

**JUDGMENT
OF THE CONSTITUTIONAL REVIEW CHAMBER
OF THE SUPREME COURT**

No. of the case	3-4-1-14-08
Date of judgment	15 December 2008
Composition of court	Chairman Märt Rask and members Peeter Jerofejev, Indrek Koolmeister, Hannes Kiris and Villu Kõve.
Court Case	Petition of the Tallinn City Council for the declaration of invalidity of § 32(1) of the Accounting Act and § 11(5) of the Minister of Finance Regulation no. 105 of 11 December 2003, and for the declaration of unconstitutionality of the Accounting Standards Board Guideline RTJ 17.
Bases of proceeding	Petition of the Tallinn City Council of 8 September 2008.
Date of hearing	14 October 2008
Persons participating at hearing	Representatives of the Tallinn City sworn advocate Aivar Pilv and sworn advocate Merit Helm; representatives of the Minister of Finance adviser of the legal department of the Ministry of Finance Tiit Rebane and deputy head of the State Treasury department, chief accountant of the state Juta Maar; representatives of the Chancellor of Justice, Deputy Chancellor of Justice-Adviser Madis Ernits and adviser to the Chancellor of Justice Kaarel Eller, and the Minister of Justice Rein Lang.
DECISION	To declare § 11(5) of the Minister of Finance Regulation no. 105 of 11 December 2003 “General rules of state accounting” unconstitutional and invalid to the extent that it requires that in preparation of annual reports local governments must observe the requirements set out in the Accounting Standards Board Guidelines.

FACTS AND COURSE OF PROCEEDING

1. On 11 December 2003, on the basis of § 36(1) of the Accounting Act (hereinafter „the AA“), the Minister of Finance issued Regulation no. 105 „General rules of state accounting“ (RTL 2003, 130, 2103; hereinafter „the general rules“), which entered into force on 1 January 2004.

2. Pursuant to § 11(5) of the general rules the local governments, among others, shall prepare annual reports in conformity with the accounting policies set out in the general rules, on the basis of requirements established for annual reports in the Accounting Act and the guidelines of the Accounting Standards Board.

3. Pursuant to § 32 of the AA the Accounting Standards Board is an independent committee whose function is, among other things, to issue accounting guidelines explaining and specifying the Accounting Act.

Pursuant to § 34(1) of the AA the guidelines of the Standards Board shall be prepared on the basis of the international financial reporting standards although, in justified cases, they may prescribe derogations from the standards or simplified application or non-application of the standards with regard to all or specific types of accounting entities. In the event of derogations, the corresponding guideline shall describe the derogations and set out the reasons why they are necessary.

§ 34(2) of the AA specifies further that the guidelines of the Standards Board are issued in order to explain and specify this Act. If a guideline is in conflict with the Accounting Act, the provisions of the Accounting Act shall apply.

4. Pursuant to § 13(1) of the general rules assets shall be entered in the balance sheet of the state accounting entities who have dominant influence over the assets (i.e. who has control over the use of assets) and who bear the essential risks related to the use of the assets. For the purposes of the general rules a dominant interest means, as a rule, the ability to use the assets in economic activities even if no economic income is earned through this.

5. On 28 January 2005, but its decision, the Accounting Standards Board approved guidelines RTJ 17 “Partnership projects of public and private sectors” (RTL 2005, 25, 348; hereinafter “the RTJ 17 version of 2005”), the application of which is compulsory in regard to the annual accounts prepared concerning the accounting periods beginning from 1 January 2005 and later.

Pursuant to clause 6 of the guidelines a partnership project of public and private sectors means a long-term contract-based co-operation project between a public sector entity and a private sector entity, pursuant to which the private sector entity shall construct, renovate or procure the assets especially created for the objective of the project, and shall provide to the agreed extent and with the agreed quality – services which are based on the use of the created assets, whereas the public sector entity is the principal buyer of the services provided by the private sector entity.

Pursuant to clause 10 of the RTJ 17 version of 2005 the assets created in the course of a partnership project of public and private sectors shall be entered in the balance sheet of either a public or private sector entity, depending on who bears the essential risks arising from the project contract.

6. On 11 February 2008, by its decision, the Accounting Standards Board approved guidelines RTJ 17 “Concession contracts of services” (RTL 2008, 20, 294; hereinafter “the RTJ 17”), which shall enter into force on 1 January 2009 and shall be applied retroactively to all concession contracts of services that are in force at the time of entering into force of the guideline. Upon entry into force of the guidelines the earlier versions of the RTJ 17 shall become invalid (RTL 2005, 25, 348; 2005, 117, 1852; 2006, 46, 816).

Pursuant to clause 15 of the RTJ 17 a private sector entity shall not enter an object of public infrastructure in its balance sheet as a tangible asset, because the public sector entity has control over the use of the object of infrastructure. Pursuant to clause 25 of the same guidelines it is the public sector entity who shall enter the object of infrastructure in its balance sheet as a tangible asset.

7. On 8 September 2008 the Tallinn City Council filed a petition with the Supreme Court for the declaration of invalidity of § 32(1) of the AA and of § 11(5) of the general rules and for the declaration of unconstitutionality of the RTJ 17.

