



**REPORT OF THE EUROPEAN ANTI-FRAUD OFFICE**  
**Fifth Activity Report for the year ending June 2004**

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## **Foreword by the Director of OLAF, Franz-Herman Brüner**

This is my fifth Annual Report on the operational activities of the European Anti-Fraud Office (OLAF). It covers the 12 months to the end of June 2004. It also marks the first five years since the Office's creation on 1 June 1999.

The working culture which OLAF inherited from UCLAF was based on the traditional disciplines – shared between the Commission and the Member States - of customs operations and of verification in the largest sectors of Community expenditure, namely agriculture and the structural funds. These remain important activities for OLAF. Notably, OLAF's actions played a key role in the reaching by the Community and certain Member States of a landmark Anti-Contraband and Anti-Counterfeit Agreement with the cigarette manufacturer Philip Morris in July 2004. \$1.25 billion will be paid over the next 12 years to the Community and to those Member States which participated in this Agreement. This sum would cover the costs of running OLAF for many years.

However, the overall balance of the Office's activities has shifted to those areas of the Community budget where the Commission administers expenditure directly. Much of these are at high risk of fraud. OLAF intervention can have an immediate impact, for example to deter fraudulent aid requests to several donors in respect of the same project. As additional investigative resources have become available, these have been allocated to protecting direct expenditure, in line with OLAF's strategic risk assessment and with the political priority attributed to the fight against corruption within the Institutions.

The complex set of investigations into the "Eurostat" affair has made steady progress. A number of dossiers are under investigation by national judicial authorities. OLAF is providing assistance where requested. I would expect visible results within months.

Evidence of the wider interest now being taken in OLAF's activities is the Report by the British House of Lords which was published in July.

OLAF's task is to fight fraud and corruption in complete independence. An anti-fraud organisation does not require or seek popularity. Rather, it needs to earn respect through the quality of its work, through its results, and by demonstrating integrity and an ability to take the right decisions under pressure.

Judgements of the Court of Justice of the European Communities and orders of the Court of First Instance during the year have demonstrated that OLAF's investigative activities are subject to effective judicial oversight. This case-law has clarified the respective roles of OLAF, of national judicial authorities, and – in relation to EU staff – of the disciplinary authorities of EU Institutions. This case-law does not substantiate the assertions sometimes made that OLAF does not respect the rights of individuals. Without seeking to anticipate any future findings in proceedings which may currently be underway, it is fair to point out that no Court decision has yet found that OLAF fails to respect such rights.

I am pleased to say that OLAF's independent operational activities have always received firm support from the Commission, and to emphasise that the Commission has never sought to interfere with my operational independence in any way. I would pay particular tribute to the outgoing Commissioner responsible for anti-fraud policy, Dr Michaele Schreyer, whose personal support has been a great comfort. During the year, routine

communications between OLAF and the Commission have been improved through coordination meetings at Director General level. These regular contacts have respected OLAF's independence and reinforced its effectiveness because they have built up mutual trust and confidence.

OLAF has faced a steep learning curve in its core business of investigating and deterring fraud. If anything, OLAF has faced a greater challenge in learning to operate within the context of the EU Institutions.

Less obvious, perhaps, the European Institutions have also faced something of a challenge in adapting to the existence of OLAF. This is partly because of OLAF's special status as a Commission service with independent investigative powers which also extend to other Institutions. It is also because some of the matters with which OLAF deals operationally have previously been handled almost exclusively at national level.

Operational services must take difficult decisions, often with consequences for individuals, always in strict respect of the law: in OLAF's case, of both European law and of relevant national law. On occasion, OLAF's decisions to open investigations – or to refrain from opening investigations – have exposed OLAF's stakeholders in the EU Institutions to issues which those Institutions have seldom had to address. Breaking new ground requires a clear strategy and can be a painful process.

The climate within which OLAF operates among the European Institutions has not therefore always been easy. Some concepts which are long established at national level are not yet fully transposed at European level. In particular, there is sometimes reluctance to accept the consequences of the principle of the secrecy of the investigative process and of the primacy of judicial proceedings over other considerations.

While the presumption of innocence is fundamental, it need not lead to the assumption that the investigating authority must be abusing its powers simply because the person under investigation so alleges. Equally, it is not OLAF's role, after reasonable scrutiny of the facts, to pursue further the unfounded complaints of nationals of one Member State against the authorities of another Member State simply because the complainants prefer lobbying in Brussels to taking legal proceedings in the competent national courts and because some of OLAF's Brussels interlocutors misunderstand this lobbying as potentially relevant for their own purposes.

The historic enlargement of the European Union to include another ten Member States took place near the end of the period covered by this Report. OLAF already has close links to the new Member States. My staff and I will now have the privilege and the pleasure of working closely with a European Commissioner and with a Chairman of the Budgetary Control Committee of the European Parliament who are both from new Member States.

Finally, I would like to thank all OLAF staff, past and present. Without their professionalism, determination and hard work, often under stress and occasionally in conditions of hardship, the achievements recorded here would not have been possible.



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## Executive Summary

- OLAF's Investigations and Operations Executive Board took almost 1200 decisions during the current reporting period (1 July 2003-31 June 2004) covering all OLAF sectors.
- The total number of new case records registered in OLAF's Case Management System increased by 9% (from 585<sup>1</sup> to 637). This change could be interpreted as an increasing confidence in the work and professionalism of the Office.
- OLAF concluded 578 initial assessments. 275 of these resulted in the opening of cases. A further 272 did not fall within the competence of OLAF or did not warrant investigative action. Where possible, relevant information was forwarded to the appropriate authorities. 31 cases were retained for further monitoring.
- 443 cases were closed during the reporting period, of which 209 required further follow-up.
- Cases in follow-up increased from 477 to 623 cases by the end of the reporting period. In relative terms, the most significant increases are in agriculture, direct expenditure and external aid.
- At the end of the current reporting period 182 case records registered in the CMS were in the assessment stage, 511 cases were active (i.e. internal/external investigations, assistance or coordination cases) and 623 were in follow-up. Follow-up was concluded for 87 cases, 40 of which are UCLAF cases.
- At the end of the current reporting period the CMS stored a total of 3992 case records; this number includes 1423 cases inherited from OLAF's predecessor UCLAF. The remaining 2569 records relate to cases created following information received by OLAF between 1 June 1999 and 30 June 2004.
- Operational work was completed for all but 7 UCLAF cases. However, follow-up activities related to UCLAF cases continue to take up considerable resources, both for financial and judicial follow-up. At the end of the current reporting period, 282 UCLAF cases were still in follow-up.
- The total estimated financial impact for all cases in financial follow-up at the end of the reporting period amounted to more than €1.5 billion.
- OLAF maintained the policy of "zero tolerance", assessing and where appropriate, investigating all allegations of corruption within the European Institutions.
- During the reporting period OLAF conducted internal investigations in the majority of the European Community organs<sup>2</sup>, with 81 new case records registered in the CMS and 24 new investigations opened.
- The revised, comprehensive OLAF Manual took effect on 1 August 2003.
- Further improvements were made to OLAF's Case Management System (CMS): to enhance the management reporting of follow-up activities: encompassing

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<sup>1</sup> Numbers referring to earlier years may deviate slightly from those reported last year due to data revision.

<sup>2</sup> Institutions, bodies, offices and agencies.

administrative, financial, legislative follow-up as well as judicial and disciplinary follow up; new reporting tools have been developed.

- Intelligence support to operational staff is managed through a new request module within the CMS.
- The Investigations and Operations Directorate was re-organised: a new unit for Multi-Agency investigations was created, and the former Direct Expenditure and External Aid Unit was divided into 2 units aimed at reinforcing investigation activity in the area of direct expenditure, both within the EU and in external aid. These cases can involve both internal investigations within the Institutions and external investigations in the recipient countries.
- The new Eurostat Task Force created in July 2003 dealt with 14 cases: 4 external and 10 internal, 9 of which are still ongoing. It completed 5 final reports, currently at the follow-up stage, 2 of which were forwarded to the judicial authorities in Luxembourg and 3 to the judicial authorities in France. Additionally, 4 of these completed cases were recommended for financial recovery procedures; three of these were also recommended for possible disciplinary action.
- OLAF continued its participation with DG AGRI in the Task Force Recovery established by the Commission to eliminate the backlog of accumulated agricultural (EAGGF Guarantee) debts. The Task Force finalised the on-the-spot audits in the Member States of cases with an individual financial impact higher than €500 000, as notified by the Member States before 1999. These cases represented initially a global financial impact of more than €1 billion.
- A Memorandum of Understanding was signed between OLAF and Europol setting out arrangements for operational cooperation.
- The Office experienced a significant increase in requests for access to documents (55 requests including 11 confirmatory requests), complaints made to the Ombudsman involving the Office (9 in total) and Parliamentary questions concerning OLAF (127 written and 7 oral questions).
- Public interest in the work of OLAF, as measured by the number of website hits, increased by 140% to more than 3.6 million during this year.

# **Mission Statement**

## **OLAF's Objectives**

The mission of the European Anti-Fraud Office (OLAF) is to protect the financial interests of the European Union, to fight fraud, corruption and any other illegal activity, including misconduct within the European Institutions that has financial consequences. In pursuing this mission in an accountable, transparent and cost-effective manner, OLAF aims to provide a quality service to the citizens of Europe.

## **OLAF's Methods and Means**

The European Anti-Fraud Office achieves its mission by conducting, in full independence, internal and external investigations. It also organises close and regular cooperation between the competent authorities of the Member States, in order to coordinate their activities. OLAF supplies Member States, Candidate Countries and third countries with the necessary support and multidisciplinary technical know-how to help them in their anti-fraud activities, and cooperates closely with international organisations with parallel interests. It contributes to the design of the anti-fraud strategy of the European Union and takes the necessary initiatives to strengthen the relevant legislation.

## **OLAF's Principles**

The Office's activities will be carried out with integrity, impartiality and professionalism, and will, at all times, respect the rights and freedoms of individuals and be fully consistent with the law.

## 1. INTRODUCTION

To mark the first five years since the Office's creation on 1 June 1999, this year's Activity Report exceptionally includes, in Chapter 2, a statistical overview of OLAF's operational activities together with its UCLAF legacy, covering the period from July 1999 until the end of this reporting period 30 June 2004. Paragraph 2.2 and beyond charts progress within the established annual reporting period 1 July 2003 until 30 June 2004. The data in this report is primarily compiled from OLAF's Case Management System (CMS).

Reference to "case" in this report includes each unique case record registered in the CMS which undergoes three major stages of processing: assessment, active stage (opening cases and proceeding with internal and or external investigation, co-ordination, assistance) and follow-up (including monitoring). More detailed definitions as described in the OLAF manual are annexed to this report.

Care is needed when drawing conclusions from statistics as quantity does not reflect time and resources expended, nor indications of quality of outcomes achieved. Likewise the statistics cannot quantify the preventive and deterrent value of OLAF's work in combating fraud.

### 1.1. The Main Competencies of OLAF

OLAF's Mission statement summarises the objectives of OLAF: to protect the financial interests of the European Union, to fight fraud, corruption and any other illegal activity, including misconduct within the European Institutions that has financial consequences. OLAF responsibility also involves, over and above the protection of financial interests, certain activities linked with the protection of Community interests from irregular acts likely to lead to administrative or penal proceedings (such as the protection of the euro against counterfeiting). It aims to pursue this mission in an accountable, transparent and cost-effective manner and achieves its mission by conducting, in full independence, internal and external investigations. It contributes to the design of the anti-fraud strategy of the European Union and takes the necessary initiatives to prepare and strengthen the relevant legislation, in the areas of activity of OLAF, including instruments which fall under Title VI of the Treaty on European Union.

OLAF is formally part of the Commission, enabling it to exercise Commission powers, but it is endowed with budgetary and administrative autonomy, designed to make it operationally independent. The legal framework includes two structures to reinforce OLAF's operational independence: guarantees associated with the post of OLAF's Director General, and the existence and powers of the Supervisory Committee

#### *Legal Basis*

The Community legal framework for the fight against fraud consists of provisions of the EC Treaty and several instruments of secondary law. OLAF was created and operates on the basis of these instruments: Primary law consists of Article 280 of the EC Treaty which establishes the legal basis for Community action against fraud. In addition, Article 274

establishes that the Commission is responsible for the implementation of the Community budget.

Secondary law includes Commission Decision 1999/352/EC/ECSC/Euratom which creates OLAF, and delegates to OLAF the Commission's powers to execute all operational activities relating to safeguarding Community interests against irregular conduct liable to result in administrative or criminal proceedings. Specifically, this Decision empowers OLAF to conduct internal (Community institutions, bodies, offices and agencies) and external (economic operators in the Member States) administrative investigations to detect fraud, corruption, and other illegal activities against the Community's financial interests, and to carry out investigative assignments in other areas at the request of Community institutions. In addition, it empowers OLAF to cooperate with the Member States in the field of fraud prevention; to prepare legislative initiatives in this field; to give technical support, in particular in the area of training, to the other Community institutions or bodies as well as to the competent Member State authorities; to maintain direct contact with national police and judicial authorities; to represent the Commission in the forums concerned.

EP/Council Regulation (EC) 1073/1999 and Council Regulation (Euratom) 1074/1999, confer on OLAF powers to conduct internal investigations and all of the Commission's powers to conduct external investigations. It provides that OLAF must conduct investigations with full respect for human rights and fundamental freedoms, including the principle of fairness, the rights of persons involved to express their views on the facts concerning them, and the principle that conclusions of an investigation may be based solely on elements that have evidential value. These Regulations provide that OLAF shall exercise the powers of the Commission in order to step up the fight against fraud, corruption and any other illegal activities detrimental to the Communities' financial interests.

OLAF conducts administrative investigations within the Community institutions, bodies, offices and agencies in conformity with EP/Council Regulation (EC) 1073/1999 and Council Regulation (Euratom) 1074/1999, concerning investigations conducted by OLAF. These Regulations specify that OLAF is also charged with investigating serious matters relating to the discharge of professional duties.

Other legislation applies such as Council Regulation (Euratom, EC) 2185/96 which empowers the Commission to conduct on-the-spot external investigations on the premises of economic operators who may have been involved in, or concerned by, an irregularity, when "there are reasons to think that irregularities have been committed," and when (1) they involve economic operators acting in several Member States, (2) the situation in a Member State requires such a check to be strengthened in a case, or (3) at the request of a Member State.

OLAF's powers and tasks are in three main areas: investigations and coordination, intelligence, and development of anti-fraud policy. While OLAF is empowered to conduct internal and external administrative investigations, it may also perform the coordination function by conducting assistance cases, coordination cases, and monitoring cases.

OLAF places priority on the development of effective cooperation with the Member States, in order to coordinate their activities. It offers assistance in conducting

investigations by providing them with information gathered at Community level, and coordinates operational actions of the national authorities in transnational cases. It maintains direct contact with national judicial, police, and administrative authorities. OLAF has established the Anti-Fraud Information Systems (AFIS), a secure network for corresponding with the Member States and providing mutual assistance.

It supplies Member States, Candidate Countries and third countries with the necessary support and multidisciplinary technical know-how to help them in their anti-fraud activities, and provides assistance with respect to specific operations, strategic analysis and risk assessment in order to target resources at the areas of greatest risk. In order to further arrangements for cooperation with new Member States and Candidate Countries an operationally independent Anti-Fraud Coordination Service ("AFCOS") has been established with responsibilities for both legislative and operational matters. OLAF cooperates closely with international organisations with parallel interests.

In addition to the three main functions, OLAF is responsible for a number of other activities, including implementation of Community legislation designed to ensure a coordinated approach within the EU and to assist the Member States in their investigations with regard to trade in sensitive products, mutual administrative assistance on customs and agriculture matters among the Member States, between the latter and OLAF and between the EU and third countries, management of the Customs Information System (CIS), and follow-up of the results of OLAF investigations and recovery in the field of direct expenditure following an OLAF investigation, including civil actions in national courts.

## **1.2. The OLAF Manual**

The internal rules of OLAF are set out in the OLAF Manual, which was adopted by a Decision of the Director General in 2001. Experience and feedback from within the Office in using the criteria set out in the original version of the manual have helped fine-tune it to a professional standard for the conduct of administrative investigations at an international level. The second revised and comprehensive version of the OLAF Manual came into effect on 1 August 2003. As a living document, it is available to staff in an electronic version. Printed copies are circulated at regular intervals. For easier reference, the third version to be produced by the end of 2004 will include a summary of the main procedural requirements of the Manual and of the rights of persons concerned.

The Manual provides OLAF staff with the following guidance:

- Title I. Presentation of OLAF: this provides an overview of OLAF's legal and administrative framework, with emphasis on specific administrative issues.
- Title II. Operational working instructions: this sets out the operational priorities of the Office and outlines the casework procedures to be followed from assessment through to final case closure. A specific section regulates OLAF's approach on respect for the rights of concerned parties, with particular emphasis on the conduct of interviews.
- Title III. Information management: this sets out the procedures relating to internal and external communications, with emphasis on document access issues and information security policy.

- Five Annexes contain standardised forms, notes and letters in use on a daily basis; these are available to investigators electronically through the Case Management System (CMS).

Although this is an internal document, an important issue in the fight against fraud is the establishment of uniform standards for administrative investigations, and for this reason the Manual has been circulated amongst OLAF's international partners, such as the UN, OECD and the World Bank, and has received a positive response.

### **1.3. The Case Management System (CMS)**

The CMS is OLAF's database containing all information on new, on-going and closed operational activities. It enables authorised personnel to track the progress of cases at all times during their lifecycle.

Initial information received by OLAF is registered as a unique case record in the CMS and undergoes three major stages of processing: assessment, investigation and follow-up. The initial assessment period runs from receipt of the initial information to the decision whether or not to open the case. This latter decision making process is explained in paragraph 1.4. The assessment procedure allows for OLAF's competent operational units to evaluate the veracity of the information and to produce reliable and transparent assessments using OLAF's information, intelligence, legal and judicial support capabilities where appropriate. The duration of the assessment varies, but overall OLAF has gradually succeeded in reducing the assessment period while producing more thorough assessments.

As the CMS is the primary source of OLAF operational statistics this reporting period has seen a considerable advance in developing and introducing new reporting tools to give managers greater flexibility in extracting relevant data. A new follow-up module was implemented in autumn 2003 to centralise data collection and maintenance of information relating to all types of follow-up. At the beginning of 2004 a new intelligence request module was introduced to facilitate the flow of information between the operational and intelligence domains, and to manage requests for intelligence support.

The success of these integrated technical improvements has led to further demand from other operational support areas. As a result CMS modules are currently being developed to support the work of the weekly Investigations and Operations Executive Board; to allow closer links between Mutual Assistance requests and OLAF investigations; and to record internal requests for legal advice. Ultimately, a full text search module on all operational documents will be developed to enhance intelligence support.

### **1.4. The Investigations and Operations Executive Board**

The Investigations and Operations Executive Board meets on a weekly basis to provide opinions to assist the Director General in taking decisions relating to the treatment of cases. These decisions concentrate on each new major stage of the lifecycle of cases: opening cases; non-cases; changing case types; closing cases; opening new follow-up paths; closing follow-up. The Board consists of representatives from each Directorate and their respective units thereby ensuring a cohesive formal approach to each decision. The Board continues to be consulted for each new major stage of the lifecycle of the case and

where relevant keeps abreast of the external investigative, judicial and associated case partners.

Once a case has been opened and the operational activity has been completed in accordance with specific formal procedures and approved by the Board, the case moves to the follow-up stage<sup>3</sup>. Follow-up includes various activities designed to ensure that the competent Community and national authorities have carried out the administrative, financial, legislative, judicial and disciplinary measures recommended by OLAF. Once all measures have been taken and the follow-up of the case has been completed, the follow-up case is formally closed and any associated organs<sup>4</sup> or other parties are informed of the outcome.

If it is decided that there is no need to open a case, for whatever reason, then the case will be classed either as a monitoring case or a non-case. Where a national authority is better suited to investigate a particular matter, but where the information is deemed sufficiently interesting, for example for fraud proofing, OLAF may wish to follow-up on the matter and will designate this as a monitoring case.

As an exception to the formal Board procedure described, it was decided towards the end of the current reporting period to introduce a new category entitled “Non-Case Prima Facie”. This relates to initial information that clearly does not relate to factors within OLAF’s competence and can be closed as a Non-Case Prima Facie without the Board’s formal procedure. For reasons of accountability and transparency, however, these cases are stored in the CMS.

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<sup>3</sup> In some circumstances follow-up activities may take place before the formal closure of the investigation stage.

<sup>4</sup> Institutions, bodies, offices and agencies

## **2. OPERATIONAL ACTIVITIES**

### **2.1. Overview of OLAF's first five years**

The major trends of the first 5 years of OLAF can be summarized as follows:

- OLAF has drastically reduced the duration of the assessment phase of initial information since the 2000-2001 reporting period, from an average of 18 months for a total of 484 assessments to an average of 5 months for a total of 661 assessments.
- Applying stricter assessment procedures to incoming information has helped the Office to focus on the most relevant cases. While in 1999 initial information led in all cases to opening a case, this number has been steadily reduced over the years to less than 50% for the current reporting period.
- OLAF has also reduced the duration of the active stage of cases. In many instances, this is partly dependent on the prompt cooperation of national authorities, but nevertheless, since the peak in the 2001-2002 reporting period, the investigation phase has been reduced from an average of 33 months to an average of 22 months.
- At the same time the percentage of cases that were closed with a follow-up recommendation increased from 18% in 1999-2000 to just above 50% in the current reporting period.
- The total financial impact for all cases, UCLAF included, is estimated at €5.3 billion<sup>5</sup>.
- By the end of the 5-year period, OLAF had opened 341 judicial follow-up cases. 318 cases had been sent to national authorities. Twenty-one cases are currently subject to trial, a court has ruled in 19 cases, and 9 cases are under appeal.
- 20 OLAF cases have been sent to the disciplinary authority of EU institutions. The appointing authorities have taken a decision in 4 cases.
- The “Complementary Evaluation Report of the Activities of OLAF<sup>6</sup>” was established on 26 October 2004 and sent to the Council, the European Parliament and the Supervisory Committee.

#### **2.1.1. The Legacy of UCLAF**

OLAF inherited from its predecessor, UCLAF, a total of 1423 cases. During the first three years of its existence, OLAF examined all of the outstanding UCLAF cases, reclassified and handled them according to the new procedures established in the OLAF Manual (first version completed in 2001). A special Task Force “Old Cases” (TFOC) was created in December 2002 to re-examine cases which had been registered before March 2000 (the date on which the Director General of OLAF took office). Further cases were added to the original list of 212 cases. By the end of the reporting period 277 dossiers had been

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<sup>5</sup> Financial impact data as estimated by the investigators at the end of an investigation.

