COURT OF AUDITORS OF THE EUROPEAN COMMUNITIES

Observations on the financial management of the ECSC

Financial year 1978

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SUMMARY

INTRODUCTION

LIST OF COMMENTS ON THE FINANCIAL YEAR 1978 OF THE ECSC

On 7 August 1979, the Court of Auditors submitted its annual report which was confined, in accordance with Article 78f of the Treaty, to the regularity of the accounting operations and to the soundness of the financial management in respect of operations other than those for the administrative expenditure and revenue of the Community.

The list sets out the findings of the Court which do not directly affect the regularity of the operations referred to in the Treaty.

In order to enable the Parliament to carry out its work preceding the proposed discharge to be given to the Commission, the Court has drafted this note on the areas which were considered during the year as being the most important and significant.

1978 LEVY INCOME

GENERAL FRAMEWORK

In accordance with Articles 49 and 50 of the Treaty and Decisions 2-52 and 3-52 of the High Authority, the basis of assessment for the levy is defined as production. The products subject to levy are listed in Annex I of the Treaty and specified in a Notice from the Institution published in OJ No.111 of 6 November 1962.

By its decision 2996/77/ECSC of 21 December 1977, the Institution maintained, for the financial year 1978, the levy rate of 0.29% of the average values per tonne of the various categories of taxable products; the average values have, however, been up-dated. In 1978 levy income amounted to 100 775 515 EUA, against 86 840 594 EUA in 1977.

COMMENTS

The comments which the Court of Auditors would make are based upon an analysis of the management and on the records of checks carried out by the Institution. These comments may be summarized as follows:

1. Absence of intensive audit of the basis of the levy

   The Institution carries out audits at the undertakings on the reliability of the monthly statements of production which the undertakings are required to submit.

   The audits are carried out by the staff of the Commission in accordance with the provisions of Article 86, last sub-paragraph, of the Treaty. The Commission staff responsible for collecting the levy (DG XVIII) draw up lists of undertakings to be audited with reference to the criteria of priority determined on the basis of irregularities in the statements and also by taking into account the length of time since the previous audit.

   The audits are carried out by another administrative unit of the Commission, i.e. the Inspection Department of the Directorate-General for Competition. It should be pointed out that this department hardly ever observes the priorities set. In fact, other criteria (such as the geographical distribution of the audits, the checks necessary in order to ensure compliance with price scales) enter into the choice of the undertakings to be audited.

In 1978, 13 undertakings out of 400, i.e. only some 3.25%, underwent an on-the-spot audit by Commission officials in respect of the levy. Such a low level of audit, almost amounting to an absence of audit, is detrimental to the Community as illustrated by the following examples:

a) An iron and steel undertaking, situated about forty kilometres from Luxembourg, which started production in 1971 was not subject to its first audit until 1978.

Such a delay is difficult to explain when it is known that the problems caused by a wrong interpretation of the texts usually arise at the beginning of newly created operations.

The audit revealed the following irregularities:

- for billets obtained from liquid steel the enterprise had made a count and applied the average density of the billets to be produced. This method results in the removal of deadheads from the production declared;
- the undertaking had never declared the production of billets from continuous casting;
- production of 1 835 tonnes of wire rod had never been declared.

The Institution applied Article 1 of Decision 5-65 of the High Authority (OJ 46-65 p. 695) whereby claims in respect of the production levy are barred after three years, except in the absence of declaration, or in the event of declarations which, intentionally or through negligence, are incomplete or inaccurate; in these circumstances the period is six years. In this case the Commission went back over six years and subjected the whole of undeclared production to tax, i.e. 670 847 tonnes, producing 116 430 EUA of levy.

b) An iron and steel undertaking in France began production in 1975 and was subject to its first audit in 1978.

This check revealed:

- the absence of declaration of any production of billets (314 000 tonnes) on the strength of a telephone conversation with the levy department from which it was understood that the gross production was not liable to tax;
- it was claimed that, during the same telephone conversation, it had been said that the entire production of the first three months after the start-up of a rolling mill could be exempted from the collection of the levy;

- the absence of declaration for 5 141 tonnes of finished products as a result of the failure to declare second grade products.

