

COUR DES COMPTES

**Audit Court Opinion on the
State's Annual Financial
Report 2010**

Summary

May 2011

 **Notice**

This summary is designed to make it easier to understand, and to comment on, the full Audit Court Opinion, which is the only document binding on the *Cour des Comptes*

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1- The Mission entrusted to the Cour des Comptes

Lawfulness, Sincerity and Faithfulness of the Financial Statements

Article 47-2 of the Constitution sets forth the principle that the accounts of public administrations are to be lawful and faithful, offering a true and fair image of the latter's management, assets and financial situation.

Article 58, paragraph 5, of the Constitutional By-law on Budget Acts (known as the LOLF in its French initials) of 1 August 2001 entrusts the *Cour des Comptes* with the task of certifying the lawfulness, sincerity and faithfulness of the State's accounts.

The Audit Opinion issued by the *Cour des Comptes* aims to assist the Parliament, which must, under Article 37-III of the LOLF, approve the Central Government's accounts. The Audit Opinion is also designed for a broader range of users.

The accounts are deemed lawful if there has been compliance with the obligation, defined in the French National Accounting Code, to “adhere to rules and procedures in force” (Article 120 - 2).

Sincerity of the accounts ensures their ability to “convey the knowledge that those responsible for drawing up the accounts have of the reality and relative materiality of recorded events” (Article 120 - 2).

The concept of faithful representation lays down an overarching requirement that only general ledger accounting can fulfil: through the application of accounting rules in good faith, the accounts must offer a relevant and fair view of reality; where necessary, additional information is to be appended in the Notes to the Financial Statements.

Audit Opinion on the Financial Statements

The Audit Opinion is a substantiated written opinion, issued by an independent body, under its own responsibility, on the accounts of an entity. It entails the collection of all necessary elements so as to ensure beyond any reasonable doubt that the financial statements, in all their material aspects, comply with a given set of accounting rules and principles.

The *Cour des Comptes* conducts its audit pursuant to the provisions of the French code on audit courts and in reference to the International Standards on Auditing set by the International Federation of Accountants (IFAC).

These standards require that the certifying body collect all evidence with a view to obtaining reasonable (and not absolute) assurance that the financial statements are free of any material misstatements. They stipulate the criteria by which this reasonable assurance is to be sought (for example, the exhaustiveness and exactitude of records, their correct entry into the accounts and the separation of financial periods).

The Audit Opinion may come in of four formats:

- unqualified Opinion;
- Opinion with one or more qualifications regarding certain aspects of the accounts, deemed non-satisfactory;
- an unfavourable Opinion, when the proportion of the financial statements deemed non-satisfactory is excessive;
- a non-Opinion, if the certifying body is unable to satisfactorily perform the audit and issue an Audit Opinion

The Audit Court Opinion is not taken to be a comment on the situation of the State's finances and assets. It is a reasoned and informed assessment of the reliability of the accounts, which need to be able to provide users with grounds for forming such an opinion.

It is therefore a prerequisite if the financial statements are to be used by:

- citizens, who will thus have access to more complete and reliable information;
- Parliament, which must approve the accounts and will be able to use the Audit Court Opinion to analyse the situation of the Central Government's finances and assets as well as the results of its management, and to refer to it both in its legislative capacity and in its auditing capacity;
- the Government and administrations, which will be able, thanks to the operational steering and management tools of the services offered by the accounting reform, anticipate future expenses, optimise their management, gauge the scope of risks and commitments faced by the Central Government, and measure the cost of policies implemented;
- financial analysts, rating agencies and investors.

2- The State's Financial Statements

Book-keeping and establishment of the financial statements

The State's financial statements trace the operations of State services, establishments or institutions which do not have an independent legal status (ministries, public authorities, ancillary budgets, etc.).

Unlike cash-based accounting, which merely records budgetary expenditure and revenue transactions on an annual basis, the accounts of the Central Government incorporate, on the one hand, the results of its management and, on the other hand, the situation of its assets, debts and multi-year commitments. They thus offer a better understanding of the costs of public policies and structures, and provide operational tools for the steering and management of services.

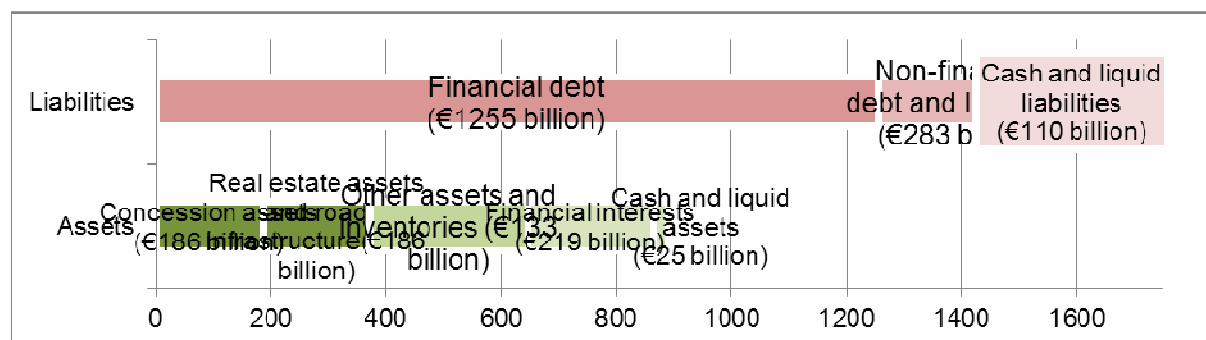
The Central Government's financial statements include a balance sheet (known as the statement of net worth), an income statement (comprising three sections: the statement of net burdens; the statement of net sovereign revenues; and balance of transactions for the financial period), a cash flow statement and the Notes to the Financial Statements. These Notes, which are a vital part of the financial statements, provide a corpus of useful information for a clear understanding and interpretation of the accounts.

