
EUROPEAN PARLIAMENT

Working Documents

1981 - 1982

13 April 1981

DOCUMENT 1-88/81

Report

by the Court of Auditors of the European Communities

**on the balance sheet and accounts of the ECSC for the financial
year 1979**

121

COMMISSION OF THE EUROPEAN
COMMUNITIES

Brussels, 6.1.1981

Mrs Simone VEIL
President of the European Parliament
Kirchberg
Luxembourg

Dear Madam President,

Pursuant to Article 78f (5) of the ECSC Treaty, I have the honour to enclose the report drawn up by the Court of Auditors for the financial year 1979 in conformity with that Article, together with the observations from the Commission of the European Communities, in its capacity as High Authority of the ECSC, on the report in question.

Yours sincerely,

Christopher TUGENDHAT
Member of the Commission

ANNUAL ACCOUNTS OF THE ECSC

Report on the financial year 1979

Annex : 1979 balance sheet and annexes

This report has been prepared in accordance with the terms of Article 78f(5) of the Treaty establishing the ECSC, which provides that the Court is to draw up an annual report stating whether the accounting and the financial management of the Commission have been effected in a regular manner.

This report must normally be submitted "within six months of the end of the financial year" but as indicated in the letter of the Court of 30.6.1980, the fact that the accounts were sent late, on 9 June 1980, meant that it was not possible to respect this time-limit.

The Court would make the following comments with regard to the financial year 1979:

- The annual accounts of the ECSC should represent the total cost of the activity of this Community.

The component parts of the operating costs of the ECSC are, it is true, entered in the general budget of the Communities as provided for by the merger treaty. It can be seen, however, that the line between operating expenditure and other expenditure is not altogether clear-cut. Thus in the case of the collateral costs of research expenditure, some are borne by the general budget while others are still borne by the 3% reserve drawn from the research allocation. The financing of certain studies under Article 46 of the ECSC Treaty is borne by the general budget. Stricter rules should be adopted, since even within the ECSC the criteria are not the same for the coal as for the steel sector.

- With regard to the bonds issued by the ECSC on the financial markets, the Commission has - for no apparent reason - changed its previous method. Whereas it treated these bonds like normal portfolio assets until maturity date even if it had redeemed them in advance, in 1979 it considered as amortized the redeemed bonds which matured during 1980. On the other hand, this kind of advance amortization was not applied to the other maturity dates. The arbitrary choice thus made is only justified by the desire to account for funds which will not in fact be available until the following year. It is true that, in its own draft directive, the Commission considered this method possible, but it made it subject to the express condition that the bonds redeemed in advance be no longer negotiable.

This condition is logical if one considers that the results of the operation must be final from the moment they are entered in the revenue and expenditure account. The year of maturity of the redeemed bonds does not constitute an objective criterion for distinguishing between identical operations. This mode of procedure has a considerable influence on the balance sheet. Since the bonds which have supposedly been amortized have remained in the normal portfolio of the holding banks - some of which have a discretionary mandate to carry out operations with these bonds to support their market rates - the former method should have been retained and the balance thus increased on the assets side by nearly 33 MEUA (initial value) and on the liabilities side by 38 MEUA (nominal value). In the same way, the result of the operation on the date of repurchase (2.7 MEUA) should not have been entered in the revenue and expenditure account, which should rather have shown the depreciation of these same bonds at the balance sheet date (2.5 MEUA).

- The items on the balance sheet should reflect the actual situation that they are supposed to represent rather than be amended by items which appear under the sundry accounts, which in themselves are insignificant in the balance sheet total. This is particularly the case with the important item "Disbursed loans" the total of which should, in the assets, represent actual amounts outstanding, while the item "Interest receivable" should include all interest due. However, under the item "Other assets" we find reimbursement of loans made by defaulting debtors (195 751 EUA) as well as the interest relating to this sub-heading (63 451 EUA).
- It is not acceptable that numerous adjustments are made as these rob the total of each item of both its significance and of the possibility of detailed exposition. Several important examples can be found which modify the gross amount of the balance sheet both on the assets and the liabilities side:
 - short-term debts to certain banks were set off against balances with other banks.Rectification of these entries should lead to the increase of the assets and the liabilities by an amount of 325 342 EUA;

