The European Anti-fraud Office has been in a transitional period since 1 June 1999 in terms of recruitment and tasks. It is evolving towards a new organisation reflecting the additional resources allocated to it by the European Parliament and the Council for the 1999, 2000 and 2001 financial years. The Office will then have 300 staff. Between now and then, I wish to reorganise the existing structures of the OLAF, initially on a provisional basis, and gradually adapt them to the availability of new resources.

Continuity with ongoing operational activities has been ensured. That can be seen from the statistics and analyses submitted in this report: the fight against organised crime and financial crime continued on the ground. The progress noted in recent years will continue with OLAF, even if the comparison between the results of various years may turn out to be difficult.

Unlike the Commission's annual reports, this document does not give an account of the Member States' reports on the fight against fraud and irregularities. I will propose that they be included in the Commission Report on the protection of financial interests and the fight against fraud, required by Article 280 of the EC Treaty as amended at Amsterdam.

Moreover, the statistical data presented here correspond to activities between 1 June 1999, when the Office was set up, and 1 March 2000, when I arrived. They do not cover a calendar year, or even a period of twelve consecutive months.

Nevertheless, the report that I submit here reviews the activities of the Office at the time of my arrival and identifies what seems to me to need developing in terms of operational activity to protect the Community's interests. This will enable me to redirect the Office's operational activity in the way called for by the reform.

My priorities are the development of cooperation with the Member States and the strengthening of transparency in the European institutions.

On the first point, as the statistics in this report clearly reveal, coordination and assistance represent a major proportion of the Office's activities. The value added by OLAF must be evidenced by its capacity to ensure more dynamic cooperation with the national authorities on the ground. The Office will therefore give its full support to national investigation services, following a service and partnership approach. Specific powers of administrative investigation should be integrated in this spirit as a

complementary and essential instrument for a more comprehensive approach to cooperation with all the national services concerned, focusing on areas of Community responsibility.

On the second, this report is presented as a quantified scoreboard allowing the Office's operational action to be monitored with some precision. Generally, it is my intention to manage the Office in a spirit of transparency. In particular with regard to internal investigations, I intend to make careful use of the new means of investigation provided for by the legislation, to neutralise the deleterious effects of criminal networks and thus to guarantee the credibility of the Community institutions and bodies.

*

Transparency is the best weapon against corruption. Clear legislation constitutes the first guarantee against the risks of illegal activities. It is to this end that the European Anti-fraud Office devotes itself as of now.

F-H. BRUENER
Director-General
European Anti-fraud Office

INTRODUCTION

The Task Force for Coordination of Fraud Prevention, better known by the acronym UCLAF, has given way, since 1 June 1999, to the *European Anti-fraud Office* (OLAF). The legal framework for the protection of the Communities' financial interests and for the fight against fraud and other illegal activity detrimental to Community interests consists of four main instruments:

- Commission Decision 1999/352/EC, ECSC, Euratom of 28 April 1999 establishing the European Anti-fraud Office (OLAF);¹
- European Parliament and Council Regulation (EC) No 1073/99 of 25 May 1999 concerning investigations conducted by the European Anti-fraud Office,² adopted on the basis of the new Article 280 of the Treaty of Amsterdam (which entered into force on 1 May 1999) by the co-decision procedure;
- Council Regulation (Euratom) No 1074/99 of 25 May 1999 concerning investigations conducted by the European Anti-fraud Office.³ Adopted on the basis of Article 203 of the Euratom Treaty, this Regulation has the same object as Regulation (EC) N° 1073/99;
- the inter-institutional agreement, of 25 May 1999 between the European Parliament, the Council and the Commission relating to internal investigations conducted by OLAF – an annex contains a model internal decision, specific to each institution or body established by or on the basis of the EC and Euratom Treaties.⁴

The second subparagraph of Article 12(3) of Regulations 1073/99 and 1074/99 requires the Director of the Office *“to report regularly to the European Parliament, the Council, the Commission and the Court of Auditors on the findings of investigations carried out, whilst respecting the confidentiality of those investigations, the legitimate rights of the persons concerned and, where appropriate, national provisions applicable to judicial proceedings”*.

This report, prepared on this basis, extends broadly to all the operational functions exercised by the Office on the independent basis established by the legislation. Ranging from information gathering to its exploitation (intelligence) and to the administrative and judicial follow-up, it deals with coordination and assistance, external investigations in partnership with the Member States and internal investigations within the institutions and bodies set up by the EC and Euratom Treaties. The Office's other activities will be covered by the report on the protection of financial interests prepared by the Commission under Article 280 of the EC Treaty.

¹ OJ L 136, 31.5.1999, page 20.

² OJ L 136, 31.5.1999, page 1.

³ OJ L 136, 31.5.1999, page 8.

⁴ OJ L 136, 31.5.1999, page 15.

This first activity report is in three parts. The first specifies the Office's powers and procedures as determined by the legislation governing it.

The Office's operational activity is considered in a second part in terms of both statistics and analysis. This part also covers the action taken during the report period on operational files opened earlier.

In the third part all the questions raised by the operational activity of the Office are presented to serve as a base for future guidelines.

The Office's operational activity began on 1 June 1999, but most of the measures in hand are the extension of measures launched before then. For practical reasons – the report must be available for the Ecofin Council in June 2000 – most of the statistical data relate to results obtained during the report period from investigations that began before then.

TITLE 1 : THE OPERATIONAL PROCEDURES OF THE OFFICE

To perform its operational tasks,⁵ the Office gathers and processes data, conducts internal or external administrative investigations, coordinates and assists the authorities in the Member States, and monitors all information and results of investigations:

1. THE TREATMENT OF INVESTIGATIONS

With regard to the examination of administrative investigations, the new mechanism confers on the Office the operational functions and resources which the Commission enjoys under the Treaties and extends the internal investigation function inherited from UCLAF to all the Community institutions and bodies. The Office can decide autonomously to launch an internal investigation in a Community institution or body and to transmit files to the national judicial authorities.

Investigations in progress were handled until 1 June 1999 on sectoral legal bases, on a horizontal legal basis (Council Regulation 2185/96) where external investigations were concerned, or on the basis of the Commission Decision of 14 July 1998 – since repealed – with regard to internal investigations. Since 1 June Regulations 1073/99 and 1074/99 have also been applicable; they contain provisions applying to all investigations. The contribution of each of these instruments is considered below.

1.1. External administrative investigations on a sectoral legal basis

Based on specific instruments that apply to the various sectors of the Community budget and are historically the earliest, what these investigations have in common is that they are conducted under the responsibility of the Member States. On the basis of these regulations, the Office may ask the Member States to open an investigation with which its staff may be associated. Henceforth the national procedural rules are applied.

Here there is no formalised and *a fortiori* uniform investigation procedure. The procedure begins, however, with a request for the opening of an investigation sent by OLAF to the Member State. In practice, although the investigation is under the responsibility of the Member State, the Office's investigators are closely involved in directing the investigations. At the end of the investigation, the report by OLAF is sent to the national supervisory authorities, which can make use of it to take action pursuant to the observations.⁶

The main legal bases are as follows:

⁵ Cf. Title 2, point 1.

⁶ Case C-476/93 P, *Nutral/Spa* [1995] ECR I-4125 (judgment given on 23 November 1995).

<i>Instrument</i> ⁷	<i>Field</i>
Article 18(3) of Regulation 1552/89	Own resources
Article 9 et seq.; 18(4); 20 et seq.; 28(2) of Regulation 515/97	Own resources and common agricultural policy
Article 6 of Regulation 595/91	Common agricultural policy
Article 9 of Regulation 1258/99	EAGGF guarantee
Article 23 of Regulation 4253/88, then Article 38(3) of Regulation 1260/99 from 1/1/2000	Structural Funds

Direct expenditure is managed by the Commission itself. The Member States have neither a management nor a supervisory role in this field. Specific regulations, Article 87 of the Financial Regulation and contractual provisions determine how the Commission acts here.

1.2. External administrative investigations on a horizontal legal basis: Regulation 2185/96

Without prejudice to the sectoral Community provisions considered above, Regulation 2185/96⁸ (the “on-the-spot checks Regulation”) applies to all areas of Community activity. The Commission has issued specific guidelines for its interpretation. Where the Regulation is silent on a given point, national procedures apply.

An external investigation can be opened if there are reasons to think that irregularities have been committed (Article 5) and the criteria for action by the Office (Article 2) are met.

With regard more particularly to administrative investigation procedures, the Regulation requires Commission inspectors to be duly authorised and to carry a written authorisation from the director of the Office. Only OLAF inspectors have a standing authorisation. For each mission a written

⁷ Own resources: Council Regulation (EEC, Euratom) No 1552/89, OJ L 155, 7.6.1989
 Mutual assistance (customs and agriculture): Council Regulation (EC) No 515/97, OJ L 82, 22.3.1997
 Common agricultural policy: Council Regulation (EEC) No 595/91, OJ L 67, 14.3.1991, and Council Regulation (EC) No 1258/99 relating to the financing of the common agricultural policy, OJ L 160, 26.6.1999

Structural Funds: Council Regulation (EEC) No 4253/88, OJ L 374, 31.12.1988 and Council Regulation (EC) No 1260/99 laying down general provisions on the Structural Funds, OJ L 161, 26.6.1999.

