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From:	Mr Vítor CALDEIRA, President of the European Court of Auditors
date of receipt:	16 October 2014
To:	Mr Linas LINKEVICIUS, President of the Council of the European Union
Subject:	Report on the annual accounts of the European Securities and Markets Authority for the financial year 2013 together with the Authority's replies

Delegations will find attached the European Court of Auditors' report on the annual accounts of the European Securities and Markets Authority for the financial year 2013.

This report is accompanied by the Authority's replies and will shortly be published in the *Official Journal of the European Union*.

Encl.: Report on the annual accounts of the European Securities and Markets Authority for the financial year 2013 together with the Authority's replies.¹

¹ In English only. The other languages of this report are available on the European Court of Auditors' website: <http://eca.europa.eu/>.

ЕВРОПЕЙСКА СМЕТНА ПАЛАТА
TRIBUNAL DE CUENTAS EUROPEO
EVROPSKÝ ÚČETNÍ DVŮR
DEN EUROPÆISKE REVISIONSRET
EUROPÄISCHER RECHNUNGSHOF
EUROOPA KONTROLLIKODA
ΕΥΡΩΠΑΪΚΟ ΕΛΕΓΚΤΙΚΟ ΣΥΝΕΔΡΙΟ
EUROPEAN COURT OF AUDITORS
COUR DES COMPTES EUROPÉENNE
CÚIRT INIÚCHÓIRÍ NA HEORPA



EUROPSKI REVIZORSKI SUD
CORTE DEI CONTI EUROPEA
EIROPAS REVĪZIJAS PALĀTA
EUROPOS AUDITO RŪMAI

EURÓPAI SZÁMVEVŐSZÉK
IL-QORTI EWROPEA TAL-AWDITURI
EUROPESE REKENKAMER
EUROPEJSKI TRYBUNAŁ OBRACHUNKOWY
TRIBUNAL DE CONTAS EUROPEU
CURTEA DE CONTURI EUROPEANĂ
EURÓPSKY DVOR AUDÍTOROV
EVROPSKO RAČUNSKO SODIŠČE
EUROOPAN TILINTARKASTUSTUOMIOISTUIN
EUROPEISKA REVISIONSRÄTTEN

Report on the annual accounts
of the European Securities and Markets Authority
for the financial year 2013
together with the Agency's replies

INTRODUCTION

1. The European Securities and Markets Authority (hereinafter “the Authority”, aka “ESMA”), which is located in Paris, was established by Regulation (EU) No 1095/2010 of the European Parliament and of the Council¹. The Authority’s task is to improve the functioning of the EU internal financial market by ensuring a high, effective and consistent level of regulation and supervision, promoting the integrity and stability of the financial systems and strengthening international supervisory coordination in order to ensure the stability and effectiveness of the financial system². ESMA was set up on 1 January 2011.

INFORMATION IN SUPPORT OF THE STATEMENT OF ASSURANCE

2. The audit approach taken by the Court comprises analytical audit procedures, direct testing of transactions and an assessment of key controls of the Authority’s supervisory and control systems. This is supplemented by evidence provided by the work of other auditors (where relevant) and an analysis of management representations.

STATEMENT OF ASSURANCE

3. Pursuant to the provisions of Article 287 of the Treaty on the Functioning of the European Union (TFEU), the Court has audited:

(a) the annual accounts of the Authority, which comprise the financial statements³ and the reports on the implementation of the budget⁴ for the financial year ended 31 December 2013, and

¹ OJ L 331, 15.12.2010, p. 84.

² ***Annex II*** summarises the Authority’s competences and activities. It is presented for information purposes.

³ These include the balance sheet and the economic outturn account, the cash flow table, the statement of changes in net assets and a summary of the significant accounting policies and other explanatory notes.

- (b) the legality and regularity of the transactions underlying those accounts.

