EUROPEAN CENTRAL BANK

EUROSYSTEM

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OPINION OF THE EUROPEAN CENTRAL BANK

of 26 October 2018

on the legal framework of the State Audit Office

(CON/2018/45)

Introduction and legal basis

On 7 September 2018 the European Central Bank (ECB) received a request from the Ministry of Finance of the Republic of Croatia for an opinion on a draft Law on the State Audit Office (hereinafter the 'draft law').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union and the third indent of Article 2(1) of Council Decision 98/415/EC[1], as the draft law relates to *Hrvatska narodna banka* (HNB). 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. Purpose of the draft law

1.1 The draft law proposes to replace in its entirety the existing Law on the State Audit Office. The scope of the draft law addresses the establishment of *Državni ured za Reviziju* (the State Audit Office), its internal organisation, competences and management, procedures and reporting, the implementation of its orders and/or recommendations, the qualifications of state auditors, cooperation with other bodies and penal provisions. The draft law specifies that in case of discrepancies between its provisions and the provisions of other laws, the provisions of the draft law apply. For the purposes of the draft law, an audit is defined as including (i) an examination of the documents, papers, reports, internal control systems, accounting, financial and other procedures, as well as other records, in order to be able to state whether the annual financial statements are prepared in accordance with the relevant financial reporting and legal framework; (ii) a procedure for evaluating whether the activities, financial transactions and information in any important aspect are in line with the relevant laws arranging the business operations of the audited entity; and (iii) a procedure for evaluating whether the programmes, projects and activities of the audited entity are implemented efficiently, i.e. according to the principles of cost-effectiveness, efficiency and purposefulness, and whether they can be improved. The draft law further provides that the audited entity's revenues and expenditures, assets and liabilities, financial statements, financial transactions, programmes, projects and activities are also subject to the audit.

1 Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions (OJ L 189, 3.7.1998, p. 42).

1.2 In particular, the draft law introduces the state audit of HNB, in addition to the existing audit of the prepared financial statements and overall operations performed by independent external auditors, as required under the Law on *Hrvatska narodna banka* (hereinafter the 'Law on HNB')[2], and establishes the scope and rules for such audit. In this respect, the draft law provides that the State Audit Office is competent to verify and evaluate the use of funds by HNB through which the goals and tasks prescribed by the Law on HNB and other laws of the Republic of Croatia, as well as the tasks performed by HNB in compliance with the Treaty and the Statute of the European System of Central Banks and of the European Central Bank (hereinafter the 'Statute of the ESCB') are not directly accomplished or performed. The draft law sets out the scope of such audit, specifying that it includes (i) a procedure for evaluating whether the activities, financial transactions and information referring to the costs of operations in respect of administrative business operations, acquisition, management and disposal of real estate, movable property and equipment in any important aspect are in line with relevant laws according to which HNB operates, and (ii) a procedure for evaluating whether the programmes, projects and activities of HNB, in respect of administrative business, acquisition, management and disposal of real estate, movable property and equipment, are implemented efficiently, i.e. according to the principles of cost-effectiveness, efficiency and purposefulness, and whether they can be improved.

1.3 The draft law provides that in performing the audit of HNB, the State Audit Office (i) is obliged, according to Article 130 of the Treaty, Article 7 of the Statute of the ESCB and Article 71 of the Law on HNB, to fully respect the independence of HNB; and (ii) is not allowed to give direct or indirect instructions to HNB, its bodies or members of the bodies of HNB which would or could have an impact on their independence.

1.4 As regards confidentiality, the draft law provides that in performing the tasks within their competence under the draft law, the certified state auditors, the deputy auditor general, the auditor general and other civil servants employed in the State Audit Office, must adhere to the rules on confidentiality of information, data and documentation encompassed by Article 37 of the Statute of ESCB in the same way as if they were employees of HNB. This obligation continues to exist even after the termination of their employment in the State Audit Office. For the purpose of performing the audit, the certified state auditors, the deputy auditor general and the auditor general may request information, data and documents from HNB that are necessary for the performance of the tasks referred to in the draft law.

1.5 The draft law clarifies that (i) the powers of the State Audit Office under the draft law are without prejudice to the goals and duties of HNB under the Treaty, the Statute of the ESCB, the Law on HNB and other existing national law of relevance; (ii) activities that are subject to the audit of business operations of HNB by independent external auditors are not subject to the audit performed by the State Audit Office in accordance with the provisions of the draft law, and (iii) the State Audit Office is not authorised to verify or evaluate the achievement of the goals and the fulfilment of the duties of HNB prescribed by the Law on HNB as well as of the duties prescribed by

2 See Article 61 of Zakon o Hrvatskoj narodnoj banci (*Narodne novine* no 75/08 and 54/13).

other laws of the Republic of Croatia and the duties that HNB exercises in accordance with the Treaty and the Statute of the ESCB.

