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(Information)

COURT OF AUDITORS

ANNUAL REPORT AND STATEMENT OF ASSURANCE CONCERNING THE ECSC for the financial year ended 23 July 2002, together with the Commission's replies

(presented in accordance with Article 45c(1) and (4) of the ECSC Treaty)

(2003/C 224/01)

CONTENTS

I. INTRODUCTION

Expiry of the ECSC Treaty

1. In accordance with Article 97 of the Treaty establishing the ECSC, the European Coal and Steel Community (ECSC) ceased to exist on 23 July 2002. Its objective had been to bring about conditions which would ensure the rational distribution of coal and steel production while safeguarding continuity of employment and taking care not to provoke fundamental and persistent disturbances. ECSC financial aid served to:

— facilitate the carrying-out of investment programmes by granting loans to undertakings or by guaranteeing other loans contracted by them (Article 54 of the Treaty),

— promote technical and economic research (Article 55 of the Treaty),

— facilitate enterprises' financing of redeployment and social protection programmes for workers (Article 56(1) and (2) of the Treaty) where such programmes had been made necessary either by technical progress (Article 56(1) of the Treaty) or by fundamental changes in market conditions (Article 56(2) of the Treaty).

The funds required to achieve the Community's objectives came from levies imposed on the production of coal and steel and from the loans contracted (Article 49 of the Treaty). Funds obtained by borrowing could only be used to grant loans (Article 51 of the Treaty).

2. On 24 July 2002, the ECSC left behind:

— 400,9 million euro in outstanding commitments under the ECSC operating budget,

— borrowings of 742,5 million euro,

— loans totalling 768,8 million euro and

— 33,5 million euro in loans granted from the ECSC's former Pension Fund.

3. A protocol annexed to the Treaty of Nice deals with the financial consequences of the expiry of the ECSC Treaty. It makes provision for all ECSC assets and liabilities at 23 July 2002 to be transferred to the European Community on 24 July 2002 and for the assets of the ECSC in liquidation to be used to finance research activities in the sectors related to the coal and steel industries. Since the Treaty of Nice was not ratified before the ECSC Treaty expired, the Member States, as the legal heirs of the ECSC, entrusted the European Commission with the task of managing the assets of the ECSC in liquidation, under a temporary management mandate based on the same principles as provided for in the Protocol to the Treaty of Nice [1]. As the Treaty of Nice came into force on 1 February 2003, the Protocol concerning the ECSC in liquidation has been applicable retroactively since 24 July 2002. A Council Decision taken on 1 February 2003 established the measures necessary for the implementation of the Protocol [2].

4. According to forecasts, the liquidation of the ECSC should be concluded, at the latest, in 2027. This date is the latest expiry date for the contracts and commitments still outstanding. In this respect it is necessary to distinguish between, on the one hand, outstanding commitments under the operating budget and, on the other, reimbursement operations concerning loans and borrowings [3]:

— of the 400,9 million euro of commitments still outstanding on 23 July 2002, the commitments for redeployment (132,6 million euro) will end, in their entirety, in 2006, the commitments for social measures (70,6 million euro) in 2007, the commitments for interest subsidies (16,8 million euro) in 2004 and, lastly, the commitments for research (180,8 million euro) in 2008,

— the ECSC's borrowings and the loans from borrowed funds will be fully amortised by 2019 at the latest. The loans from own funds will be fully amortised by 2025 at the latest and loans from the former Pension Fund by 2027 [4].

The audits carried out

5. The Court examined the financial statements of the ECSC in liquidation for the financial year closed on 23 July 2002 and the Commission report relating to them. The Court based this examination, in part, on the work of the private audit company which audited these financial statements. On conclusion of its work, the Court submitted a report on the reliability of the financial statements of the ECSC in liquidation and on the legality and regularity of the underlying transactions. As a complement to this report, the Court has drawn up the following observations on the management of the ECSC during the financial year.

II. IMPLEMENTATION OF THE ECSC'S LAST BUDGET

6. The ECSC's budget consists of two parts: one for the administrative budget and a second for the operating budget.

7. The ECSC Treaty contains lengthy provisions on the administrative budget (Articles 78 to 78d). Since the Treaty which merged the Communities in 1968, the administrative budget has

(1) Decision by the Representatives of the Governments of the Member States meeting within the Council of 27 February 2002 (2002/234/ECSC) (OJ L 79, 22.3.2002, p. 42).
(2) Decision 2003/76/EC.