JUSTIFICATIONS OF THE PARTICIPANTS IN THE PROCEEDING

8. The Tallinn City Council argues first that both § 11(5) of the general rules and the RTJ 17 are acts that can be contested by way of constitutional review. The legal effect of the RTJ 17 in conjunction with the general rules is similar to the effect of legislation of general application, and therefore the RTJ 17 can be regarded a part of the general rules.

9. The petitioner is of the opinion that the general rules and the RTJ 17 as pieces of legislation ranking lower than parliamentary Acts violate the institutional guarantee of local governments, which arises from §§ 154 and 157(1) of the Constitution, the Local Government Organisation Act, and the Rural Municipality and City Budgets Act (hereinafter "the RMCBA"). The petitioner argues that the referred Acts guarantee to local governments autonomy (delimited by law) in establishing their budgets, and in preparing their annual reports and the booking of income and expenditure therein.

The Tallinn City Council is of the opinion that the autonomy of local governments in establishing their budgets and preparing their financial statements is further emphasised by the European Charter on Local Self-Government (RT II 1994, 95). Pursuant to Article 8 of the Charter local authorities shall, within the limits of the law, have full discretion to exercise their initiative with regard to any matter which is not excluded from their competence nor assigned to any other authority. Article 9(1) establishes that local authorities shall be entitled, within national economic policy, to adequate financial resources of their own, of which they may dispose freely within the framework of their powers.

The Local Government Organisation Act (primarily § 22(1)1 and 5) of the Act) and the Rural Municipality and City Budgets Act underline the right of a local government to independently carry out economic transactions and enter these in the budget and annual reports. At the same time § 11(5) of the general rules and the RTJ 17 restrict – by legislation ranking lower than parliamentary Acts the local governments' right to decide matters independently.

10. In regard to substantive conflict of § 11(5) of the general rules and the RTJ 17 with the Constitution and the Accounting Act the Tallinn City Council argued as follows.

First, these legislative acts violate the institutional guarantee of local governments by forcing them to re-classify the already concluded partnership contracts. This re-classification is necessary due to the fact that the RTJ 17, applicable also to the contracts concluded before the entry into force thereof, employs a solution essentially different from the RTJ 17 version of 2005. Pursuant to the latter, the assets that are the object of a partnership project of public and private sectors can be entered in the balance sheet of the entity which bears the essential risks related to the assets, whereas under the new guidelines the assets must be entered in the balance sheet of a public sector entity. The Tallinn City Council is of the opinion that as a result of this the local governments have to bear unforeseen expenses.

Secondly, the RTJ 17 in conjunction with the restrictions imposed on assuming debt obligations by § 8(1) of the RMCBA restrict the autonomy of local governments through restricting the right of local governments to implement their development plans through partnership projects of public and private sectors, and to choose the best ways for the discharge of local government functions. Bearing in mind the long-term nature, high value and restrictions on partnership projects of public and private sectors established in § 8(1) of the RMCBA, and the retroactive application of the RTJ 17, local governments are forced – as of 1 January 2009 – to significantly decrease the volume of planned projects.

Thirdly, the RTJ 17 is in conflict with § 3 of the Constitution, pursuant to which the state authority shall be exercised solely pursuant to the Constitution and laws which are in conformity therewith, and with § 154 of the Constitution, pursuant to which duties may be imposed on a local government only pursuant to law or by agreement with the local government. The RTJ 17 in conjunction with § 8(1) of the RMCBA restricts the autonomy of local governments, although the Accounting Act does not authorise the Accounting Standards Board to restrict, through their guidelines, the rights and the possibilities of public sector entities to participate in projects.

Fourthly, the RTJ 17 is in conflict with § 16(10) of the AA and with § 13(1) of the general rules. The former provision includes the principle of substance over form, which requires – upon choosing which entity shall enter the assets in its accounts – the implementation, inter alia, of the methods of control and risk-assessment. The referred provision of the general rules establishes that assets shall be entered in the balance sheet of the state accounting entity who has dominant influence over the assets (i.e. who has control over the use of assets) and who bears the essential risks related to the use of the assets. As the RTJ 17 version of 2008 is based on the premise that the public sector has control over the use of assets and therefore the assets must be entered in the balance sheet of a public sector entity only, the guidelines are in conflict with the referred provision.

Fifthly, the retroactive application of the RTJ 17 violates the principle of legitimate expectation, arising from § 10 of the Constitution. The RTJ 17 requires the re-valuation of already concluded contracts and entering of the contractual obligations in the balance sheet of a local government, which causes a change in the drawn financial forecasts and development plans and – with great probability – also the need to amend procurement contracts. In regard to the amendment of procurement contracts the Tallinn City Council makes a reference to the ECJ judgment C 337/98: Commission versus France of 5 October 2000 (paragraph 44 and ff) pursuant to which each amendment in a procurement contract relating to essential terms of contract must be deemed equal to conclusion of a new contract, which requires a new procurement. That is why the new guidelines create the danger that the projects will remain unimplemented and local governments shall have to bear the expenses arising due to disputes over contracts and the need to organise procurement procedures. The retroactive application of the RTJ 17 must, thus, be justified by a legitimate aim that is weightier than the legitimate expectation of a local government that it will not have to re-valuate the obligations it has assumed under the valid law.