<sup>6</sup> SEC (2004) 1370

analysed. While most of the cases were old UCLAF cases, the Director decided to add a number of pre-CMS OLAF cases in order to evaluate them under the new procedures. The TFOC's work was concluded in December 2003. Only 7 of the 277 cases analysed by the TFOC are still in the active stage.

Figure 1 shows how over the last five years OLAF eliminated the backlog of old UCLAF cases previously recorded in the IRENE system<sup>7</sup> which had not been assigned to a specific category and how concurrently the number of OLAF cases following the new nomenclature increased. Figures show the number of cases active in each group at the end of each OLAF year<sup>8</sup>. At the end of the current reporting period, all active cases belong to one of the 4 classes: internal investigations, external investigations, assistance cases or coordination cases.

*Figure 1: Evolution of active OLAF/UCLAF Cases*

Case Type	30/06/1999	30/6/2000	30/6/2001	30/6/2002	30/6/2003	30/6/2004
OLAF cases	30	38	367	594	641	511
IRENE cases	872	774	640	205	41	0
<b>Total</b>	<b>902</b>	<b>812</b>	<b>1007</b>	<b>799</b>	<b>682</b>	<b>511</b>

Figure 2 shows that OLAF closed 1202 UCLAF cases during the 5-year period, 319 (26%) of which were closed with follow-up. By the end of the current reporting period, operational work was complete for all but 7 UCLAF cases that had been reclassified in the meantime. However, follow-up activities continue to take up considerable resources, both for financial and judicial follow-up. At the end of the reporting period, 282 UCLAF cases were still in follow-up.

*Figure 2: Closure of UCLAF Cases*

Type of Closure	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004	Total
Follow-up	40	21	134	96	28	<b>319</b>
No Follow-up	154	265	372	69	23	<b>883</b>
<b>Total</b>	<b>194</b>	<b>286</b>	<b>506</b>	<b>165</b>	<b>51</b>	<b>1202</b>

<sup>7</sup> IRENE (IRrégularités, ENquêtes, Exploitation): Name given to UCLAF's database.

<sup>8</sup> From 1 July of each year to 30 June of the following year.

### 2.1.2. Evolution of OLAF's Operational Activities (July 1999 - June 2004)

Figure 3 gives a snapshot of all cases stored in the CMS and their stages at the end of the current reporting period (30 June 2004). The total number of case records stored in the Case Management System (CMS) is 3992 cases, including the 1423 UCLAF cases. The remaining 2569 records relate to cases created upon information received by OLAF between 1 June 1999 and 30 June 2004.

*Figure 3: Distribution of cases according to the various stages*

Assessment	Non Cases	Monitoring	Open	Closed without Follow-up	Follow-up	Follow-up completed	Total cases
182	714	71	511	1803	623	88	3992

Figure 4 shows the development of incoming information over the 5-year period. During the first year 322 new cases were created; a substantial increase to 589 cases occurred in the second year and this number remained stable for three years; last year saw a new peak with 637 new cases. This is an encouraging increase of 9%, and could be interpreted as an increasing confidence in the work and professionalism of the Office.

*Figure 4: Information Received - New Cases Created*

1999-2000	2000-2001	2001-2002	2002-2003	2003-2004	Total
322	589	588	585	637	2721

The decision to open a case or not is prepared by the Investigations and Operations Executive Board. The assessment period runs from receipt of the initial information to the decision whether or not to open the case. This procedure allows for a reliable and transparent assessment of incoming information. The duration varies, but overall OLAF has gradually succeeded in cutting the duration of the assessment period.

Figure 5 shows the development of the average duration of the assessment phase. Due to the change from UCLAF to OLAF and to the development and implementation of new procedures that took effect only in late 2000, the first reporting period (1999-2000) cannot be considered representative. In fact, only 36 assessments were completed during the first year; UCLAF did not have a formal assessment procedure. For the remaining 4 reporting periods there is a continuous decrease in the time needed to assess the initial information from 18 months in 2000-2001 to 5 months in the current reporting period. With respect to the number of assessments, a peak of 826 assessments was completed in 2001-2002 (including the reclassification of old cases), which reflects the major clean-up operation of the UCLAF legacy. Since then the number of assessments completed per year has stabilised at around 650 cases, but this number is expected to rise next year reflecting the greater amount of information received.

Figure 5: Duration of Assessment Phase

	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
Assessments completed	36	484	826	651	661
Average duration	6 months	18 months	15 months	10 months	5 months

Applying stricter assessment procedures to incoming information has helped the Office to focus on the most relevant cases. The evolution of the number of non-case decisions is a good indicator for both stricter assessment procedures and prioritisation. Figure 6 demonstrates that in 1999 all initial information (with only one exception) led to opening a case; this statistic has steadily reduced over the years to 272 out of 578 cases (47%) for the current reporting period. It also shows how the Office gradually introduced the new classification of cases as described in section 1.2, for example in 2000, the introduction of coordination and assistance cases: these two new case types constitute in the current reporting period 55% of all active cases (151/275); and in 2002, the introduction of monitoring cases.

Figure 6: Decisions taken at the end of the evaluation stage

Type of Decision	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004	Total
Internal investigations	9	47	43	30	24	153
External investigations	9	206	159	145	100	619
Coordination cases	n/a	73	142	86	103	404
Assistance cases	n/a	22	44	62	48	176
IRENE cases	109	166	152	54	0	481
Non cases	1	55	195	191	272	714
Monitoring cases	n/a	n/a	10	38	31	79
<b>Grand Total</b>	<b>128</b>	<b>569</b>	<b>745</b>	<b>606</b>	<b>578</b>	<b>2626</b>

Figure 6 also shows that the application of stricter assessment and verification criteria has led to a drop in the number of internal investigations for the last two years. After a peak of 47 internal investigations in the 2000-2001 period numbers have decreased to 24 cases in the current reporting period (cases relating to the “Eurostat” affair are included.). Figure 7 shows a similar picture for direct expenditure and external aid cases.

Figure 7: Number of Direct Expenditure and External Aid cases initiated

Sector	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004	Total
Direct Expenditure	5	65	38	30	24	162
External Aid	10	66	94	70	41	281

Old UCLAF cases focused on three principal areas where management of Community funds is shared between the Commission and Member States (structural funds, agriculture, own resources). Active cases relating to direct expenditure and external aid at that time represented less than 14% of the 1408 cases opened<sup>9</sup>. Figure 7 shows that of the 275 cases opened after assessment 65 are in direct expenditure and external aid; this is a percentage increase to almost 24%. Activities are thus shifting towards areas where Member States exercise no specific responsibility and OLAF is the principal actor, or even the only administrative authority engaged in the fight against fraud.

Where Member States share responsibility, more joint action with the relevant services of the Member States should be encouraged. The number of assistance, coordination and monitoring cases stored in CMS is a good and positive indicator on how cooperation with the Member States has evolved over the years.

Figure 8 below shows that cooperation with the Member States in the traditional areas, such as customs, agriculture and structural actions – as measured by the number of coordination, assistance and monitoring cases - has improved substantially over the 5-year period. While in the 2000-2001 period, external investigations accounted for 53% of cases in these domains today they account for only slightly less than 27% of all cases. This is a very promising result for the future, as these cases involve not only regular meetings with the Member States but also the participation of the Member States’ investigators in OLAF investigations and of OLAF investigators in national investigations.

*Figure 8: Cooperation with Member States in the field of agriculture, customs (including alcohol, cigarettes, drug precursors and VAT) and structural funds*

Case type	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004	Grand Total
Coordination cases	n/a	73	140	86	93	<b>392</b>
Assistance cases	n/a	15	26	38	22	<b>101</b>
Monitoring	n/a	n/a	7	12	18	<b>37</b>
<b>Total</b>	<b>0</b>	<b>88</b>	<b>173</b>	<b>136</b>	<b>133</b>	<b>530</b>
	0%	47%	69%	66%	73%	
<b>External cases</b>	<b>4</b>	<b>101</b>	<b>76</b>	<b>70</b>	<b>49</b>	<b>300</b>
	100%	53%	31%	34%	27%	
<b>Grand Total</b>	<b>4</b>	<b>189</b>	<b>249</b>	<b>206</b>	<b>182</b>	<b>830</b>

Figure 9 shows the development of the average duration of the active stage of cases. Here too, there has been continuous improvement since the peak of 747 cases closed in 2001-2002 with an average duration of 33 months. This peak was also caused by a major clean-up operation of the UCLAF legacy, with relatively longer average active stage periods. Within two years, OLAF has succeeded in reducing the average active stage phase from 33 months to 22 months.

<sup>9</sup> Complementary Evaluation Report of OLAF

Figure 9: Duration of Active Stage of Cases

	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
Cases completed	217	319	747	492	443
Average duration	29 months	26 months	33 months	26 months	22 months

The statistics on duration for both assessments and active stage must be interpreted with care, as they only refer to assessments/investigations closed – they do not include estimates for the assessments/active stage that were still ongoing at the end of the respective reporting period.

Figure 10 shows the number of cases closed with/without a follow-up recommendation. In percentage terms follow-up recommendations have increased steadily from 18% in 1999-2000 to slightly more than 50% in the current reporting period.

Figure 10: Cases closed with/without follow-up at end of active stage

Type of Closure	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004	Total
Follow-up	40	24	209	220	209	<b>702</b>
No Follow-up	181	372	546	271	234	<b>1604</b>
<b>Total</b>	<b>221</b>	<b>396</b>	<b>755</b>	<b>491</b>	<b>443</b>	<b>2306</b>

Figure 10 shows all cases, including the cases inherited from UCLAF. A comparison of this figure with Figure 2 demonstrates that during the first three years more than two-thirds of OLAF's operational results concerned UCLAF cases, and that only during the last two years has this percentage reduced to 33% and 11% respectively.

Figure 11 summarises the evolution of follow-up activities. It should be noted that a case in follow-up might require several different follow-up activities, for example administrative, financial and judicial follow-up, or disciplinary and judicial follow-up. There is therefore, a considerable difference between the number of cases in follow-up and the number of follow-up activities. OLAF has launched a total of 1045 follow-up activities, nearly half of which are financial follow-up, another 40% concern judicial follow-up, and close to 10% concern administrative follow-up. Internal investigations have led to 25 distinct disciplinary follow-up activities.

Figure 11: Cases closed with Follow-up by Type

Type of Closure		1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
<b>Cases closed with follow-up</b>		<b>40</b>	<b>24</b>	<b>209</b>	<b>220</b>	<b>209</b>
Related Follow-up Activity	Administrative		4	19	27	44
	Disciplinary	1	2	8	7	7
	Financial	33	17	163	160	139
	Judicial	10	11	98	147	140
	Legislative			1	2	5
<b>Total</b>		<b>44</b>	<b>34</b>	<b>289</b>	<b>343</b>	<b>335</b>

A new category of cases, the monitoring case was introduced in 2002. A monitoring case is a case where OLAF has the legal power to open an external investigation, but for which a national authority is in a much better position to investigate. Such cases are transferred to the competent national authorities, but as interests of the European Union are at stake, OLAF requests regular information about progress. In OLAF's terminology, monitoring cases are a special type of follow-up. Figure 12 summarises the evolution of the number of monitoring cases and the related follow-up activities.

Figure 12: Monitoring cases created and Type of Follow-up

Type of Closure		1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
<b>Monitoring Cases</b>		<b>n/a 0</b>	<b>n/a 0</b>	<b>10</b>	<b>38</b>	<b>31</b>
Related Follow-up Activity	Administrative	0	0	3	9	8
	Financial	0	0	6	18	14
	Judicial	0	0	4	19	16
<b>Total</b>		<b>0</b>	<b>0</b>	<b>13</b>	<b>46</b>	<b>38</b>

Follow-up is in most cases the responsibility of the national authorities to whom the dossier was sent. Figure 13 shows that number of cases for which follow-up is completed and the type of follow-up concerned. There is an increase from 4 cases in 2000-2001 to 73 cases in 2003-2004 with follow-up completed.

Figure 13: Completion of Follow-up by Type

Type of Closure		1999-2000	2000-2001	2001-2002	2002-2003	2003-2004	Total
<b>Cases with follow-up completed</b>		<b>0</b>	<b>0</b>	<b>4</b>	<b>10</b>	<b>73</b>	<b>87</b>
Type of Follow-up Activity Closed	Admin.	0	0	0	3	9	<b>12</b>
	Financial	0	0	3	8	50	<b>61</b>
	Judicial	0	0	2	4	27	<b>33</b>
	Legislative	0	0	0	0	2	<b>2</b>
<b>Total Follow-up Activities</b>		<b>0</b>	<b>0</b>	<b>5</b>	<b>15</b>	<b>88</b>	<b>108</b>

Finally, Figure 14 illustrates the accumulated estimated<sup>10</sup> financial impact in € million of all cases by stage<sup>11</sup> and by sector.

Figure 14: OLAF cases by stage with financial impact at 30/06/2004

Sector	Open	Closed	Total
<b>Agriculture</b>	61.8	188.8	250.6
<b>Alcohol</b>	0	179.8	179.8
<b>Anti-corruption</b>	5.3	47.0	52.3
<b>Cigarettes</b>	441.3	855.7	1.296
<b>Customs</b>	238.0	424.6	662.6
<b>Direct expenditure</b>	35.6	79.8	115.4
<b>ESTAT</b>	0	3.1	3.1
<b>External aid</b>	37.6	140.2	177.8
<b>Multi-Agency</b>	0	0.1	0.1
<b>Structural Funds</b>	332.7	924.2	1.256.9
<b>Trade</b>	0.3	934.7	935.0
<b>VAT</b>	185.2	224.3	409.5
<b>Total</b>	<b>1372.8</b>	<b>4001.3</b>	<b>5339.1</b>

<sup>10</sup> Financial impact data as estimated by the investigators at the end of an investigation.

<sup>11</sup> “Open” corresponds to the number of cases at the investigation phase (admitted by the Investigations and Operations Executive Board after the assessment phase). “Closed” corresponds to the number of cases closed with or without follow-up and monitoring cases.

## 2.2. Operational Activities in the Reporting Period (July 2003-June 2004)

During the current reporting period OLAF received 669 reports of alleged fraudulent activity. Assessment and identification of duplicate information led to the registration in CMS of 637 new case records. This reflects a 9% increase over last year.

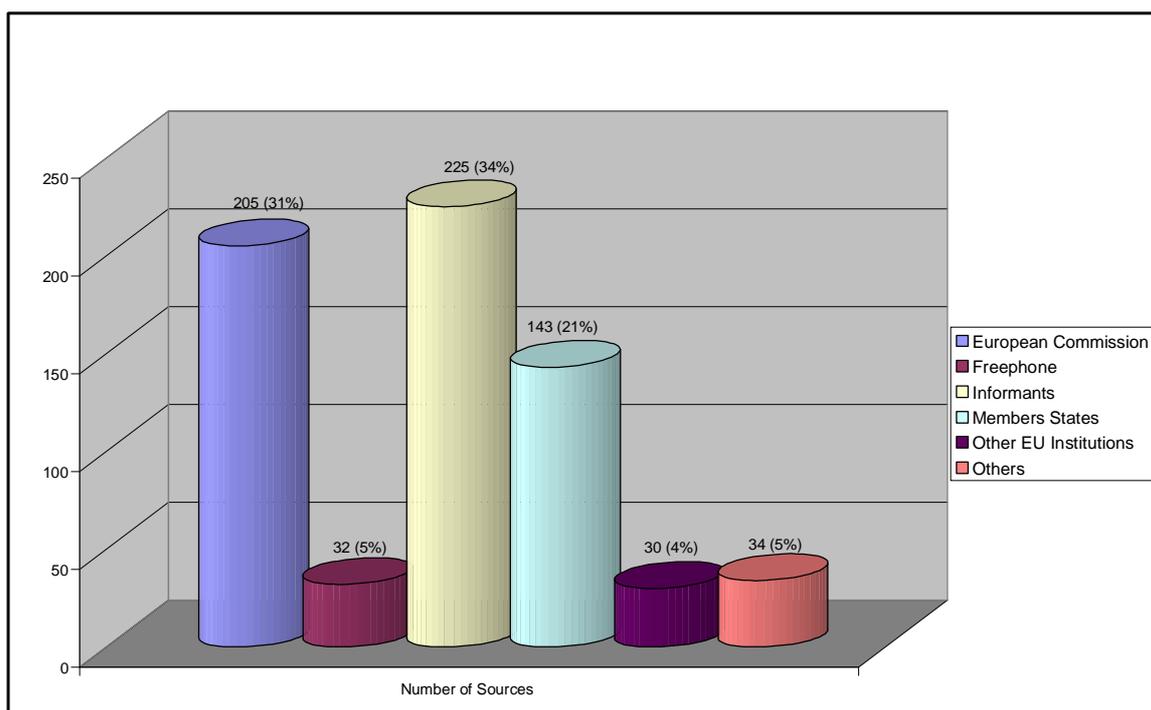
As promised in last year's report, OLAF has improved its system of recording of incoming information so as to produce data on the sources of information. The single most important source of information are informants (34% of the total) closely followed by Commission services (31%). Information received from the Commission services and from the Member States increased by 18% and 22% compared to last year.

Informants are generally defined as being individuals who provide information concerning a matter within the legal competence of OLAF. This category can be broken down into four further sub-sectors; witnesses; informants; anonymous, media and trade sources; whistleblowers.

At the end of the reporting period, OLAF had five active cases where the primary source of information was a whistleblower. A whistleblower is defined as an official of a Community organ who, in the course of or in connection with the performance of his duties, becomes aware of facts which indicate either possible illegal activity falling under the competence of OLAF, or serious failure by an official to comply with his professional obligations, and who then reports these facts to OLAF.

The sources of registered incoming information are displayed in Figure 15 below.

*Figure 15: Distribution of incoming information by source*



The geographical spread of fraudulent activities as determined by new case records is shown in the following figures. Towards the end of the reporting period the Union was enlarged to 25 countries. For better comparability the following 2 figures have been kept in line with last year's report. Figure 16 shows the distribution of new case records by the original 15 Member States.

*Figure 16: Distribution of new case records from the reporting period by Member State*

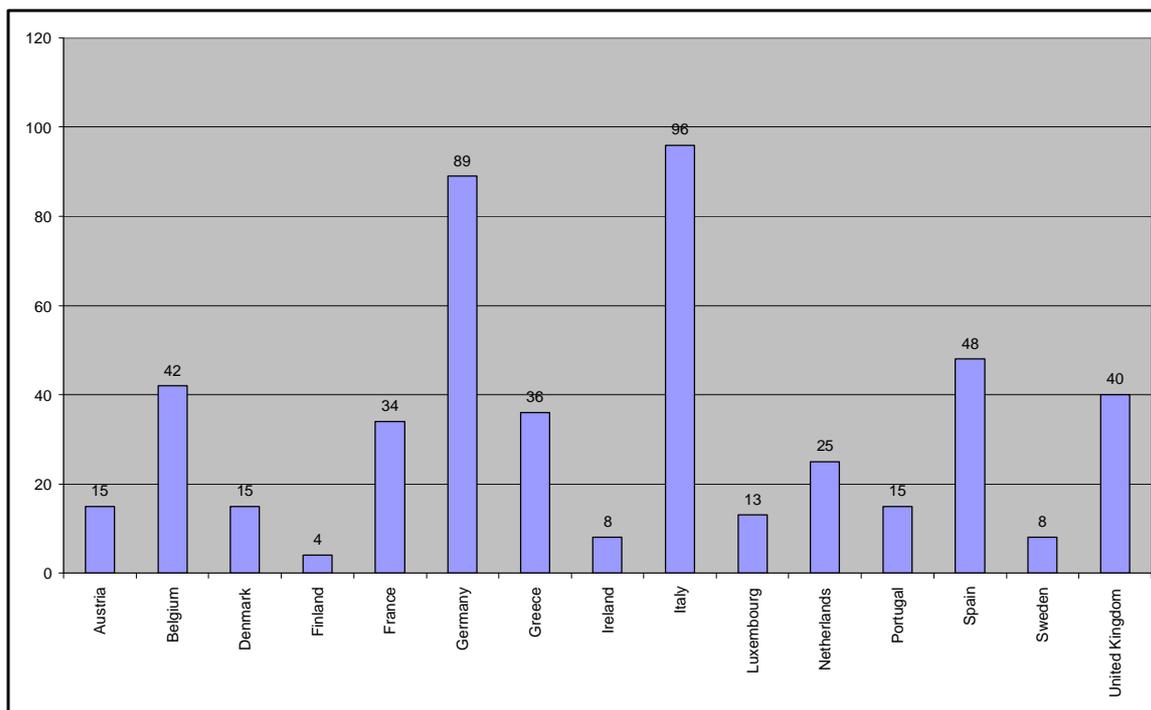


Figure 17 shows the new case records that have been created during the reporting period by new Member States and Candidate Countries. The number of cases for the new Member States has increased from 65 last year to 74 this year (an increase of 14%). The number of new case records relating to the three Candidate Countries fell from 60 last year to 45 this year. This decrease was caused almost exclusively by a reduction in new case records from Romania from last year's high point of 49 to this year's 33 cases.

