

# Municipal Corporations and Supreme Audit Institutions: Practices in the World and Turkey

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## 1. The Situation Of Municipal Corporations In The World

The European Charter of Local Self-Government, which was adopted by the European Union and took effect in 1998, aims at providing the local governments with stronger and more democratic structures. Envisaging the reinforcement of local government as a requirement of identifying the demands of the people electing the local government more closely, the European Charter of Local Self-Government was adopted by Turkey, as well, and put into effect on 01.04.1993. In this document, Local Self-Governments are defined as governments granted the right and authority to arrange and manage a significant portion of public works under their responsibilities and in line with the interests of the local population within the limits determined by laws.

European Union (EU) took further measures to ensure the implementation of the principle of decentralisation. The implementation of this principle required strengthening municipal corporations along with municipalities. This is because of the fact that the hierarchical effect of the central government on the municipalities is higher than its effect on the municipal corporations.

In general, in Turkey, what determines the line between the Turkish Court of Accounts (TCA) and the public entities is the concept of expediency. While the TCA audits whether the public entities in Turkey deliver their services in accordance with laws, it cannot assess whether these services are necessary or not. In this respect, the EU acts in parallel to the practice in Turkey and has refrained from determining general principles and rules in terms of the municipal corporations that the

Member States use in the delivery of local services. In this case, each EU Member State adopted different practices in terms of their attitudes to the municipal corporations within the framework of their financial structures, experience and views. While some Member States (like the Netherlands, Hungary) behaved timid for the establishment of municipal corporations, a large number of municipal corporations have been established in countries like Germany and France.

The number of municipal corporations was highly limited in Turkey in the past, but every municipality (including district municipalities) established a company as per the Decree Law no. 696 (publicly known as the subcontractor law) and now countless municipal corporations operate in the commercial arena. These different practices have impact on the audit of municipal corporations, as well.

In some Member States, municipal corporations are audited by the commissions/committees established by the municipalities to which the corporations are affiliated while local audit committees audit the municipal corporations in some countries. Apart from this, in some other countries like Germany, municipal corporations are audited by the SAI just like in Turkey. Finally, in some countries, local audit offices are established, and municipal corporations are audited by these offices.

The following table shows the audit procedures applied to the municipal corporations in some EU Member States (Hasan ÖZÇELİK; Doctoral Dissertation: Municipal Corporations in the European Union and Turkey: A Study on the Municipal Corporations of İstanbul Metropolitan Municipality).

Countries	Type of Audit on Municipal Corporations
Austria	Management control by the local government and the charter of the Union may permit the right to veto or approve for local government ( personnel management)
Belgium	Post-action control of the local government (budget, decision making) Audit control at federal levels
Czechia	State control for some public services
Denmark	Control by the local government Legal control of the Ministry of Industry for the companies within the scope of the Law no. 384  Legal control of the Ministry of Interior for the companies within the scope of the non-written local government laws or the Law no.383.
Estonia	Supervisory committee consisting of the municipality councillor State Audit Office (financial control over property and aids) The approval of the municipal council is needed for important decisions.
Finland	Special power to regulate for some activities; for energy, state control in the electricity market
France	Control by the local government Post-execution control by the state representative (SAI)
Germany	Control by the local government and upon request, control by the local audit authority (local government control with respect to the efficiency of the representatives in the corporations), (SAI).
Greece	Local government budget audit State legal control (Ministry of Trade)
Hungary	Municipality control committee consisting of the municipal councillors Municipality finance committee and other possible special committees based on the decision of the municipal council
Ireland	Ministry of Environment Local government General Auditor Monitoring committees within the framework of the National Development Plan authority with respect to the national and local public services

<b>Italy</b>	<b>Control over the activities of the corporations by a special regulatory In recent years, regulatory authorities for the gas and electricity sectors (the same for the two sectors)</b>
<b>Latvia</b>	<b>Annual reports approved by the local government audit committee (not mandatory) Control of the state audit office</b>
<b>Lithuania</b>	<b>Municipality control authority for a company the total capital of which is owned by the municipality (100%) State control authority for municipal corporations and mixed capital companies</b>
<b>The Netherlands</b>	<b>Control by the National Audit Commission for companies owned by the local governments and the State Auditors one third of whom are appointed by the local government</b>
<b>Poland</b>	<b>National control office</b>
<b>Portugal</b>	<b>Approval of the local government is required for all main decisions of the corporations (budgets, management report, loans etc.)</b>
<b>Slovakia</b>	<b>Prior approval of the municipal council is required for all important decisions</b>
<b>Slovenia</b>	<b>Local control committee appointed by the municipal council Court of Auditors</b>
<b>Spain</b>	<b>Approval of the local government is required for the estimated budgets and budget expenditures Control over the accounts of the corporations by the National Audit Commission</b>
<b>Sweden</b>	<b>Control by the local government Control by the citizens The principle of free access to the administrative documents of corporations (Law no. 1980 on Official Secret), Ombudsman</b>
<b>United Kingdom</b>	<b>Control over the loans of the corporations under state control by the State Control by the local government auditors</b>

On the other hand, there is no uniformity among the EU Member States in terms of the legal status of municipal corporations. Municipal corporations carry out their activities as legal entities operating in accordance with the provisions of the commercial code fully independent from the municipalities in some countries as in the case of Turkey while they operate as a subsidiary/affiliate like an organ of the administration in some countries.