(3) In view of the expiry of the Treaty, the ECSC ceased granting loans from borrowed funds as from 1997.
(4) All these maturity dates are given by way of information to underline the extent of the stipulated deadlines.

been reduced to the ECSC contribution to the administrative expenditure of the merged Community institutions and takes the form of a commitment entered in the operating budget under the heading of administrative expenditure. The Council Decision of 21 November 1977 reduced this contribution to a flat rate of 5 million euro per year. *Pro rata temporis*, administrative expenditure for 2002 was 2,8 million euro ([1]).

8. The headings of the ECSC's operating budget are divided into resources (revenue) and utilisation of resources, or requirements (expenditure).

9. The initial estimates for the operating budget for 2002 amounted to 167,8 million euro. Commitments for the financial year came to a final total of 130,8 million euro. Redeployment aid absorbed 35,2 million euro of the 64 million entered in the budget and social measures (coal) took 21 million euro, compared to the 29 million entered in the budget. *Table 1* shows the operations to be financed from the resources for the financial year (estimates and outturn). The commitments for the operating budget changed during this period as shown in *Table 2*.

10. The estimates of resources in the operating budget of the ECSC for 2002, including the lump sum for administrative expenditure, amounted to 167,8 million euro. The Commission decided to reduce the rate of the ECSC levy to 0 % as of 1998. The provisions entered in the ECSC balance sheet at 31 December 2001 were deemed sufficient to maintain its financial activities until the expiry of the Treaty.

On conclusion of the implementation of the ECSC operating budget, the sum total of appropriations used was 130,8 million euro. *Table 3* shows the resources for the financial year (estimates and outturn).

III. CLOSING BALANCE SHEET OF THE ECSC

11. *Table 4* shows the principal data in the ECSC balance sheet at 23 July 2002; it shows that the balance sheet total declined by 839 million euro compared with the situation at 31 December 2001.

12. On the assets side, the decrease can be explained mainly by the reduction in loans and advances to credit institutions (down by 341,6 million euro) and the decline in loans and advances to customers (down by 405,2 million euro). The latter include business loans, which fell by 363 million euro to 682,1 million euro at 23 July 2002 (compared to 1 045,1 million euro at 31 December 2001). The loans to businesses in difficulty totalled 216,2 million euro at 23 July 2002 (297 million euro at the close of the previous financial year). The decrease in doubtful debts can mainly be explained by the recovery of loans from defaulting debtors and by the ceding of debt instruments. Liquid assets fell by 149,6 million euro to 1 676,6 million euro at the close of the financial year.

13. With regard to liabilities, the ECSC's liabilities vis-à-vis third parties decreased by half to 801,7 million euro at 23 July 2002 (1 518,9 million euro at 31 December 2001). On the closure date outstanding commitments under the ECSC operating budget totalled 400,9 million euro ([2]). As regards loans and borrowings, in view of the expiry of the Treaty the Commission decided to adjust its policy concerning coverage of the risk of default: it committed itself to creating a guarantee fund to achieve a level of reserves to cover 100 % of the total outstanding loans which are not covered by a government guarantee. At 23 July 2002 the coverage was 100 % and was the equivalent of 529 million euro. A withdrawal of 51 million euro from the guarantee fund provision was entered in the accounts in the course of the accounting year. In the past, the ECSC had also created a provision for major exposures, the objective of which was to make advance provision against a concentration of risks in respect of beneficiaries of loans not covered by a first-rank government guarantee and which, individually, exceed 25 % of own funds. This provision, which amounted to 6 million euro at the end of the financial year closed on 23 July 2002, was withdrawn in its entirety, because the guarantee fund already covers 100 % of the amount of loans outstanding.

14. Income for the financial year closed on 23 July 2002 amounted to 417,1 million euro and charges to 258,5 million euro. The surplus for the period was approximately 158,7 million euro. The exceptionally large surplus was mainly due to the withdrawals from the provision for financing the ECSC operating budget and the provision for budgetary contingencies, which, before the closure, amounted to 149,8 million euro.

