

# Report about the results of the audit activities by the Supreme Audit Office of the Slovak republic in 2015

## Introduction

In May 2015, there was a change in the Office management. The National Council of the Slovak Republic elected **Karol Mitrik as SAO SR President for a seven-year term**. The new management gradually implemented several measures to streamline the strategy and organisation of audit activities and the implementation of its results, as well as adjusting the communication strategy in order to improve and actively present the Office activities. In addition, a Legislative Council was established. It is responsible for the legislative agenda in relation to the external environment within the interdepartmental commenting procedure and publishes in monthly intervals in electronic form professional information for auditors, focusing mainly on supporting their professional readiness in connection with changes in legislation concerning the Office.

## 1 Audit activity plan

The audit activities plan for 2015 was harmonised with the budget of the SAO SR according to the Act on the State Budget for 2015 in connection with the 06S Program "Independent Audit Activities". According to cited law, the programme is intended to facilitate better management of public property, and the selected goal of the program is to perform independent audit activities in accordance with the approved audit plan following the internationally recognised audit standards.

Following the cited intention, goal and determined budget of expenditures, the SAO SR approved a strategic plan of audit activities for 2015-2017 in December 2014. It was based on its own audit findings and the results of risk analysis in budget management and other public administration entities with special regard to entities in the field of territorial self-government. It placed great emphasis on the selection of audit activities in EU funds, especially in terms of possible support for the activities of stakeholders in solving persistent problems. External evaluators were also invited for the risk assessment in these areas. The suggestions by citizens, institutions, deputies of the National Council of the Slovak Republic and municipal councils were an important source of information. The SAO SR obligation arising from the SAO SR Act to prepare a Statement about State Budget draft and Statement about the State Final Account draft was duly taken into account. In some potential audit areas, the possibilities of the SAO SR involvement in international cooperation were also assessed.

The basic role of the strategic plan of audit activities by the SAO SR for the period 2015 - 2017 were *good management of public funds and an increase in the quality of life*.

The annual plan of audit activities by the SAO SR in 2015 was thematically based on strategic plan for 2015-2017 and focused on important social issues. It contained 41 audits. During 2015, this planned number was increased by one extraordinary audit.

## 2 Audit activities results

In accordance with the updated plan of audit activities in 2015, the SAO SR performed 42 audits in 549 audited entities, of which in the area of territorial self-government it performed 15 audits in 306 audited entities.

During the performed audits, it audited the management of public funds in the total amount of EUR 11 117 794 111.00. Violation of financial discipline was found in the total amount of EUR 12 659 664.00. Of these, as part of the audits performed in territorial self-government, funds in the amount EUR 344 180 807.00 were audited and a breach of financial discipline was found in total for EUR 9 214 267.00.

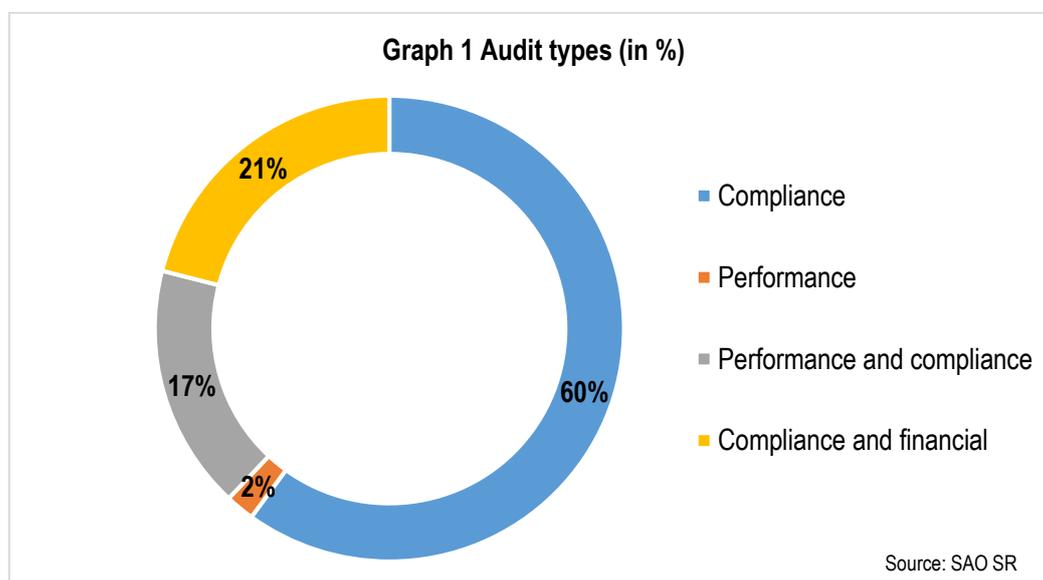
In 2015, the **continuation of the audit of financial management in the project of completion of Units 3 and 4 of the Mochovce Nuclear Power Plant / EMO 34 / in the company Slovenské elektrárne, a. s.,** was and extraordinary audit. It was requested of the National Council of the Slovak Republic according to its resolution 1354 from 24.09.2014. The audit focused primarily on verifying the fulfillment of conditions arising from contracts for the provision of funds and the fulfillment of conditions agreed in contracts concluded with suppliers of design, engineering and construction work, in the project of completion of Units 3 and 4 in the Mochovce Nuclear Power Plant. In addition to the SAO SR auditors, the persons involved were the representatives from the Ministry of Finance SR, Financial Directorate, PPO and the Nuclear Regulatory Authority of the Slovak Republic. At the same

