Audit conclusion from audit No.

11/11

Financial resources provided to the Czech Export Bank from the state budget and this company's management of state-guaranteed finances; exercise of the state's shareholder rights in the Czech Export Bank

The audit was included in the audit plan of the Supreme Audit Office ('SAO') for 2011 under number 11/11. The audit was managed by and the audit conclusion drawn up by Ing. Daniel Reisiegel, MPA.

The purpose of the audit was to scrutinise the procedures followed by the Czech Export Bank (Česká exportní banka, a.s.) when claiming and using finances provided from the state budget for the operation of supported export financing and when managing finances obtained on financial markets. It also sought to scrutinise the work of the Ministry of Finance when providing appropriations towards the operation of supported export financing and when exercising the state's shareholder rights in the Czech Export Bank.

The audited period was the years 2009 to 2011. Where relevant, the preceding and following periods were also subject to scrutiny.

The audit took place from May 2011 to March 2012 (in the case of the Ministry of Finance up to December 2011).

Auditees:
Ministry of Finance;
Czech Export Bank.

The objections against the audit protocols lodged by the Ministry of Finance and the Czech Export Bank were dealt with by decisions on objections issued by the heads of the audit teams. The Czech Export Bank's appeal against the decision on objections was dealt with by a resolution of the SAO Board.

At its 13th session held on 25 June 2012 the ***SAO Board***
issued resolution No. 4/XIII/2012 ***approving***
the following audit conclusion.

I. Introduction

Section 4 of Act No. 2/1969[1] provides that the Ministry of Finance ('MoF') is the central body of state administration responsible for, among other things, the state budget, the state closing account, the financial market, the protection of foreign investments, financial management and management of state property. As well as being the administrator of budget heading 312 – *Ministry of Finance*, the MoF is also the administrator of headings 398 – *Universal Treasury Administration* ('UTA'), 396 – *Operations of State Financial Assets*, and 396 – *State Debt*.

The MoF performs the following activities in relation to the Czech Export Bank ('CEB'):

- providing appropriations from the state budget to cover CEB's losses stemming from the operation of supported financing;
- exercising shareholder rights in the CEB;
- granting the CEB consent to the acquisition of financial resources on capital markets.

The CEB was established in 1994 by a deed of association and was incorporated on 1 March 1995 upon being entered in the commercial register. Its supreme organ is the general meeting; its control organ is the supervisory board. The bank's activity is managed by a board of directors which elects a chief executive officer from its members in accordance with the statutes.

The following table provides the basic information about the CEB.

Table 1 – Selected indicators of the CEB **(CZK millions)**

	2009	2010	2011
Financial results			
Net revenue from interest	−158	132	577
Net revenue from fees and commissions	25	38	29
Net operating revenues, including state appropriations	783	558	582
Reduction in the value of assets	−176	−170	−527
Total operating costs	−306	−341	−327
Income tax	−74	−146	−173
Net profit	94	71	161
Balance sheet			
Balance	49,733	64,795	78,063
Receivables from clients	37,529	55,647	65,454
Receivables from banks	5,538	4,139	4,298
Clients' deposits	4,360	5,663	6,860
Banks' deposits	7,056	6,049	5,400
Issues of bonds	33,361	46,852	58,569
Total equity	2,953	3,919	3,945
Miscellaneous			
Guarantees provided	1,834	3,299	3,153
Loans pledged	14,650	13,594	17,212

NB: Costs are shown in the table by a minus sign.
Source: CEB annual reports for 2010 and 2011.

[1] Act No. 2/1969, on the establishment of ministries and other central organs of the state administration of the Czech Republic.

The CEB is a bank within the meaning of Act No. 21/1992[2]; it is an issuer within the meaning of Act No. 256/2004[3]; and it is an entrepreneur within the meaning of Act No. 513/1991[4].

With effect from 24 April 1995 it was entrusted by Act No. 58/1995[5] with the operation of discounted financing; it was entrusted with supported export financing with effect from 28 June 2002. Act No. 58/1995 lays down conditions that the CEB must fulfil in order to be able to operate supported export financing and the conditions on which it may operate it. The CEB is supposed to acquire finances for supported financing primarily on the financial markets. In line with Act No. 58/1995 Coll., it receives appropriations from the state budget to cover its losses stemming from the operation of supported financing. The state guarantees the repayment of the financial resources and liabilities from other CEB operations on the financial markets.

For book-keeping and compiling financial statements the CEB is obliged, in accordance with Section 19a of Act No. 563/1991[6], to use international accounting standards governed by European Union law (‘international accounting standards’).