The management's responsibility

4. The management is responsible for the preparation and fair presentation of the annual accounts of the Authority and the legality and regularity of the underlying transactions⁵:

- (a) The management's responsibilities in respect of the Authority's annual accounts include designing, implementing and maintaining an internal control system relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies on the basis of the accounting rules adopted by the Commission's accounting officer⁶; making accounting estimates that are reasonable in the circumstances. The Director approves the annual accounts of the Authority after its accounting officer has prepared them on the basis of all available information and established a note to accompany the accounts in which he declares, *inter alia*, that he has reasonable assurance that they present a true and fair view of the financial position of the Authority in all material respects.
- (b) The management's responsibilities in respect of the legality and regularity of the underlying transactions and compliance with the principle of sound financial management consist of designing, implementing and maintaining

⁴ These comprise the budgetary outturn account and the annex to the budgetary outturn account.

⁵ Articles 39 and 50 of Commission Delegated Regulation (EU) No 1271/2013 (OJ L 328, 7.12.2013, p. 42).

⁶ The accounting rules adopted by the Commission's accounting officer are derived from the International Public Sector Accounting Standards (IPSAS) issued by the International Federation of Accountants or, where relevant, the International Accounting Standards (IAS)/International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board.

an effective and efficient internal control system comprising adequate supervision and appropriate measures to prevent irregularities and fraud and, if necessary, legal proceedings to recover funds wrongly paid or used.

The auditor's responsibility

5. The Court's responsibility is, on the basis of its audit, to provide the European Parliament and the Council⁷ with a statement of assurance as to the reliability of the annual accounts and the legality and regularity of the underlying transactions. The Court conducts its audit in accordance with the IFAC International Standards on Auditing and Codes of Ethics and the INTOSAI International Standards of Supreme Audit Institutions. These standards require the Court to plan and perform the audit to obtain reasonable assurance as to whether the annual accounts of the Authority are free from material misstatement and the transactions underlying them are legal and regular.

6. The audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the accounts and the legality and regularity of the underlying transactions. The procedures selected depend on the auditor's judgement, which is based on an assessment of the risks of material misstatement of the accounts and material non-compliance by the underlying transactions with the requirements in the legal framework of the European Union, whether due to fraud or error. In assessing these risks, the auditor considers any internal controls relevant to the preparation and fair presentation of the accounts, as well as the supervisory and control systems that are implemented to ensure the legality and regularity of underlying transactions, and designs audit procedures that are appropriate in the circumstances. The audit also entails evaluating the appropriateness of accounting policies, the

⁷ Article 107 of Regulation (EU) No 1271/2013.

reasonableness of accounting estimates and the overall presentation of the accounts.

7. The Court considers that the audit evidence obtained is sufficient and appropriate to provide a basis for its statement of assurance.

Opinion on the reliability of the accounts

8. In the Court's opinion, the Authority's annual accounts present fairly, in all material respects, its financial position as at 31 December 2013 and the results of its operations and its cash flows for the year then ended, in accordance with the provisions of its Financial Regulation and the accounting rules adopted by the Commission's accounting officer.

Opinion on the legality and regularity of the transactions underlying the accounts

9. In the Court's opinion, the transactions underlying the annual accounts for the year ended 31 December 2013 are legal and regular in all material respects.

10. The comments which follow do not call the Court's opinions into question.

COMMENTS ON BUDGETARY MANAGEMENT

11. The overall level of committed appropriations increased from 86 % in 2012 to 93 % in 2013, indicating that commitments were made on a more timely basis. However, the level of committed appropriations carried over to 2014 was high for title III (operational expenditure) at 3 688 487 euro (58 %). This was caused by IT services received in 2013 but not yet paid for (0,8 million euro), IT services planned in the 2014 work programme and contracted at year-end (1,1 million euro), some delays in IT procurements (0,4 million euro) and also the multiannual nature of some IT projects.

12. In 2013 the Authority made 12 budget transfers amounting to 5,1 million euro or 18 % of the budget (2012: 22 transfers amounting to 3,2 million euro or 16 % of the budget), which indicates continued weaknesses in budget planning.

OTHER COMMENTS

13. Some 27 % of payments made in 2013 for goods and services received were late. Where payments were late, they were overdue by an average of 32 days. Late interest paid in 2013 amounted to 3 834 euro.

14. According to the Protocol on the privileges and immunities of the European Union⁸ and the EU VAT Directive⁹, the Agency is exempt from indirect taxes. Total VAT charged to ESMA in the period 2011-2013 was 3,3 million euro. Following lengthy discussions with the host Member State, the Authority started claiming VAT reimbursements in the last quarter of 2012, but only 1,3 million euro had been claimed back by the end of 2013.

