

Information and arguments

Extension of powers of the Supreme Audit Office

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What will the new act bring and why is it necessary?

- The Supreme Audit Office is the only independent and external auditing authority capable of guaranteeing impartial and politically neutral information on the management of public funds. However, it only audits a part of the public funds in the Czech Republic.
- An amount of 680,000,000,000 CZK lies beyond the reach of external audits in state- and municipality-owned enterprises (total turnover in 2010), as well as hundreds of billions in municipal budgets. As repeatedly announced by BIS (the Security and Information Service of the Czech Republic), these companies are subject to systematic enrichment due to close relations between management and representatives of the state in supervisory boards of companies with ownership interests of the state who do not perform their supervisory function. The BIS report has further warned about ongoing corruption in the management of public property of some statutory cities and towns.
- The extension of audit powers is based on the requirements of the Lima Declaration, which is an important and generally respected document of the International Organisation of Supreme Audit Institutions (INTOSAI). The audit institutions of all neighbouring countries act in compliance with these recommendations.

“All operation with public funds should be subject to audits of supreme audit institutions, regardless if, or how, they are represented in the national budget.”

the **Lima Declaration**, an international standard for supreme audit institutions

Support of Members of Parliament

In their Pledge of Support for Reconstruction of the State, 158 deputies have pledged to support the amendment of the Constitution of the Czech Republic extending the audit powers of the Supreme Audit Office (the SAO¹).

I shall support a constitutional amendment and an amendment to the Supreme Audit Office Act extending the Supreme Audit Office's powers to:

- manage the property of territorial self-governing units and the income and expenses of their budgets in compliance with the law,
- manage the property of legal entities, in which either the state or a territorial self-governing unit has at least a 50% share,
- manage the property of other public legal entities, such as health insurance companies, public research institutions, voluntary unions of municipalities, state-funded institutions of self-governing units, Regional Councils of the cohesive regions, Czech Television, Czech Radio, the Czech Press Agency, public universities, and the Czech National Bank.

1 In Czech: Nejvyšší kontrolní úřad (NKÚ).

Current bill



The constitutional amendment of the Constitution of the Czech Republic passed the first reading in a version that is in compliance with the key parameters as outlined in the Pledge of Support for Reconstruction of the State:

Constitutional bill amending Institutional Act No. 1/1993 Coll., of the Constitution of the Czech Republic, as amended by later constitutional acts.

Key parameters of the bill:

The bill introduces new auditing possibilities regarding self-governing units, public institutions and legal entities with ownership interests of the state or a self-governing unit. The current version of the constitutional bill enables the audit of the management of self-governing units in its full extent—as “compliance with law” includes statutory obligations to manage property of a self-governing unit in an economical and effective manner.

Bill history:

The bill is based on a previous bill of the Ministry of Justice from May 9, 2011. This bill was passed by the Chamber of Deputies, but not by the Senate. The current Document No. 43 is identical to the one previously passed by the Chamber of Deputies, with only one difference: it uses the term “public institution” instead of the term “public juridical person”.

The related amendment of the Supreme Audit Office Act, which was withdrawn for reworking (Document No. 44), differed from the version passed by the Chamber of Deputies in the following points:

- it does not contain exceptions for quoted joint-stock companies (ČEZ)
- it explicitly excludes the SAO from auditing whether the property of self-governing units is managed economically and effectively

The last point was added as a response to the requirements of some Senators who refused the possibility of auditing economical and effective management.

CONSTITUTIONAL AMENDMENT

The version passed by the previous Chamber of Deputies:

The wording of Article 97 of Constitutional Act No. 1/1993 Coll., of the Constitution of the Czech Republic, paragraph 1 is:

“(1) The Supreme Audit Office is an independent authority, which audits

- a) the management of state property and resources provided to the state from foreign countries,
- b) incomes and expenses of the state budget, the state final account, and the income and expenses of state funds,
- c) the management of property of territorial self-governing units and the income and expenses of their budgets in compliance with the law,
- d) the management of property of **public juridical persons**, as stipulated by law, and in a legally defined extent,
- e) the management of the property of legal entities, in which either the state or a territorial self-governing unit has an ownership interest, as stipulated by law.