## 1. Status of Municipal Corporations In Turkey

### 2.1. The Need to Establish Municipal Corporations

As entities using public resources, the municipalities have to operate under the rules of law that are stricter than the rules that bind the private law legal entities. For example, while a company can act quite freely in recruiting personnel, the municipalities are obliged to comply with the Civil Servant Law no.657 and other personnel legislation in recruiting personnel. Of course, this obligation requires more procedures (written exam, oral exam etc.) and, while people discuss whether it has faults or not, these procedures cause public entities to spend more time and effort while implementing their activities. Due to many such reasons, municipalities that use public resources become inclined to establish corporations. We can list those reasons as follows:

- To be able to move more freely in resource utilization.
- To be able to move more freely in employment policy.
- To ensure that public resources are used more effectively and efficiently by ensuring flexibility and rapidity in activities.
- To avoid the TCA audits etc., which are considered a control power on decentralization.
- To benefit from the experiences of workers that gained important experiences in the private sector.
- To be able to act more quickly in the procurement of goods, services and construction works.
- To avoid the strict attitude of the personnel laws in terminating personnel.

- To decrease the cost of produced goods and services to gain competitive power in the free market.
- Corporations can make a profit and transfer it to the municipalities.
- To create synergy with the people residing within municipal borders by bringing other local resources and municipal resources together,
- To ensure that the products produced intensively by the private sector and needed by the whole public (milk, bread etc.) are delivered to the public more economically.

### 2.2. Establishing Municipal Corporations

In Turkey, the legislation that allows for the establishment of municipal corporations consists of the Municipal Law no.5393 covering the duties, authorities and responsibilities of municipalities and the Metropolitan Municipality Law no.5216. Both laws state that municipalities can establish corporations in their own duty and service areas according to the procedures specified in the relevant legislation.

Here, the most significant issue is that the municipalities are allowed to establish corporations that operate in "their own duty areas". The duty areas of municipalities are defined clearly in their relevant laws, and the basic characteristic of these duties is that they aim to meet the common local needs. TCA audits regarding the municipal corporations found that one municipal corporation made expenditure to carry out helicopter taxi activity. While one might think that the Commercial Law does not prevent municipal corporations, which operate as private law legal entities, from carrying out air transportation in addition to bus, tramway and metro as means of passenger transportation, it is clear that passenger transportation with a high-cost means of

transportation such as helicopters does not meet a common need. Consequently, the main purpose of the corporations established by municipalities should be to meet the common local needs within municipal borders.

Turkey has a very interesting practice regarding the ownership of corporations by municipalities. The main law on the establishment of municipal corporations is Article 26 of Law no.4046 on Privatization Practices. According to this law, establishment of corporations by municipalities or their contributions to the capital of corporations that exist or will be established is subject to the permission of the President of Republic. That means if a municipality wants to establish a corporation or become partners with one by contributing to the capital; it has to get a permission from the President of Republic.

Not let us talk about the interesting practice mentioned in the above paragraph: In one of its decisions, the Council of State decided that when a company was donated to the municipality and thus, the municipality operated under Turkish Commercial Law as the owner of the relevant corporation, this was not illegal. That means, if a person establishes a corporation and then grants it to a municipality, the municipality will be the owner of this corporation and can operate in the commercial area. While the relevant decision of the Council of State broke the system stipulated by Law no.4046 and created a loophole, it was born in the legal realm and has been practiced since the date of this decision. In this scope, either the condition of getting a permission from the President of Republic in Law no.4046 should be revoked or a new law should forbid municipalities from acquiring corporations through grants.

## 2. TCA AUDIT OF MUNICIPAL CORPORATIONS IN TURKEY

The purpose of Law no.5018 on Public Financial Management and Control, which entered into force in 2003 is to regulate structure and functioning of the public financial management, preparation and implementation of the public budgets, accounting and reporting of all financial transactions, and financial control in line with the policies and objectives covered in the development plans and programs, in order to ensure accountability, transparency and the effective, economic and efficient collection and utilization of public resources.

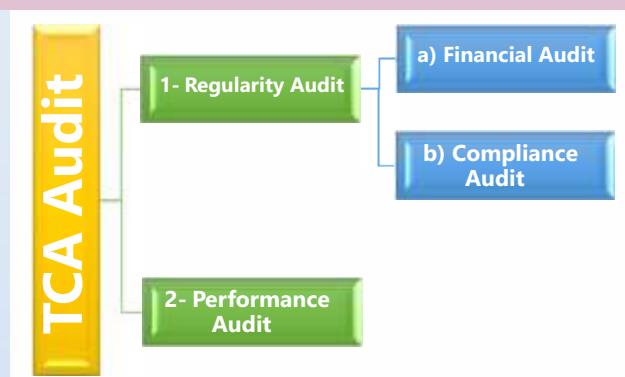
The most important tool used by this Law no.5018 to achieve this purpose is "external audit", which is

expressed in Article 68 of this law. According to this, the purpose of the ex-post external audit to be performed by the TCA is to audit the financial activities, decisions and transactions of management in terms of their compliance with the laws, institutional goals, objectives and plans, and to report their results to the Parliament within the framework of the accountability of public administrations within the scope of general government.