15. On the date of expiry of the Treaty that established the ECSC the ECSC's own funds amounted to 1 188,9 million euro at 23 July 2002, as shown in *Table 5*. The ECSC's own funds are mainly invested in bonds and other fixed-income securities issued by first-ranking public entities (1 129,4 million euro).

IV. SPECIFIC ASPECTS OF MANAGEMENT

Redeployment aid

16. The Court carried out audits in the field of redeployment aid. The conditions governing eligibility and the granting and payment of the aid are regulated by bilateral conventions between the

([1]) Commission Report: Financial statements of the ECSC at 23 July 2002, p. 19.

([2]) In this connection, see the Court's observation in paragraph 20.

Commission and the Member States [1]. The audits were carried out in the Commission departments responsible and in two Member States (Italy and the United Kingdom) which absorbed 37 % of the aid during the 2002 financial year. The Court's audits revealed some weaknesses in the application of the bilateral conventions.

17. A clause in the bilateral conventions states, 'The following shall not qualify for aid: (a) workers entitled to a normal retirement pension having reached normal pensionable age; (b) workers who have been declared to be totally and permanently incapacitated for work, who are consequently entitled to the relevant allowances'. The Court observed errors in the application of these rules in the United Kingdom, as regards normal pensionable age, and weaknesses in Italy as regards checks on incapacity.

18. In Italy the Court noted that data provided by the enterprises themselves were used to calculate the aid, without the data being subjected to adequate independent verification. In this respect it must be emphasised that it is often the enterprises which pay the aid to the beneficiary workers that are responsible for applying for its reimbursement under ECSC aid.

19. According to the bilateral conventions (Article 5), redeployment aid may only be granted to workers engaged in the production of the products specified in the ECSC Treaty. This limitation requires adequate procedures to be put in place in the enterprises concerned so that the workers engaged in the production of goods and products that fall within the scope of the Treaty can be accurately identified. In the cases audited the Court found practical problems with the procedures in question.

Outstanding commitments

20. The Commission cancelled individual commitments amounting to 15,4 million euro. These commitments concerned redeployment aid (5,8 million euro), research (4,2 million euro) and interest subsidies (5,4 million euro).

Administrative reorganisation

21. One of the requirements of the Commission reform launched in 2000, which concerns the application of the principle that management and control functions should be separate [2], has not yet been implemented by the departments responsible for redeployment aid and research aid.

22. Management of the operations of the ECSC in liquidation (see paragraphs 2, 3 and 4 on this subject) is the Commission's responsibility. At the time of the audit, no department had yet been designated to provide the administrative organisation for technical and financial management of the research projects concerning the ECSC in liquidation.

Revenue from financing research

23. It has been estimated that the total amount of aid devoted by the ECSC to research in the steel sector alone over the last 15 years is approximately 800 million euro at current prices. It has been possible for the benefits and outcome of the research work financed in this way to be exploited in a practical way by the industry concerned, resulting in commercial applications.

24. The ECSC has not established a system for keeping an inventory of any patents that may have been filed by these organisations. Recognition of the ECSC's rights as regards these patents is explicitly provided for in Annexes III and IV to the contracts signed between the Commission and the aid beneficiaries.

Situation regarding loans and advances

25. In view of the ECSC's liquidation, the Court reviewed the situation regarding ECSC loans and advances.

26. As a result of the restructuring of certain loans, the ECSC has a portfolio of miscellaneous financial instruments. The valuation of some of them is problematic [3]. The Commission valued these instruments on the basis of quotations provided by a single specialist broker. In the liquidation context, it would have been preferable for the quotations provided by this broker to be compared with those of other intermediaries.

Loans to officials

27. The Court examined the loan files available at the Commission.

28. After the merger of the European Community institutions in 1968, the Council decided to use the amounts available from the former Pension Fund for ECSC officials in the following way:

(1) Agreements collected by the Commission under reference V/1274/91 of 1 July 1991.

(2) See COM(2000) 200 final/2 of 5 April 2000.

(3) At 23 July 2002 the acquisition cost of these bonds and instruments was 131 million euro and the related value adjustments totalled 47 million euro.