Sixthly, the retroactive application of the RTJ 17 is also in conflict with the principle of consistency and comparability established in § 16(5) of the AA. Due to the fact that the valid projects are of long-term nature the adjustments of the referred nature render it practically impossible to reflect the same projects during different accounting periods in a consistent and comparable manner.

The petitioner adds further that the RTJ 17 is in conflict with § 17(1) of the AA, because it is in conflict with international financial reporting standards and with the International Accounting Standards Board (IASB) interpretation of financial reporting IFRIC 12 "Service Concession Arrangements", which served as the basis for issuing the RTJ 17. IFRIC 12 is meant for the private sector

and does not regulate the entering of partnership projects of private and public sectors in the accounts of the public sector. Furthermore, IFRIC 12 has not yet been recognised as the Community accounting standard as required by Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002.

11. In regard to the conflict of § 32(1) of the AA with the Constitution the Tallinn City Council points out that the referred provision, entitling the Accounting Standards Board to issue accounting guidelines explaining and specifying the Act, is not in conformity firstly with § 59 of the Constitution, pursuant to which legislative power is vested in the Riigikogu. The competence given to the Accounting Standards Board constitutes a serious danger of interference with the competence of the legislator, because the issuing of the guidelines may result in rendering the Act a new and /or amended content, which in turn can be viewed as exercise of legislative power by the executive.

Secondly, § 32(1) of the AA is in conflict with the constitutional principle of legal clarity, because it does not appear from the provision what exactly the right of the Accounting Standards Board to explain and specify the Act means. Due to this situation there is a danger of arbitrariness of the executive and of changing the actual will of the legislator. To specify the Act it must be amended in the Riigikogu; the gaps must not be filled by the guidelines issued by the Accounting Standards Board.

12. At the hearing of the Supreme Court, in response to the allegations of the representative of the Minister of Finance, the representative of the Tallinn City Council argued that the implementation of the RTJ 17 must not bring about problems for the local governments who have concluded concession contracts, that in Tallinn only the concession contracts of schools make up 55% of the debt burden limit of local governments established by law and therefore the implementation of the RTJ 17 may result in a financial crisis. The City of Tallinn has concluded concession contracts for the renovation of 16 school-buildings in the amount of 1.2 billion kroons. In six instances the person who conducts the work is the Public Limited Company Government Real Estate, in the rest of the instances works are conducted by other companies.

The representative of the Tallinn City Council also argued that in practice it was impossible to deviate from the guidelines of the Accounting Standards Board, and that no accountant or auditor would dare to take such a risk. The failure to observe generally accepted accounting principles may result in penal sanctions. § 32 of the AA directly authorises the Accounting Standards Board to issue explanations and specifications, and it can be concluded from this that in fact the guidelines of the Accounting Standards Board have obligatory force.

13. On behalf of the Riigikogu written opinion has been submitted by the Constitutional Committee.

The Constitutional Committee is of the opinion that as local governments lack the general competence to initiate abstract norm control, the Tallinn City Council is not competent to contest the constitutionality of § 32(1) of the AA. The referred provision does not affect the constitutional guarantees of local governments.

The Constitutional Committee also argues that upon establishing the general rules the Minister of Finance has not violated the formal requirements of issuing regulations and has not exceeded the authority delegated.

The Constitutional Committee expressed the opinion that the RTJ 17 essentially and without justification changes the accounting principles for local governments, driving several local governments into a financial crisis and thus endangers the constitutional right and possibility of local governments to independently resolve all local issues.

14. The Minister of Finance argues in his written opinion that the petition of the Tallinn City Council should be dismissed, because the explanation of requirements of entering in balance sheets of assets related to partnership projects of public and private sectors and choosing between different methods of entering in the accounts are not, essentially, local issues and are not related to the right of self-organisation of local governments. A local government council may submit a petition for constitutional review only if legislation of general application is in conflict with the constitutional guarantees of local governments.

Regulating accounting is not related to the constitutional guarantees to revenue base and budgeting established in §§ 154 and 157(1) of the Constitution. A budget is a forecast of income and expenses for an impending period, whereas the purpose of the norms regulating making entries in financial accounts is to guarantee that the concluded transactions are objectively reflected. The objective of the norms regulating accounting is, thus, not to create obligations but to objectively record the existing obligations. The function of accounting is to fix the financial situation, economic results and cash-flow of an accounting entity. § 16 of the AA establishes the accounting and reporting principles. An overview of the financial situation, economic results and cash-flows of accounting entities, including local governments, can be obtained only if the bases of accounting of local governments are unified and the accounts record data objectively and on the basis of the principle of substance of a transaction over the form thereof.

The Minister of Finance is of the opinion that the manner of recording obligations does not affect the discharge of the essential functions of local governments. The guidelines of the Accounting Standards Board but explain the principle provided in the Accounting Act, and an object of infrastructure relating to a partnership project of public and private sectors should, at all events, be entered in the balance sheet of a public sector entity irrespective of whether the RTJ 17 specifies this obligation or not.

15. Nevertheless, the Minister of Finance touches upon the substance of the petition and in this context makes a reference to the letter of the Accounting Standards Board of 19 February 2008 addressed to the Tallinn City Government, appended to his written opinion.

