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(Information)

COURT OF AUDITORS

ANNUAL REPORT ON THE ECSC

for the financial year 1997 together with the Commission's reply

(98/C 352/01)

(Article 88 of the Financial Regulation of 21 December 1977, as last amended by Council Regulation (EC, Euratom, ECSC) No 2335/95 of 18 September 1995)

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CHAPTER 1

ECSC SOLVENCY AND DEVELOPMENTS CONCERNING MAIN ECSC ACTIVITIES

Introduction

1.1. This chapter concerns the ECSC's solvency at 31 December 1997 and the changes in its main budgetary and financial activities during the year. The ECSC's solvency is of particular interest for the following reasons:

— apart from some marginal lending from the ECSC's 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 ratings. That, in turn, requires an excellent solvency level;

— since most ECSC loans are back-to-back with the corresponding borrowings (in terms of rates, currency and maturity), the main remaining banking risk is the risk of non-recovery. Other risks may arise if the balance between loans and borrowings is disturbed by a debtor's defaulting;

— the Treaty of Paris expires in 2002 and in consequence any changes in the 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

1.2. Since 1994 the solvency ratio provided for in Council Directive 89/647/EEC has been the main instrument by which the ECSC's solvency is assessed (1). The denominator of the ratio comprises assets and off-balance-sheet items weighted in accordance with the Directive. For the numerator, however, the Commission takes the Guarantee Fund and unallocated surplus items and omits others which might be considered to form part of the ECSC's own funds (see paragraph 1.8). 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.

1.3. At 31 December 1997 the ECSC's solvency ratio was 28,3 % compared with 21,1 % at 31 December 1996. The change was due partly to the increase in the Guarantee Fund (+6,7 %) but mainly to a substantial decrease in the volume of outstanding loans, owing to the reduction in ECSC activity as the Treaty approaches expiry. On 11 September 1996 (2), the Commission confirmed its desire to keep the level of reserves at 100 % of loans outstanding after 2002 which are not covered by a State guarantee. To do this, the Guarantee Fund needs to be increased each year until 2002. Consequently, the solvency ratio will gradually approach 100 %.

Provision for large exposures

1.4. The expiry of the Treaty of Paris in 2002 is already having a significant effect on the level of ECSC activity. The loan portfolio is shrinking steadily and becoming concentrated on an increasingly small number of debtors. The risk generated by such a concentration of liabilities vis-à-vis third parties was the subject of a Council Directive on the monitoring and control of large exposures of credit institutions) (3). The Court referred to the two limits provided for in the Directive in its reports on the ECSC for the financial years 1994 (paragraph 1.5) and 1995 (paragraph 1.6) (4).

1.5. The Commission established a provision for large exposures in 1995 in order to offset the risk associated with this concentration. The amount of the provision is calculated as a function of the amounts by which the above two limits have been exceeded, as specified in Annex VI to Council Directive 93/6/EEC (5). Although the Directive is not directly applicable to the ECSC situation, it does result in a policy which is sufficiently prudent as regards the exposures resulting from past transactions. The provision decreased from ECU 36 million at 31 December 1996 to ECU 27 million at 31 December 1997. The change is due to the fall in the assets in question following repayments in 1997.

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

(2) Questions concerning the expiry of the ECSC Treaty financial activities (PV(96) 1306). Discussion on the basis of documents SEC(96) 1492/1493.

(3) 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).

(4) Annual report concerning the ECSC for the financial year 1994 (OJ C 329, 7.12.1995, p. 3). Annual report concerning the ECSC for the financial year 1995 (OJ C 377, 13.12.1996, p. 3: The limits apply to the value of the ECSC's commitment to any one client or group of connected clients:
— the total exposure to any one client or group of connected clients must not exceed 25 % of the ECSC's own funds,
— the total volume of large exposures must not exceed 800 % of the said own funds. The exposure is deemed to be large if the total exposure to any one client or group of connected clients is 10 % or more of own funds.

(5) 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).

Specific value adjustments

1.6. Under the Council Directives concerning annual accounts) [6] [7], the asset items in the balance sheet must be valued individually and must be the subject of specific value adjustments if necessary. The amount shown in the balance sheet by way of specific value adjustments for loans, including interest, fell from ECU 193 million at 31 December 1996 to ECU 170 million at 31 December 1997 [8]. This 12 % reduction is due, in particular, to the recalculation of the value adjustment in respect of a significant debtor following the restructuring of its debt.