time, the members of the control group were also experts from the Institute of Forensic Engineering from the University of Žilina, who prepared an expert opinion. The audit report was processed in the "Reserved" confidentiality mode. On 11 August 2015, the report was discussed at the SAO SR premises by drawing up minutes with the statutory representatives of Slovenské elektrárne, a.s., thus terminating the audit. The audited entity took appropriate measures to eliminate the identified deficiencies. The President of the Slovak Republic, the Chairman of the National Council of the Slovak Republic, the Prosecutor General of the Slovak Republic, the Minister of Economy of the Slovak Republic, the Financial Directorate of the Slovak Republic and the National Criminal Agency were informed about the conclusions and findings from the audit.

Based on mediated information and received suggestions, in November 2015 the SAO SR plan of audit activities included, as an extraordinary audit, and **audit of the conclusion of contractual relations and reimbursements for the provision of health care** at the General Health Insurance Company. The audit started in November 2015 and continued in 2016.

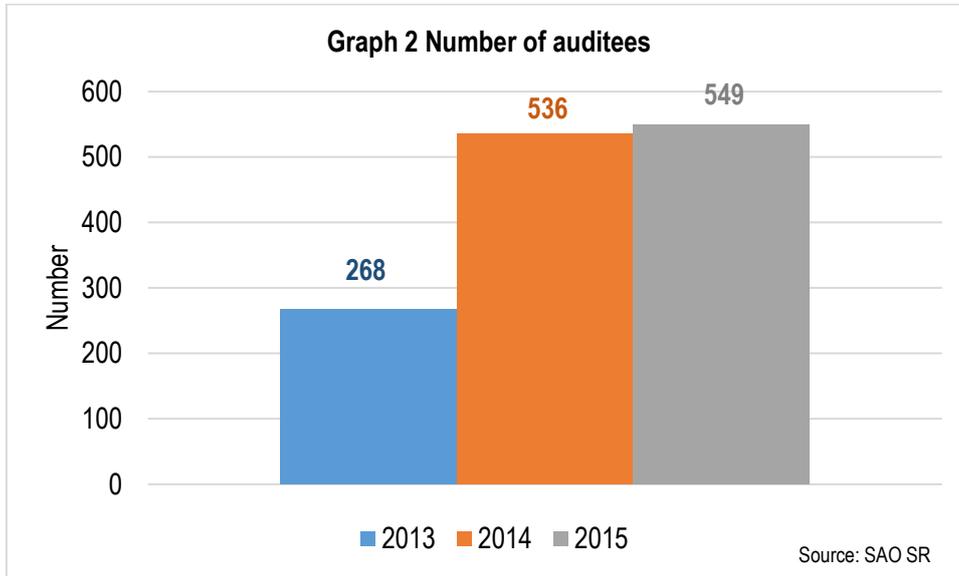
An overview of SAO SR audits in 2015 is in the **annex** to this report.

