

IN THE NAME OF THE RUSSIAN FEDERATION

CONSTITUTIONAL COURT  
OF THE RUSSIAN FEDERATION

Judgment  
of 1 April 2003 No. 4-II

in the case concerning the review of the constitutionality of the provision of Subsection 2, Article 7 of the Federal Law “On Audit” in connection with a complaint of I. V. Vystavkina.

Moscow, 1 April 2003

The Constitutional Court of the Russian Federation composed of Presiding Judge L. M. Zharkova and Judges M. V. Baglay, Yu. M. Danilov, G. A. Zhilin, V. D. Zorkin, S. M. Kazantsev, M. I. Kleandrov, N. V. Seleznev, O. S. Khokhryakova,

in the attendance of I. V. Vystavkina, attorney V. V. Lebedev as her representative, Permanent Representative of the State Duma to the Constitutional Court of the Russian Federation V. V. Lazarev, Yu. A. Sharandin, Member of the Council of the Federation, as Representative of the Council of the Federation to the Constitutional Court of the Russian Federation, Plenipotentiary Representative of the President of the Russian Federation to the Constitutional Court of the Russian Federation M. A. Mityukov,

pursuant to Section 4, Article 125 of the Constitution of the Russian Federation, Subsection 3, Section 1, Sections 3 and 4, Article 3, Subsection 3, Section 2, Article 22, Articles 36, 74, 86, 96, 97, and 99 of the Federal Constitutional Law “On the Constitutional Court of the Russian Federation”,

in an open hearing, examined the constitutionality of the provision of Subsection 2, Article 7 of the Federal Law “On Auditing”.

The reason for the consideration of the case is a complaint of I. V. Vystavkina about violation of her constitutional rights by the mentioned provision, which stipulates that mandatory audits shall be conducted by auditing organizations. The ground for the consideration of the case is the discovered uncertainty of whether the provision challenged by the applicants is in conformity with the Constitution of the Russian Federation.

Having heard the report of Judge-Rapporteur V. D. Zorkin, statements by the parties’ representatives, a statement by M. Yu. Barshchevsky, Plenipotentiary Representative of the Government of the Russian Federation to the Constitutional Court of the Russian Federation, statements by the following representatives invited to the hearing: V. P. Knyshev, Judge of the Supreme Court of the Russian Federation, A. A. Makovskaya, Representative of the Supreme

Arbitration Court of the Russian Federation, O. V. Kurilin, Representative of the Ministry of Finance of the Russian Federation, T. A. Ryzhkova, Representative of the Prosecutor General of the Russian Federation, T. S. Fedotov, Representative of the Commissioner on Human Rights in the Russian Federation; and having considered written submissions and other materials, the Constitutional Court of the Russian Federation

e s t a b l i s h e d :

1. I. V. Vystavkina, who is an individual auditor licensed to conduct general audit, had conducted annual mandatory audits of the accounting and the financial (accounting) statements of the Inzhenerny Tsentr CJSC for a number of years. However, after Inspectorate No. 1 of the Ministry of Taxes and Duties of the Russian Federation in the Tsentralny Administrative Circuit of the City of Moscow informed the Inzhenerny Tsentr CJSC that the auditor's report, which was part of its accounting report for 2001, could not be accepted pursuant to Subsection 2, Article 7 of the Federal Law "On Audit" of 7 August 2001 I. V. Vystavkina was refused concluding an agreement for conducting regular mandatory audit.

In her complaint submitted to the Constitutional Court of the Russian Federation, I. V. Vystavkina claims that Subsection 2, Article 7 of the Federal Law "On Audit", which prohibits individual auditors from conducting mandatory audit, imposes ungrounded limitations on the freedom of entrepreneurial activities, which is exercised on the basis of everyone's equality before the law and the court, and thus violates Articles 2, 19, 34 and 55 of the Constitution of the Russian Federation.