1.7. The Commission also reviewed the financial position of the other high-risk debtors, namely those whose debts to the ECSC were not covered by first-class guarantees [9], and made the necessary value adjustments. No further borrowers defaulted in 1997.

Changes in applications of ECSC funds and resources

1.8. The commitments for the ECSC operating budget continued to fall in 1997 (by 10 %, see *Table 1*), whilst the level of resources from the year increased appreciably beyond the estimates, mainly for two reasons: firstly, due to major decommitments (ECU 195,2 million, more than half of which stems from subsidies committed under Article 56(2)(a)); secondly, due to a re-evaluation of the ECSC's claims on a major debtor following the restructuring of its debt (see paragraph 1.6). The corresponding surplus made it possible to allocate a further ECU 31,3 million to the Guarantee Fund and to produce a net increase of ECU 224,9 million in the provision available for financing the ECSC operating budget (see *Table 2*), thereby considerably increasing the ECSC's own funds (see *Table 3*). This provision for the financing of future operational budgets should make it possible to absorb the 1998 reduction of the rate of ECSC levy to zero, and should thus be utilised during the financial years 1998 to 2002.

(6) Fourth Council Directive of 25 July 1978, based on Article 54(3)(g) of the Treaty, on the annual accounts of certain types of companies (78/660/EEC) (OJ L 222, 14.8.1978, p. 11).

(7) Council Directive 86/635/EEC of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions (OJ L 372, 31.12.1986, p. 1).

(8) ECSC financial statements at 31 December 1997: specific value adjustments for loans (ECU 170 million, note 5.1).

(9) 'First-class guarantees' are guarantees from Member States of the EU or the equivalent (public institutions and public industrial corporations of Member States) and bank guarantees.

Changes in the ECSC balance sheet

1.9. The ECSC's balance sheet total declined by ECU 1 080 million (15,4 %) between 31 December 1996 and 31 December 1997 (see *Table 4*), mainly owing to the lower level of loans outstanding from borrowed funds: during the financial year 1997, the ECSC received ECU 1 661 million in loan reimbursements whereas it disbursed only ECU 541,2 million of new loans.

1.10. The volume of new loans disbursed was double that for the financial year 1996 (see *Table 5*). The increase in loans disbursed pursuant to Article 56(2)(a) is linked to the disbursement of the last eligible loans for which the ECSC had received a request by 31 December 1996, the deadline for entering such requests in the accounts. As regards loans disbursed pursuant to Article 54, the ECSC disbursed six for the restructuring and modernisation of steel companies (Article 54(1)) and two in support of the consumption of Community steel (Article 54(2)).

1.11. Furthermore, in paragraph 2.9 of its Annual Report on the ECSC concerning the financial year 1995, the Court noted that the value of loans disbursed by the ECSC for the construction of the Great Belt bridge was approximately twice the value of the Community steel consumed by this project. The Commission replied that, as a result, it would not renew the proportion of these loans due to expire in 1997. The Court notes that the loans concerned were indeed reimbursed in 1997 without being renewed and that the value of the ECSC loan outstanding on this project (to expire in 2001) is within the prescribed limits.

1.12. The amount of outstanding loans from borrowed funds was ECU 3 600 million on 31 December 1997. This item will continue to decline, falling to around ECU 715 million by 23 July 2002 (before value adjustments), almost 90 % of which will not be covered by first-class guarantees. The last of these loans will mature in 2019. The above figures were calculated on the basis of the loans disbursed before 31 December 1997. Following a Commission Decision [10], there must be no new loans to tie up reserves or mature after the expiry of the ECSC Treaty.

1.13. At 31 December 1997 the liquid asset accounts made up 34 % of the ECSC's assets and constituted the second largest item, after loans. The accounts concerned

(10) Adaptation of the 'loans/borrowings' policy in view of the expiry of the ECSC Treaty (OJ C 175, 28.6.1994).

and the main balancing items under liabilities are shown in *Table 6*.

