



STATE AUDIT
OFFICE OF HUNGARY

R E P O R T

on the Activities of the State Audit Office of Hungary in 2008

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INTRODUCTION

The State Audit Office of Hungary (SAO) reports on its activities to the National Assembly on an annual basis. The activity report is put on the agenda of several parliamentary committees, and then it is discussed at the plenary session. After the discussion of the annual activity report, the National Assembly passes a decision evaluating the SAO's activities and setting the future development trends. The SAO compiles its annual audit plan and performs research and consulting activities supplementing the audit activities on the basis of these parliamentary resolutions.

The SAO carries out its tasks under consolidated and stable conditions, by continuously developing its organisational system, in a closed technological process, building on values confirmed by the audit results.

In 2008, the SAO prepared 53 reports. Similarly to the previous year, the parliamentary committees discussed 13 reports on 56 occasions. In line with the former practice, a few reports, e.g. the report on the execution of the budget, the SAO's opinion on the budget appropriation bill, and the annual SAO activity report were put on the agenda by several committees. In the SAO reports published in 2008 more than 1,100 recommendations were made on the basis of on-site audits conducted at around 900 organisations.

In addition to performing its audit tasks, in 2008 the SAO updated – after almost four years – its basic rules on auditing, as a result of which the revised Audit Manual of the SAO could be published. Through international relations and cooperation the SAO receives those 'technical transfers' with the help of which it can utilise in its audit work the latest results achieved at international level in the development of the audit methodologies. This also contributed to the fact that despite a modest decline in staff, in the past years the SAO could achieve increased audit coverage through scheduled and continuous IT developments.

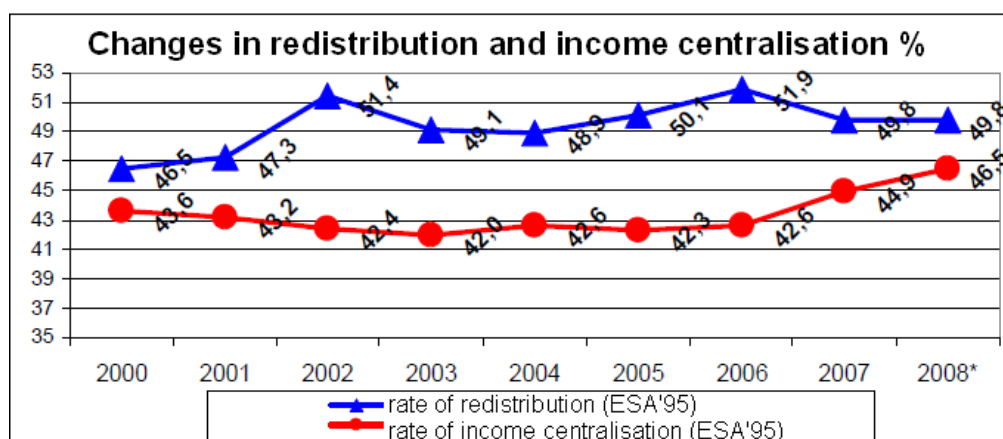
Due to the nature of the audit activity, the SAO's audit work pertains to the past, which may seem inconsistent with the rapid changes in the processes of the global and domestic economy, but similarly to the former years, the recommendations and findings published in the present aim at the tasks of the future, and are designed to provide a background for the substantiation of future decisions.

The SAO annual activity report makes it possible to have a systemic evaluation of audit experiences, review measures taken as a result of the recommendations, and review the influencing factors. Furthermore, the report presents the operation, financial management and development of the organisation of the SAO.

In compliance with the Act on the State Audit Office, the financial management of the SAO is audited by an independent chartered accountant mandated by the Speaker of the National Assembly following a tender procedure. The chartered accountant attached an unqualified opinion to the 2008 financial statement.

SUMMARY

The SAO has been confronted with the fundamental problem posed by the **lack of identification of public tasks** since its establishment. This deficiency goes beyond itself, since it affects strategic thinking, financing and the organisational structure, too. Almost all our audit findings and recommendations draw attention to this problem. The recurrent experiences of the SAO and the limited utilisation of its recommendations draw attention to the fact that the current problems of public finances and the national economy would likely be much less serious if within a reasonable time following the political transformation a consensus-based decision had been made about the content and size of public tasks that the state could assume and finance.



*Note: Figures calculated by the SAO, source: HCSO 'Figures for the government sector' and 'Gross domestic product', * 2008 forecast*

The measures that have recently been initiated with a view to rationalisation and efficiency improvement, and the changes that have occasionally been accompanied by organisational restructuring, have not been implemented within the framework of an independent and comprehensive and full reform programme or development strategy. As a consequence, those measures have been given preference that aim to promote shorter-term stabilisation and consolidation, as well as to increase revenues and decrease expenditures. All this considerably influences not only the position of the budget, the balanced operation of the public sector, but – to the same extent – the competitiveness of the entire national economy.

In the absence of transparent and consistent administrative operations, clear principles and the necessary decisions the tasks and the required resources could not be harmonised. The system audit of the development of central public administration concluded that **no progress had been made** in relation to the most important deficiency, **i.e. the creation of the regulatory and organisational frameworks of planning, strategy development and ex-ante/ex-post impact assessments**. The exploration of required professional correlations between the scheduling and implementation of the individual measures was still

unsystemic, while the time requirements, starting and ending dates of the programmes were often assessed wrongly. The modernisation process was hampered by the fact that the related system of governmental responsibility was frequently modified, and that the analysis of the work of the Government as an organisation was not given utmost priority.

Within the Government's objective of creating a 'smaller and more efficient state' the decision-makers failed to assess the impacts (including the costs and risks) of the frequent modifications, of the regulatory and organisational restructuring related to the institutional system of the central public administration and to the internal organisations of the individual institutions. Equally, they failed to assess the benefits of stability, and whether there was real decline in expenditures after the 'outsourcing' of functions, or only the composition of expenditures changed.

The modernisation of the **large supply systems** also requires the thorough analysis of social correlations, and requires an approach that **goes beyond fiscal aspects taken in the narrow sense of the word**. The SAO's audit experiences show that **this approach was not enforced in the changes**.

A major change in the recent past was the strengthening of the social security nature of healthcare services, and the increased linkage of services to insurance. However, no mature and consensus-based **solutions** have been found to **the most important structural and financing issues**, as well as to the modernisation of the insurance system. Although the social security system closed the year 2007 with a surplus, apart from the rationalising measures of the Government this was also due to the fact that the central budget supplemented the revenues by nearly HUF 780 billion. Consequently, this increased the deficit of public finances taken as a whole. According to the preliminary data, despite increasing fund transfers (HUF 835 billion) from the central budget, the social security system closed the year 2008 with a significant deficit (HUF 67.7 billion) again.

Several streamlining and cost-reducing sub-measures were taken in the **education sector**, too, however the directions of actions and the concrete steps that could improve the general level of knowledge and the specific quality indicators – and on the basis of which the entire system of education could better suit the needs of a modern economy (by making a definite shift toward the so called knowledge society) – are not known yet.

The recurrent audit experiences warn that one of the most important problems is that of increasing the **quality of employment**. However, this is adversely affected not only by the consequences of declining growth, but also by the **structural and quality obstacles of the supply of labour that can be overcome only in the long run**.

The content, operation and financial management related problems of public administration, healthcare and education also appear in the day-to-day practice of the local governments and their institutions. The audit of the final accounts altogether found the budget relations of the local governments in order, just like the regularity of fund transfers and utilisation, but other SAO

audits and the study prepared by the **Research Institute of the SAO confirmed** that in relation to the funding system, as well as regional and settlement development, the reform of the local governmental system, including the revision of tasks and scopes, **is becoming increasingly inevitable.**

In the absence of the identification of financeable public tasks, another shortcoming of the current Hungarian budgetary system is that **due to the inadequately structured information system the amount of funds spent on the individual tasks cannot be accurately determined, and due to the lack of performance indicators it is impossible to determine in what manner and how effectively the expenditures are utilised.**

Budget planning that takes social correlations and also long-term perspectives **into account** assumes and requires the operation of a macroeconomic financial planning system that is more developed than the current one and is adjusted to the nature of the market economy. This is not only an efficiency and competitiveness factor, but also a consequence: this is how the operation of the state becomes **more transparent and authentic.** This is why it was emphasised in various SAO audit reports and in the studies of the Research Institute of the SAO that a **national economic development policy** built on a **consensus-based strategy** must and can be elaborated, which also assumes and requires the development and operation of **a national economic planning system.** The most important feature of the system to be created is **institutional harmony** between **real development** (national development concept and plan, regional development, settlement development, economic development, development of the social and the cultural sectors) and **financial planning** (Convergence Programme and the annual budgets at central and local levels alike). Another requirement towards this system is that it should integrate the structural reforms into the development plans while keeping the requirements of development policy and competitiveness in mind.