- . in the "Other assets" account, the adjustment against other assets of a debt to undertakings resulting from the system of aid to coke is not acceptable and a rectification of 98 939 EUA is required.
- In the revenue and expenditure account, the item "Interest on bank deposits and portfolio" bears the net loss on the sale of bonds and is thus wrongly decreased by an amount of 3 157 033 EUA.
- The valuation of the portfolio at the date of the balance sheet using the lowest value method, was not thorough enough. Consequently the balance sheet recorded an under-value of 294 450 EUA.
- With regard to doubtful debtors, their debt is treated normally among disbursed loans except for the contentious part which is placed with the "Other assets". In the case of one of these debtors, however, no payment has been made for thirteen years and the realization of the guarantees is almost impossible, which would justify writing the debt off altogether. The Commission has provided against the total of doubtful debts (there are three in all), for a sum of 800 000 EUA which does not even represent the total debt of the debtor whose insolvency would justify writing it off altogether (1 152 820 EUA). One may thus conclude that the difference of 352 820 EUA at least does not represent a genuine debt.
- As far as interest collected and other income from loans and guarantees are concerned, there is a mixture of real figures and estimates. The latter is the case with interest from short-term deposit of borrowings, amounting to a total of 18 510 568 EUA. This amount is seen to be theoretical by reason of its method of calculation: the gross return on the average amount of the total funds in the Treasury is applied to the borrowed funds for the period during which they remained in the Treasury. A more accurate calculation is necessary to ensure that the loan or guarantee conditions have not been such as to lead to the application of the provisions of Article 51(3) of the Treaty. It would be simpler and more accurate in this respect to record only the return on the difference in the rates of interest of loans and borrowings. The Treaty does in fact lay down that these profits should be placed in reserve and not otherwise employed.

- The presentation of the balance sheet and its annexes does not contain all the information which one would be entitled to expect from these documents. Thus, no mention is made of the guarantees given which in fact amount to a total of 11 543 542 EUA and which should be placed in a memorandum account.

A number of important items of information do not appear in the annex to this balance sheet. These are the breakdowns relating to:

- . loans to be classified according to whether the beneficiary is a bank or financial institution on the one hand or an undertaking on the other;
- . borrowings, according to type, either public or bank;
- . portfolio securities according to whether they are issued by the public sector, bank sector or the private sector.

Finally, the annexes should above all serve to indicate special operations whose frequency has not necessitated separate accounts being opened (for example, deposit of bills and forward currency transactions). The breakdowns in the annexes should contain all the information required to identify clearly the categories in question: unclassified amounts should not be allowed (thus when describing the loan guarantees the item "miscellaneous" includes a large amount of loans for which there is no guarantee (64 853 419 EUA) without the reader being able to see this).

Subject to the reservations arising from the above comments on the financial year 1979, the Court of Auditors finds that the balance sheet and the statement of revenue and expenditure drawn up at 31.12.1979 as annexed to this report have been effected in a regular manner.

BALANCE SHEETS AS OF DECEMBER 31, 1979 AND 1978

(Currency -- European Units of Account)

A S S E T S

L I A B I L I T I E S

	1979	1978
Loans outstanding (Note 3)	4,793,693,335	4,549,891,467
Bank balances and deposits	448,858,943	309,677,931
Investment securities	169,380,099	167,265,666
Accrued interest receivable	113,121,166	105,172,535
Deferred issuing costs and premiums	70,902,275	70,494,637
Other assets (Note 4)	47,523,448	43,356,556
Bank deposits for bonds and coupons payable	40,376,952	34,230,814
Repurchased bonds (Note 5)	37,254,525	78,209,905
Property	260,752	272,401
	230,000,000	200,000
Reserves (Note 6)--		
Guarantee fund	140,000,000	138,500
Special fund (housing and reconversion)	41,530,962	41,062
Former pension fund	411,530,962	379,552
	310,021,337	267,084
Allocations from income (Note 7)--	105,033,906	76,194
Financial aid	415,055,243	343,279
Other	419,033	113
Unallocated income	827,005,230	772,954
Total reserves and allocations	4,675,047,371	4,416,237
Borrowings (Note 8)	166,822,825	151,289
Accrued interest	40,76,859	34,230
Bonds and coupons payable	8,268,671	28,457
Due to banks	2,848,482	4,196
Other liabilities and payables	1,001,983	1,204
Reimbursement premiums payable	5,721,371,495	5,358,571,712
	5,721,371,495	5,358,571,712

The accompanying notes are an integral part of these balance sheets.

EUROPEAN COAL AND STEEL COMMUNITY

STATEMENTS OF REVENUES AND EXPENDITURES

FOR THE YEARS ENDED DECEMBER 31, 1979 AND 1978

(Currency -- European Units of Account)

