I

*(Information)*

# COURT OF AUDITORS

## ANNUAL REPORT ON THE ECSC

## for the financial year 1998 together with the Commission's reply

(1999/C 338/01)

*(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 2779/98 of 17 December 1998)*

**CONTENTS**

CHAPTER 1

## ECSC SOLVENCY AND DEVELOPMENTS CONCERNING MAIN ECSC ACTIVITIES

### Introduction

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:

(a) 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;

(b) 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;

(c) 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*

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. 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. At 31 December 1998 the ECSC's solvency ratio was 32,8 % compared with 28,3 % at 31 December 1997. The change was due partly to the increase in the Guarantee Fund (+ 6 %) but mainly to a substantial decrease in the volume of outstanding loans, owing to the Commission's decision [2] to achieve a level of reserves equal to 100 % of loans outstanding after 2002 which are not covered by a State guarantee. Consequently, the solvency ratio will gradually approach 100 %.

*Provision for large exposures*

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].

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 27 million at 31 December 1997 to ECU 23 million at 31 December 1998. The change is due to the fall in the assets in question following repayments in 1998.

[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). Deliberations based on 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:
(a) the total exposure to any one client or group of connected clients must not exceed 25 % of the ECSC's own funds,
(b) 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*

6. Under the Council Directives concerning annual accounts ([1]), 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 for specific value adjustments for loans, including interest, fell from ECU 170 million at 31 December 1997 to ECU 130 million at 31 December 1998 ([2]), i.e – 24 %. This reduction is due, in particular, to the removal from the balance sheet item 'current assets' of a loan ([3]), including the related value adjustment, to a defaulting debtor, which, within the framework of the restructuring of its debt, issued new paper in 1998 to replace a part of its borrowings. The value adjustment in respect of this reduction would otherwise have been ECU 185,2 million.

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 ([4]), and made the necessary value adjustments.

**Changes in applications of ECSC funds and resources**

8. The commitments for the ECSC operating budget continued to fall in 1998 (by 14,9 %, see *Table 1*). This trend is due, for the most part, to a decrease in the aid given for retraining (ECU – 25,1 million) and, to a lesser extent, to the absence of new interest subsidies since no subsidised loan was granted in 1998 ([5]). In addition, commitments were ECU 60 million below the budgetary estimates because of the decrease in retraining aid (traditional aid and social aid, (ECU – 30 million) and reconversion aid (ECU – 30 million). As far as the latter are concerned, in particular, the Commission submitted, on 10 June.1998, a proposal for a decision pursuant to Article 95 of the ECSC Treaty in respect of the transfer of ECU 60 million (ECU 30 million in 1998 and the same amount in 1999) from the ECSC operating budget to the general budget of the European Union with a view to reinforcing the Rechar II and Resider II ([6]) Community Initiatives. As the Council issued an unfavourable opinion, this proposal was not adopted and, consequently, the transfer was not made.

9. Resources continued to decline after an isolated increase in 1997 ([7]). This was mainly the result of two opposing factors: on the one hand, the reduction to zero of the levy, for the first time, and, on the other hand, a particularly large amount in decommitments for the second consecutive year.

10. In contrast with the estimates, the budget was in surplus for the third consecutive year, which allowed the Guarantee Fund (ECU + 30 million) and the provisions for the financing of the ECSC operating budget (ECU + 26 million, see *Tables 2 and 3*) to be bolstered even further. This provision will be used, if required, in the course of subsequent financial years.

**Changes in the ECSC balance sheet**

11. The ECSC's balance sheet total declined by ECU 903 million (15,2 %) between 31 December 1997 and 31 December 1998 (see *Table 4*), mainly owing to the lower level of loans outstanding from borrowed funds: during the financial year 1998, the ECSC received ECU 690,6 million in loan reimbursements whereas it disbursed only ECU 19,7 million of new loans (see *Table 5*).

12. The amount of outstanding loans from borrowed funds was ECU 2 898 million on 31 December 1998. This item will continue to decline, falling to around ECU 730 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 1998. Following a Commission decision ([8]), there must be no new loans that would tie up reserves and mature after the expiry of the ECSC Treaty .

13. At 31 December 1997 the liquid asset accounts made up 39 % of the ECSC's assets and constituted the second largest item, after loans. The accounts concerned and the main balancing items under liabilities are shown in *Table 6*.

**Conclusion**

14. The financial year 1998 was the third consecutive year in surplus, due, on the one hand, to a sizeable number of cancelled commitments, and, on the other hand, to the fact that fewer commitments were entered into than had been planned for. This

([1]) 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. 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.