— up to a maximum of 40 % for loans in the context of a housing policy for European Community officials ([1]),

— up to a maximum of 60 % to guarantee commitments for redeployment (Article 56 of the ECSC Treaty) and to grant loans at reduced rates to further the pursuit of the social and economic objectives of the ECSC Treaty within the framework of the financial transactions provided for in that Treaty ([2]).

29. Following adjustment of the borrowing and lending policy, the grant of loans to finance workers' housing stopped after the 12th programme for the financing of housing for workers in the iron and steel industries, which covered the period 1995 to 1997.

30. European officials received loans up to the liquidation of the ECSC (the last loans were approved at the end of June 2002) ([3]). Some of these loans will mature in 2027 and will have the effect of postponing the final closure of the ECSC's liquidation by a number of years.

31. The amount entered in the ECSC's financial statements at 23 July 2002 (33,5 million euro) is the total for loans outstanding at 30 June 2002, not 23 July 2002.

32. Reconciliation of the data provided by the Commission's Directorates-General for Personnel and Administration (DG ADMIN), the Budget (DG BUDG), and Economic and Financial Affairs (DG ECFIN) revealed differences which, even if they are not significant, indicate certain weakness in the control systems which are supposed to guarantee the accuracy of these data.

33. According to Article 11(1) of the implementing rules concerning the grant of building loans to European officials, the Commission (DG ADMIN) must draw up an annual report on the situation of and changes in these loans. One report, covering the years 1996 to 2002, has been adopted by the Commission, but only on 26 March 2003.

([1]) In reality, loans intended for the purchase of homes or the financing of housing construction by European officials.
([2]) In fact, to finance loans for steelworkers' housing.
([3]) The Court notes, in this respect, that in the Commission report on the financial statements of the ECSC at 23 July 2002 (SEC(2002) 1415 of 7 January 2003), the Commission asserted (in its comments concerning the management of ECSC loans and guarantees), 'In view of the expiry of the ECSC Treaty on 23 July 2002, the Commission did not engage in any lending operations in 2002'. This assertion does not take account of the loans granted to officials.

V. STATEMENT OF ASSURANCE CONCERNING THE ECSC

34. 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.

35. The accounts concerned are the financial statements of the ECSC at 23 July 2002, which were drawn up under the responsibility of the Commission and published in the *Official Journal of the European Union* ([4]).

36. In its report on the financial statements of the ECSC at 23 July 2002 ([4]), which includes the statement of assurance concerning the reliability of the accounts and is published with the financial statements concerned, the Court concluded that the latter give a true and fair view of the assets and financial situation of the European Coal and Steel Community at 23 July 2002 and of the results of its operations for the financial year then ended.

37. The Court performed its audit in accordance with its audit policies and standards. These have been adapted from generally accepted international auditing standards to reflect the specific characteristics of the Community context. The Court carried out such tests of the accounting records and other audit procedures as it deemed necessary in the circumstances. Through this audit, the Court obtained a reasonable basis for the opinion expressed below.

38. In the opinion of the Court, taken as a whole the legality and regularity of the transactions underlying the ECSC accounts for the financial year closed on 23 July 2002 are sufficiently assured.

VI. FINAL OBSERVATIONS

39. Since it began its financial activity, the ECSC has disbursed 24 500 million euro by way of loans, including 23 800 million euro from borrowed funds and 643 million euro from own funds. During the same period, it provided guarantees in respect of 77,9 million euro. ECSC financial aid has exceeded 24 500 million euro ([5]). In addition, it is currently estimated that, major changes excepted, on conclusion of its liquidation, the ECSC will leave funds in excess of 1 200 million euro to the European Community.

([4]) Financial statements of the ECSC at 23 July 2002 (OJ C 127, 29.5.2003).
([5]) Data provided by the Commission: Financial statements of the ECSC at 23 July 2002, SEC(2002) 1415 final, p. 8.

40. In its final annual report on the ECSC, the Court would like to pay homage to those men and women who conceived and implemented this first European Community. In its general annual report, the Court will continue to keep a watchful eye both on the transactions involved in the liquidation of the ECSC and on the setting-up and management of the new Coal and Steel Research Fund.

This report was adopted by the Court of Auditors in Luxembourg at the Court meeting of 26 June 2003.

