

COURT OF AUDITORS OF THE EUROPEAN COMMUNITIES

**Observations
on the financial management of the ECSC**

Financial year 1979



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Comments of the Court of Auditors on the administration
of the ECSC in 1979

1. GENERAL

- 1.1. On 9 January 1981 the Court sent to the Commission draft comments concerned principally with an analysis of the accounting system.

Certain aspects of organization and internal control had also to be considered by reason of their possible effect on the reliability of the figures in the balance sheet and in the revenue and expenditure account. This report is therefore not concerned with the validity of financial decisions but with the structural and procedural framework of the administration.

In its conclusions, the Court draws attention to the dangers inherent in the present situation.

- The first question to be considered is the effectiveness and the efficiency of the administration; this depends directly on the organizational framework within which the administration operates:
 - weaknesses were observed regarding the separation and limitation of powers (between decision, execution, recording and cross-checking), the absence of any procedure for assigning powers and, above all, the absence of any effective internal audit; these may affect the merits and validity of decisions taken and their correct execution;
 - the lack of job descriptions for each post leads to the inefficient use of staff and equipment;
 - a number of weaknesses in the accounting system make it unsuitable as a basis for, among other things, management decisions or as a tool for supervising the execution of financial decisions.
- The second question is that of the security of assets; this requires organizational steps, especially in DG XVIII. The present arrangements with no separation or limitation of delegated powers could allow assets to suffer, quite unnoticed, the direct consequences of errors, negligence or other anomalies which make it impossible to ensure total security of assets.
- The third question concerns the correctness of annual accounting statements: this is directly influenced by the quality of the procedures intended to ensure the correct and complete recording of all financial operations. The absence of accounting instructions and the weaknesses we have noted cast doubt on the recording procedures and these no longer guarantee, by themselves, the reliability of annual accounts which are not drawn up in strict conformity with the accounting books.

- 1.2. It is useful to recall the organization of the ECSC accounting system as a help to understanding the comments on it.

The annual accounts are not based on a single accounting system: there is a "budgetary" system at Brussels (DG XIX for aid) and a "financial" system at Luxembourg (DG XVIII for borrowing/lending and fund-management operations); the two systems were devised for different requirements and are, in fact, incompatible.

The annual balance sheet combines the two; it is drawn up by DG XVIII which thus assumes responsibility for it although the DG's administrative powers are confined to its own accounting system.

Moreover, the accounting system within DG XVIII is not unified either; although there is a general accounting system covering all financial transactions, the different branches have developed either their own accounting systems (levy) or their own statistics (cash-management, borrowing/lending) which are later absorbed into the general accounts but not automatically.

- 1.3. In its letter of 12.3.1981 the Commission stated that it very largely shares the concern expressed by the Court of Auditors. It is conscious that the problems raised are urgent and indicated that the new computerized accounting system should, within 18 to 24 months, provide the bulk of the improvements required. It has, moreover, included in its programme of reform solutions designed to meet the main comments of the Court.

It has also undertaken to keep the Court regularly informed of the progress of the various arrangements contemplated and to forward, as necessary, basic documents about progress achieved. For its part the Court will make a practical assessment of improvements observed in order to inform the discharge authorities of results in this matter.

- 1.4. The Court summarizes below the comments it made to the Commission and the replies it received.

2. PROBLEMS OF ORGANIZATION

2.1. Scattered administration

On the merger of the executives, ECSC activities were dispersed among numerous departments with authorizing officer powers.

The distribution of ECSC activities among different Directorates-General (with different accounting requirements) has, moreover, led to the existence of several accounting systems at the same time.

2.2. Separation of delegated powers

A fundamental principle in the organization of any system of internal control is the separation of powers of decision, execution, recording and cross-checking.

At present most of the decisions on lending and cash management are very largely the prerogative of individual officials without any system of control based on hierarchical or functional responsibility.

2.3. Limitation of powers

Cash-management transactions such as those of the ECSC are remarkably extensive; at present they are of the order of 2 000 MEUA a year.

The powers given to the "dealers" contain no formal medium-term or long-term directives designed to reduce risks by setting ceilings to placing of funds according to criteria of balance.

2.4. Procedures

As regards management the Commission has laid down purely internal rules organizing the conduct of "budgetary" transactions entrusted to the responsibility of several Directorates-General, thus imposing some discipline in the distribution of functions and responsibilities among those involved in the process. By contrast, in the organization of the conduct of functions entrusted to DG XVIII there is, for practical purposes, no code of procedure and rules even though it is by far the most important activity of the Community.

This deficiency affects, indeed, all stages of the administration:

- the decision stage: it is accepted that decisions on loans, borrowings and placing of funds should follow the general principles of good management but the Commission, by failing to lay down procedures, deprives itself of the means of ensuring that the decisions really do conform with the principles of efficiency and effectiveness;
- the execution stage: the Court can only report the absence of established procedures. There are, indeed, a number of customs but they have no status as official rules and are not binding on everyone; moreover, they are developed out of the specific day-to-day requirements of each branch without adequate regard for the general requirements of the department as a whole.
- the recording stage: here too the Institution has drawn up no code of accounting rules to provide a continuity of accounting practice or a precise and consistent definition of a real balance sheet structure and of the content of each balance sheet item.

