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Orig.: English

Munich, 21.03.2000

SUBJECT: Revision of the EPC: Articles 37, 38, 42 and 50

DRAWN UP BY: President of the European Patent Office

ADDRESSEES: 1. Committee on Patent Law (for opinion)
2. Budget and Finance Committee (for opinion)

SUMMARY

As a result of comments by the Board of Auditors in their report for the 1998 accounting period, the Office proposes amendments to the EPC under the heading of financial provisions, with the aim of making EPO financial practice compatible with generally accepted accounting principles and reflecting the financial position of the Organisation.

The Administrative Council at its meeting in Dublin on 24.02.2000 agreed that these proposals be submitted for opinion to the Committee on Patent Law and the Budget and Finance Committee.

I. INTRODUCTION

1. In their report for the 1988 accounting period, the Board of Auditors drew attention to the fact that the EPO's budgetary and accounting practices failed to reflect the literal wording of the European Patent Convention and the Financial Regulations. The President of the Office, in his reply, explained that the financial policy for the Office had always been a hybrid one, largely because of inconsistencies between the three official languages in Chapter V of the EPC. The reply mentioned also that the accounting policies of the Pension Reserve Fund observed generally accepted accounting principles, based on market practice.
2. The Board of Auditors also recommended that the EPO's pension liabilities be recorded in the annual accounts of the Organisation. In his reply, the President of the Office stated that this recommendation would need to be examined from the point of view of compatibility with the financial provisions of the EPC. The PRF, which did not exist and was not envisaged when the EPC was drafted, is governed by its own set of regulations.
3. The Office takes the view that Chapter V EPC needs to be revised in order to put these fundamental recommendations into effect. Generally accepted accounting principles, it is proposed, should form the basis of future budgetary and financial policies.

II. OUTLINE OF PROPOSED CHANGES

A. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

4. The major alteration to Chapter V EPC is found in Article 42 (Budget), where it is proposed that "**generally accepted accounting principles**" should now be established as the basis for budgetary and financial accounting practice. The Chapter will not therefore refer to or imply any specific accounting policies, practices or principles. Article 42 (1) therefore becomes redundant, apart from the provision for amending or supplementary budgets; any budget will be based mainly on estimates. It follows that the Financial Regulations will have to be rewritten so as to adopt the financial standards ultimately selected.

The principle that the budget should be balanced is now incorporated in Article 42(1). Paragraph (2) is therefore deleted. Article 42(3) is retained.

B. BUDGETARY FUNDING

5. The concept of budgetary funding, it is proposed, should be introduced so as to reflect the current financial practice of the Organisation. Third-party funding, from lending institutions (secured) and project finance, is therefore specified under new

paragraphs, to be added to the existing sources of funding in Article 37. The term "cover for expenditure" is eliminated in the heading.

The more realistic term "**funding**" refers to both capital and operating expenditure, a distinction that was not made when the EPC was originally drafted.

C. OWN RESOURCES

6. As a result of the Introduction of the funding concept, "**own resources**" will therefore need be redefined in Article 38. The proposal now reflects the current budgetary practice of financing the budget, not only from fee and other income for the current budgetary period but as necessary, from the Office's retained earnings (or liquid reserves) from prior years. These changes are reflected in Article 38(a).

The **Pension Reserve Fund** was neither mentioned nor envisaged when the Convention was drafted. It is now the major asset of the Organisation. The Fund is not possessed of its own legal capacity and thus forms part of the Organisation's own resources. However, its special status, as a "special class of asset to serve a particular purpose", designed to "lend support to the pension scheme by providing the appropriate reserves" is recognised in Article 38(b). The wording of this paragraph reflects the legal status and purpose of the Fund, as set out in the general provisions of the Regulations of the Pension Reserve Fund.

III. PROPOSED AMENDMENTS

Present Wording

Chapter V

Financial provisions

Article 37

Cover for expenditure

The expenditure of the Organisation shall be covered;

- (a) by the Organisation's own resources;
- (b) by payments made by the Contracting States in respect of renewal fees for European patents levied in these States;
- (c) where necessary, by special financial contributions made by the Contracting States;
- (d) where appropriate, by the revenue provided for in Article 146.

Proposed Wording

Chapter V

Financial provisions

Article 37

Budgetary funding

The **budget** of the Organisation shall be **financed**,

(a) - (d) *Unchanged*

(e) **where appropriate, by third-party borrowings secured on land or buildings;**

(f) **where appropriate, by third-party funding for specific projects.**

Article 38

The Organisation's own resources

The Organisation's own resources shall be the yield from the fees laid down in this Convention, and also all receipts, whatever their nature.

Article 42

Budget

- (1) Income and expenditure of the Organisation shall form the subject of estimates in respect of each accounting period and shall be shown in the budget. If necessary, there may be amending or supplementary budgets.
- (2) The budget shall be balanced as between income and expenditure.
- (3) The budget shall be drawn up in the unit of account fixed in the Financial Regulations.

Article 38

The Organisation's own resources

The Organisation's own resources shall **comprise**

- (a) **all income from fees and other sources and retained earnings of the Organisation;**
- (b) **the resources of the Pension Reserve Fund, which shall be treated as a special class of asset of the Organisation designed to lend support to the Organisation's pension scheme by providing the appropriate reserves.**

Article 42

Budget

- (1) **The budget** of the Organisation shall **be balanced, based on generally accepted accounting principles as laid down in the Financial Regulations.** If necessary, there may be amending or supplementary budgets.
- (2) **Delete**
- (3) *becomes (2) Text unchanged*

Article 50
Financial Regulations

The Financial Regulations shall in particular establish:

- (a) the procedure relating to the establishment and implementation of the budget and for the rendering and auditing of accounts;
- (b) the method and procedure whereby the payments and contributions provided for in Article 37 and the advances provided for in Article 41 are to be made available to the Organisation by the Contracting States;
- (c) the rules concerning the responsibilities of accounting and paying officers and the arrangements for their supervision;
- (d) the rates of interest provided for in Articles 39, 40 and 47;
- (e) the method of calculation the contributions payable by virtue of Article 146;
- (f) the composition of and duties to be assigned to a Budget and Finance Committee which should be set up by the Administrative Council.

Article 50
Financial Regulations

The Financial Regulations shall in particular establish:

- (a) - (f) *Unchanged*

- (g) **the accounting principles on which the budget and the annual financial statements shall be based.**