  The rectification made it possible to recover the sum of 118 411 EUA of levy.

These examples alone show the value of a careful audit.

2. Inadvisability for the Commission staff giving merely oral interpretations on the actual application of the principles of collection

The levy should be considered as a tax with collection rules which are strictly applied. It is not for the Commission staff to decide on their own initiative if certain kinds of production are taxable or not.

As was stated under 1b above, the staff have given rulings in this matter and, on several occasions, by means of a mere telephone call. Such practices should be avoided.

Since then, written instructions have been given to the officials responsible requiring a written confirmation of any verbal communication.

3. Problems inherent in the precise definition of the basis for assessment in view of the development of production techniques - Need to bring up to date the decisions laying down the basis for assessment

In 1978 a new problem arose concerning the definition of the basis for assessment. It involves tip coal; owing to present-day energy problems, this coal, mixed with formerly rejected extraction residues, undergoes a new grading and washing and thus enters commercial distribution.

At the time of the drafting of this report, the Commission had not yet settled the question whether this tip coal should be subject to the levy considering its nature and the somewhat distant date of its extraction.

In some pits in one Member State the quantity of tip coal not included in a levy statement, amounted for the years 1975 to 1977 to over four million tonnes.

In another Member State, this recovered coal was declared up until June 1977 but has since ceased to be declared, as the producers consider that the coal was extracted (thus, in their opinion, 'produced') before the country's accession to the Community.

This question has still not been settled, since the Commission has expressed reservations on the point.

4. Determination, at the appropriate stage of production, of the weight of the products subject to the levy

It should be recalled that production subject to the levy is determined by the Treaty and by the subsequent decisions of the Commission.

Where a works is integrated and manufactures iron and steel products at different stages of completion or finishing, it is at the stage laid down by the legislation that tonnages should be quoted in order to decide the quantity to be entered in the levy statement.

It has happened several times that, on the occasion of on-the-spot audits, the Commission inspection staff discovered statements made at the wrong stage. These practices, too, could have been avoided by a more intensive inspection.

5. Need to supervise the deliveries to mills working on contract

In contract work the contractor has to pay the levy. Therefore the undertaking which produced the raw material and delivered it to the contractor is exempted from payment of the levy on this part of its production which is deducted from its statement.

Under these conditions, the Commission should take care to ensure that these tonnages are in fact declared by the contractor. An appropriate accounting comparison should be carried out and form the subject of an audit report.

6. Difficulties encountered in undertakings working under licence

In December 1978, it was possible to resolve the difficulties encountered hitherto in respect of coal-mines in the United Kingdom working under licence.

On this date, in fact, at the request of the Commission levy office, the licence-holders' organization forwarded, for the first time, a list of its undertakings indicating their production. This list requires a regular follow-up; in fact, even if the overall production of these mines only amounts to 1 million tonnes out of 120 million produced in the United Kingdom, a follow-up is necessary both because of the fluctuating nature of their production which, at any moment, may exceed the collection threshold (100 EUA per month) and in deference to the general principle of equity which should apply in respect of the levy collection.

It may be noted, in this respect, that there are still certain problems in obtaining from these mines both the monthly statements and the payment of levy.

REHABILITATION EXPENDITURE

GENERAL FRAMEWORK

The ECSC intervenes up to a maximum of 50% of the expenditure of official bodies which are competent and eligible in the rehabilitation of the labour force under Article 56 of the Treaty. Financial aids are granted for this purpose mostly in non-repayable form.

The procedures for grant and for payment are included in general agreements entered into separately with Member States.

In 1978 rehabilitation expenditure amounted to 20 993 860 EUA.

COMMENTS

1. Lack of precision or incomplete information at the decision-making and processing stages

   An analysis by random sample of the files on applications for rehabilitation aid which resulted in legal commitments during 1978 enables the following conclusions to be drawn:

   1.1. The files on applications for aid by some Member States (Italy, Belgium) contain very little information on the socio-professional categories of the workers affected by the closure and on the technical departments to which they belonged.