In the same way, there is no definition of an exact period (after 31 December) during which the documents necessary to close the accounts of the previous year can be taken into account. The Commission should take steps to ensure that it receives all these documents on that date.

2.5. Job description

- In DG XVIII the absence of any exact assignment of functions results in a certain amount of confusion in the distribution of tasks which are thus not done, done twice or done by those who make no use of the results.

- Definition of tasks and responsibilities and the resulting elimination of unnecessary work might improve the output of the staff; staff numbers have not kept step with the increase in activity which has followed a geometrical curve in recent years.

2.6. With the assistance of a firm of specialist consultants the Commission has begun to compile a proper handbook of procedures; this should lead to a provisional system of rules of management, the first phase being introduced at the end of the third quarter of 1981.

3. ACCOUNTING PROBLEMS

In describing weaknesses in the accounting system we deal first with those strictly concerning efficiency and then with those which might affect the validity of figures appearing in the annual accounts.

3.1. Procedures to be revised in the interests of efficiency

3.1.1. The accounting plan

The accounting plan is unclear and illogical.

Some accounts of minor importance are too detailed (for example interest receivable is given for each borrowing). On the other hand, others of absolute necessity for management do not exist at all: accounts for loans (which have no numbering system of their own) follow the order and numbering of the accounts for borrowings; this method means that, if a loan is financed from more than one borrowing, there is no complete account of the whole loan.

When an administrator needs to carry out simple administrative tasks (such as checking that a loan has been paid out or interest paid) he must turn to several lists or even to the file in order to find the undertaking/loan/borrowing reference code which will enable him to find the accounting data required, these being classified only by borrowings. Given this difficulty in relying on the general accounting system, administrators always rely, where loans are concerned, on subsidiary statistics and, as these are inadequate themselves, they also keep manual indexes which they have developed for their own purposes.

Finally, it must be stressed that the accounting plan includes in the same class several accounts of a different character, which obviously has an adverse effect on clarity.

3.1.2. Duplication of work

Duplication is caused by the dispersion of accounting work. The general accounts branch continues to do statistical work by hand even when it is later undertaken by the computer. In the absence of day-by-day information administrators keep manual accounts of transactions which concern them.

3.1.3. Manual recording

The inadequacy of the computer programmes makes it necessary to keep a large amount of manuscript data which, following normal practice, should be recorded automatically by means of a classical computer programme.

3.2. Validity of figures in annual accounts

3.2.1. Structural aspects

Finding a solution to the problems mentioned under this heading would require agreement among several Directorates-General.

3.2.1.1. Centralization and integration of accounting

As has been stressed above there are a number of departments taking part in ECSC accounting. There is no general accounts branch able to integrate all these; there is thus no single account showing, at any given moment, the whole of the transactions. It is therefore necessary to refer to sub-accounts. These are kept not only at Brussels for the management of aids but also at Luxembourg for levy receipts. These subsidiary books showing details of the transactions are not reconciled with the main ledger on which the balance-sheet is based.

This state of affairs causes, on the one hand when the accounts are closed, a great deal of work and adjustment which is not done until after, sometimes several months after, 31 December and, on the other hand, an increased danger of error.

3.2.1.2. Compatibility of the accounting systems

The different accounts branches have developed their systems following entirely different ideas (either budgetary or financial) and purely in order to meet their own objects and requirements, without concerning themselves with the overriding need to seek out adequate consistency in order to ensure the unity of the general accounts. The two accounting systems of Luxembourg and Brussels are mutually incompatible.

3.2.2. Procedural aspects

The problems which arise under this heading concern more particularly the administration by DG Credit and Investments.

3.2.2.1. Reconciliation of figures

As the systems are separate and incompatible it is necessary to undertake regular reconciliations between the accounts in order finally to arrive at single annual accounts. In fact such reconciliation is not undertaken often enough.

Reconciliation is made between DG XIX and DG XVIII only once a year, thus causing delay in closure. Moreover it is not carried into the main ledger for the year of the accounts but done statistically outside the books of account.

At 31.12.1979 the position of the accounts was as follows:

	Ledger DG XIX	Ledger DG XVIII	Balance Sheet ⁽¹⁾
Provisions for legal commitments			
- Research	73 379 930.41	65 369 487.44	73 379 930.-
- Rehabilitation	189 567 278.82	158 942 125.72	189 567 279.-
- Interest			
reduction Art. 54	19 097 906.61	22 631 866.82	17 686 418.-
Art. 56	21 879 216.54	47 298 689.06	20 562 518.-
- Coking Coal	8 825 192.-	10 575 000.-	8 825 192.-

This state of affairs goes against the principle that the balance sheet should correspond with the accounts for the year.