	<u>1979</u>	<u>1978</u>
REVENUES:		
From loans and guarantees (Note 9)	406,186,807	374,456,791
Levy (Note 10)	103,239,638	100,775,514
Contributions from Member States	28,000,000	28,000,000
Interest from deposits and investments	44,080,665	33,787,463
Gain on retirement of repurchased bonds (Note 8)	2,739,281	
Miscellaneous	801,725	187,876
	-----	-----
	585,048,116	537,201,644
	-----	-----
EXPENDITURES:		
For borrowings and guarantees (Note 11)	382,613,609	352,181,251
Reduction of portfolio to market value (Note 12)	10,387,724	-
Other financial expenses	231,627	236,252
Budgetary expenditures-		
Research projects	33,101,821	32,306,675
Rehabilitation projects	33,020,436	20,993,860
Assistance under Article 54	5,374,622	3,976,808
Assistance under Article 56	6,399,500	4,799,675
Coke projects	4,570,486	-
Administration (Note 13)	5,000,000	5,000,000
	-----	-----
	480,699,825	419,494,521
	-----	-----
EXCESS OF REVENUES OVER EXPENDITURES	104,348,291	117,707,123
LOSS FROM CONVERSION OF FOREIGN CURRENCIES	297,923	10,783,339
	-----	-----
NET INCOME AVAILABLE FOR ALLOCATIONS	104,050,368	106,923,784
	-----	-----

The accompanying notes are an integral part
of these statements.

EUROPEAN COAL AND STEEL COMMUNITY

STATEMENTS OF NET INCOME ALLOCATIONS

FOR THE YEARS ENDED DECEMBER 31, 1979 AND 1978

(Currency -- European Units of Account)

	<u>1979</u>	<u>1978</u>
Unallocated income as of January 1	113,045	85,593
Net income available for allocations	104,050,368	106,923,784
Available for allocations	104,163,413	107,009,377
Allocations to (Note 1)-		
Guarantee fund	30,000,000	17,000,000
Special fund	1,500,000	4,000,000
Former pension fund	468,300	1,146,241
Financial aid	42,937,063	76,917,616
Other	28,839,017	7,832,475
Total allocations	103,744,380	106,896,332
Unallocated income as of December 31	419,033	113,045

The accompanying notes are an integral part
of these statements.

EUROPEAN COAL AND STEEL COMMUNITY

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 1979 AND 1978

(Currency -- European Units of Account)

1. PRESENTATION OF FINANCIAL STATEMENTS

The European Coal and Steel Community (ECSC) was established as a sovereign entity by the Treaty of April 18, 1951. The purpose of the ECSC under the Treaty is to aid the economic development of the nine Member States through the creation of a common market for coal and steel. The ECSC's principal sources of funds are its levy-taxing power and borrowings.

Since 1967, the European Commission manages all the affairs of the ECSC subject to the cooperation of and review in certain circumstances by the Council of the European Communities.

The accompanying financial statements as of December 31, 1979, include the proposed allocations of the 1979 net income. Such allocations are still subject to the approval by the Commission.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Foreign currency conversion

The ECSC uses the European unit of account (EUA) as the unit of measure for presenting its financial position and operations. The EUA as adopted by the Council of the European Communities has been defined as equal to the sum of the following amounts of the currencies of the Member States:

Belgian francs	3.66
Danish crowns	0.217
Dutch guilders	0.286
French francs	1.15
German marks	0.828
Irish pounds	0.00759
Italian lire	109.00
Luxembourg francs	0.14
United Kingdom pounds	0.0885

The value of the EUA, in terms of the currencies of the Member States, is determined by the Commission of the European Communities by converting the above-mentioned amounts of currencies into the currency concerned on the basis of the official exchange rates prevailing on that currency's national market. The value of the EUA in terms of a non-mem-

ber currency is determined on the basis of the cross rates of the currency concerned relative to the ECU on a financial market of the Member States that the Commission considers to be representative; normally this is the Brussels market.

Accounts denominated in foreign currencies were converted into ECU's using the following rates as of December 31,

	1979	1978
Belgian francs	40.3181	39.6543
Danish crowns	7.71697	6.99114
Dutch guilders	2.74085	2.71453
French francs	5.79312	5.75538
German marks	2.49057	2.50868
Irish pounds	0.670579	0.675274
Italian lire	1157.19	1140.06
Luxembourg francs	40.3181	39.6543
Swiss francs	2.29783	2.22839
United Kingdom pounds	0.646904	0.675274
United States dollars	1.43839	1.37688

The gain or loss resulting from the conversion at year end of the accounts in foreign currency is taken into account in the determination of net income available for allocation.

b. Investment securities

Investment securities, mainly governmental securities, are valued at the lower of average cost or market.

c. Property

Property consists of a building located in Washington D.C., which is valued at cost.

d. Deferred issuing costs and premiums

Issuing costs and related expenses are amortized over the terms of the respective borrowings.