⁸ Council Regulation (Euratom, EC) No 2185/96 concerning on-the-spot checks and inspections carried out by the Commission in order to protect the European Communities’ financial interests against fraud and other irregularities, OJ L 292, 15.11.1996.

authorisation is issued, specifying the subject-matter and purpose of the inspection (Article 6(1) and (2)).

Checks and inspections are conducted by the Commission, preferably in close cooperation with the competent authorities of the Member State concerned. Member States are informed in good time of the subject-matter, purpose and legal basis of the checks so that they can give all requisite help (Article 4). If an economic operator objects to the inspection, the Member State concerned provides the requisite assistance so as to take the appropriate precautionary measures (Article 7(2)) and to allow Commission inspectors to perform their task (Article 9).

The administrative investigation culminates in a report reflecting the procedural requirements of the national law of the Member State concerned (Article 8(3)). The material and supporting documents gathered are annexed to it. The report has the same status as a national administrative inspection report; it constitutes admissible evidence in administrative or judicial proceedings in the Member State in which its use proves necessary. Where the inspection is conducted jointly with national inspectors, they are asked to countersign the report drawn up by the Commission inspectors.

1.3. The contribution of Regulations 1073/99 and 1074/99

Since 1 June 1999, OLAF has proceeded on the basis of the common framework that Regulations 1073/99 and 1074/99 now constitute for the treatment of internal or external investigations. Accordingly, new rules of procedure are added to the previous ones and formalise the main stages of the administrative investigation.

All external administrative investigations are now opened by a decision of the Director of the Office, of his own initiative or following a request from a Member State (Article 5). The Director of OLAF directs the conduct of the investigation, which run continuously for a period of time proportionate to the circumstances and complexity of the case.

When an investigation has been in progress for more than nine months, the Director informs the Supervisory Committee why it has not been possible to wind up the investigation and of the expected time for completion (Article 11).

At the end of the investigation, OLAF draws up under the Director's authority a report which takes account of the procedural requirements of the national law of the Member State concerned. This report is then sent to the relevant administrative or judicial authorities of the Member State concerned, in accordance with the Regulation concerning external investigations.

Regulations 1073/99 and 1074/99 also broadened the internal investigation concept to include those conducted within the other European Union institutions and bodies. The Office is empowered to conduct internal

investigations in all the institutions and bodies set up by or on the basis of the EC and Euratom Treaties.⁹

Under these Regulations, internal investigations are still opened by a decision of the Director of OLAF, acting on his own initiative or following a request of the institution or body in which the investigation is to be carried out. The Office can still carry out on-the-spot checks and inspections into economic operators, as provided for by Regulation 2185/96. But, as in the case of external investigations, the inspectors must be duly empowered and hold a written authorisation from the Director of the Office.

The report drawn up following an internal investigation and any related supporting documents are sent to the institution or body concerned, the interested party being informed. They then draw the disciplinary conclusions from the internal investigation and its findings and inform the Director of the Office of the action taken on the investigations, within the period determined by him in the conclusions of his report. The Director of the Office sends the report to the judicial authorities, if appropriate.

2. THE TREATMENT OF COORDINATION CASES

Acting on the basis of the information gathered, the Office also ensures strengthened coordination and assistance for investigations conducted by the Member States. This means supplying the Member States with the information gathered at Community level and directing the operational actions of the national authorities, in agreement with them.

When there is a major transnational dimension to a case, the Office supports the investigation activities of the Member States. This support can take the form of:

- **coordination** of operational activities by OLAF;
- bilateral or multilateral **assistance**, where the Office provides the investigating authority with information, supplies or know-how.

Article 280(3) of the EC Treaty commits the Member States to close and regular cooperation between competent authorities, together with the Commission, to protect the financial interests of the Community against fraud.

⁹ The rules concerning the conduct of internal investigations within the Commission were previously laid down by the Commission Decision of 14 July 1998 on investigations carried out by the Task Force for Coordination of Fraud Prevention and the detailed rules adopted on 9 December 1998 (references: C (1998) 2049/5, 13.7.1998, and C (1998) 3232/4, 2.12.1998). The Commission Decision of 28 April 1999 repealed them, but some of the investigations ongoing during the report period were opened on the basis of these previous provisions, which are therefore taken over either in the Commission Decision in question, or in Regulations 1073/99 and 1074/99, or in the model decision annexed to the Interinstitutional Agreement of 25.5.1999.

Coordination and assistance can be formal when they are based on the computerised mutual assistance forms mentioned above. But the Office also inherited the Working Parties set up by the Commission (UCLAF), which provide a forum for ongoing monitoring and coordination of investigations in the most sensitive sectors (alcohol, cigarettes and olive oil task-groups) with the specialised services of the Member States. There is no express provision for such coordination in the Regulations. It flows from a pragmatic approach based on Article 280 of the EC Treaty. It is in keeping with the objectives set by that Article, detailed rules for which could be laid down in a horizontal Regulation. It meets a practical need.

Certain sectoral Regulations, referred to in aggregate terms in Article 9(2) of Regulation 2988/95 and again in Article 3 of Regulation 1073/99, comprise special provisions, in particular:

<i>Field</i>	<i>Text</i>
Own resources	Titles III, IV and V of Regulation 515/97
Common agricultural policy	Article 4 of Regulation 595/91
Structural measures	Article 4 of Regulation 1681/94 Article 4 of Regulation 1831/94

Article 1(2) of Regulations 1073/99 and 1074/99 requires the Office to arrange the Commission's assistance to the Member States in organising such cooperation. Regulations 1073/99 and 1074/99 do not therefore depart from previous practice.

TITLE 2 : SURVEY OF THE OPERATIONAL ACTIVITIES OF THE EUROPEAN ANTI-FRAUD OFFICE

1. THE OPERATIONAL ACTIVITIES OF THE OFFICE TO PROTECT THE FINANCIAL INTERESTS OF THE COMMUNITY

In general terms, the Office carries out four principal activities to perform its operational tasks:

- (1) gathering and processing operational data;
- (2) administrative investigations involving the Office directly;
- (3) coordination/assistance for the operational actions by the Member States;
- (4) monitoring all information and all operational results sent to it.

1.1. Gathering operational information

The fraud and irregularity cases coming to the Office's attention tend to be somewhat complex. It is important to gain a real insight into the reality of transactions and to identify all possible links between the persons and firms potentially involved in forms of unlawful conduct. Proceeding from the facts available to any one of the players, only research into all accessible data sources can provide a full overview allowing the true nature and the full implications of a given operation or transaction to be assessed.

OLAF gathers and processes data from varied sources and then opens a file for any new case, on the basis of which the Director of the Office can decide either to open an investigation or to launch or continue coordination.

1.1.1. The Office's information sources

OLAF obtains its information either from the Member States or from other sources.

- a) The communications by the Member States on the basis of the Regulations

Member States are required to report irregularity cases on which an initial administrative or judicial report has been made on the basis of the following provisions, depending on the field:¹⁰

¹⁰ From 1999, reports from the Member States in response to their regulation requirements are summarised in the Commission report on the protection of financial interests following the entry into force of the Amsterdam Treaty (Article 280 EC).

Field	Instrument ¹¹
Own resources	Regulation 1552/89
Common agricultural policy	Regulation 595/91
Structural Funds	Regulation 1681/94
Cohesion Fund	Regulation 1831/94

The procedures for reporting by the Member States were harmonised by these provisions. A uniform presentation is imposed to facilitate computer processing. All information notified on these legal bases is entered in the Office's database (IRENE¹²).

Articles 17 and 18 of Regulation 515/97¹³ further require the Member States to notify the Commission of all useful information with regard to infringements of the customs Regulations in the broad sense (for example commercial policy) or agricultural Regulations. The Commission, in return, notifies them of all information that will help them enforce these Regulations. Since they are of Community interest, these exchanges take the form of standardised computerised mutual assistance sheets. The point here is that information notified can concern both a proved irregularity case and a suspected case. When an investigation is undertaken on the basis of one or more mutual assistance sheets, information is then recorded in the IRENE base.

b) Other information sources

Apart from the formal reports from the Member States, OLAF has other information sources, in particular:

- information received from Commission departments (authorising departments, other departments with horizontal responsibilities such as Financial Control, Budget, Legal Service, etc.);
- information received from specialised services in the Member States;
- transmission by the European Court of Auditors of irregularities noted during its audits;
- telephone hotline, which can be used to deposit a voicemail message reporting an irregularity;

¹¹ Commission Regulation (EC) No 1681/94, OJ L 178, 12.7.1994.

Commission Regulation (EC) No 1831/94, OJ L 191, 27.7.1994.

¹² IRENE, from the French acronym for Irregularities, Investigations and Exploitation.

¹³ Council Regulation (EC) No 515/97 on mutual assistance between the administrative authorities of the Member States and cooperation between the latter and the Commission to ensure the correct application of the law on customs and agricultural matters, OJ L 82, 22.3.1997.

- contacts with professional circles;
- information supplied by private individuals, which may be anonymous;
- general information sources (press, media).

The Office's Information Support Office dealt with about 40 000 messages concerning the transport of sensitive products in the transit procedure during the report period. It acted on about 2 500 requests for specific information, 70% of which were received from the Member States' specialised services, and presented the information gathered in the form of several hundred summary reports.