([2]) Financial Statements of the ECSC at 31 December 1998: specific value adjustments for loans (ECU 130 million, note 5.1).

([3]) Paragraph (b) of note 6.2 annexed to the Financial Statements of the ECSC at 31 December 1998.

([4]) 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.

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

([6]) Document SEC(98) 967 final.

([7]) The reasons for this increase are given in paragraph 1.8 of the Annual Report on the ECSC for the financial year 1997, OJ C 352, 18.11.1998.

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

surplus enabled the ECSC to reinforce its solvency substantially and to make the necessary provisions and value adjustments.

15. With an eye to 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. In addition, in accordance with the European Council's instructions, contained in its resolution on growth and employment, which was adopted in Amsterdam, the reserves available on that date will be placed in a fund devoted to research in the coal and steel sector.

## CHAPTER 2

## STATEMENT OF ASSURANCE CONCERNING THE ECSC

16. 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.

17. The accounts concerned are the financial statements of the ECSC at 31 December 1998, which were drawn up under the responsibility of the Commission and published in the *Official Journal of the European Communities* (1).

18. In its report on the ECSC's financial statements at 31 December 1998 (2), 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 1998, and of the result of its operations for the financial year ending on the same date'.

19. Furthermore, with a view to checking the legality and regularity of the underlying transactions in the ECSC's accounts for the financial year 1998, 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.

20. 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 at the Court meeting of 22 and 23 September 1999.

*For the Court of Auditors*

Jan O. KARLSSON

*President*

(1) Financial Statements of the ECSC at 31 December 1998, published in OJ C 240, 25.8.1999.

(2) Report on the Financial Statements of the ECSC at 31 December 1998, published in OJ C 240, 25.8.1999.

*Table 1*

**Use of funds and changes in resources during the period 1991 to 1998**

*(million ECU)*

| Item | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 (a) | 1998 (b) | Variation (b) - (a) |
|---|---|---|---|---|---|---|---|---|---|
| **A — Use** | | | | | | | | | |
| Administrative expenditure | 5,0 | 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 | 154,0 | – 26,9 |
| 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 | 159,0 | – 26,9 |
| **B — Resources of the year** | | | | | | | | | |
| Result of non-budgetary operations | 254,7 | 131,5 | 201,3 | 112,5 | 90,8 | 95,6 | 143,3 | 69,6 | – 73,7 |
| Levy | 175,0 | 146,5 | 121,3 | 107,7 | 102,3 | 95,9 | 101,6 | — | – 101,6 |
| Other budgetary resources (fines, rebates, etc.) | | | | 4,8 | 11,6 | 4,4 | 4,3 | 12,3 | + 8,0 |
| Cancellations of commitments | 32,3 | 75,8 | 94,0 | 63,3 | 70,7 | 90,0 | 195,2 | 134,2 | – 61,0 |
| Exceptional resources | — | — | — | 91,9 | — | — | — | — | — |
| Total resources of the year (B) | 462,0 | 353,8 | 416,6 | 380,2 | 275,4 | 285,9 | 444,4 | 216,1 | – 228,3 |
| B - A | 2,6 | – 214,3 | – 126,7 | – 43,7 | – 7,5 | 79,7 | 258,5 | 57,1 | – 201,4 |
| **Transfer from (+)/to (-) the provision for financing the operating budget** | – 1,4 | + 163,2 | + 105,9 | + 43,3 | + 0,3 | – 58,6 | – 224,9 | – 26,0 | + 198,9 |
| **Transfer from (+)/to (-) reserves** | — | + 53,0 | + 22,0 | + 2,0 | + 9,0 | – 19,0 | – 31,3 | – 30,0 | + 1,3 |
| Surplus for the financial year | 1,2 | 1,9 | 1,2 | 1,6 | 1,8 | 2,1 | 2,3 | 1,1 | – 1,2 |

*Source:* ECSC financial statements for the year in question.

*Table 2*

**Movements against the provision for financing the ECSC operating budget (BOC) in 1998**

*(million ECU)*

| Item | Balance at 31.12.1997 | Utilisation | Allocation | Net change | Balance at 31.12.1998 |
|---|---|---|---|---|---|
| 1. Available provision for financing the ECSC operating budget | 354,0 | — | + 26,0 | + 26,0 | 380,0 |
| 2. Provision for fines and surcharges to be paid subsequently and for subsidies to be recovered [1] | 87,7 | – 8,9 | + 17,2 | + 8,3 | 96,0 |
| Total | 441,7 | – 8,9 | + 43,2 | + 34,3 | 476,0 |

[1] Fines, surcharges and interest subsidies are considered to be ECSC resources only at the point when they have actually been paid. Until then an amount equivalent to these claims is included in this provision. The ECU 96 million in question is thus not yeat available as finance for the operating budget.

