

## I

*(Information)*

## COURT OF AUDITORS

## ANNUAL REPORT ON THE ECSC

## for the financial year 1999 together with the Commission's replies

*(Article 45c(4) of the ECSC Treaty and Article 88 of the Financial Regulation of 21 December 1977, as last amended by Council Regulation (EC, ECSC, Euratom) No 2673/1999 of 13 December 1999)*

(2000/C 347/01)

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## ECSC SOLVENCY AND DEVELOPMENTS CONCERNING THE MAIN ECSC ACTIVITIES

### Introduction

1. The solvency of the ECSC is of particular importance for the following reasons:

- (a) apart from some marginal lending from its own funds, ECSC loans are financed by bank borrowings and bond issues. It is therefore important for ECSC securities to have the best possible financial market rating. That, in turn, requires an excellent solvency ratio;
- (b) most ECSC loans are back-to-back with the corresponding borrowings in terms of rates, currency and maturity. The main banking risk is therefore the risk of non-recovery;
- (c) the Treaty of Paris, which created the ECSC, expires in 2002 and in consequence any changes in the level of own funds needed to safeguard the ECSC's solvency must be monitored carefully, right up to the expiry of the Treaty, and beyond that date, to ensure that the remaining borrowings can be serviced.

### The solvency of the ECSC

#### Solvency ratio

2. Since 1994, the solvency ratio provided for in Council Directive 89/647/EEC <sup>(1)</sup> has been the main instrument by which the ECSC's solvency is assessed. The denominator of the ratio comprises assets and off-balance-sheet items weighted in accordance with the Directive. For the numerator, the Commission takes the Guarantee Fund and unallocated surplus items (see *Table 1*). The definition of own funds used in calculating the solvency ratio is the result of an interpretation of the Directive which provides a sufficiently prudent valuation.

3. The Commission has decided to adjust borrowing and lending policy in view of the expiry of the ECSC Treaty in 2002 <sup>(2)</sup>. At that point it expects to have achieved a level of reserves equal to 100 % of the loans still outstanding that are not covered by a State guarantee <sup>(3)</sup>. Furthermore, the solvency ratio (the relation

ship between reserves and total risk-adjusted assets) is gradually increasing and rose from 32,8 % at 31 December 1998 to 37,8 % at 31 December 1999. As was the case in the previous year, this change was due partly to the increase in the Guarantee Fund (+ 4 %), but mainly to the decrease in the volume of outstanding loans to banks.

### Provision for large exposures

4. Pursuant to Council Directive 92/121/EEC <sup>(4)</sup> on the monitoring and control of large exposures of credit institutions, the Commission established a provision for large exposures in 1995. The amount of the provision is calculated as a function of the amounts by which the two limits set in Annex VI to Council Directive 93/6/EEC <sup>(5)</sup> have been exceeded. The provision fell from 23 million euro at 31 December 1998 to 18 million euro at 31 December 1999. This change is due to the fall in the assets in question following repayments in 1999. Although this Directive is not legally applicable to the ECSC, it does result, if the ECSC observes it, in a policy which is prudent as regards the exposures resulting from past transactions.

### Changes in applications of ECSC funds and resources

5. In view of the forthcoming expiry of the ECSC Treaty, the commitments for the ECSC operating budget continued to fall in 1999 (– 8,4 million euro, see *Table 2*), but by less than in 1998. For the second consecutive year, budgetary expenditure was significantly lower than estimated (– 27,4 % in 1998 and – 23 % in 1999). The differences were due in large part to the fact that actual requirements for rehabilitation aid were considerably lower than forecast (– 30 % in 1998 and – 50 % in 1999).

6. Resources also continued to decline in 1999 (– 28,3 million euro), but by less than in 1998. This was mainly due to the net effect of two opposing factors: the increase in the result of non-budgetary operations (+ 13,3 million euro) and the decrease in cancellations of commitments (– 48,8 million euro). It should be stressed that, although cancellations were higher than forecast, there ought to have been even more in 1999 (see paragraph 17).

7. The budget was in surplus for the fourth consecutive year, thus allowing the Guarantee Fund to be increased to 553 million euro (+ 23 million euro) and the provision for the financing of the ECSC operating budget to be raised to 393 million euro

<sup>(1)</sup> Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions (OJ L 386, 30.12.1989, p. 14).