The telephone hotline played an important role in revealing the invisible portion of fraud against the Community budget. Most of the calls that contained information of substance confirmed reports or suspicions from other sources.

All this information can prompt the opening of an initial file, followed either by on-the-spot checks and inspections initiated by the Office itself or by coordination/assistance for operational actions by the Member States.

1.1.2. Information processing by the Office between 1 June 1999 and 29 February 2000

a) Information analysis

Effective prevention, detection and enforcement all demand detailed analysis of information that has been gathered. The great challenge lies in matching information from different sources so as to gain a clear perception of the reality. With support from the Joint Research Centre in Ispra the Office has developed a prototype "data warehouse" for information on imports of textile products and exports of agricultural products.

Like its counterparts in the Member States, OLAF is still in the early stages of building up a coherent and practical risk-analysis system. It is continuing its work within a group of representatives of the Member States for checks and inspections based on Regulation No 4045/89 and another for customs cooperation. The Office has decided to set up a new unit – the Intelligence Unit – for the purposes of its new strategy.

b) Opening a file

If, after checking, information received proves sufficiently serious and prompts a suspicion of irregularity, it is recorded in the relevant existing file. A new file is opened if the case is a new one.

The **241 new files opened** reflect, therefore, only a modest part of the Office's operational activity. For one thing, when information is processed, unreliable information may have to be weeded out; alternatively, existing files may be supplemented. For another, the volume of the file and the workload it requires will vary considerably from case to case within the same sector. Lastly, the number of new files is far less than the stock of current

cases, as the full treatment of international financial business is by nature time-consuming. As the following table shows, the new files opened between 1 June 1999 and 29 February 2000 represented less than half the total. The proportion was less than 6% in the direct expenditure area.

	Structural Funds	Direct expenditure	External actions	Agricultural trade	Common organisation of agricultural markets ¹⁴	Own resources	Total
Current files opened before 1 June 1999	190	81	46	131	7	96	551
Files opened over the period	11	20 ¹⁵	55	48	25	82	241
Files closed over the period	111	47	12	16	18	4	208

The information obtained in the course of on-the-spot checks and inspections, in whatever form, is subject to confidentiality and business secrecy obligations and to Community and national provisions concerning personal data protection.¹⁶ It is also protected by the specific provisions governing on-the-spot checks and inspections.¹⁷ Information gathered in advance or outside the context of checks and inspections qualifies for similar protection.

Files are closed either without action – when the information has been validated or the checks and inspections are completed – or when it is reasonable to consider that all the follow-up procedures are completed. This operational follow-up activity is considered below. Over the period, **208 files were closed**. This high number is the exceptional result of purely formal *ex post* file-clearance work relating to the structural funds and direct expenditure.

Generally, the action to be taken on the information contained in the files can consist of putting a case on hold (reasons being required), continuation or launching of operational coordination, a request to a Member State for an investigation, the opening of an OLAF investigation with a proposal for designation of one or more investigators, etc.

¹⁴ The common organisation of the markets refers here to expenditure on the common agricultural policy (European Agricultural Guidance and Guarantee Fund (EAGGF), Guarantee Section, excluding export refunds). This field is subdivided in two sectors, plant products and animal products, which account on average for 2/3 and 1/3 respectively of the activity.

¹⁵ Of these 20 files on direct expenditure, 11 concern internal investigations, including 8 within the Commission.

¹⁶ European Parliament and Council Directive 95/46/EC of 24.10.1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data; Articles 286 and 287 of the EC Treaty and subsequent instruments.

¹⁷ Article 8 of Regulations 1073/99 and 1074/99.

1.2. Investigation activity from 1 June 1999 to 29 February 2000

The Office organises and conducts administrative investigations to detect frauds or other irregularities detrimental to the financial interests of the Community. These investigations consist in checking the relevance of the facts when there is suspicion of an irregularity and gathering evidence.¹⁸

On the basis of a file, once the information gathered has been validated, an investigation can be opened.

To carry out necessary checks and inspections, the Office's inspectors are given their empowerment decision, the decision opening the investigation and finally the written authorisation for their investigation, specifying the object and the legal basis. These three essential documents are issued by the Director (Article 5, first subparagraph, and Article 6(2) and (3) of Regulations 1073/99 and 1074/99).

Over the report period, as can be seen from the table below, **68 administrative investigations were opened, 30 others were closed and 67 reports were filed.**

The administrative investigations opened and closed between 1 June 1999 and 29 February 2000 are not generally the same. Given the upstream work of validating information, a investigation once opened will generally lead to a detailed investigation. Hence it is exceptional for an investigation in a complex case opened after 1 June 1999 to be completed by 29 February 2000.

The discrepancy between the number of reports filed and the number of investigation and coordination cases is explained easily. For one thing, the generalisation of the practice of drawing up a report, not only following a investigation (obligatory since 1 June 1999) but also on the completion of a coordination file (in accordance with the instructions issued by the Director on 29 February 2000) is recent. For another, even where a report is drawn up following an investigation, it can be sent even before the case is closed. It can actually prove necessary to transmit partial conclusions, in order to avoid falling foul of the Regulation time-limits.

¹⁸ Article 2 of Regulation 1073/99 gives a definition of administrative investigations: “*all inspections, checks and other measures undertaken by employees of the Office in the performance of their duties, in accordance with Articles 3 and 4, with a view to achieving the objectives set out in Article 1 and to establishing, where necessary, the irregular nature of the activities under investigation. These investigations shall not affect the powers of the Member States to bring criminal proceedings.*”

	Structural Funds	Direct expenditure	External actions	Agricultural trade	Common organisation of agricultural markets	Own resources	Total
Investigations opened	5	9	11	20	7	16	68
Investigations closed	0	4	3	11	6	6	30
Reports sent to competent authorities (*)	15	17	2	15	7	11	67

(*) Not all are reports drawn up following a investigation.

Of the nine checks and inspections relating to direct expenditure, five were internal to the Commission, two were internal to other Community institutions or bodies and two were external, conducted in partnership with the Member States. This means that the Office commenced **a total of seven internal checks and inspections during** the report period.

It is also noteworthy that this administrative investigation work does not represent the bulk of the Office's operational activities and that the proportion varies widely according to the sector. The fields in which Community money is in theory spent within the Union (Structural Funds, direct expenditure) are easier to investigate, whereas in the fields involving non-member countries (external action, agricultural trade, own resources) there is a greater frequency of coordination actions, which will be explained below.

	Structural Funds	Direct expenditure	External actions	Agricultural trade	Common organisation of agricultural markets	Own resources ¹⁹	Total
Investigations opened / total investigations and coordination files	100%	100%	85%	19%	37%	17%	27%

The significance of these percentages depends, of course, on the relatively short report period, but they do reveal that checks and inspections were unevenly spread over the various areas.

¹⁹ Disregarding activity relating to VAT, as data is not available. In the current state of the VAT regulations, there is no legal basis for OLAF checks and inspections and the Member States are under no obligation to act on OLAF initiatives. Coordination is the only form of activity available.

The importance of administrative investigative activity thus needs to be assessed in its proper context to avoid concealing the other tasks performed by the Office.

1.3. Coordination and assistance to protect the financial interests of the Member States and the Community between 1 June 1999 and 29 February 2000

The effect of the validation of the information contained in a file can be to continue or launch operational coordination,²⁰ which can be a useful alternative to an investigation where the Member States have substantial investigation facilities.

These activities involved **181 coordination files** during the report period. The volume of coordination activity in each sector, as can be seen from the table below, is in direct proportion to the volume of investigation activity. Since trade with non-member countries is concerned, coordination is actually the technique most often used.

	Structural Funds	Direct expenditure	External actions	Agricultural trade	Common organisation of agricultural markets	Own resources	Total
Files in the process of coordination	0	0	2	88	12	79	181
Investigations opened / total investigations and coordination files	0%	0%	15%	81%	63%	83%	73%

Regarding trade in goods, coordination is the predominant technique. The table below sets out, for each of the own resources sectors identified by OLAF, both the number of ongoing coordination files and the number of actions which they prompted during the period. These actions can be the issuance of a mutual assistance sheet, coordination meetings with the authorities concerned, coordination missions in the Member States or associated inspection missions on the basis of Regulation 515/97.

²⁰ In certain sectors, such as own resources (mutual assistance), the regulations oblige the Commission to notify the Member States of information which meets the criteria set by the legislation. In that event cooperation can begin automatically even before a file is opened.

Own resource sectors	Cigarettes	Textiles	Indirect taxation (VAT)	Fisheries	Industrial products	Drug precursors	Total
Coordination files	12	21	9	7	14	16	79
Coordination actions	75	35	23	9	26	16	184

The example of own resources also illustrates the point made above: the volume of the files and the resultant workload vary from one case to another. Witness the fact that several actions can correspond to a single file over the report period, which is actually rather brief.

1.4. Follow-up activity

Follow-up is not part of the coordination or investigation, whether it is handled by the Member States or by the Office, but results naturally from it. When the suspicion of irregularity proves founded or the irregularity is formally reported by the Member State, all the necessary conclusions must be drawn at financial, administrative, disciplinary and criminal level.

This activity is an increasingly heavy burden on the investigators. It is expanding every year. As anti-fraud operational work reaches cruising speed, the number of files reaching the follow-up phase is bound to increase likewise. It is now therefore necessary to reconsider the organisation of this function.