*Source:* ECSC financial statements at 31 December 1998, note 16.

*Table 3*

**ECSC own funds in 1998**

*(million ECU)*

| Item (after allocation of surplus) | 31.12.1997 | Allocation | Withdrawal | 31.12.1998 |
|---|---|---|---|---|
| Guarantee Fund ([1]) | 500,0 | 30,0 | 0,0 | 530,0 |
| Special reserve | 176,0 | 0,0 | 0,0 | 176,0 |
| Former Pension Fund | 71,2 | 1,7 | 0,0 | 72,9 |
| Surplus brought forward ([1]) | 1,2 | 0,0 | – 0,5 | 0,7 |
| Provisions for large exposures | 27,0 | 0,0 | – 4,0 | 23,0 |
| Available provision for financing the operating budget | 354,0 | 26,0 | 0,0 | 380,0 |
| Total | 1 129,4 | 57,7 | – 4,5 | 1 182,6 |

([1]) Own funds used by the Commission in the numerator of the ECSC solvency ratio.
*Source:* ECSC financial statements at 31 December 1998.

*Table 4*

**Changes in the ECSC summary balance sheet, before allocation of surplus, from 31 December 1997 to 31 December 1998**

| | 31.12.1997 | | 31.12.1998 | |
|---|---|---|---|---|
| | million ECU | % | million ECU | % |
| **Assets** | | | | |
| Loans (to banks and undertakings) | 3 584 | 60,4 | 2 833 | 56,4 |
| Liquid assets (bank balances and bonds) | 1 997 | 33,7 | 1 966 | 39,1 |
| ECSC operating budget ('ECSC OB') (levy, fines and subsidies receivable) | 90 | 1,5 | 97 | 1,9 |
| Tangible and intangible assets | 2 | 0,0 | 1 | 0,0 |
| Other assets | 87 | 1,5 | 8 | 0,2 |
| Prepayments and accrued income | 170 | 2,9 | 122 | 2,4 |
| Total | 5 930 | 100,0 | 5 027 | 100,0 |
| **Liabilities** | | | | |
| Amounts owed (including bond issues) | 3 637 | 61,3 | 2 806 | 55,8 |
| Other liabilities | 13 | 0,2 | 30 | 0,6 |
| Accruals and deferred income | 121 | 2,0 | 94 | 1,9 |
| Provisions for liabilities and charges | 87 | 1,5 | 123 | 2,4 |
| Provisions for large exposures | 27 | 0,5 | 23 | 0,5 |
| ESCS OB (commitments and provisions) | 1 296 | 21,8 | 1 172 | 21,9 |
| Reserves and surplus | 749 | 12,6 | 780 | 15,5 |
| Total | 5 930 | 100,0 | 5 027 | 100,0 |

*Source:* ECSC financial statements at 31 December 1998.

*Table 5*

**Loans disbursed by the ECSC under Articles 54, 56 and 95, 1989 to 1998**

*(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 |
| 1998 | — | — | — | — | 19,7 | 19,7 |

*Source:* 1998 figures obtained from Commission (DG II).

*Table 6*

**Changes in ECSC liquid assets and principal balancing items, 31 December 1997 to 31 December 1998**

*(million ECU)*

| Balance sheet item | 31.12.1997 | 31.12.1998 |
|---|---|---|
| **Liquid assets** | | |
| Balances with central banks | 0,6 | 0,0 |
| Loans and advances to credit institutions | | |
| — repayable on demand | 6,4 | 5,7 |
| — with agreed maturity dates or periods of notice | 367,4 | 400,7 |
| Bonds | 1 623,5 | 1 559,2 |
| Total liquid assets | 1 997,9 | 1 965,6 |
| **Principal balancing items** | | |
| Guarantee fund | 500,0 | 530,0 |
| Provisions for financing the ECSC operating budget | 354,1 | 380,0 |
| (Multiannual) commitments for the operating budget | 853,8 | 695,7 |
| Specific value adjustments in respect of loans and advances | 170,2 | 129,6 |
| Provisions for liabilities and charges | 87,4 | 122,9 |
| Provision for large exposures | 27,0 | 23,0 |
| Total principal balancing items | 1 992,5 | 1 881,2 |

*Source:* ECSC financial statements at 31 December 1998.

## 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.