<sup>(2)</sup> Adjustment of borrowing and lending policy with a view to the expiry of the Treaty (23 July 2002) (OJ C 175, 28.6.1994, p. 5).

<sup>(3)</sup> Questions concerning the expiry of the ECSC Treaty — financial activities (PV(96) 1306). Deliberations based on documents SEC (96) 1492-3.

<sup>(4)</sup> Council Directive 92/121/EEC of 21 December 1992 on the monitoring and control of large exposures of credit institutions (OJ L 29, 5.2.1993, p.1).

<sup>(5)</sup> Council Directive 93/6/EEC of 15 March 1993 on the capital adequacy of investment firms and credit institutions (OJ L 141, 11.6.1993, p.1).

(+ 13 million euro, see *Tables 1 and 3*). At 31 December 1999, this provision was clearly in excess of the requirement of 240 million euro <sup>(1)</sup> forecast by the Commission for the period 2000 to 2002.

### **Changes in the ECSC balance sheet**

8. The ECSC balance sheet total declined by 539 million euro (10,7 %) between 31 December 1998 and 31 December 1999 (see *Table 4*), mainly owing to the lower level of outstanding loans from borrowed funds: during the financial year 1999, the ECSC received 463,5 million euro in loan reimbursements, whereas it made no new loans.

9. At 31 December 1999, the liquid asset accounts made up 41,1 % of the ECSC's assets and constituted the second largest item, after loans. The accounts concerned and the balancing items under liabilities are shown in *Table 4*.

### **Conclusion**

10. The budget for the financial year 1999 was in surplus for the fourth consecutive year, due to cancellations of commitments and the underimplementation of budgetary expenditure, especially rehabilitation aid. This surplus enabled the ECSC to reinforce its solvency substantially and to make the necessary provisions and value adjustments.

### **FOLLOW-UP TO PREVIOUS OBSERVATIONS**

11. An analysis of the action taken by the Commission in response to the observations made in the Court's previous annual reports gave rise to the following comments. These have no bearing on the statement of assurance concerning the financial statements of the ECSC at 31 December 1999 (see paragraph 23).

#### **Loans to officials**

12. In its annual reports on the ECSC for the financial years 1981 and 1991 <sup>(2)</sup>, the Court noted that the accounts covering loans to officials had been drawn up on the basis of estimates rather than

<sup>(1)</sup> Illustrative scenario — ECSC 2002, version 9, Annex I, to the draft ECSC operating budget for 2000 (document SEC(1999) 803 final, 9 June 1999).

<sup>(2)</sup> Paragraph 2.3.3.2 'Accounts' of the Annual report for 1981 (page 28) and paragraph 1.7 of the Annual report for 1991 (page 12). These reports were not published in the Official Journal, but can be obtained from the secretariat of the European Court of Auditors.

actual figures. The Commission replied in both cases that the staffing and informatics problems which were the cause of these shortcomings would be resolved. In 1999 these accounts were once more drawn up on the basis of estimates.

### **Performance of liquid assets**

13. The ECSC holds sizeable liquid assets, the principal balancing items for which are the reserves (Guarantee Fund and available sections of the special reserve and the former pension fund), commitments for the operating budget, provisions for the financing of future operating budgets, provisions for specific value adjustments in respect of loans and advances and outstanding borrowings back-to-back with prepaid loans. Each of these balancing items is a fund (i.e. a monetary reserve) which has been created to deal with specific requirements <sup>(3)</sup>. *Table 5* shows the position of these funds at 31 December 1999.

14. The Commission's rules of procedure stipulate that the management of liquid assets must be based on traditional rules of prudence, which is to say that it should aim to limit risks and guarantee a degree of liquidity in respect of commitments, while still procuring an acceptable return on investments. Speculative operations are therefore prohibited, the balancing items must have a good rating and the funds must be invested in negotiable bonds, bank deposit accounts or other short-term investments.

15. Investment policy is formulated by a management committee with the aim of covering estimated cash requirements. The Court recommends that the ECSC's annual report should include all the information needed to assess whether these liquid assets are being managed in a financially efficient manner, taking account of market conditions.