Follow-up activity is of paramount importance, which is why a detailed account of it will be given in the part relating to the Office's operational results.

2. MAIN PRIORITIES

Whether it takes the form of an investigation or of coordination, the operational activity of the Office is guided by certain priorities, somewhat flexible at different times, depending whether they fall to be considered in a constant legal and organisational framework or not.

Two opening remarks will be helpful. First, the Office can set priorities only within the limits of its powers. These are determined by the legislation and reflect the state of progress of Community integration. In general, OLAF is to act wherever the financial interests of the Community are in danger and action at Community level (information, coordination, investigation, etc.) gives added value in relation to measures taken by the Member States alone. Its powers even extend to protection of Community interests in general,

according to the fifth recital to Regulations 1073/99 and 1074/99: “Whereas the responsibility of the Office as set up by the Commission extends beyond the protection of financial interests to include all activities relating to safeguarding Community interests against irregular conduct liable to result in administrative or criminal proceedings”.

Secondly, it must be borne in mind that most actions undertaken by the Office are based on information initially obtained from the various sources mentioned above. First, therefore, there must be a reaction to this information. The volume of information gathered, which is well beyond the Office’s human resources, is such that priorities for action have to be set.

2.1. Priorities flowing from the organisation inherited from UCLAF

Certain priorities are reflected by the organisation which the Office inherited.²¹ These have hitherto been determined by the relative share of the manpower devoted to operational tasks²² and even more by their fixed distribution between the various sectors of activity (cf. table below). Operational work is currently based on the long-term specialisation of investigators, warranted by the high degree of complexity of financial and transnational frauds.

At 31.3.2000	Structural Funds and direct expenditure	External actions	Agricultural trade	Common organisation of agricultural markets	Own resources	Total
Total staff complement	17	6	18	10	25	76
Share (%)	22%	8%	24%	13%	33%	100%
Manpower devoted to operational activities ²³	10	4	14	6	18	52
Share (%)	19%	8%	27%	12%	35%	100%

The concentration of the Office’s resources on the various budgetary sectors, of course, does not correspond mathematically to the volume of the financial resources that the Community’s general budget devotes to them.

There are several reasons for this situation. First, fraud is not distributed evenly; on the contrary, it is more frequent in certain sectors of the budget.

²¹ The organisation chart of UCLAF - still that of OLAF - consists of the director, three horizontal units and five operational units, each of them specialised vertically in a sphere of activity corresponding to one or more budgetary sectors.

²² At 30.4.1999, the operational units had 87 out of a total of 139 posts, i.e. more than 62%.

²³ Depending on the fields concerned, these staff complements may or may not include coordinators for the various sectors.

For example, organised and transnational crime especially go for agricultural processing and export refunds, rather than agricultural financial resources across the board. Generally, customs fraud affecting own resources and agricultural trade has priority. This task of the Office is the spin-off of the close integration of these two Community policies.

Secondly, the protection of the Community financial interests is by no means confined to the general budget; it also includes the defence of Community assets in the broad sense. It should be remembered that, in the field of external actions for example, the European Development Fund (EDF) is not part of the general budget but even so accounted for about €1 440 million in payment appropriations in 1998.

Lastly, the rigidity of the organisation and of the specialisation currently inherited from UCLAF, the structural inadequacy of the Office's manpower, the difficulty of recruiting specialist experts in all the useful fields,²⁴ and the adjustment time-lags inherent in the management of human resources, all tend to perpetuate gaps in the distribution of manpower. This question is important enough to warrant further detailed consideration.

But since priorities in the fight against fraud are set in the medium term, the distribution of the Office's manpower will not reflect the budgetary structure arbitrarily, as can be seen in the table below.

Fields of the general budget of the Community for 1999 ²⁵	Structural measures, internal policies, administrative expenditure	External actions ²⁶	Agricultural export refunds, ²⁷ agricultural levies	Traditional own resources (customs duties) ²⁸	EAGGF Guarantee Section (excl. refunds) ²⁹	Total
Amount (€ million)	49 389	5 908	8 361	11 894	34 000	109 552
%	45%	5%	8%	11%	31%	100%

More flexible priorities are then set in the short run. They can evolve without affecting the organisation of the Office. For any given field, versatility is essential within each sector. These are these priorities which are presented below.

²⁴ The backgrounds of category A and B staff, excluding management and vacant posts, in 1999 was mainly customs (31%), agricultural (19%) and tax investigation services (10%), as well as financial inspection services (10%) and financial police forces (8%), plus some judges and lawyers (5%).

²⁵ Source: European Commission, The Community Budget: The facts in figures 1999, SEC(99)1100 (appropriations for commitment)

²⁶ Including the European Development Fund (EDF), external actions account for 7% of the total covered by the Office.

²⁷ These amounts do not include agricultural customs duties as they cannot be distinguished from other customs duties entered in the accounts by the Member States.

²⁸ Customs duties on both industrial and agricultural products. If VAT is included, these resources would then represent 30% of the total.

²⁹ I.e. 80% of the commitment appropriations for the common agricultural policy.

2.2. Priorities set over the period as regards coordination

As explained above, coordination of investigations is the most widely used method of operational work in agricultural and customs matters.

2.2.1. External actions

As regards coordination in the field of external actions, particular priority was given to a case concerning the European Development Fund, owing to its financial scale, its multinational character and the fact that it involved several institutional donors.

2.2.2. Trade in agricultural produce

Two fields had priority as regards trade in agricultural produce. In one, it was decided to try to improve the control of evidence of arrival in Russia, in view of the problems noted at the time of certain investigations. Efforts were therefore made to set up a mutual assistance system between OLAF and the Russian customs.

In the second, there were many developments in the alcohol cases during the report period. Frauds are increasingly frequent owing to the weaknesses of the excise duties Regulations. The wide disparity in rates of taxation on alcohol between the countries of the south and the north makes fraud in this sector a highly attractive proposition.

2.2.3. Common agricultural policy: common organisation of the markets

The three main coordination actions in this field concerned milk on the animal side and flax and potato starch on the plant side. The Office coordinated the action of the Member States as regards control of milk quotas and highlighted the risks of irregularities in the management of the potato starch quotas.

2.2.4. Own resources

Regarding industrial and fishery products and drug precursors, priority was given to cases requiring action at the Community level and meeting one or more of the following criteria: high customs duties or combined customs and anti-dumping duties, threats to other Community policies, involvement of international groups aiming to corner markets by fraudulent practices, large-scale circumvention of commercial regulations or health protection measures.

Action especially concerned imports declared with a false preferential origin to evade the prohibition measures applicable to certain countries or to evade payment of anti-dumping duties, and imports with under-declared values or false descriptions with a view to reducing the customs duties payable, generally involving international groups dominating the world market and controlling production facilities and all or part of the import business.

With regard to textiles and shoes, priority was given to fraud in relation to preferential schemes, to circumventions of quantitative restrictions and antidumping duties, to removal of goods from transit schemes and to cases of undeclared value.

With regard to cigarettes, the emphasis was on information-gathering and on coordination with the Member States. Priority was given to strengthening relations with a number of countries of transit for cigarettes. A Community mission was also carried out to obtain convincing evidence in various files being dealt with, and other missions are planned in other non-member countries.

The action plan for indirect taxation concerns all the types of goods and services. However, attention was paid more particularly to cars, mobile telephones, electronic components and metals.

2.3. Priorities set over the period as regards administrative investigations

Administrative investigations have hitherto been the preferred operational technique for the Structural Funds, direct expenditure and by definition for internal cases. In agricultural matters, they are also used, in a more variable way, for the common organisation of markets.

2.3.1. Structural measures, direct expenditure and internal investigations

Within the unit responsible for structural measures, direct expenditure and the fight against corruption, priority in the opening of investigations was given to internal investigations, owing to their sensitivity. Internal investigations accordingly advanced more rapidly than other administrative investigations.

In the field of the Structural Funds, where part-financed operations are the common pattern, priority was given to cases with a major economic impact and those that are exemplary in one way or another.

In future, the possibility of developing coordination in the field of structural measures will have to be envisaged.

2.3.2. External actions

In the field of external actions, special attention was paid to the follow-up to investigations concerning humanitarian aid.

With regard to the PHARE programme of aid for the central and eastern European countries, close attention was paid to cases where there was clear evidence of serious irregularities.

2.3.3. Common agricultural policy

As in the case of coordinated measures, in addition to the alcohol cases, the Office had to concentrate on the whole range of agricultural exports to Russia, in particular because of the Russian customs' expectations as to

cooperation. Numerous administrative investigations were accordingly opened.

A second line of investigation regarding agricultural trade concerned frauds in dairy produce, both imported and exported. Major administrative investigations began. Some concern butter (carousel between the eastern European countries and the Community), on which the Court of Auditors also focused in the same period; others are concerned with milk proteins, where numerous problems arise as regards both tariff classification and health aspects (products used in animal feed).

Lastly, there was heavy emphasis on continuing investigations in relation to preferential schemes, with regard primarily to sugar from the overseas countries and territories and to preserved fruits and vegetables, in particular from Turkey.

As regards agricultural trade, fruit and vegetables and milk were the Office's prime concern with regard to the common organisation of markets. Investigations were commenced in the fields of processed tomatoes and fishery products, milk quotas and olive oil, on which a special report is due from the Court of Auditors. The Office continued its investigations.