Here, it is first necessary to specify the public administrations within the scope of general government. Such public administrations were specified in paragraph (a) of Article 3 of Law no.5018, and local administrations were included in the scope of general government. In this framework, it is clear that the external audit of the local administrations shall be performed by the TCA. However, how about the municipal corporations? Will the external audit of those corporations be performed? If so, how will the methodology be?

### According to Law no.5018, external audit is performed by:

- a) Performing financial audit on the reliability and accuracy of financial statements, and determining whether the financial transactions related to revenues, expenditures and assets of public administrations comply with the laws and other legal arrangements, on the basis of public administrations' accounts and relevant documents,
  - b) Determining whether the public resources are used in an effective, economic and efficient way measuring the activity results and evaluating them as to their performance.
- The following table indicates the schema of external audits.



As the above table indicates, if an administration is subject to TCA audit, it goes through the following

audits, bar the exceptions, and the audits will result in the preparation of reports stipulated by the TCA Law no. 6085. However, there will be exceptions as indicated.

In the light of this perspective, for the audit of municipal corporations, first, we need to consider whether they fall under the scope of the TCA audit.

According to the general perspective of INTOSAI Auditing Standards, the SAIs have the legal infrastructure to audit all public funds.

Based on this framework, it is necessary to evaluate the limits of the audit area of the TCA. Article 4 of TCA Law no.6085 specifies the audit areas of the TCA very extensively. According to this, the TCA has the authority to audit the local administrations including municipalities and all types of administrations, organizations, institutions, associations, enterprises and companies affiliated to or founded or partnered

by these administrations directly or indirectly.

With the enforcement of TCA Law no.6085, municipal corporations became subject to the TCA audit, and they were audit in 2014 for the first time. In this framework, the TCA performed financial audits of 59 municipal corporations from 2014 to 2017. Before Law no.6085, municipal corporations were not audited by the TCA. These corporations were audited by the private sector just like other companies and by those companies in the framework of the authority of the Ministry of Customs and Commerce to audit other companies.

We screened the findings included in the financial audit reports written by the TCA after the financial audit of municipal corporations. The following table lists some of the finding titles.:

Making retrospective journal entries
Differences between 2014 Closing Records and 2015 Opening Records
Bouncing checks
No provision was made for the amounts recorded in the account of 128 Doubtful Receivables
Receivables, which were finalized by court decisions, were not recorded as collections
The stocks were not included in the financial statements with their real values because stock recording system was not in order
The account of 193 Pre-paid Taxes and Reserves had remaining receivables
The amounts, which were given as business advances, did not have provisions
The corporation paid %18 VAT instead of 1% for the helicopter rented for the helicopter taxi activity
There were amounts, which were not recorded in 245 Affiliated Partnership
Values belonging to 288 Fixtures were not included in the financial statements
The rented immovable properties were followed in the account of 252 Buildings just like the owned tangible assets
No amortization was reserved although the corporation procured fixtures
There were incomplete records in the account of 252 Buildings
Current Activity Expenses were recognized in the account of 280 Expenses for Following Years
Social security premiums, which were not paid yet, were monitored in the account of 280 Expenses For Following Years

Using bank credits without receiving the decision of the Municipal Council
Since the legal obligations of the corporations, such as taxes, duties and charges were not paid on time, there was an unnecessary increase in general management expenses
Not using the accounts of 372 Provisions For Employee Termination Benefits and 472 Provisions For Employee Termination Benefits
The need to increase the equity capital of the corporation
The expense record was not made for the rent that the entity should pay for the carpark building
The relatives of the personnel benefited free-of-charge from the in-city transportation services
Borrowing contrary to the Municipal Law no.5393
Not declaring bankruptcy although the corporation was heavily in debt
Not taking the necessary legal precautions although two third of corporation capital was lost due to losses
The contracts regarding the renting of places that belonged to public hospitals included clauses that were contrary to legislation
The corporation procured various assets without bidding although they were not included in the exceptions in paragraph (g) of Article 3 of Public Procurement Law no.4734
Immovable properties were rented without bidding
Electronic fee collection system of the corporation had internal control weaknesses
Cash and in kind donations were made to the associations
Propellers and engines of the newly-procured air vehicles were changed shortly after starting to use them
Attendance fee was paid to the corporation's board members contrary to the decision of the general council
More than one social houses were sold to the same person

As the above table indicates, the financial audit findings detected and reported by the TCA after auditing the municipal corporations were wide ranging and not limited to accounting errors. While assessing whether the financial statements of municipal corporations give a true and fair view, the

auditors evaluated the personnel legislation, procurement legislation and other legislative provisions. I.e. while drawing the framework of the financial audit of municipal corporations, the audit of financial statements was interpreted and implemented broadly.