As for the allegation that the RTJ 17 is in conflict with an international standard, which – in addition – is not a part of the valid law, the Minister of Finance points out that it is allowed, by the guidelines of the Accounting Standards Board, to explain and specify the issues not yet regulated by standards. As it appears from clause 40 of the RTJ 17, the entering of concession agreements in the financial reports of public sector is, indeed, not dealt with either in the IFRIC 12 interpretation or in the International Public Sector Accounting Standards (IPSAS). Therefore the RTJ 17 can not be in conflict with the referred documents.

In regard to the retroactive force of the RTJ 17 it appears from the letter of the Accounting Standards Board that IAS 8, IPSAS 3, as well as RTJ 1 the amendments in accounting principles, as a rule, must always be recorded retroactively, in order to ensure comparability of transactions carried out during different periods. For example, the IFRIC 12 interpretations, too, are applied retroactively.

The Minister of Finance is of the opinion that § 32(1) of the AA is constitutional, because it authorises the Accounting Standards Board only to explain and specify the Accounting Act. What arises from the guidelines must, at all events, be in conformity with the Accounting Act and must be based on the principles established in the Act and would therefore be valid even if no guidelines

were issued. To endorse this view the Minister of Finance makes a reference to the judgment of the Civil Chamber of the Supreme Court of 21 December 2004 in case no. 3-2-1-145-04, paragraphs 18 and 19 of which express a similar opinion.

In regard to lawfulness of § 11(5) of the general rules the Minister of Finance points out that the obligatory force of the guidelines of the Accounting Standards Board for local governments does not arise from the provision itself but from §§ 3(7), 35(2) and 36 of the AA. If § 11(5) of the general rules – essentially reiterating the requirement of the Act to apply the guidelines of the Accounting Standards Board were declared invalid, a local government would not be exempted from adhering to the guidelines of the Accounting Standards Board.

The Minister of Finance argues further that the declaration of unconstitutionality of the version of the RTJ 17 which has not yet entered into force would be inexpedient in the practical sense, as § 17(1) of the AA enables an accounting entity to choose whether to apply the accounting principles generally accepted in Estonia or the international financial reporting standards.

In the response of the Accounting Standards Board to the Tallinn City Government, appended to the written opinion of the Minister of Finance, it is pointed out, inter alia, that if anything restricts the freedom of activity of local governments, it is the debt burden limits of local governments established in the Rural Municipality and City Budgets Act. It is argued that the Standards Board had repeatedly expressed the opinion that instead of searching for possibilities to avoid entering obligations in the balance sheet the local governments should exert pressure to have the Rural Municipality and City Budgets Act amended if they consider the established limits on debt burden to be unjustifiably high and that they could perform their obligations also if the debt burden was higher. The same opinion is expressed in the Accounting Standards Board's reply of 20 February 2008 to the Association of Municipalities of Estonia.

In the referred reply it is also argued that if a local government concluded contracts under the previous version of the RTJ 17 and the limits were not considered to be applicable to the obligations assumed by these contracts, the amending of the RTJ 17 creates for them the problem of retroactive amendment of principles of accounting, as a result of which compliance with the referred limits may be jeopardised. Nevertheless, it is stated that this could not create the real problems for the avoidance of which the limits had been established – that a local government would be unable to perform its obligations in the future, because the amendment of accounting principles does not mean the decrease of finances accrued by local governments or increase of amounts to be transferred by local governments.

16. At the hearing in the Supreme Court the representative of the Minister of Finance pointed out that there are eight local governments (including two who knew beforehand that upon concluding the contracts they will have to adhere to the RTJ 17 as of 1 January 2009) who have concluded the concession contracts falling within the sphere of application of the RTJ 17; whereas the volume of none of the concluded concession contracts – when the RTJ 17 is applied, i.e. if the concession contracts are entered in the account in accordance with the RTJ 17 – would exceed the limits of debt obligations established for local governments in the Rural Municipality and City Budgets Act. Concession contracts have been concluded primarily in regard to school-buildings. The majority of the concession contracts of services have been concluded by the Tallinn City Government, including with private companies, and they concern the construction of ten schoolhouses. It has to be taken into account that the obligations are not registered in the accounting documents in their full volume, only the construction costs are registered as obligations and later the interest costs, maintenance costs, repair expenditures shall be added, but these shall be entered in the accounts only after they have incurred. Thus, the volume of debt obligations to be entered in the balance sheet is smaller than the total volume of contractual obligations. For example, by the end of 2007 the City of Tallinn had incurred obligations in regard to one school-building only, the construction of the rest of the schoolhouses should be completed in 2008 and 2009.

The representative of the Minister of Finance was of the opinion that the guidelines of the Accounting Standards Board do not cause to flow more finances out of the Tallinn City Government than required by the obligations undertaken by the contracts. Valid contracts, the rights and obligations arising from and legal consequences of the contracts are not affected by the fact which party enters these in its accounting and how. Contracts remain to be binding and there is no need to amend these. The way how things are recorded in accounts can not affect actual cash-flows and cause financial difficulties for local governments. The question is whether the City of Tallinn, when recording the contracts, will fit in the limits established for the debt burden of local governments. The objective of the limits is to prevent local governments from ending up in serious financial difficulties.

The representative of the Minister of Finance pointed out that a draft Act concerning financial management of local governments is being prepared with the aim of loosening up the debt burden limits of local governments.