2. Pursuant to the Constitution of the Russian Federation, freedom of economic activities shall be guaranteed in the Russian Federation (Section 1, Article 8); everyone shall be entitled to freely use his abilities and property for entrepreneurial activities and other economic activities which are not prohibited by law (Section 1, Article 34) and to have, possess, use and dispose of property both personally and jointly with other people (Section 2, Article 35). It follows from Articles 17 (Sections 1 and 2) and 19 (Sections 1 and 2) of the Constitution of the Russian Federation that these rights shall be guaranteed in the Russian Federation as basic and inalienable rights of man and citizen and exercised on the basis of general legal principles of legal equality, inviolability of property and freedom of contract that imply equality, autonomy of will and property independence of the participants in civil and legal relations and impermissibility of anyone's arbitrary interference with others' private affairs. The said principles are proclaimed in the Civil Code of the Russian Federation among the basic foundations of the civil legislation (Subsection 1, Article 1).

Pursuant to Articles 71 (Subsections “c” and “n”) and 76 (Section 1) of the Constitution of the Russian Federation, a law shall regulate the right to possess, use, and dispose of property, freedom of entrepreneurial activities, freedom of contract of participants in civil transaction, *inter alia* by determining grounds and procedures for their creation, alteration, and termination, the rights and responsibilities of those involved in civil and legal relations (individuals or legal entities (including commercial organizations) that carry out entrepreneurial activities).

Not being absolute, these rights may be restricted; however, the possibility and nature of restrictions shall be determined relying on the Constitution of the Russian Federation, which states that the rights and freedoms of man and citizen may be limited by federal law only to the extent necessary to protect the fundamentals of the constitutional order, morality, health, rights and lawful interests of others, and to ensure defense of the country and the security of the state (Article 55, Section 3).

This provision corresponds to the Convention for the Protection of Human Rights and Fundamental Freedoms, pursuant to which every natural or legal person’s right to enjoy his possessions (and hence the freedom of using property, including its use for the purpose of carrying out entrepreneurial activities) shall not impair the right of the state to enforce such laws as it deems necessary to control the use of property in accordance with the general interest (Article 1 of Protocol No. 1 as amended by Protocol No. 11).

Within the meaning of Article 55 (Section 3) in its connection with Articles 8, 17, 34, and 35 of the Constitution of the Russian Federation, possible limitations imposed by the federal legislation on the right to possess, use, and dispose of property and the freedom of entrepreneurial activities and freedom of contract shall be – as follows from the general principles of law – fair, adequate, proportional, balanced, and necessary to protect constitutionally significant values, including private and public rights and other persons’ lawful interests; they shall be general and abstract, shall not be retrospective, shall not affect the essence of the constitutional right, i.e. shall not restrict the scope and application of the core contents of the respective constitutional norms.

3. The constitutional meaning of the challenged provision of Subsection 2, Article 7 of the Federal Law “On Audit”, pursuant to which mandatory audit shall be conducted by auditing organizations, cannot be identified without considering its systemic relation with other provisions of the mentioned Federal Law.

The Federal Law “On Audit” stipulates that audit is an entrepreneurial activity conducted by commercial auditing organizations acting as a legal entity of any organizational and legal form (except for an open joint stock company) and by unincorporated entrepreneurs (individual auditors) through independent review of the accounting and financial (accounting) statements of

organizations and individual entrepreneurs (Subsections 1 and 5, Article 1; Subsections 1 and 3, Article 4); the objective of the audit is to express an opinion on the authenticity of the financial (accounting) statements of the audited persons and compliance of the accounting with the legislation of the Russian Federation, i.e. on the degree of accuracy of the data in the financial (accounting) statements, which allows the person using these financial (accounting) statements to draw correct conclusions – based on that data – as to the results of the audited persons’ business activities, financial and property status and make informed decisions relying on these conclusions (Subsection 3, Article 1); the audit shall be conducted under an auditing services contract which shall be signed either upon the initiative of the audited person or on a mandatory basis within the timeframe established by the legislation of the Russian Federation (Subsection 2, Article 6).