The SAO's experiences also confirm that a modern and reliable national economic planning system is beneficial not only for the operation and development of the national economy (including public finances), but also because it makes the operation of the state more traceable, transparent and predictable, which is a major precondition for the reinforcement of public trust.

1. TASKS OF THE STATE AUDIT OFFICE OF HUNGARY IN 2008

1.1. Execution of the annual audit plan

In 2008, the SAO continued to perform its activities based on the approved audit plan, which was discussed by the National Assembly's Committee on Budget, Finance and Audit Office.

The annual audit plan included a total of 78 topics, including 55 to be completed in 2008. During the year one audit was added to, while one task was deleted from the audit plan, wherefore the amended audit plan also included 78 audits.

Audit included in the plan during the year: audit of the accounting of funds used for the by-election campaign in February 2008.

Audit deleted from the plan during the year: audit of the operation of the Ministry of Economy and Transport, since in the meantime it was disintegrated into several organisations.

In 2008, the SAO published as many as 53 audit reports. The completion of two reports that had been planned to be prepared in 2008 was carried over to 2009.

The audit of the Hungarian public administration system was completed in 2008, but the relevant audit report was published in 2009.

The financial regularity audit on the legality of the financial management of the Hungarian Justice and Life Party in 2005 and 2006 had to be interrupted mid-year due to the obstructive conduct manifested by the audited organisation. Consequently, the planned deadline for completion could not be met; the audit was completed in January 2009.

In 2008, the SAO fulfilled its audit obligations by using 55,817 direct auditor days, 3,723 days fewer than in the previous year. The actual capacity was 6,270 days smaller than planned. This decline was the consequence of staff restrictions, financial austerity measures and the growth in the number of retiring staff members.

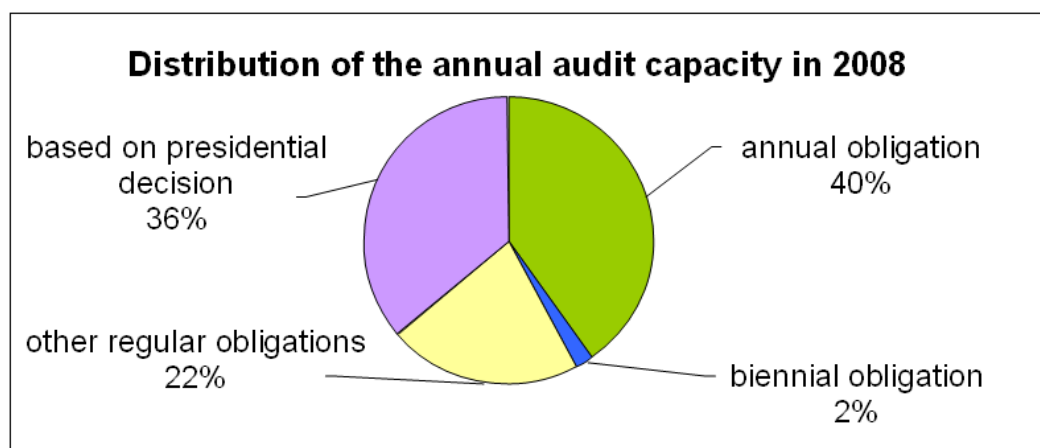
Audits that are required by the law to be **performed with certain regularity** (annually, biannually and regularly) represent top priority tasks of the SAO. The completion of these tasks resulted in the publication of **32 audit reports**, which absorbed **64%** of the audit capacity of the SAO, just like in the previous years.

As a result of compliance with the **annual** audit obligations five reports were prepared (opinion on the fairness of the state budget, audit of the final accounts, audit of the operations of the Hungarian Privatisation and State Holding Company and the Hungarian News Agency Corporation, as well as the audit of revenues to be shared between the Municipality and the district local governments of Budapest).

Within the annual audit obligations the task that required the largest capacity was the audit of the execution of the 2007 budget, which absorbed 28% of the annual audit capacity of the SAO, similarly to the previous year.

Within the framework of the **biennial** audit obligation, altogether four reports were prepared on the financial management of two political parties and two party-affiliated foundations.

Within the framework of **regular audit tasks**, the SAO published 23 reports. The majority of this work (over 80%) was made up by the comprehensive audit of the financial management of local governments. In addition to the report summarising the findings of the comprehensive on-site audit of 167 local governments, separate SAO reports were drawn up on 17 local governments with significant budgets and property. From among the chapters of the central budget, a report was compiled on the comprehensive audit of the Ministry of Finance, which spanned several years. Furthermore, this activity included the audit of the operation of the Research and Technology Innovation Fund and the National Bank of Hungary, as well as the audit of two national minority self-governments (Armenian and Ukrainian).



In addition to compliance with the legal obligations, as much as 36% of the annual audit capacity could be used for audits the frequency of which is not regulated by law. The audit capacity absorbed by **audits carried out on the basis of the decision of the SAO's President** equalled the same proportions as last year, and altogether 21 audit reports were compiled.

In line with the strategic objectives of the SAO, the audits performed on the basis of the decision of the SAO's President concentrated on four major areas.

The audits on the institutional system of the central budget, the system of chapter-managed appropriations, the system of public procurements and the system of state instruments for economic development aimed to promote the transparent and regular operation of public finances and to reinforce budgetary responsibility.

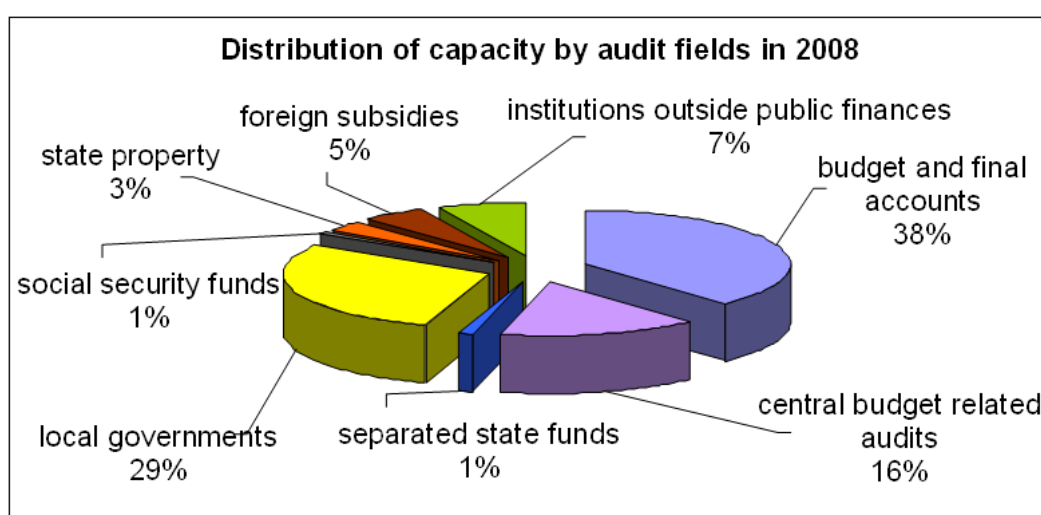
In order to examine whether the EU funds are utilised for the designated purposes, the SAO audited the operation of the National Development Agency and the utilisation of budgetary appropriations allocated for INTERREG purposes.

For the protection of state development resources, and for the detection of risks inherent in the relationships between public finances and the private economy,

audits were carried out in connection with the motorway investment projects completed in 2007, certain priority local governmental investment projects, and the modernisation of rail transport.

Under the Chapter 'Ministry of Education and Culture', the audit of the funding system of public education tasks and the audit of the utilisation of budgetary subsidies granted to non-profit organisations engaged in educational activities, the audit of the effective utilisation of funds provided for oncological screening programmes, for nursing and rehabilitation in local government owned hospitals and residential social care institutions, for development programmes in vocational schools, the audit of the operation of multi-purpose micro-regional associations of local governments, as well as the audit of the operation of the system of public health services aimed to ensure the efficient and effective performance of public tasks.

In 2008, no audit requests were submitted to the SAO by the National Assembly or the Government.