FOLLOW-UP OF PREVIOUS YEARS' COMMENTS

15. An overview of the corrective actions taken in response to the Court's comments from previous years is provided in **Annex I**.

This Report was adopted by Chamber IV, headed by Mr Milan Martin CVIKL, Member of the Court of Auditors, in Luxembourg at its meeting of 1 July 2014.

For the Court of Auditors

Vítor Manuel da SILVA CALDEIRA
President

⁸ Protocol (No 7) on the privileges and immunities of the European Union (OJ C 115, 9.5.2008, p. 266).

⁹ Council Directive 2006/112/EC (OJ L 347, 11.12.2006, p. 1).

Follow-up of previous years' comments

Year	Court's comment	Status of corrective action (Completed / Ongoing / Outstanding / N/A)
2011	The Authority's commitments amounted to 12 841 997 euro or 76 % of the 2011 budget. The commitment rates were low especially for title III "Operational expenditure" (47 %). This impacted on the Authority's IT objectives which were not entirely achieved. The low budget execution rates indicate difficulties in budget planning and implementation.	N/A
2011	The Authority's budget for the financial year 2011 amounted to 16,9 million euro. In accordance with Article 62(1) of its Founding Regulation, 60 % of the 2011 budget was financed from Member States' and EFTA countries' contributions and 40 % from the Union budget. At the end of 2011, ESMA recorded a positive budget outturn of 4,3 million euro. In compliance with its Financial Regulation ¹ , the full amount was then recorded in the accounts as a liability towards the European Commission.	Ongoing
2011	Weaknesses were noted as regards six legal commitments made in advance of budget commitments (483 845 euro).	Ongoing²
2011	The Court identified a number of cases with a total value of 207 442 euro in which payment appropriations carried over to 2012 did not correspond to legal commitments made. These carry-overs were therefore irregular and should be cancelled.	Ongoing

Year	Court's comment	Status of corrective action (Completed / Ongoing / Outstanding / N/A)
2011	There is a need to improve the Authority's management of fixed assets. For intangible assets developed by the Authority, accounting procedures and information on costs were not reliable.	Completed
2011	The Authority needs to improve the transparency of recruitment procedures. The number of years of experience required for a given position was not respected, applications received after the deadline were accepted, questions for oral and written tests were not set before the applications were examined by the selection board and there was no decision of the Appointing Authority to appoint the selection board.	Completed
2012	The Authority's accounting system has not yet been validated by the Accounting Officer.	Completed
2012	During its second year of activity, the Authority took an important step with the adoption and implementation of the baseline requirements for all internal control standards. However, full implementation of the standards has not been achieved.	Ongoing
2012	There is considerable room to improve the timeliness and documentation of procurement procedures.	Ongoing
2012	The Authority's total appropriations for 2012 amounted to 20,3 million euro, out of which 2,8 million euro (14 %) were cancelled and 4,2 million euro (21 %) of committed appropriations were carried over to 2013. The high level of cancellations results mainly from the fact that the budget was established on the basis of a fully implemented staff establishment plan at the beginning of 2012, whereas some recruitments were only made during the year. Delays in IT procurements also caused cancellations.	N/A

Year	Court's comment	Status of corrective action (Completed / Ongoing / Outstanding / N/A)
2012	<p>The level of committed appropriations carried over is high for title II (administrative expenditure) at 39 % and for title III (operational expenditure) at 52 %. For title II, this was mainly caused by the fact that a significant contract for works on the Authority's premises was awarded in December 2012 (0,6 million euro) and by the purchase of IT hardware (0,5 million euro), telephony equipment (0,1 million euro) and furniture (0,3 million euro) for which delivery was not completed at year-end. For title III, the high level of committed appropriations carried over results from the multiannual nature of significant IT development projects and delays in related procurements.</p>	N/A
2012	<p>In 2012, the Authority made 22 budget transfers amounting to 3,2 million euro (16 % of total 2012 budget), which indicates weaknesses in budget planning.</p>	Ongoing
2012	<p>The Authority needs to further improve the transparency of its recruitment procedures. In particular, in one audited recruitment procedure, the number of years of experience for a given position was not applied and in three audited recruitment procedures there was no evidence that thresholds for the shortlists were established before the examination of the applications.</p>	Completed

¹ Articles 15(4) and 16(1).