3. RESULTS OBTAINED OVER THE PERIOD

In reference to the statistical assessment presented here, it goes without saying that the bulk of the results obtained are in cases opened before the report period.

Moreover, a preliminary comment is necessary: to have a better appreciation of the results obtained, the Office would wish to be better informed of the action that Member States and Community institutions and bodies take on its reports. For example, Article 49 of Regulation (EC) No 515/97 requires the Member States to "*transmit to the Commission administrative or legal decisions ... relating to the application of penalties for breaches of customs or agricultural legislation*", but this needs to be better organised between the Member States and the Commission.

Subject to this proviso, it is possible to give an account of the operational results of the Office from various angles.

3.1. Typology of frauds and other irregularities

The typology of the illegal activities encountered remains relatively stable over time.

3.1.1. Frauds relating to structural expenditure and direct expenditure, including external actions

Inspections reveal that frauds and irregularities were perpetrated by a variety of methods, among them:

- the ineligibility of expenditure financed,
- the absence of cofinancing,
- over-invoicing of unit prices, sometimes on a considerable scale,
- invoicing of supplies and services on the basis of unreliable supporting documents, or even false invoices,
- expenditure split into sub-components to escape the thresholds for tendering procedures,
- market-sharing agreements,
- favouritism,
- conflicts of interest,
- services not performed,
- embezzlement,
- corruption.

The fraud cases detected in this field often reveal forgery: false invoices, false expenditure statements, false signatures and so on. A new kind of case also began to appear: transmission of sensitive and protected information, akin to insider dealing.

3.1.2. *Frauds in relation to agricultural expenditure in the framework of the common organisation of markets*

The majority of frauds or irregularities here fall within in the following categories:

- processing:
 - over-declaration of quantity produced,
 - concealment of quantities produced in excess of quotas, thus circumventing them,
 - failure to comply with the minimum prices to be paid to the producers,
- storage:
 - over-declaration of quantity stored,
 - storage of products of substandard quality.

In addition, some of the more complex fraud mechanisms have been developed further in recent times. These involve both producers and industrial firms, and the national supervisory authorities need to be more closely involved: they are sometimes discouraged by the complexity of certain rules and regulations that come out of the Community decision-making process.

3.1.3. *Frauds connected with trade: own resources, agricultural trade*

a) Own resources

The principal categories of frauds or irregularities encountered here are:

- circumvention of the highest customs duties and of anti-dumping duties,
- circumvention of quantitative restrictions,
- counterfeit American or European cigarette brands, in particular from the People's Republic of China,
- trafficking in cigarettes imported from third countries,³⁰ and a very sharp increase in imports of cigarettes in containers, cleared with false declarations of type of goods,
- trafficking in cigarettes manufactured in Europe; cigarette consignments are dispatched in intra-Community trade with suspension of excise duties, and then either declared wrongfully as being intended for export or exported and finally smuggled back into the Community,
- false declarations of origin for the purpose of obtaining unlawful benefit of preferential schemes or of circumventing quota schemes,
- unlawful transit,
- under-declaration of value and incorrect tariff classification of the same products,
- carrousel techniques making it possible to evade payment of VAT.

b) Trade in agricultural produce

The typology of the main frauds or irregularities affecting trade in agricultural produce is similar to that observed in customs matters in general, namely:

- declaration of type of goods not in conformity with the tariff classification, in particular in the dairy sector (e.g. difference between casein and peptone),
- false declaration of origin, concerning numerous products benefiting from preferential schemes with the aim of evading payment of customs duties and circumventing quota measures (e.g. concentrated apples and tomatoes declared from Turkey but coming from Iran; Chinese garlic declared under various origins; sugar declared originating in the overseas countries and territories),
- false declarations of destination at the time of import in a third country of products with differentiated refunds, as it is very attractive to declare the highest-refund country as destination and provide false evidence of release on the market there,
- removal from the transit procedure and false clearance of accompanying documents, in particular for alcohol.

³⁰

This traffic involves misuses of transit procedures or illicit direct imports by sea via certain ports now identified.

These are the main types of frauds or irregularities detected over the period. Their inventory naturally does not exhaust the question of the results achieved by the Office. These consist in practice of reports transmitted to the relevant authorities and highlight major financial, administrative, disciplinary and judicial issues, which are considered in turn below.

3.2. Reports transmitted

As has been seen, a report by the Director of the Office is drawn up at the end of each investigation. The recommendations it contains distinguish, if necessary, the financial, administrative, disciplinary and judicial consequences. The documents underlying the conclusions are inventoried, indexed and annexed to the report. A report is drawn up even if the conclusion is that the investigation should be closed with no action.

This report is then sent to the competent authorities of the Member States or the Community institutions and bodies, as the case may require. Over the report period, as the table below shows, **67 reports were transmitted**.

	Structural Funds	Direct expenditure	External actions	Agricultural trade	Common organisation of agricultural markets	Own resources	Total
Reports sent to the competent authorities (*)	1 common investigation report		2	15	7	11	66
	2 investigation reports ³¹ 12 mission reports	11 investigation reports ³² 5 mission reports					
Reports sent to judicial authorities	2	7	2	-	-	4	15
Reports sent to disciplinary authorities	1	2 ³³	-	-	-	-	3
Reports recommending no action	0	- ³⁴	-	4	2	-	6

(*) National administrative and judicial authorities and the like, and Commission departments. *Not all are reports drawn up following a investigation.*

Reports are usually transmitted to the judicial authorities by the national administrative authorities to whom the Office addressed them.

³¹ Social Fund in the United Kingdom and Belgium; fisheries structural measures in Italy.

³² In particular in research and administrative expenditure.

³³ These two reports are also counted in the reports sent to the judicial authorities.

³⁴ In five direct expenditure cases, although the report was not formally transmitted, persons who had been informed that an investigation had been opened in accordance with the rules and procedures then in force were informed that it was being closed without action.

Secondly, it should be noted that reports recommending closure without action represent only a small proportion of the reports sent, which is a guarantee of efficiency. This bears out what was said above regarding the inevitably long duration of investigations. The Office does effective validation work before opening an administrative investigation; in the vast majority of cases, once an investigation has been opened, it will culminate in a recommendation for action.

3.3. Financial consequences

The Office endeavours to determine the financial loss on the occasion of each operation. The financial consequences of each file are calculated. The amounts may be estimated if the scale of the fraud remains to be defined with precision.

The scale of the amounts recorded as being in issue in OLAF files over the period, i.e. **more than €264 million at stake in aggregate**, without prejudice to amounts from previous years, gives an idea of the importance that should be attached to the fight against fraud against the Community's financial interests. The distribution of these amounts is variable from one sector of the budget to another. As explained above, transnational organised crime, which accounts for the bulk of the frauds which the Office is supposed to be combating, concentrates its attacks on certain fields.

Outstanding amounts (in € thousand)	Structural Funds, internal policies	External actions	Agricultural trade	Common organisation of agricultural markets	Own resources	Total
Determined ³⁵	n.a. ³⁶	35 617 ³⁷	24 241	-	114 510	174 368
Estimated		250	- ³⁸	13 400 ³⁹	76 500 ⁴⁰	90 150
Total		35 867	24 241	13 400	191 010 ⁴¹	264 518

³⁵ These amounts cover only the findings of missions carried out during the reference period.
³⁶ The total balance to be recovered in these sectors is € 360.5 million. But the Office does not have the means of sorting data that would make it possible to isolate the outstanding amounts confirmed or estimated over the reference period within this total.
³⁷ Of which € 28 million already refunded in the course of coordination and follow-up action.
³⁸ The five main excise duties files of 1999 are not entered here; they represent evaded taxes evaluated at € 759 million (including € 115 million of VAT). The evaluation of these amounts is somewhat rough and ready, as only the quantities of goods that disappeared (alcohol) are certain; on the other hand, the Member States whose excise duties are evaded, and therefore the applicable rates, remain unknown. Moreover, OLAF is never informed of the action taken on these files by the Member States.
³⁹ This amount does not include the amounts to be recovered from the Member States in the procedure for clearance of accounts, which is within the Commission's powers and can in some cases take several years.
⁴⁰ The relevant amounts concern only files for which the evidence of the impact of fraud and the identification of the debtors of the own resources evaded is sufficiently reliable.
⁴¹ Indirect taxation does not appear in this total. The outstanding amounts cannot be identified for lack either of information coming from the Member States or of means enabling OLAF to verify such data as was transmitted. However, by way of example, a file followed by the

The financial amounts in question may have to be recovered from the economic operator concerned, for example the recipient or the taxpayer (in the Member State), through the financial correction procedure. This can be undertaken via the procedure for clearance of accounts for expenditure or the recovery procedure for own resources. Anti-fraud strategy in this field is constant: the point is to see that the financial burden of fraud is borne as far as possible by the actual fraudsters, who must be prosecuted.

But the Office has no financial management powers, not even in relation to recovery in the event of irregularity. It cannot replace the Member States, who bear the primary responsibility, nor the authorising departments of the Commission. Fuller transmission of information to the Commission is provided for by the Community Regulations.⁴²

The Office has merely developed a selective and targeted monitoring system for its own needs, fed by its investigations and coordination activities. It includes, in all cases under investigation by OLAF, an examination of the possible liability of the Member State concerned by a failure to recover. The Office has more detailed information and more direct means of intervention if it has investigated the case itself or coordinated the Member States' investigations. Otherwise, it exploits whatever information has been transmitted to it and stored in its database.