In its audit activities, the SAO SR applied, in accordance with the ISSAIs, procedures according to the methodology of the three basic types of audits (compliance, performance and financial) or combinations thereof. The share of individual types of audits in the total number of performed audits in 2015 is in the graph below:

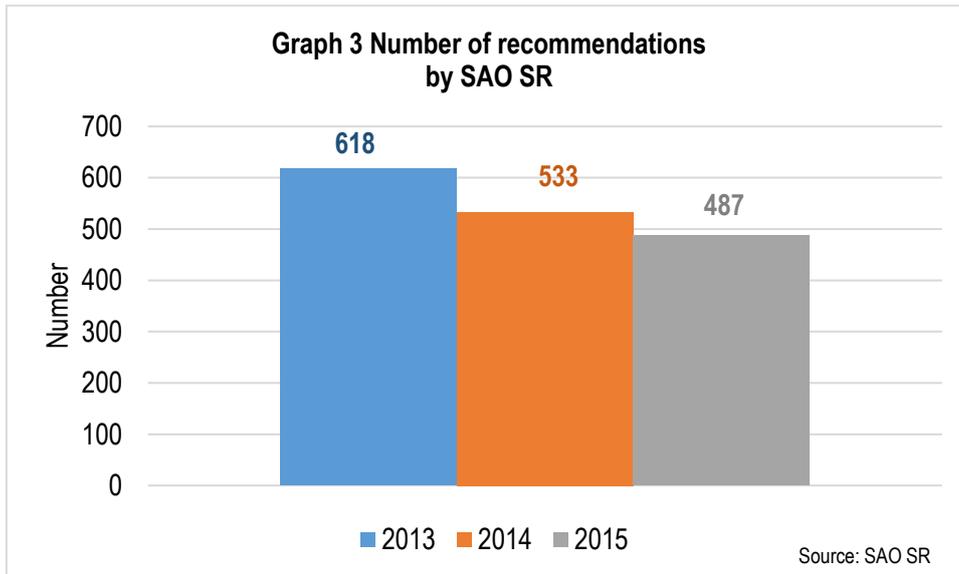


In 2015, the largest share of the total number of audits was accounted for compliance. This type, as in 2014, represented 60% of the total number of audits. This was also the case for the share of performance audits, which in both 2014 and 2015 represented 2% of the total number of audits. The share of combined performance control and compliance decreased from 22% in 2014 to 17% in 2015. In 2015, on the other hand, the share of combined compliance and financial audit increased from 17% in 2014 to 21% in 2015. The strategic intention of the SAO SR is to increase gradually the share of performance audits and its combined type in order to better assess public State policies and increasing the added value of the Office's audit activities.

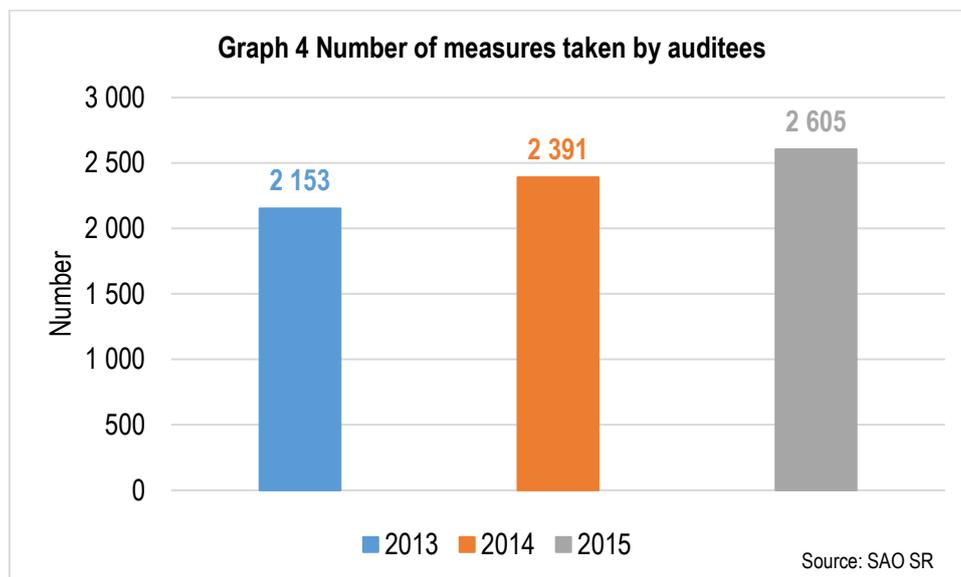
As part of the audits performed by the SAO SR, it audited 549 entities, of which 306 were entities in the area of territorial self-government. The comparison of the number of audited entities in 2013 to 2015 is in the graph below:



In 2015, the SAO SR submitted 487 recommendations to audited entities and interested parties in order to eliminate the identified shortcomings and improve the situation in the audited area. The year-to-year comparison of the number of recommendations by the SAO SR in 2013 to 2015 is in the graph below:



The decrease in the number of recommendations related to their factual focus. The recommendations were gradually and increasingly profiled as measures of a systemic nature, thus reducing their total number. The auditees accepted the shortcomings identified by the audits in total of 2 605 measures, which was 214 measures more than in 2014. The SAO SR continuously monitors the implementation of the adopted measures and assesses them on the spot in a reasonable time interval. The year-to-year comparison of measures taken by the audited entities to eliminate the identified shortcomings in 2013 to 2015 is the graph below:



The increased number of measures taken by audited entities to the audit results by SAO SR resulted mainly from the expansion of mutual communication between the Office and the audited entity and from the Office increased demands on the quality and scope of measures taken to eliminate identified shortcomings.

## 2.2 Implementation of audit activities results

The SAO SR paid planned systemic attention to ensuring the quality of audit activities at a level corresponding to the relevant international control standards. In the stage of implementation of the audit results, when proceeding with the discussion of the resulting audit materials and notification of audit findings, it proceeded in accordance with the SAO SR Act. It discussed the resulting audit materials with the statutory representatives of the auditees. SAO SR also reported the deficiencies to the relevant bodies. It made recommendations to eliminate the identified shortcomings. At the same time, SAO SR ensured the adoption of measures by the auditee to eliminate the identified shortcomings and to improve the situation in the audited area. SAO SR informed the relevant public authorities of particularly important findings with recommendations for further action, including a proposal for legislative changes.

In the current case, SAO SR also informed the relevant committees of the National Council of the Slovak Republic about the audit results. In this context, it sent:

- fifteen notifications to the Committee for Finance and Budget of the National Council,
- five notifications to the Committee for Public Administration and Regional Development,
- four notifications to the Committee for European Affairs,
- three notifications to the Committee for Economic Affairs,
- one each to the Committee for Agriculture and Environment, the Committee for Defense and Security, the Committee for Education, Science, Youth and Sport and the Committee for Culture and Media.

In five cases, the SAO SR reported the audit results to the Prime Minister who also informed the relevant ministers about the results.

The SAO SR informed the relevant representative bodies about the audit results in territorial self-government. In two cases, the SAO SR also sent information about the audit results to the ZMOS (Association of Towns and Municipalities of Slovak Republic) bodies.

The SAO SR has no sanctioning powers. For this reason, SAO SR reported the established cases of breach of financial discipline, suspicion of criminal activity and other serious deficiencies to the competent authorities for further action.

Violation of financial discipline under the Act on Budgetary Rules in Public Administration in 16 cases in amount of EUR 244 138.87 were reported to the relevant financial control administration.

Seven cases were reported to law enforcement authorities, of which five cases went to prosecutors and provided co-operation to the Police Force in two cases.

Violation of the Public Procurement Act was reported to the Public Procurement Office in seven cases. The Office also records another 16 cases of findings passed to other materially competent public administration bodies.