3. LOANS

The breakdown of approximately 1,000 loans granted in the European Community is as follows as of December 31, 1979:

From borrowed funds in-	
United States dollars	1,951,819,054
German marks	1,149,083,958
Swiss francs	491,932,563
French francs	422,395,220
Luxembourg francs	159,997,281
Belgian francs	135,183,027
Dutch guilders	120,542,897
Italian lire	85,776,952
Canadian dollars	44,527,298
United Kingdom pounds	41,240,663
European Units of Account	8,908,071
European Monetary Units	17,062,784

	4,628,469,764

From other sources-	
Special reserve fund for the financing of workers housing projects	137,743,009
Pension fund for housing loans to the European Communities' personnel	21,246,399
Pension fund for Frioul Iron Industry	3,888,730
Funds allocated for technical research	2,114,038
Funds allocated for rehabilitation	231,395

	165,223,571

	4,793,693,335

An analysis of these loans by country is as follows:

Germany	1,216,142,003
United Kingdom	1,437,608,204
France	942,524,992
Italy	692,784,344
Belgium	192,711,409
The Netherlands	141,129,397
Denmark	36,760,068
Luxembourg	97,970,568
Ireland	14,815,951

	4,772,446,936
Communities' personnel	21,246,399

	4,793,693,335

A breakdown of these loans by principal form of guarantee is as follows:

Loans secured by Member States	1,981,423,442
Loans secured by banks	977,141,594
Loans secured by mortgages	961,399,179
Loans secured by other guarantees	94,993,154
Loans secured by industry groups	778,735,926
	4,793,693,335

The terms of the loans granted to corporations within the European Community vary significantly.

The duration of the loans for workers housing projects varies between 20 and 25 years while the duration of the loans to the Communities' personnel varies between 10 and 20 years.

4. OTHER ASSETS

As of December 31, 1979, this caption included the following accounts:

Levy receivable	21,547,051
Member States contributions	19,676,293
Others	6,300,104
	47,523,448

5. REPURCHASED BONDS

Repurchased bonds, which are temporarily held in treasury, are valued at the lower of average cost or market, except for the bonds maturing in 1980, which were retired (Note 8).

At December 31, 1979, the nominal value of the repurchased bonds in portfolio was 45,227,489.

6. RESERVES

The guarantee and special fund result from allocations of the ECSC's net income made by the Commission.

The former pension fund represents the balance of the pensions funded by the ECSC prior to March 5, 1968, from which date on the pension commitments for the personnel are assumed directly by the Member States.

7. ALLOCATIONS FROM INCOME

Allocations from net income are made for industrial projects, social housing projects for workers and technical and economic research in accordance with the provisions of the treaty establishing the ECSC. As of December 31, 1979, these funds were planned to be used for the following projects:

Financial aid (contracted commitments)-	
Rehabilitation projects	189,567,279
Research projects	73,379,930
Developments and reconversion (Art. 56)	20,562,518
Industrial loans (Art. 54)	17,686,418
Coal and coke grants	<u>8,825,192</u>
	310,021,337
Other (approved commitments)-	
Research projects	11,930,288
Developments and reconversion (Art. 56)	41,607,911
Industrial loans (Art. 54)	18,495,707
Budget 1980	23,000,000
Other	<u>10,000,000</u>
	105,033,906

	415,055,243

8. BORROWINGS

As of December 31, 1979, the ECSC had borrowed 4,675,047,371 under the form of approximately 220 loans on different capital markets at varying interest rates. The loans come to maturity at various dates through 2001.

The breakdown of the net debt outstanding by currency was as follows:

United States dollars	1,951,344,142
German marks	1,202,667,421
Swiss francs	493,726,690
French francs	427,079,881
Luxembourg francs	171,566,244
Belgian francs	127,555,614
Dutch guilders	120,926,700
Italian lire	82,959,324
Canadian dollars	44,527,298
United Kingdom pounds	35,631,253
Units of Account	17,062,784

	4,675,047,371

Repurchased bonds held in treasury as of December 31, 1979, for a nominal value of 38,103,892 and maturing in 1980 were retired and a profit of 2,739,281 was recorded.

9. REVENUES FROM LOANS AND GUARANTEES

The detail of the revenues from loans and guarantees is as follows:

Interest on loans	382,896,568
Interest on available funds	18,810,568
Guarantees fees	61,976
Miscellaneous	4,417,695

	406,186,807

10. LEVY

The ECSC is authorized under the Treaty to impose a levy on the average value of the production of coal and steel of the enterprises in the Community. During the year 1979 the percentage was 0.29%.

11. EXPENDITURES FOR BORROWINGS AND GUARANTEES

The detail of the expenditures for borrowings and guarantees is as follows:

Interest on borrowed funds	363,208,185
Amortization of issuing costs	14,510,254
Guarantees fees	3,864,210
Miscellaneous	1,030,960

	382,613,609

2. REDUCTION OF PORTFOLIO TO MARKET VALUE

In accordance with its accounting policies, which call for the valuation of its portfolio of investment securities and repurchased bonds at the lower of average cost or market, the ECSC recorded a provision of 10,387,724 to reflect the reduction in market value of the portfolio as of December 31, 1979. As of December 31, 1978, the difference amounted to 6,574,993 for which no reduction was recorded but which was included in the "Other allocations from income".