The SAO classifies its audits according to **three main types**. In 2008, the SAO used 46% of its capacity on regularity audits (opinion on the budget appropriation bill, audit of the final accounts, audit of the financial management of political parties and foundations), 29% on comprehensive audits (local governments, ministries, the institutional system and appropriations of the central budget), and 25% on performance audits. This distribution does not differ significantly from that of the previous year.

1.2. Other tasks of the State Audit Office of Hungary

Other activities of the SAO include several authorisations and tasks that are prescribed by the Constitution, the Act on the State Audit Office and other legal regulations, which authorisations and tasks go beyond the audit obligations and mandates taken in the narrow sense of the word.

The President of the SAO countersigns the contracts related to the borrowings of the central budget, and gives an opinion on proposals aiming to further develop the accounting system and the internal financial control system of public finances. He makes recommendations for the post of chairman of the supervisory board of the

state holding company, as well as the chartered accountants of the separated state funds. He comments on the chartered accountants of the National Bank of Hungary and the Hungarian Development Bank, and may form a preliminary opinion about the person to be appointed to the post of President of the Hungarian Tax and Financial Control Administration.

In business organisations where the state is at least a majority shareholder – and where the registered capital exceeds HUF 200 million – the chairman of the supervisory board is recommended by the SAO upon the request of the head of the business organisation.

In the case of certain business (credit, investment, insurance and budgetary) organisations – specified by law – auditing required by law can only be performed by a certified auditor or audit firm for which certification can be issued by the Chamber of Hungarian Auditors upon request, in the framework of an official procedure. Pursuant to the new Act on the Chamber of Hungarian Auditors, the Activities of Auditors, and on the Public Oversight of Auditors, the SAO needs to be asked to form opinion in the procedure launched for the approval or revocation of the budgetary certification of a member (auditor or audit firm) of the Chamber. The SAO has the right to express opinion to the Chamber in relation to suspected conflict of interest and disciplinary offences.

Complaints and announcements of public interest can be lodged by anybody – orally, in writing or electronically – to the agency authorised to conduct procedures in the given subject matter. The legal basis for procedures related to announcements, proposals and requests of public interest is provided by the articles of Act XXIX of 2004 pertaining to announcements, complaints and request of public interest (Articles 141 through 143).

Countersigning authority

The President of the SAO fulfilled his countersigning obligation in 2008, too, in relation to loans designed to maintain the liquidity of the budget.

On behalf of the Republic of Hungary, the Minister of Finance authorised the chief executive officer of the Government Debt Management Agency Private Company Limited by Shares to sign rollover loan contracts in the amount of at least EUR 200 million to ensure coverage for swap transactions. In 2008, contracts were signed with three banks for EUR 50, 50 and 100 million, respectively. After the documentation related to the loan contracts was checked for regularity, the President of the SAO countersigned all three loan contracts.

Similarly to the former years, no project financing loans were countersigned by the SAO in 2008¹. These loans are designed to finance budgetary investment projects implemented in areas that are given priority by the Government, and the implementation of which is approved beforehand by the National Assembly or the Government. International investment loans are disbursed through the chapters' budgets. These credit relations, the commitments arising from the

¹ Since 2004 as many as 35 project financing loans have been taken out, including eight in 2008.

drawdown of these credits, as well as compliance with such commitments are always audited by the SAO within the framework of ex-post audits.

According to the written information provided by the undersecretary of the Ministry of Finance, the credit lines extended by the International Monetary Fund (EUR 12.5 billion), by the European Communities (EUR 6.5 billion) and by the World Bank (EUR 1.0 billion) are designed to finance the current balance of payments, and the amounts drawn down increase the foreign currency reserves of Hungary. Therefore, the obligation to countersign did not apply in these cases either.

Opinion forming authority

In 2008, the SAO exercised its opinion forming authority – **provided in relation to changes in the accounting rules** – in connection with the bill on the amendment of certain acts on taxation and contributions affecting the Act on Accounting, in connection with the amendments in Government Decree 249/2000 (XII. 24.) on the financial reporting and accounting obligations of public finance institutions, and that of Government Decree 240/2003 (XII. 17.) on the reporting and accounting obligations of **treasury** accounting.

Pursuant to the provisions of the new Act on the Chamber of Hungarian Auditors, the Activities of Auditors, and on the Public Oversight of Auditors, in 2008 the SAO formed opinion on the **certification as public auditor** of 182 auditing firms that belong to the Chamber of Hungarian Auditors, and two public accountants that are members of the Chamber. During the year no initiation was made for the withdrawal of the certification, and no suspected conflict of interest or disciplinary offence was reported either.

Authority to make recommendations

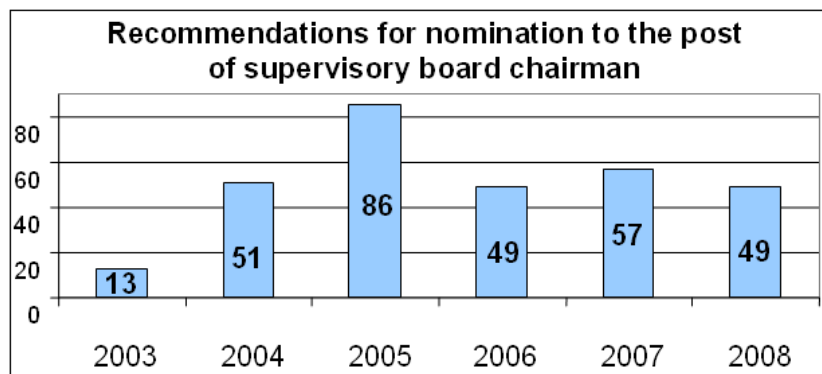
Upon the request of the Minister of Finance the President of the SAO recommended a nominee for the post of chartered accountant at the Wesselényi Miklós Flood and Inland Water Compensation Fund for the business years 2008 and 2009, and one for the post of chairman of the supervisory board, after a cause of conflict of interest was reported.

Upon the request of state business organisations, and acting within the SAO's scope, the SAO's Secretary General made recommendations for the posts of supervisory board chairmen exclusively from among successful applicants included in the list of candidates.

In order to increase the list of potential nominees, following the former six calls for proposals, the SAO launched a call for proposal in June 2008, as a result of which the number of successful applications managed by the SAO grew by 32. Based on these applications the number of potential nominees was 711 as of 31 December 2008.

In 2008, the SAO considered requests submitted by 51 business organisations. After additional information was supplied upon the SAO's request, the Secretary General of the SAO made recommendations on personal nomination for 49

business organisations in line with the rules of procedure established and published.



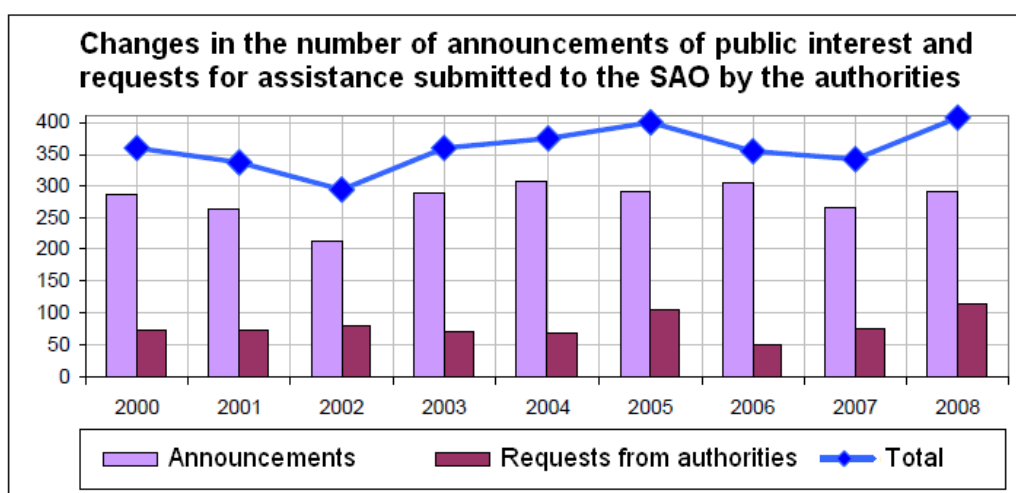
In 2008, no proposal was submitted for the withdrawal of any supervisory board chairman elected upon the SAO's recommendation.

As of 31 December 2008, as many as 129 persons were in position as supervisory board chairmen upon the SAO's recommendation.

Announcements, proposals and requests of public interest, official enquiries

In 2008, the number of citizens that contacted the SAO with questions and recommendations pertaining to the utilisation of public funds continued to grow. Contacts initiated by official bodies for the request of information hit record high.