Its accounts are divided into two sections (section 01 – section for operational transactions, which are undertaken under market conditions, and section 02 – section for financing with an entitlement to state budget appropriations).

In the case of the CEB only finances provided from the state budget and its management of resources guaranteed by the state were audited, in accordance with Act No. 166/1993[7].

NB: The legal regulations referred to in this audit conclusion are applied in the wording effective for the audited period. The figures given are rounded in accordance with the rounding rules. The Czech National Bank exchange rate applicable as of 31 December 2011 was used to convert the credit framework and the released drawdown of loans.

II. Facts ascertained by the audit

1. Ministry of Finance

1.1 Budgeting of appropriations to cover losses

In the UTA budget heading for the years 2009, 2010 and 2011 **the MoF budgeted for** an expenditure item *Appropriations for Export Support – Czech Export Bank* **on the basis of incomplete applications from the CEB**. The MoF also **accepted the delivery of an application**, in which the CEB proposed earmarking a sum of CZK 998 million in the state budget for 2011 to cover losses from the operation of supported export financing, **more than 3 months later** than is stipulated in Section 2 (4) of Decree No. 165/2008[8].

2 Act No. 21/1992, on banks.
3 Act No. 256/2004, on undertakings on the capital market.
4 Act No. 513/1991, Commercial Code.
5 Act No. 58/1995, on insurance and the financing of exports with state support and amending Act No. 166/1993, on the Supreme Audit Office.
6 Act No. 563/1991, on accounting.
7 Act No. 166/1993, on the Supreme Audit Office.
8 Decree No. 165/2008, specifying the scope and structure of data for drawing up the draft act on the state budget and the deadlines for their submission.

Table 2 – Sums budgeted for the CEB in the UTA budget heading and drawdown thereof (CZK thousands)

Year	Budget	Appropriation provided
2009	470,940	470,785
2010	919,000	741,704
2011	998,000	350,436

Source: budgets of heading UTA; decision on the provision of a non-investment appropriation from the state budget of the Czech Republic.

NB: The *'Appropriation provided'* figure for 2011 does not include the last quarterly appropriation provided in 2011.

1.2 Provision of appropriations to cover losses

The MoF provided appropriations to cover losses from the operation of supported financing on the basis of applications in which the CEB gave data from its accounts as of the end of the quarter to document the calculation of the required appropriation amount. The MoF always paid appropriations out of the current-year budget for the 4th quarter of the preceding year and for the first three quarters of the current year.

During the audited period the MoF did not proceed in accordance with Section 7 (2) of Decree No. 278/1998[9] in two cases, where it did not provide the CEB with an appropriation on the basis of facts reported in the CEB's accounts.

In contravention of the provision referred to above **the MoF made an agreement with the CEB to shift the coverage of part of the loss for the 3rd quarter of 2009 amounting to CZK 134,848,447.19 to the following year, i.e. an agreement that this sum would be drawn from the UTA budget heading for 2010; its justification for this was that the sum budgeted for 2009 was insufficient even at the time of the compilation of the budget for 2009**. The MoF then covered the part of the 4th quarter 2009 loss amounting to CZK 70,166,888.05 at the same time as the loss from the operation of supported financing for the 3rd quarter of 2010, i.e. out of the UTA budget heading for 2010.

In all its decisions issued on the provision of a non-investment appropriation from the state budget of the Czech Republic the MoF awarded the appropriation amount requested by the CEB. The conditions governing the use of the appropriation set out in these decisions were ambiguous and incomprehensible, however. In the audited period the MoF did not check whether the conditions of *'using the state budget appropriation economically and efficiently'* and *'undertaking proper and separate monitoring of received and used appropriations in its accounts'* were met and so failed to make sure that the state budget finances were not being used wrongfully.

During the audited period the MoF provided the CEB with six instalments on an appropriation within an interval of from two to 13 days after the period specified by Decree No. 278/1998 and thus failed to comply with Section 7 (2) of this Decree.

1.3 Financial settlement with the state budget

The MoF did not draw the CEB's attention to the shortcomings in the documentation for financial settlement with the state budget for 2009 and for 2010 and did not demand that it make corrections, thus contravening Section 20 (1) of Decree No. 52/2008[10].

[9] Decree No. 278/1998, implementing Act No. 58/1995, on insurance and the financing of exports with state support and amending Act No. 166/1993, on the Supreme Audit Office, as amended by Act No. 60/1998.

[10] Decree No. 52/2008, laying down the principles and deadlines of the financial settlement of relations with the state budget, state financial assets or the National Fund.