   1.2. It is hardly possible to compare the distribution into socio-professional categories according to Member States.

   Germany alone draws a distinction between "workers directly affected" and "those affected indirectly".

   1.3. On the formal level, only in exceptional cases do the files contain additional information arising either from meetings attended by representatives of the national departments and undertakings concerned, or from an exchange of correspondence on the subject under examination. As a result the figures finally adopted sometimes differ from the initial figures with no indication of any justification (France, Luxembourg).

   1.4. According to the authorizing department (DG V), a significant part of the information missing from the files is available at Directorates-General III (for iron and steel) or XVII (for coal).

   Nevertheless the dispersion of information means that a large part

of the processing procedure for each application escapes the Directorate-General responsible. This department has, in fact, only a limited knowledge of the information necessary, on the one hand, for a prior analysis of the contents of operations and of their cost, results and anticipated impact and on the other hand, for following up each activity and comparing it with the forecasts. This follow-up thus proves to be an impossible task for DG V. Moreover, one may wonder whether the other DGs concerned had the missing information, since DG XVII does not wish to comment on the figures contained in the files.

1.5. The document submitted for the Commission's approval reveals, in general, only the number of jobs lost, which represents the theoretical upper limit for beneficiaries of the aid. In fact, according to the information in the file, the aid actually provided for usually involves a smaller number of people.

1.6. The files do not make it possible to determine, by operation, the number of beneficiaries and the departments and the installations to which they are attached.

1.7. The nature of the rehabilitation operations involved, the various responsibilities which these operations imply and the expected direct results are not very explicit in British files and the Belgian and German files make no mention of these matters.

1.8. The costing of operations rarely gives details of methods of calculation, of rates or of averages used.

With regard to Belgium, Germany and the United Kingdom, the invoiced amount in respect of the operations is limited to a single sum based on an average cost of rehabilitation per worker (Federal Republic of Germany, Belgium) or on average costs relating to certain categories of worker (United Kingdom). It should be noted that the Commission is not bound to follow the development of a scheme on a regular basis.

It should also be pointed out that, in addition to the macro-estimates based on the average cost per worker, estimates of financial means by concrete type of aid, on the basis of a detailed assessment

of the rehabilitation requirements of workers affected by closures, would make it possible to take decisions on the basis of the true management data and to follow up their realization.

This is a basic requirement, even if it has proved in the past that the estimated total cost has later been found to correspond with payments in most cases and even if the detailed estimates described above are uncertain; the authorizing departments concerned in fact maintain that undertakings are not yet able, at the time when they apply for rehabilitation aid, to indicate either who will benefit from rehabilitation or the methods of rehabilitation.

1.9. With regard to re-employment outside the undertakings affected by the rehabilitation aid, the files show neither the sectors or undertakings where, as a result of rehabilitation, the workers affected by the closure of installations would find a new job, nor even the degree of probability of their finding one.

With regard to internal re-employment there is no statement of the departments or sectors in which the workers receiving aid would be recruited.

1.10. Moreover, except in cases of early retirement and re-employment by transfer within the undertaking without rehabilitation expenditure, the files do not contain any reference to the subject of the future of the workers if rehabilitation aid had not been applied to them; this factor however is an aspect to be considered in assessing the justification of the aid.

Conclusion

From the above-mentioned points it may be concluded that the decision-making and processing procedures — although exactly followed in form — are based, in essence, on incomplete or dissimilar information.

2. Methods adopted by the Commission for its audits

The Court of Auditors has been unable to discern any effort on the part of the Commission to standardize its audit activity.

In fact, in most cases, the Institution's audits concern solely accounting and factual aspects. It is only in exceptional cases that the Commission has been able to complete them by a description and an evaluation of the national decision-making system: the sole case was that of the United Kingdom.