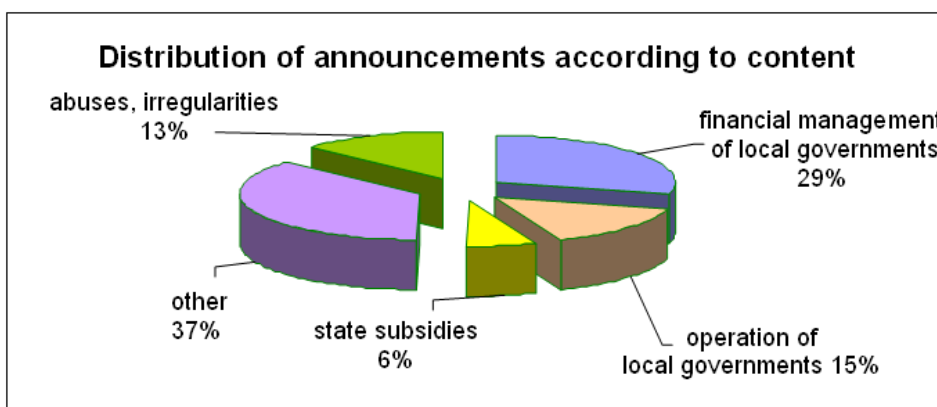
During the year the SAO received 293 written announcements and complaints of public interest, while state and local governmental authorities requested assistance 115 times. In addition, the SAO was contacted via telephone 147 times. The growing number of announcements of public interest submitted to and contacts made with the SAO indicates that the general public is showing increasing interest in the utilisation of funds from the state budget and the European Union.



Announcements of public interest submitted in relation to the financial management and operation of local governments and local minority self-governments are still high in number. The SAO saw a rise in the share of

announcements/requests pertaining to the finances of organisations fully or partially funded from the state budget, to the utilisation of public funds received through tendering procedures, to public procurements, as well as to the utilisation and accounting of EU funds. The announcements were often linked to the personal enrichment by certain state or local governmental officials, as well as to suspected abuses.

With the announcers' consent, the SAO forwarded 11 announcements on suspected crimes to the investigation authorities. Requests for the interpretation of law and for opinion on the application of law continued to arrive in large numbers; however in 2008 such requests were mostly submitted by professional entities (officials of local governments, representatives of assemblies).



Out of those who submitted announcements to the SAO in 2008, 34% were private individuals, 15% were heads or officials of local governments and local minority self-governments, and 30% belonged to other entities (private entrepreneurs, representatives of various social organisations or parties, lawyers, etc.), and 21% were persons who were unwilling to disclose their names.

The contents of these announcements are on one hand utilised during the development of the audit programmes and the performance of the audits, while on the other hand the SAO informs the announcers about the possible legal remedies and other possibilities.

1.3. Further tasks assigned to the SAO and pending regulation

By adopting Act X of 2008 – to amend Act LVII of 2006 on central public administration organisations and on the legal status of Government members and undersecretaries, the National Assembly commissioned the SAO, as of 27 March 2008, **to audit the personal enrichment of senior state officials**. The new regulation, which orders the application of the Act on the Rules of Taxation, obliged the SAO to perform specific public authority tasks. This regulation failed to take into account several decisions of the Constitutional Court, according to which the SAO is not a public authority, but a body of executive power performing audit tasks and having a specific legal status.

Therefore, in its Decision No 72/2008 (VI. 10.) on the approval of the SAO activity report 2007, the National Assembly requested the Government to review the provisions of Act X of 2008 on certain legal amendments required

for the transparency of the remuneration of senior state officials, and to submit – on the basis of the results of such review – a proposal on the modification of the audit of the personal enrichment of senior state officials.

This proposal was not submitted by the closure of this report despite the fact that the SAO submitted its own draft proposal on the amendments to the Prime Minister's Office on 2 June 2008. Since no discussion took place on the merit of the draft proposal, the SAO repeatedly offered to participate in the preparation of an enforceable regulation.

Within the framework of the reform of public finances, the SAO recommended the **further development of the audit system of local governments**. Taking this into account, too, progress was made in the integration of the European standards into the internal audit systems of the local governments, but despite support from the Consultation Forum of the Government and Local Governments, the issue of developing a system of auditing the statements of the local governments under the SAO's ultimate responsibility was left open.

2. AUDIT FINDINGS OF THE STATE AUDIT OFFICE OF HUNGARY

2.1. Main findings classified by the subsystems of public finances

Considering the entire system of public finances, the 2008 audit on the final accounts concluded that the actual general government deficit in 2007 totalled HUF 1,361.5 billion (5.4% of the GDP), 22% less than the original appropriation. Over 90% of the more favourable than planned deficit was realised at the level of the state budget. The fiscal objectives stipulated in the Convergence Programme were attained despite the fact that certain macroeconomic processes took an unfavourable turn (the GDP growth decelerated at a higher rate than expected, investment projects stagnated and the inflation rate was higher than planned).

The favourable change in the balance of public finances was influenced by several factors, and was fundamentally triggered by the surplus generated on the revenue side. On the revenue side, balance improvement can be attributed to the surplus revenues from taxes, contributions and interest, as well as to the excess of revenues and payments of central budgetary organisations and chapter managed appropriations. On the expenditure side interest expenditures and payments made in connection with the underground line construction turned out to be smaller than planned. Furthermore, pharmaceutical subsidy and sick pay related expenditures fell short of the appropriations, and so did EU contributions. The position was improved by debt assumptions that were completed a year before the original schedule.

The achievement of the balance of the large supply systems of public finances, which improved the financial position of the general government, resulted from legal regulations and government measures adopted in 2006 and 2007 with a view to improve the general government balance (to increase revenues and decrease expenditures), as well as from changes in the economic processes.

2.1.1. Central budget

In 2008, the SAO audits focused on the systemic approach to several distinct fields of the central budget, such as its institutional system, the system of chapter-managed appropriations, state instruments available for economic development, and the public procurement system. The experiences so obtained highlight the basic problems of the operation of the central budget, which the SAO has indicated for many years.

The modernisation of the institutional system of the central budget has been a definite intention since 2004. To this end several government decisions formulated measures between 2004 and 2006. The government programme for 2006 announced the comprehensive reform of the state, the large supply systems. Being compelled to act due to the financeability of public finances and the feasibility of the Convergence Programme, in 2006 the Government decided to restructure the institutional system of the central budget. It called for the elaboration of bills and the continuous monitoring of execution. In relation to further tasks linked to the review of public tasks a 2007 government decision required the elaboration of a concept for the introduction of programme-based budgeting (which builds on performance information, too) under the guidance of the Minister of Finance by 31 December 2008.

The draft proposal on the financial requirements of the operation of public finances, on the method of utilisation of resources required for the performance of public tasks, and on the restructuring of the institutional system – which was elaborated by the Minister of Finance, who was the number one official in charge of the tasks related to the reform of public finances until 2006 – was not discussed by the Government. The division of tasks and responsibilities between the State Reform Committee and the Ministry of Finance regarding the state reform and public finances was not clear.

The restructuring of the organisational system and the modernisation of the institutional system would have required the definition of longer-term tasks to be performed and financed by the state, the elaboration of the organisational models of public institutions, and the compilation of comparable databases containing public administration and statistical information typical for budgetary organisations. The SAO audits concluded that although the principles of restructuring the institutional system of budgetary organisations should have been developed by the competent ministry by the end of April 2004, the aspects and arranging principles of the reviews that were designed to lay the foundations for the action plans were identified only in the summer of 2004. No institutional models and criteria were established for the elaboration and consideration of the organisation related proposals. The ministries failed to take measures, wherefore in March 2005 a new government decision ordered the renewal of the action plans, and then, at the end of May 2006, another government decision ordered the elaboration of recommendations for the restructuring of organisations with the largest expenditure appropriations.

When deciding about the radical restructuring of the institutional system of the central budget in 2006 the Government did not review the tasks to be

performed by the state, and nor did it specify organisational types, or task and performance criteria. **The lack of strategic foundations may pose a risk for the attainment of permanent savings, as well as the long-term stability of the institutional structure and the budget.** No documented debate took place in connection with the government decision in the public administration system, although that could have prevented the prescription of measures that cannot be implemented for professional or legal reasons, the prescription of unrealistic deadlines, and the modifications of the ordered measures. **The government decision was amended 19 times.**

The action package aiming at the restructuring of the institutional system of the central budget included tasks for all ministries and their institutions (liquidation of institutions, merger of national networks, regional restructuring, inclusion of the tasks of off-budget organisations into the scope of budgetary institutions). By the end of 2007 the tasks had either been completed, or performance was under way. The execution of the decision affected 415 budgetary institutions, and 96 organisations outside the system of public finances. As a result, the institutional system of the chapters became smaller, operations and staff became more concentrated. These changes laid the foundations for an expenditure reduction of HUF 50 billion in the budget for 2007 through downsizing.