Pursuant to Article 30 of the LOLF, the financial statements are drawn up in accordance with the accounting principles and rules applicable to the private sector, except where the specificity of State activities makes this impossible, although such instances are to remain limited. These rules and principles are set forth in the Central Government Accounting Standards.

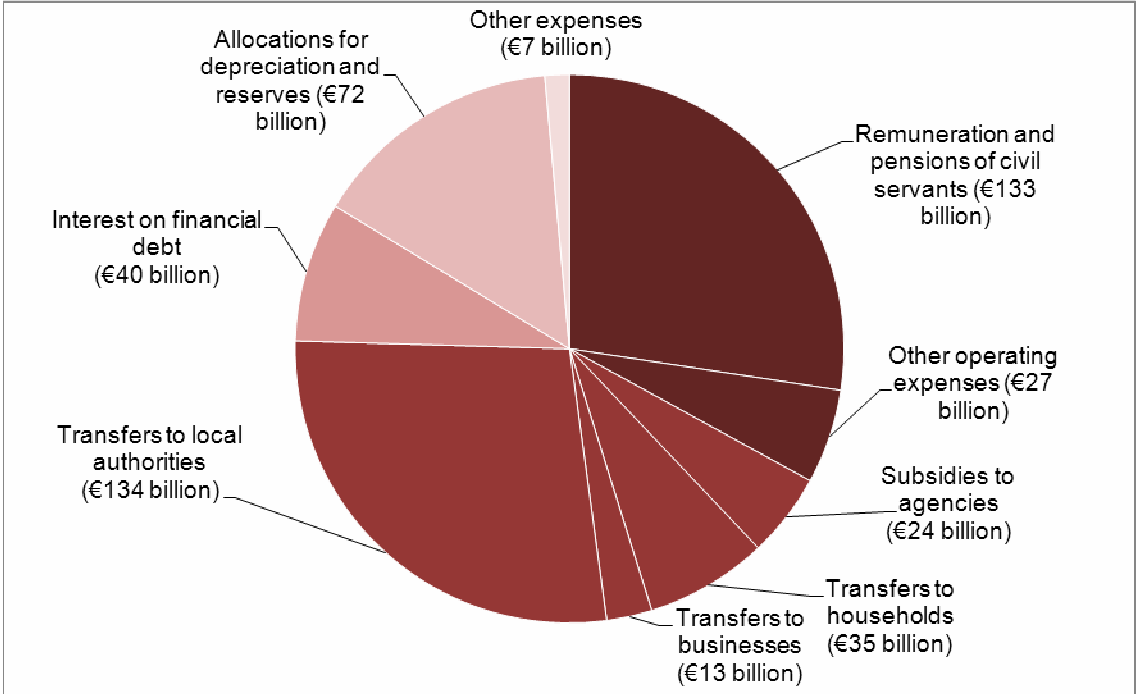
The State's financial statements are prepared under the responsibility of the centralising accountant. They are approved by the Director General of Public Finances and are then subject to approval by the Minister for the Budget, Public Accounts, the Civil Service and State Reform.

The State's 2010 financial statements: key figures As at 31 December 2010

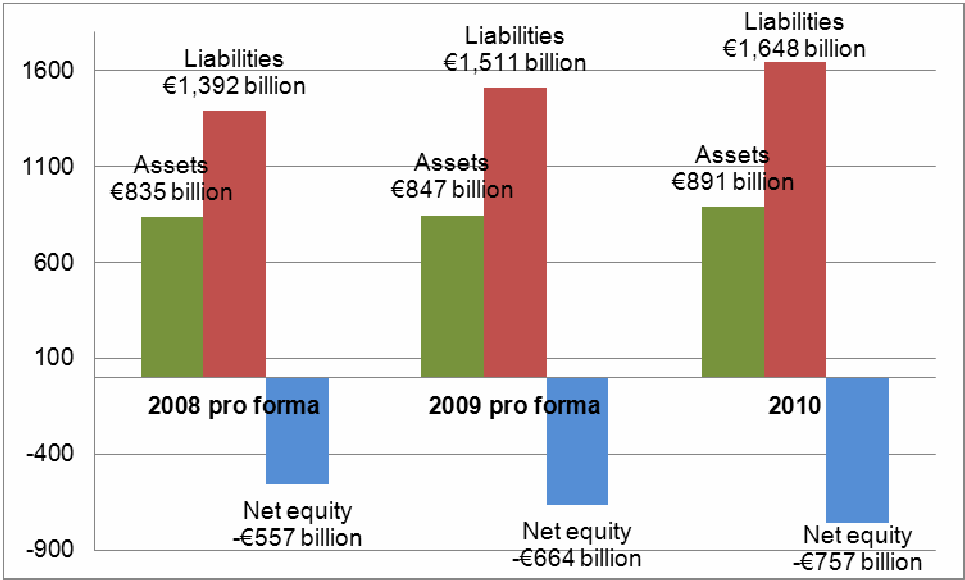
A situation of negative net worth of €757 billion, stemming from the difference between assets and liabilities, and which reflects the accumulation of deficits year upon year:



A net loss of €112 billion, stemming from a shortfall in tax revenues (€254 billion) and revenues from other sources (€119 billion, including €73 billion in reversals of provisions) with regard to overall costs borne by the Central Government in 2010 (€485 billion), which can be broken down as follows:



As compared to 31 December 2009 (*pro forma*)



Total assets increased by €44 billion, owing chiefly to:

- hydraulic concessions entered into the accounts for the first time in 2010 (+€44 billion) and the revaluation of Banque de France in the public accounts (+€24 billion);
- reduced cash and liquid assets (-€17 billion), the level of which was higher in late 2009 owing to the circumstances at that time.

Total liabilities increased by €137 billion, mainly due to heavier financial debt (+€82 billion)

and cash and liquid liabilities (+€44 billion).

A net loss which has worsened by an additional €12 billion as compared with the situation in 2009 (-€100 billion), due mainly to increased transfers to local authorities (+€29 billion), despite the net increase in tax revenues in 2010 (+€14 billion).

A net situation which has shifted €92 billion further into the negative, with the impact of the 2010 deficit (-€112 billion) mitigated by the integration of assets and the effects of some error corrections (+€20 billion).

The State's 2010 Financial Statements: cash flow statement

The State's net cash flow (cash assets less cash liabilities) went from -€21 billion on 31 December 2009 to -€85 billion as at 31 December 2010; a variation of -€64 billion.

Indeed, the State's activities resulted in net cash flow requirements (inflows less outflows) of €102 billion:

- €422 billion in funds collected, including taxes and dues (€334 billion) and dividends received (€12 billion);
- €524 billion in disbursements, including expenditure related to staff (€121 billion), intervention expenditure (€183 billion), refunds and reimbursements on taxes and dues (€66 billion) and interest paid (€42 billion).

Moreover, government investment transactions resulted in an additional net cash flow requirement of €44 billion:

- €11 billion in disbursements for acquisitions of tangible and intangible fixed assets;
- €46 billion in outflows in connection with the State's financial transactions, including disbursements made within the framework of future expenditure (€32 billion), the loan to Greece (€4.5 billion), the advance payments authorised in 2010 to the Services and Payment Agency (€6.5 billion) for pre-financing Community agricultural expenditure;
- €13 billion in inflows, notably those related to repayments to the Central Government of the loans awarded to automobile manufacturers (€2.2 billion) and the advance payments authorised in 2009 to the Services and Payment Agency (€6.7 billion) for pre-financing Community agricultural expenditure.

These cash flow requirements (totalling €146 billion) were met in the following manner:

- €82 billion through financial indebtedness (financial debt of €193 billion acquired in the fiscal year, €111 billion repaid in the same period);
- €64 billion through Treasury funds.

The State's 2010 Financial Statements: main off-balance sheet information

Information relating specifically to 2010

- Launch of the future investments programme (€35 billion);
- Reform of local taxation (€32 billion transferred to local authorities);
 - Loan to Greece (€4.5 billion);
 - Agreed guarantee for the new European Financial Stability Facility (ceiling of €111 billion);
 - Effects of pension reform on the Central Government;
 - The organic law reclassifying the Social Debt Redemption Fund (CADES) as part of the social insurance system.

Significant events occurring after 31 December 2010

- Early repayment of automobile sector loans: €6 billion repaid in full to the Central Government between January and April 2011;
- France's loan guarantee for the loan to Ireland (€1 billion);
- Additional loan to Greece (€3 billion).

Taxation-related liabilities

- Taxes collected by the State and transferred to third parties such as local authorities or social insurance entities: €114 billion in 2010 (out of a total of €385 billion collected, or 30 %), as opposed to €144 billion in 2009 (out of €403 billion collected, or 36 %);
- Tax loss carry-forward provisions: corporate taxes (€315 billion), income tax (€12 billion);
- Deferred taxation of capital gains from sales of shares: €12 billion.