3. ADMINISTRATIVE EXPENDITURE

The ECSC contributed to the administrative budget of the Commission of the European Communities for an amount of 5,000,000.

4. COMMITMENTS

As of December 31, 1979, the Commission had signed formal agreements for the borrowing of a total amount of 147,488,642; outstanding loan commitments amounted to 48,038,104.

5. GUARANTEES GIVEN

The ECSC guarantees loans made to various coal and steel companies by third parties; such guarantees are secured by guarantees to the ECSC from Member States, industrial concerns and banks or by mortgages on the projects financed.

ECSC BUDGET FOR 1979 - IMPLEMENTATION AS AT 31 DECEMBER 1979

(Provisional statement)

REQUIREMENTS	Budget		RESOURCES	Budget	
	Estimate (1)	Implementation		Estimate (1)	Implementation
1. Administrative expenditure	5	5	1. Current resources		
2. Aid to resettlement (Article 56)	67	67	1.1 Levy yield at 0.29%	103	103,2
3. Aid to research			1.2 Interest on investments and on loans from non-borrowed funds	18	18
3.1 Steel	20	20	1.3 Fines and late payment surcharges	p.m.	0,8
3.2 Coal	17	17	1.4 Miscellaneous	p.m.	-
3.3 Social	9,5	9,7	2. Cancellation of commitments which will probably not be implemented	8,7	10,1
4. Aid in the form of interest relief grants			3. Revaluation of assets and liabilities	p.m.	p.m.
4.1 Investment (Art. 54)	20	21,7	4. Unused resources carried over from the previous year	5,8	5,8
4.2 Redevelopment (Art. 56)	27	25,5	5. Recourse to the contingency fund	4	4
5. Aid to coking coal and metallurgical coke (Art. 95)	6	6	6. Special contribution (Member States decision of 9 April 1979).	28	28
6. Effect in EUA terms of changes in currency conversion rates on legal commitments to be met in national currencies	-	0,2			
Sub-total	171,5	172,1	Sub-total	167,5	169,9
Surplus	-	-	Deficit	4	2,2(2)
TOTAL BUDGET	171,5	172,1	TOTAL BUDGET	171,5	172,1
OPERATIONS FINANCED BY NON-BORROWED FUNDS			ORIGIN OF NON-BORROWED FUNDS		
7. Social housing	17,5	17,8	8. Repayment of loans for social housing	7,5	7,8
			9. Special reserve and former ECSC Pension Fund	10	10

(1) Including the Commission's implementation estimates of 24 October 1979.

(2) To be covered from income from interest from the financial year 1979.

BREAKDOWN OF ALLOCATION OF ECSC ASSETS

FINANCIAL YEAR 1979

ANNEX 3

	Assets on 1-1-1979	Allocations for current financial year	Revisions for current financial year	Pay rates for current financial year	Changes due to exchange rates	Assets on 31-12-1979	Allocations to 1979 balance sheet	Assets on 31-12-79
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
<u>Reserves</u>								
Guarantee fund	200 000 000,-					200 000 000,-	30 000 000,-	230 000 000,-
Special/Fundi reserve	138 500 000,-					138 500 000,-	1 500 000,-	140 000 000,-
Old pension fund	41 062 662,-	823 957,-			- 355 657,-	41 530 962,-		41 530 962,-
<u>Provisions relating to implementation of ECSC operational budget</u>								
Resettlement	158 942 126,-	67 020 750,-	3 519 930,-	33 020 436,-	+ 144 769,-	189 567 279,-		189 567 279,-
Research	65 369 487,-	43 177 708,-	2 114 736,-	33 101 821,-	+ 49 892,-	73 379 930,-		73 379 930,-
Interest subs. Art. 54	12 634 870,-	10 420 070,-	495,-	5 352 820,-	- 15 207,-	17 686 418,-		17 686 418,-
Interest subs. Art. 56	19 562 790,-	7 999 192,-	588 073,-	6 394 465,-	- 16 926,-	20 562 518,-		20 562 518,-
Aid to colking coal	10 575 000,-	6 000 000,-	3 179 322,-	4 570 466,-		8 825 192,-		8 825 192,-
Commitments to be contracted	Research	8 298 463,-	46 810 616,-	43 178 991,-		11 930 288,-		11 930 288,-
	Art. 54	7 174 866,-	21 723 520,-	10 420 070,-	+ 77 391,-	18 495 707,-		18 495 707,-
	Art. 56	24 793 628,-	25 448 450,-	8 724 192,-		41 607 911,-		41 607 911,-
For following financial year (interest)	18 000 000,-		18 000 000,-				23 000 000,-	23 000 000,-
Unforeseen budgetary expenditure	4 000 000,-		4 000 000,-				10 000 000,-	10 000 000,-
Non-allocated appropriations	5 877 446,-	363 190 680,-	327 722 291,-			41 345 835,-	- 40 926 802,-	419 033,-
<u>Loans relating to ECSC financial activities</u>								
Loan servicing		406 186 807,-	382 613 609,-			23 573 198,-	- 23 573 198,-	-
Unreliable debtors (loans)	1 588 538,-		1 588 538,-					-
Depreciation of portfolio	6 574 993,-		6 574 993,-					-
	722 954 859,-	398 801 350,-	812 275 240,-	82 440 028,-	- 85 713,-	827 065 238,-	-	827 065 238,-

