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EUROPEAN CENTRAL BANK

**OPINION OF THE EUROPEAN CENTRAL BANK**

**of 28 June 2006**

**at the request of the Cypriot Ministry of Finance on a draft provision amending the draft law amending the Central Bank of Cyprus Laws of 2002 and 2003**

**(CON/2006/33)**

## Introduction and legal basis

On 24 May 2005 the European Central Bank (ECB) received a request from the Cypriot Ministry of Finance for an opinion on a draft provision (hereinafter the 'draft provision') amending the draft law amending the Central Bank of Cyprus Laws of 2002 and 2003 (hereinafter the 'CBC Law') in respect of the appointment of independent external auditors for the Central Bank of Cyprus (CBC).

The ECB's competence to deliver an opinion is based on Article 105(4) of the Treaty establishing the European Community and the third indent of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions[1], as the draft law relates to a national central bank. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

## 1. Subject matter and background

1.1 The subject matter of this opinion is a draft provision, the purpose of which is to resolve the incompatibility between Section 60 of the CBC Law, which deals with the audit of the annual financial statements of the CBC, and Article 27.1 of the Statute of the European System of Central Banks and of the European Central Bank[2]. In an earlier opinion on a draft law amending the CBC Law[3], the ECB commented on a previous draft provision to amend Section 60 of the CBC Law, and emphasised the conditions for the correct application of Article 27.1 of the Statute.

1 OJ L 189, 3.7.1998, p. 42.

2 This inconsistency was identified on p. 222 of the 2004 ECB Convergence Report.

3 ECB Opinion CON/2006/4 of 27 January 2006 at the request of the Central Bank of Cyprus on a draft law amending the Central Bank of Cyprus Laws of 2002 and 2003.

1.2 In Opinion CON/2006/4, the ECB concluded that, notwithstanding the Auditor General's independence[4] as enshrined in the Cypriot Constitution[5], the Audit Office of which the Auditor General is the Head is not an external auditor within the meaning of Article 27.1 of the Statute and cannot, for that reason, be appointed as the CBC's independent external auditor[6].

1.3 Reaffirming its view on this matter[7], in Opinion CON/2006/4 the ECB also concluded that the appointment of an independent external auditor, in accordance with Article 27.1 of the Statute, to audit the CBC's annual financial statements once Cyprus has adopted the single currency, 'will not prevent the Audit Office from continuing to perform a control function, provided that its auditing activities: (i) do not interfere with the review of European System of Central Banks (ESCB) related tasks of the CBC to be undertaken by the CBC's independent external auditors to be approved by the Council of the European Union in accordance with Article 27 of the Statute; and (ii) do not jeopardise the CBC's independence'[8].

## 2. Assessment of the draft provision

2.1 In line with the previous draft law amending the CBC Law, subsection 1 of the draft provision provides that the financial statements of the CBC shall be audited in accordance with Article 27 of the Statute. The ECB welcomes this.

2.2 However, there are still some elements that would need to be brought into line with the Statute as recommended in the previous ECB opinion. While subsection 1 of the draft provision provides that the financial statements of the CBC shall be audited in accordance with Article 27.1 of the Statute, subsection 2 gives the Cypriot Auditor General the power to conduct a full audit of the operational efficiency of the CBC as well as of its financial statements, in parallel with the audit conducted by the independent external auditor appointed in accordance with Article 27.1 of the Statute and without providing for the necessary safeguards, referred to in the ECB's earlier opinion, against the Auditor General's interference in the activities of the CBC's independent external auditor. Similarly, subsection 3 of the draft provision fails to provide any limits to the Auditor General's access to the CBC's books and records. Finally, while subsection 4 of the draft provision provides that the Auditor General shall not question the merits of the policy objectives of the CBC, it

4 The personal independence of the Auditor General is guaranteed under Article 115.3 of the Cypriot Constitution, according to which he or she is not to retire or to be removed from office except on the same grounds and in the same manner as a judge of the Supreme Court.

5 Under Article 116(1) of the Cypriot Constitution, '[T]he Auditor General assisted by the Deputy Auditor-General shall, on behalf of the Republic, control all disbursements and receipts and audit and inspect all accounts of moneys and other assets administered, and of liabilities incurred, by or under the authority of the Republic and for this purpose he shall have the right of access to all books, records and returns relating to such accounts and to places where such assets are kept'.

6 Paragraphs 2.1. and 2.2 of Opinion CON/2006/4.

7 As expressed in paragraphs 5 to 7 of ECB Opinion CON/2002/22 of 2 September 2002 at the request of the Swedish Ministry of Finance on a draft legislative proposal establishing the National Audit, including proposed amendments to the Sveriges Riksbank Act (1988:1385).

8 Paragraph 2.3. of Opinion CON/2006/4.

provides no safeguards against interference by the Auditor General in the activities of the CBC's independent external auditor.

2.3 In order to bring the draft provision into line with the requirements of the Statute, as expressed in Opinion CON/2006/4, the scope of the control exercised by the Auditor General over the financial statements of the CBC should be clearly defined by the national legal framework and should be without prejudice to the activities of the CBC's independent external auditor as laid down in Article 27.1 of the Statute[9], and in line with the ECB's observations in paragraph 2.2. of this opinion. The ECB draws the consulting authority's attention to its May 2006 Convergence Report, where the ECB concluded that the powers of auditors, other than those appointed under Article 27.1 of the Statute, are compatible with central bank independence when the necessary safeguards are in place[10]. Since neither the draft provision nor Cypriot law[11] presently provide the requisite safeguards, the ECB notes that safeguards in line with the conclusions of its earlier opinion should be introduced. In particular, such safeguards should include guarantees that the Auditor General cannot interfere with the independent external auditor's control of the ESCB-related accounts of the CBC and that the Auditor General may not jeopardise the independence of the CBC.

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 28 June 2006.

[*signed*]

*The President of the ECB*

Jean-Claude TRICHET

9 See ECB Convergence Report, May 2006, page 66, available at http://www.ecb.int/pub/pdf/conrep/cr2006en.pdf.

10 Specific examples can be found at page 74 of the ECB Convergence Report of May 2006 (Appointment of Independent External Auditors),.*ibid.*

11 The reference is to Article 116 (1) of the Cypriot Constitution, see footnote 7.