For the Court of Auditors

Juan Manuel FABRA VALLÉS

President

Table 1

Operations to be financed from the resources for the financial year

(million euro)

	Estimate	Outturn
1. Administrative expenditure	2,80	2,80
2. Aid for redeployment (Article 56)	64,00	35,20
3. Aid for research (Article 55)	72,00	71,80
3.1. Steel research	52,00	51,80
3.2. Coal research	20,00	20,00
4. Social measures — coal (Article 56)	29,00	21,00
	167,80	**130,80**

Source: Financial statements of the ECSC at 23 July 2002.

Table 2

Commitments under the ECSC operating budget

(euro)

	Amount at 31.12.2001	New legal commitments	Payments	Cancellations	Total at 23.7.2002
Redeployment	128 960 809	35 199 572	25 720 457	5 832 213	132 607 711
Research	174 023 995	71 779 540	60 813 446	4 160 694	180 829 395
Interest subsidies Article 56	25 008 679	—	2 737 620	5 426 905	16 844 154
Social measures (coal) (Rechar)	52 932 945	21 009 507	3 305 000	2 000	70 635 452
Total	**380 926 428**	**127 988 619**	**92 576 523**	**15 421 812**	**400 916 712**

Source: Financial statements of the ECSC at 23 July 2002.

Table 3

Resources for the financial year

(million euro)

	Estimates	Outturn
1. Current resources		
1.1. Yield from levy at a rate of 0 %	0	0
1.2. Net balance on financial operations	31	31,1
1.3. Fines and surcharges for late payment	p.m.	4,6
1.4. Miscellaneous	1	0,7
2. Cancellation of commitments not likely to be implemented	17	15,4
3. Withdrawal from provision for financing ECSC operating budget	118,8	79,0
	167,8	**130,8**

Source: Financial statements of the ECSC at 23 July 2002.

Table 4

Changes in the ECSC summary balance sheet, before allocation of the surplus, between 31 December 2001 and 23 July 2002

	23.7.2002 (million euro)	%	31.12.2001 (million euro)	%
Assets				
Balances with central banks	0,03	0,00	0,06	0,00
Loans and advances	155,59	6,35	497,20	15,12
Loans and advances to customers	682,42	27,87	1 087,60	33,08
Bonds and other fixed-income securities	1 556,90	63,59	1 613,10	49,07
Other assets	6,02	0,25	7,09	0,22
Prepayments and accrued income	47,57	1,94	82,53	2,51
Total assets	**2 448,53**	**100,00**	**3 287,58**	**100,00**
Liabilities				
Liabilities vis-à-vis third parties	801,68	32,74	1 518,91	46,20
ECSC operating budget	400,92	16,37	530,72	16,14
Provisions for liabilities and charges	586,01	23,93	736,70	22,41
Budget for financing coal and steel research	240,00	9,80	240,00	7,30
Reserves and surplus	419,92	17,15	261,25	7,95
Total liabilities	**2 448,53**	**100,00**	**3 287,58**	**100,00**

Source: Financial statements of the ECSC at 23 July 2002.

Table 5

Changes in ECSC own funds for the financial year ending 23 July 2002

(million euro)

Item	31.12.2001 (after allocation)	Allocation	Withdrawal	Allocation at 23.7.2002	23.7.2002
Guarantee Fund	580,0	0,0	51,0	0,0	529,0
Special Reserve	118,0	0,0	5,7	0,0	112,3
Former Pension Fund	40,0	0,0	4,0	0,0	36,0
Assets of the Coal and Steel Research Fund	100,0	9,7	0,0	158,3	268,0
Surplus brought forward	3,3	0,0	0,0	0,3	3,6
Subtotal	**841,3**	**9,7**	**60,7**	**158,6**	**948,9**
Provision for major exposures	6,0	0,0	6,0	0,0	0,0
Provision available for financing the ECSC operating budget	149,8	0,0	149,8	0,0	0,0
Provision for financing coal and steel research	240,0	0,0	0,0	0,0	240,0
Total	**1 237,1**	**9,7**	**216,5**	**158,6**	**1 188,9**

Source: Financial statements of the ECSC at 23 July 2002.