According to Subsection 1, Article 7 of this Federal Law, a mandatory audit is an annual audit of the accounting and financial (accounting) statements of an organization or individual entrepreneur. Within the meaning of these provisions (Subsections 1–4) the need for mandatory audits is predetermined by the specific organizational and legal form of audited persons (open joint stock companies), the nature of their functions (credit and insurance organizations, stock exchanges, investment funds), or large amounts of revenues, or a significant amount of assets recorded on the balance sheet at the end of the reporting year, i.e. circumstances that require imposition of increased guarantees of authenticity of the audited persons’ financial (accounting) statements, in order to protect other persons’ rights and lawful interests and ensure economic safety of the Russian Federation.

4. It follows from Article 71 (Subsections “g”, “r”) of the Constitution of the Russian Federation in its connection with Articles 8 (Section 1), 29 (Section 4), 34, and 114 (Subsection “b”, Section 1) that official accounting in the Russian Federation serves as an instrument for conducting financial regulation and ensuring a unified financial (and tax) policy, guaranteeing the exercise of the constitutional right to information in the sphere of entrepreneurial activities and economy based on the principles of legal equality and contractual relations, competition and risk. Accounting is one of the constitutional guaranties of a single market and integrity of economic space as one of the foundations of the constitutional order of the Russian Federation.

Thus, the federal legislator is entitled to oblige those engaged in entrepreneurial and other economic activities to perform official accounting and to provide certain market players and authorized official persons (including tax authorities) with the right to access accounting information and to review its authenticity.

The fact that the Constitution of the Russian Federation specifies the official nature of accounting implies its public nature and therefore the need for such guarantees that allow ensuring, for public purposes, authenticity of the accounting information, which is impossible without preparing and submitting financial (accounting) statements and appropriate control and review of the respective accounting procedures. One of such guarantees that ensure authenticity of official accounting in the sphere of economic activities (including entrepreneurial activities) is the mandatory audit prescribed by Article 7 of the Federal Law “On Audit”. It shall be conducted by independent auditing organizations authorized by law and devoid of the rights to conduct any other activities except for auditing and respective supplementary services.

Within the meaning of the provisions of Article 7 in its connection with Article 4 and Subsection 2 (1), Article 6 of the Federal Law “On Audit”, a mandatory audit, being the final stage in the system of official accounting, constitutes independent official control (supervision) of authenticity of financial (accounting) statements. Although an auditing organization is chosen and its services are paid for on a commercial basis under a civil law contract, i.e. mediated through a private law form, the mandatory audit – considering its objectives, intended purpose, and functions – is conducted in the interests of an indefinite scope of persons and the state, i.e. in the public interest.

The relations that arise in the course of audit to a considerable extent have public law nature. By performing an audit, an auditing organization acts officially as an independent control (supervision) entity authorized by the state in accordance with the legislation; the mandatory audit does not imply the audited person’s initiative, but is rather its duty and public law burden. The auditors’ report prepared on the basis of the results of the audit is a mandatory part of the official annual financial (accounting) statements, which cannot be accepted without it, and persons using the financial (accounting) statements including the state tax authorities may not consider them as reliable.

The legal entity that conducts a mandatory audit shall enter into an audit services contract as a private law corporation, i.e. within the framework of entrepreneurial activities. At the same time such legal entity shall have a special status: it shall be established specifically and exclusively for conducting auditing activities, may not undertake any other entrepreneurial activities, and shall essentially fulfil public functions, since it is public rather than private interest that underlies the auditing process.

5. Considering the fact that the mandatory audit is aimed at protecting public interests and ensuring authenticity of official accounting, i.e. it belongs to the financial regulation and public law sphere, the federal legislator shall define the organizational and legal form for activities of

independent auditors who perform mandatory audit of accounting and financial (accounting) statements of an organization or an individual entrepreneur.

Within the meaning of Articles 1, 3, 4, and 7 of the Federal Law “On Audit”, mandatory audit shall be conducted by individual auditors acting in the name of a duly licensed auditing organization. They shall meet qualification requirements established by an authorized federal body, shall have a qualification certificate of an auditor, and conduct auditing activities as employees of an auditing organization or as persons employed by it under a civil law contract. At the same time the auditor can be a founder or a co-founder of the auditing organization.