COMMISSION OF THE EUROPEAN
COMMUNITIES

COMMENTS

ON THE

1979 REPORT OF THE COURT OF AUDITORS ON THE REGULARITY OF THE ACCOUNTING
EXCLUDING ADMINISTRATIVE EXPENDITURE AND REVENUE AND THE
FINANCIAL MANAGEMENT OF THE HIGH AUTHORITY

- Article 78 f (5) ECSC -

- 15 December 1980 -

Being particularly regardful of the image of the ECSC and its credibility on the capital market - the scene of its borrowing and lending operations - the Commission does not wish to underestimate the potential impact of the Court of Auditors' report for 1979, and in particular the reservations expressed with regard to the regularity of the balance sheet and the statement of revenue and expenditure. Hence its desire to answer each of the comments contained in the report in full.

As it has been unable to discover whether or not the Court is planning to present any further comments on ECSC financial operations during 1979, the Commission has decided to annex its own remarks to the Court's report. It trusts that these will be of use for the preparatory work on the discharge decision due to start shortly.

It is important for the Commission in its capacity as High Authority that the Court of Auditors adopt a coherent approach to the preparation of the reports specified in Article 78f(5) ECSC.

Examination of the Court's performance in respect of 1977, 1978 and 1979, as outlined below, does not suggest that this has been done.

For 1977 all that the Commission received, and this was in October 1979, was the balance sheet and revenue and expenditure account certified by the Court and accompanied by one page of comments, claimed by the Court to be the report drawn up in accordance with Article 78f(5) ECSC. These were followed a few days later by the Court's comments on the ECSC's financial operations in 1977. All the above papers were discussed by the European Parliament before it granted the Commission discharge for 1977 on 22 May 1980.

For 1978 the Commission received no more than the balance sheet and revenue and expenditure account certified by the Court, again accompanied by one page of comment, despite Parliament's reminder in point 6 of its 1977 discharge decision (OJ C 147, 16 June 1980, page 76) "that it is absolutely essential for the European Parliament to be given precise information on the ECSC's activities in order both to assess the soundness of the financial management and to form a political appraisal of the implementation of the ECSC budget as a whole".

The Commission sent the Court of Auditors' report to Parliament on 9 January 1980.

Finally, for 1979, the Commission received the Court's report, in one language only, on 3 October 1980. The report consists of the ECSC's balance sheet and revenue and expenditure account, together with four pages of comments by the Court, closing with the statement that subject to the reservations arising from its comments it "finds that the balance sheet and the statement of revenue and expenditure drawn up at 31 December 1979 as annexed to (its) report have been effected in a regular manner".

*

*

*

The Commission regrets the abruptness of the comments on the 1979 balance sheet.

On 22 December 1979 the Court of Auditors informed the Commission of its new approach to assessing the ECSC accounts, and in particular of its intention to give greater consideration to the requirements of the Fourth Council Directive of 25 July 1978 based on Article 54(3) (g) of the EEC Treaty on the annual accounts of certain types of companies (OJ L 222, 14 August 1978). This information was borne in mind by the Commission when it drew up the 1979 ECSC balance sheet, the presentation of which is completely different from that of previous years.

For the purposes of applying the Fourth Directive to the ECSC balance sheet, it is essential to take into account the special nature of the institution (see Article 51(4) ECSC, which engages in financial operations rather like a long-term credit bank, and also manages a budget in the same way as a public body. The Commission regrets that the Court of Auditors did not examine this issue with it in greater detail and even more that it did not make any attempt to discuss the problems raised in its annual report before this was finally adopted. It is quite sure that, had this been done, several of the comments would have proved unnecessary and the general presentation of the report would have been different.