THE COMMISSION'S REPLIES

SPECIFIC ASPECTS OF MANAGEMENT

17. For the normal pensionable age, the British authorities have always checked ages. It was by error that some cases were mistakenly included in their claim to the Commission. Discovery of this error led to a discussion on the eligibility of women over 60. It was necessary to consult the Commission's Legal Service on the interpretation of Article 5(2)(a) of the bilateral convention. The Legal Service concluded that this Article only disqualifies those women continuing to work over 60 while drawing a pension at the same time (and not those working over 60 while deferring their pension). The British authorities were informed of this and have checked how many women fall into each category.

For the Italian case, the Commission accepts the conclusions of the Court. There are several weaknesses in Italy's implementation of the scheme, particularly because of the fragmentation of responsibilities within the national administration. However, the Commission would stress that there is an interministerial ECSC Affairs Committee that is responsible for verifying the information supplied by the companies before these details are transmitted to the Commission. For invalidity for instance, the Commission understands that this is one of the points checked by the ECSC Affairs Committee.

The Commission will, however, continue to remind Member States of the need to check these points during future control visits.

18. As noted in paragraph 17, the Commission accepts that there are some weaknesses in Italy's administration of the ECSC aid scheme. The interministerial committee is responsible for verifying the information supplied by companies and the Commission will remind the Italian authorities of the need for this work to be done adequately.

19. The Commission accepts that the classification of workers as ECSC/non-ECSC can be problematic.

For the United Kingdom, the Commission considered this point carefully during its July 2002 audit mission. The Commission had discussed this matter with the British authorities when they were drawing up the rules of the national scheme in 2001. The need for a clear separation of the two sets of workers had been stressed and it had been agreed that, for the workers engaged in both types of activities, those whose spent at least 50 % of their time on ECSC work would be accepted as eligible for ECSC aid. The British authorities confirmed that plants which produce both ECSC and non-ECSC products are rare.

The Commission's conclusion, following its audit visit, is that the system as described and adopted, although not entirely perfect, is probably the best that could be devised.

For Italy, the Commission understands that the classification of workers as ECSC or non-ECSC is verified by the interministerial committee. The Commission will, however, continue to remind Member States of the need to check these points during future control visits.

21 and 22. The Commission accepts this point but would ask that the following explanation be taken into account.

There are now only 2,5 officials (one A, half-time, and two B, full-time) in DG EMPL who are responsible for ECSC aid payments. Two officials take part in control visits. It is preferable that one of the officials taking part in each visit has specialised knowledge of the ECSC but, as there are only three such officials and given the linguistic constraints, it is not always possible to ensure that this official will have had no previous involvement with the payments to be verified. Nevertheless, in future, control visits will be carried out by one of the three ECSC officials and by one other Commission official who is independent of the ECSC sector. This will ensure better separation of the management and control functions and the Commission would ask the Court to accept this arrangement as a pragmatic solution to an awkward problem.

At the end of December 2002 the Commission changed the way it organises research programme management. Since then the management and control functions have been separate.

23. The rules on ownership, exploitation and the award of patents are laid down in Annex IV to the ECSC RTD model contract. If contractors obtain a fee in return for industrial property rights covered by patents or for passing on knowledge, the ECSC is entitled to a share corresponding to the value of its contribution to the invention.

24. The Commission takes note of the Court's observation and will study the possibility of setting up an inventory of patents filed by these organisations.

26. Normally it is the Commission's policy to value its portfolio on the basis of quotes from several sources. The instruments under reference were an exceptional case and their valuation on the basis of quotes from a single source was due precisely to the lack of liquidity in the market. The Commission's experience over previous years, in relation to these particular illiquid instruments, has been that when quotations were found to be available in the market for the same closing date from different sources, the differences were not significant.

32. There are three reasons for the differences mentioned by the Court.

The first, concerning the balance, is a difference in closing date.

The second reason, concerning movements during the financial year, is that certain payments to beneficiaries were not taken into account, as the value date was not known at the time of closure.

The third reason, concerning movements over a number of financial years, is a combination of a certain lack of control and a procedure for transmitting personal data (invalidity, resignation, CCP) that could be improved. The Commission noted these points when producing the report for 1996 to 2002; it is currently examining and rectifying them on a case-by-case basis.