Pursuant to Subsection 3, Article 4 of the Federal Law “On Audit”, an auditing organization may be established in any organizational and legal form (except for an open joint stock company), including a company founded by one or several individuals as follows from the Civil Code of the Russian Federation. At the same time, pursuant to a transitional provision stipulated in Subsection 1, Article 22 of the mentioned Federal Law, the provision of Subsection 5 of its Article 4 stipulating that the auditing organization’s staff shall consist of at least five auditors shall come into force upon the expiry of a two-year period after the mentioned Federal Law comes into force (i.e. on 9 September 2003). Therefore, an individual auditor engaged in auditing activities as an individual entrepreneur having personally established such a company becomes its single participant and may currently conduct mandatory audit equally to other auditing organizations.

Within the meaning of Subsection 2, Article 7 of the Federal Law “On Audit” in its connection with its Articles 7, 9, 13–21, the requirement that the mandatory audit shall be conducted by an auditing organization with its staff consisting of at least five auditors is determined by the necessity to provide for a proper scope and quality of the mandatory audit. It shall be guaranteed by the relevant federal standards for auditing activities, the auditing organization’s responsibility to insure the risk of liability for a breach of the contract, and the exercise of the function concerning state regulation of auditing activities entrusted to the Government of the Russian Federation and its authorized executive authorities, in particular through control mechanisms (the system of evaluation of the quality of auditing organizations’ work by external inspectors, licensing auditing organizations, appraising auditing organizations for the right to conduct audit activities, accrediting professional audit associations, etc.).

Independence and quality of the mandatory audit shall also be guaranteed by conducting open tenders to choose a company with which to sign audit services contracts. Pursuant to Article 7 of the Federal Law “On Audit”, organizations whose charter (share) capital contains at least 25 percent property belonging to the state or a subject of the Russian Federation, shall sign respective contracts with auditing organizations relying on the results of an open tender

(Subsection 2). Within the meaning of this provision in its connection with Article 12 of the said Federal Law, there shall be no obligation to conduct such a tender unless it is specifically prescribed by law, however, an audited person may not be anyway deprived of the right to sign an audit services contract relying on the results of an open tender, which correlates with the public purpose of the mandatory audit and necessity to guarantee its independence and quality.

6. Thus, the provision of Subsection 2, Article 7 of the Federal Law “On Audit”, pursuant to which mandatory audits shall be conducted by auditing organizations, within the meaning in the system of norms of this Federal Law, does not prevent an individual auditor from either conducting the mandatory audit as an employee of an auditing organization or being its founder or a co-founder. This provision being aimed at protecting constitutionally significant values and balancing private and public interests does not affect the essence of the constitutional guarantees aimed at protecting property, freedom of entrepreneurial and other economic activities which are not prohibited by law, and freedom of contract of the participants of civil transactions (Articles 8, 34, and 35 in connection with Article 17, 19, and 55 of the Constitution of the Russian Federation). Considering the nature of the mandatory audit, it cannot be considered an excessive limitation of the mentioned constitutional rights and freedoms; and therefore it does not contradict the Constitution of the Russian Federation.

Concluding from the above and pursuant to Section 1 and 2, Article 71, Articles 72, 75, 79, and 100 of the Federal Constitutional Law “On the Constitutional Court of the Russian Federation”, the Constitutional Court of the Russian Federation

h e l d :

1. To recognize the provision of Subsection 2, Article 7 of the Federal Law “On Audit”, pursuant to which mandatory audit shall be conducted by auditing organizations, as conforming to the Constitution of the Russian Federation.

2. This Judgment shall be final and shall not be subject to any appeal, it shall come into force immediately upon pronouncement, shall be directly applicable and shall not require confirmation by any other state body or official.

3. Pursuant to Article 78 of the Federal Constitutional Law “On the Constitutional Court of the Russian Federation”, this Judgment shall be published in the Collection of Laws of the Russian Federation, *Rossiyskaya Gazeta*. The Judgment shall also be published in the Bulletin of the Constitutional Court of the Russian Federation.

Constitutional Court  
of the Russian Federation