² Similar cases were found in 2013.

European Securities and Markets Authority (Paris)**Competences and activities**

<p>Areas of Union competence deriving from the Treaty</p> <p><i>(Article 114 of the Treaty on the Functioning of the European Union)</i></p>	<p>The European Parliament and the Council shall, acting in accordance with the ordinary legislative procedure and after consulting the Economic and Social Committee, adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market.</p>
<p>Competences of the Authority</p> <p><i>(Regulation (EU) No 1095/2010 of the European Parliament and of the Council and Regulation (EC) No 1060/2009 of the European Parliament and of the Council)</i></p>	<p>Tasks</p> <ul style="list-style-type: none"> – To develop draft regulatory technical standards. – To develop draft implementing technical standards. – To issue guidelines and recommendations. – To issue recommendations where a national competent authority has not applied sectoral acts or has applied them in a way which appears to be a breach of Union law. – To take individual decisions addressed to competent authorities in certain emergency situations and in settlement of disagreements between competent authorities in cross-border situations. – In cases concerning directly applicable Union law, to take individual decisions addressed to financial market participants, where: (i) a national competent authority has not applied sectoral acts or has applied them in a way which appears to be a breach of Union law and where the competent authority has not complied with a formal opinion of the Commission; (ii) in certain emergency situations where a competent authority does not comply with the decision of the Authority adopted, or (iii) in settlement of disagreements between competent authorities in cross-border situations where a competent authority has not complied with the decision of the Authority. – To issue opinions to the European Parliament, the Council or the Commission on all issues related to its areas of competence. – To collect the necessary information concerning financial market participants to carry out the duties assigned to it. – To develop common methodologies for assessing the effect of product characteristics and distribution processes on the financial position of financial market participants and on consumer protection. – To provide a centrally accessible database of registered financial market participants in the area of its competence where specified in sectoral legislation. – To issue warnings in the event that a financial activity poses a serious threat to its objectives. – To temporarily prohibit or restrict certain financial activities that threaten the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system in the Union in the cases specified and under the conditions laid down in sectoral legislation or if so required in the case of an emergency situation. – To participate in the activities of colleges of supervisors, including on-site examination, carried out jointly by two or more competent authorities. – To address any risk of disruption in financial services that is caused by an impairment of all or parts of the financial system and has the potential to have serious negative consequences for the internal market and the real economy. – To draw up additional guidelines and recommendations for key financial market participants, to take account of the systemic risk posed by them. – To conduct an inquiry into a particular type of financial activity or type of product or type of conduct in order to assess potential threats to the integrity of financial markets or the stability of the financial system and make appropriate recommendations for action to the

	<p>competent authorities concerned.</p> <ul style="list-style-type: none"> – To carry out tasks and responsibilities delegated by competent authorities. – To provide opinions to competent authorities. – To conduct peer reviews of the activities of competent authorities. – To coordinate between competent authorities, in particular where adverse development could potentially jeopardise the orderly functioning and integrity of financial markets or the stability of the financial system in the Union. – To initiate and coordinate Union-wide assessments of the resilience of financial market participants to adverse market developments. – To take decisions on applications for certification and registration of credit rating agencies and on withdrawal of such certification and registration. – To establish cooperation agreements with the relevant credit rating agency supervisory authorities of third countries. – To conduct investigations of and on-site inspections at the premises of credit rating agencies, rated entities and related third parties. – Where a credit rating agency has committed an infringement, to take decisions to withdraw its registration, temporarily prohibit it from issuing credit ratings, suspend the use for regulatory purposes of the credit ratings it issued, require the infringement to be brought to an end, and/or issue public notices. – Where a credit rating agency has committed an infringement intentionally or negligently, to take decisions to impose a fine.
Governance	<p>Board of Supervisors</p> <p><i>Composition</i></p> <p>Chairperson (non-voting); the head of the national public authority competent for the supervision of financial market participants in each Member State; one representative of the Commission (non-voting); one representative of the European Systemic Risk Board (non-voting); one representative of each of the other two European Supervisory Authorities (non-voting).</p> <p><i>Tasks</i></p> <p>Gives guidance to the work of the Authority and is in charge of taking decisions referred to in Chapter II of the founding Regulation.</p> <p>Management Board</p> <p><i>Composition</i></p> <p>Chairperson and six other members of the Board of Supervisors, elected by and from the voting members of the Board of Supervisors. The Executive Director and a representative of the Commission participate in meetings without the right to vote (though the representative of the Commission can vote on budgetary matters).</p> <p><i>Tasks</i></p> <p>Ensures that the Authority carries out its mission and performs the tasks assigned to it in accordance with the founding Regulation.</p> <p>Chairperson</p> <p>Representative of the Authority responsible for preparing the work of the Board of Supervisors and chairing the meetings of the Board of Supervisors and the Management Board. Appointed by the Board of Supervisors after having been heard by the European Parliament.</p> <p>Executive Director</p> <p>Appointed by the Board of Supervisors after confirmation by the European Parliament. In charge of the management of the Authority and prepares the work of the Management Board.</p> <p>Internal audit</p> <p>European Commission's Internal Audit Service (IAS).</p>