Figure 17: Distribution of new case records from the reporting period for new Member States and Candidate Countries

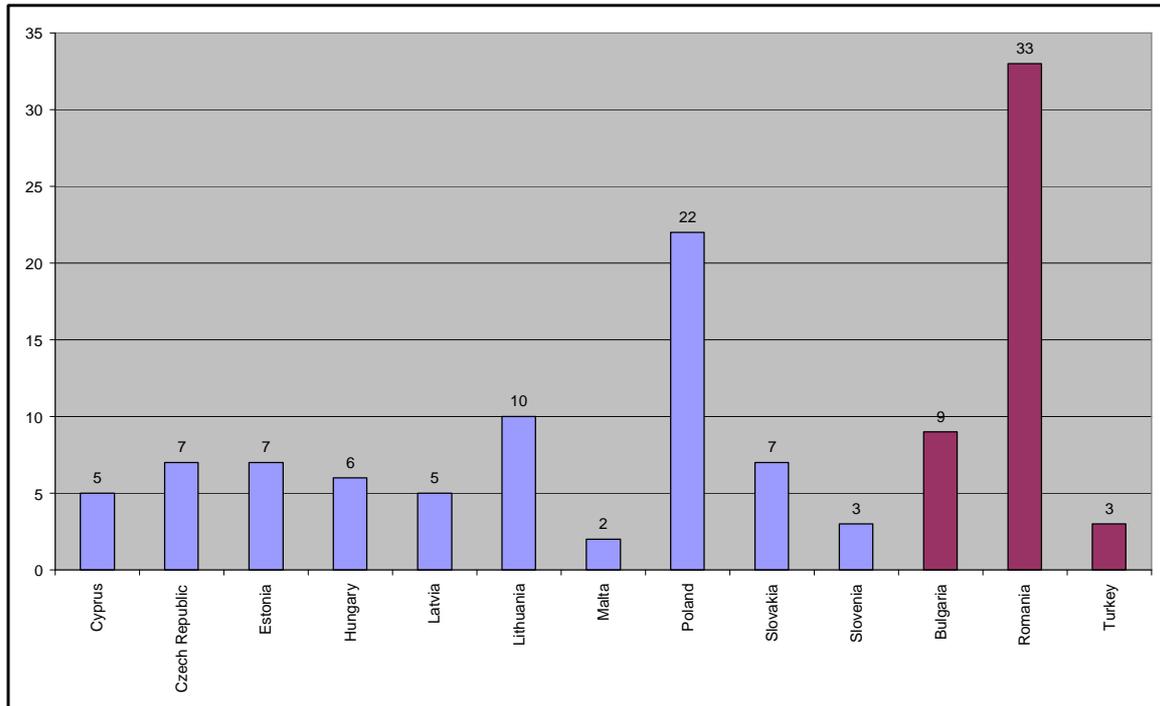


Figure 18 shows new case records by third countries. The total number of cases has risen from 210 last year to 225 this year (an increase of 7%). The most notable change compared to last year is the increase of “Other European Countries” from 18% to 25%.

Figure 18: New case records from the reporting period by geographical region

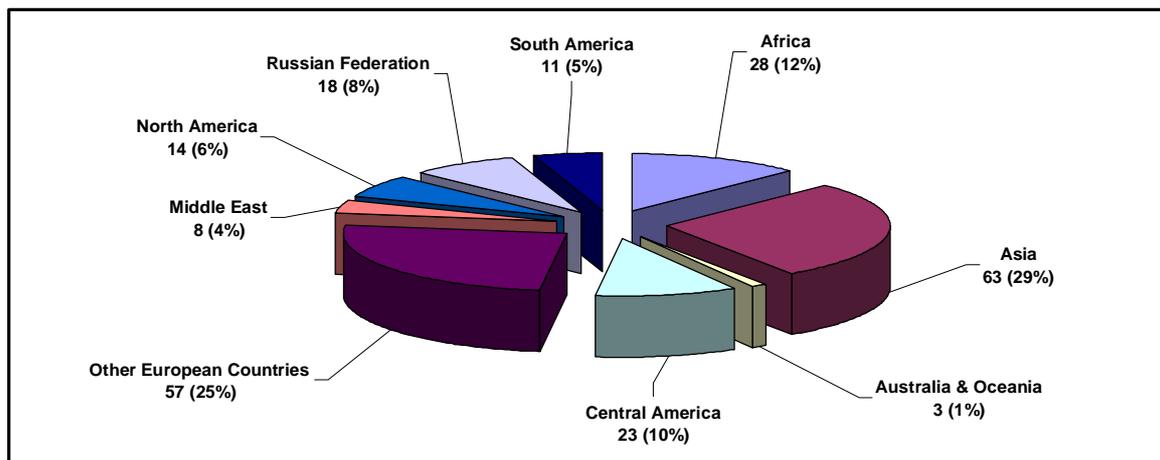


Figure 19 shows the 637 new case records by sector. The spread of cases is broadly similar to last year. The biggest percentage change relates to the Agriculture sector, where the number of new case records rose from 95 (17%) last year to 142 (23%) this year.

Figure 19: New case records from the reporting period by OLAF sector

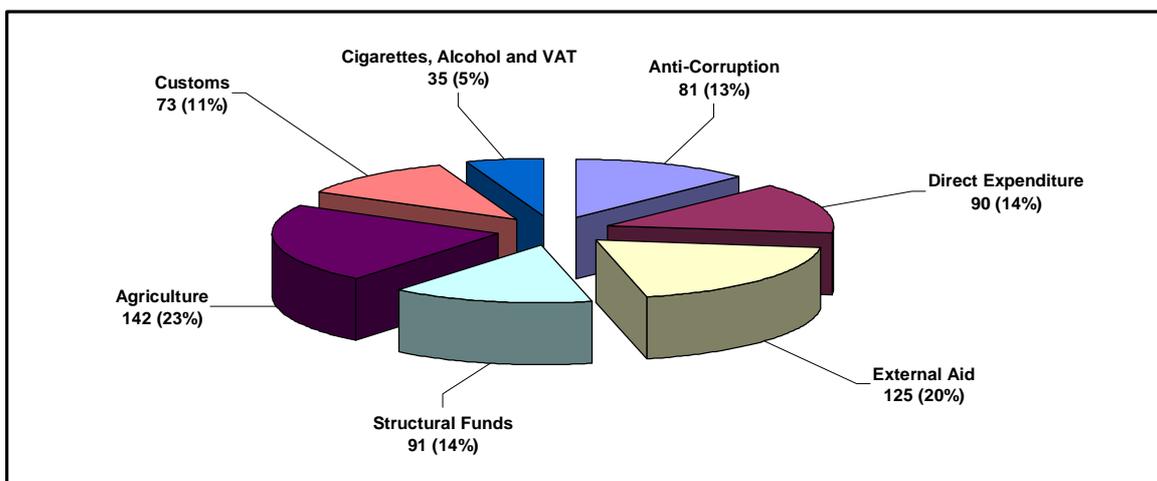
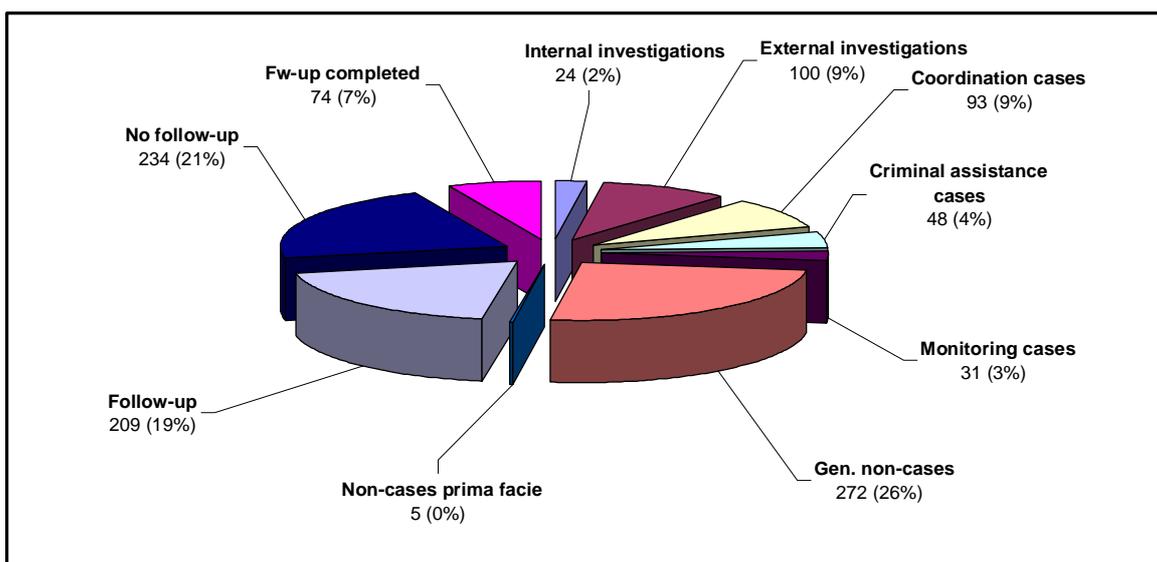


Figure 20 below shows the opening and closing decisions taken during the course of the reporting year. The impact of improved prioritisation has continued this year with the total number of non-cases climbing to 277 (26.5%) compared to 190 (17%) last year. The number of completed follow up cases rose from 10 (1%) last year to 74 (7%) this year. Figure 20 also shows a new category of cases, the “Non-Case Prima Facie” that was introduced in chapter 1.

Figure 20: Decisions taken during the reporting period



The following two figures give the details of all opening and closing decisions by sector and type of cases. Figure 21 confirms the high percentage of coordination and assistance cases for the traditional sectors, agriculture and customs, cigarettes, alcohol and VAT. In fact, all new precursor cases, 66% of all new customs cases and 65% of all new agriculture cases are coordination cases, and all VAT cases are either coordination or assistance cases.

Figure 21: Opening Decisions taken during the reporting period

Major Sector	Internal Inv.Cases	External Inv.Cases	Coord. Cases	Assistance Case	Grand Total	Monitor. Cases	Non Cases
Agriculture		17	38	4	59	14	44
Alcohol			1		1		0
Anti-Corruption	17			4	21		22
Cigarettes		1	10	4	15		0
Customs		13	28	2	43	1	29
Direct Expenditure		17		8	25	2	58
ESTAT	7	1			8		1
External Aid		27		13	40	11	72
Multi Agency		6		1	7		0
Precursors			16		16		0
Structural Funds		18	5	8	31	3	41
VAT			5	4	9		5
<b>Grand Total</b>	<b>24</b>	<b>100</b>	<b>103</b>	<b>48</b>	<b>275</b>	<b>31</b>	<b>272</b>

Figure 22 shows the final result of OLAF cases by sector. More than half<sup>12</sup> of the investigations in agriculture, customs and VAT end with a follow-up recommendation. This figure shows also that two-thirds of internal investigations end without follow-up.

Figure 22: Cases closed during the reporting period

Major Sector	Follow-up	No follow-up	Grand Total
Agriculture	32	25	57
Alcohol	1	1	2
Anti-Corruption	16	34	50
Cigarettes	9	15	24
Customs	41	46	87
Direct Expenditure	31	15	46
EUROSTAT	4		4
External Aid	30	38	68
Multi Agency		1	1
Precursors		8	8
Structural Funds	28	33	61
Trade	8	12	20
VAT	9	6	15
<b>Grand Total</b>	<b>209</b>	<b>234</b>	<b>443</b>

<sup>12</sup> Excluding monitoring cases.

Figure 23 shows for each sector how many cases were active at the end of the current reporting period. Internal and external investigations account for slightly more than 50% of the active caseload.

*Figure 23: Active cases by type and cases in evaluation as at 30/06/2004*

Major Sector	Internal Inv.	External Inv.	Coord. Cases	Assist. Cases	Total	Evaluations
Agriculture	0	24	53	12	89	27
Alcohol	0	0	1	0	1	1
Anti-Corruption	44	0	0	4	48	34
Cigarettes	0	3	37	8	48	3
Customs	0	43	41	0	84	12
Direct Expenditure	1	36	0	10	47	27
EUROSTAT	8	2	0	0	10	4
External Aid	0	62	1	14	77	37
Multi Agency Inv.	0	5	0	1	6	0
Precursors	0	0	11	0	11	0
Structural Funds	0	39	7	13	59	37
Trade	0	2	2	1	5	0
VAT	0	0	18	8	26	0
<b>Grand Total</b>	<b>53</b>	<b>216</b>	<b>171</b>	<b>71</b>	<b>511</b>	<b>182</b>

Finally, Figure 24 gives a snapshot of all active cases (in assessment or investigation) at the end of the reporting period for all Member States, new Member States and Candidate Countries by sector concerned.

Figure 24: Active Cases by Member State, New Member State and Candidate Country concerned and by Sector

Status of Country	Country Involved	Agriculture	Alcohol	Anti-Cor.	Cigrttes	Customs	Dir. Exp.	ESTAT	Ext. Aid	Multi Agency	Precursors	Str. Funds	Trade	VAT	Total
Member State	Austria	2	0	2	3	3	3	0	2	0	0	1	0	5	21
	Belgium	5	0	33	20	3	10	2	3	0	0	3	2	8	89
	Denmark	1	1	1	2	5	0	0	0	0	2	0	0	6	18
	Finland	3	0	0	1	1	0	0	0	0	0	1	0	0	6
	France	19	0	2	7	6	6	0	3	0	1	6	2	4	56
	Germany	18	0	1	14	23	14	0	3	0	2	17	1	12	105
	Greece	9	0	0	6	4	3	0	1	0	0	10	0	1	34
	Ireland	6	0	1	2	2	2	0	0	0	1	1	0	1	16
	Italy	25	1	8	8	11	12	0	8	0	0	22	2	18	115
	Luxembourg	0	0	4	0	3	1	11	2	0	1	0	0	1	23
	Netherlands	14	0	1	12	13	1	0	0	0	0	5	2	9	57
	Portugal	6	1	0	1	5	2	0	1	0	0	8	0	2	26
	Spain	18	0	1	11	12	8	0	2	0	1	15	0	7	75
	Sweden	0	1	0	3	2	0	0	0	0	0	0	0	4	10
United Kingdom	10	0	2	13	8	6	0	5	0	4	8	0	8	64	
<i>Net Total</i>		<b>100</b>	<b>2</b>	<b>53</b>	<b>44</b>	<b>58</b>	<b>61</b>	<b>13</b>	<b>26</b>	<b>0</b>	<b>11</b>	<b>95</b>	<b>4</b>	<b>25</b>	<b>492</b>
New Member State	Cyprus	2	0	0	7	0	0	0	0	0	1	0	0	0	10
	Czech Republic	1	0	1	1	0	1	0	5	0	0	0	0	0	9
	Estonia	3	0	0	2	1	0	0	2	0	0	0	0	0	8
	Hungary	2	0	0	0	1	1	0	2	0	0	0	0	0	6
	Latvia	1	0	0	3	1	0	0	0	0	0	0	0	0	5
	Lithuania	3	0	0	3	1	2	0	3	0	1	0	0	0	13
	Malta	1	0	0	0	0	0	0	0	0	0	0	0	0	1
	Poland	2	0	1	4	3	1	0	6	0	0	0	0	0	17
	Slovakia	0	0	1	1	1	0	0	7	0	0	0	0	1	11
	Slovenia	3	0	0	5	1	0	0	0	0	0	0	0	0	9
Candidate Countries	Bulgaria	2	0	0	2	4	1	0	2	0	1	0	0	0	12
	Romania	2	0	0	1	1	1	0	15	0	0	0	0	0	20
	Turkey	1	0	0	0	3	0	0	0	0	0	0	0	0	4
	<i>Net Total</i>		<b>21</b>	<b>0</b>	<b>3</b>	<b>21</b>	<b>13</b>	<b>7</b>	<b>0</b>	<b>40</b>	<b>0</b>	<b>3</b>	<b>0</b>	<b>0</b>	<b>109</b>

### **2.2.1. Eurostat Task Force**

In July 2003, OLAF created a new investigation unit: the Eurostat Task Force charged with conducting all internal and external casework and connected cases related to Eurostat and other Commission Directorates General directly involved, from the assessment of the initial information to the investigation to judicial and disciplinary follow-up. This new unit cooperates closely with the present Eurostat management. During the reporting period, the Task Force dealt with 14 cases: 4 external and 10 internal, 9 of which are still ongoing. It completed 5 final reports, currently at the follow-up stage, two of which were forwarded to the judicial authorities in Luxembourg and three to the judicial authorities in France. Four cases were recommended for financial recovery procedures; three of these were also recommended for possible disciplinary action. An analysis of the Eurostat cases by type of allegation shows that the majority concern “Tender/Grant Procedures” (70%), followed by “Management of Community Funds” (20%) and “Professional Conduct” (10%).

### **2.2.2. Internal Investigations**

At the end of the reporting period, 48 internal investigations (in addition to those linked to Eurostat) were open, compared to 75 at the end of the previous reporting period. This reduction can be explained by the stricter criteria used to assess incoming information during this period. However, there was an increase in the number of cases pending assessment at the end of the reporting period: 34 in June 2004, most of which dated from less than 4 months, as opposed to 24 cases under assessment in June 2003.

During the reporting period OLAF conducted internal investigations<sup>13</sup> in the majority of the European Community organs, with 81 new case records registered in the CMS and 24 new investigations opened. Figure 25 confirms that as the Commission carries out the vast majority of financial transactions within the EU Institutions, it inevitably accounts for the large majority of initial allegations and also of internal investigations<sup>14</sup>.

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<sup>13</sup> The following figures do not include Eurostat cases, which have been dealt with in chapter 2.2.1 above.

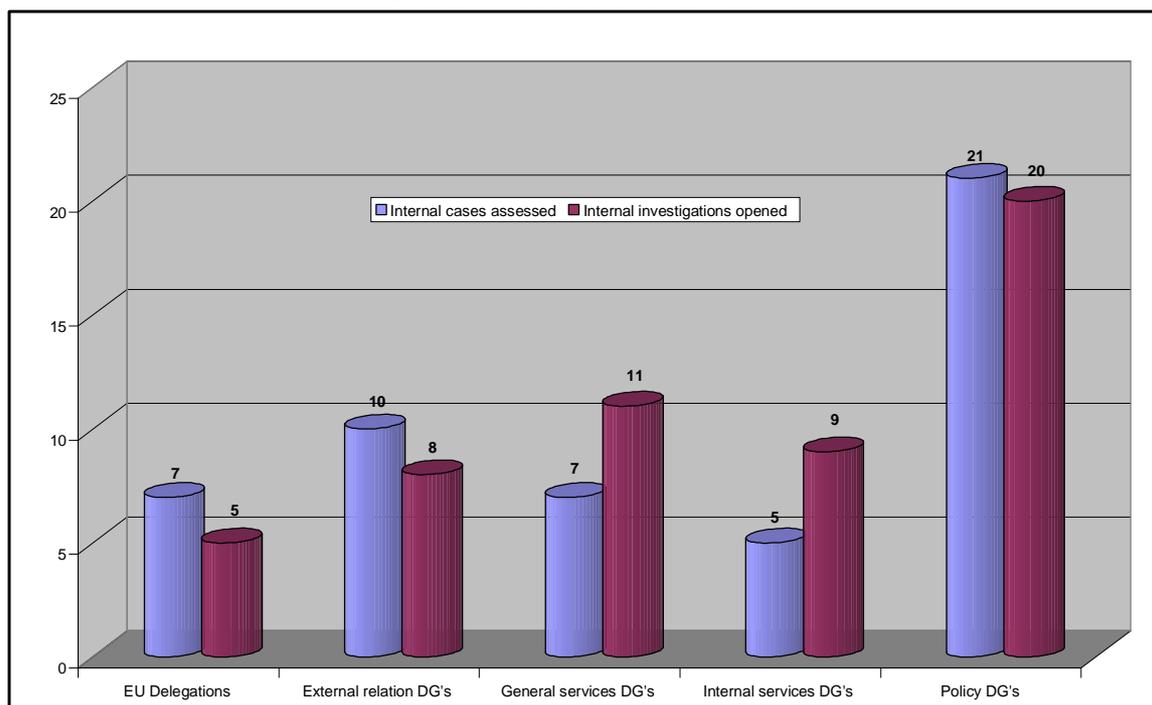
<sup>14</sup> More than one Institution may be concerned by an assessment/investigation.

Figure 25: Anti-Corruption cases in evaluation and in active stage at the end of the reporting period

EU Institution	Evaluations	Active Investigations	Grand Total
Committee of the Regions	2	0	2
Council	1	2	3
Court of Auditors	0	1	1
EU Agencies	2	0	2
Economic and Social Committee	0	1	1
European Commission	18	38	56
European Commission – Multiple DG	2	4	6
European Commission/Agency	1	0	1
European Investment Bank	1	0	1
European Parliament	1	2	3
Unspecified	6	0	6
Others	0	1	1
<b>Grand Total</b>	<b>34</b>	<b>49</b>	<b>83</b>

Figure 26 illustrates for the reporting period the number of internal cases assessed and internal investigations opened by Commission Service: Policy DGs, External Relation DGs, General Services DGs, Internal Services DGs, Agencies and EU delegations<sup>15</sup>. Several allegations and investigations relate to more than one Commission Service.

Figure 26: Distribution of internal cases assessed and investigations opened by Commission services concerned



<sup>15</sup> The first four groups follow the description of the Commission Services on the EUROPA Website. Further subdivision into agencies and EU delegations follows a request by the European Court of Auditors.

Figure 27 shows the internal investigations cases by domain. The main category is “Tender/Grant Procedures” at 54%. The remainder relate to “Management of Community Funds” (15%), “Remuneration and Allowances” (13%), “Professional Conduct” (8%), “Recruitment and Promotion” (6%) and “Administration of Internal Market” (4%). An increasing number of cases have been referred to the judicial authorities of Member States, mainly reflecting the elimination of a backlog relating to one specific area of business.