The representative of the Ministry of Finance argued further that the Accounting Act contains the wish that the guidelines of the Accounting Standards Board would constitute a part of generally accepted accounting principles and have obligatory force. The recording entity can choose, under § 17 of the AA, whether to base the accounting on the accounting principles generally accepted in Estonia or on the international financial reporting standards. If the accounting entity decides to adhere to the accounting principles generally accepted in Estonia, it should interpret the principles set out in the Accounting Act in conformity with the generally accepted accounting principles.

17. The Chancellor of Justice argues firstly, that the petition of the Tallinn City Council is not permissible to the extent that it applies for the declaration of unconstitutionality of the Accounting Standards Board guidelines RTJ 17 in entirety or alternatively for the declaration of unconstitutionality of clause 36 of the RTJ 17.

Namely, the Chancellor of Justice is of the opinion that § 7 of the Constitutional Review Court Procedure Act (hereinafter “the CRCPA”) can not be interpreted broadly and when determining the right of appeal of local governments one must be strictly confined to the legislative acts enumerated in this provision. The list established in § 7 of the CRCPA does not refer to the guidelines and decisions of the Accounting Standards Board (which have entered into force, or which have been promulgated but have not yet entered into force). Pursuant to §§ 32(1) and 34(1) of the AA the Accounting Standards Board guidelines shall be issued to explain and specify the Accounting Act, on the basis of international financial reporting standards; also, it can be concluded from the second sentence of § 34(2) of the AA that it is allowed to derogate from the guidelines, including the RTJ 17, if the interpretation of the Act of the entity who applies the Act (including an accounting entity) differs from the interpretation of the Accounting Standards Board. Consequently, the legislator has not delegated legislative competence to the Accounting Standards Board.

At the same time the Chancellor of Justice considers it necessary to point out that the guidelines of the Accounting Standards Board are authoritative interpretations by accounting specialists, which form a part of generally accepted accounting principles in Estonia. That is why the Chancellor of Justice is of the opinion that when an accounting entity who is drawing up an annual report on the basis of accounting principles generally accepted in Estonia interprets law differently than the Accounting Standards Board, the entity must point out that it has derogated from the guidelines in its annual report and must justify the derogation. Otherwise the comprehensibility and comparability of the annual report would not be guaranteed.

18. The Chancellor of Justice argues further that the petition of the Tallinn City Council is not permissible to the extent that it applies for the declaration of invalidity of § 32(1) of the AA, because the petition has not been submitted for the protection of a constitutional guarantee of local governments.

The Tallinn City Council justifies the petition for declaration of invalidity of § 32 of the AA with the argument that it is in conflict with § 59 of the Constitution and with the principle of legal clarity. The Chancellor of Justice is of the opinion that § 59 of the Constitution has no direct connection to the guarantees of local governments and relations between the state and the local governments established in Chapter XIV, and therefore the local government has no right to initiate a constitutional review proceeding under § 7 of the CRCPA by arguing that the contested legislation is in conflict with § 59 of the Constitution. At the same time, the requirement of legal clarity does not constitute a specific guarantee of local governments established in Chapter XIV; instead it is a general principle, applicable primarily to fundamental rights, but on the basis of the principle of a state based on the rule of law (§ 10 of the Constitution) it is also applicable to relations between the state bodies referred to in the Constitution, and to relations between the state and the local governments. Thus, the mere fact that a piece of legislation lacks legal clarity does not constitute a violation of constitutional guarantees of local governments. The petition of the Tallinn City Council lacks explanation about how exactly § 32(1) of the AA or the lack of legal clarity of the provision violate the constitutional guarantees of local governments; neither is the infringement of these guarantees apparent in regard to the contested provision.

19. The Chancellor of Justice is of the opinion that § 11(5) of the general rules is in conformity with the Constitution. The petition of the Tallinn City Council invokes §§ 154 and 157(1) of the Constitution. Pursuant to § 154(2) of the Constitution duties may be imposed on a local government only pursuant to law or by agreement with the local government. Expenditure related to duties of the state imposed by law on a local government shall be funded from the state budget. What is meant by imposition of duties is the assignment of state administrative duties to local governments. In conjunction with the right of self-organisation the second sentence of § 154(2) of the Constitution gives rise to a financial guarantee of local governments, i.e. the creation of a mechanism for financing local governments so that it would guarantee to local governments sufficient funds for both the performance of state duties and for the management of local issues is, pursuant to § 154 of the Constitution, the duty of the state. § 157(1) guarantees independent budgets to local governments. The independence of a local budget means that the budget of a rural municipality or a city is not a part of the state budget, that it is a separate budget.

Pursuant to § 14(1) of the AA rural municipalities and cities as accounting entities are required to submit annual reports. § 11(5) of the general rules establishes the accounting principles that a local government unit has to employ in annual reports and the requirements that the reports must meet. The requirements of financial reporting do not actually affect the amount of existing funds or the independence of budgets. That is why § 11(5) of the general rules does not infringe upon the financial guarantee of local governments or the guarantee established in § 157(1) of the Constitution.