3.4. Administrative consequences

Apart from recovery, a variety of measures can be taken in response to the operational report transmitted by the Office. The Office can, for example, update the black list of risk operators with respect to recipients of EAGGF Guarantee Section expenditure. National or, in the agricultural field, Community administrative penalties may also be available.

Although it is difficult to evaluate the impact with precision, the fact remains that OLAF contributes to:

- improving the internal procedures of the Community institutions and bodies, and in particular the Commission, in an ongoing process often involving other departments with horizontal powers (DG Audit, DG Budget, Legal Service, etc.),
- strengthening relations with Member States, in terms of irregularity reporting or of coordination of operational activities,

sector in 1998 represented an amount of €100 million. This involved a VAT fraud relating to mobile telephones.

⁴² Examples: in the common agricultural policy, the amounts actually recovered are reported by the Member States by the procedure of Article 3 of Regulation 595/91. In the field of own resources, the administrative and judicial procedures set in motion for the recovery of the amounts in question are reported under Regulation 1355/96, amending Regulation 1552/89. As regards structural policies, Regulations 1681/94 and 1831/94 (Cohesion Fund) organise the methods of reporting the information concerning the recovery of the unduly paid amounts.

- improving the Regulations, in particular for the sensitive sectors.

But the Office’s management report is not the place to deal at length with a subject which really belongs in the Commission annual report on fraud prevention, drawn up in cooperation with the Member States on the basis of Article 280 EC.

3.6. Judicial consequences

The Office has been informed of only a few judgments given on the substance of criminal or civil matters during the reference period as a result of its administrative investigations. This is hardly a surprising situation, given the time for cases to come to judgment. But the number of judicial decisions is likely to grow in the years ahead.

The Office receives only scant information from the national authorities in the Member States - *a fortiori* in non-member countries - regarding judicial decisions in response to its files. A special effort will have to be made to increase the Office’s ability to monitor and improve the information sent to it.

Within this framework, however, the Office cooperates on a continuous basis with the national judicial authorities by transmitting reports and documents obtained during external or internal investigations in situations where criminal proceedings are possible.⁴³

Moreover, OLAF investigators take part in the preparatory stage of the proceedings – in particular by providing technical assistance in the preparation and implementation of international letters rogatory – and in the actual court action as witnesses (cf. table below).

	Structural measures, direct expenditure	Agricultural trade	Common organisation of agricultural markets	Own resources	Total
Cases in which staff of the Office gave evidence in court	10	2	1	1	14
International letters rogatory in which staff of the Office took part	6	3	0	10	19

The judgments given against defendants in criminal and civil proceedings prompted by the Office’s investigations illustrate the value of its operational activity in terms of both deterrence and of enforcement.

⁴³ Article 10 of Regulations 1073/99 and 1074/99.

4. THE LIMITS ENCOUNTERED

These results are the fruit of continuous work, from UCLAF to OLAF. They testify to the effectiveness of and the need for the Office to fight against fraud and other irregularities to the detriment of the Community's financial interests.

But in its operational activity the Office encounters several types of obstacle. First of all, OLAF is limited by the human and financial resources and the legal means available to it. And OLAF has to improve cooperation with certain national authorities in the Member States and in non-member countries.

4.1. Limited operational manpower

The human resources available to the Office during the report period, with a staff of 139, were out of proportion to the existing potential for irregularities. The need for a multidisciplinary approach in the fight against organised and transnational fraud meant that staff had to be recruited on limited-duration temporary contracts from the relevant national authorities.

The results of the Office over the period were achieved in spite of the transitional period provoked by the reform of 1999 and of the reduction in operational manpower between the second quarter of 1999 and the first quarter of 2000 (cf. table below).⁴⁴

Total staff complement	Structural Funds and direct expenditure	External actions	Agricultural trade	Common organisation of agricultural markets	Own resources	Total
30.4.99	20	3	21	13	27	84
30.3.00	17	6	18	10	25 ⁴⁵	76
Variation	- 15%	+100%	- 14%	- 23%	- 7%	- 10%

4.2. Legal difficulties

The legal means available to the Office have been established on a new basis since 1 June 1999. But weaknesses remain in the Community legislation with respect to the risks of fraud and irregularities.

4.2.1. Horizontal legislation

The adoption of the new legislation connected with the establishment of OLAF, implemented since 1 June 1999,⁴⁶ was paradoxically a source of

⁴⁴ The additional staffing agreed to by the budgetary authority is detailed at point 1.1 of Title 3.

⁴⁵ Manpower dealing with requests from the Member States on VAT is equivalent to 1.2 full time.

difficulty insofar as, apart from the inevitable change of procedure, a number of ambiguities also appeared in the legislation. This legislation undeniably provides the basis for OLAF's independence, but it also imposes new procedural constraints.

In general terms, the Office is faced with the difficulty of familiarity with all the requirements imposed by the national procedures of the Member States.

Lastly, it is worth highlighting certain institutional difficulties concerning the rules for the application of the legislation concerning the Office, now pending in the European Court of Justice. The Office hopes that problems of interpretation will be confined to the current transitional period.

4.2.2. *Sectoral legislation*

The shortcomings and lack of uniformity of the Community sectoral anti-fraud legislation and the deficiencies in its application are particularly striking as regards trade in industrial and agricultural products.

In relation to textile products and shoes, for instance, the Office observes that the Regulations are on occasions incorrectly applied, that improvements are required in the area of import statistics at Community level and that procedural facilities are not always correctly used. The same applies to VAT.

Regarding the cigarette trade, the mutual assistance agreements do not cover all non-member countries and they do not provide systematically for judicial cooperation.

Another essential problem encountered by the Office concerns alcohol. The sectoral Regulations do not give OLAF a clear role in cooperation with the Member States as regards excise duties, which means that action by the Office is decidedly unpredictable. It would be desirable for the Regulations to be amended to make it possible for OLAF to play its coordination role to the full.

In the field of value-added tax, there is no clear legal basis establishing an incontestable framework for exchanges of information between the Office and the Member States. The value of the coordination that the Office can offer thus has to be demonstrated each time. As a result, the Office's limited human resources are distracted from their main operational functions.

One of the Office's general objectives is to make the Member States aware of their responsibilities and encourage them to develop their own controls. But the difficulties⁴⁷ and delays generated by the recovery procedure are perceived as a weakness in the accomplishment of this mission.

⁴⁶ Cf. Title 1.

⁴⁷ Attention should be drawn to the 24-month limit (preceding the date of the information letter sent to the Member State) on the period for flat-rate financial correction (Regulation 1287/95 on the financing of the common agricultural policy) and, in the field of the preferential

4.3. Improvements to cooperation with national authorities in the Member States

Cooperation with the Member States is the corner-stone of the fight against fraud in the Community. As has been seen, it generates substantial results that bear witness to its effectiveness.

But there are cases where this cooperation could be improved. The first two examples below are taken from the external actions field, the third concerns trade in agricultural produce and the last two concerns own resources.

In the first case, the judicial authorities to which a matter was referred were asked to act with due speed as required by Article 280 of the Treaty, following a recommendation by the Supervisory Committee.

In the second case, evidence of fraud was transmitted to two judicial authorities, both of whom have declined jurisdiction for more than eighteen months.

The third example concerns the application of Regulation 595/91 on irregularities in the financing of the common agricultural policy. In this case no precautionary measures had been taken to protect Community financial interests and no reports were made under Regulation 595/91 for eight years. It has been concluded that the Community budget cannot bear the burden of the amounts unduly received by the company.

In the fourth case, the work of the cigarettes Task Group would be speeded up by faster responses to the Office's requests for assistance from the Member States concerning customs warehouses, better use of the early warning system and more effective checks on customs and tax warehouses in the Member States.

In the last case, concerning indirect taxation (VAT), cooperation with prosecution services has sometimes been more effective than with certain national investigation services. In this field, the Office is sometimes faced with reluctance, on a scale varying from one Member State to another, as certain national authorities do not recognise OLAF's powers in this field.

These examples illustrate certain difficulties encountered in seeing that the proper judicial follow-up is given at national level in cases clearly identified by the Office.

4.4. Possible progress in cooperation with national authorities in non-member countries

The room for improvement in international cooperation is even more clearly apparent in the Community's relations with non-member countries, particularly in the customs and agricultural fields.

schemes, the absence of a time-limit for recoveries where a non-member country does not reply or replies only incompletely.

The main area where improvements might be made concern the implementation of cooperation agreements with non-member countries. Numerous requests for mutual administrative assistance are dealt with after long delays, in particular in customs matters, and this holds files up. The Office also runs up against deficiencies in administrative cooperation as regards preferential origin.

In the field of textile products and shoes, the under-utilisation of the budget set aside (TAFI⁴⁸) is regrettable.

Another area where improvements might be made is the well-known deficiencies of international legal cooperation in criminal matters. The example of Switzerland is significant, as slow transmission of the results of international letters rogatory has hitherto complicated the organisation of judicial proceedings. A future improvement in this area seems to be on the horizon. More generally the Office keenly hopes that progress will be made here, notably in the context of the current Intergovernmental Conference reviewing the Treaties.