In addition, for 2009 and 2010 the MoF incorrectly filled in the form given in Annex 6 to Decree No. 52/2008 for the UTA budget heading. Specifically, in the part concerning appropriations provided to the CEB it did not state the values of finances actually used from the appropriation as of 31 December; instead it reported for 2009 an amount corresponding to the CEB loss as of 31 December 2009 and for 2010 an amount equalling the sum total of appropriations provided for the 1^{st} to the 4^{th} quarters of 2010.

1.4 Exercise of shareholder rights

Act No. 58/1995 provides that at least two thirds of CEB shares are to be owned by the state and one third by the Export Guarantee and Insurance Company (Exportní garanční a pojišťovací společnosti, a. s., or 'EGAP'). In accordance with Section 6 (1) of Act No. 58/1995 the state exercises its shareholder rights through four ministries, with the CEB statutes prescribing that for the state's voting as a shareholder and the distribution of votes among the relevant ministries 52 out of the 100 votes fall to the MoF. The MoF is thus the shareholder with controlling influence, as it controls both voting on the state's behalf and voting on behalf of all the CEB's shareholders. According to the number of allocated votes, the individual ministries also have a share in the state's total number of shares, i.e. in the CEB's registered capital– see Table 3.

Table 3 – Shares of the state and EGAP expressed in absolute (CZK millions) and percentage terms

	State as of 31.12.2008		**State as of 31.12.2009**		**State as of 31.12.2010**	
	Value	Share of reg. capital (%)	Value	Share of reg. capital (%)	Value	Share of reg. capital (%)
MoF	780	39.00	1,118	37.90	2,168	54.20
MoIT	450	22.50	645	21.86	645	16.13
MoFA	180	9.00	258	8.75	258	6.44
MoA	90	4.50	129	4.37	129	3.23
State total	**1,500**	**75.00**	**2,150**	**72.88**	**3,200**	**80.00**
EGAP	500	25.00	800	27.12	800	20.00
Reg. capital total	2,000	100.00	2,950	100.00	4,000	100.00

Source: Ministry of Finance.
NB: MoIT – Ministry of Industry and Trade; MoFA – Ministry of Foreign Affairs; MoA – Ministry of Agriculture; reg. capital – registered capital.

At the CEB general meetings held in 2009 and 2010 MoF employees exercised shareholder rights on behalf of the MoF on the basis of written powers of attorney granted by the finance minister. With one exception, no written instructions were issued for these powers of attorney. The minister was informed about the course of the general meetings by the minutes taken at these general meetings.

1.5 Increase of the state's ownership interest in the CEB (increase of registered capital)

The CEB's registered capital was increased in 2009 by a total of CZK 950 million by the subscription of 950 new core shares with a nominal value of CZK 1 million. 650 of these shares went to the state, with 338 of these going to the MoF and 312 to the remaining ministries through which the state exercises its shareholder rights in the CEB. In August 2009 the MoF paid the CEB CZK 650 million out of the UTA budget heading and posted the subscription of the shares in the same value to the costs account. It then entered 338 shares with a total value of CZK 338 million in its assets.

The CEB's registered capital was then increased further in 2010 by CZK 1,050 million by the subscription of 1,050 new core shares with a nominal value of CZK 1 million. 546 shares went to the MoF and 504 to the remaining ministries. In July 2010 the MoF paid the CEB CZK 1,050 million out of the UTA budget heading and posted the same amount to its assets account. The transfer of shares to the other ministries exercising the state's shareholder rights in the CEB did not take place, however, as these ministries were still opening accounts with the Central Securities Depository, which replaced the dissolved Securities Centre. At the time of the audit the instruction to transfer the shares to these ministries had not been issued. In this way **the MoF registered among its assets shares it was not competent to manage.**

1.6 State guarantee of the CEB's liabilities

Section 8 of Act No. 58/1995 provides that the state guarantees the CEB's liabilities in connection with the repayment of acquired finances and for liabilities arising from its other operations on the financial markets. The MoF sets a limit on guarantees for the CEB every year; this limit represents the maximum level of debt the CEB may incur. The limit was part of the approved state budgets and was also referred in the report on the state budget. The limit for 2009 was defined in the state budget as CZK 61 billion; for 2010 CZK 70 billion (increased during the year to CZK 80 billion); and for 2011 CZK 90 billion.

The MoF was informed by the CEB about the state of the liabilities guaranteed by the state as of the end of every quarter. The state of state guarantees as of 31 December 2009 and 2010 is shown in the following table.