### **Cancellation of dormant commitments**

16. The Commission's rules of procedure on drawing up and implementing the ECSC's operating budget stipulate that budgetary commitments must be cancelled when the corresponding legal commitments cease. The corresponding amounts thus become available as revenue for the financial year in progress.

17. However, the audits that the Court carried out on the budgetary commitments at 31 December 1999 in respect of interest subsidies revealed that substantial amounts had not yet been cancelled. These commitments had generally been entered into in the

<sup>(3)</sup> For details of the ECSC's reserve funds, see the Court of Auditors' annual reports on the ECSC for the financial years 1992 (paragraphs 1.30 to 1.33) and 1991 (Annex I), which can be obtained from the secretariat of the European Court of Auditors.

period 1989 to 1992, and totalled 26,1 million euro. The Court notes the corrective measures taken by the Commission, which during the financial year 2000 cancelled 90 % of these commitments, to the value of 23,5 million euro.

### **Repayment of taxes levied at source**

18. The ECSC balance sheet at 31 December 1999 shows a claim of 2,4 million euro relating to three applications concerning tax levied at source between March 1989 and June 1996. The three applications were sent, on average, six years and one month late. As a result of this delay, the ECSC has not earned the legal interest to which it was entitled.

### **STATEMENT OF ASSURANCE CONCERNING THE ECSC**

19. Pursuant to Article 45c of the Treaty establishing the European Coal and Steel Community (ECSC), the Court has examined the ECSC's accounts so as to provide the European Parliament and the Council with a statement of assurance concerning the reliability of the accounts and the legality and regularity of the underlying transactions.

20. The accounts concerned are the financial statements of the ECSC at 31 December 1999, which were drawn up under the responsibility of the Commission and published in the *Official Journal of the European Communities* <sup>(1)</sup>.

21. In its report on the ECSC's financial statements at 31 December 1999 <sup>(2)</sup>, which incorporates the statement of assurance concerning the reliability of the accounts and which is published together with the financial statements concerned, the Court concluded that the latter gave 'a true and fair view of the assets and financial situation of the European Coal and Steel Community at 31 December 1999, and of the result of its operations for the year then ended'.

22. Furthermore, with a view to checking the legality and regularity of the transactions underlying the ECSC's accounts for the financial year 1999, the Court carried out its audit in accordance with generally accepted international auditing standards. In particular, the audit was based on an analysis of the systems and on tests.

23. In the Court's view, it obtained adequate assurance that the transactions, taken as a whole, are legal and regular.

This report was adopted by the Court of Auditors in Luxembourg at the Court meeting of 11 and 12 October 2000.

*For the Court of Auditors*

Jan O. KARLSSON  
*President*

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<sup>(1)</sup> Financial statements for the ECSC at 31 December 1999 (OJ C 281, 4.10.2000, p. 5).

<sup>(2)</sup> Report on the financial statements of the ECSC at 31 December 1999 (OJ C 281, 4.10.2000, p. 5).

Table 1  
ECSC own funds in 1999

(Mio EUR)				
Item (after allocation of surplus)	31.12.1998	Allocation	Withdrawal	31.12.1999
Guarantee Fund <sup>(1)</sup>	530,0	+ 23,0	0,0	553,0
Special reserve	176,0	0,0	0,0	176,0
Former pension fund	72,9	+ 1,6	0,0	74,5
Surplus brought forward <sup>(1)</sup>	0,7	0,0	- 0,5	0,2
Value adjustment reserve	0,0	+ 16,9	0,0	16,9
<b>Subtotal (Reserves and surpluses)</b>	<b>779,6</b>	<b>+ 41,5</b>	<b>- 0,5</b>	<b>820,6</b>
Provision for large exposures	23,0	0,0	- 5,0	18,0
Available provision for financing the operating budget	380,0	+ 34,0	- 21,0	393,0
<b>Total</b>	<b>1 182,6</b>	<b>+ 75,5</b>	<b>- 26,5</b>	<b>1 231,6</b>

<sup>(1)</sup> Own funds used by the Commission in the numerator of the ECSC solvency ratio.  
Source: ECSC financial statements at 31 December 1999.