The implementation procedures of the SAO SR were appreciated by several representatives of interested parties. For example, the Minister of Labour, Social Affairs and Family, Ján Richter, thanked the SAO SR President Karol Mitrik, in a letter dated 30 September 2015 for the systematic efforts by the SAO SR in social services facilities in SAO SR audit activities. He appreciated that the resulting audit materials, in addition to audit findings, also contain recommendations, conclusions and systemic measures, which are a valuable source of information for the Ministry in the preparation of proposals for legislative changes. The SAO SR approach to the audit and the method of implementation of its results were also appreciated by several representatives from audited entities and other stakeholders in territorial self-government (e. g. ZMOS, Union of Slovak Cities), who consider the SAO SR audit conclusions valuable contribution for municipalities modernisation and management.

In order to deepen the awareness of constitutional officials about the results from audit activities and intentions about the further direction of the Office, the SAO SR President Karol Mitrik met Andrej Kiska, the country President on 29 September 2015 in a working meeting. K. Mitrik informed A. Kiska about the audits planned in 2016, as well as how to fulfill the Office efforts to strengthen the societal seriousness of the Supreme Independent Audit Institution and streamline work with audit findings.

In exercising its competence in audit activities, the SAO SR pays special attention to eliminate shortcomings and improving the level of management of public funds and management of public property in territorial self-government. In particular, with the aim of preventive action in relation to stakeholders, it continuously develops forms of examples of good and bad practice presentation. In addition to publishing the resulting audit materials and professional publications, SAO SR organised professional seminars for interested parties about audits of identified shortcomings, their causes, as well as the possibilities and ways to eliminate them. The SAO SR actively presented its support for the improvement of the control system in territorial self-government to the bodies of ZMOS and the Union of Slovak Cities. Current problems in the control system in territorial self-government, possibilities of their solution, as well as mutual cooperation were the subject of regular working meetings between the SAO SR and the Association of Chief Comptrollers representatives at regional level.

The findings of the audit activities were also implemented by the SAO SR in contacts with educational institutions and students. In addition to the lecturing activities, the employees of the SAO SR provided consulting activities to university students during the elaboration of the final study theses. In order to increase the level of mutual relations in professional cooperation in the audit activities by the Office and the school educational process, the SAO SR and the Faculty of Health and Social Work from the Trnava University in Trnava concluded a cooperation agreement in 2015 aimed at providing professional advice and consultations in methodological and empirical activities in health care and social work and the participation of SAO SR employees in educational activities and solving scientific research projects.

The openness of the SAO SR is directly proportional to the number of registered complaints and submissions from the public demanding the audit activity by the Office. In 2015, the SAO SR processed 461 submissions, a year-to-year increase of 10%. Almost a quarter of submissions were lodged anonymously and 318 fell within the Office scope. Most (134) submissions touched the financial management, for possible errors at the public procurement pointed 38 submissions. Up to 211 submissions were related to the activities of local self-government, the functioning of municipalities and cities. Most submissions were from the Prešov Region - 42; at least from the Bratislava region - 18. Three concerned the competence of self-governing regions, these were pointing to problems in the social field.

The the SAO SR expert units evaluated the risk degree of each received submission and 28 cases were recommended to the Office sections and branches to perform an audit directly at the auditee. Submissions that do not fall within the Office competence included, for example, consumer complaints, dissatisfaction with the decision of a court, an administrative body, or with the activity of bodies active in criminal proceedings. In 2015, the SAO SR acceded a memorandum on cooperation with the Prosecutor General SR and Ministry of the Interior SR; Based on a new form of cooperation, the Office made available audit findings, audit reports in 15 cases. It is a form of

systemic cooperation between the SAO SR and bodies active in criminal proceedings, and also an important tool in the prevention in the fight against corruption and fraud.

## 1.2.2 Fiscal consolidation

In 2014, the **SAO SR** performed **4 audits in this area** focusing on the administration of selected excise taxes and effectiveness of their collection by the Financial Administration SR and the tax administrator's procedure for registering a tax subject for value added tax and the effectiveness of the tax security process on value added tax.