	<p>External audit</p> <p>European Court of Auditors.</p> <p>Discharge authority</p> <p>European Parliament, acting on a recommendation from the Council.</p>
<p>Resources made available to the Authority in 2013</p>	<p>Final Budget</p> <p>Total budget: 28,189 million euro, including: Union subsidy: 8,6 million euro Contributions from National Competent Authorities: 12,9 million euro Fees from supervised entities: 6,53 million euro (Credit Rating Agencies: 5,7 million euro; Trade Repositories: 0,83 million euro)</p> <ul style="list-style-type: none"> – Staff as at 31 December 2013 – Statutory staff: 106 temporary staff posts authorised in the establishment plan, of which recruited: 102 – Contract staff: 25 contract staff posts planned in the budget; contract staff posts actually filled at 31.12.2013: 19 – Seconded National Experts: 14 Seconded National Expert posts planned in the budget; Seconded National Experts posts actually filled at 31.12.2013: 15
<p>Products and services in 2013</p>	<ul style="list-style-type: none"> – Monitoring financial stability. Issued several periodic risk reports and trend summaries of financial markets. – Conducted tailored economic research and impact assessments. – Contributed to ESRB work on central counterparties and systemic risk. – Developed benchmark principles and recommendations together with EBA. – Looked into impact of the Short-Selling Regulation. – Carried out reviews of retailisation in the EU. Published a report on retailisation, i.e. the sales of complex products to retail investors. – Expanded work on monitoring markets and financial innovation. Put in place a financial innovation framework. – Conducted in-depth analysis of innovative financial products and processes. Conducted analysis of bail-in securities and securitisation. Surveyed NCAs on the topics of captive placement and crowdfunding. – Monitored and analysed retail investor trends. – Worked on investor education. Became an associate member of the OECD International Network on Investor Education. – Prepared reinforced investor protection regime under MiFID II. Prepared for future investor protection work. – Issued remuneration guidelines for investment firms. Guidelines covered governance, design and control of pay schemes. – Warned investors about contracts for difference (CFDs). Published joint warning with EBA on dangers of investing in CFDs. – Issued jointly with EBA guidelines for complaints-handling for securities and banking. – Published three ESAs joint positions on principles for manufacturers' product oversight and governance processes. – Held Joint Consumer Protection Day of the three ESAs in Paris. – Strengthened its credit rating agencies (CRA) supervision. Twenty-two CRAs registered, two certified. – Following the cross-CRAs investigation into the bank rating methodologies in 2012, the implementation of the resulting remedial actions was monitored in 2013 as part of on-going supervision. Published a report on sovereign ratings investigation. Carried out an assessment of 14 small and medium-sized CRAs focusing on the systems and controls put in place by the CRAs to ensure compliance with the regulation. – Assessed CRAs' compliance with the new requirements focusing on the disclosure

aspects of sovereign ratings, pricing policies and procedures.