Table 2  
Use of funds and changes in resources during the period 1992 and 1999

(Mio EUR)									
Item	1992	1993	1994	1995	1996	1997	1998 (a)	1999 (b)	Variation (b) — (a)
<b>A — Use</b>									
Administrative expenditure	5,0	5,0	5,0	5,0	5,0	5,0	5,0	5,0	—
Commitments	477,2	531,2	386,4	277,9	201,2	180,9	154,0	145,6	- 8,4
Exceptional uses of funds	85,9	7,1	32,5	—	—	—	—	—	—
<b>Total uses (A)</b>	<b>568,1</b>	<b>543,3</b>	<b>423,9</b>	<b>282,9</b>	<b>206,2</b>	<b>185,9</b>	<b>159,0</b>	<b>150,6</b>	<b>- 8,4</b>
<b>B — Resources of the year</b>									
Result of non-budgetary operations	131,5	201,3	112,5	90,8	95,6	143,3	69,6	82,9	+ 13,3
Levy	146,5	121,3	107,7	102,3	95,9	101,6	—	—	—
Other budgetary resources (fines, rebates, etc.)	—	—	4,8	11,6	4,4	4,3	12,3	19,5	+ 7,2
Cancellations of commitments	75,8	94,0	63,3	70,7	90,0	195,2	134,2	85,4	- 48,8
Exceptional resources	—	—	91,9	—	—	—	—	—	—
<b>Total resources of the year (B)</b>	<b>353,8</b>	<b>416,6</b>	<b>380,2</b>	<b>275,4</b>	<b>285,9</b>	<b>444,4</b>	<b>216,1</b>	<b>187,8</b>	<b>- 28,3</b>
<b>B — A</b>	<b>- 214,3</b>	<b>- 126,7</b>	<b>- 43,7</b>	<b>- 7,5</b>	<b>79,7</b>	<b>258,5</b>	<b>57,1</b>	<b>37,2</b>	<b>- 19,9</b>
<b>Transfer from (+) / to (-) the provision for financing the ECSC budget</b>	<b>+ 163,2</b>	<b>+ 105,9</b>	<b>+ 43,3</b>	<b>+ 0,3</b>	<b>- 58,6</b>	<b>- 224,9</b>	<b>- 26,0</b>	<b>- 13,0</b>	<b>+ 13,0</b>
<b>Transfer from (+) / to (-) reserves</b>	<b>+ 53,0</b>	<b>+ 22,0</b>	<b>+ 2,0</b>	<b>+ 9,0</b>	<b>- 19,0</b>	<b>- 31,3</b>	<b>- 30,0</b>	<b>- 23,0</b>	<b>+ 7,0</b>
<b>Surplus for the financial year</b>	<b>1,9</b>	<b>1,2</b>	<b>1,6</b>	<b>1,8</b>	<b>2,1</b>	<b>2,3</b>	<b>1,1</b>	<b>1,2</b>	<b>+ 0,1</b>

Source: ECSC financial statements for the years in question.

Table 3

**Movements against the provision for financing the ECSC operating budget (ECSC OB) in 1999**

(in Mio EUR)

Item	Balance at 31.12.1998	Utilisation	Allocation	Net change	Balance at 31.12.1999
1. Available provision for financing the ECSC operating budget	380,0	- 21,0	+ 34,0	+ 13,0	393,0
2. Provision for fines and surcharges to be paid subsequently and for subsidies to be recovered <sup>(1)</sup>	96,0	- 54,3	—	- 54,3	41,7
<b>Total</b>	<b>476,0</b>	<b>- 75,3</b>	<b>+ 34,0</b>	<b>- 41,3</b>	<b>434,7</b>

<sup>(1)</sup> Fines, surcharges and interest subsidies are considered to be ECSC resources only at the point when they are actually paid. Until then, an amount equivalent to these claims is included in this provision. The 41,7 million euro in question is thus not yet available as finance for the operating budget.

Source: ECSC financial statements at 31 December 1999, note 16.