Commitments undertaken as part of agreements

- Guarantees agreed under the budget: €138 billion as at 31 December 2010, as compared with €150 billion as at 31 December 2009;
- Guarantees to *Coface* (credit insurance): €78 billion;
- Guarantee for the interest rate stabilisation procedure (€6 billion);
- Guarantee to ensure protection for individual savers: holders of *livret A*, *livret bleu* and 'sustainable development' savings accounts (€260 billion), holders of *livret d'épargne populaire* (€54 billion);
- Liability guarantees: multilateral development banks (close to €50 billion), temporary art exhibitions, etc;
- Financial commitments: home-ownership savings schemes (€5 billion), loans to be paid out to foreign States (€1.2 billion), etc.

Civil servant and military pension commitments

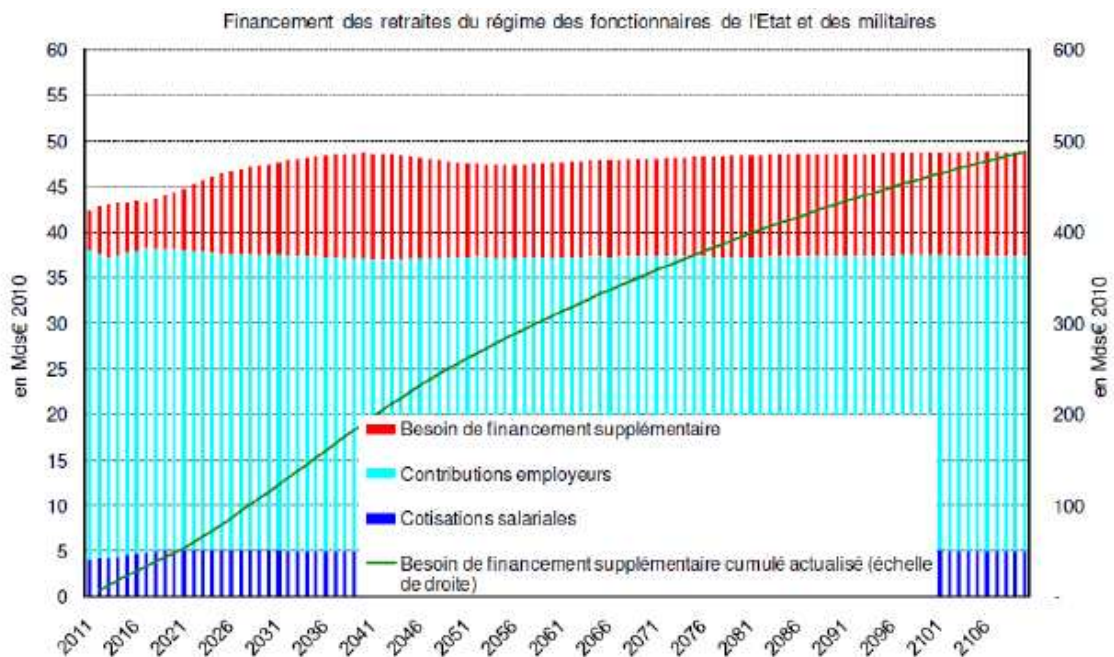
– €1,200 billion in commitments, representing a future funding requirement of €490 billion (all funding yet to be sourced, given projected future deficits of the regime);

Other pension commitments

- Officials from the French postal service: €105 billion in commitments, representing a future funding requirement of €110 billion;
- Special State-subsidised regimes: €210 billion in future funding requirements;
- Other pensions and benefits (veterans, victims of war, etc.): €63 billion in commitments.

Other State commitments

- Budgetary liabilities not liquidated as at 31 December 2010 (€96 billion), concerning chiefly Programme 146 for equipping the forces (€38 billion), Programme 854 on loans to EU member States (€12 billion), Programme 178 on training and employing the forces (€7 billion), and Programme 110 on economic and financial development aid (€5 billion);
- 2007-2013 State-Region project contracts: €6 billion in liabilities, or 50 % of the total sum forecast;
- Social liabilities: housing assistance (approximately €90 billion in commitments), RSA income support (liability undetermined), adult disability allowance (approximately €17 billion in liabilities)
- Public service concessions: 354 contracts currently under way, including 334 relating to dams and 17 relating to overhead lines
- Public private partnership contracts: 7 detention facilities, 4 police stations, 2 *gendarmerie* stations, the diplomatic archive centre, etc.



3- Audit Court Opinion on the State's Annual Financial Report 2010

Findings from the *Cour des Comptes*' audit

Two qualifications from 2009 fully lifted, concerning:

- the Social Debt Redemption Fund (CADES);
- the other fixed assets and inventories of civil ministries.

Four qualifications from 2009 partially resolved:

- procedures for establishing the list of implementing agencies (qualification regarding the identification and valuation of the agencies);
 - the State's commitments vis-a-vis the French railway network (*Réseau Ferré de France* - RFF), the State's commitments regarding the adult disability allowance (or AAH in its French initials) and housing assistance, non-inclusion of the national housing aid fund (FNAL) and the RSA income support fund (FNSA) into the State's accounts, exemption from contribution on overtime and financial information annexed to the financial statements (qualifications on intervention expenditure and liabilities);
 - the capitalisation threshold applied by the Ministry of Defence (qualification on Ministry of Defence assets);
 - the provisions for asbestos removal (qualification regarding State's real estate assets).