*Figure 27: Internal investigations cases open at the end of the reporting period by domain*

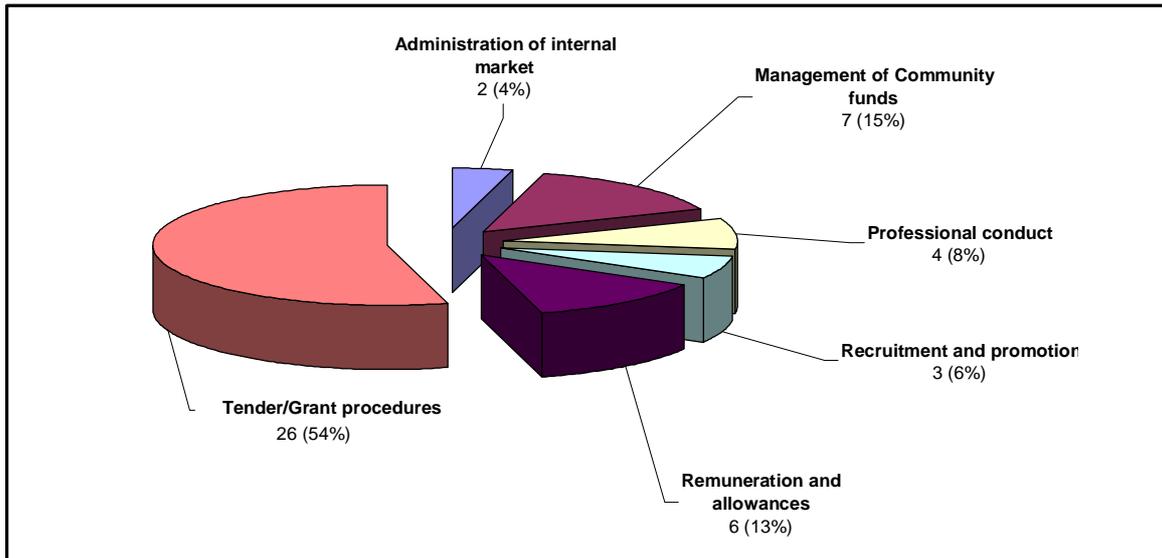
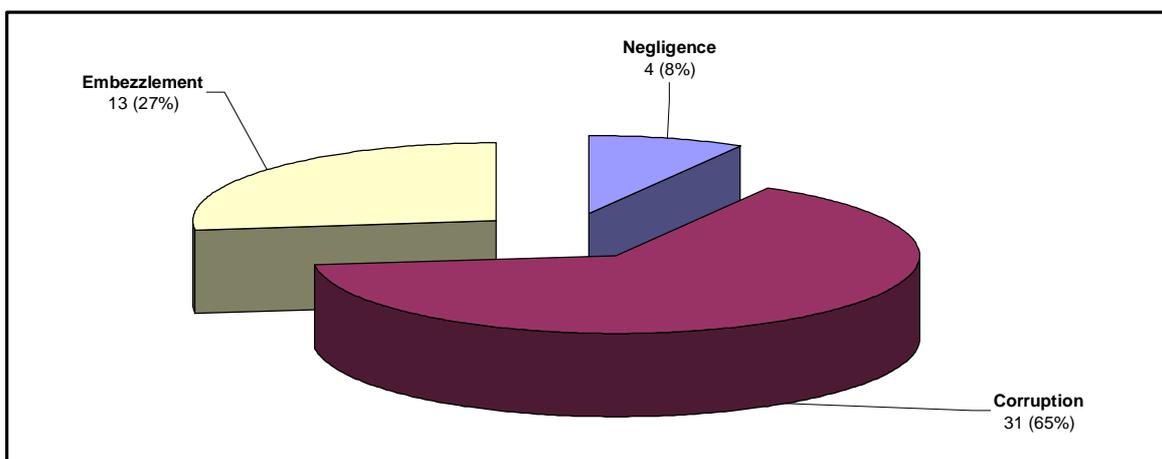


Figure 28 shows internal investigations cases by type of allegation. OLAF has identified three major allegations giving rise to internal investigations; the most prevalent is corruption, which accounts for 31 (65%) of 48 cases.

*Figure 28: Internal investigations cases open at the end of the reporting period by allegation*



*Case Study: Mismanagement of a Contract*

The European Commission invited tenders for the design and supervision of construction of nine school buildings as part of an aid programme for African, Caribbean and Pacific (ACP) countries, funded by the European Development Fund. A European firm (“the consultant”) was awarded the contract. The performance of the contract was to be supervised by the EC Delegation in the ACP territory concerned.

Initial information received by OLAF indicated the possibility of corruption of a member of the Delegation by the contractor, as well as of mismanagement of the contract. OLAF opened both an external investigation case into the conduct of the contractor and an internal investigation case into that of the relevant officials. OLAF obtained relevant documentation and conducted interviews of the relevant officials. The suggestion of corruption was not substantiated by the investigation. However, evidence obtained by OLAF suggested that Delegation staff were negligent in supervising the contract, in that they took no effective action to require the contractor to perform the contract in accordance with the representations it had made, in spite of clear indications that it was failing to do so.

In addition OLAF obtained evidence of a possible conflict of interest on the part of an official of the Commission, who was appointed during the running of the contract to take over aspects of the dossier, in that the official had a long-standing friendship with a director of the consultant. OLAF also found evidence suggesting that this official offered advice to the consultant, that the official provided replies to the consultant which conflicted with the Delegation’s policy and on at least one occasion the official passed a draft letter to the consultant.

On completion of its investigation OLAF passed its final case report to the Investigative and Disciplinary Office of the Commission (IDOC) to enable consideration to be given to appropriate disciplinary measures in relation to the officials of the Delegation and to the Commission official mentioned above.

*Case Study: Favouritism*

In November 2002 OLAF received documentation indicating possible misuse of Community funds in the EC Representation in a Member State. The indications contained in the documentation were principally of improper benefits obtained by officials and of favouritism shown by them towards particular outside parties.

On the basis of an evaluation, OLAF opened an internal investigation case. OLAF investigators conducted missions to the Representation concerned, firstly, in order to secure documents and electronic information and, subsequently, to carry out interviews with relevant parties. In the course of the investigation 18 interviews were held.

OLAF’s investigation uncovered misleading declarations of expenses on the part of one official, as well as irregularities in the treatment of the Representation’s confidential information. In addition, OLAF found that certain officials appeared to have had a conflict of interest in that they participated in juries for the selection of candidates with whom they were connected.

OLAF's final case report was passed to the Commission with a recommendation to undertake measures to recover the loss resulting from the misstatement of expenses. In addition it was recommended that the responsible Directorate General improve the financial administration of the Representation. The competent judicial authorities have also been informed of certain facts discovered.

*Case Study: Unjustified allowances*

OLAF received information from a Directorate General of the Commission which raised two separate allegations against an agent employed by an agency.

The first allegation was that the agent had favoured a particular consortium in the award of a contract for a major infrastructure project, by giving advice to the contractor on preparation of the tender document. OLAF's investigation found strong indications that this was the case, although no direct evidence of benefit received by the agent was discovered. As a result, OLAF passed the relevant documentation to the judicial authorities of the member-state within which the consortium was based, to enable consideration to be given to opening a criminal investigation.

The second allegation was that the agent had submitted false documents to the Commission in support of claims for child and education allowance and to confirm the agent's work experience, so as to enable the agent to receive a higher grading. It was found that the agent had wrongly claimed an amount in excess of €20 000 in allowances. This was reported to the Agency, which recovered the amount by deducting it from the agent's severance grant.

The allegation concerning the falsification of experience was reported to IDOC and to the Commission's Office for Individual Entitlements (PMO). The matter was also reported to the judicial authorities in the Member State in which the agent had been based.

*Case Study: Alleged Collusion*

In July 2001 OLAF received information from an informant of possible misconduct in a Directorate General. The allegation was that a contractor had failed to observe safety rules in relation to a maintenance contract for construction works. The official responsible for managing this contract was named in the allegation. OLAF opened an internal investigation into the matter. In July 2003 the responsible Directorate General informed OLAF of a suspicion of favouritism by the same official, in relation to a contract for road works. OLAF incorporated the new information into the existing investigation.

It was found in the course of the OLAF investigation that the official concerned had for a substantial period played a dominant role in awarding and managing framework contracts in this area. Numerous irregularities in relation to these contracts were discovered, indicating collusion between the official in allowing contractors to alter contract terms after signature, to submit excessive invoices and to carry out private work for the benefit of the official. On completion of the OLAF investigation, the matter was passed to the national judicial authorities.

### 2.2.3. Enlargement Investigation/Operational Activities

The enlargement of the European Union to include another ten Member States took place near the end of the period covered by this Report. All of OLAF's activities took account of this expansion across all sectors as a priority horizontal area. Chapter 5 makes reference to the variety and depth of training, support and assistance provided by OLAF to the Anti-Fraud Coordination Services (AFCOS) and to their partner institutions in parallel to the execution of operational activities in consultation with the AFCOS.

By the last day of the reporting period as indicated in Figure 24, 18% of all active cases concerned new Member States and Candidate Countries, primarily in the area of external aid followed equally by cigarettes and agriculture. This mirrors the overall balance of the Office's activities towards the emphasis on direct expenditure as a high risk area of the Community budget.

Figure 29 shows for new Member States and Candidate Countries how many cases moved into investigation during the reporting period by sector. It highlights the importance of external aid cases in relation to Romania.

*Figure 29: New active cases by new Member States/Candidate Country and by sector*

Country involved	Agriculture	Anti-Cor.	Cigarettes	Customs	Direct Exp.	External Aid	Precursors	VAT	Grand Total
Bulgaria	1		1	1		2	1		6
Cyprus	1		1				1		3
Czech Rep.	1		1			3			5
Estonia	1		1	1		2			5
Hungary	2			1	1				4
Latvia			2						2
Lithuania	1					2	1		4
Poland	1	1	2		1	3			8
Romania				1	3	7			11
Slovakia		1	1			2		1	5
Slovenia	1								1
Turkey				1					1

Recognising this and thanks to the appointment of a Romanian speaking investigator in OLAF and to regular operational meetings in Brussels and in Bucharest, a good level of mutual cooperation has been reached with the Romanian AFCOS and also with the judicial authorities in charge of prosecution for corruption at national level. The exchange of information tends to enrich the investigations carried out by both Romanian AFCOS and OLAF.

#### *Case study: Leonardo da Vinci Project*

As a result of information received from the Romanian AFCOS that a project carried out in the framework of Leonardo da Vinci programme did not comply with the agreed guidelines, OLAF opened an assistance case to co-operate with the Romanian Government's Control Department and with the judicial authorities who had issued an

international arrest warrant. The suspect was prosecuted for offences of fraud, forgery and forgery usage. OLAF's primary role was to offer coordination assistance to DG EAC and BUDG and to the Romanian authorities in particular.

*Case study: Call for Tenders*

On the basis of information received from the EC delegation in Romania, a case was opened to investigate problems in relation to two contracts for which the design and treatment process varied from the offer and accepted tender. OLAF began to investigate this matter and is continuing in full cooperation with the Romanian administrative and judicial authorities.

In the Customs area OLAF has long established contacts, particularly in the cigarettes area; the competent services of the Member States were trained in the use of and connected to AFIS terminals by June 2004 to facilitate exchange of customs information; all new Member States' competent services are partners in Marinfo, a multi-national cooperation arrangement; representatives from intelligence and investigation services of new Member States have carried out internships in OLAF.

*Case Studies: Cigarette Smuggling into the EU*

Lithuanian Customs informed OLAF about a suspect container coming from the Russian Federation destined for an unknown Northern European port. This led OLAF to alert all possible ports' customs offices. Belgian Customs subsequently reported that they had detected the container in which about 1 million cigarettes had been concealed in a double wall.

A Lithuanian national was arrested in Latvia on a Belgian international arrest warrant. The Belgian Judge was able to base this warrant on specific information received from OLAF which OLAF requested from partner contacts in Lithuania. The person in question has been extradited to Belgium and is allegedly involved in a case involving the smuggling of alcohol contaminated by methanol. This alcohol caused the deaths of 13 people in Norway, and OLAF organised several meetings with the authorities from Sweden, Norway, Belgium and Eurojust in order to ensure a successful outcome to the case.

#### **2.2.4. Direct Expenditure and External Aid**

OLAF plays the leading role in the investigation of direct expenditure and external aid cases, since these concern expenditure managed wholly by the Commission and other EU Institutions and bodies, such as the European Investment Bank (EIB), rather than by Member States. OLAF's internal organisation was improved in November 2003 in order to handle respectively those cases which are related to direct expenditure within the EU and the PHARE and TACIS programmes, and all other external aid programmes.

This change in internal organisation has enabled a new proactive strategy to identify high risk areas in relation to the TACIS programmes. In line with OLAF's strategic risk assessment and ongoing intelligence support, small groups of investigators are increasing their specialist knowledge on the specific regions and economic operators benefiting from

the TACIS programmes, particularly in public procurement, allocation and execution of contracts.

Active progress is continuing towards a close working cooperation with the competent Commission services, such as DGs EAC, RTD, ECFIN, AIDCO and RELEX and with the operational investigative and judicial partners through the auspices of the Anti-Fraud Coordination Services (AFCOS) in the new Member States and in the Candidate Countries.

The caseload in this sector continues to be high: OLAF assessed information from 195 initial case records compared to 215 in the previous reporting period.

Figure 30 shows the total number of external aid investigations, opened since the creation of OLAF, concerning the new Member States and Candidate Countries; the relevant programmes<sup>16</sup> are also detailed. By the end of the reporting period a total of 123 such cases had been opened.

*Figure 30: External aid investigations by relevant programme and by new Member State and Candidate Country*

Program	BG	CY	CZ	EE	HU	LV	LT	MT	PL	RO	SK
ECHO	0	0	0	0	0	0	0	0	0	1	0
ISPA	2	0	1	0	0	0	0	0	2	4	3
JOP	5	0	0	2	0	0	1	0	6	6	0
DA VINCI	0	0	0	0	0	0	0	0	0	4	0
LIFE	0	1	0	0	0	0	0	0	0	0	0
MED	0	1	0	0	0	0	0	1	0	0	0
OBNOVA	0	0	1	0	0	0	0	0	0	0	1
PHARE	6	0	5	0	11	3	6	0	10	26	9
SAPARD	0	0	0	1	0	0	1	0	0	1	0
TACIS	0	0	0	0	0	0	0	0	1	0	0
TEMPUS	0	0	0	0	0	0	0	0	0	1	0
<b>Total</b>	<b>13</b>	<b>2</b>	<b>7</b>	<b>3</b>	<b>11</b>	<b>3</b>	<b>8</b>	<b>1</b>	<b>19</b>	<b>43</b>	<b>13</b>

Figure 31 shows new external aid cases for third countries by geographical area. Compared to last year, there is a slight increase from 48 to 52 cases<sup>17</sup>. In the three areas

<sup>16</sup> ECHO: European Humanitarian Aid Office

ISPA: Instrument for Structural Policies for Pre-Accession;

JOP: Joint Venture Programme;

DA VINCI: Vocational Training Action Programme;

LIFE: Financial Instrument for the Environment;

MED: European Mediterranean Aid Programme;

OBNOVA: European Programme for the rehabilitation and reconstruction of Bosnia-Herzegovina, Croatia, the Federal Republic of Yugoslavia and the FYR of Macedonia

PHARE: Technical assistance for 10 Central and Eastern European countries;

SAPART: Special Accession Programme for Agriculture and Rural Development;

TACIS: Technical Assistance for the Commonwealth of Independent States;

TEMPUS: Higher Education Cooperation between EU Member States and Partner Countries

<sup>17</sup> Please note that more than one geographical area may be concerned by an external aid case.

mentioned in last year's report as potentially critical, Latin America, Africa and Asia, the number of external aid cases has remained almost identical.

Figure 31: New External Aid cases from the reporting period for third countries by geographical area

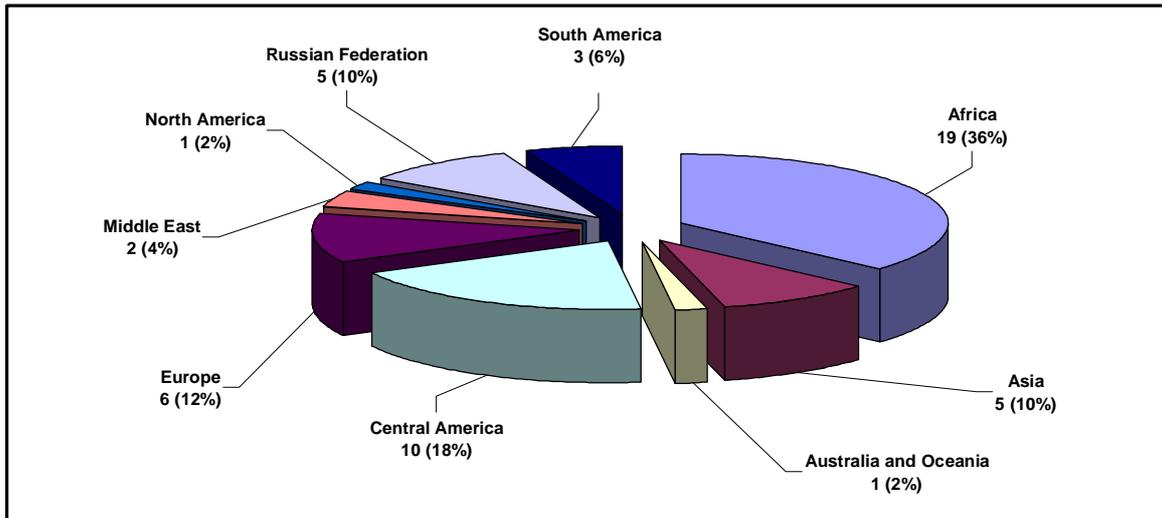
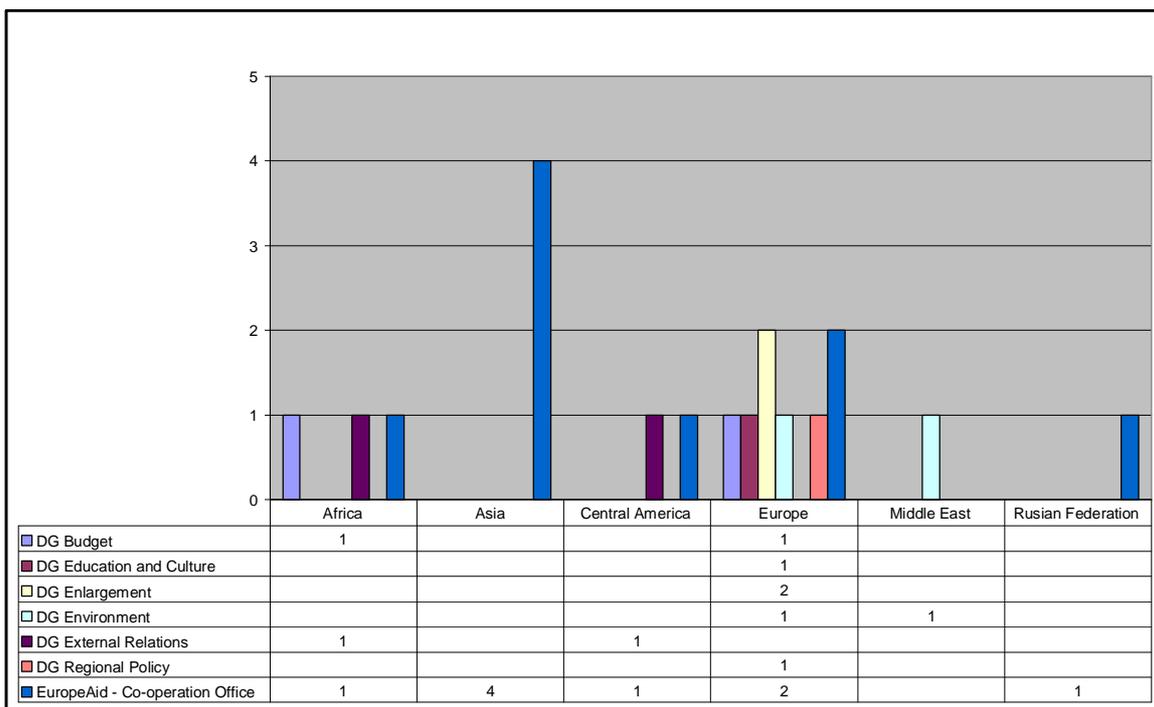


Figure 32 illustrates the number of external aid cases opened during the reporting period and shows the Commission Directorate-General with which OLAF cooperated on these cases. Compared to last year, the number of cases has decreased considerably. Cases related to EuropeAid have fallen from 30 cases to 9.

Figure 32: External Aid cases opened within the reporting period by cooperating Commission DG concerned and geographical area



The success of OLAF's operations in the external aid sector depends heavily on the quality and enhancement of the information received. An advanced level of cooperation with EU and other international bodies is essential. The same is true of cooperation with the relevant administrative and judicial authorities of EU Member States and third countries.

Typical modus operandi revealed in recent cases highlights the complex and well-organised nature of financial fraud in humanitarian and development EU aid to third countries. Such fraud takes advantage of the lack of coordination in monitoring and auditing activities between the various international donors and also of the lack of coordination between the multiplicity of intermediary and beneficiary organisations, both within the EU and in third countries. The combination of multiple sources of financing and other factors has increased the complexity of accounting and reporting requirements and so made it easier to divert funds for personal or criminal benefit. The methods employed include declaring bogus costs and financial transfers, declaring projects as completed when that is not the case, and seeking and receiving double or multiple funding of projects from different donors.

OLAF will endeavour to improve the efficiency of this type of investigation by developing arrangements for the exchange of information with relevant bodies in Member States and in third countries and with international institutions. OLAF is also developing specific computerised tools to support these investigative operations.

#### *Case Study: Lesotho Highlands Water Project*

The Lesotho Highlands Water Project (LHWP) is a multi purpose project comprising dams, water transfer tunnels and an underground hydroelectric power plant. The project was developed in several phases to supply water to South Africa and indirectly to produce electricity for Lesotho. The EU has been involved in this project since the 1980s. The European Development Fund (EDF) provided financing of €61 million and the European Investment Bank (EIB) €122 million. Other donors included the World Bank and the Government of Lesotho.

It appears that one Lesotho official was in a position to influence the awarding of contracts. Following legal proceedings in Lesotho, several bank accounts were identified in Switzerland containing more than €3 million considered to be from bribes. The official was found guilty and sentenced to 15 years' imprisonment. In 2003, following a meeting and exchange of information with the Prosecutor in charge of the case in Lesotho, OLAF opened its own external investigation into the allegations and at the same time provided assistance to the Prosecuting Authorities of Lesotho. These and other ongoing enquiries have assisted the Lesotho authorities to continue to examine further suspect transactions and contributed towards a guilty plea by a multi-national company to corruption charges in Lesotho. Two other companies have been convicted in Lesotho and OLAF is continuing its enquiries into the activities of other companies.

#### *Case Study: Non-Governmental Organisation*

In April 2003 an Italian Public Prosecutor launched an investigation into a non profit-making organisation whose aims are to assist developing countries in cooperation with local NGOs of third countries and national or regional institutions. In this context, the organisation in question has received finance of almost €17 million from the national

budget for 23 projects, and of €11 million from the European Commission for 28 projects. The judicial authorities seized a large number of documents during the investigation. They requested OLAF's assistance to examine details of the projects funded from both the Italian and EC budgets, since dual financing can only be demonstrated by an investigative process which involves both donors.

Due to the nature of the documentation proving expenditure within certain third countries, OLAF concentrated its initial efforts on verifying direct bank transfers from Italy to those countries. Investigations indicated that bank statements showing proof of payment for projects had been at times duplicated and falsified, especially where projects were being financed by different bodies in the same third country. Sometimes only half the sum was actually transferred. Other anomalies were identified such as references in the accounts presented to the donor agencies to fictitious supporting documents, duplication of supporting documentation for more than one project, unsigned invoices and procurement of goods through a commercial firm owned by the legal representatives of the non-profit making body.

Investigations in Italy are ongoing in close collaboration with OLAF and the Italian Ministry of Foreign Affairs.