1.6 Regarding reporting, the draft law sets out a special procedure for HNB[3]. The draft law provides that after the audit has been performed, the State Audit Office delivers a draft audit report, which may contain the orders and/or recommendations of the State Audit Office to HNB for its opinion. The Governor of HNB has the right to give his opinion on the draft audit report within 15 days. After receiving the Governor's opinion, the State Audit Office prepares the audit report with this opinion included and returns it to the Governor. The Governor may lodge an objection to the audit report within 15 days from the date of its receipt and, thereafter, the auditor general must decide on the lodged objection within 30 days from the date of receipt. If the Governor does not accept the orders and/or recommendations contained in the audit report to which he lodged an objection, which the auditor general did not accept, he is obliged to inform the State Audit Office, without any delay, of such non-acceptance, and to state the reasons for non-acceptance. HNB is not obliged to deliver a plan for the implementation of the orders and/or recommendations to the State Audit Office. If HNB does not implement the orders and/or recommendations stated in the audit report to which no objection has been lodged, it is obliged to inform the State Audit Office thereof, without any delay, and to state the reasons for not implementing them. The explanatory memorandum accompanying the draft law notes that the State Audit Office opposes the proposed audit arrangements in respect of reporting and implementation of orders and/or recommendations, as this is not in line with the conduct of audits for other audited entities. The State Audit Office is of the opinion that the state audit of HNB should be conducted in line with the auditing standards of the International Organisation of Supreme Audit Institutions (INTOSAI) and with the Code of Professional Ethics of State Auditors, whereby it is prescribed that all state audits are conducted on a non-political, independent and purely professional basis. In that sense, it is the State Audit Office's opinion that these provisions should not be part of the draft law.

1.7 Further, the draft law provides that the certified state auditors, the deputy auditor general and the auditor general, in implementing the duties regarding the audit of HNB under the draft law, will act in accordance with the procedures laid down in the framework of the auditing standards of the International Organisation of Supreme Audit Institutions (INTOSAI) and the Code of Professional Ethics of State Auditors[4].

1.8 Finally, the draft law provides that it enters into force on the eighth day upon the day following its publication in the Official Gazette.

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3 See Article 13 of the draft law.

4 Kodeks profesionalne etike državnih revizora, Class: 003-05/16-02/2, File No: 613-01-01-16-1, available at www.revizija.hr.

2. General observation

The ECB notes that it has previously issued Opinions CON/2016/33, CON/2016/52 and CON/2018/17 in response to legislative consultations from the Croatian authorities on legislative initiatives concerning the State Audit Office's audit of HNB[5].

3. Specific observations

3.1 *State Audit Office's audit of HNB*

3.1.1 As previously noted by the ECB[6], the principle of institutional independence referred to in Article 130 of the Treaty and Article 7 of the Statute of the ESCB refers to the fact that the exercise of central bank powers and the performance of the tasks and duties conferred on central banks must not be subject to external instructions or government influence. In particular, where the operations of a national central bank (NCB) are subject to the control of a state audit office or similar body charged with controlling the use of public finances, the scope of the control (a) should be clearly defined by the legal framework; (b) should be without prejudice to the activities of the NCB's independent external auditors to examine all books and accounts of the NCB[7] and, further, in line with the principle of institutional independence; (c) should comply with the prohibition on giving instructions to an NCB and its decision-making bodies; and (d) should not interfere with the NCB's ESCB-related tasks[8]. The state audit should be conducted on a non-political, independent and purely professional basis[9].

3.1.2 In line with the abovementioned criteria (see paragraph 3.1.1), the ECB notes that the draft law is committed to fully respect the independence of HNB and, consequently, prohibits the State Audit Office from giving direct or indirect instructions to HNB which would or could have an impact on its independence[10]. Similarly, the orders and/or recommendations that the audit report may contain[11] must not have an impact on HNB's independence.

3.1.3 The ECB understands that the general provisions of the draft law, as set out in paragraph 1.1, are subject to the specific provisions of the draft law pertaining to the audit of HNB.

3.1.4 The ECB notes that the provisions of the draft law regarding the audit of HNB, in particular the procedure whereby the Governor may express his opinion on draft audit reports and lodge objections to, and not accept, audit reports as well as that HNB should not be obliged to deliver a plan for the implementation of orders/recommendations to the State Audit Office[12], are compatible with the principle of central bank, including institutional, independence.

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5 All ECB opinions are published on the ECB website at www.ecb.europa.eu.

6 See paragraph 2.1.1 of Opinion CON/2016/33, paragraph 3.1.1 of Opinion CON/2016/52 and paragraph 3.1.1 of Opinion CON/2018/17.

7 See Article 61 of the Law on HNB for the activities of the independent external auditors of HNB.

8 See paragraph 3.3 of Opinion CON/2011/9, paragraph 2.1 of Opinion CON/2011/53 and paragraph 4.2 of Opinion CON/2015/57.

9 See paragraph 4.4 of Opinion CON/2015/8, paragraph 4.2 of Opinion CON/2015/57, paragraph 2.1 of Opinion CON/2016/24 and paragraph 2.2 of Opinion CON/2016/59.

10 See Article 11(4) of the Law on HNB.

11 See Article 13 of the Law on HNB.

12 See Article 13 of the Law on HNB.

3.1.5 For practical reasons, the authorities may wish to consider the introduction of a transitional period for the implementation of the draft law. For example, it may make sense for the provisions relating to the newly introduced audit of HNB to be brought into operation within a specified period of months (e.g. three or six months) after the entry into force of the draft law, in order to enable HNB to make the necessary adaptations to discharge its new obligations under the draft law.

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

Done at Frankfurt am Main, 26 October 2018.

[signed]

The President of the ECB

Mario DRAGHI