Conclusion

1.14. The financial year 1997 showed a substantial surplus due, in particular, to a sizeable number of cancelled commitments, thus enabling the ECSC to reinforce its solvency substantially and to make the necessary provisions and value adjustments. In view of the expiry of the ECSC Treaty, the object of the accumulated reserves is, firstly, to provide for the end of budgetary activities despite the 1998 reduction of the ECSC levy to zero and, secondly, gradually to bring the Guarantee Fund to a level corresponding to 100 % of the amount of loans not backed by Member State guarantees outstanding at 23 July 2002, after deduction of the specific value adjustments.

CHAPTER 2

STATEMENT OF ASSURANCE CONCERNING THE ECSC

2.1. 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.

2.2. The accounts concerned are the financial statements of the ECSC at 31 December 1997, which were drawn up under the responsibility of the Commission and published in the *Official Journal of the European Communities* [11].

2.3. In its report on the ECSC's financial statements at 31 December 1997 [12], 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 an accurate picture of the assets and of the financial situation of the European Coal and Steel Community at 31 December 1997, and of the result of its operations for the financial year ending on the same date.

2.4. Furthermore, with a view to checking the legality and regularity of the underlying transactions in the ECSC's accounts for the financial year 1997, 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 the tests carried out.

2.5. In the Court's view, the legality and regularity of the transactions are, on the whole, adequately guaranteed.

This report was adopted by the Court of Auditors in Luxembourg at the Court meeting of 14 and 15 October 1998.

For the Court of Auditors
Bernhard FRIEDMANN
President

(11) Financial statements of the ECSC at 31 December 1997, published in OJ C 255, 13.8.1998.
(12) Report on the financial statements of the ECSC at 31 December 1997, published in OJ C 255, 13.8.1998.

Table 1

Use of funds and changes in resources during the period 1991 to 1997

(million ECU)

Item	1991	1992	1993	1994	1995	1996 a	1997 b	Variation b – a
A — Use								
Administrative expenditure	5,0	5,0	5,0	5,0	5,0	5,0	5,0	—
Commitments	454,4	477,2	531,2	386,4	277,9	201,2	180,9	– 20,3
Exceptional uses of funds	—	85,9	7,1	32,5	—	—	—	—
Total uses (A)	459,4	568,1	543,3	423,9	282,9	206,2	185,9	– 20,3
B — Resources of the year								
Result of non-budgetary operations	254,7	131,5	201,3	112,5	90,8	95,6	143,3	+ 47,7
Levy	175,0	146,5	121,3	107,7	102,3	95,9	101,6	+ 5,7
Other budgetary resources (fines, rebates, etc.)				4,8	11,6	4,4	4,3	– 0,1
Cancellations of commitments	32,3	75,8	94,0	63,3	70,7	90,0	195,2	+ 105,2
Exceptional resources	—	—	—	91,9	—	—	—	—
Total resources of the year (B)	462,0	353,8	416,6	380,2	275,4	285,9	444,4	+ 158,5
B – A	2,6	– 214,3	– 126,7	– 43,7	– 7,5	79,7	258,5	+ 178,8
Transfer from (+) / to (–) the provision for financing the operating budget	– 1,4	+ 163,2	+ 105,9	+ 43,3	+ 0,3	– 58,6	– 224,9	– 166,3
Transfer from (+) / to (–) reserves	—	+ 53,0	+ 22,0	+ 2,0	+ 9,0	– 19,0	– 31,3	– 12,3
Surplus for the financial year	1,2	1,9	1,2	1,6	1,8	2,1	2,3	+ 0,2

Source: ECSC financial statements for the years in question.

Table 2

Movements against the provision for financing the ECSC operating budget (BOC) in 1997

(million ECU)

Item	Balance at 31.12.1996	Utilisation	Allocation	Net change	Balance at 31.12.1997
1. Available provision for financing the ECSC operating budget	129,2	– 49,1	+ 274,0	+ 224,9	354,1
2. Provision for fines and surcharges to be paid subsequently and for subsidies to be recovered [1]	78,4	—	+ 9,2	+ 9,2	87,6
Total	207,6	– 49,1	+ 283,2	+ 234,1	441,7

[1] Fines, surcharges and interest subsidies are considered to be ECSC resources only when they have actually been paid. Until then an amount equivalent to these claims is included in this provision. The ECU 87,6 million in question is thus not yet available as finance for the operating budget.