Table 4 – State of state guarantees for CEB liabilities **(CZK thousands)**

Year	2009	2010
State as of 31.12.	49,679,169	64,038,256

Source: Ministry of Finance.
NB: The state as of 31 December 2011 is not given as the audit of the MoF ended before the end of 2011.

In 2009 and 2010 the MoF did not keep records of guarantees for CEB liabilities on off-balance sheet accounts. As of 31 December 2009 the MoF thus undervalued the balance of the off-balance sheet account in question by CZK 49,679,169,000 and as of 31 December 2010 by CZK 64,038,256,000. In so doing the MoF failed to keep accurate accounts in 2009 and 2010 in contravention of Section 8 (1) of Act No. 563/1991.

In the notes to the financial statements as of 31 December 2009 and 31 December 2010 the MoF did not mention these guarantees, thus contravening Section 24 (4) of Decree No. 505/2002[11] and Section 54 (j) of Decree No. 410/2009[12].

In addition, the MoF failed to give specific figures for state guarantees for CEB liabilities in the 'overviews of the state and development of state guarantees' for 2009 and 2010, which form an annex to the state closing account according to Section 29 (3) of Act No. 218/2000[13].

[11] Decree No. 505/2002, implementing certain provisions of Act No. 563/1991, on accounting, as amended, for accounting units which are territorial self-governing units, budget-funded organisations, state funds and organisational components of the state.
[12] Decree No. 410/2009, implementing certain provisions of Act No. 563/1991, on accounting, as amended, for certain selected accounting units.
[13] Act No. 218/2000, on the budgetary rules and amending certain related acts (the budgetary rules).

1.7 MoF consents granted to the CEB's acquisition of financial resources on capital markets

In the audited period, the MoF, in accordance with Section 8 (4) of Act No. 58/1995, granted consents to the CEB's obtaining of financial resources on the capital markets, documenting consents for loans from banks operating in the Czech Republic with a total value of EUR 140 million, for increasing the *Euro Medium Term Note Programme* ('EMTN programme') to CZK 2 billion in 2009 and CZK 3 billion in 2010, for the issuance of short-term debt instruments in the total maximum volume of issued and unrepaid debt instruments to a value of EUR 400 million and for all loans which the MoF will provide to the CEB on the basis of a contract from the year 2010.

Neither the particulars of the CEB's requests for the MoF's consent to the acquisition of resources on financial markets nor the particulars of the MoF's consent to the acquisition of these resources are regulated either by Act No. 58/1995 or by any other act. The MoF's consents to loans thus merely contained basic information (the name of the CEB's creditor and the amount of the liability); the same was the case for consents for the EMTN programme (maximum nominal price of all issued bonds under this programme).

1.8 MoF loans provided to the CEB

In February 2010 the MoF entered into a contract with the CEB on the rules and conditions for the provision of loans. The contract was concluded for an indefinite period; it prescribes neither an annual nor any other limit for the amount of the possible loans. Within the meaning of Section 8 (4) of Act No. 58/1995 the contract contains the MoF's consent to all loans that will be provided on the basis of the contract.

Authorised persons are empowered to exercise rights and obligations in connection with the negotiation of the terms of individual loans and to conclude the relevant loan confirmations. On behalf of the MoF these persons are employees in the post of division director and lower. The MoF did not update a list of these employees because it does not envisage any further use of the contract. This means that persons who are currently not employed with the MoF, or hold a different work post, are among the authorised persons.

The contract was used in February and March 2010, when two loan confirmations were signed and a total of CZK 1,748,608,000 was subsequently transferred to the CEB. **The MoF provided these loans out of funds earmarked to cover the state budget deficit of the Czech Republic for 2009.** As a result, it violated Section 1 (1) of Act No. 214/2009[14], which states: *'The purpose of the state bond programme is to cover part of the budget deficit of the state deficit of the Czech Republic for 2009.'*

The provision of loans for the CEB was mentioned in Act No. 487/2009, on the state budget of the Czech Republic for 2010. The MoF did not budget for it in the expenditure side of the budget headings it is the administrator of. The MoF reported the provision of loans in the *State Debt* budget heading, in a budgetary composition item which is not intended for this type of operation. The MoF neither explained nor documented any connection between the provision of loans and the management of the state budget.

[14] Act No. 214/2009, on the state bond programme to cover part of the budget deficit of the state budget of the Czech Republic for 2009 and amending Act No. 218/2000, on the budgetary rules and amending certain related acts (the budgetary rules).

In the context of both loans provided to the CEB the MoF also failed to comply with Section 30 of Act No. 563/1991, as the inventory list of assets reported in the relevant account did not contain facts enabling a categorical determination of the ascertained assets.