The comments of the Court of Auditors, which are devoted primarily to accounting, fall into three groups :

- a) criticism of the longstanding accounting methods accepted by the Court of Auditors in its first two reports (1977 and 1978);
- b) criticism arising from a divergence in the interpretation of the principles laid down in the draft Directive on the coordination of laws, regulations and administrative provisions relating to the annual accounts (and consolidated accounts) of banks and other financial institutions";
- c) criticism of specific points.

A) Criticism of longstanding accounting methods accepted by the Court of Auditors in its first two reports (1977 and 1978):

The Commission acted wherever possible on the suggestions made by the Court of Auditors at the end of 1979 in regard to accounting. It will make a further effort when preparing the 1980 balance sheet.

In answer to the comments in the Court of Auditors' 1979 report, the Commission would make the following points :

1. Presentation in the balance sheet of loans of defaulting debtors - comment 3 (page 2 -

The Court of Auditors criticizes the fact that the items "Loans disbursed" and "Interest receivable" appearing on the assets side of the balance sheet do not represent the full amounts due, since the item "Other assets" covers the loans of defaulting debtors (195 751 EUA) and the interest relating to such loans (63 451 EUA).

This method has long been used to distinguish "good" debtors from the others. By definition, the item "Other assets" comprises sundry operations which are insignificant in themselves. There is no rule of accounting to stop doubtful debtors being considered a minor item which can be included among "Other assets", provided the "Other assets" do not constitute a sizable and significant percentage of the balance sheet total.

In the ECSC balance sheet this item represents 0.8 % of the total and within that item the net amount outstanding is only 0.006 % of the same total.

2. Adjustments

- comment 4 (page 2) -

The Court of Auditors observes that :

"- short-term debts to certain banks were set off against balances with other banks.

Rectification of these entries should lead to the increase of the assets and the liabilities by an amount of 325 342 EUA;

- in the "Other assets" account, the adjustment against other assets of a debt to undertakings resulting from the system of aid to coke is not acceptable and a rectification of 98 939 EUA is required."

The offending adjustments are the result of accounting methods which had been accepted by the Court for the two previous years and, before the Court was established, by the former ECSC Auditor. The Commission has since modified the accounting procedures concerned in line with the Court's wishes.

- comments (page 3) -

The Court criticizes the Commission for having deducted from "Interest on bank deposits and portfolio" the sum of 3 157 033 EUA, which represents the net loss on the sale of bonds.

The Court neglected to mention that the Commission did the same thing in respect of the net profit on the sale of bonds. These profits exceed the amount of the losses quoted by the Court. The method used by the Court does not affect the surplus balance for 1979, for the result would have been simply to increase expenditure and revenue by equal amounts.

The method applied by the Commission for working out profits and losses on the sale of bonds was to take into consideration the differences as compared with an average value of those bonds determined according to previous operations. This simplified considerably the task of the accounting department, a real blessing in view of the limited number of staff available. Because of the criticism expressed by the Court the Commission has dropped this method of accounting during 1980.

- B. Criticism arising from a divergence in the interpretation of the principles laid down in the Draft Council Directive on the coordination of the laws, regulations and administrative provisions relating to the annual accounts (and consolidated accounts) of banks and other financial institutions of 25 April 1980

- comment 2, page 1 -

The Court of Auditors criticizes the changes made by the Commission in its method of accounting for operations involving the redemption of ECSC bonds for amortization. The Court criticizes in particular the fact that "the Commission has - for no apparent reason - changed its previous method. Whereas it treated these bonds like normal portfolio assets until maturity date even if it had redeemed them in advance, in 1979 it considered as amortized the redeemed bonds which matured during 1980".

On 31 December 1979 the Commission deducted the nominal value of the bonds maturing in 1980 - because they were not to be resold - from the amount of the bonds issued. Contrary to the Court's statement the Commission's draft Directive does not make this method subject to "the express condition that the bonds redeemed in advance be no longer negotiable".

The Court considers - wrongly - that the method chosen by the Commission does not constitute a final operation. In fact, the operation is subject neither to the Fourth Directive nor to the draft Directive to which the Court refers. The operation is final from the moment the Commission has decided not to resell the bonds redeemed.

The Commission changed its previous method of accounting for redeemed bonds to provide a truer picture of the assets, the financial situation and the ECSC results and has therefore applied in advance the draft Directive in question.

However, contrary to what is implied by the Court of Auditors' report, the Commission is not obliged to apply the rules envisaged in the draft Directive. Work on the draft is still at the preparatory stage and the Commission has not yet formulated a proposal.

The Commission would incidentally point out that the accounting method criticized by the Court is entirely consistent with the draft Directive which provides :

- at Article 16(4) (Assets : Item 5 : Debt securities held in portfolio)
"Only those debt securities which are intended to be resold in the market shall be included under this item";
- at Article 24 (Liabilities : Item 4 : Debt securities issued)
"A credit institution's own debentures which have been repurchased on the market and which are not intended for resale shall be set off against the amount of debt securities issued".