5. DEVELOPMENTS IN METHODS USED

The Office has endeavoured to respond to these difficulties and improve the situation as far as its powers allow it to do so. It carries out a whole series of tasks which directly back up its operational activities. It takes part in training activities and maintains permanent contacts with:

- the judicial authorities directly concerned and the police authorities in the Member States, from the preparatory phase of the investigation to the follow-up phase,
- numerous administrative authorities in the Member States;
- all Commission departments, whether they are authorising officers for expenditure or responsible for horizontal functions (budget, financial control, Legal Service, etc.);
- the Court of Auditors and other institutions and bodies.

5.1. The Office's methods

5.1.1. Internal procedures

The entry into force of the new legislation concerning OLAF on 1 June 1999 led to a review of investigation procedures, as stated throughout this report. The period from 1 June to 29 February 2000 was a transitional period, at the end of which the implementation of Regulations 1073/99 and 1074/99 was formalised.

⁴⁸ Textile Antifraud Initiative, specific budget item (appropriations entered in the 1999 budget: €495 000, amount spent €81 000).

A sectoral risk analysis taking account of fraud mechanisms already known or suspected to exist in the field of the common organisation of the markets was also carried out.

5.1.2. Information processing and computer facilities

Fraud is by definition pursued on a clandestine basis. A specialised department therefore obviously needs to be able to assess whether the irregularities detected by investigation services generally constitute the bulk of the irregularities actually committed or just a small part. In that respect the Office cannot be content with the information received from traditional sources that point explicitly to an irregularity situation.

The objective must be to gradually extend the range of available information sources and to develop technical facilities giving access to open sources that can be scanned automatically so as to retain only new or directly relevant facts. The Office is currently paying special attention to information on business activities, trade statistics, accounting data on transactions financed by the Community budget and the results of relevant checks and inspections and audits by other departments and authorities. In particular it is counting on the cooperation of the Member States to pool the available information.

Several improvements have been or are being made. First and foremost, the database (IRENE) constitutes the Office's operational memory. It stores more than 1300 OLAF cases and 30 000 cases notified by the Member States. Its continuous improvement is necessary for the effective specific management of current files.

The new Intelligence Unit is also expected to constitute a valuable new support tool, particularly with regard to the gathering of information. The manpower of the intelligence and information technology units rose considerably between April 1999 and March 2000.

Since the beginning of 2000, the Office has had a direct link to the database (AGRI) relating to EAGGF Guarantee Section payments by the Member States. This should help to enhance risk analysis and target more precisely the investigations and coordination actions in relation to the common market organisations.

A sizeable proportion of the Office's work is taken up by coordination and information flows between the partners, with the specialised services of the Member States or non-member countries. The Office continued to develop and extend its dedicated secure network – the Anti-Fraud Information System (AFIS). The countries of central Europe are gradually being integrated into the system. Moreover, a specific module has been brought on line to exchange structured information on movements of non-commercial vessels.

Even so, the Office does not have all the detailed information available outside the context of the formal reporting obligations under the regulations, on matters such as the execution in accounting terms of indirect expenditure

managed by them, which represents around 80% of the Community's general budget.

5.1.3. *Communications policy*

The establishment of an independent Office in operational matters meant that a specific institutional communication scheme had to be set up to assist the media in their task of informing the public about the European Union.

The Director of the Office accordingly appointed a press officer to help the public understand, without oversimplifying them, the tasks of the new European Anti-fraud Office. He will operate in full transparency to give the general public full information. The only limits on this policy are those imposed by Community legislation, national laws on confidentiality of legal proceedings and respect for individual rights.

5.2. **Methods used with the Member States**

In the technical assistance context, the Office, acting on the basis of Article 280 of the EC Treaty as amended at Amsterdam, endeavours to provide the Member States with the assistance they need in their task of combating fraud against the Community's financial interests. This contribution is especially useful in technical respects, which is where efficiency demands in terms of compatibility of equipment are particularly important.

In partnership with the national administrations exercising powers in this field, a programme of technical assistance for investigations was therefore set up in 1995 on a cofinancing basis. Requests for subsidies presented by specialised services are for the acquisition of equipment selected by them, in accordance with certain Community compatibility requirements. The national administrations thus having received cofinancing in 1999 are indicated in an Annex.⁴⁹

In addition, following the discussions launched by UCLAF, regular cooperation between OLAF and the Italian National Antimafia Directorate,⁵⁰ mainly concerning the exchange of information, has been established in the light of Article 280 EC. This cooperation has already made it possible to dismantle certain international organised crime networks. It will also cover specialist training activities – the possibility of a Community financial contribution is being considered. This is the first experiment and is to be extended to other relevant national authorities.

5.3. **Methods used with non-member countries**

The Office endeavours to remedy the difficulties inherent in international cooperation by improving relations with non-member countries – which are

⁴⁹ Cf. Annex.

⁵⁰ Cf. European Commission, *Annual report 1998 concerning the protection of the financial interests of the Communities*, Chapter 4, item 4.1.

frequent in the field of external actions, agricultural trade and own resources – through a range of administrative agreements and arrangements.

5.3.1. *The need for technical assistance to non-member countries in the field of external actions*

The Office is in contact with the judicial authorities of a number of non-member countries facing practical difficulties when determining liability for confirmed frauds and the response of the criminal law. These difficulties reflect the paucity of the resources available to many examining judges in certain non-member countries enjoying financial support from the European Union.

In such cases it is clear that the possibility of technical assistance to the legal authorities of these countries to protect the Communities' financial interests would be worth studying.

5.3.2. *Stronger cooperation with Russia in agricultural trade*

The Office, in cooperation with the Russian authorities and the Member States, began work on a proposal for the adoption of a system of exchange of information with the Russian customs in order to give greater reliability to the documents certifying release on the market in Russia. An agreement is being negotiated with the Russian customs. It is hoped that it will be concluded and put in operation before the end of the second quarter of 2000, following negotiations conducted for nearly a year.

5.3.3. *The development of mutual assistance in customs matters*

In 1999, eight agreements or protocols on mutual assistance in customs matters entered into force, most of them between the European Community and certain countries of central Asia.

Several agreements between the Community and Asian countries relating to trade in textile products and shoes were negotiated and concluded and in some cases came into operation this year. These agreements contain provisions on administrative cooperation in cases of fraud and suspected or confirmed irregularities.

In the field of textile products, specific importance was attached to strengthening cooperation with certain exporting and transit countries, in particular in the Far East, and to the organisation of seminars on investigations and coordinated projects against fraud.

A mission in Ukraine provided an opportunity to develop valuable cooperation with the customs authorities and security forces with respect to cigarette trafficking. In particular, an information exchange system was set up; this has already made it possible to achieve concrete results such as the smuggling of cigarettes.

Lastly, cooperation methods were strengthened with other Commission departments concerned with frauds or irregularities in fisheries and industrial

products in order to develop synergies and rationalise the allocation of functions in the context of obligations imposed by the rules and regulations.

5.3.4. *Assistance for the installation of the Polish anti-fraud office*

The Office gave its full assistance to the establishment and operation of a new Polish service specifically responsible for the protection of the Community's financial interests. It will be OLAF's direct liaison contact where anti-fraud checks and inspections are to be organised with the Polish authorities. OLAF is delegated authorising officer for €3.4 million of PHARE appropriations to assist the Polish authorities in getting this service up and running.

TITLE 3 : ELEMENTS FOR A NEW OPERATIONAL APPROACH

The establishment of the European Office entails a new operational approach. This is now based on enhanced and reorganised resources (1). The aim is especially to prioritise the Office's activity in full knowledge of the facts (2). It presupposes improvements to the existing legal framework (3).

1. THE RESTRUCTURING OF THE EUROPEAN ANTI-FRAUD OFFICE

The limits in terms of human resources facing the Office should be relaxed soon. The budgetary posts allotted to it should rise to 300 in 2001. The Director of the Office, who is now the appointing authority, can operate a staff policy adapted to the needs and priorities of the Office. And a new multidisciplinary, flexible and decompartmentalised organisation is being studied so that OLAF can cope with its potential for activity, reflecting the priorities that it will have set quite independently.

1.1. The strengthening of resources

The establishment of the Office gives concrete expression to the political will of the Member States and of the institutions. They are to work together in setting it up and making a success of it. The Office must accordingly, as requested by the Cologne European Council of 3 and 4 June 1999, be given the financial resources and manpower it needs to perform its tasks. In December 1999, the Council and the European Parliament decided to strengthen the Office by allocating 75 new posts in the budget of the European Union for 2000. The plan is to pursue this effort so as to reach a manpower target of 300 in 2002.

The Office, which is attached administratively to the Commission, is independent in the conduct of its operational activities. Concerning the management of human resources, its Director has the power to recruit and appoint staff. In accordance with the decision of 28 April 1999, he lays down the terms and procedures for recruitment, in particular those relating to the duration and renewal of contracts. This new power provides him in particular with the opportunity to organise the selection of temporary staff. This approach, regularly called for by the budgetary authority, is likely to reconcile the need for permanent updating of external expertise with the acquisition of a durable internal experience.