1.9 Implementation of measures to eliminate the shortcomings found at the MoF by SAO audit No. 01/34[15] in relation to the CEB

In the years 2007 to 2010 the MoF stopped implementing one of the two measures it adopted in response to SAO audit no. 01/34, whereby it did not give specific data in the state closing accounts of the Czech Republic for these years about the size of state guarantees for liabilities arising from the repayment of finances acquired by the CEB and for liabilities from the CEB's other operations on the financial markets.

2. Czech Export Bank

2.1 Fulfilment of the conditions laid down by an act or other regulation for the operation of supported export financing

In the audited period the state always owned more than two thirds of the CEB's shares, which are registered and in book-entry form. The CEB statutes contain the particulars referred to in Section 6 (1) of Act No. 58/1995. In line with Section 6 (14) and (6) (since 4 September 2009) of Act No. 58/1995 the CEB issued general terms and conditions for the provision of supported financing.

2.2 Funding for supported export financing

The CEB primarily funds its commercial activities from external resources in the form of liabilities to financial institutions and non-bank entities. The basic source of funding is issues of medium-term and long-term bonds. As of the end of 2011 their compounded value[16] had reached CZK 57,484 million (CZK 46,852 million as of the end of 2010; CZK 33,361 million as of the end of 2009). The CEB supplements this source of funding with loans in the form of passive deposit transactions, short-term loans on the interbank market and long-term loans from credit institutions. As of the end of 2011 the compounded value of these was CZK 5,400 million (CZK 6,049 million as of the end of 2010; CZK 7,056 million as of the end of 2009). In 2010 the CEB also began to make use of loans from the MoF (the compounded value as of the end of 2010 was CZK 1,830 million).

In the audited period the CEB, in accordance with Section 8 (4) of Act No. 58/1995, requested the MoF's consent to the acquisition of the relevant finances on the capital markets and the MoF always granted this consent. The CEB also received a one-off consent to all loans which it will obtain from the MoF on the basis of the contract on the loan provision rules and conditions that was concluded for an indefinite period and provides that the conditions for the provision and drawdown of individual loans are to be specified in the confirmation of the particular loan.

In 2009 and 2010 the payment of the due interest and principals of bonds issued by the CEB under the EMTN programme took place properly and in good time as of the dates defined in the issue terms.

[15] The audit conclusion was published in volume 2/2002 of the *SAO Bulletin*.

[16] The compounded value is the value including compound interest, agio or discount, calculated by the 'effective interest rate' method.

Costs relating to both issues of bonds under the EMTN programme and credit and loans on the interbank market were included in the calculation of losses from the operation of supported export financing in accordance with Act No. 58/1995.

2.3 State guarantees for CEB liabilities

The CEB informed the MoF of the state of its state-guaranteed liabilities in accordance with Section 8 (1) (b) of Act No. 58/1995 as of the end of every quarter in an annex to applications for the subsidising of losses from the operation of supported financing. The states of these liabilities at the end of 2009, 2010 and 2011 are shown in Table 5.

Table 5 – State-guaranteed CEB liabilities **(CZK thousands)**

State guarantees	**31. 12. 2009**	**31. 12. 2010**	**31. 12. 2011**
Liabilities to financial institutions	7,056,085	6,049,417	5,400,027
Client accounts	4,335,098	3,819,007	4,985,172
Bonds issued	33,361,075	46,852,093	58,568,936
Miscellaneous financial liabilities	1,578,826	2,070,270	3,120,570
Pledges to accept credit	3,348,084	5,247,469	3,870,000
Total state guarantees	**49,679,169**	**64,038,256**	**75,944,705**

Source: CEB – annexes to quarterly requests for the subsidising of losses from the operation of supported financing; CEB extended general ledger.

Between 2009 and 2011 the state of state guarantees for CEB liabilities increased by 53%, which is related to the development of its commercial activity and above all the growth in the volume of the provided credit, as revealed *inter alia* by the published annual reports.

2.4 Correctness of procedure when operating supported export financing

The correctness of the CEB's procedure when operating supported export financing was scrutinised in nine business cases with a credit framework of CZK 13,152,393,000, which took place from 2005 to 2011 and have not yet been completed (the final repayment date of the credit provided in these business cases has not been reached yet). The audit revealed that **the applicant for supported financing was one and the same exporter in five of these business cases and another single exporter in three cases**.