Corrections requested by the *Cour des Comptes* and taken into consideration

The “net” impact of the corrections that the administration implemented following the *Cour des Comptes*' audit findings is greater than that of the corrections from previous programmes:

- -€9.6 billion on the balance of transactions for the 2009 fiscal year (as opposed to -€2.1 billion on that of 2009 and -€5.5 billion on that of 2008);
- +€32.2 billion on the Central Government's net worth as at 31 December 2009 (compared to +€15.4 billion as at 31 December 2009 and +€20.8 billion as at 31 December 2008).

These adjustments attest as much to the work remaining to be done – five years after the LOLF entered into force – if the financial statements are to be truly in compliance with the applicable Central Government Accounting Standards, as to the importance of the verification work undertaken annually by the *Cour des Comptes* to help ensure their reliability.

But disagreement persists over other corrections requested, which were not taken into consideration

Had these modifications, suggested by the *Cour des Comptes*, been undertaken, they would have led, notably:

- to a net balance of transactions for the fiscal year improved by €1.8 billion;
- to a deterioration in the Central Government's net worth as at 31 December 2010 by an additional €12.8 billion;
- to a number of reclassifications on the balance sheet (€0.5 billion, absolute value) and income statement (€0.1 billion, absolute value).

A significant number of uncertainties and limitations

The remaining uncertainties and limitations, pertaining to a still sizeable series of items in the financial statements, could have a major financial impact, but it is not possible, by definition, to draw a firm conclusion.

Given the sum total of these discrepancies, uncertainties and limitations, the *Cour des Comptes* is able to certify that, with regard to the applicable accounting rules and principles, the State's Annual Financial Report for the fiscal year ending 31 December 2010, approved 17 May 2011, is true and correct and offers an accurate image of the State's finances and assets, with the exception of seven substantive qualifications:

- **1. The State's financial and accounting information systems;**
- **2. The ministerial internal control and audit mechanisms;**
- **3. Sovereign revenues;**
- **4. Agencies and other financial fixed assets of the State;**
- **5. Ministry of Defence assets;**
- **6. Intervention expenditure and liabilities;**
- **7. The State's real estate assets.**

Since its first audit of the public accounts in 2006, the *Cour des Comptes*' approach has been to offer support in the gradual implementation of the accounting reform.

This approach has led to a gradual lifting of several qualifications, which dropped in number from 13 substantive qualifications on the 2006 public accounts to 12 (including nine substantive) in the accounts for 2007 and 2008, followed by nine qualifications (including eight substantive) for those pertaining to 2009, and, finally, seven (all substantive) for the 2010 accounts.

In 2010, the administrations have made even more progress when it comes to identifying accounting risks and the process of ultimately bringing these under firmer control.

The year 2010, however, saw the reorganisation of territorial administration, the overhaul of public policies and the progressive rollout of the integrated management software

package, Chorus. This context meant that some of the endeavours aimed at enhancing accounting reliability were hindered, at times considerably; the network of local internal accounting audit specialists was destabilised; and the administration's resources were concentrated on the adaptations relating to these reforms.

As a result, the *Cour des Comptes* observed marked differences across the accounts, with some financial aggregates becoming steadily more reliable, while other others failed to make sufficient progress, or even plateaued, with regard to accounting quality requirements.

A major issue today is the appropriation of the new accounting software package, Chorus, by all of the managerial services, the successful migration of the general accounts to Chorus, planned for January 2012, and the swift achievement of guaranteed reliability of the various data to be entered into it.

Naturally, Chorus is but one manifestation of the current computerised accounting environment (Accord and Palier LOLF) and will not in itself be enough to ensure implementation of all of the provisions of the LOLF.

Qualification No.1:

The State's financial and accounting information systems

– The characteristics of the Central Government's financial and accounting information systems impose an overarching limitation on the scope of the audit that the *Cour des Comptes* could conduct for the 2010 fiscal year. There are still numerous uncertainties regarding the ability of the Central Government's new IT tools to take into consideration the corpus of observations expressed by the *Cour des Comptes* since 2006 when auditing the public accounts.

Information systems insufficiently integrated

- The ability to shift the balances from the trial balance of the accounts to the original individual transactions, and vice-versa, is far from systematic.
The weak links between applications limit the possibility of cross-checking accounting data, and even show up inconsistencies in some cases.

Computer applications unsuitable for general ledger book-keeping

– The functional shortcomings and characteristics of the accounting and management computer applications limit the *Cour des Comptes'* ability to audit the file from which the Central Government Annual Financial Report is derived.

The *Cour des Comptes* is unable to issue an opinion on the exhaustiveness of the Central Government's non-financial debts to third parties (suppliers, social insurance entities, local bodies, etc.), which totalled €21 billion as at 31 December 2010, because there is no usable auxiliary accounting system in place.

The very design choices inherent in the Chorus property management module lead to uncertainty regarding the valuation of real estate assets in the State's books.