Source: ECSC financial statements at 31 December 1997, note 16.

Table 3

ECSC own funds in 1997

(million ECU)

Item (after allocation of surplus)	31.12.1996	Allocation	Withdrawal	31.12.1997
Guarantee Fund [1]	468,7	31,3	0,0	500,0
Special reserve	176,0	0,0	0,0	176,0
Former Pension Fund	69,5	1,7	0,0	71,2
Surplus brought forward [1]	0,5	0,7	0,0	1,2
Provisions for large exposures	36,0	0,0	– 9,0	27,0
Available provision for financing the operating budget	129,2	224,9	0,0	354,1
Total	879,9	258,6	– 9,0	1 129,5

[1] Own funds used by the Commission in the numerator of the ECSC solvency ratio.
Source: ECSC financial statements at 31 December 1997.

Table 4

Changes in the ECSC summary balance sheet, before allocation of surplus, from 31 December 1996 to 31 December 1997

	31.12.1996		31.12.1997	
	million ECU	%	million ECU	%
Assets				
Loans (to banks and undertakings)	4 583	65,4	3 584	60,4
Liquid assets (bank balances and bonds)	2 126	30,3	1 997	33,7
ECSC operating budget ('ECSC OB') (levy, fines and subsidies receivable)	80	1,1	90	1,5
Tangible and intangible assets	3	0,0	2	0,0
Other assets	20	0,3	87	1,5
Prepayments and accrued income	198	2,8	170	2,9
Total	7 010	100,0	5 930	100,0
Liabilities				
Amounts owed (including bond issues)	4 677	66,7	3 637	61,3
Other liabilities	78	1,1	13	0,2
Accruals and deferred income	160	2,3	121	2,0
Provisions for liabilities and charges	75	1,1	87	1,5
Provisions for large exposures	36	0,5	27	0,5
ECSC OB (commitments and provisions)	1 268	18,1	1 296	21,9
Reserves and surplus	715	10,2	749	12,6
Value adjustment reserve	1	0,0	0	0,0
Total	7 010	100,0	5 930	100,0

Source: ECSC financial statements at 31 December 1997.

Table 5

Loans disbursed by the ECSC under Articles 54, 56 and 95, 1989-1997

(million ECU)

Year	Article 54		Article 56	Article 95	Workers' housing	Total
	Article 54.1	Article 54.2				
1989	195,7	30,0	458,4	—	16,0	700,1
1990	243,1	155,2	585,4	—	10,1	993,8
1991	438,7	66,3	859,5	—	17,7	1 382,2
1992	215,2	831,8	426,2	—	13,0	1 486,2
1993	7,6	209,7	688,1	—	12,9	918,3
1994	108,9	347,0	208,8	—	8,7	673,4
1995	60,5	25,7	260,2	42,3	14,1	402,8
1996	52,4	25,2	167,1	15,6	19,4	279,7
1997	194,1	122,4	206,8	—	17,9	541,2

Source: Figures obtained from Commission (GD II).

Table 6

Changes in ECSC liquid assets and principal balancing items, 31 December 1996 to 31 December 1997

(million ECU)

Balance-sheet item	31.12.1996	31.12.1997
Liquid assets		
Balances with central banks	0,6	0,6
Loans and advances to credit institutions		
— repayable on demand	15,7	6,4
— with agreed maturity dates or periods of notice	662,1	367,4
Bonds	1 447,4	1 623,5
Total liquid assets	2 125,8	1 997,9
Principal balancing items		
Guarantee fund	468,7	500,0
Provisions for financing the ECSC operating budget	129,2	354,1
(Multiannual) commitments for the operating budget	1 059,9	853,8
Specific value adjustments in respect of loans and advances	193,1	170,2
Provisions for liabilities and charges	75,0	87,4
Provision for large exposures	36,0	27,0
Total principal balancing items	1 961,9	1 992,5

Source: ECSC financial statements at 31 December 1997.

COMMISSION'S REPLY

The Commission has no particular remark to make. It is pleased that the Court of Auditor's report contains no criticism and that a positive statement of assurance is proposed.