3.2.2.2. External and internal verification of balances

As is known, the management of loans and bank accounts involves a large number of banking establishments. The Commission is thus required to keep a large number of accounts for these types of transaction and it is therefore essential at the end of the year to verify the balances on the basis of external confirmation by the banks concerned.

Unlike the Commission the Court (following a system firmly implanted in private-sector audit)⁽²⁾ considers, especially in view of the deficiencies noted above, that it is of the greatest importance for it to be able to obtain directly from the banks the external confirmation of balances with such details as it considers necessary both for loans and for bank accounts.

Internally, the accounts branch does not seek any confirmation from the administrative branches.

(1) The balance sheet figures, which are the correct ones, include information from DG XIX for Research, Rehabilitation and Aid for Coke; for interest reduction they also include information from DG XIX, deducting accrued interest. The figures in DG XVIII's ledger at 31.12.1979 include only balances at 1 January 1979, and therefore do not show any transactions in 1979.

(2) It is also used in public sector audit.

3.2.2.3. Serial numbering of documents

This problem arises in several of the branches of DG XVII and causes uncertainty about whether all the documents are registered. In the different branches there are to be found either monthly series or numbering according to much larger classifications which thus do not ensure continuity of numbering for the whole year.

3.2.2.4. Transitional accounts

This type of account is a particular problem in DG XVIII's accounting. It was devised to provide a link between accounts in currencies and those in EUA and should have shown a purely accounting balance.

In fact these accounts also include currency exchange transactions which may cause a realized loss or gain and which should be shown as a separate item in the revenue and expenditure account; this item should explicitly show the result of currency exchange transactions, which is particularly important because of the growth of this type of transaction, and which is falsified by the inclusion of a mere unrealized difference. It is therefore necessary to break up the item "loss on exchange rate adjustment".

3.3. The Commission considers that all these accounting problems should be solved by the introduction of the computer programme for which it has already entered into 3 contracts with specialist firms and which should produce results over 1982.

4. PROBLEMS OF INTERNAL AUDIT

4.1. Structural aspects

There is no effective organized system, whether inside or outside DG XVIII, for the internal audit of the financial activities of the ECSC.

4.2. Procedural aspects

The deficiencies in the procedures for internal audit result, on the whole, from the deficiencies already noted in the organization: no separation of powers, no job descriptions and no handbook of procedure. They therefore apply in almost all branches.

In general it may be said that there are no adequate counterchecks (i.e. independent of the official concerned and continuous); similarly checks by the superior officer or by a different official in the same division are not as total and systematic as required.

4.2.1. Checks by DG XX

DG XX is involved only for budgetary operations which, in amount, represent only a very small part of the activity of the ECSC which is mainly concerned with borrowing and lending.

4.2.1.1. On rehabilitation

It can happen that expenditure for the year cannot be carried out completely because of a refusal to exceed the forecasts in the operational budget: where payments are concerned this attitude results in retaining short term debts on the liabilities side of the balance sheet. This result of budget treatment is contrary to the proper administration of contracts.

4.2.1.2. On interest reduction

DG XX is unable to carry out completely the function assigned to it by the Commission as there are not available to it all the documents required to justify the grant of interest reduction in cases where it applies to only a part of the loan.

4.2.2. Checks in DG XVIII

4.2.2.1. Cash management

To the criticisms already expressed there must be added:

- The powers of signature laid down by the Commission take account of the importance of certain transactions by limiting the delegation to each class of signatory; there is no such limitation for cash-management operations.
- Encoding of telex payment orders to banks is neither separated from the dealers nor subjected to an independent check.
- In order to reconcile the requirements of control and the speed needed in placing funds it should be the practice to require the dealer to keep dealer slips numbered in advance and coded for different types of operation. There is nothing of this sort in the Community.
- There is no appropriate cross-check by the accounts branch on cash management operations.

4.2.2.2. Levy service

- The levy service is able to verify only the arithmetical accuracy of levy declarations, physical checks at the premises of undertakings being carried out by inspectors of DG IV. The levy service is unable to determine appropriately the frequency of checks on the spot (which the Court considers inadequate), the undertakings to be checked or the subjects to be examined.⁽¹⁾
- Moreover, no system has been set up which would ensure that all undertakings required to declare their production are fully recorded.

4.2.2.3. Interest reduction

The Commission pays out interest refunds without satisfying itself that the undertaking has paid the interest due. The contracts do not even stipulate that the two transactions are interdependent - they are carried out by two Directorates-General (XVIII and XIX) - because of the currency problems which arise.

(1) See Annual Report 1977

4.2.2.4. General accounting service

In the general accounting service some purely accounting checks are either not carried out at all or are inadequately carried out.

There is no formal check on the correction of posting errors to ensure that it is justified. If the official, often the only official carrying out a certain operation, is not available there is no automatic provision of a substitute, even if delay cannot be accepted.

- 4.3. Following these latest comments, the Commission signed a study contract with an international firm to define new procedures for internal control; these should become operational in 1982.



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