The *Cour des Comptes* is incapable of verifying, within reasonable time-frames, the effectiveness of the numerous manual checks set up by the administration to remedy certain existing tools' inability to guarantee the integrity of the data they convey.

The conditions in which many budgetary programmes underwent migration to Chorus and the under-utilisation of its accounting functions in 2010 pose a major risk for its ability to handle the Central Government's general accounts in 2012.

The process of compiling the appended financial information fails to display sufficient security measures and is not auditable, notably because of the lack of suitable information systems.

There are currently more than 10,000 accounting schemas in use and the number of entries exceeds 36 million, of which more than two-thirds bear no relation, for technical reasons, with the account balances.

- The Chorus project – for which rollout is programmed for 2008-2012 and of which the cost exceeds €1.3 billion – aims to cluster the functions of as many currently-used management applications as possible (at least 80) into one integrated management software package, which should enable improved integration of the accounting information.

- Migration of the Central Government's accounting in its entirety to Chorus is planned for 1 January 2012

Qualification No. 2:

Ministerial internal control and audit mechanisms

- Improvements were again noted in 2010, not only with regard to the progressive rollout of ministerial internal control mechanisms, but also as concerns the structuring of internal auditing. The ministries are still not able, however, to make sufficiently substantiated assessments on the level of accounting and financial risk management.

Ministerial internal control processes

In all of the ministries, dedicated governance structures for internal accounting checks are now up and running, with the exception of just two ministries (Education, as well as Higher Education and Research).

This initial rollout phase has not yet reached a point of perfect balance. The decentralised services of some ministries are not always sufficiently involved in the risk identification and management process. In parallel, the territorial administration reform and the rollout of Chorus have caused considerable upheaval for the network of local correspondents.

In many ministries, identification of risks related to the territorial re-organisation and rollout of Chorus remains patchy. Risk management activities regarding Chorus tend to be most often of a general nature and their effectiveness is far from certain, especially in decentralised services.

Several processes, which the *Cour des Comptes* examined in depth in 2010, display significant shortcomings.

The fact that the level of maturity of internal ministerial control mechanisms varies greatly makes it all the more necessary and urgent to ensure that the Secretaries General are provided with the tools that will enable them to offer a substantiated assessment of the effectiveness and efficacy of the procedures implemented.

Ministerial internal audits

The number of internal audit services whose work could be used by the *Cour des Comptes*, pursuant to the provisions of International Standard on Auditing 610, was limited to the two financial ministries and the Ministries of Defence, Ecology and Agriculture.

While, in a small number of cases, the internal audit function has indeed been identified and is, although still insufficiently mature, under development, the majority of ministries had not yet approved an operational strategy for developing the internal audit function as at the end of 2010.

Internal accounting control refers to any organised, formalised and permanent measures or processes, selected by management and implemented by officers at every level so as to ensure the proper conduct of their activities with a view to providing reasonable assurance as to the lawfulness, truthfulness and accurate correspondence between the entries and the facts they represent (“true and fair view”).

- Given its position, which is independent to the usual reporting lines, the internal financial and accounting audit service aims to oversee the in-house accounting checks, which are designed to deliver on the government’s accounting quality objectives.

- As an external auditor, the Cour des Comptes must be able to base its own verifications on a reliable system of internal checks and auditing.

Qualification No. 3:

Sovereign revenues

- Accrual accounting of sovereign revenues is possible if the following conditions are satisfied:
 - a taxation system designed in a way which enables collection of the information necessary for assessing the State's liabilities and those of taxpayers;
 - an information system capable of seamlessly managing all useful accounting information;
 - a regulatory environment which respects the principles of accrual accounting, consubstantial with the LOLF, as far as is possible.These conditions were not met for most of the taxation provisions in force as at 31 December 2010.

Lack of appreciable improvement

Accounting management of taxation of professional income (€179 billion in 2010) has shown no progress in 2010.

There is also a high level of risk as concerns the accounting management of personal taxes.

Justification for accounting entries and balances still insufficient

The account justification process is not guided by a procedure robust enough to guarantee the accounting quality of the records.

Inexistent or insufficient formalisation of the controls in place seriously limits the scope of the audits that the *Cour des Comptes* can conduct, since it is not possible to systematically return to the unit-level data on which the accounting entries are based.

Impact of taxation instruments presented in the Central Government's accounts in a way that does not reflect reality

An insufficient analysis of the taxation mechanisms in force, at times coupled with a complete lack of tax declaration data, means that the full impact cannot be systematically recorded in the public accounts, in conformity with the Central Government Accounting Standards.

When new taxation initiatives are being designed and established, the administration fails to learn from the shortcomings of most of the existing mechanisms, which have been highlighted regularly since 2006, so as to improve the quality of the information entered into the general accounts.

The information contained in the Notes to the Financial Statements in the table of allocated taxes and duties fails to adequately represent the allocation of gross revenues between the Central Government's budget and the funding of third-party recipients.

In 2010 net sovereign revenues amounted to €271 billion, stemming mainly from value added tax (49 %), corporate taxation (20%) and personal income tax (18%), up 5 % from 2009 as a result of the increased VAT revenues and the expiration of the exceptional measures taken as part of the economic stimulus plan.