Besides compliance with Act No. 58/1995 and the particulars of the applications for supported financing, compliance with the statutes and internal regulations related to the operation of supported export financing and the influence on compliance with the prudential rules were scrutinised (the binding nature of internal regulations is laid down by Act No. 21/1992 and Decree No. 123/2007[17]). The statutes are a fundamental document of the CEB as a joint stock company and a bank. They must contain at least the particulars required by Section 173 of Act No. 513/1991 and other fundamental obligations with particular regard to the board of directors and supervisory board of the CEB as laid down *inter alia* in Sections 8 and 9 of Act No. 21/1992. They must also set out how the management and control system is organised and arranged.

The audit detected the following shortcomings:

– In three cases **the CEB concluded credit contracts which did not mention all the deferral conditions approved by board of directors and supervisory board** before the first drawdown of the credit.

[17] Decree No. 123/2007, on the prudential rules for banks, savings banks and credit cooperatives and securities traders.

– In two cases **the board of directors changed, without authorisation, the conditions for concluding credit contracts that had already been approved by the supervisory board.**
– In four cases **the CEB made it possible to draw credit even though the deferral conditions before the first drawdown of the credit were not satisfied**, or made it possible to draw the credit on the basis of waivers, but it failed to demonstrate that these waivers had been approved by the board of directors and supervisory board. **In these cases the CEB had not arranged security effectively, so the drawdown of the credit should not have been enabled.**
– In two cases **the CEB did not ensure that the conditions negotiated in credit and insurance conditions were coordinated.**
– In one case **the CEB provided credit intended for the purchase of an almost 100% share in two foreign companies from the debtor's own parent company, even though this credit was not consistent with either the definition or the basic parameters of permitted CEB products and the CEB did not submit this case to the supervisory board for approval, even though the credit beneficiary was a member of an economically connected group and the provision of supported export financing in the case in question was subject to the supervisory board's assent.**
– In one case **the CEB made it possible to draw credit on the basis of a drawdown request in which the exporter's provision of actual performance to the debtor was not documented.**
– In one case **the CEB did not arrange for the performance of controls during the project in the scope and frequency approved by the board of directors, or supervisory board.**

In the nine audited business cases the CEB therefore should not have enabled the drawing of credit with a total value of CZK 8.2 billion out of a credit framework of CZK 13.2 billion. **In six of the cases it did not proceed prudentially**, thus violating Section 12 (1) of Act No. 21/1992 and the CEB statutes, as it released the credit to debtors when it should not have. The total amount of funds released in this way was CZK 4.2 billion. In two cases it contravened its statutes by releasing credit worth CZK 3.8 billion; and in one case when it should not have provided the credit because it was not a permitted product of the CEB: in this case it released credit worth CZK 239 million.

Other shortcomings were revealed by the audit reports of external companies with which the CEB concluded a contract in several of the audited cases, for example:
– the exporter returned an advance payment from the loan to the debtor, although the debtor was meant to pay it out of its own funds;
– the debtor performed building work without a building permit;
– part of the finances from the credit was used in contravention of the approved purpose, or it was not possible to discover what it was used for.

It was also stated in the audit reports that in the course of one business case the share of a subcontractor based in a 'tax haven' was increased to more than 40% of the value of the entire export contract. Such an event gives rise to doubt whether the system's functioning, whereby such significant amounts of provided funds are collected by a company from a tax haven, is consistent with the purpose of Act No. 58/1995, i.e. supporting exports by Czech companies.

The proportion of the total credit framework provided by the CEB in the years 2005 to 2011 (CZK 143 billion) accounted for by the business cases in which the applicants for supported financing were two exporters (out of more than one hundred) who applied for supported financing in eight of the audited business cases as well **was 13.63% in total (i.e. 19.5 billion)**; one exporter accounted for 8.17% (i.e. CZK 11.7 billion); the other 5.46%

(i.e. CZK 7.8 billion). **Fundamental and repeated irregularities were committed by the CEB in the scrutinised credit process involving these eight business cases.** In addition, it is not clear in these cases whether the provision of such significant financing to a limited number of applicants (exporters) constitutes support for Czech companies' exports.

The CEB's approach to the audited business cases is testimony to a lack of rigour in compliance with the internal regulations and the control procedures laid down in them and is testimony to an inappropriately devised system for managing the business cases. The findings also raise doubts whether, at the time when the business cases were being decided on, or possibly in the following period, the members of the board of directors of the CEB exercised their powers with due professional care, as they are required to by Section 194 (5) of Act No. 513/1991.

The course of the audited business cases shows that materials concerning some of them were not submitted to the supervisory board for approval; in exceptional cases the materials were not even submitted to the board of directors for approval, in other words the CEB organs were not sufficiently informed of developments in the business cases.