3. Determination of the efficiency and efficacity of the aid policy

In its reply to the Court's observations on the financial year 1977, the Commission considered that contacts, before the grant of Community funds, between Commission departments and national or local departments are sufficient as elements of audit. In the same way the Commission considers that examination of the results of the rehabilitation, in particular the re-employment of workers who have undergone periods of training and the re-integration of the beneficiaries of aid, is neither possible nor useful and would involve considerable expense.

This opinion is confirmed by the absence in 1978 of any effort to follow up the results of rehabilitation operations and of any comparisons with forecasts.

The Court is of the opinion that adequate examination by the Commission of the results of co-financed rehabilitation operations implies the regular follow-up of the management systems of Member States and in particular, the systems for planning, implementing and auditing aid projects under bilateral agreements.

On the basis of this follow-up of systems it would be possible to arrive at a direct and somewhat extensive analysis of the results of national aid policies.

If the Commission, in its capacity as administrator, shows no sign of a manifest interest in these audit activities, the question arises of how it can comment validly on the efficacity and efficiency of its policy.

LOANS FOR INVESTMENT AND INDUSTRIAL STRUCTURAL REORGANIZATION

GENERAL FRAMEWORK

As in other areas of activity for the benefit of the coal and steel industries, the Commission's credit policy is based, on the one hand, on the 1980-1985 general objectives for steel and, on the other hand, on the 1975-1985 medium-term guidelines for coal, i.e., on medium/long-term data, valid for all of the Community, drawn up by broad categories of product.

The objectives and guidelines in these sectors may be summarized as follows:

- in respect of coal : an increase in production to a level of 250 million tonnes in 1985, by directing domestic demand towards Community production and by maintaining the necessary extraction capacity;

- in respect of iron and steel : adaptation of production capacities to anticipated demand by taking into account changes in the range of products and in their quality, while trying to increase the competitiveness of the iron and steel industry on the world market.

The total outstanding of loans for industrial investment (Article 54) and industrial structural reorganization (Article 56) amounted to 4 372 540 317 EUA in 31.12.78 including 779 120 789 EUA for new loans granted in 1978.

1. Weaknesses found with regard to the formal aspects of the files drawn up when loans are granted

   In order to draw up the files on loans, the Institution introduced a dual series of documentation. The first deals with cases in the process of being drawn up and contains all the documents in support of an application, the second contains the documents relating to the technical operation of the loan.

   The criteria governing these two classifications are different and require that a cross-reference file between them be kept; they should be reconsidered in the light of the systematic follow up of the files.

Some gaps were established in respect of the actual value of the documentation contained in the files, i.e.

- supporting documents required when considering other sources of financing the project are not contained in the files;

- when security is furnished, the external audit should be able, by a mere examination of the file, to satisfy itself whether the security has actually been checked for realizable value, there is not always a statement to this effect in the files consulted;

- the principal file contains only the conclusion, whether favourable or unfavourable, of the various departments consulted: in order to know the overall view on which the Commission's final decision was based it should be possible for the external audit to have access not only to these brief conclusions but above all to the detailed opinions upon which they were based.

2. The duration of the procedure for granting loans

The period of time between the application for a loan and the moment when the funds are made available is about eight months, which hardly seems justifiable.

The applicant's file must go through many stages, i.e.:

- the period for examining the case, which is the longest stage of the administrative procedure. It takes four months on average;

- the time required by the Commission to take a decision on a paper drawn up by the departments, which is about a month;

- once a favourable decision has been taken, there is another period of an average of 80 days in order to find the funds on the financial market;

- finally there is a further period of about a month between the time when the funds are available and the actual disbursement.

The period for examining the file is the only thing for which responsibility may be shared with the recipients since they do not always provide the Commission with the supporting documents required in order to examine the case. It may be noted, however, that were the Commission to make available some general but very detailed information to applicants for loans, some subsequent correspondence and requests for information would undoubtedly be avoided.

The periods taken for processing and decision-making are too long in comparison with those required by other financial organizations and might encourage undertakings to abandon ECSC financing.

3. Absence of a systematic follow-up

The Institution has not established a systematic means of checking on the operations carried out after the loans have been granted.