- As at 31 December 2010, the net total of taxpayer liabilities was listed as €47 billion on the State's balance sheet under assets, while fiscal liabilities stood at €17 billion, listed under liabilities.

- Taxation collected by the State and transferred to third parties, such as local authorities or social insurance bodies, amounted to €114 billion in 2010.

Qualification No. 4:

Agencies and other financial fixed assets of the State

– In the Central Government’s 2010 financial statements, significant uncertainties affect the valuation of its implementing agencies and some of its other financial fixed assets, as well as the exhaustiveness of the inventory of the latter.

The State’s agencies

The positive dynamics of having external certification of agencies’ accounts is again severely limited because their closure of accounts occurs too late in the year.

Despite considerable progress, the internal accounting verification mechanism set up by most of the agencies remained insufficient as at 31 December 2010.

Government agencies’ real estate holdings were not always correctly listed under assets on their balance sheets as at 31 December 2010, and inadequacies were also noted regarding the main items under liabilities.

The majority of the agencies fail to always comply with the accounting instructions applicable to assets (component-based approach, cultural goods, historic monuments, etc.).

The *Cour des Comptes* is still not in a position to issue an opinion on the reliability of the procedure for reconciling reciprocal debts and claims between the Central Government and its agencies.

The fact that the accounting standards applied by the Central Government and its implementing agencies differ affects the quality of their valuation in the financial statements as at 31 December 2010.

Other financial assets and interests of the State

Audits conducted on some of the entities’ accounts – agencies excluded – revealed that they are affected by the same uncertainties as those identified in the case of agencies.

Two scope-related issues point to a significant uncertainty: representation in the accounts of funds without legal personality and the clarification regarding the accounting treatment of 1,043 public health-care institutions.

Uncertainty remains as to the exhaustiveness of the scope for State loans that benefit from subsidisation in the form of reduced interest rates and deferred repayment periods, as well as to the valuation of these at the end of the fiscal year.

The information provided in the Notes to the Financial Statements concerning unaudited financial participations and interests is insufficiently detailed.

As at 31 December 2010, the value of the State’s financial fixed assets was €283 billion, representing 32 % of the balance sheet total. These assets include 876 financial participations, valued at €219 billion, claims relating to these participations, totalling €43 billion, loans and advances with a net value of €17 billion, and other financial assets valued at €4 billion.

- Among the State’s participations, 775 are audited by the Central Government itself, and these amount to a value of €118 billion; of these, 571 entities, valued at €60 billion, fulfil a public service mandate under tight control from the Central Government – their main source of funding – and these entities are thus classified as implementing agencies of the State.

Qualification No. 5:

Ministry of Defence assets

– Endeavours to ensure maximal reliability that began in 2007 and were continued in 2010 have been continued with the simultaneous rollout of Chorus, which has proved difficult and required a great deal of effort on the part of the ministry. Despite all the energy mobilised, some major difficulties remained at the closure of the 2010 fiscal year. The ministry has undertaken to deal with these outstanding challenges through a new action plan.

Material misstatements continue to hound Defence inventories

The valuation as at 31 December 2010 of the Army munitions inventory was not able to be justified.

Reconciliation of inflows in the electronic inventory files with the total amount of purchases in storage, as listed in Chorus, has not been performed.

There is a risk of double-counting in fixed assets and inventories in the case of deductions made regarding aircraft that are being withdrawn from active service.

Some inventories are entered into the books with values that have been deduced using methods that fail to comply with Standard No. 8 of the Central Government Accounting Standards.

Inventory of assets and liabilities still insufficient

Shortcomings in the inventorying and accounting of some assets and liabilities have led to an ongoing uncertainty.

As at 31 December 2010 the scope of inventory concerning assets that the Ministry of Defence has made available to the manufacturing sector was not always exhaustive.

The accounting treatment of State-to-State contracts, applied as of 2006, fails to correctly portray the State's true responsibility when it comes to this type of commercial operation.

Fixed asset valuations not very reliable

Numerous fixed assets that are commissioned appear in the financial statements at unjustified values.

Some of the fixed assets under construction or development are still being valued on the basis of a method that is incompatible with the applicable accounting standards.

Ancillary expenses are insufficiently taken into consideration in the valuation of tangible and intangible assets acquired.

The depreciation schedule for fixed assets and inventories is applied inconsistently and only partially.

Equipment delivered to the armed forces in 2010 is still listed as being in progress as at 31 December 2010.

As at 31 December 2010, the Ministry of Defence fixed assets in service, excluding real estate holdings, amounted to a gross value of €116 billion or €51 billion, net value. Those in progress totalled €32 billion (gross and net value). Inventories exceeded €34 billion in terms of gross value, or approximately €31 billion, net value.

- These assets are extremely diverse in nature, and also vary greatly in terms of their length of service; there are limitations to the information systems employed to inventory and value them.