It is clear from the way the audited business cases developed that the CEB stepped up its own control work from 2011 onwards and even used the services of independent audit companies when necessary.

The current state of seven of the nine audited business cases confirms the debtors' problems with repaying the credit: in these cases the CEB had to restructure the loans. Another risk is the danger that the projects will not be completed in a manner allowing the loans to be repaid.

In six business cases where the CEB did not proceed prudentially, there is a risk that if the loans are not repaid, the payment of insurance indemnification that secured the loans will be refused, i.e. the money owed to the CEB will not be recouped.

2.5 Correctness of the calculation of the appropriation amount to cover losses from the operation of supported export financing

The procedure for calculating losses from the operation of supported export financing, which is defined in Section 6 of Act No. 58/1995, was given concrete form by the CEB in an internal regulation. The CEB also established a separate section of the accounts (02) for financing with an entitlement to an appropriation. Table 6 gives an overview of the assets, liabilities and certain selected indicators structured by section of the accounts and for the CEB as a whole.

Table 6 – Operational segments of the CEB **(CZK millions)**

	2009			2010			2011		
	section 01	section 02	**total**	section 01	section 02	**total**	section 01	section 02	**total**
Interest revenues	587	1,424	**2,011**	696	2,191	**2,887**	839	2,588	**3,427**
Interest costs	−51	−2,118	**−2,169**	−29	−2,726	**−2,755**	−28	−2,822	**−2,850**
Losses from reducing the value of loans	−106	−70	**−176**	−173	3	**−170**	−266	−261	**−527**
Pre-tax profit	168	0	**168**	217	0	**217**	334	0	**334**
Income tax	−74	0	**−74**	−146	0	**−146**	−173	0	**−173**
Net profit for the accounting period	94	0	**94**	71	0	**71**	161	0	**161**
Loans and other receivables	5,473	37,737	**43,210**	4,383	55,473	**59,856**	2,959	66,853	**69,812**
Total assets	**8,454**	**41,279**	**49,733**	**7,548**	**57,247**	**64,795**	**7,638**	**70,425**	**78,063**
Financial liabilities in accumulated value and secured liabilities	3,942	41,013	**44,955**	4,074	54,616	**58,690**	2,321	68,558	**70,879**
Total liabilities and equity	**8,197**	**41,536**	**49,733**	**9,325**	**55,470**	**64,795**	**7,715**	**70,348**	**78,063**

Source: CEB annual reports for 2010 and 2011.
NB: Costs are shown in the table by a minus sign.

The CEB requested appropriations to cover losses from the MoF when the costs in section 02 of the accounts outweighed revenues in section 02, i.e. when this section returned a loss. In doing so the CEB quantified individual losses and the sum of these constituted the total loss for the given period.

In the years 2009 to 2011 the CEB always entered revenues and costs from credit operations of supported export finances and the costs and revenues associated with the acquisition of funds for supported financing in section 02 of the accounts. The audit did not find that in the audited period CEB had included in section 02 items that did not belong there.

Audit of the accounting for selected costs and revenues in section 02 of the accounts demonstrated that the CEB included these items in the calculation of the appropriation amount to be provided out of the state budget to cover losses from the operation of supported export financing in accordance with Section 6 (12) and (4) of Act No. 58/1995.

2.6 Submission of applications for the subsidising of losses; receipt and settlement of advance payments; financial settlement of provided appropriations to cover losses for the relevant year with the MoF

When submitting applications for appropriations during the compilation of the state budgets for 2009, 2010 and 2011 the CEB did not proceed in line with Section 6 (12) and (4) of Decree No. 278/1998, as it failed to attach to its applications overviews of the size of liabilities ensuing from contracts on the acquisition of finances concluded as of the day on which the application was submitted, overviews of the use of financial resources, of the repayment of the provided finances and of the expected need for financial resources.

The CEB also failed to comply with Section 2 (4) of Decree No. 165/2008, as it did not send the application for the provision of an appropriation to cover losses stemming from the operation of supported financing from the state budget for the budgetary year 2011 by 30 April 2010, but almost three months later.