#### *Case Study: Water Supply Project in Paraguay*

In early 2004, the European Commission Delegation to Paraguay informed OLAF of the alleged misappropriation of Community funds that were intended to improve the water supply system in 50 local authorities of that country. An external audit at the end of 2003 had indicated that about 90 % of the EC funds transferred to the project had been diverted to a bank account belonging to a foundation that was not involved in the project. The relevant Paraguayan authorities had reported the matter formally to the Public Prosecutor's Office which began a judicial enquiry in January 2004.

OLAF opened an external investigation and carried out an on-the-spot control of the use of these EC funds in Paraguay. An in-depth analysis of the relevant documentation, in close cooperation with the Prosecutor, identified an additional fraudulent practice; the declared sub-contractors for one part of the project turned out not to exist, and the work was carried out by a company controlled by one of the directors of the project. It is also possible that the expenditure was significantly inflated. A Paraguayan lawyer has been appointed to defend the EC's interests in the ongoing criminal proceedings.

#### *Case Study: Alleged Financing of Terrorism*

In February 2003, following allegations that European funds were used to finance terrorism or other illegal activity, OLAF decided to open an external investigation into alleged irregularities relating to financial assistance provided by the European Commission to the Palestinian Authority since the end of 2000.

OLAF investigators visited the region in October 2003, January and October 2004 and held information-gathering meetings with representatives of various national and international bodies from the IMF, the World Bank, Middle Eastern countries, the private sector and Member States. Despite improvements to the financial control systems within

the Palestinian Authority, these systems are not yet sufficiently consolidated to exclude all risk of misuse. OLAF will report its final conclusions by the end of 2004.

## 2.2.5. Structural Actions

During the reporting period, OLAF evaluated 72 items of information relating to the Structural Funds. This led to the opening of 31 cases (18 external investigations, 5 coordination cases and 8 assistance cases), of which 48% related to the European Social Fund (ESF), 29% to the European Regional Development Fund (ERDF), 10% to the European Agricultural Guidance and Guarantee Fund – Guidance section (EAGGF) and 10% to the Financial Instrument for Fisheries Guidance (FIFG) and 3% to the Cohesion Fund.

During the same period 105 cases were closed. 41 of these were classified as non-cases. The remaining 64 consisted of ESF (51%), ERDF (28%), FIFG (10%), EAGGF (9%) and Cohesion fund (2%), many of which were forwarded for judicial follow-up and/or financial recovery. During this period the last remaining cases initiated by UCLAF were closed. Some were sent for financial or judicial follow-up. Others required no further action. Figure 33 provides the details on structural funds cases.

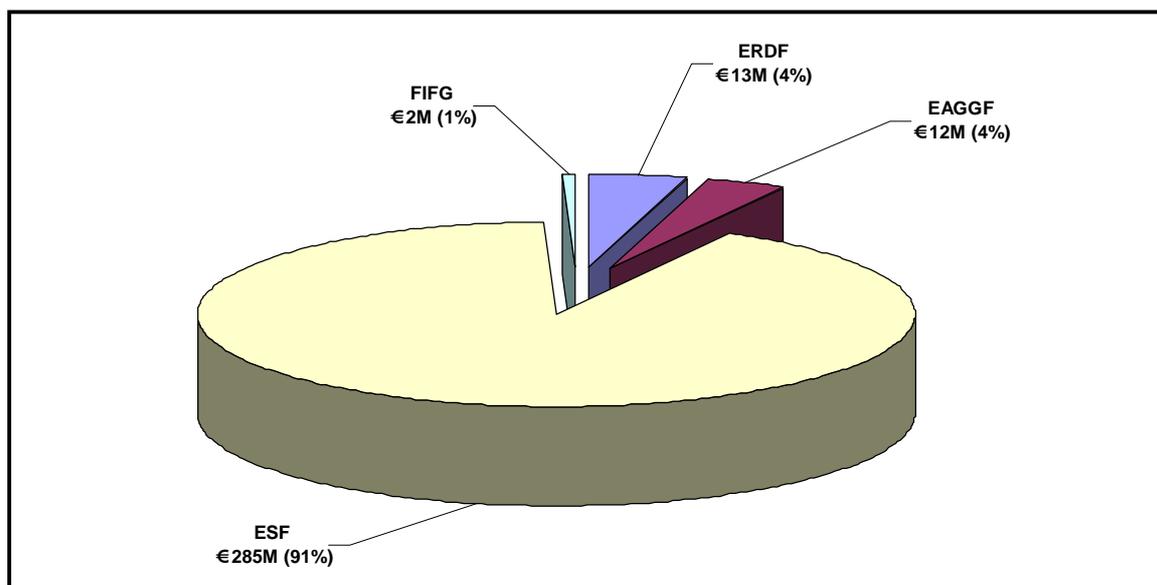
Figure 33: Cases closed during the reporting period by Member State and by Fund<sup>18</sup>:

Member States	ERDF	EAGGF	ESF	FIFG	Grand Total
Austria	1		1		2
Belgium	1		4	1	6
Denmark			1		1
France	3		2	1	6
Germany	1		3		4
Greece			3		3
Ireland	1	1	1		3
Italy	5	4	7	1	17
Luxembourg			1		1
Netherlands			2		2
Portugal		1	3		4
Spain	1		9	4	14
United Kingdom	8		1		9
<b>Grand Total</b>	<b>21</b>	<b>6</b>	<b>38</b>	<b>7</b>	<b>72</b>

Figure 34 shows the financial impact of the cases closed. Last year 147 cases were closed with an estimated impact of €330 million. This year 64 cases were closed with a financial impact of €312 million. This financial impact is primarily due to the high value of one specific case.

<sup>18</sup> More than one fund and more than one Member State can be concerned by the same investigation.

Figure 34: Structural Funds cases closed during the reporting period with financial impact by programme (€ millions)



These results were obtained by targeted operational steps strengthened by risk analysis produced within OLAF and by the exploitation of effective legislation (namely on-the-spot controls under Regulation 2185/96). The results also reflect close cooperation with Member States authorities and positive coordination with the relevant Commission services.

Close cooperation with judicial authorities was particularly important for cases where the allegations related to corruption or collusion between beneficiaries and civil servants managing the funds.

Cross checks performed under Regulation 2185/96 on other economic operators related to the transactions proved to be an essential tool in detecting fraud. These uncovered information indicating organised fraud and agreements between operators to defraud both the European and national budgets. For example, beneficiaries and suppliers were the same, certain operations did not take place, funds were used incorrectly, and suppliers returned funds to the beneficiary.

#### *Case Study: Construction of a Groundwater Recharge Facility*

OLAF opened an assistance case further to a request for technical support by a State Prosecutor during an investigation concerning possible misuse of EU subsidies totalling approximately € 700 000. The funding concerned a project financed by the European Regional Development Fund (ERDF) and by the Guidance section of the European Agriculture Guarantee and Guidance Fund (EAGGF) for the construction of a groundwater recharge facility for irrigation purposes. The allegations were related to possible collusion between the beneficiary and the regional authority aimed at subsidising a project that did not comply with the eligibility criteria provided by the Single Programming Document and with the provisions of environmental directives.

OLAF coordinated the expertise necessary to analyse the technical specifications of the waste water treatment plant together with the Commission Directorates-General responsible for Environment and Agriculture policies. The analysis concluded that the project could have had a negative impact on the region's drinking water and could impair the water quality. It was also confirmed that the project description had been modified by the beneficiary and by the national authority in order to appear to comply with the eligibility criteria. The regional managing authority finally decided not to use any European subsidies for the implementation of this project.

*Case Study: Manufacturing of Fishing Vessels*

OLAF participated in the financial recovery process after it became clear that there had been serious irregularities in manufacturing projects for new fishing vessels co-financed by the Financial Instrument for Fisheries Guidance (FIFG). As a result, OLAF noticed that a particular beneficiary was continuing to obtain subsidies for the modernisation of fishing vessels. OLAF opened an external investigation and with the assistance of the national authority performed an on the spot control at the beneficiary's premises. Verification visits were also made to suppliers and sub-suppliers. The investigators established that an intermediary company issued one single consolidated invoice to the beneficiary, although the work had actually been carried out by several small businesses. The same invoice contained false descriptions of the work which had been carried out before the start of the project. The beneficiary used the consolidated invoice and the intermediary company as interface between itself and the subcontractors with the sole purpose of concealing the real scope of the projects and their actual timeframe.

A thorough analytical comparison of the documents provided by the beneficiary to the national authority, with all of the suppliers' manufacturing and accounting records, allowed OLAF to detect major discrepancies between the nature of the works actually performed, the timeframe and the true scope of the projects. In reality the beneficiary financed mainly routine maintenance for its boats, and did not modernise the fishing vessels as required by the specific project objectives. Nor did the beneficiary comply with the obligation to keep the vessels for at least five years; indeed it had sold them shortly after completion of the maintenance work. OLAF recommended that the national managing authority recover the full amount of the subsidies (€650 000) and referred the case to the national judicial authority.

*Case Study: Co-financing of Training Programme*

An external investigation case was opened following a complaint by a trainer that the part of the financing of a training activity (co-financed by the European Social Fund - ESF) intended to pay the trainers' wages had not been paid in full to the trainer. On-the-spot checks carried out at the premises of both the recipient (a federation of contractors) and the principal supplier (a training institution) showed that the costs declared to the management authorities, on the basis of which ESF co-financing had been granted, had been inflated. The training institution had restricted itself to invoicing the recipient with the goods and services placed at its disposal (in particular, computer equipment and the trainers' wages), without adding anything else, but had increased its profit margin by between 240% and 640%. In effect the trainers received only 25% of the declared "wage

expenses". The invoices for computer equipment were used by both the recipient and the supplier (who also directly benefited from ESF co-financing) to justify their expenditure (i.e. double financing). The amounts invoiced for the *rent* of computer equipment alone would have *purchased* twice the equipment at normal market prices.

OLAF discovered that the manager of the training institution had paid the recipient more than €500 000 for no apparent commercial reason. It is believed that this amounted to his half share of the profits from a plot intended to defraud Community and national budgets. OLAF recommended that the aid paid to the recipient should be recovered in full (almost €2 million) as well as recommending that the authorities of the Member State concerned carry out exhaustive checks of any other type of Community aid granted to the same recipient. The legal authorities of the Member State were also informed in order to consider criminal proceedings. Additionally, OLAF opened another external investigation into the training institution as a recipient of ESF aid.

On-the-spot checks exposed the same kind of problems already described in the previous example. Again, total recovery of the aid already granted was recommended (more than €250 000) and the information was transmitted to the national judicial authorities.

### **2.2.6. Agriculture and Trade**

OLAF's operational activities relating to agriculture are focussed on two separate but linked areas of activity, both of which have huge implications for the EC Budget. These are the detection and prevention of fraud and irregularities:

- In the framework of the aid and subsidy schemes of the Common Agricultural Policy;
- In the trade of agricultural products, including both imports and exports as governed by agricultural and customs legislation.

The objective of cases opened in the domain of agriculture aid and subsidies is to gather information and evidence about funds irregularly/fraudulently obtained or paid out under the Common Agriculture Policy and Rural Development Funds, to assist the Member States in enabling them to carry out these actions, to assist in the prosecution of the perpetrators of such illegal activities and to help in the recovery of such funds.

Activities related to trade in agricultural products reflect obligations in the Treaty. Investigative work related to the suspicion of fraud in the import of agricultural products and/or export operations (notably export refunds) is often similar in nature to OLAF's Customs work. Such cases often require investigative activities in the Customs area both in Member States and third countries, and are usually dealt with by OLAF through the coordination and facilitation of enquiries which are carried out simultaneously by investigative services in several Member States. OLAF does however conduct a number of its own investigations, as opposed to coordinating the investigations of others, mainly where Member States have decided not to invest investigation resources in specific areas of concern to OLAF.

There is an increasing tendency for staff dealing with agriculture cases to become more closely involved in criminal cases initiated by judicial authorities in Member States, where OLAF is asked to provide technical expertise. Such activities can include participation in judicial actions within the Member State concerned, and assisting judicial authorities in

the course of the execution of International Rogatory Commissions outside that Member State. Such assistance is given both in the course of criminal investigation which have been initiated following the transmission of a report from OLAF to the national authorities, and in cases where the national authority had initiated an investigation without prior involvement of OLAF.

During the reporting period, OLAF evaluated 103 items of information relating to Agriculture. 44 of these were classified as non-cases. 59 cases (17 external investigations, 38 coordination cases and 4 assistance cases) were opened. Furthermore, 71 cases were closed at the operational stage. During this period the last remaining cases initiated by UCLAF were closed. Some were sent for financial or judicial follow-up. Others required no further action. Figure 35 shows the breakdown of decisions during the reporting period by product or agricultural measure.

*Figure 35: Breakdown of Agriculture cases in assessment and active stage at the end of the reporting period by product*

<b>Product</b>	<b>Evaluation</b>	<b>Active investigations</b>	<b>Total</b>
<b>Alcohol Products</b>	1	5	<b>6</b>
<b>Animal Feed</b>	0	1	<b>1</b>
<b>Cereal Products</b>	1	3	<b>4</b>
<b>Egg Products</b>	0	1	<b>1</b>
<b>Fats and Oils</b>	1	3	<b>4</b>
<b>Fish Products</b>	1	1	<b>2</b>
<b>Food of non animal origin</b>	0	1	<b>1</b>
<b>Fruit and Vegetables</b>	4	21	<b>25</b>
<b>Farmland</b>	0	2	<b>2</b>
<b>Live Animals</b>	0	2	<b>2</b>
<b>Meat Products</b>	4	21	<b>25</b>
<b>Milk Products</b>	2	5	<b>7</b>
<b>Multi Products</b>	1	0	<b>1</b>
<b>Rice Products</b>	0	1	<b>1</b>
<b>Structural Actions</b>	7	3	<b>10</b>
<b>Sugar</b>	1	18	<b>19</b>
<b>Tobacco</b>	0	1	<b>1</b>
<b>Wine</b>	1	0	<b>1</b>
<b>Others</b>	3	0	<b>3</b>
<b>Total</b>	<b>27</b>	<b>89</b>	<b>116</b>

Sugar, meat products and fruit and vegetable cases account for more than half of the active cases.

*Case Study: Sugar Import from the Balkans*

In April 2002 OLAF requested Member States to reinforce control measures on imports of sugar declared at Customs clearance in the EU as originating in the Western Balkans. The Greek customs authorities duly sampled such consignments imported into Greece in order

to establish whether these consisted of cane or of beet sugar. The analysis indicated that most imports declared as of Croatian origin in fact consisted of a mixture of cane and beet sugar (cane sugar is not produced in Croatia). The Greek judicial authorities opened a criminal investigation and designated OLAF investigators to render assistance.

The Greek judicial authorities performed an International Rogatory Commission in Croatia in June 2003 in which OLAF officials participated as experts. In the course of this Rogatory Commission it was established that some 24 000 tons of sugar had been misdescribed as being of Croatian origin. These facts being confirmed by the Croatian authorities led to the cancellation of some 1000 EUR.1 certificates of origin. Recovery procedures have started in the Member States in relation to customs duties estimated at about €10 million.

In addition, the Italian judicial authorities have started a criminal investigation against an Italian trading company involved into the operations following the transmission of information by OLAF.

#### *Case study: Abuse of the Community funded flax regime*

EU Regulations (619/71 and 1164/89) provide for aid for the production and processing of flax. Aid may be paid for flax produced but not processed only when the product is declared as unfit for processing due to bad weather conditions. Flax produced is processed into linen, paper and internal car padding. In 2001 OLAF opened a case about possible irregularities involved in the production of flax in the UK between 1997 and 2000. The allegations were that flax-processing companies had falsely declared straw to be unsuitable for processing in order to avoid high haulage and processing charges, but had still claimed the subsidy. Four flax processors accounted for over 80% of the flax processed in the UK.

Following the investigation carried out in the UK one processor was convicted in a UK Court in 2003. Two directors of the company received prison sentences. The other three processors have been the subjects of irregularity notifications under Community law. The total risk to the Community budget was at least €10 million.

### **2.2.7. Customs, Alcohol, Cigarettes, Precursors and VAT**

OLAF's activities in these sectors are undertaken in coordination with the Office's partners in the Member States and third countries. The frauds tackled include evasion of anti-dumping and conventional customs duties by misdescription of origin, undervaluation, etc, relating to industrial, textile and fisheries products; cigarettes fraud (smuggling and diversion of authentic and counterfeit cigarettes); and, to a lesser extent, alcohol frauds (smuggling and diversion). As well as combating these traditional customs frauds, OLAF is also active in the area of international VAT frauds, particularly carousel frauds.

This type of work generally attracts less public and political attention than OLAF's operations against corruption and fraud within the EU Institutions. However, in quantitative terms the impact of frauds in these areas is particularly harmful to Community and national interests: evasion of customs duties and national taxes means that taxpayers have to contribute more than they should otherwise do; evasion of anti-dumping duties has the added consequence that products which so enter the Community market can cause

serious damage to legitimate businesses; smuggling of cigarettes, whether genuine or counterfeit, leads to enormous losses of revenue (with knock-on effects in other policy areas) and is usually carried out by criminal organisations which conduct many other illegal operations and whose profits in extreme cases may contribute to the funding of terrorism; while VAT carousel fraud quickly undermines legitimate trade and produces huge amounts of illegal profits which can quickly be ploughed into other illegitimate activities.

OLAF's actions in these areas are designed to enable the national authorities to gather essential evidence needed to recover the evaded duties and taxes and to prosecute the fraudsters. The role of OLAF in these activities cannot be replicated elsewhere and forms a vital element in achieving the results obtained. OLAF's services are much in demand. In order to make best use of limited resources, OLAF participates only in cases which meet exacting priorities, including the amount of revenue at stake and the chances of successfully recovering this revenue. Methods of investigation and actions undertaken are reviewed and modified in the light of developments in Community legislation, Community case law and in the nature of frauds themselves.

During the reporting period, OLAF evaluated 118 items of information relating to this sector. 34 of these cases were classified as non-cases. 84 cases (14 external investigations, 60 coordination cases and 10 assistance cases) were opened. Furthermore, 137 cases were closed at the operational stage. During this period the last remaining cases initiated by UCLAF were closed. Some were sent for financial or judicial follow-up. Others required no further action.

Figure 36 shows customs cases by type of fraud. It should be noted that most of the specified fraud concern false declaration of origin.

*Figure 36: Breakdown of Customs cases in assessment and active stage at the end of the reporting period by type of fraud*

Method of Fraud	Customs	Alcohol	Cigarettes	Pre-cursors	VAT	Grand Total
Accounting records not presented					1	1
Drug precursor traffic				11		11
False description of goods	6		2			8
False origin declaration	43		1			44
False quantity declaration	2					2
False supporting documents	1					1
False value declaration	3					3
Other false declaration	8		2		2	12
Other fraud	19		8		17	44
Other irregular documents	1					1
Other transit fraud	1		1		2	4
Smuggling		1	34		4	39
<b>Grand Total</b>	<b>84</b>	<b>1</b>	<b>48</b>	<b>11</b>	<b>26</b>	<b>170</b>

*Case Study: Civil Action in the US Courts on Cigarettes*

Historically, a key concern for the European Community has been the introduction of contraband cigarettes into the European Community. For that reason, the European Community has taken vigorous action to address cigarette smuggling. European law-enforcement efforts, including those of OLAF, have resulted over the past several years in the reduction of the amount of cigarettes that enter the EU as contraband. In 2000 and 2001 the European Commission and ten Member States (Belgium, Finland, France, Germany, Greece, Italy, Luxembourg, the Netherlands, Portugal and Spain) launched a civil action in the Courts in New York against the cigarette manufacturers Philip Morris, RJ Reynolds and Japan Tobacco International alleging that they bore responsibility for cigarette smuggling, and seeking injunctive relief to prevent smuggling in the future.

Following negotiations with Philip Morris (in which OLAF played a key role, in cooperation with the Legal Service of the Commission), on 9 July 2004 the European Commission, together with 10 Member States, and Philip Morris International (PMI), announced a multi-year Anti-Contraband and Anti-Counterfeit Agreement that includes an efficient system to fight against future cigarette smuggling and counterfeiting and which ends all litigation between the parties on this issue. Through the Agreement, Philip Morris International will work with the European Commission, OLAF, and law enforcement authorities to help in the fight against contraband, including the rapidly growing problem of counterfeit cigarettes. The agreement includes substantial payments by PMI, which could total approximately USD 1.25 billion over twelve years, and which could be used to improve the fight against cigarette fraud. The Agreement also includes an initiative whereby PMI has agreed to make payments in the event of future seizures in the European Community of its genuine products above defined quantities. If other Member States sign the Agreement, including the new Member States, they will also be entitled to receive these payments.

The initiative includes far-reaching product tracking procedures that will facilitate law enforcement efforts to determine the point at which any genuine product is diverted from the authorised sales channel. Consistent with the Agreement, PMI will mark certain packaging with information indicating the intended market of retail sale, mark “master cases” of cigarettes with machine-scannable barcode labels, and implement other procedures useful for the tracking and tracing of its products. These tracking and tracing obligations embody the first major initiative in this area and are consistent with the anti-contraband provisions of the World Health Organization’s Framework Convention on Tobacco Control (on which OLAF made an important contribution in the negotiations).

With the enlargement of the Community OLAF faces new challenges in the Customs area. OLAF has worked with many authorities in the new Member States in the past under the provisions of the Protocols to the Europe Agreements and has already established good contacts, particularly in the cigarettes area: these contacts are being deepened and strengthened.

*Case Study: Fraudulent Importation of Stainless Steel*

In February 2004, OLAF closed an investigation into the fraudulent importation of stainless steel wire into the European Community, opened in January 2001 on the basis of

information received from a Member State and industry sources. The investigation established that stainless steel wire manufactured in India had been imported into the Community via intermediaries in the United Arab Emirates (UAE) in violation of the antidumping and countervailing duty regulations introduced on such products. The applicable regulations, in force between 1999 and 2004, applied antidumping and countervailing duty rates ranging up to 55.6% on the value of the imported goods. By means of false declarations of origin more than 6 million euros in antidumping and countervailing duties were evaded. The fraudulent traffic of the goods concerned had ceased in 2001 due to the conduct of OLAF's operational activities in the UAE and the investigations in the United Kingdom at the time.

OLAF initiated and coordinated the case in close cooperation with the competent services from Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Sweden and the United Kingdom, and was assisted by the competent authorities in the UAE and India. In the UAE, a Community team composed of OLAF officials and representatives from certain Member States inspected the production facilities of the six UAE companies concerned, and assessed the production processes carried out on the stainless steel wire imported from India so as to determine whether the processing involved could confer the UAE preferential or non-preferential origin on the goods. The alleged UAE producers had claimed to process the Indian raw material to an extent which conferred UAE origin. The results of the mission proved that the origin of the product remained India and that the duties should therefore have been declared at import into the Community.