Within the budgetary institutions the types of central public administration bodies were determined by the National Assembly in June 2006. Organisational forms suitable for the nature of the different public tasks were introduced by Act CV of 2008.

Based on the monthly reports of the ministries, the Prime Minister's Office monitored the performance of tasks related to the restructuring of the institutional system of the central budget. The system of reporting did not yield reliable data on one-off and permanent savings. By November 2007 the ministries failed to assess the financial impacts of all organisational measures, and the Prime Minister's Office did not filter out the distorting effect of insufficiently reported figures. The savings expected to be realised pursuant to the measures were determined only for downsizing, wherefore the occurrence of the expected impacts too can be determined only in this field.

During the audit of the system of chapter-managed appropriations the SAO concluded that several factors implied in the financial management of such appropriations were against the transparency of financing and utilisation. These factors include: the frequent modification of the priorities of the budget policy; lack of indicators and indexes determining the usefulness of expenditures at the time of the adoption of the budget acts; the complicated structure of chapter-managed appropriations; the development of different titles in the chapters; lack of traceability of performances in the chapter-level records in case of utilisation through the reallocation of appropriations.

Neither the state's and the Government's economic development tasks, nor the exact performance of such tasks were defined. Consequently, the exact amount of needed and available resources is not known. During the audit of the system of state instruments available for economic development the SAO concluded that for years the budget had

annually spent HUF 1,500 billion **without having comprehensive** (covering both EU and national resources) **medium- and long-term social and economic strategies**. For the lack of a long-term strategy spanning governmental cycles, and as a result of changes in concepts affecting the role and tools of, and resource utilisation by the state, the implementation of development programmes was characterised by booms and busts. A long-term tax strategy promoting the development objectives was also missing. Such a tax strategy should define the types and extent of tax allowances that would be required for the achievement of the goals.

No comprehensive legal regulations were developed for the reinforcement of the planning of state development tasks. The different types of development subsidies that were financed exclusively from Hungarian resources were governed by different legal regulations. Consequently, different rules of procedure, registration and monitoring systems, as well as information systems developed separately for each organisation were in use.

The SAO audits also extended to the audit of the level of efficiency and regulation of the control and internal audit systems. Earlier the SAO concluded that the reliability of accounts and statements were endangered by the fact that the chapters' internal control system had degraded to such an extent that the conditions for the legality and efficiency control of the financial management of public funds were nonexistent. It was concluded that **the tasks related to the development of the public internal financial control system were not performed**. The annual reports prepared for the Government by the competent ministry drew attention to the quantitative and qualitative problems of human resources, but took no steps for finding a solution. The public internal financial control system was not reconsidered in a systemic manner, international experiences were not adapted, the relationship between the internal financial control systems and the internal audit system was not clarified or regulated, and the reliability checks were not integrated into the internal audit or control system.

The recurrent weaknesses of the control systems of the management of chapter-managed appropriations were caused by the deficient audits of utilisation. The number of audits related to chapter-managed appropriations significantly dropped in the ministries, typically due to staffing problems. It often happened that the supervisory bodies did not plan audits regarding the utilisation of chapter-managed appropriations, or they did not conduct the planned audits.

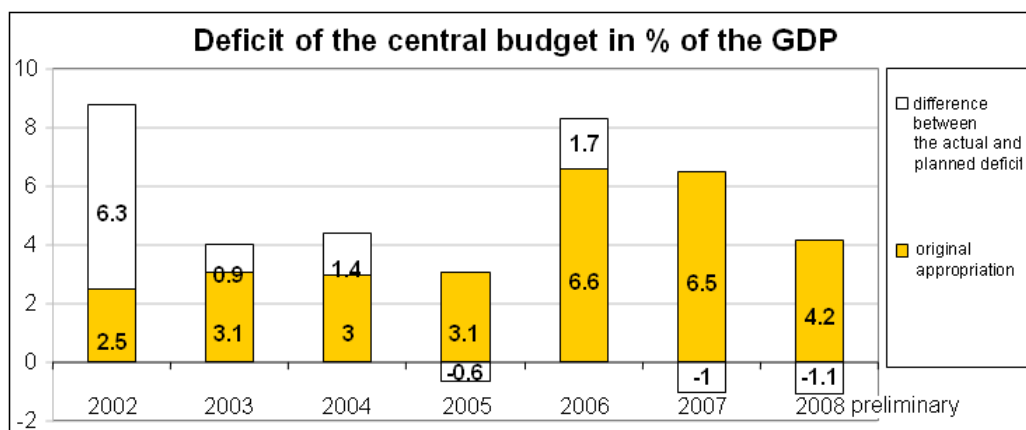
The internal audit of public procurements is neglected both by the central and the local governmental organisations. This also restricted the enforcement of the supervisory controls and the proprietary interests of business organisations affiliated to the state or to local governments.

Audit of the 2007 final accounts

A major task performed in 2008 was the audit of the execution of the budget. The legally set deficit (HUF 1,656.5 billion) of the central budget in 2007 turned out to be significantly smaller than planned (HUF 1,398.1 billion), which could be achieved only once in the past six years, in 2005.

It points to planning inaccuracies and problems in the central budget – which were indicated by the SAO earlier, too – that similarly to the former years, in 2007 the deficit significantly differed (by HUF 258.4 billion or 16.6%) from the planned deficit stipulated in the act, albeit this time the discrepancy was for the better.

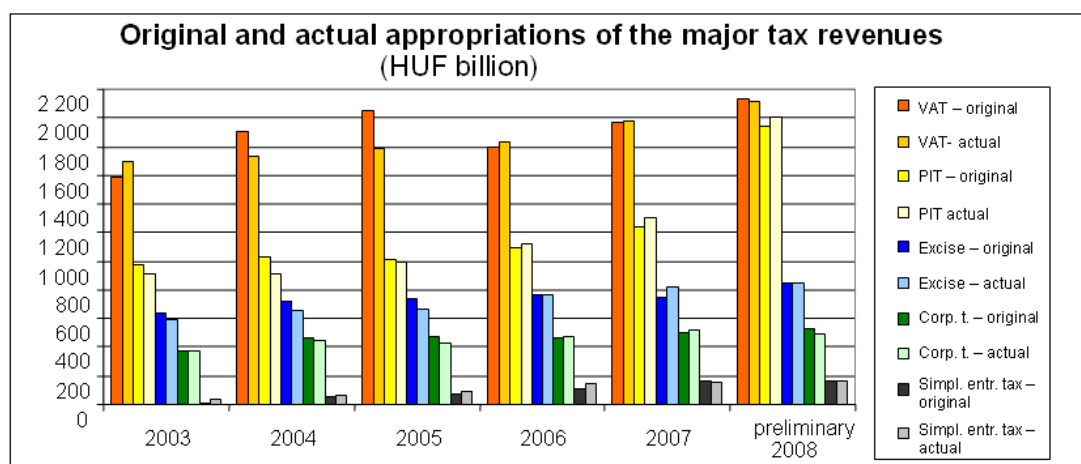
In connection with the deficit for 2007 it must be noted that the bad practice of the previous years was not repeated (when following modifications effected throughout the year, an amendment to the budget act was ‘designed’ to legalise the deficit of the central budget in the last month of the budget year).



Source: budget appropriation and final accounts acts, preliminary figures calculated on the basis of the information provided by the Ministry of Finance on 20 January 2009.

The size of the central budget deficit stipulated in the budget act was basically influenced by the tax revenues, as well as by expenditures related to debt assumptions and interest burdens.

The larger than planned revenues from the major tax types (VAT, PIT, excise tax, corporate tax and dividend tax) yielded an additional income of HUF 158 billion for the central budget, while the smaller than planned revenues from other taxes and duties (that represent a minor share in the central budget) reduced such income by HUF 45 billion.



Source: budget and final accounts acts

The tax revenue appropriations and the completion thereof indicate that contrary to the former years, no ‘overplanning’ occurred in 2007.