The CEB sent an advance enumeration of the appropriation to cover losses from the operation of supported export financing to the MoF in the form of a request. In the requests for appropriations to cover losses for the 1st to the 3rd quarters of 2009 and for the 1st to the 4th quarters of 2009 they did not, however, comply with Section 7 (2) of Decree No. 278/1998, as they did not request from MoF the provision of an appropriation to cover losses based on the facts reported in the accounts as of the quarters in question. **By prior agreement with the MoF the CEB requested lower appropriations, thus enabling the MoF to defer the provision of part of the appropriation amounting to CZK 134,848,000 to the following budget year and part of the appropriation amounting to CZK 70,167,000 to another quarter of the same budget year.**

The CEB performed financial settlement with the state budget for 2009, 2010 and 2011 by the deadlines laid down by Decree No. 52/2008. However, the forms submitted to the MoF for 2009, 2010 and 2011 contained incorrect data as a result partly of the CEB's endeavour to enumerate its receivable from the state budget and partly of the unsuitability of the form, which does not reckon with the provision of appropriations in the form of advance payments which, moreover, are shifted from one budget year to the following budget year.

2.7 Information about supported financing submitted by the CEB to the Chamber of Deputies

The CEB submitted information about supported financing for the years 2009 and 2010, after the supervisory board had expressed consent, in the times and in the scope laid down by Section 6 of Act No. 58/1995.

2.8 Measures to eliminate shortcomings found by audit No. 01/34 and implementation thereof

Based on the assessment of the implementation of measures to eliminate the shortcomings found by audit No. 01/34, performed by the CEB as of 30 November 2002, and after verifying the implementation of some of these measures in the following periods, the SAO can state that the CEB implemented its measures.

III. Summary and assessment

In the UTA budget heading for the years 2009, 2010 and 2011 the MoF budgeted for an expenditure item *Appropriations for Export Support – Czech Export Bank* on the basis of incomplete requests.

In 2009 the Ministry of Finance agreed with the CEB on the form of the request for the subsidising of losses so that the appropriation of CZK 135 million was drawn down from the 2010 with the reasoning that the amount budgeted for 2009 was insufficient even at the time of the compilation of the budget for 2009.

In its decisions on the provision of appropriations the Ministry of Finance did not specify categorical and comprehensible conditions and did not check that the defined conditions were met by the CEB.

As the particulars of requests for consent to the acquisition of finances for supported financing are not specified by Act No. 58/1995, **the Ministry of Finance's consents only contained basic information, i.e. the creditor's name and the size of the CEB liability.**

In 2009 and 2010 the Ministry of Finance did not keep records of the state's guarantees and liabilities in the CEB on off-balance sheet accounts.

The MoF did not give any information about the size of the state guarantees in the annex to the state closing account. Between 2009 and 2011 the state of state guarantees for CEB liabilities grew from CZK 49.6 billion to CZK 76 billion, i.e. by 53%.

The Ministry of Finance concluded with the CEB a contract on the loan provision rules and conditions for an indefinite period and without setting limits and, based on two confirmations, **provided it in 2010 with loans totalling CZK 1.7 billion, using for this purpose finances intended to cover part of the state budget deficit for 2009 in contravention of their purpose.**

The Czech Export Bank did not attach the overviews required by an act or by a decree to the requests for subsidising when the state budgets for 2009, 2010 and 2011 were being compiled. In two cases the CEB requested from the Ministry of Finance a lower appropriation than that enumerated. In one case (by prior agreement with the MoF) it thus enabled the MoF not to exceed the amount budgeted for 2009. It did not fill in the form for settlement with the state budget for 2009, 2010 and 2011 correctly.

In the nine audited cases, when using funds under the supported export financing accounts section t**he Czech Export Bank should not have released credit worth CZK 8.2 billion** out of a credit framework of CZK 13.2 billion. **In six of these cases it did not proceed prudentially**, as it released credit worth CZK 4.2 billion even though the approved deferral conditions before the first drawing of the credit were not satisfied. **If these six loans are not repaid there is a risk that the payment of insurance indemnification to cover CEB's credit receivables on behalf of debtors will be refused.**

In two other cases the CEB should not have released credit to debtors amounting to CZK 3.8 billion, as it entered into the credit contracts, or their annexes, on conditions different from those approved by the supervisory board. In this way the CEB contravened its own statutes. In one case, when it released credit of CZK 239 million, it should not have provided the credit because it did not constitute one of the CEB's permitted products.

The shortcomings found in the area of the provision of credit demonstrate that the supervisory board was not sufficiently informed of the approval process for certain business cases and also underline the insufficiently specific wording of certain provisions of Act No. 58/1995, which may result in the purpose of this act being obviated.

The shortcomings and facts found by the audit show that, above all, there has to be rigorous control of the Czech Export Bank's credit provision by the Ministry of Finance, partly in its position as the provider of annual appropriations from the state budget, and partly as the controlling shareholder in the Czech Export Bank.