To date more than € 4 million of the evaded duties have been recovered. Criminal proceedings and prosecutions against importers and Indian principals have taken place or are still ongoing in Germany. OLAF supported German Customs in rejecting an appeal launched by one of the importers by providing additional evidence obtained from the Indian manufacturers.

#### *Case Study: False Declaration of Origin of Shrimps Imports*

Shrimps exported from the Philippines to the Community were suspected to be of Chinese origin. By declaring the shrimps to be of Philippine origin the importers made false claims to preferential duty treatment as well as evading a Community health prohibition. All Member States concerned were informed about the problem, and the Philippine competent authorities were contacted. In order to obtain proof to support the allegations OLAF officials visited the Philippines in March 2004. As a direct result of this exercise in administrative cooperation, Community own resources (customs duties and import VAT) in the region of € 2.5 million are expected to be recovered by the Member States' authorities. In addition, information obtained during the mission will be used by the Netherlands and Spain in their investigations into possible criminal actions by the importing companies.

The following 2 cases give some indication of the variety and types of cooperation that OLAF can provide to its partners in the cigarette and alcohol sectors of anti-fraud activity:

#### *Case Studies: Cigarette Smuggling into the EU*

As a result of a seizure in Sweden of 27 million cigarettes coming from the Russian Federation, Swedish Customs requested OLAF's assistance to check an address of a Belgian

company that appeared to be connected. With the company identified, Swedish Customs informed the Belgian Customs risk analyses section, which continued to monitor the activities of the company concerned leading to the detection of a container from Vietnam with 4.5 million cigarettes. It has been established that a significant criminal organisation is behind this fraud, which can be linked to several consignments of seized cigarettes in different EU countries.

At the request of the UK authorities, OLAF organised a meeting in Madrid with the Portuguese and Spanish authorities in relation to an ongoing operation in the UK concerning cigarettes and alcohol smuggling. Subsequently, the Spanish authorities instigated a judicial investigation, intelligence from which was shared, through OLAF, with the other countries involved in the investigation, especially with the UK, since the main target in Spain used to travel frequently to London. This intelligence greatly benefited the Portuguese and UK investigations. Further investigations by the Belgian Police identified a warehouse containing a large amount of cigarettes and alcohol, including 5000 litres of pure alcohol/ethanol. OLAF's main goals at the beginning of the case were to facilitate the identification and dismantling of a bottling plant under the criminals' control; the disruption of their cigarette smuggling activities; the investigation and disruption of their alcohol diversions and the investigation and disruption of a VAT carousel fraud. These goals were achieved at the end of the investigations in all the countries involved. In total, the most significant results of the investigation were: seizures of more than 25 million cigarettes, more than 80 000 litres of spirits, around 5 000 litres of pure alcohol, and 4.5 tons of cannabis resin; and the dismantling of one warehouse and one bottling plant.

Figure 37 shows the breakdown of VAT cases by product involved.

*Figure 37: Breakdown of VAT cases at the end of the reporting period by product*

<b>Product</b>	<b>Total</b>
<b>Automobiles</b>	8
<b>Computer Equipment</b>	4
<b>Foodstuffs</b>	2
<b>Jewellery</b>	2
<b>Mobile telephones</b>	4
<b>Multiple Items</b>	3
<b>Non Ferrous Metals</b>	1
<b>Precious Metals</b>	1
<b>Silicone Carbide</b>	1
<b>Total</b>	<b>26</b>

*Case Study: VAT Carousel*

The Italian judicial authorities requested OLAF's assistance in an ongoing investigation in the field of intra-Community trade in computer processing units (CPUs). Italian "missing traders" had failed to pay significant amounts of VAT to the Italian State in respect of computers and other hardware components, which had been shipped from Belgium and

Germany. The investigation was complex as the CPUs had allegedly been sold to intermediate companies (also in Italy) which in turn had sold them again to Germany.

The problem for the Italian judicial authority was to demonstrate that the same CPUs had again been sold to Italy and thus to prove that they had been traded in a closed VAT carousel circuit. This would have allowed VAT fraudsters to gain VAT at each passage of the commodities through the same Italian “missing traders”. As a result of OLAF’s assistance to the German and Italian judicial authorities and of the cooperation and investigation activity carried out in Germany and in Italy, excellent judicial results were obtained in Italy: 25 persons were reported for involvement, 7 persons were arrested, 15 fiscal carousels were discovered involving a fraud of €30 million unpaid VAT perpetrated by missing traders and €8 million VAT unduly reimbursed. OLAF will continue to offer its assistance, and further inquiries in France, Switzerland and Monaco will follow.

### **2.2.8. Multi-Agency Investigations**

Last year’s activity report highlighted a successful investigation conducted jointly by OLAF and the U.N. Office of Internal Oversight Services (OIOS) into a suspected fraud of €3.9 million by a former EU employed consultant working for the U.N. in Kosovo.

Encouraged by this success, a new Multi-Agency investigations unit was established within OLAF to develop and strengthen cooperation on administrative investigations with bodies and agencies such as the OIOS and donor institutions such as the World Bank, where there are clear mutual interests and potentially overlapping investigations into alleged frauds. In addition to the agreement with the United Nations, a new cooperative arrangement was signed between OLAF and the World Bank to conduct joint investigations based on mutual interest and on identified common needs. Due to the increasing worldwide expenditure of the EU budget, further similar administrative investigative agreements are foreseen.

During the reporting period the new unit dealt with 8 cases: one in evaluation, 6 under investigation and one closed without follow up. Allegations of irregularities reported within an audit of the Publicly Owned Enterprises (POE) in Kosovo led to the setting up in November 2003 of a joint investigation task force of investigators from OLAF, the OIOS and the Italian Guardia di Finanza with the aim of examining the possibility of fraud, irregularities and corruption. The EU, including the European Agency for Reconstruction (EAR), has been the major aid donor to these enterprises (Railways, Electricity, Water, Airport), and OLAF’s role in investigating potential fraud affecting the EU budget in Kosovo has been pivotal. To date the task force has fully concentrated its efforts on the activities of the enterprise responsible for running Pristina airport. This has extended to 37 differing elements within one case and includes allegations concerning procurement contracts, bribes to secure employment, the sale of Schengen visas, and the non-accounting of fees paid by companies using the airport.

### **3. OPERATIONAL SUPPORT**

#### **3.1. Intelligence Activity**

##### **3.1.1. Strategic Intelligence**

The strategic intelligence capability of OLAF has continued to develop. It is improving its ability to gather information and provide in-depth analysis to give strategic direction and support to OLAF's operational activities and to reinforce OLAF's policy role. Output in the reporting period included:

- A preliminary risk assessment across the whole Community Budget. This exercise had two main objectives; first, to support the analysis underlying the Programme of Activities for 2005 and second, to help identify potential areas for more in-depth analysis by OLAF's intelligence units;
- A number of risk assessments based on reports of irregularities in the funding of the Common Agricultural Policy and Structural Funds have been produced to support Member States in the setting of priorities for control and investigation policies, and to support policy development and the prioritisation of case related issues. Effort has also been dedicated to training and support for the new Member States to prepare them for reporting and analysing irregularities in these sectors;
- Several mid-long term projects have been initiated in the area of External Aid;
- An in-depth analysis of certain statistical information relating to VAT has been carried out to determine its potential as a source for the detection of fraud, fraud patterns and fraud sensitive product groups. Intra-Community VAT fraud data is being more systematically exploited using text mining tools;
- Cooperation with anti-fraud intelligence units in the Member States, Candidate Countries, third countries and other international institutions has been further strengthened. Specific attention has been paid to building working relationships with authorities in the new Member States as part of the Multi-country PHARE programme. A working partnership has been developed with Europol following the signature of a Memorandum of Agreement, both in terms of strategic intelligence exchange and the sharing of analysis techniques and IT capabilities;
- Progress in the development of new tools and techniques to gather and exploit information and to identify new and improve existing sources. The ability to access, exploit and analyse data is key to the success of OLAF's intelligence capability.

##### **3.1.2. Operational Intelligence**

Operational intelligence includes specialist support and assistance to OLAF investigators on internal and external investigations. The team is sometimes also asked to assist the Member States. Figure 38 shows the distribution of some 1500 requests for information and intelligence support that were handled within OLAF:

Figure 38: Requests for Intelligence Support by Domain

Intelligence Sector	Total
Information Support	1259
Operational Intelligence	141
Technical Assistance	48
Evaluation Cell	51
<b>Total</b>	<b>1499</b>

Since 1 April 2004, such requests have been made through the Case Management System (CMS) following the development of an intelligence module within the CMS. The latter initiative makes it easier to manage the relationship between the intelligence analyst and the investigator who requires intelligence support. It is also consistent with the objective of strengthening the security of OLAF's operational environment. The analysts' involvement with OLAF investigators is becoming more intensive, with intelligence increasingly an integral part of the investigative process. Good interaction between the investigator and the analyst has become a key success factor in achieving results in the more complex cases.

Major projects carried out by the operational intelligence analysts include:

- Development and deployment of an automated monitoring tool. On the basis of experience gained during the 1995 wave of accession (Austria, Finland and Sweden) OLAF assessed the possible risk that operators within the EU could fraudulently take advantage of the transition process to membership. A pilot project undertaken with the Joint Research Centre during the first half of 2003 demonstrated that an automated monitoring tool could be created to assist in the detection of potential irregularities. This identifies unusual trade patterns by employing statistical methods which can then be further analysed and used by investigators;
- Analysis of beef imports. The EU import regime for beef prohibits multiple applications for tariff quota by single or connected traders. OLAF devised a methodology to identify related companies within and across Member States that unduly benefited by lodging multiple applications. The methodology applied in this investigation could serve as a basis to other quota driven regulations in the agricultural domain;
- Analysis of high risk trade flows. Experience in recent years shows that there has been a significant increase in fraudulent trading by certain exporters, mainly within the Community's external commercial policy areas and most prominently in the evasion of anti-dumping duties and in matters of food safety. OLAF has analysed the relevant products systematically in order to create an improved follow-up mechanism, using experience gained from the automated monitoring tool project. This initiative will be developed during the next reporting year. An early example of its use has led to the opening of OLAF investigations into the fraudulent importation of garlic of Chinese origin into the EU via transshipping in third countries.
- OLAF has continued to provide operational and logistical support for the Member States during Joint Customs Operations (JCOs). The technical difficulties encountered

by the Virtual Operational Coordination Unit (Virtual OCU) IT application in the beginning of 2003 have been overcome and the scope of the operations has now been extended to containers and to road transport. During this period two general container operations (each involving over 20 participating countries) were run from within the standard OCU and one regional operation was run exclusively via the Virtual OCU.

- The Contraffice search tool to assist in tracking containers has been developed and has entered the acceptance phase. The first operational tests show promising opportunities for the detection of fraudulent operations.

### **3.1.3. Technical assistance**

OLAF continued to provide technical support in computer forensics for several OLAF investigations, for other Commission services, Agencies such as the European Agency for Reconstruction and Development, the Committee of the Regions and the UNMIK Organisation in Kosovo. The specialist team keeps abreast of international professional standards and has improved the efficiency of this service.

OLAF's technical assistance team has assessed the relevant capacities of law enforcement agencies in the new Member States in the context of a partnership in Special Investigation Methods. It has organised training in special investigative methods in Latvia and Hungary for these agencies under the Multi-country Phare programme.

OLAF has contributed to the "Border Control Project" at the new external borders by assisting in technical definitions. This project is a Commission activity, falling within the areas eligible under the Transition Facility (external border control, protection of the Communities' financial interests), administered by DG ELARG. The aim of this project is to assist the new Member States in equipping some 45 major land border crossings and 17 railway crossing points with automatic licence plate and container recognition software tools for multi authority use. This will assist in better targeting of controls and improved enforcement and anti-fraud capability, with minimum interference to legitimate traffic movements.

### **3.2. Information/IT support**

All business mail received or generated by OLAF is now scanned and distributed internally by electronic means. This approach is more efficient than relying solely on the physical circulation of paper and has important security benefits. During the reporting period 39 500 documents were scanned, representing 312 000 pages.

Original case-related documents are stored in individual case files within the Greffe according to a standardised format. Documents removed by investigators for further examination are carefully controlled and monitored, thus ensuring that OLAF has a complete record of all documents relating to a particular file.

During the course of the reporting period significant improvements were made to the Case Management System (CMS). The CMS provides an individual electronic file for each case, from initial receipt of information right through the assessment, investigation and follow up stages. For each case there is a record of all scanned documents, relevant administrative information and comments on key events in the development of the case.

This allows case handlers to run their cases more effectively and gives managers a useful tool with which to monitor case progress and ensure that procedures are followed.

The CMS is the primary source of OLAF operational statistics; new reporting tools have been introduced that give managers greater flexibility in extracting relevant data. A new follow-up module was implemented in autumn 2003 to centralise data collection and maintenance of information relating to all types of follow-up. A new intelligence request module was introduced at the beginning of 2004 to facilitate the flow of information internally, between the operational and intelligence domains, and to manage request for intelligence support. Further CMS modules are being developed to allow closer links between Mutual Assistance requests and OLAF investigations, to record requests for legal advice, and to support the work of the weekly Investigation and Operations Executive Board.

### **3.3. Anti Fraud Information System (AFIS) / Customs Information System (CIS)**

#### **3.3.1. The AFIS Communications & Collaboration Network**

The primary means of cooperation and information exchange with Member States is under the framework of Mutual Assistance (Regulation 515/97) using AFIS, the secure communication system. During the reporting period, considerable effort was expended in ensuring that the new Member States were trained in the use of and connected to AFIS terminals by June 2004. The enlarged user community extended to 3700 registered users, more than 800 of whom exchanged some 80 000 messages during the reporting period.

In response to the business and operational demands of Member States, IT development continued to provide streamlined and structured tools within AFIS aiming towards an increasingly targeted basis for risk assessment and analyses of the suspicious movements of goods. A new tool to support a YACHTINFO application to complete the set of tools for exchange of Maritime Intelligence (both non-commercial and commercial traffic) is one example. Likewise, in the framework of the Virtual OCU, specific reporting tools for container traffic (ConSur) and commercial road traffic (ViaSur) were added to the system. The ability of Member States to coordinate these operations using a Virtual OCU application provided by OLAF is a significant boost to the feasibility and practicality in running multi-country cross-border operations.

Preparations have begun towards providing a permanent structure to host an OCU within OLAF, to support Member States in joint customs operations. This will allow flexibility in timing of operations and a reduction in costs and other resources.

The Mutual Information System (MIS), extended to AFIS in 2003 initially to include beef meat exports by road to the Russian Federation, operated increasingly successfully. This led to the implementation of a new regulation 44/03 (modifying regulation 2584/00) in February 2004. This allowed for the monitoring of this traffic to the Russian Federation by all forms of transport and to the development of a more structured system of reporting within AFIS. Due to the changing nature of export refunds, pork meat was also included. The impact of this system is that exports can be verified and export refund payments can be paid to traders more accurately and quickly. More than 3000 communications from nine Member States were recorded during the reporting period.

### *Joint Customs Operations*

Three operations (a maritime operation targeting the smuggling of sensitive goods by yachts and other vessels with a maximum tonnage of 1000 T; an operation focusing on the traffic of sensitive goods in sea containers; and a container operation focusing on the smuggling of cigarettes and alcohol) during the reporting period, all using the virtual OCU, led to the seizures of more than 42 million cigarettes, alcohol, counterfeit goods and dangerous goods, as well as seizures of illicit drugs.

### **3.3.2. The Customs Information System & FIDE**

The Customs Information System (CIS) was implemented in March 2003 to enable competent partners involved in the application of Customs and Agriculture legislation and in customs legislation in the field of intergovernmental jurisdiction to input and interrogate a central database containing sensitive information. Since then limited use has been made of the database. In response to Member States' demands OLAF has instigated an ambitious 2-year plan for CISWeb, a more user friendly web application and has proposed legislative changes to address business needs. Training activities and follow up visits have been carried out in all Member States and CIS terminals were extended to the new Member States. An operational manual has been produced in 20 languages.

The feasibility study for the European Customs Files Identification Database (FIDE – from the French acronym) was completed and the resulting prototype and promotion material (video and leaflets) were provided to Member States in preparation for development to start later in 2004.

### **3.4. Legal support**

OLAF has the capability to produce in-house the three categories of legal support which it requires to operate effectively and independently. These are legal advice on:

- national criminal law in Member States;
- general European law, including matters as diverse as the implications of the Director-General's independence, the public's right of access to documents, and the Staff Regulations;
- specific sectors of EC law such as agriculture and structural actions.

#### **3.4.1. Legal advice on national criminal law**

Specific in-house advice on national criminal law, investigation and judicial procedures is provided in support of investigations and follow-up matters. An increasingly important working cooperation with the national judicial authorities is also maintained. During the reporting period formal written advice was given to OLAF investigators on 26 occasions, particularly in the domains of structural actions and direct expenditure. In specific cases where the facts indicated potential criminal conduct, informal legal support was provided on an ongoing basis on 92 cases during the reporting period.

Figure 39: Judicial advice in the course of an investigation by sector

OLAF Sector	Number of cases
Anti-Corruption	13
Multi Agency Investigations	1
Direct Expenditure	13
External Aid	21
Structural Funds	10
Agriculture	16
Cigarettes	8
Customs	3
VAT	7
<b>Total</b>	<b>92</b>

Further to the Commission Decision of 4 April 2002 on whistleblowers, OLAF, as a designated EU contact point for EU officials who may exercise their legal obligation to report serious wrongdoing, has taken initial organisational steps to implement a suitable contact procedure within the Judicial Advice Unit. Details of the procedure will be published in due course.

One of OLAF's major challenges is to increase the contribution made by national public prosecutors to combat fraud against the financial interests of the EU. In response OLAF has developed further contacts and participated in meetings with the European Judicial Network and has created a flexible and operational network of prosecutors which held its first annual conference in November 2003.

### 3.4.2. Legal advice on European law

During the reporting period, regular advice and support was provided in the framework of OLAF investigations and follow-up activities and on specific matters including:

- the Code of Conduct which is intended to ensure timely exchange of information between OLAF and the Commission relating to the internal investigations of OLAF, as agreed with the Commission in July 2003;
- the OLAF Manual;
- the legal basis for the Office's strategic intelligence and analytical activities;
- Preparation for the civil proceedings with cigarette manufacturers involving the Community in the US courts (this advice and support was provided to OLAF colleagues, the relevant Member States and the Commission's U.S. lawyers).
- Particular attention was also paid to an increase in questions concerning access to documents (56 requests including 45 initial requests) and data protection, as well as to the complaints made to the European Ombudsman (9 in total) involving the

Office and to preparing responses to European Parliamentary questions concerning OLAF (127 written questions and 7 oral questions).

In addition, a contribution was made to developing the Office's working methodology. Advice was given in the drafting of cooperation instruments: including the Memorandum of Understanding between OLAF and Europol (April 2004) and inter-departmental memoranda of agreement with Commission departments to establish ground rules for cooperation, as recommended in the Commission's evaluation report of the activities of OLAF.

### **3.4.3. Legal advice on specific sectors of EC law**

Sectoral legal advice and assistance in relation to EU law issues is part of OLAF's internal support to its investigation function, for instance on the competence of the Office to carry out external investigations in the field of projects financed by the European Investment Bank in third countries. It is often necessary to clarify the interpretation of complex sectoral legislation (e.g. on agriculture, structural funds, customs origin and preference issues as well as on the great variety of legislation and international agreements in the field of internal and external policies) at both the assessment and investigation phases of operational casework in order to determine whether suspicions of irregularity or fraud are well founded and can be properly substantiated. Advice on the application of time-bars laid down in Community legislation is also important, in order to ensure that the possibilities for successful recovery action are not lost. Furthermore advice on administrative sanctions has been provided, such as on the exclusion of beneficiaries and the flagging of possibly suspect counter parties in the Commission's Early Warning system (EWS).

In the direct expenditure and external aid sector, specific advice provided has contributed to 66 draft assessments on opening investigations (30 on direct expenditure and 36 on external aid) and to 80 draft final case reports (42 on direct expenditure and 38 on external aid) when it is proposed that investigations should be closed. The objective is to ensure the legality of an investigation, including conformity with Community financial regulations, internal rules, international law and contractual obligations.

#### 4. FOLLOW-UP ACTIVITY

Follow-up activity refers to action taken by OLAF once the case investigation phase is closed. This activity falls into two broad categories, as follows:

- Financial (including recovery), administrative, and legislative follow-up;
- Judicial and disciplinary follow-up.

During the reporting period a “Follow-up Module” was created in the OLAF Case Management System (CMS) in order to facilitate the administration of OLAF follow-up activity. This has consequently enhanced the efficiency of related data capture, structuring and reporting.

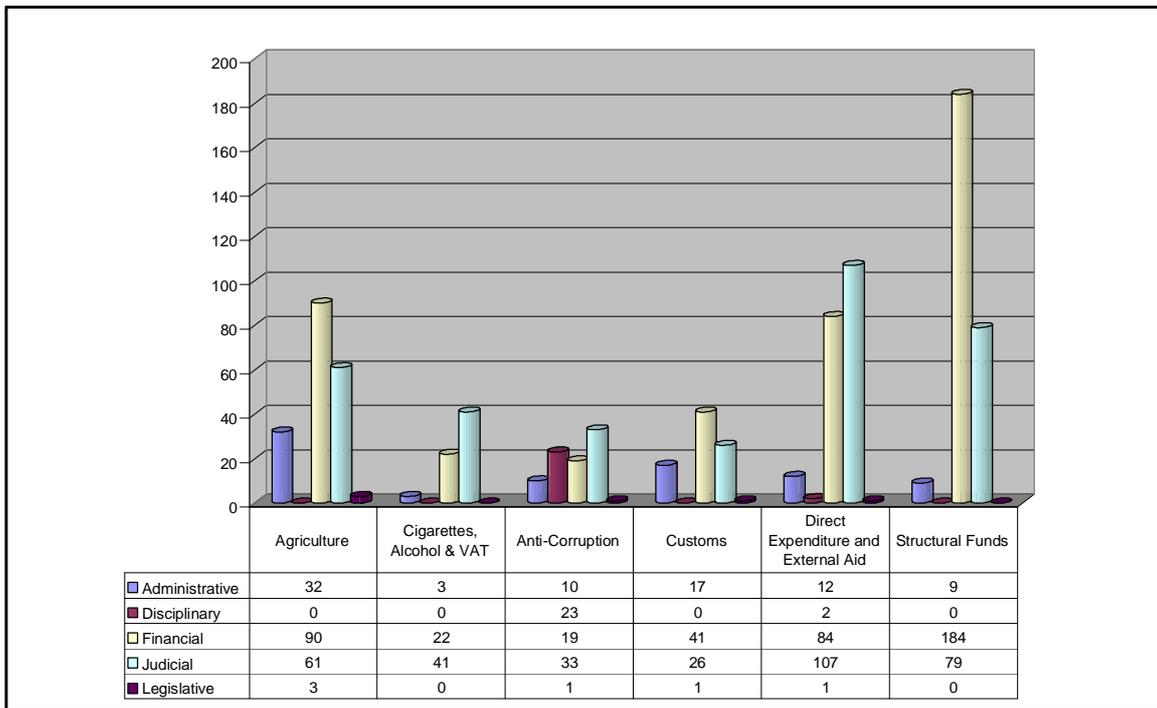
Figure 40 shows the increase in the number of follow-up cases during the reporting period by sector. While Structural Funds accounts for nearly one third of all cases in follow-up, significant increases in relative terms can be observed for all sectors, with peaks in Customs and Anti-Corruption.