The actual completion of the investment projects financed and the fulfilment of the aims of the investment should be subject to a detailed examination.

Utilization of the funds for the completion of the proposed investments is confirmed only by the borrowers themselves by means of a very general form sent to the Institution by the agent bank and under its contract the bank is not obliged to carry out, on its part, any verification in this connection.

There are even delays in the submission of these forms, which illustrate the little interest taken in the follow-up of the operations.

Loans granted under Article 56 for the creation of new jobs intended for former workers in the coal and steel industries are examined by reference to objectives. In these cases also, however, the undertakings forward, via the agent bank, a list of the wage-earners employed which is verified by the employment inspectorate responsible.

This list, however, does not always specify whether the wage-earners actually come from ECSC industries.

It has been impossible to detect the existence of a systematic verification of other investment objectives.

Such an audit is necessary and should be carried out at the latest when an undertaking submits a new loan application.

TECHNICAL AND SOCIAL RESEARCH

GENERAL OBSERVATIONS

This year, audits covered coal and steel research which represents 80% of the total financial allocation of 65 369 487 EUA.

GENERAL FRAMEWORK

Steel

Definition of the Commission's policy on research in the steel sector should be based on the guidelines laid down in the document on general steel objectives which the Commission published on 4 October 1976 under Article 46(3) of the Treaty and which covered the period 1980-1985. A section of this document is in fact devoted to research and technological innovation.

The Commission's document listed 10 priority areas some of which specify the objectives while others give details of the purpose of the research.

Coal

The objectives for coal research are set out in the 1975-1980 medium-term aid programme for coal research published on 25 May 1974. This programme specifies both the priority areas and the general direction which research should take. Further elements are added by the (1975-1985) medium-term guidelines in respect of coal published on 30 January 1975.

OBSERVATIONS

1. Lack of coherence in the decisions taken by the Commission

   During the year 1978, the Commission approved 146 new research projects (including the social sector) involving a total aid of 40.3 MEUA for projects; these are to take, on average, three years for completion.

   In both the coal and the steel sectors the Commission takes its decisions within an overall framework, after examining applications for aid. All the projects adopted are contained in memoranda approved each year by the Commission.

   These two memoranda should, however, be more standardized and more complete and cover the following points:

   a) Indication of the number of applications received and distribution of aid requested by subject of research.

b) Summary of the reasons for the rejection of projects not adopted.

c) Indication, for each project adopted, of the total cost and of the ECSC contribution.

d) Explicit reference, for each project adopted, to the specific research objective indicated in the medium-term programme or in the general objectives.

e) Indication of any preliminary studies or analyses which prompted the adoption of certain particularly costly projects.

It is thus advisable to check the compatibility of the allocations of aid decided upon in 1978 with the priority objectives which the Commission itself laid down under the procedure described above

With regard to steel, however, the 1978 memorandum does indicate the purpose of the research but not the objectives; it is therefore almost impossible to check whether the accepted projects do, in fact, fall into the category defined as priority areas by the general objectives, since no reference is made to these objectives.

Moreover, this memorandum refers to other objectives, less well defined, in the form of 4 broad lines of development, i.e.:

1. The increase in productivity.
2. The reduction in production costs.
3. The improvement of the quality of iron and steel products.
4. The improvement of service characteristics of iron and steel products.

Another objective quoted in the general objectives, reduction in the number of current contracts, does not appear to have been fulfilled to any great extent; they fell, in fact, from 367 at the beginning of 1978 to 362 at the end of the same year, which means that the projects were not concentrated but just as scattered as in the past.

With regard to coal, the memorandum makes explicit reference to the medium-term programme. The new decisions taken in 1978 were all made under this programme, without it being possible to assess the importance given to each of the priority areas.

Within the limits of the information at its disposal, however, the Court considers that the Commission should take care to make research objectives more operational (both in respect of steel and of coal) in order to make better use of Community funds. To this end while taking into account the limit of the funds available, it would be possible to develop from the present situation (characterized as it is by objectives which are mainly qualitative and without internal priority) definitions laying down a ranked classification of options together with quantitative standards which should, of course, be sufficiently flexible to make possible any necessary adjustments.