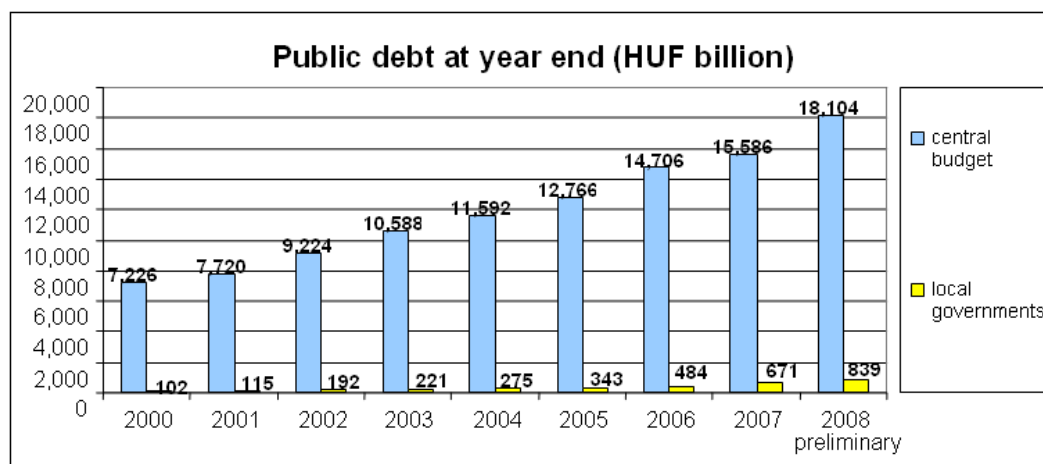
The actual debt service and debt assumption related expenditures turned out to be HUF 106.6 billion and HUF 87.9 billion less than appropriated, respectively.

The smaller than planned cash-flow deficit of the central budget can be attributed to one-off factors that would not permanently improve the budget balance.

Year after year, the SAO has recommended the renewal of the methodology of budgeting, the substantiation of macroeconomic forecasts, the realistic determination of major revenue and expenditure appropriations, with proper consideration to the economic and social processes. **This recommendation has not been taken into account yet.**

Funding for the central budget, for the financial funds of the social security system, and for the separated state funds was ensured in 2007. Funding for public finances turned out to be much more favourable than planned.

At the end of 2007 the debt of the central budget was by HUF 1,321.1 billion smaller than planned in the act (HUF 15,585.5 billion), yet it was twice the size of the debt as of 31 December 2001.



Source: Government Debt Management Agency, Ministry of Finance, the figures on local governments pertain to Q1-Q3 of 2008

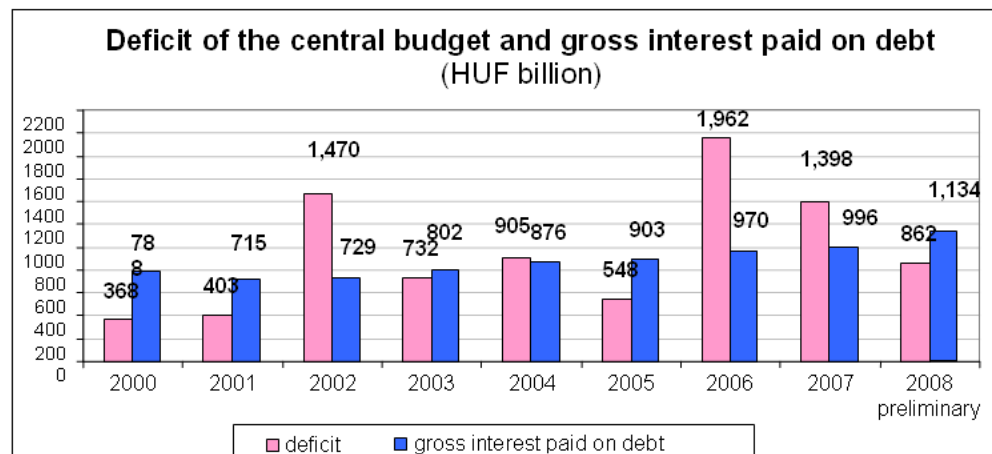
Note: The debt of the central budget grew by HUF 2,518.4 billion in 2008 HUF 1,034.8 billion of this increment served actual financing objectives, and HUF 1,483.6 billion was deposited in foreign currency at the National Bank of Hungary (IMF, EC).

The significantly smaller (6%) than planned (15%) increase in debts resulted from the combined effect of several factors. In 2007, the financing needs of the central budget were more favourable than planned, and liquidity was improved by EU funds. All this allowed for declining bond issuances and higher rates of debt repayment. The debt of the central budget was also reduced by the fact that the average foreign currency exchange rate (251.3 HUF/EUR) fell short of the forecasted average exchange rate (HUF 275.5/EUR).

The debt totalled 61.3% of the GDP, 0.6% less than in the previous year.

On the basis of preliminary data, by the end of 2008 the debt of the central budget grew by 16.2%, which means a higher growth rate than that seen in the previous year. At the end of the year the debt of the central budget totalled HUF 18,103.9 billion. Excluding the foreign currency deposit at the National Bank of Hungary, the debt equalled HUF 16,620.3 billion. The foreign currency deposit comes from the loan package extended by the IMF, the EU and the World Bank, from loans that can be drawn down by the Hungarian State. On 12 November 2008 the Hungarian State drew down a loan totalling EUR 4.9 billion from the IMF, which was deposited in full at NBH. On 9 December 2008, a loan of EUR 2 billion was drawn down from the credit line provided by the European Union, EUR 1 billion of which was used for financing, and the other EUR 1 billion was deposited. At the end of 2008 the debt/GDP ratio equalled 66.5%. (Together with the foreign currency deposits kept in the NBH, the debt/GDP ratio was 61.1%).

Expenditures related to debt services and interest repayment in the 2004-2007 period represented an alternating share of the total expenditures, and annually equalled 11.8% to 14.2%, or HUF 900-1,100 billion.



Source: final accounts acts, Ministry of Finance, Government Debt Management Agency

In 2007, the absolute amount of the gross interest paid on the debt of the central budget grew by HUF 25.7 billion, while in 2008 – on the basis of preliminary data – the amount of the gross interest paid increased by HUF 138.3 billion. The increased interest expenditure is related to the higher growth rate of the debt of the central budget, as well as other factors.

The size and weight of expenditures related to debt services significantly narrows the room for manoeuvre of the budget policy, and also of the Government.

The finances of the central budgetary organisations were characterised by permanently high debts in 2007, too, however the debt somewhat reduced by the end of the year. Contrary to the former years, the size and share of financing problems decreased. The SAO has repeatedly experienced in the past years that government measures are needed to reduce the high debt generated by the end of the year. This draws attention to the shortcomings of the work of the Government, i.e. **that the tasks of the**

budgetary institutions and the funds required for the performance of these tasks have not been harmonised yet.

The amended appropriations of the reserves of the central budget for 2007 (general reserve, special reserve, central balance reserve) altogether contained HUF 139.9 billion. During this year not only this amount was used, but another HUF 73.4 billion was utilised legally, too.

The reason behind this is that upon the amendment of the budget act, payments were made from the special reserve with a view to improve income relations in the public sector.

Similarly to the audit experiences of the former years, **the utilisation of the general reserve exceeded the amount approved by the legal regulations** (by 24% of the appropriation).

In the case of certain tasks the chapters' additional funding needs financed from the general reserve could not be regarded as unforeseeable and unplannable expenditure items, or appropriated expenditures that had to be replaced from the general reserve due to the loss of revenues for unpreventable causes.

The budget act originally appropriated HUF 50 billion as **central balance reserve**, which amount was then amended to HUF 45 billion, and was actually used. The budget act provided a general authorisation to the Government to decide on the utilisation of the central balance reserve depending on the budgetary and economic processes. This authorisation meant unrestricted utilisation, **since no legal regulation specified the purposes, conditions and methods of utilisation of this reserve**. Consequently, **the SAO audit could not examine the legality and expediency of these budgetary expenditures**.

According to the statements of the Hungarian Tax and Financial Control Administration, debts owed by taxpayers to the central budget increased by HUF 130.3 billion to HUF 1,079.7 billion. Since the data of 2006 tax returns that were incomplete and were processed without corrections were also taken into account, the unpaid taxes indicated in the opening balance of 2007 are not realistic. On the other hand, the closing balance cannot be regarded authentic due to problems that occurred during the takeover of outstanding duties.

The amount of the accumulated unpaid taxes deserves special attention, because it almost equals the budgetary expenditure spent on the payment of interest on public debts in 2007, or three quarters of the revenues of the central budget from the personal income tax.