The Commission has adopted the following measures :

- Has instructed its departments not to resell any bonds which have been deducted from the amount of bonds issued. These instructions have been carried out to the letter;
- Has taken other practical steps to ensure that the bonds are not negotiable.

The Court mentions the discretionary mandate given to certain banks to use these bonds in operations to support market rates.

This mandate has been given to the Banque Nationale de Belgique. In 1980 this bank fulfilled its mandate without touching bonds already deducted from the amount of bonds issued.

The Court comments that "the result of the operation on the date of repurchase (2.7 MEUA) should not have been entered in the revenue and expenditure account, which should rather have shown the depreciation of these bonds at the balance sheet date (2.5 MEUA)".

The result of the operation was entered in the revenue and expenditure account on the date of repurchase because it was final. It was not therefore necessary to calculate the depreciation at the balance sheet date.

C. Criticism of specific points

1. Expenditure relating to meetings of experts

- comment 1 (page 1) -

The Court of Auditors has noted that the administrative costs of the ECSC are charged to the general budget of the Communities pursuant to Article 20 of the Merger Treaty. However, this does not include the collateral costs of research and the expenditure entailed by making available to all concerned in the Community the results of research which the Commission has helped to finance under Article 55 (2) ECSC.

These latter costs are considered not as operating costs but as an extension of research expenditure, and as such are charged to the 3 % reserve drawn from the research allocation and set up for the purpose by decision of the Commission of 28 November 1967.

Internal rules on the establishment and execution of the ECSC operating budget govern the authorization and clearance of expenditure from the 3 % reserve.

The Commission is willing to consider harmonizing procedures and, as soon as possible, to charge all expenditure relating to meetings of experts to the General Budget.

2. Valuation of portfolio

- comment 6 (page 3) -

The Court of Auditors claims that the portfolio was undervalued by EUA 294 450. It is possible that the sources of information (official quotations) on which the calculations were based were different. The Commission has carried out a check and found that the difference noted by the Court of Auditors was largely due to rounding. The difference amounts to 0,14 % of the value of the portfolio.

3. Writing off doubtful debts

- comment 7 (page 3) -

The Court of Auditors points out that "in the case of one of these (doubtful) debtors, ... no payment has been made for thirteen years and the realization of the guarantees is almost impossible, which would justify writing the debt off altogether. The Commission has provided against the total of doubtful debts (there are three in all) for a sum of 800 000 EUA which does not even represent the total debt of the debtor whose insolvency would justify writing it off altogether (1 152 820 EUA. One may thus conclude that the difference of 352 820 EUA at least does not represent a genuine debt.

As far as the application of Article 51(3) ECSC is concerned, the Court of Auditors would like a clearer distinction to be made between the return on the difference in the rates of interest of loans and borrowings on the one hand and other income from loans and guarantees on the other. In the view of the Court of Auditors the calculation of the amount resulting from the difference in the rates of interest is affected by the fact that interest from short-term deposit of borrowings is calculated by applying the gross return on the average amount of the total funds in the Treasury to the borrowed funds for the period during which they remained in the Treasury.

The Commission would point out that :

- the return on loans and guarantees amounted to	406 186 807	EUA
- interest on deposits and the portfolio amounted to	44 080 665	EUA
	<hr/>	
Total :	450 267 472	EUA

The Commission and the Court of Auditors both arrive at the same total, but use different methods to produce the two subtotals. The Commission is currently studying the problem raised by the Court of Auditors with a view to complying with its request.

The Court of Auditors also commented that the Commission should "ensure that the loan or guarantee conditions have not been such as to lead to the application of the provisions of Article 51(3) of the Treaty". This comment contradicts the provisions of the Article in question.

5. Presentation of the balance sheet and its annexes

- comment 9 (page 4) -

With respect to the guarantees given by the ECSC, reference is made to note no. 15 annexed to the balance sheet. The Commission will comply with the request for more detailed information when drawing up the 1980 balance sheet.

The non-guaranteed loans to which the Court of Auditors referred at the end of its report are loans for low-cost housing granted by the ECSC through leading banks. The loans are not guaranteed, since the banks are the debtors.

As regards the other information which the Court of Auditors considers should be included in the annexes to the balance sheet, the Commission feels bound to express its surprise that the Court, having approved the 1977 and 1978 balance sheets on the basis of the same criteria as the former ECSC auditor, should complain that the annexes to the balance sheet are insufficient, when the Commission has of its own accord considerably expanded the annexes and explanatory notes for the first time in several years.

However, the Commission recognizes the usefulness of the details requested by the Court of Auditors and intends to follow its suggestions.

*

*