Moreover, the Office is henceforth clearly identified in the general budget of the European Union. Its Director prepares and in good time provides the Commission with a preliminary draft budget which includes staff costs, operational costs – including buildings and IT equipment – and expenditure on the exercise of the operational and anti-fraud tasks. He is the authorising officer for anti-fraud budget headings.

1.2. Reorganisation

The restructuring of the Office, which was essential in the run-up to the increase in manpower, is primarily intended to staff it with versatile investigators, brought together in a single operational structure. They will work in close conjunction with the Intelligence interface and a strengthened Policy and Legislation pole, responsible specifically for translating observations on the ground into legislative activity. The intelligence function that is already being developed will now guide the development of priorities and operational strategy.

1.2.1. Strategic monitoring

The accent will be on the Office's ability to gather and evaluate information targeted on the protection of the Communities' interests in general and its financial interests in particular. The Director of the Office will devise operational strategy in conjunction with the Intelligence Unit and the operational units.

The task of the Intelligence service will be to take the initiative of gathering and actively analysing information on the economic and criminal environment of Community activities. On this basis, it will prepare the investigators' work programme. For that purpose, the Office will set up an economic and criminal monitoring unit to support the intelligence function. It will be responsible for directing field work and will offer its services to the Member States' corresponding units.

1.2.2. Versatile investigators

Investigation expertise should naturally be sought in the Member States' national services, which have the requisite manpower in terms of number and qualification. The former UCLAF always recruited investigation specialists in this way. OLAF will proceed likewise, with the aim of forming a pool of versatile investigators who can be used to build up multidisciplinary teams.

In the establishment of these multidisciplinary teams, expertise will be matched to operational priorities. They will then be in a position to facilitate the detection of infringements with the relevant national and Community authorities and to match investigations with the requisite follow-up measures, thanks in particular to closer coordination with the Member States' authorities.

1.2.3. Monitoring the legal quality of operational work

Coordination between the operational and the policy and legislation poles will be ensured when investigation and cooperation projects are prepared and followed up, both administratively and financially.

The follow-up function has to be separated from the investigation and coordination functions, and serious resources must be allocated to it. Legal quality control of operational work will be carried out in cooperation with a

team of specialists in general and criminal law set up to evaluate administrative investigation methods and to monitor the results obtained in terms of both national and Community legislation.

2. SETTING MORE PRECISELY TARGETED PRIORITIES

Strengthening resources, reorganising, clarifying the legal bases: each of these developments should help the Office redirect its activities according to better targeted priorities.

The Office must henceforth define its operational strategy – its fields of action and its priority methods – proactively, according to the information that it will have gathered, shared with the Member States and analysed thanks to its Intelligence service.

Its priorities will also better reflect the activities of the Member States. The value added by the Office lies first and foremost in the possibility of coordinating the action undertaken by the national authorities. In the future, coordination and assistance activity should be developed in all fields – own resources or indirect expenditure, including structural measures.

It must be stressed that the operational strategy of the Office will be updated permanently. Investigations must keep pace with fraud. It is precisely this mobility that the Office must acquire through a new versatile, multidisciplinary organisation. The dissuasive effect of its action will be all the stronger as a result.

3. IMPROVING THE LEGAL FRAMEWORK

3.1. At the investigation stage

Concerning first of all the horizontal legislation applicable to on-the-spot checks and inspections, the conclusions of the Commission Report on the application of Regulation No 2185/96 and the ensuing debate with the Member States may prompt the Office to consider whether there should be a Commission proposal to improve and reinforce the legislation. It may well be found necessary to clarify and improve the regulation.

As regards the sectoral legislation, the gaps and inconsistencies in the various legal bases for on-the-spot controls have already been stressed,⁵¹ in particular with regard to trade in industrial and agricultural products. These bases could gain in terms of legal certainty and user-friendliness if they were brought within a horizontal regulation. The Office would then conduct investigations only on the basis of Regulation No 2185/96 or of a new horizontal regulation incorporating all the current sectoral bases, in a spirit of cooperation with the Member States.

⁵¹ Point 4.2.2, *supra*.

The aim will at the same time be to consider ways and means of improving the legislative framework for assistance and coordination. With this in mind, thought might be given in particular to broadening the mutual assistance mechanisms beyond own resources and agricultural trade to other fields such as taxation or the fight against counterfeiting.

3.2. The follow-up phase

3.2.1. Administrative and financial consequences (recovery)

Firstly, regarding the information available to the Office, transmission to the Commission by the Member States of administrative and judicial decisions imposing penalties for infringement of customs and agricultural regulations needs to be organised better.⁵² The obligation to report such information should also be extended to the different fields affected by fraud and other illegal activity.

Secondly, administrative penalty rules need amplifying. Community administrative penalties should be extended to other financial interests on the basis of what the agricultural regulations provide for. The relevant points of the Commission's 1998/99 anti-fraud work programme deserve to be implemented.

Hitherto the Office had no powers as regards recovery in the event of irregularity,⁵³ but the White Paper on the reform of the Commission seeks to improve coordination between the European Anti-fraud Office and other Commission departments and closer involvement of OLAF in the fraud-proofing of legislation and in the rules governing tendering and contract management.

To make the current system of fraud prevention more effective, Commission departments proposing new legislation likely to affect the Community budget would be required to submit proposals to the Office in advance for risk evaluation. OLAF could also offer advice on fraud prevention at all stages of the legislative process.

3.2.2. Cooperation with judicial authorities

The question of the effectiveness of the judicial response to the Office's operational activity is more and more acute. There are fifteen different systems of criminal law, and it is difficult or even impossible to enforce the principle of effective and equivalent protection of the Community's financial interests in the Member States as required by the Treaty (Article 280 EC). The Office's operational activity reveals new fraud and irregularity techniques, such as the transmission of sensitive and protected information, akin to insider dealing. Yet illegal activities are not always treated in the same way by the laws of all the Member States. And the strict construction

⁵² Article 49 of Regulation (EC) No 515/97 referred to above.
⁵³ Point 3.3, *supra*.

principle applies in the criminal law. Differences between Member States are not compatible with need for rigorous application.

The Office will accordingly organise itself in such a way as to offer the enforcement authorities the assistance they need to boost the effectiveness of national checks and inspections and to improve cooperation and coordination between judicial authorities in the Member States in accordance with their obligations under Article 280 of the EC Treaty and the second Protocol to the Convention for the protection of financial interests. It might therefore be worth considering the possibility of defining all the possible offences against the Community's financial interests, irrespective of the implementation measures taken by Member States, along with penalties also defined at Community level.

3.3. Beyond the protection of financial interests

There are areas in which there is a need for protection of the Community's interests in which, in the absence of a specific legal basis, the Office's role is called into question by the Member States, even though the results accrue for their benefit. This kind of situation means that choices will have to be made.

3.3.1. Indirect taxation

Given the experience acquired by the Office in indirect taxation matters (see above), there needs to be a clear legal basis for this activity if it is to be continued. It has already proved its usefulness.⁵⁴

First of all, it has generated awareness in national investigation services of the seriousness and scale of value-added tax fraud and consequently of the usefulness of Community cooperation to combat it. The fact that the Member States have set up an ad hoc Council working party is certainly related to this. It is true that certain national authorities officially express doubts as to the role of OLAF here, but their investigators and courts do not hesitate to submit fraud cases to the Office so as to enjoy the cooperation that it organises.

Similarly, in the alcohol cases, action undertaken by the Office yielded significant operational results. This raises the question whether its role should be acknowledged by all the Member States.

Yet OLAF action benefits national resources – exclusively in the case of alcohol. The time has therefore come for the legislature to clarify the role of the Office: if the Office is expected to make a contribution, an explicit legal basis should be established for it.

3.3.2. Counterfeiting

The fight against counterfeit industrial and agricultural products is part of the protection of the Community's economic interests. Here, the Office can

⁵⁴ Points 3.4 et 4.2.2, *supra*.

coordinate national operational activity. It notes that the Member States place great expectations at the highest level, though in practice there is some reluctance by the national administrations to work together on specific cases.

Hence political consensus on the allocation of resources is a precondition for the development of coordinated action against counterfeiting.

3.3.3. *Euro counterfeiting*

The introduction of the new currency in 1999 and of euro notes and coins in 2002 will greatly extend the shared assets of the citizens of Europe. The fight against euro counterfeiting will be a major concern in the protection of the Community's financial interests. The Commission communication of 22 July 1998⁵⁵ gives the Office the task of preparing an overall approach to the protection of the single currency against counterfeiting. The Office has worked with experts from the Member States, the European Central Bank and Europol on identifying needs here: apart from purely technical protection, they embrace the exchange of operational and strategic information, cooperation with the Member States and non-member countries, etc. The Office has also begun running training measures.

In the future, strategic and operational protection will have to be shared between the Office and Europol, whose remit has been broadened to include euro counterfeiting.

⁵⁵

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ANNEX

National administrations of the Member States having benefited from the technical assistance programme for investigations in 1999⁵⁶

<i>Country</i>	<i>Administrations</i>
Germany	Customs
Germany	Border police
Finland	Customs
Finland	Police
France	Criminal Investigation police
France	Gendarmerie
Greece	Police
GB	Customs
Luxembourg	Police
Portugal	Revenue Police

Other national administrations, of course, also benefited from the programme in earlier years.

⁵⁶ The budgetary year serves necessarily here as a reference period.