The years-long rise in the amount and share of the outstanding tax receivables compared to the revenues, as well as the continuous deterioration of the composition of such unpaid taxes in terms of collectibility justify the need to present the tax and duty claims of the central budget in the report on the execution of the budget. Despite this fact the justifications of the final accounts do not contain information about the year-end unpaid taxes of revenue types that belong to the competence of the Hungarian Tax and Financial Control

Administration, about changes in these unpaid taxes, and about the causes underlying such changes.

In addition to the taxpayers' behaviour and the impossibility to collect, the rise in unpaid taxes is indirectly caused by slower economic growth, as a result of which business organisations incurred liquidity problems. Therefore, to ensure continuous operation, companies first of all strive to clear debts with the suppliers before they pay off their tax debts. The deceleration of economic growth can be witnessed in the rising number of insolvent companies, too. The unpaid taxes of taxpayers subjected to liquidation procedures in 2007 exceeded HUF 193 billion. The procedures affected as many as 9,147 companies. (In comparison, in 2006 the unpaid taxes totalled HUF 148.5 billion and affected 8,809 companies.) The Tax and Financial Control Administration tried to mitigate the growth in unpaid taxes with the available tools. As a result, it collected HUF 241 billion, HUF 16 billion more than in the previous year.

According to the statements of the Tax and Financial Control Administration, **tax, subsidy and duty overpayments totalled HUF 836.5 billion in 2007.** However, this amount does not represent all payment obligations of the Hungarian State. This can be explained by the fact that payments are recorded in the timeframe when unprocessed and incorrect tax returns are corrected. Furthermore, a large share of payments are made without the submission of tax returns, and there are a lot of tax returns that are submitted in the last months of the year and contain tax reclaims, wherefore the payment or rejection of such funds after the tax returns are checked, and then the related accounting operations are carried over to the next year.

The number of financial regularity audits performed within the framework of the audit of the final accounts – with the involvement of the audit organisations of the chapters – continued to grow in 2007. As a result, the SAO **could form an opinion on the reliability of 93% of the total expenditures of the central budget. Based on these opinions the SAO concluded that the cash flow data contained in the final accounts bill in relation to the central budget were altogether reliable.**

However, within these audits the financial statement of one institution could not be reviewed using the financial audit method; errors and deficiencies well exceeding the materiality threshold were revealed in several areas; and the SAO detected errors that allowed for the approval of the financial statement only with a qualified opinion. In several fields the SAO had to draw attention to errors that were below the materiality threshold, yet posed potential threats.

The 2003 Government Decree on the internal audit of budgetary organisations stipulates that the conditions for annual comprehensive reliability audits must be developed gradually by 2010. The performance of this task requires the development of the internal control system of the chapters and the internal audit organisations of the ministries, for which budgetary resources are indispensable.

A government decision stipulated that by 1 January 2007 the supply and event organisation tasks of the ministries – excluding property and assets management tasks – had to be transferred to the Central Services Directorate.

The transfer of assets was carried out in several rounds, and was still incomplete at the end of the audited period. According to the explanations of the ministries, delays in or non-performance of the transfer of certain assets were due to the deficient provisions of the relevant act.

Opinion on the 2009 budget

The preparation of the budget appropriation bills for 2009 and the approval thereof by the National Assembly **did not follow the ordinary course**. Within 30 days significant changes were made to these documents.

The Government repealed the budget appropriation bill submitted on 29 September 2008. The new, partially revised bill was resubmitted on 18 October, and then, on 31 October a motion was submitted with a view to modify the major tax revenue and reserve appropriations of the central budget, as well as certain appropriations of the budgetary chapters.

The budget appropriation bill that was newly submitted, and was subsequently modified two weeks later contained all those problems to which the SAO had drawn attention for years, to no avail. The management of these problems has become increasingly important due to the expected unfavourable real economic processes and the social consequences thereof.

The SAO opinion on the newly submitted budget appropriation bill and on the motion for amendment pointed out the **risks inherent in the realisation of the macroeconomic forecasts**, including, first of all, in relation to economic recession, household consumption, investments and employment.

Furthermore, the SAO drew attention to **the lack of harmony between the macroeconomic figures** compiled on 14 and 28 October 2008. It especially stressed that the employment level was left unchanged despite a 2.2% change in the GDP, and that the bill envisaged a mere 0.2% decline in exports and a modest setback in investments.

The SAO emphasised that the mitigation of the budgetary effects arising from the predicted macroeconomic processes would have justified **the formation of larger general and central balance reserves** than in 2008, and it recommended increasing these amounts to at least 1% of the GDP, i.e. to put an additional HUF 151.7 billion into the reserves. The Government and National Assembly ignored this proposal both during the preparation and the debate of the motion for amendment. This in part contributed to the fact that in the middle of January 2009 the Prime Minister announced the need for a budget adjustment of HUF 100-200 billion.

During the amendment of the tax revenue appropriations of the central budget problems occurred not only in connection with the substantiation of the macroeconomic forecasts, but also due to planning errors.

Similarly to the former years, **the necessary calculation data were typically unavailable** for the SAO to assess the fairness and realisation risks of the tax revenue appropriations contained in the repealed and newly

submitted bills of 2009. **Furthermore, in the case of the submitted motion for amendment the justification was not available either.**

The financial crisis, the financing problems of public finances, and the still unassessable economic recession and its consequences would have specifically **justified the identification of economic and budget policy instruments suitable for the management of budgetary priorities and the crisis alike.** Similarly to the former years, this identification is missing from the budget appropriation bill accepted for 2009 and from the enforcing legal regulations, too.

Similarly to the previous years, the conditions of the planning work related to the development of the 2009 budgets of the budgetary chapters did not make the elaboration of substantiated budgetary appropriations possible. **Instead of building on the completion of professional tasks, planning work became a process of revising the main figures obtained in the course of the bargaining processes.** For different reasons (partial acceptance of the additional funding needs, impacts of governmental restructuring on the chapters, etc.) the chapters' subsidy related figures were incessantly modified until the submission of the bill to the National Assembly.

During the elaboration of the chapter appropriations, the organisations supervising the chapters typically observed the provisions of the planning circular – just like in the previous years – but did not investigate how the appropriations (formulated as the sum of the different impacts) would influence task performance.

In violation of the provisions of the Act on Public Finances, the major figures for the three years following the subject year were not given for the chapters, wherefore the medium-term budgetary target figures were not updated in the planning period.

In contrast with the former years, the 2009 appropriations were modified due to the evolving macroeconomic processes. The amendment of the bill affected the personal allowances of the central budgetary organisations, and the contributions payable by the relevant employers.

2.1.2. Separated state funds

According to the experiences of audits conducted in 2008, **the financial position of the funds was balanced both in the individual funds, and in aggregate terms.** At the level of the subsystem more revenues were realised than expected, while expenditures were lower than planned. The separated state funds altogether improved the balance of the entire system of public finances by HUF 62.9 billion. At the level of the system of public finances the surplus of the separated state funds does not appear as saving, since it is used to finance the deficit of the central budget. The savings are included in the statements year after year, however, for the lack of resources their utilisation in the subsequent years is limited by law, wherefore **operation as a fund is a mere formality.**

In terms of budget size, the **Labour Market Fund** is still the largest among the funds of this subsystem. It fulfils state tasks related to the promotion of employment and the management of unemployment through the national network of labour organisations.

The SAO audits have indicated for years that some of the changes that have occurred in the internal structure of the expenditures show unfavourable trends. Although the amount of subsidies serving the implementation of employment policy goals somewhat increased in 2007, their ratio compared to the budgetary expenditure of the Fund fell short of the 2006 level. In relation to the budget for 2009 it can be concluded that funds to be used for active employment policy tools will continue to be neglected. **The active employment policy tools** have become more transparent due to the amendment of the relevant legal regulation, **but it is still difficult to measure their impacts on employment.**

The SAO's recommendations made for the review of the budget relations and legal background of the Labour Market Fund have been only partly welcome so far. A growing part of funds available for the Labour Market Fund are used to finance the operational costs of organisations, foundations and bodies that are directly or indirectly linked to employment.

In its opinion on the budget appropriation bill for 2009 the SAO stressed the high risk implied in the expenditures appropriated for passive benefits, and criticised the fact that the amount of aid to job-seekers was the same as in the previous year.