2. Delays in the implementation of contracts
(Final audit and closure of accounts)

Both the departments of the Institution and the Court of Auditors continue to operate a timetable of current files in order to follow up systematically those relating to projects due for completion during the financial year. These files should, in fact, be subjected to a final financial verification and the recipient should submit his scientific report within the time-limits laid down under the research contract; after this the balance of the aid (10%) is payable.

In the course of 1978(1) 175 contracts fell due (completion of work); 48 in respect of coal, 80 in respect of steel and 47 in respect of social research. Of the 175 contracts which fell due 111 contracts were submitted in 1978 to on-the-spot visits considered necessary for the closure of the accounts. Even if 111 visits represent a considerable effort on the Commission's part, there are still 64 contracts which are lacking the final audit (but whose closure is not necessarily late) which must be kept under observation. Of the 111 contracts which had undergone the final audit, only 57 were closed, thus leaving 54 which may also be considered as outstanding, not having been closed. The Court intends to follow carefully the development of the number of files outstanding for lack of the final audit (64) or of the closure of the accounts (54).

It may also be pointed out that 5 contracts were closed without the Commission having deemed it necessary to carry out a final on-the-spot visit.

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(1) A period of 12 months between July 1977 and July 1978, an interval of 6 months being the normal time-limit for the submission of the reports.

The Court of Auditors examined a significant proportion of the files lacking a final audit, within the offices of the technical administrators at the Commission. It was not possible from this study to discover the particular reasons justifying the delay.

With regard to the contracts awaiting closure of the accounts, an examination of the files revealed that the main cause of delay was the late submission of the final technical report by the recipients. The Court of Auditors considers that, in this event, systematic transmission of a written reminder is necessary. It appears that the fraction of the aid held back by the Commission until the final technical report is made available, 10% of the amount, is not considered by the recipients to be large enough to encourage them to observe their contractual obligations within the prescribed time-limits. The question arises whether an increase in this percentage might possibly be recommended.

3. Lack of documentation on the technical assessment of the services of the recipients

The administering departments concerned should draw up a technical assessment on the work carried out, the results obtained and their significance. This assessment should be included in both the financial and the technical files. At present the Committee of Experts (or Executive Committee) merely agrees at one of its meetings that the final technical report of the beneficiary of the aid is approved.

4. Management of the technical iron and steel files

With regard in particular to iron and steel research, the Court expresses its dissatisfaction with the way in which the technical files are managed.

In reality, it is impossible to check the course of the work from closed files, because of the absence — in almost all the files examined — of one or more of the basic documents (e.g. the application for aid, the memorandum, the half-yearly technical reports, the request for and acceptance of extensions, the final audit report, the payment order of the final settlement).

5. Delays in the completion of the work

The Court of Auditors noted — on the basis of random sampling — that in respect of almost half the closed cases, it had been necessary to amend the clause relating to the completion of the work, thereby endorsing

a considerable delay in implementation, on average of the order of one year. Although pointed out before, this problem still remains: in 1978 the number of extensions amounted to almost a half that of new contracts issued. The Court of Auditors does not share the Commission's opinion which — in reply to the same observation for the financial year 1977 — maintained that it was not unreasonable to state that, as a general rule, the actual time required to carry out the work is longer than anticipated. On the contrary, the Court considers that delays in implementation should be the exception and not the rule, since it is in the Community's interest to obtain definite results within definite time-limits, especially when either the conclusion of a group of research projects or the implementation of one or several additional projects depends upon the result of one research project. Moreover, there seems to be a contradiction between the adoption of a priority criterion "the expected dates of completion of the research and of its practical application"(1) and the passive and inevitable acceptance of such widespread and significant delays in completion. It would thus be advisable for the Commission, before accepting the project, to satisfy itself more strictly of the validity of the proposed programming.

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(1) OJ No C 60 of 25.5.1974, p. 18


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