CONSTITUTIONAL AMENDMENT

The current version of the bill:

The wording of Article 97 of Constitutional Act No. 1/1993 Coll., of the Constitution of the Czech Republic, paragraph 1 is:

“(1) The Supreme Audit Office is an independent authority, which audits

- a) the management of state property and resources provided to the state from foreign countries,
- b) incomes and expenses of the state budget, the state final account, and the income and expenses of state funds,
- c) the management of property of territorial self-governing units and the income and expenses of their budgets in compliance with the law,
- d) the management of property of **public institutions**, as stipulated by law, and in a legally defined extent,
- e) the management of the property of legal entities, in which either the state or a territorial self-governing unit has an ownership interest, as stipulated by law.

Proposed amendments



The comprehensive amendment to the Constitution will contain audits of public funds and juridical persons controlled by the state and municipalities. Reconstruction of the State considers this solution to be expertly most suitable and supports the effort to find political consensus for this ambitious bill.

The current bill constitutionally limits the possibilities of audits of local self-governing units to only legislative compliance. Currently, this does not expressly exclude carrying out economic and efficiency audits. For example, the Act on Municipalities stipulates an obligation to manage property economically and effectively. However, it is not a good solution in the long term as this and other relevant acts may later be amended. In practice, auditors may also be denied access, for example, to accounting documents (kept in accordance with subordinate legislation), which may result in legal proceedings and, more importantly, make the results of the audits practically meaningless. A more suitable solution would be a shorter form of the Constitutional amendment, based on the recommendation of the Lima Declaration:

The wording of Article 97 of Constitutional Act No. 1/1993 Coll., of the Constitution of the Czech Republic, paragraph 1 is:

“(1) The Supreme Audit Office is an independent authority, which undertakes management audits:

- a) of public funds and funds provided from public budgets, and
- b) of properties of legal entities in which the state or self-governing units have ownership interests.

Details are defined by law.

In terms of time, we recommend submitting the comprehensive amendment to the current bill. Ideally, the bill should be prepared by the government coalition and consulted with the opposition deputies as well as the SAO. It is absolutely vital to concurrently debate the bill with Senators and to receive assurance of sufficient support from the Senate. Otherwise we risk that the Senate will once again not pass the constitutional amendment.



Technical adjustments to the current bill – dealing with issues with the term “public institution” and overlapping definitions of audited entities. Should the comprehensive amendment not be agreed upon, we would recommend this version.

The current bill is based on the bill passed by the Chamber of Deputies so it has the same problem with overlapping definitions of audited entities, where letter c) accepts auditing property management of self-governing units, and letter d) auditing property management of “public juridical persons”. Thanks to the used term “public institution”, an overlapping of letters d) and e) also emerges, because public institutions are joint-stock companies controlled by the state or self-governing units. A simple solution would be the replacement of the term “public institution” with “juridical person governed by public law” as used in the new Civil Code. Similarly, the overlapping letters c) and d) can be resolved with the wording “other juridical persons governed by public law”. Letter d) of the amendment of the Constitution of the Czech Republic would then be as follows:

- d) the management of property of **other juridical persons governed by public law**, as stipulated by law, and in a legally defined extent,

We believe that the problem with subordinate legislation in this version could be solved with a related Supreme Audit Office Act explicitly defining the obligation to grant auditors access to all materials of an audited entity, whereas the audit would be limited to the statement of conformity/nonconformity with law.

Practice abroad

In Germany, Austria, Poland and Slovakia, it is explicitly stated that the audit of municipalities is related not only to the lawfulness, but also to the economy of managing public funds. In all these countries, the supreme audit institutions may audit businesses or companies in which the state or a municipality has at least a 50% share.



A

In Austria, the Court of Auditors may, in compliance with the Constitution, audit the management of the Federation, countries, municipality unions, municipalities and other legally specified entities. In accordance with the law, companies with an ownership interest in stock capital of at least 50% belonging to audited companies are also subject to economic audits. The audit is not only focused on compliance with legislation but also on the accuracy of numerical data, efficiency, economy and purposefulness.



D

The German Federal Court of Auditors may also audit municipalities managing federal subsidies or, for example, legal entities founded by the Federation. In accordance with the German Constitution, the Court of Auditors audits the correctness, economy, and proper budget of federal management, including special regime property and the management of federal companies. Joint-stock companies are federally audited if more than 50% is owned by the state. Companies owned by self-governing units are audited by the provincial courts of auditors.