*Figure 40: Follow-up cases by sector*

<b>Sector</b>	<b>Number at 30 June 2003</b>	<b>Number at 30 June 2004</b>	<b>Percentage Increase</b>
<b>Agriculture</b>	93	125	34%
<b>Anti-Corruption</b>	28	45	61%
<b>Cigarettes, Alcohol and VAT</b>	30	46	53%
<b>Customs</b>	20	52	160%
<b>Direct Expenditure and External Aid</b>	113	156	38%
<b>Structural Funds</b>	198	199	1%
<b>Total</b>	<b>482</b>	<b>623</b>	<b>29%</b>

Figure 41 shows the follow-up activities at the end of the reporting period by type of follow-up and sector.

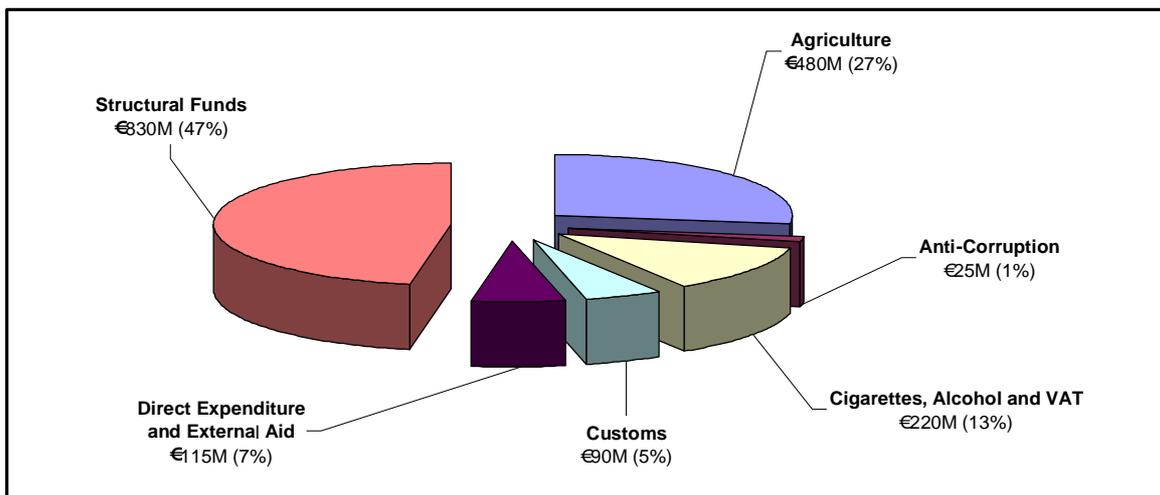
Figure 41: Follow-up activities by type and sector at the end of the reporting period



#### 4.1. Administrative and Financial Follow-Up

The total financial impact of all cases that were in follow-up at the end of the reporting period as estimated at the end of the investigations amounts to more than € 1.76 billion. Figure 42 shows the distribution of estimated financial impact by sector.

Figure 42: Cases in Follow-up with estimated financial impact by sector (€ millions)



Financial recovery action is often, depending on the method of implementation for the budget sector concerned, carried out by national authorities under national legislation. Several Member States may be involved in a single case. Long term civil and/or criminal proceedings may also be underway. Legislation and the arrangements for its implementation may need to be formally clarified before practical steps can be taken.

#### **4.1.1. Own Resources**

Follow-up in the Own Resources sector mainly concerns closed investigation cases in the Agricultural import duties or Customs (import duties including anti-dumping duties, involving all types of industrial and fishery products) domains. Account must be taken of the strict provisions of the Community Customs Code (especially relating to applicable time-bar provisions for the notification of Customs debts), the rules of Origin/Preference (including those specified in the various Trade Agreements concluded by the Community) and the detailed operating requirements of certain specific regimes with economic impact, such as Inward Processing Relief. Related points of principle and/or interpretation of legislation issues frequently have to be settled before financial recovery action may proceed.

##### *Case Study: Fur Imports under Wrong Tariff*

Laboratory testing in Denmark of samples of furs imported from China established that the goods in question had been declared under the wrong tariff heading. Customs duties had therefore been paid at a rate of 4.2% instead of 13.4%. All Member States were accordingly alerted to the risk of such misclassification by a Mutual Assistance message. Although the financial impact of the case was initially estimated as being in the region of € 150 000, liaison with Member State authorities after the closing of the investigation phase has led to reports of additional instances of misclassification following post-clearance checks in Austria, Finland, France, Germany, Italy, Spain and Sweden. Additional duty liability has consequently been established. € 652 000 have been recovered to date in respect of this case.

#### **4.1.2. Indirect Expenditure**

The financial management of expenditure in the fields of agriculture (EAGGF-Guarantee) and of Structural Actions (Structural Funds and Cohesion Fund) is shared between the Commission and Member States. The initial responsibility for recovering funds wrongly paid out falls on the Member States. OLAF's financial follow-up function consists of consulting with the responsible services in Member States and with other Commission services in order to ensure that such sums are recovered. This is without prejudice to possible improvements in legislation as a result of lessons learned (legislative follow-up) or to criminal prosecution for fraud (judicial follow-up).

OLAF follows up cases which have been investigated by the Office, or where the Office has coordinated investigative action carried out by others. For cases involving agricultural expenditure and structural actions OLAF monitors the financial follow-up carried out by the Member States concerned. For every irregularity OLAF verifies whether the Member State has informed the Commission in application of Community Regulations and follows the progress of recovery of funds through the Member States' quarterly communications. Irrecoverable amounts are dealt with by the application of the relevant sectoral Community legislation.

*Case study: Irregularities with Closure of Structural Programme*

This case concerned the possible over-claiming of costs in connection with 18 projects co-financed within the framework of the Structural Funds Operational Programme in one Member State. The main fund affected was the Regional Fund during the period 1994-99. Following an inspection by OLAF, together with the national authorities, OLAF monitored the closure procedure for the programme concerned in order to check that the amount identified as affected by the irregularities established during the inspection was duly deducted from the final payment. This safeguarded some €32 000. Financial follow-up was closed in 2004. Further enquiries into the same beneficiary led to the opening of an external investigation concerning other direct expenditure matters. OLAF assisted the national judicial authorities of the Member State concerned during the "commission rogatoire" procedure in another Member State. Penal proceedings continue in the Member State initially concerned.

*Case study: Beef Exports to Turkmenistan*

A Member State received information about discrepancies in the quantities of frozen beef exported from the EU to and arriving in Turkmenistan. These discrepancies were not reflected in the customs declarations made in Turkmenistan, presented to the paying agency as proof of arrival by the exporter. OLAF organised a joint on the spot mission to Turkmenistan, establishing that only some 30 000 tonnes had arrived over a period of six years and had been released for home consumption in that country, although the EU statistics showed higher quantities exported to Turkmenistan in the same period. These investigation results, combined with those gained from linked investigations in two Member States, have established that more than € 3.4 million in export refunds were unduly paid. OLAF is monitoring the reporting of the irregularities and the ongoing recovery procedures through contact with the paying agencies. The case will be closed either when the unduly paid amounts have been completely recovered or when a final decision is taken on the financial responsibility for those amounts which have not been entirely recovered.

OLAF continued its participation with DG AGRI in the Task Force Recovery established by the Commission to eliminate the large backlog of accumulated agricultural (EAGGF Guarantee) debts. The Task Force Recovery finalised the on the spot audits in the Member States of cases with an individual financial impact higher than €500 000, as notified by the Member States before 1999. These cases represented initially a global financial impact of more than €1 billion.

OLAF cooperated with DG REGIO in the follow-up of the audits that were carried out previously in all Member States to evaluate the national systems for the application of relevant structural fund legislation. It also drafted together with DG REGIO the summary report on the audits that was transmitted to the European Parliament, the Council and the Court of Auditors. Supplementary audits were carried out in Germany and Italy.

OLAF examined the closure statements for a total of 1088 programmes in the structural funds sector (operational programmes and direct projects 1994-1999) and coordinated with the relevant Commission services to make sure that amounts involving irregularities

had been properly settled. OLAF also finalised the closure of the follow-up stage including the “final closure report” in respect of 32 operational OLAF cases.

#### **4.1.3. Direct Expenditure**

Follow-up in the field of direct expenditure and external aid (including the follow up of multi-agency investigations) concerns expenditure where implementation tasks are performed by Commission departments rather than the Member States, or are delegated by the Commission to third countries. Follow up activities cover also the financial and administrative/legislative follow up, if appropriate, of internal investigations. The accumulated expertise and experience of the Office in recovery matters can be used in order to improve the fraud proofing of legislation, contract clauses and financial agreements with third countries. In addition, action to secure the Community’s financial interests can be taken effectively during the investigation phase.

Most of these activities relate to monitoring of recovery of Community entitlements in conformity with the Financial Regulation. Financial follow up in the area of direct expenditure focuses especially on those investigations, which have led to criminal proceedings. In order to support recovery, OLAF assesses and supports the possibility of launching civil action within criminal proceedings.

#### *Case study: Advance Payment for a Research Programme*

Following the conclusion of a contract and an advance payment of € 333 000 to a beneficiary in the framework of the specific programme for research and technological development, the Commission received no results, cost claims nor management reports. It seemed that no work had been done on the project. The relevant Commission service, in its capacity as Authorising Officer, duly terminated the contract. In order to find the company’s correct address, and also for the preparation of a recovery order, the responsible service requested OLAF’s assistance. As the company seemed to have disappeared, OLAF conducted a debtor search and informed the Authorising Officer of the company’s last known address. This search also identified that the contract was signed by the coordinator although the company had already been struck off the trade register. On the basis of this information and after having received further documents from the Authorising Officer, OLAF opened an external investigation. In cooperation with the Italian authorities, the matter proceeded to criminal proceedings in Italy. OLAF is involved in ensuring the recovery of the sums involved and the Italian Public Prosecutor is preparing the seizure of assets prior to possible civil action within criminal proceedings against the owner of the coordinating company.

In its role in searching for missing debtors in the areas of direct expenditure, OLAF established the latest known location of the parties concerned in 74% (55) of the 74 requests received from several Commission Services.

#### **4.2. Judicial and disciplinary follow-up**

Article 9 of Regulations (EC) No 1073/1999 and (Euratom) No 1074/1999 requires OLAF to draw up a report at the end of the investigation, specifying the facts established, the financial loss, if any, and the findings of the investigation. The report has evidential value, in particular in national judicial proceedings. In this connection, many reports by the

Office were sent to the judicial authorities of the Member States for use in criminal proceedings.

Whenever the investigation report recommends disciplinary and/or judicial follow-up, the file is first reviewed by OLAF's Judicial Advice Unit and then transferred to the national judicial authorities or the relevant institution's disciplinary authorities. Members of this Unit communicate as necessary with the relevant authorities in Member States and with the disciplinary authorities of EU Institutions so as to provide assistance when requested and to ensure that OLAF is aware of action taken following the transmission of OLAF reports. This is necessary so that any lessons can be learnt and so that OLAF can assess and report the final outcome of OLAF investigations.

#### *Definitions*

To assess the progress of judicial and/or disciplinary follow-up, OLAF has designed a simple system for each stage or phase, which is sufficiently general to cover the legal systems of each of the 25 Member States. This is explained here as background to the statistics below.

The following six stages were established for the judicial follow-up:

1. Review (OLAF)
2. Report sent to the national judicial authority
3. Criminal investigation
4. Trial
5. Ruling
6. Appeal

A similar system has been designed to assess progress in disciplinary measures. The following five stages were established:

- (1) Review (OLAF)
- (2) Report sent to the disciplinary authorities
- (3) Disciplinary procedure
- (4) Decision of the appointing authority
- (5) Appeal

#### **4.2.1. Judicial Follow-Up**

Figure 43 gives an overall view of the judicial follow-up position. The Office opened 341 judicial follow up cases. 23 of these cases are under internal review, 318 have been sent to national authorities.

214 cases are shown as being processed by the national authorities. (In future this category will be broken down into two categories: report sent to national authority/criminal investigation commenced.) 21 cases are being tried in the courts. 19 have been closed following judicial rulings at national level.

Figure 43: Judicial Follow-up summary

Stage	Outcome	No of Cases
1	Review (OLAF)	23
2/3	National Authority	214
4	Trial	21
5	Ruling	19
6	Appeal	9
	Cases Dismissed	55
	<b>Total</b>	<b>341</b>

Figure 44 gives a breakdown of the 55 cases dismissed according to the justification given by the national authority. In 34 cases, the national authorities have informed OLAF that they are unable to proceed because they considered that there was insufficient evidence. Most of the cases in question were related to former UCLAF investigations. Criminal investigations are, of course, the sole preserve of the national authorities.

Figure 44: Justification for “Case dismissed”

Justification	No of Cases
Prescription (out of time)	10
Lack of evidence	34
No legal basis	3
Low priority	3
Others	5
<b>Total</b>	<b>55</b>

Figure 45 shows the 105 cases which were transferred to disciplinary and judicial follow-up during the reporting period by sector.

Figure 45: New judicial follow-up cases during reporting period by sector

OLAF Sector	Number of cases in judicial follow-up
Anti-corruption	4
Direct Expenditure	17
External Aid	24
Structural Actions	13
Agriculture	18
Cigarettes	3
Customs	18
VAT	8
<b>Total</b>	<b>105</b>

#### 4.2.2. Judicial monitoring cases

OLAF receives information related to cases which have been opened by judicial national authorities. OLAF may decide not to conduct any operational activities itself but nevertheless to monitor the development of the case. In such situations, once the information has been assessed, a “monitoring case” is opened. OLAF always makes it clear that, if requested, it will give national authorities technical and/or operational assistance. Figure 46 summarises monitoring cases opened in relation to judicial proceedings during the reporting period.

Figure 46: New judicial monitoring cases during reporting period by sector

OLAF Sector	Number of cases in judicial follow-up
Direct Expenditure	1
External Aid	7
Structural Actions	2
Agriculture	9
<b>Total</b>	<b>19</b>

#### 4.2.3. Disciplinary Follow-Up

Figure 47 shows that OLAF has opened 20 disciplinary follow-up cases. Two of these cases are currently under internal (OLAF) review; three cases have been sent to the disciplinary authority of the EU Institution concerned; 7 disciplinary procedures are ongoing. The appointing authority (AIPN) has taken a decision in four cases. No cases are under appeal. Four cases have been dismissed by the disciplinary authority.

*Figure 47: Disciplinary Follow-Up Summary*

<b>Outcome</b>	<b>No of Cases</b>
Review (OLAF)	2
Disciplinary Authority	3
Disciplinary Procedure	7
Decision of the Appointing Authority	4
Appeal	0
Cases Dismissed	4
<b>Total</b>	<b>20</b>

## **5. ENLARGEMENT**

Throughout the reporting period OLAF was fully engaged in the preparations for Enlargement and in particular in preparing the new Member States and the remaining Candidate Countries for their new responsibilities in relation to the protection of the financial interests of the EC.

### **5.1. Anti-Fraud Coordination Structures (AFCOS)**

OLAF has continued its support to the national Anti-Fraud Coordination Services (AFCOS) and their partner institutions. Prior to the date of accession, meetings with all AFCOS representatives were organised in Brussels, Malta and Vilnius. Specific topics of interest for the new Member States and Candidate Countries were discussed and experience was exchanged with experts from existing Member States and OLAF.

To reinforce the focus on the institutional building aspects, OLAF requested SIGMA, a consultancy arm of the Organisation for Economic Cooperation and Development (OECD), to undertake an assessment of the administrative and operational capacity of the national anti-fraud structures in the new Member States and Candidate Countries. On the basis of the final country reports, recommendations to strengthen these capacities where needed are being formulated and will be discussed with the countries concerned. This will lead to further support activities.

The final report of a second needs assessment of the communication infrastructure undertaken by a specialised external company will be analysed to determine possible follow-up actions.

On 1 May 2004, all the new Member States had an AFCOS in place. OLAF is continuing to support the AFCOS structure through follow-up meetings in order to strengthen their legal framework and to develop their role as OLAF's main interlocutor.

### **5.2. The Multi-Country PHARE Programme (MCP)**

The implementation of the MCP Activity Plan referred to in last year's report led to OLAF organising 33 different activities covering training, seminars, workshops, internships and exchange of know-how. These began in September 2003 in a number of centres. Several hundred civil servants from administrative control and law enforcement authorities from the new Member States and Candidate Countries took part in training seminars organised in these centres. Others took part in internships in OLAF and in sister organisations in other Member States. AFCOS representatives were also invited for study visits in OLAF.

Complementary training and needs identified following the SIGMA assessment meant that the expiry dates for the MCP were extended until 30 June 2005 for contracting and 30 June 2006 for disbursement. This gives OLAF the opportunity to make an interim evaluation of the results already obtained and to draft a complementary activity plan.

### **5.3. Expanding communication and information strategy to Candidate Countries**

The OLAF Antifraud Communicators Network (OAFCN) has continued its activities in the context of enlargement, a major priority area for of its information and communication policy as a means of fraud prevention.

The OAFCN seminar in October 2003 in Romania was aimed at anti-fraud communicators from the (former) Candidate Countries. The importance of the meeting was underlined by the presence of the Romanian President, Prime Minister and Minister of Finance as well as the Commissioner for the Budget and the Chair of the Budgetary Control Committee of the European Parliament.

A seminar on anti-fraud communication for journalists from Malta in Valetta in February 2004 was co-organised by OLAF, the Maltese national authorities and the OAFCN. A further seminar for anti-fraud communicators from the New Member States and the Candidate Countries will take place in Brussels in October 2004.

## **6. COOPERATION WITH OLAF'S PARTNERS IN THE FIGHT AGAINST FRAUD**

### **6.1. Consultation with the Member States**

Committee work continued at a steady pace in 2003, with 5 meetings of the Advisory Committee for the Coordination of the Fight Against Fraud (COCOLAF) and its working party, Group Article 280. The Committees worked on the annual report on the protection of the EC's financial interests and debated documents such as OLAF's Activity Report, the Annual Report of the Commission under Article 280 of the EC Treaty. Regular exchange of information also took place on the irregularities, including suspected fraud, notified by the Member states and on how to improve the reliability of the data and simplify the reporting system.

From 2003, the AFCOS in Accession and Candidate Countries attended as observers in both Committees.

### **6.2. Customs Mutual Administrative Assistance Arrangements with Third Countries**

Preferential trading arrangements with third countries form an integral part of the external commercial policy of the EU. Within this overall policy framework, in addition to its existing commitments with regard to on-going negotiations, the Commission has entered into new negotiations with certain third countries for the conclusion of various types of preferential agreements. These include overall Free Trade Agreements and Stabilisation and Association Agreements, as well as certain sector specific agreements, including in the customs and textiles sectors. Within the context of the commercial and sector specific negotiations, OLAF, under mandate by the Council for each specific country agreement, is responsible for the negotiation of the provisions on mutual administrative assistance in customs matters.

OLAF is also responsible (again under mandate from the Council) for the negotiation of specific provisions detailing anti-fraud measures. These 'defensive' measures are intended to provide a framework within the preferential agreements which would empower the Community to take unilateral measures to suspend the preferential treatment in the product sector concerned by the fraud or other irregularities.

Prior to the start of the reporting period there were 42 such agreements containing protocols of mutual administrative assistance in customs matters, relating to 45 third countries. During the reporting period, formal arrangements were concluded with further partner countries including Syria, India, Japan, China and Tajikistan. In addition, negotiations involving similar agreement provisions with countries including, respectively, the Gulf Arab States, Albania, Iran and the Mercosur Group are progressing well and are expected to be concluded within the coming months. Furthermore, a specific agreement on administrative cooperation with the US has recently been modified to include improved provisions on security issues affecting bilateral trade.

### 6.3. Fraud-proofing

The “fraud-proofing” procedure, aimed at preventing fraud, was devised to aid Directorates General of the Commission systematically to consult OLAF at a very early stage in drafting legislative proposals in areas sensitive to fraud or introducing (adapted) standard contracts used by them. OLAF’s role here is to ensure that anti-fraud elements are included within both draft legislation and contractual clauses for conclusion with operators (relating to financial control, recovery, sanctions and prevention of conflicts of interests, for example).

In order to obtain a global view of the fraud-proofing procedure (in respect of both draft and existing legislation), preventive analysis has been further extended into the operational domain, to benefit from feedback arising out of operational experience. In this respect OLAF investigators have been asked systematically to include in their final reports a “lessons learned” statement focusing on possible weaknesses and loopholes detected in the relevant legislation. As a parallel development, the same kind of feedback has also been requested from Member States, asking them to indicate to OLAF any problems encountered in the practical implementation of EU legislation. A dedicated email address entitled “OLAF fraud-proofing Member States” was set up in January 2004 to facilitate this.

#### *Case Study: Fraud-Proofing*

During the course of the Financial and Judicial follow-up of a case where a company had benefited from EU funds and later became insolvent, OLAF traced the unused funds to a trustee bank account in the company’s Member State. As a result those funds were successfully transferred back to the Commission budget. An investigation into a potential fraudulent insolvency is still ongoing in the Member State.

The clear lesson that has been learned was in the value of the actions of a Commission official in DG RTD who ensured that the transfer of funds was subject to an additional contractual condition (“the setting up of a trustee bank account”): so that the funds could only be used for the benefit of the specified project financed by the Commission and could not become part of the beneficiary’s property. Consequently, EU funds did not become part of the funds available to the creditors of the company when it became bankrupt. The legal nature of trustee-ships also assists investigators of bankruptcy fraud due to the transparent legal obligations on the trustee which are relatively easy to monitor.