Nevertheless, the Chancellor of Justice argues that it can not be excluded that § 11(5) of the general rules may infringe the right of a local government to resolve and manage all local issues, established in § 154(1) of the Constitution. The Tallinn City Council is allowed to petition for the declaration of invalidity of the contested provision only to the extent that it establishes that local government units shall prepare annual reports in conformity with the accounting principles set out in the general rules, on the basis of the requirement established in the Accounting Act and the guidelines of the Accounting Standards Board. In regard to the rest of the provision – concerning other legal persons in public law – the petition of the city council is not permissible.

In their annual reports the rural municipalities and cities must enter in the accounts, inter alia, those economic transactions performed and resolutions taken in management of local issues during the accounting period that influence the financial situation of a local government unit, and the economic consequences of such transactions and resolutions. The Chancellor of Justice is of the opinion that the obligation to prepare reports on resolutions concerning local issues infringes the right of self-organisation, established in § 154(1) of the Constitution. That is why the regulatory framework concerning annual reports of local governments, established in § 11(5) of the general rules, constitutes an infringement of the guarantee established in § 154(1) of the Constitution. Reporting requirements that create too extensive or labour-intensive administrative burden may affect the decisions to be taken.

The principle that the specification of fundamental rights and freedoms established by Acts may be delegated to the executive power can, on the basis of analogy, applied to regulatory provisions affecting constitutional guarantees of local governments. What delimits the extent of norms delegating authority is the definition – in the norm delegating authority of the object to be specified by a regulation, but also other provisions of law that a regulation must not contradict, as well as the prohibition to impose additional restrictions to those established by law.

In accordance with §§ 35(2) and 36(1) of the AA, § 11(5) of the general rules specifies that an annual report of a local government unit must conform to the accounting principles established in the general rules. § 11(5) of the general rules establishes further that annual reports shall be based on the Accounting Act and the guidelines of the Accounting Standards Board. The aim for the achievement of which the Minister of Finance is entitled, under §§ 35(2) and 36(1) of the AA, to establish accounting principles for the annual reports of local government units, is the fulfilment of the obligation arising from § 35(1) of the AA: The Ministry of Finance shall organise state accounting and financial reporting. Pursuant to § 45(1) of the State Budget Act (hereinafter "the SBA") and § 37(1) of the AA the Ministry of Finance shall prepare the consolidated annual report of the state, which shall contain, inter alia, additional information concerning local governments, and in consolidated form concerning state and local governments (§ 48(13) of the SBA). The observance of unified accounting principles and requirements in annual reports of local governments facilitates the organisation of accounting of the state by the Ministry of Finance and helps to prepare the consolidated annual report. At the same time, the lack of requirements concerning annual reports of local governments, which are more detailed than those in the Act, would render it materially more difficult and ineffective for the Ministry of Finance to perform the referred duties. Bearing in mind, inter alia, the possibility arising from § 34(2) of the AA and § 11(6) of the general rules to derogate from the guidelines of the Accounting Standards Board, the Chancellor of Justice is of the opinion that the general requirement of § 11(5) of the general rules to prepare annual reports in conformity with specified requirements does not significantly affect the resolutions taken by local governments within the right of self-organisation arising from § 154(1) of the Constitution.

Further, the Chancellor of Justice argues that the creation of possibilities for the Ministry of Finance to efficiently organise state accounting and prepare consolidated annual reports of the state guarantees the possibility for the state to fulfil its international financial obligations. Also, the Riigikogu derives important information from the annual report of the state, enabling it to make essential resolutions and to exercise parliamentary control (see § 37(2) of the AA).

20. The Minister of Justice is of the opinion that § 11(5) of the general rules is in formal conflict with the Constitution and thus infringes upon constitutional guarantees of local governments. Namely, the contested provision of the general rules constitutes an infringement of a constitutional guarantee of local governments and a restriction of the right of local governments to freely make resolutions, because § 11(5) of the general rules imposes an obligation on local governments to observe, upon preparation of annual reports, the accounting principles established in the general rules and in the guidelines of the Accounting Standards Board. At the same time § 32(2) of the AA establishes that the Minister of Finance has the right to establish, in the general rules, accounting policies, report formats and the procedure for the submission thereof, but this provision of the AA does not entitle the Minister of Finance to further delegate these duties. Yet, in the formal sense the right to establish the above-referred has been delegated, because on the basis of § 11(5) of the general rules the guidelines of the Accounting Standards Board become binding, i.e. instead of legislation issued by the Minister of Finance duties are imposed by the guidelines of the Accounting Standards Board. As delegation of competence is not permitted in the substantive sense, either, the Regulation is in formal conflict with the Constitution.

At the same time the Minister of Justice argues that it does not appear from the petition of the Tallinn City Council how exactly § 32(1) of the AA violates the constitutional guarantee of the local government unit. The mere fact that the Government of the Republic has set up a body whose function is to issue guidelines which do not have obligatory force can not infringe the guarantee of local governments and therefore the petition of the Tallinn City Council in regard to the contested provision is not permissible. Neither does the RTJ 17 infringe upon the guarantee of local governments, because this is not a piece of legislation and the non-binding act can not infringe or violate anyone's rights. Namely, the guidelines issued under the Accounting Act are not legislation issued by an administrative agency for the exercise of executive power; neither do the guidelines have characteristics of legislation of specific application. Pursuant to the Accounting Act the guidelines are documents explaining and specifying the Act (the first sentence of § 34(2) of the AA) and thus, for the purposes of § 7 of the CRCPA, these do not constitute legislation subject to constitutional review.