- Enhanced its CRA risk analysis framework. Looked into CRAs' implementation of regulatory rule changes. Furthered ESA cooperation and cooperation with international authorities on CRA matters.
 - Conducted CRA policy-related work. Published guidelines and recommendations providing clarity on the scope of the CRA Regulation and the list of registered CRAs with their market shares. Published a discussion paper on CRA3 implementation and on the three draft Regulatory Technical Standards (RTS). Published the first advice concerning the feasibility of a network of smaller CRAs.
 - Authorised six trade repositories and took on supervision.
 - Participated in CCPs supervisory colleges. Finalised a framework written agreement for the establishment and functioning of the colleges of supervisors and a common risk assessment template. Began recognition of third-country CCPs - 35 third-country CCPs applied for recognition.
 - Published further advice on the equivalence between the EU regulatory regime for CRAs and the respective legal and supervisory frameworks of Argentina, Brazil, Mexico, Hong Kong and Singapore.
 - Provided implementing rules for EMIR. Published Q&A to promote consistent implementation of EMIR. This included:
 - Preparing technical details for clearing obligation
 - Commencing examination of pension scheme arrangements and intra-group transactions
 - Raising awareness of non-financial counterparties (NFC) on obligation
 - Issuing regulatory technical standards on CCP colleges
 - Publishing a final report on the guidelines and recommendations for interoperability arrangements, as mandated under EMIR
 - Issuing standards on OTC derivatives entered into by non-EU counterparties
 - Advising Commission on equivalence of third-country rules and EMIR
 - Preparing for Central Securities Depositories Regulation (CSDR)
 - Coordinating international derivatives dialogue
 - Prepared for future MiFID II mandates.
 - Submitted to the Commission the standards on acquisitions and increases in holdings in investment firms under current MiFID. Reviewed implementation of MiFID conduct of business rules.
 - Reviewed and clarified data reporting rules from a cross-regulatory perspective.
 - Clarified reporting of on-exchange derivatives. Prepared details for transaction reporting, order record keeping and reference data.
 - Advised Commission on review of the Short-Selling Regulation.
 - Prepared implementing measures of future Market Abuse Regulation (MAR). Consulted on MAR policy options for certain implementing measures.
 - Strengthened framework for retail investment funds.
 - Clarified impact of EMIR on the calculation of counterparty risks for UCITS.
 - Concluded supervisory cooperation arrangements for alternative investment funds with 46 non-EU authorities.
 - Continued clarifying rules for alternative investment funds (AIFMs). Published a final report on Draft RTS on types of AIFMs and submitted it to the Commission for endorsement.
 - Clarified scope of AIFMD. Published a final report on guidelines on key concepts of the AIFMD. Adopted remuneration guidelines for alternative investment fund managers. Published a final report on guidelines on sound remuneration policies under the AIFMD.
 - Clarified reporting requirements for alternative investment fund managers. Published guidelines on reporting obligations under the AIFMD. Addressed late transposition of the AIFMD. Issued an opinion on practical arrangements for the late transposition of the AIFMD.
 - Delivered first standards under Prospectus Directive (PD). The draft RTS and the report were submitted to the Commission. Updated framework for equivalence of third-country
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	<p>prospectuses. Prepared standards on transparency requirements for major shareholdings.</p> <ul style="list-style-type: none">– Published report on liability regimes under Prospectus Directive (PD).– Clarified concept of ‘acting in concert’ to international investors. Published a statement containing information on shareholder cooperation and acting in concert under the PD.– Promoted convergent application of Short-Selling Regulation.– Finalised guidelines on market making activities. Published guidelines on the exemption for market making activities and primary market operations.– Facilitated and coordinated the implementation of temporary bans. ESMA played its coordination role in eight instances in 2013.– Monitored settlement discipline and fails.– Contributed to the consistent application of International Financial Reporting Standards (IFRS) in the EU. Consulted on draft guidelines on enforcement of financial information. Published a consultation paper on proposed guidelines on the enforcement of financial information.– Compared IFRS and EU firms’ financial statements. Participated in the development of IFRS. Prepared standards for financial information. Monitored proposed rules on audit.– Facilitated development of code of conduct for EU proxy advising industry.– Reviewed Member States’ implementation of EU law. Amended methodology for peer reviews. Finalised a peer review on its Money Market Funds Guidelines.
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Source: Annex supplied by the Authority.