In particular the need for this fraud proofing instrument applies to the field of research (Sixth Framework Programme) where each contract is concluded with a large number of contractors (consortium) and where significant amounts are paid to the coordinator of the project who is obliged to administer and allocate the Community contribution between those contractors. OLAF has recommended the use of trustee bank accounts to DG RTD within the framework of the fraud proofing of the model contract for the implementation of the Sixth Framework Programme. The special clauses of the model contract adopted by DG RTD now contain a specific clause on Trust Bank Account. Although this clause is only implemented on an optional basis (for practical reasons, in particular as this system is not available in all Member States) it is nevertheless an effective mechanism for preventing the loss of EU funds especially where the beneficiaries have been declared bankrupt.

#### **6.4. Contributions to developing OLAF's legal framework**

Following the Commission's 2003 evaluation report under article 15 Regulation (EC) 1073/1999 further debate took place with the institutions on how to develop OLAF's legal framework. While the Commission's February 2004 proposal on amending Regulations (EC) 1073/199 and (Euratom) 1074/1999 aims to improve the legal framework for OLAF investigations and information exchange with the Commission, reflections on further medium term developments were proposed in the "Prodi" action plan presented to the European Parliament in November 2003.

The draft Constitutional Treaty on which the Intergovernmental Conference reached a political agreement in June 2004 foresees the possibility of OLAF assisting the future European Public Prosecutor's Office in its potential role in investigating and prosecuting perpetrators of offences against the Union's financial interests, as provided for in Article III-274. The Commission's anti-fraud action plan 2004-2005 comments on preparations for a White paper to create and implement a European Public Prosecutor's Office. OLAF will contribute by assisting the Commission in drawing up an extensive impact study together with the preparation of the White Paper. This will also include ideas on the future functional and organisational relationship between OLAF and an independent Public Prosecutor's Office.

#### **6.5. Cooperation with bodies in charge of police and judicial cooperation**

Further to the administrative agreement dated February 2003 between OLAF and Europol establishing a framework of cooperation in their respective competences, an administrative arrangement was signed on 8 April 2004 to allow for the practical modalities for cooperation between Europol and OLAF in order to fight fraud, corruption or any other criminal offence or illegal activity in the framework of international organised crime affecting the European Community's financial interests. This focuses on developing the exchange of technical and strategic information in the field of threat assessment and risk analysis within the areas of common interest, excluding the exchange of personal data.

Since then regular meetings have taken place between members of OLAF Intelligence units and their counterparts in the economic crime section of Europol. OLAF officials have participated in a number of restricted Analytical Work File meetings with a view to moving towards a more operational cooperation. There has been close cooperation in support of an AGIS funded programme with the French Gendarmerie on Financial Crime Analysis, for which both Europol and OLAF are partners. There have also been regular exchanges of information about developments in analytical tools and information sources.

In May 2004, in the area of judicial cooperation, OLAF and Eurojust adopted a new common document detailing the specific practical arrangements for the implementation of the 2003 Memorandum of Understanding. Several operational meetings have taken place between OLAF and EUROJUST in relation to different OLAF investigations, resulting in strengthened cooperation.

#### **6.6. Protection of the Euro**

OLAF continued to exercise its coordination role under the Commission's authority in relation to the protection of the Euro against counterfeiting. This coordination is mainly carried out through the counterfeiting experts' group of COCOLAF. This brings together

Member States' experts from national law-enforcement agencies, legal affairs and finance departments, as well as central banks. Europol and the European Central Bank (ECB) participate.

During the reporting period OLAF implemented the "Pericles" exchange, assistance and training programme, where seventeen projects were financed or co-financed, for a total amount of over €1 million. These projects, initiated by OLAF or by Member States, were carried out with the participation of experts from Member States, Accession Countries, OLAF, the ECB and Europol.

On 3 September 2003 of the Commission published its second report on the implementation of the Framework Decision of May 2000 concerning the protection of the euro with criminal penalties. The report shows that Member States, before enlargement, generally comply with the provisions of the Decision.

The Commission's proposal for a Council Decision concerning the analysis and cooperation with regard to counterfeit euro coins was adopted by the Council on 8 December 2003. Member States thereby formally assigned to the Commission responsibility for the technical protection of euro coins. On 27 January 2004 the Commission adopted a proposal for a Council Regulation concerning medals and tokens similar to euro coins. This is intended to avoid fraud and confusion between such objects and euro coins. The European Technical and Scientific Centre (ETSC), functioning within OLAF, continued to analyse counterfeit coins and draw up statistics. The statistics show an increase in the counterfeiting of euro coins.

#### **6.7. External training**

The Office organised and/or co-financed 8 seminars involving more than 700 participants outside the scope of the MCP Activity Plan (*see 4.2*) during the reporting period, in cooperation with Member States, Candidate Countries and international organisations. These included:

- "International Anti-Fraud seminar for auditors from Member States, Candidate Countries and Switzerland in the field of Regulation 4045/89 and the EAGGF";
- AFCOS Roundtable "Protection of the financial interests of the EU and the fight against fraud – "The Responsibilities of Accession Countries and Candidate Countries";
- "European Union Conference of Fraud Prosecutors";
- "Fraud and Aid Funds: what the international community can do";
- "Europe against Value Added Tax fraud".

A Programme for the promotion of actions in the field of the protection of the Community financial interests (Hercules) was adopted in April 2004 by the European Parliament and the Council. It was granted a budget of €11 775 000 for a three-year period from 2004. A fuller account is given in the Annual Report of the Commission 2004 adopted on 30 August 2004 (COM(2004) 573 final).

## **6.8. Information and Communication as a means of fraud prevention**

OLAF supports its operational independence with its own information and communication strategy. The objective of this strategy is to satisfy the right of the citizen to know about what is being done to protect their interests. OLAF reinforces its information activities as a means of fraud prevention in the framework of the OLAF Anti-Fraud Communicators' Network (OAFCN)<sup>19</sup>, together with its national operational partners. Although media relations comprise only part of this communication policy, OLAF has a spokesman function in reporting its operational activities. This must be balanced with the obligation to protect investigations and to respect the fundamental rights of the suspect, within the constraints prescribed by international, Community and national law. In spite of repeated challenges during the reporting period, the Office has maintained its firm line of balancing these interests.

OLAF initiated a Euro barometer survey on the subject of fraud and corruption in the EU and the (former) Candidate Countries<sup>20</sup> to explore the extent of public awareness of fraud in general and fraud against the EU and its budget, in particular. The results were published in January 2004:

More than half of the respondents disagreed with the statement that fraud against the EU and its budget happens very rarely. There was a wide consensus that defrauding the EU and its budget is harmful both for the vast majority of citizens who are honest and for national economies. Citizens of the then 15 Member States trusted the police to fight fraud, while citizens from Accession and Candidate Countries looked more to the EU itself. Both groups agreed that fighting fraud should be a political priority and that the EU definitely has a role to play. However, a majority felt poorly informed about the fight against fraud against the EU and its budget and expected the EU to provide more information about anti-fraud campaigns and success stories.

During the reporting period there were several hundred contacts with the media. These included press briefings, written and oral replies to press questions, referrals to members of the OLAF Anti-Fraud Communicators Network (OAFCN) and assistance to Commissioners' Spokespersons. Additionally, the Office published 22 press releases and produced a video and brochure to publicise OLAF's international cooperation with its operational partners in the Member States (investigative services, police, judicial and administrative authorities).

An internet Round Table on Anti-Fraud Communication has been created on the OLAF website aimed at experts in institutional communication (more specifically in anti-fraud, police and other law enforcement matters), academia (legal, economic, journalistic and communication fields), representatives of investigative and judicial services (national and international), members of the European Institutions, journalists and any other persons with specific experience in these fields. This has been supported by the partners of the OLAF Anti-Fraud Communicators Network (OAFCN). The Network has grown from 40 to 70 members to include additional law enforcement agencies in the New Member States and in the Candidate Countries.

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<sup>19</sup> The OAFCN includes those responsible for public relations and the information officers from the national investigation services with whom OLAF cooperates. [http://europa.eu.int/comm/anti\\_fraud/olaf-oafcn/en.html](http://europa.eu.int/comm/anti_fraud/olaf-oafcn/en.html)

<sup>20</sup> Euro barometer 60.01: [http://europa.eu.int/comm/anti\\_fraud/press\\_room/eurobar/en.html](http://europa.eu.int/comm/anti_fraud/press_room/eurobar/en.html)

## 6.9. Public relations

The area of public relations encompasses visits to OLAF, the provision of OLAF participants for events, particularly training events, which are neither financed nor organised by OLAF and the response to general information requests from the public. There were 56 group visits to the Office, involving some 840 persons in total, mainly from customs, investigation services and public prosecutors offices from Member States and other countries. Additionally, the Office welcomed a number of distinguished visitors, including:

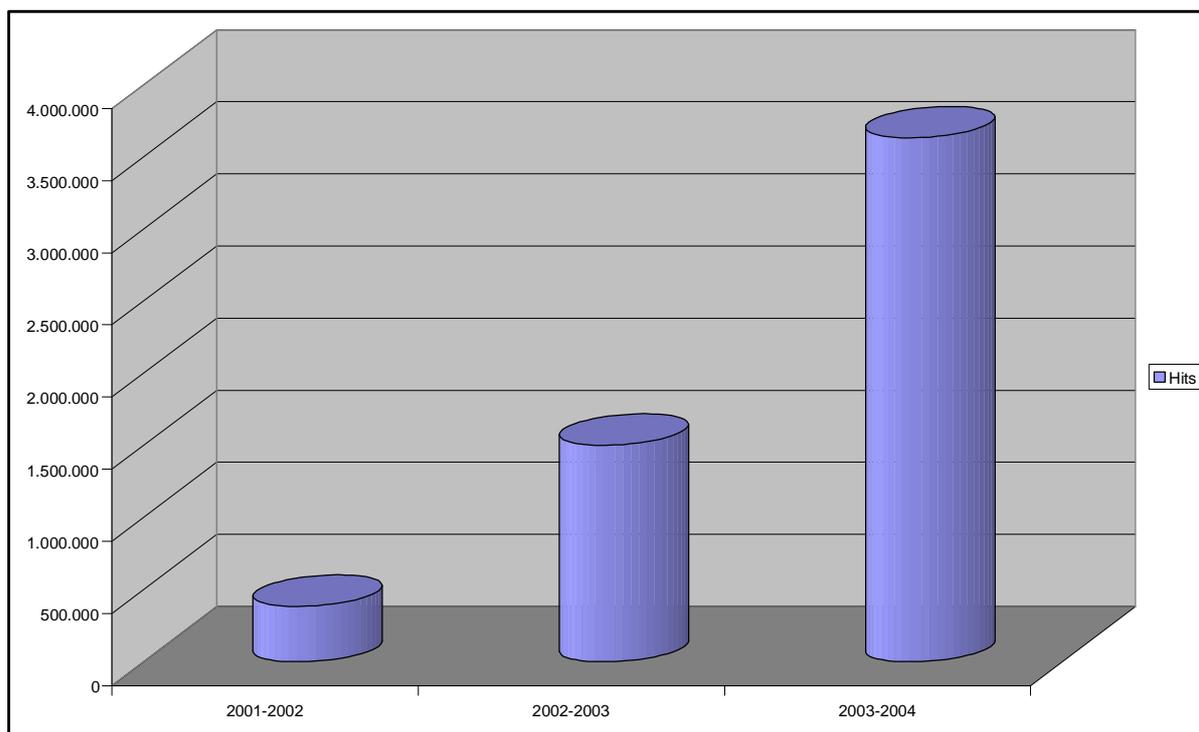
- The Deputy Head of the Administration of the President, Russian Federation,
- The Romanian Delegate Minister for the Implementation of the EU *acquis*;
- The Secretary-General of the Ministry of Security, Bosnia-Herzegovina;
- The Director of Europol;
- The Chairman of the European Union Military Committee;
- The Director-General of the Spanish Guardia Civil;
- The Director of the Serious Fraud Office, United Kingdom;
- The German Federal Ministry of Finance;
- The Brazilian Court of Auditors.

OLAF participated in 126 anti-fraud training actions which were organised externally.

## 6.10. OLAF Website

The OLAF Website continued to be the basic tool of the communication and information policy of the Office. During this reporting period the number of hits increased by 140 % (from 1.5 to 3.6 million), demonstrating the increased public interest in OLAF's work. The pages which received most hits were those of the "Press Room" followed by the "Reports" and the "Partners" pages.

Figure 48: Annual Number of Hits on OLAF's Website



## **7. ADMINISTRATION**

### **7.1. Human Resources**

Over the reporting period, the most significant factors to impact on OLAF's human resource planning were enlargement and the new staff regulations and related implementing rules.

OLAF benefited in the 2004 budget from an increase in the number of statutory posts beyond the 300 initially foreseen when the Office was created. An extra 29 posts were provided; though for technical reasons related to the enlargement process recruitment could not begin until after the end of the period covered by this report. 27 of the new 29 "A" posts are earmarked for enlargement related tasks (18 temporary and 9 permanent). These posts will largely be filled by successful candidates from the new member countries as soon as competition lists are available.

During this period 28 individuals left OLAF and 46 joined. On 1 June 2004, OLAF employed 287 members of staff compared to 262 twelve months earlier. A further 100 persons are employed as external staff (national experts, auxiliaries and "intra muros" contractors). A number of "external" staff have been employed through the use of financial appropriations which were originally provided to finance statutory posts which remain unfilled because of factors outside OLAF's control, notably delays in the setting up of a new recruitment and employment regime for temporary agents.

### **7.2. Internal training**

Between July 2003 and June 2004, the Training Team organised 14 training sessions targeted at more than 160 operational staff and included trainers from DGs AIDCO, REGIO and BUDG. Mainstream operational subjects were covered including operational procedures, internal investigations, structural funds, agriculture and customs.

### **7.3. Budget**

Last year's activity report noted that after implementation of the new Financial Regulation and improvements in the management of financial transactions, OLAF used 97.4% of the planned budget for 2002. This progressed to 99.72% for OLAF's 2003 budget.

While Title 24 of the European Commission's budget includes OLAF total budget, OLAF's administrative budget is described in annex COM III to the budget. Figure 49 outlines the areas of expenditure within this budget.

Figure 49: Development of the OLAF administrative budget 2002-2004

	Budget 2002 (€m)	Budget 2003 (€m)	Budget 2004 (€m)
<b>Personnel</b>	19.3	23.4	26.7
<b>External Personnel</b>	4.7	4.6	5.0
<b>Furniture/Infrastructure</b>	7.8	7.7	8.6
<b>Anti-fraud Actions</b>	1.7	1.9	2.0
<b>Supervisory Committee</b>	0.2	0.2	0.2
<b>Lawyers associations</b>	0.4	0.4	n/a
<b>Total</b>	<b>34.1</b>	<b>38.2</b>	<b>42.5</b>
<b>Percentage committed</b>	95%	97%	n/a

Since 2004 OLAF's operational budget has been allocated in Title 24 of the European Commission's budget. The distribution of expenditure is shown in Figure 50.

Figure 50: Development of the OLAF operational budget 2002-2004

Budgetary line	Budget 2002 (€m)	Budget 2003 (€m)	Budget 2004 (€m)
<b>24.0201 General Anti-fraud measures<sup>21</sup></b>	5.5	5.1	3.3
<b>24.0202 Péracles<sup>22</sup></b>	0.6	0.9	1.0
<b>24.0203 Anti-fraud Information System (AFIS)<sup>23</sup></b>	2.6	3.8	4.3
<b>24.0204 Hercule (lawyers associations included from 2004 on)</b>	n/a	n/a	3.9
<b>Total</b>	<b>8.7</b>	<b>9.8</b>	<b>12.5</b>
<b>Percentage committed</b>	96.79%	95.20%	n/a

<sup>21</sup> Ex B5-910

<sup>22</sup> Ex B5-911

<sup>23</sup> Ex B5-912 and B5-3070

## Forward Look

The main developments anticipated over the next reporting period (the 12 months ending on 30 June 2005) are as follows:

- Further concentration of resources on OLAF's main activities with particular emphasis on increased working cooperation with the relevant EU institutions in identifying and combating internal corruption and in protecting direct expenditure.
- Closer liaison with EU institutions and other international bodies in further developing information access and exchange procedures to improve actionable intelligence to help inform and prioritise OLAF's operational activity.
- Reinforcement of the role of the intelligence units by producing an improved overall risk assessment of the threat of fraud to the EC Budget in an ongoing cyclical process and in line with other EU threat assessments. Expansion of analytical and information sourcing skills.
- Greater emphasis on fraud prevention and deterrence benefiting from lessons learned from within OLAF and from EU institutions.
- Strengthening relationships with OLAF's network of partners including expansion of the tasks of the new multi-agency investigations unit in forging closer links with international partners and in developing new administrative investigative agreements.
- Improvement of management structures and practices in the light of the outcome of the audit by the European Court of Auditors.
- Implementation of the revised, comprehensive OLAF Manual (1 December 2004). This will include a summary of procedures and rights which will also be reproduced separately for ease of reference.
- Further improvements to OLAF's Case Management System (CMS), to support the weekly meetings of the Investigations and Operations Executive Board, a module to facilitate legal advice for operational staff, and a full text search module on all operational documents to enhance intelligence support.
- Increased training to improve case handling and a common investigative culture, incorporating the operational advisory and support activities of the Office.
- Increases in the levels of involvement of OLAF's legal advisers in OLAF's operational activity.
- Recruitment of staff from the new Member States and posting of OLAF officers in a number of new Member States, Accession and Candidate Countries within the overall aim to coordinate enhanced activity in relation to the EC budget in those countries.
- Implement the recommendations of the Article 15 Report.
- Continuing commitment to establishing multi-disciplinary task forces for complex and large cases.

# ANNEX

## DEFINITIONS (OLAF MANUAL, AUGUST 2003)

**Assessment:** The purpose of an initial assessment is to analyse the information initially received at OLAF in order to make a recommendation as to whether an investigation should be opened, and if so, which category of case.

**Internal investigations:** Internal investigations are administrative investigations within the Community organs for the purpose of detecting:

- fraud, corruption, and any other illegal activity affecting the financial interests of the European Community;
- serious matters relating to the discharge of professional duties that constitute a dereliction of the obligations of officials and other servants, members of the institutions and bodies, heads of offices and agencies, or members of staff, and liable to result in disciplinary or criminal proceedings. (Individuals who work inside Community organs but are not subject to the staff regulations, such as interim employees, cannot be the subject of an internal investigation.).

**External investigations:** External investigations are administrative investigations outside the Community organs for the purpose of detecting fraud or other irregular conduct of natural or legal persons. They may be carried out under either horizontal or sectoral legislation. Such cases are classified as external investigations where OLAF is providing the majority of the investigative input.

**Coordination cases:** Coordination cases are cases that could be the subject of an external investigation, but where OLAF's role is simply to facilitate the exchange of information and operational synergy among acting national and Community services; the majority of investigative resources are provided by other authorities. OLAF's role is to facilitate contacts and to encourage the responsible authorities to work together.

**Assistance cases:** (Criminal) assistance cases are cases within the legal competence of OLAF in which competent authorities of a Member State or Candidate Country carry out a criminal investigation and request OLAF's assistance, or OLAF offers its assistance

**Monitoring cases:** Monitoring cases are cases where OLAF would be competent to conduct an external investigation, but in which a Member State or other authority is in a better position to do so (and is usually already doing so). Monitoring cases are passed directly to the authority judged competent to handle them. No OLAF investigation resources are required, but, as the interests of the EU are at stake, OLAF will follow up, via the appropriate follow-up unit, with requests for reports on developments at regular intervals.

**Non-case:** Non-cases are cases where there is no need for OLAF to take any investigation, coordination, assistance or monitoring action. Non-cases result from assessments that conclude, for a variety of reasons, that there is no reason to believe that EU interests are at risk from irregular activity. This process may result in the transmission to Member States of information about possible offences not related to the protection of EU interests.

**Follow-up:** Follow-up includes various activities designed to ensure that the competent Community and national authorities have executed the legislative, administrative, financial or judicial measures recommended by OLAF.

**Administrative follow-up:** Administrative follow-up consists of all measures taken by national administrative authorities or by the Commission services with regard to the execution of Community policies and law. It includes case-specific measures: ensuring that the authority in question has taken the necessary administrative measures to remedy the fraud, irregularities or other illegal activity at issue in a specific case; and more general measures, with wider relevance, such as ensuring that all the appropriate notifications have been made by the national authorities to the Commission services.

**Legislative follow-up:** Legislative follow-up involves the development of proposals for the “fraud-proofing” of draft legislation or contract provisions. Practical experience gained as a result of OLAF’s operational activities is often the basis for a legislative follow-up action, which may include proposals for: new Community legislation; amendment of existing Community legislation; to modify standard Community contract clauses; and opinions on the need to modify Member States’ legislation.

**Financial follow-up and recovery:** Financial follow-up activities differ significantly according to the sector involved. When recovery issues arise during the investigation, the investigator coordinates activities with the follow-up units. This includes Traditional own resources, Agricultural sector, Structural policy field and Direct expenditure.

**Judicial follow-up:** Judicial follow-up is where there is evidence of possible criminal acts and the case is referred to the competent national judicial authorities for further investigation and prosecution where necessary. OLAF prepares a report setting out details of the alleged criminal activity and the supporting evidence for transmission to the relevant national judicial authority; provides legal or investigative assistance as required by the competent national judicial authorities.

**Disciplinary follow-up:** Disciplinary follow-up concerns internal cases only where there is evidence of serious matters relating to the discharge of professional duties, such as to constitute a dereliction of the obligations of an official or other servant of the Communities, liable to result in disciplinary proceedings. OLAF would recommend that the case be referred to the appropriate EU authorities (DG ADMIN and the disciplinary services of the other Community organs) for appropriate disciplinary action. A recommendation should also be made, where appropriate, to initiate a procedure under Article 22 of the Staff Regulations for the recovery of funds from the officials/other servants guilty of deliberate misconduct (full reparation) or gross negligence (partial reparation).<sup>24</sup> This includes monitoring the progress of the case from the investigation stage to disciplinary proceedings and sanctions in order to provide relevant information in relation to the status of the case.

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<sup>24</sup> See Guidelines for applying Article 22 of the Staff Regulations (financial liability of officials), SEC(2004)730/5, June 2004, point 4.2.

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