At the hearing of the Supreme Court the Minister of Justice added that the guidelines of the Accounting Standards Board serve the purpose of ensuring transparent and unambiguous accounting in Estonia in a uniform manner for all local governments so that the Estonian state would know, upon drawing up the state budget, the position of the entire public sector. The activities of the Accounting Standards Board are reasonable and expedient, yet the present legal space does not allow the board to establish binding rules; this right has been given by the legislator to the Minister of Finance, who has failed to avail himself of the possibility.

21. The Association of Municipalities of Estonia agrees with the opinions expressed in the petition of the Tallinn City Council. In its written opinion the association argues in addition that § 32(1) in conjunction with § 34 of the AA is in conflict also with § 86 of the Constitution, pursuant to which the executive power is vested in the Government of the Republic, and with §§ 87(6) and 94 of the Constitution, pursuant to which the Government of the Republic and the ministers shall issue regulations and orders on the basis of and for the implementation of law. The referred provisions of the Accounting Act establish that the Accounting Standards Board shall issue guidelines to explain and specify the Act, without restricting the scope of application and extent of the guidelines. § 34(2) of the AA positions the guidelines in the hierarchy of Estonian legislation (if a guideline is in conflict with this Act, the provisions of this Act shall apply) as a result of which the guidelines – unconstitutionally – are considered equal to the regulations of the Government of the Republic and the ministers. Yet, at the same time, pursuant to § 11(5) of the general rules, the guidelines of the Accounting Standards Board, including the RTJ 17, are binding on local governments.

The Association of Municipalities of Estonia points out that the RTJ 17, enacted as of 1 January 2009, shall create consequences for local governments that are not created by the Act or the Regulation of the Minister of Finance. When the guideline enters into force the possibility of local government units to participate, in the future, in the partnership projects of public and private sectors (so called PPP-projects) will be limited. Namely, it is highly probable that the retroactive application of the guideline – which is unjustified and contrary to the principle of legal certainty – shall result in the conflict of the referred projects with § 8(1) of the RMCBA. In conjunction with the latter Act the RTJ 17 constitutes a restriction on local government autonomy, as it restricts the right of local governments to implement their development plans through the PPP-projects, and thus also the right to choose the most suitable and effective way for the performance of local government duties.

22. The Association of Estonian Cities supports the petition of the Tallinn City Council and considers the arguments and justifications thereof correct. The RTJ 17 and § 11(5) of the general rules restrict the constitutional guarantees and right of independent resolution of local governments, as these are legislative acts ranking lower than parliamentary Acts. The Association of Estonian Cities argues also that § 32(1) of the AA is defective, as it allows the Accounting Standards Board to interfere with law-creation, because explaining and specifying the Act in the form of binding guidelines contains the danger of rendering the Act a new content, thus assuming the role of legislator. The regulatory framework ignores the principles of legal clarity and legitimate expectation.

The Association of Estonian Cities is of the opinion that the obligation – arising from clause 36 of the RTJ 17 to review and amend the partnership contracts that have already been concluded will have unprecedented fiscal effect on the activities of local governments.

CONTESTED PROVISIONS

23. § 32(1) of the Accounting Act reads as follows:

“ § 32. Accounting Standards Board

(1) The Government of the Republic shall establish the Accounting Standards Board (hereinafter Standards Board) whose function is to issue accounting guidelines explaining and specifying this Act and to direct activities in the field of accounting. [...]”

24. § 11(5) of the Minister of Finance Regulation no. 105 of 11 December 2003 “General rules of state accounting” reads as follows:

“§ 11. Annual report

[...] (5) Local governments, other legal persons in public law, public sector foundations, non-profit organisations, the State Forest Management Centre and subsidiaries shall prepare annual reports in conformity with the accounting principles set out in the general rules, on the basis of the requirements to annual reports established in the Accounting Act and the guidelines of the Accounting Standards Board. [...]”

25. The Accounting Standards Board guideline RTJ 17 “Concession contracts of services” (RTL 2008, 20, 294), too, was contested.

OPINION OF THE CONSTITUTIONAL REVIEW CHAMBER

26. The Constitutional review Chamber shall first examine the permissibility of the petition of the Tallinn City Council (I), and shall thereafter form an opinion on whether the petition is justified (II).

I.

27. The Chamber examines the permissibility of the petition of the local government council on the basis of § 7 of the CRCPA, pursuant to which a local government council may submit a request to the Supreme Court to declare an Act which has been proclaimed but has not yet entered into force or a regulation of the Government of the Republic or a minister which has not yet entered into force to be in conflict with the Constitution or to repeal an Act which has entered into force, a regulation of the Government of the Republic or a minister or a provision thereof if it is in conflict with constitutional guarantees of the local government. Consequently, when examining a petition the Chamber has to ascertain whether the provision the review of constitutionality of which is requested constitutes a part of one of the legal acts enumerated in § 7 of the CRCPA, and the Chamber must ascertain whether the provision may violate constitutional guarantees of local governments.