Table 4

**Changes in the ECSC summary balance, before allocation of surplus, from 31 December 1998 to 31 December 1999**

	31.12.1998		31.12.1999	
	Mio EUR	%	Mio EUR	%
<b>Assets</b>				
Loans (to banks and undertakings)	2 833	56,4	2 473	55,1
Liquid assets (bank balances and bonds)	1 966	39,1	1 845	41,1
ECSC operating budget (ECSC OB) (levies, fines and subsidies receivable)	97	1,9	42	0,9
Tangible and intangible assets	1	0,0	1	0,0
Other assets	8	0,2	21	0,5
Prepayments and accrued income	122	2,4	107	2,4
<b>Total assets</b>	<b>5 027</b>	<b>100,0</b>	<b>4 488</b>	<b>100,0</b>
<b>Liabilities</b>				
Amounts owed (including bond issues)	2 806	55,8	2 432	54,2
Other liabilities	30	0,6	28	0,6
Accruals and deferred income	94	1,9	85	1,9
Provisions for liabilities and charges	123	2,4	113	2,5
Provisions for large exposures	23	0,5	18	0,4
ECSC OB (commitments and provisions)	1 172	23,3	991	22,1
— Commitments	696	13,8	556	12,4
— Provisions	476	9,5	435	9,7
— for financing the OB	380	7,6	393	8,8
— for fines and subsidies to be recovered	96	1,9	42	0,9
Reserves and surplus	780	15,5	821	18,3
<b>Total liabilities</b>	<b>5 027</b>	<b>100,0</b>	<b>4 488</b>	<b>100,0</b>

Source: ECSC financial statements at 31 December 1999.

Table 5

## Changes in ECSC liquid assets and balancing items, 31 December 1998 to 31 December 1999

(in Mio EUR)

Balance sheet item	31.12.1998		31.12.1999	
	Breakdown	Total	Breakdown	Total
<b>Liquid assets</b>				
<i>Loans and advances to credit institutions</i>		406,4		76,3
— repayable on demand	5,7		5,0	
— with agreed maturity dates	400,7		71,3	
<i>Bonds</i> <sup>(1)</sup>		1 617,3		1 855,5
— public issuers	1 114,0		1 223,3	
— ECSC bonds	22,0		23,4	
— sundry items <sup>(2)</sup>	481,2		608,9	
<b>Total liquid assets</b>		<b>2 023,6</b>		<b>1 931,8</b>
<b>Balancing items</b>				
<i>Reserves</i>		575,7		614,5
— Guarantee fund	530,0		553,0	
— Special reserve	15,6		27,8	
reserve	176,1		176,1	
utilisation <sup>(3)</sup>	- 160,5		- 148,3	
— Former pension fund	30,1		33,7	
reserve	71,3		73,0	
utilisation <sup>(4)</sup>	- 41,2		- 39,2	
<i>Commitments for the ECSC OB</i>		695,7		556,2
<i>Provision for financing the ECSC OB</i>		380,0		393,0
— for budget imponderables	80,0		59,0	
— for financing future operating budgets	300,0		334,0	
<i>Provisions for liabilities and charges</i>		122,9		113,5
<i>Provision for large exposures</i>		23,0		18,0
<i>Value adjustments</i>		187,7		231,1
— on loans disbursed on loan capital	129,6		143,8	
— on bonds	58,1		87,3	
<i>Sundry items</i>		38,6		5,6
<b>Total balancing items</b>		<b>2 023,6</b>		<b>1 931,8</b>

<sup>(1)</sup> Before value adjustments.<sup>(2)</sup> This item includes 98,4 million euro of financial instruments issued by a defaulting debtor.<sup>(3)</sup> Loans for the construction of social housing.<sup>(4)</sup> Building loans granted to officials of the European Communities.

Source: ECSC financial statements at 31 December 1999.

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**COMMISSION'S REPLIES****FOLLOW-UP TO PREVIOUS OBSERVATIONS*****Loans to officials***

12. The Commission would point out that the accounts have been in order since July 2000.

***Performance of liquid assets***

15. From next year onwards, the Commission will indicate the average rate of yield on liquid assets in the ECSC's annual report.

***Repayment of taxes levied at source***

18. The Commission recognises that these three late applications for repayment led to a loss of revenue in the form of the legal interest which was not collected. However, attention should be drawn to the fact that most of the applications for repayment were made punctually. It was after a detailed audit by the Commission that the applications for repayment were found to be missing in some cases and that corrective measures were taken.

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