These audits followed five audits from previous years 2012 and 2013, which focused on the procedure of the tax administrator in the administration and performance of the tax audit in excessive deductions for value added tax; fulfillment of tax revenues and the procedure by the Financial Administration SR in tax administration; ensuring the efficiency and effectiveness of implementation of the unification of the taxes collection, duties and insurance contributions through the UNITAS program as at 31 December 2012; the effectiveness of the system for combating tax evasion and fraud. The audit results in administration of selected excise duties in 2014 showed the high collection efficiency. On the other hand, the other **audits showed several shortcomings in the activities by most of the auditees**. To eliminate them and improve the situation in the audited area, **the SAO SR submitted the following recommendations to the audited entities:**

- **in excise duties area**
  - modify the SysNed application software module so that goods with insufficient tax security cannot be sent;
  - introduce a uniform system of measurable performance criteria in excise administration;
  - review the internal control system, focusing on the number of controls performed in excise administration.
  
- **in procedure by the tax administrator when registering a tax subject for VAT**
  - introduce systemic monitoring of the taxpayer in the first year after registration and take effective measures in case the risk attribute is recorded;
  - review the procedures in the internal control system to verify compliance with the legal procedures by the tax administrator in the VAT registration process in accordance with the relevant provisions in the VAT Act and the Tax Code, especially in compliance with deadlines, correct assessment of real reasons for VAT registration, areas of compliance with the implementation of the guarantees to pay the outstanding tax liability;
  - re-evaluate, resp. to extend the current monitoring of the indicators measuring the obligation to provide a financial security for a more objective evaluation of the Anti-Fraud Action Plan fulfilment;
  - reiterate the call for the introduction of a unique identifier for an objective assessment of the taxpayer' appetite for risk.

Following **the recommendations by the SAO SR**, the audited entities took their **own measures**. The individual audits in the mentioned strategic area revealed:

***The audit of selected excise taxes administration and efficiency of their collection by the Financial Administration of the Slovak Republic*** was performed for the period 2010-2013 in the entities - Financial Directorate of the Slovak Republic in Banská Bystrica, Customs Office Bratislava and Customs Office Nitra.

**The SAO SR found** in Customs Office Bratislava that it registered a total of 44 tax subjects in the audited period, of which were 24 eligible recipients and one operator of a tax warehouse for alcohol / alcoholic beverages, 16 eligible recipients for mineral oil, one operator of a tax warehouse, which was a mineral oil producer and two operators of a tax warehouse for mineral oil. By examining the procedure by the Bratislava Customs Office for the registration of 44 tax entities, **the SAO SR found** the following shortcomings:

- in four cases, the Bratislava Customs Office, when issuing the certificate of registration for excise duty on alcoholic beverages, which is alcohol, did not comply with the provisions of the Tax Administration Act, when it did not make an official record of the issuance of the certificate in question,;

- in one case, the tax subject did not submit an application on a proper format determined by the Ministry of Finance SR pursuant to the Tax Administration Act. The Bratislava Customs Office did not call on the applicant to eliminate this deficiency and on 20 February 2014 it issued permits for the operation of a tax warehouse for foreign representatives.

**The SAO SR found** that the collection of excise duties took place without major fluctuations even with a declining number of employees. The costs of administering excise duties were affected by organizational changes in 2011 and 2012, when the first phase of the UNITAS programme was implemented and subsequently suspended due to the tax system failure.

The collection of excise duties has been highly successful. This finding is also confirmed by the fact that up to 99.06% of the tax declared in the audited period was paid on time. The total amount of unpaid duly declared tax was 0.01%.

Wage costs decreased despite the increase in the average wage, as the Financial Administration performed tasks in the area of excise duties with a lower number of employees. Overall, it can be stated that the percentage of administrative costs for the administration of excise duties reached a minimum level in relation to the total collection of excise duties in the Slovak Republic. From this point of view, the collection of excise duties could be assessed as effective.

**The SAO SR** stated that in some customs offices no internal inspections focused on excise duties were performed in 2010 - 2013 and therefore considers that in the next period it will be necessary to direct the audits to this area as well. In contrast, the system of tax audits carried out on taxable persons was quite extensive, with a total of 20,580 tax audits carried out in the audited period. The highest number of audits was performed on excise duty on mineral oil, alcoholic beverages and alcohol. The number of tax audits was differentiated according to individual types of tax, which resulted from the volume of collection of these taxes, as well as the risk of possible tax evasion.