28. The Chamber is of the opinion that the request that RTJ 17 or clause 36 thereof be declared unconstitutional is not permissible. A guideline of the Accounting Standards Board is not legislation of general application for the purposes of § 7 of the CRCPA. It has not been issued pursuant to procedure established for passing legislation by a body competent to legislate. The RTJ 17 was issued by the Accounting Standards Board which acts as an independent committee pursuant to § 32(2) of the AA – and not by the Minister of Finance on the basis of a norm of the Act delegating pertinent authority. Contrary to the opinion of the petitioner the Chamber is of the opinion that the reference in § 11(5) of the general rules to the guidelines of the Accounting Standards Board does not make the RTJ 17 a part of the general rules, and it can not be contested alongside with § 11(5) of the general rules.

29. The Chamber is of the opinion that the request to declare § 32(1) of the AA invalid because of conflict with the principle of legal clarity and with § 59 of the Constitution is not permissible, either.

Similarly with the Chancellor of Justice the Chamber is of the opinion that the mere fact that a piece of legislation lacks legal clarity does not constitute a violation of constitutional guarantees of local governments. If a local government council requests the declaration of invalidity of a legal act on the ground that the act is in conflict with the principle of legal clarity, the council has to explain how the lack of legal clarity affects one of the guarantees of local governments. The petition of the Tallinn City Council does not contain an explanation of how exactly § 32(1) of the AA or the lack of legal clarity of the provision violates the constitutional guarantees of local governments. Neither is the infringement of local government guarantees obvious in the case of this provision.

As regards § 59 of the Constitution the Chamber is of the same opinion as the Chancellor of justice, namely that this provision – pursuant to which the legislative power is vested in the Riigikogu – has no direct connection with the guarantees of local governments or the relations between the state and the local governments. This provision regulates the competence of the Riigikogu and the position of the Riigikogu within the system of separate powers of the state.

30. The Chamber is of the opinion that the petition of the Tallinn City Council is permissible only to the extent that it requests that § 11(5) of the general rules be declared invalid because of conflict thereof with §§ 154 and 157(1) of the Constitution. The general rules can be contested under § 7 of the CRCPA, because the rules constitute a regulation of minister which has entered into force. The possibility that the provision may violate constitutional guarantees of local governments can not be excluded.

31. On the basis of the above considerations the Chamber shall examine the substance of the petition only to the extent that it pertains to the constitutionality of § 11(5) of the general rules.

II.

32. The Chamber is of the opinion that the obligation established in § 11(5) of the general rules to prepare annual reports in conformity with the accounting principles set out in the general rules, on the basis of the requirements to annual reports established in the Accounting Act and the guidelines of the Accounting Standards Board infringes the right of local governments to independently resolve and manage local issues, and the financial autonomy of local governments.

The obligation included in § 11(5) of the general rules means that a local government must show in the annual report the economic transactions and resolutions made in the management and resolution of local issues during the accounting period, that influence the financial situation of the local government. The data included in annual reports may affect independent resolution and management of local issues, among other things, due to the fact that the amount of obligations shown in the reports influences the ability to assume debt obligations. Consequently, preparation of reports concerning local issues infringes the right established in § 154(1) of the Constitution and the financial autonomy arising from § 157(1) of the Constitution.

33. Next, the Chamber shall analyse the formal constitutionality of the infringement included in § 11(5) of the general rules.

Pursuant to the first sentence of § 3(1) of the Constitution the state authority shall be exercised solely pursuant to the Constitution and laws which are in conformity therewith. This provision means, inter alia, that only those norms have obligatory force that have been issued, pursuant to appropriate procedure, by a body in whom the Constitution has vested the competence to establish generally binding provisions of law. § 11(5) of the general rules imposes on local governments an obligation to prepare annual reports on the basis of the requirements set out in the guidelines of the Accounting Standards Board. Pursuant to § 32 of the AA it is the Accounting Standards Board, which is set up by the Government of the Republic and acts as an independent committee, who prepares the guidelines and approves these by its decisions. Yet, the Constitution does not authorise the Accounting Standards Board to establish generally binding norms. That is why local governments may not be required, by a regulation of a minister, to adhere to these guidelines.

The Chamber, similarly with the Minister of Justice, is of the opinion that in the formal sense § 11(5) of the general rules is not constitutional. The obligation of local governments, arising from the provision, to prepare annual reports on the basis of the guidelines of the Accounting Standards Board is in conflict with the first sentence of § 3(1) of the Constitution.

34. The Chamber points out further that the opinion of the Tallinn City Council that pursuant to §§ 154 and 157 of the Constitution a regulatory framework restricting the local governments' right of self-organisation and financial autonomy must in its entirety be included in parliamentary Acts, is erroneous. The requirement of establishment by law only, included in the referred provision, does not mean that an Act must exhaustively provide for a regulatory framework concerning constitutional guarantees

of local governments and that it is prohibited to delegate the establishment or pertinent regulatory framework to the executive. The Chamber is of the opinion that the legislator must decide on all issues that are important from the point of view of restricting the right of self-organisation and financial autonomy. What is allowed to be delegated to the executive is the right to specify the restrictions on the right of self-organisation and financial autonomy established by law.

35. For the above reasons the Chamber declares § 11(5) of the general rules unconstitutional and invalid to the extent that it requires local governments, in preparing annual reports, to observe the requirements set out in the guidelines of the Accounting Standards Board.