PL

The Polish SAO (NIK) may audit, in accordance with the Constitution and the Supreme Audit Office Act, local self-governing units including organizational units and legal entities controlled by self-governing units. In compliance with the Supreme Audit Office Act, self-governing units are audited in regards to lawfulness as well as economy. Business companies may be audited by NIK even if a single share is owned by the state or self-governing unit.



SK

In Slovakia, the Constitution defines the scope of auditing authority of the SAO in a similar way as in the aforementioned countries, including municipalities and local authorities. The Slovakian SAO (NKÚ) carries out audits in regards to compliance with generally binding legislation, economy and efficiency. Business companies may be audited by NKÚ even if only 1% is owned by the state or self-governing unit.

Audits of companies traded on the stock market

With regard to the fear of arbitration, which was used as an argument to pass the exception of companies listed on the stock market (ČEZ) by the Chamber of Deputies, we offer a brief overview of foreign audits of supreme audit institutions in companies listed on the stock market. None of these cases had arbitration proceedings.

For example the Polish NIK audited the joint-stock company **PKN Orlen** which is a quoted business company with state ownership interest, or the company **KGHM Polska Miedz S.A.**, also a quoted joint-stock company with state ownership interest, and the company **PZU** (one of the oldest and largest commercial insurance companies in Poland), which is also listed on the stock market and the state owns only a minority share. Only KGHM Polska Miedz S.A. repeatedly refused the audits of NIK, the audits nevertheless took place (no international arbitrations began), and according to the opinions of Polish legal experts, NIK does have the authority to undertake the audits.

The Austrian Court of Auditors carried out an audit of **Österreichische Post AG** which is a quoted business company with a 51% state share, and focused on the uneconomical sale of real-estate, the property of the company.

The German Federal Court of Auditors audited **Deutsche Telekom** (listed on the stock market) in regards to a case of the incorrect appraisal of real estate in 2002. Telekom is a company listed on the stock exchange with state ownership interest.

Frequently asked questions

Do management audits of local self-governing units by the SAO represent a breach of rights of self-governed municipalities?

The process of auditing does not represent a limitation or intervention in self-governance because the SAO, which carries out the audit, only formulates audit results. The proposal and implementation of specific measures to remove ascertained issues is exclusively in the authority of the mayor and the local authority of a municipality or region. The SAO is an independent institution that stands beside executive or other powers. Should the SAO's audits in municipalities intervene in their right to self-governance, then, according to the same logic, the SAO's audits of the state budget would intervene in the Government's right to decide how to allocate funds, which is obviously nonsense.

Is an extension of the powers of the SAO pointless, because it would not be able to audit all the entities anyway?

The SAO does not replace blanket audits that should be carried out by other state authorities. It undertakes selective audits. The SAO creates an annual plan of audit activities based on suggestions from the Office President, Vice-president, and the members of the Office. These suggestions are based on the auditing activities of the Office, the Chamber of Deputies, the Senate, its bodies and the Government. The SAO's audit has a preventive purpose and is undertaken selectively and represents a supplementary function to other audits carried out by other bodies, whereas it is not intended to replace these audits.

If the SAO's audit powers are extended to joint-stock companies with state ownership interest and to other entities, would the Czech Republic be subject to international arbitration?

This argument is based on the theory that the SAO's audits of these companies discriminates against the foreign minority shareholders when compared with the majority shareholder, the state (or a local self-governing unit), who has access to more information. Even if we set aside the fact that this argument is not supported by any legal analysis, and that a number of other requirements must be met to even begin international arbitration, we may decisively refute this argument. The state, as a majority owner, would not obtain more information through the SAO's audit than a minority shareholder. The SAO is an independent auditing authority and nobody can assign tasks as to whether and when a certain person should be or should not be audited by the SAO, as is stipulated in Article 17 of the Supreme Audit Office Act, amending the plan of audit activities. Therefore, the state cannot use the SAO to search for information about a specific joint-stock company of which it is a majority shareholder.

All shareholders have the right to information in compliance with Article 180 of the Commercial Code. They may also request information by applying the Freedom of Information Act to those joint-stock companies that are in compliance with Article 366 of the Business Corporations Act and specified as public institutions (e.g. ČEZ). In addition, compliant to Article 181 of the Commercial Code, the minority shareholders have the right to request a joint-stock company to convene a general meeting and to discuss their suggested topics, including the right to request information about the results of the SAO's audit.