***The audit of the procedure by the tax administrator in registering a tax subject for value added tax and the audit of the efficiency of depositing a tax security in the registration of a tax subject for value added tax*** was performed at the Financial Directorate. Within the Financial Directorate of the Slovak Republic, the inspection was performed in the Tax Office Bratislava and in the Tax Office Banská Bystrica for the period of 2012 and 2013.

The audit of the procedure by tax administrator in registering a tax subject for VAT revealed the following violations of generally binding legal regulations and tax administrator did not act in accordance with:

- the Act on VAT, when not registering the subject within 60 days from the date of delivery of the application for tax registration;
- the Act on VAT, when not returning the security to the taxpayer immediately;
- the Act on VAT, when not using the security to cover the tax arrears which arose after the taxable person was registered as a taxable person;
- the Act on VAT, when it repeatedly violated the 30-day period for the return of the security or part thereof from the date when 12 months have elapsed from the date of the tax security deposit, i. e. returned the security before the expiry of 12 months or 30 days after the expiry of the 12-month period;
- the Tax Code, for not verifying the facts stated in the application for registration under the Act on VAT;
- the Act on VAT and in accordance with the Tax Code, by requiring the taxable person to lodge a security on the grounds that the VAT registrant did not supply goods and services at the time of the VAT application and only performs preparatory work for business, despite the fact that the result of the local survey showed that the company is already performing economic activity and the manager submitted supplier and customer invoices.

Furthermore, the audit found that:

- IS RDS does not draw the attention of the tax administrator to the fact that the tax subject did not deposit the security imposed by the decision (when registering under the law with the obligation to lodge a security) when recalculating the excess VAT deduction. **According to the SAO SR, there is a risk of the tax code violation;**

- IS RDS does not draw the attention of the tax administrator to the fact that the tax subject has a security deposit in the event of a tax arrears on VAT. The tax administrator must visually verify this fact and assess it according to the status of arrears / overpayments. **According to the SAO SR, there is a risk** of violation of the Act on VAT, when the deposited security will not be used to pay the tax arrears, which arose after the registration of the taxable person as a payer;
- the tax administrator has weak systemic support for the lodged security return, i. e. in IS RDS, a browser is available via the collateral management report - an overview - which contains a list of entities to which the collateral needs to be returned. This browser is considered by the employees of the tax administrator only as a basis for better orientation in which taxpayer has lodged the security and which is expected to return the security. The tax administrator must also keep his own manual records, which is not a guarantee of meeting the legal condition of timely return of the security. **According to the SAO SR, there is a risk** of violation of the Act on VAT, when the deposited security is not returned to the taxpayer within the specified period;
- **the identified risk of correctness of determining the reasons for granting the security** is the missing unique identifier (e.g. birth number, or ID number) especially for partners of legal entities, which is caused by their absence in published data from the Commercial Register of the Slovak Republic, from which IS RDS and subsequently module DM41 uses the necessary data;
- the audited entity in the evaluated period did not have a set system for measuring the effectiveness of the adopted measure, which is the obligation to provide a financial security for the tax.

The data analyses for the audited sample determined that:

- in the case of compulsory VAT registration (according to the Act on VAT), the efficiency of the collection of the tax security achieved was **assessed by the SAO SR as very low**, when the collection of the prescribed tax security was on 0.84% level. At the same time, the audit found that the degree of efficiency of the process of recovery of the unpaid security for the taxpayer's property tax at compulsory registration was zero (0%);
- from the point of view of securing the tax liability granted not paid by the taxpayers, the efficiency has been shown to be at a very low level, only 0.03% of the total volume of the tax security deposited was used for the tax arrears that arose after the taxable person was registered as a VAT payer;
- in view of the effectiveness of the measure adopted „Introduction of the obligation to provide a tax security for taxable persons at risk in VAT registration“under Phase 1 of the Action Plan to Combat Tax Fraud for 2012-2016, effectiveness has been demonstrated (under the Act on VAT) for which the tax security is considered to be an essential element. Failure to pay in full and within the time limit set by the tax administrator will result in the rejection of the application for registration. It can be stated that the institute of tax security has a positive effect on the elimination of possible risky taxpayers in the VAT system.