Qualification No. 6:

Intervention expenditure and liabilities

– When it comes to the exhaustiveness of the assets and liabilities stemming from the State's role as an economic and social regulator that are entered into the public accounts, a series of discrepancies and uncertainties persist.

Uncertainty as to the exhaustiveness of the intervention liabilities inventory

There is significant uncertainty surrounding the exhaustiveness of the inventory of liabilities to be entered as intervention measures, which were not audited by the *Cour des Comptes*, and which represent an expenditure of €25 billion in 2010, as opposed to €44 billion in 2009. Uncertainty also surrounds the exhaustiveness of intervention liabilities relating to mechanisms handled by the State's decentralised services.

The Central Government's liabilities under the VAT Offset Fund (FCTVA) not provided for

Last year's disagreement between the *Cour des Comptes* and the preparer of the financial statements concerning the event generating the Central Government's liability under the FCTVA remains unresolved.

The Central Government becomes liable to pay from the moment that the local authorities disburse the eligible expenditure sums, and not upon receipt of the reimbursement claim for those sums.

The administration's decision to consider the receipt of the reimbursement claim as the liability-generating event is inconsistent with its *modus operandi* for other, comparable, intervention mechanisms, as well as with prevailing practice of private and public enterprises.

The *Cour des Comptes* has assessed the Central Government's liability regarding the FCTVA as amounting to €6.5 billion as at 31 December 2010, whereas only €0.4 billion had been provided for upon the closure of the accounts.

Debt Reduction and Development Contracts

Debt Reduction and Development Contracts (a form of debt relief for highly indebted poor countries) are not always accounted for in the Central Government's financial statements in a manner that reflects their true characteristics.

The method employed by the preparer of the financial statements is to erroneously depreciate the claim over the other country, whose debt is thus taken to be annulled.

In the aggregate, intervention expenditure totals €211 billion for the 2010 fiscal year, while intervention liabilities stand at €75 billion as at 31 December 2010.

- Intervention expenditure refers to all expenses of a social nature or which relate to economic development, and these comprise:

- transfers to households, totalling €35 billion (housing assistance, adult disability allowance, etc.); to businesses, totalling €13 billion (exemptions from dues, measures to foment employment, etc.); to local authorities, totalling €110 billion (overall contribution to operating costs, compensation following the reform of locally-levied business tax, etc.); and to other local bodies, totalling €25 billion.

- provisions for transfer costs (liabilities), totalling €28 billion.

- various liabilities which could not be accurately quantified are described in the Notes to the Financial Statements.

Qualification No. 7:

The State's real estate assets

- **At the end of the second financial year in which real estate data are handled in Chorus RE-FX, serious doubts still surround the valuation of the State's real estate holdings.**
- **Indeed, contrary to expectations, the real estate data from the previous heterogeneous systems have not been satisfactorily made reliable or consistent.**

Inventorying the assets

The pre-Chorus applications are still being used for inventorying and managing the real estate holdings, which runs counter to the key objective of utilising the new software package: to enable the creation of one single database for management of the State's property.

The information which ought to enable a clear view of the situation regarding management of government real estate, in accordance with regulatory provisions, is not currently sufficiently available. Such information is entirely lacking for nearly three-quarters of the assets comprising the real estate holdings.

Asset valuation

The sub-standard quality of the data contained in the RE-FX module leads to an uncertainty concerning the valuation of the State's real estate assets, given that this data is required if the book value of the marked-to-market assets is to be correctly discounted.

The assessment methods employed by France Domaine are based on scales that are largely inappropriate for government property holdings. This is true, for example, for most of the assets located abroad whose market value has barely budged since the opening balance sheet of 1 January 2006.

The lack of regular on-site evaluation of the marked-to-market real estate assets means that uncertainty weighs on their book value entry as assets on the Central Government's balance sheet. At least 10.7 % of the marked-to-market assets, representing €4.9 billion, have not undergone an on-site evaluation since the 2006 opening balance sheet.

The unsatisfactory quality of the relationship between the physical and accounting inventories implies a risk of calculation errors when determining the revaluation surplus and the valuation of fixed assets; this risk confirms the irregularities identified by the *Cour des Comptes*. There are unjustified discrepancies between the value of assets recorded in the physical inventory and those in the accounting inventory, which the *Cour des Comptes* values at €1.3 billion (in absolute value) as at 31 December 2010.

Disagreement as to the classification of assets belonging to the Military Fuel Service (SEA in its French initials) means that an uncertainty surrounds the valuation of these assets on the State's balance sheet as at 31 December 2010.

The accounting treatment of subsequent expenditure on governmental monuments (expenses aiming to enhance their permanence or usefulness) are still overshadowed by uncertainty.

The State's real estate assets, as they appear in the public accounts as at 31 December 2010, show a net book value of €66.4 billion, as opposed to €65.3 billion at the end of 2009 (on a *pro forma* basis).

- This assessment is based chiefly on market values. Some assets, the use of which by third parties would only be possible at heavily discounted rates (as is the case with historic monuments), are valued at one symbolic euro. Detention facilities are assessed at the depreciated replacement cost. □