In 2007, the revenue appropriation of the **Homeland Fund** totalled HUF 2,349.7 million together with the funds transferred from the Labour Market Fund and certain chapters of the central budget. Fund transfers were effected with a view to realise the objective (consolidation of resources designated for similar purposes) specified in the government decision that initiated the establishment of the Fund. The lack of such transfers was criticised in former SAO reports. As much as HUF 981.1 million was disbursed under the concluded support contracts. The Fund Manager spent HUF 183.6 million on operational costs, which, pursuant to the relevant government decree, did not exceed 5% of the revenues realised in the subject year. The Fund increased its deposits by HUF 1,128.5 million in 2007, from which HUF 1,172.4 million shall be paid in relation to awarded, but not yet disbursed subsidies.

The appropriations of the **Central Nuclear Financial Fund (CNFF)** were implemented according to the requirements. Its accumulated balance-sheet total continued to rise (by HUF 16.1 billion), and reached almost HUF 115 billion by the end of 2007. It is an unfavourable turn that operational expenditures grew by 4.6% compared to the accumulation expenditures. **The legal appropriations of the budget of the CNFF have been considerably lower than the amounts specified in the medium- and long-term professional plans for years.** The lack of resources may cause certain tasks to be cancelled or deferred. Yet, all tasks contained in the working programme for 2007 were completed.

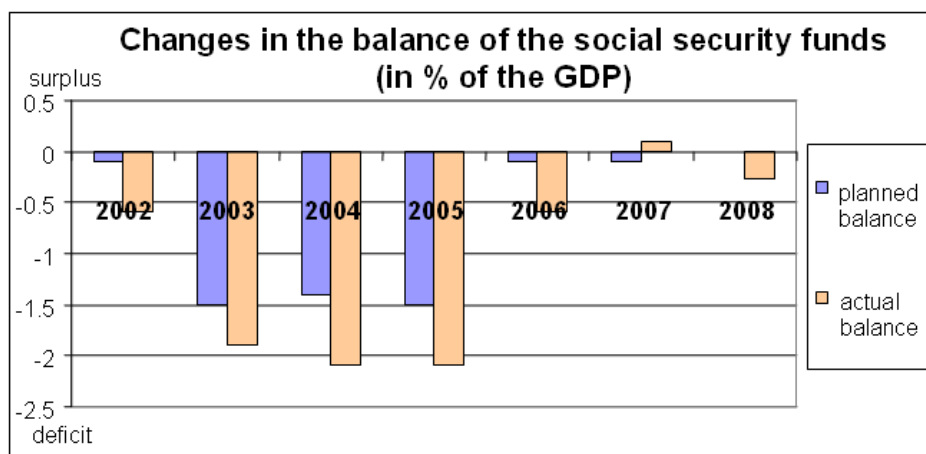
The budget act approved identical expenditure and revenue appropriations for the **National Cultural Fund** for 2007, and the subject year was closed with a surplus. In 2007, the residue of the appropriation of the Fund mostly resulted from the revenue surplus. The cultural contribution continued to be the most significant source of revenue for the Fund. As much as 89% of payments made from the Fund are used to finance grant programmes. The rest serves operational purposes.

The SAO's doubts raised in the earlier reports on the final accounts in connection with the operation of the **Wesselényi Miklós Flood and Inland Water Compensation Fund** – basically about the expediency and effectiveness of operation – seem to be proven by the findings of 2007, too. The off-budget resources of the Fund are negligible, and no funds are generated to cover claims for damages. **Most of the Fund's revenues come from budgetary subsidies.** In 2007, the number of contracts concluded with the Fund rose (and totalled 1,007), however this number is still a far cry from the number of contracts anticipated when the Fund was set up. The SAO's comments made on the Fund in the previous years are still valid (the residue cannot be used, operation as a fund is a mere formality) despite the fact that the operational costs were decreased, which resulted in a surplus for the Fund.

The financial position of the **Research and Technology Innovation Fund** was stable in 2007, too, it closed the subject year with a surplus of HUF 19.6 billion. The cancellation of the expenditures in 2007 was caused by the protraction of the reporting procedure introduced with a view to harmonisation to the EU legal frameworks. Therefore, tenders were invited only in the second half of the year. The 'reserve' of the Research and Technology Innovation Fund – just like the reserves of other separated state funds – is used to fund the budget deficit, and cannot be used for the original objectives of the Fund. Thus, the provisions of the budget act restrict operation as a fund, as a result of which the money available for launching new grant programmes shrinks from year to year.

2.1.3. Social security funds

According to the audits performed in the reporting period, the financial situation of the social security subsystem of public finances was favourable in 2007. The consolidated surplus of the funds totalled HUF 27.6 billion, which was practically entirely generated by the Health Insurance Fund. According to preliminary figures, the entire consolidated deficit of HUF 67.7 billion recorded by the funds in 2008 comes from the Pension Insurance Fund.



Source: Final accounts acts, HCSO

The **Pension Insurance Fund** closed 2007 with a balanced budget, with a surplus of HUF 0.2 billion. This balance could be achieved with total revenues and expenditures exceeding the plans by 3%. Revenues grew **despite smaller direct subsidies were granted from the central budget**.

Expenditures, deficit and direct central budgetary subsidies of the Pension Insurance Fund

HUF billion

	Compensation of deficit	Transfers from the central budget	Total (2.+3.)	Total expenditures of the Pension Insurance Fund	Index % (4./5.)
1.	2.	3.	4.	5.	6.
2001	+1.5	51.8	50.3	1,175.1	4.3%
2002	-14.2	185.2	199.4	1,405.9	14.2%
2003	-39.0	115.9	154.9	1,540.1	10.1%
2004	-80.2	144.3	224.5	1,707.0	13.2%
2005	-93.5	187.3	280.8	1,916.0	14.7%
2006	-19.5	321.0	340.5	2,113.1	16.1%
2007	0	138.5	138.5	2,354.1*	5.9%
2008	-67.7**	143.4***	-	2,872.2***	-

*Same data content as in the previous years, except for disability pension related expenditures, which were formerly covered by the Health Insurance Fund.

** Preliminary amount.

*** Amount planned in the budget for 2008.

The discrepancy between the actual and planned total expenditures and revenues – which has occurred for years, but affected both sides of the budget equally in 2007 – can be explained with the other than planned economic processes, the supplementary pension rise, and consequently the larger than expected effects of automatic measures that determine the growth in pension expenditures. The equity capital of the Pension Insurance Fund continued to be in the negative, which is due to the loss of value of outstanding contributions.

According to the Hungarian Tax and Financial Control Administration, **the Pension Insurance Fund's outstanding contributions and overpaid contributions** were 43.2% and 37.6% smaller, respectively, in 2007 than in 2006. The changes were not triggered by favourable economic

processes. The audits concluded that altogether the changes in the data reflect an improvement in the level of processing of tax return data submitted to the Tax and Financial Control Administration. The more detailed audit of the figures of budgetary organisations justified that securing an adequate level of tax return data still poses a problem in this field, and the level of processing does not make it possible to qualify unpaid contributions and overpaid contribution payments as actual unpaid taxes or tax overpayment made by the taxpayers. The absence of accurate tax return submission and processing hinders the distribution of contributions that are transferred to a single account kept by the Tax and Financial Control Administration. **For this reason the SAO initiated that each type of contribution should be paid to a different account so that the revenues from contributions paid by the employers and individuals could be identified.** Until the date of this report the SAO saw no measures taken for the implementation of this recommendation.

The 3% growth in pension benefits paid from the Pension Insurance Fund compared to the original appropriation was caused by factors that could not be taken into account in the planning process (subsequent obligation to raise pension benefits, automatic concomitants). Within the 10.7% increase in the amount spent on pension benefits compared to the previous year 6.5% can be attributed to pension rises made in January and November, 1.6% can be attributed to pension adjustments, and 2.5% can be attributed to automatic concomitants (changes in the number and composition of pensioners, changes in the number of supplementary benefits, fluctuation). The effects of legal regulations adopted with a view to decrease pension expenditures could not yet be felt in 2007. Similarly, the new legal institution established due to the introduction of the individual contribution payment obligation for pension recipients that continue to work on the side did not yet influence the expenditures either in 2007. During the evaluation of the preparatory work the SAO concluded that on the basis of legal requirements the newly developed system results in disproportions, provides for the utilisation of legal loopholes, and as such it jeopardises the expenditures of the Pension Insurance Fund, and is extremely labour intensive. Therefore, the SAO initiated changes in the system.

The daily liquidity of the Fund and the smooth payment of benefits are ensured by the interest-free loan taken from the Single Treasury Account. The Pension Insurance Fund could operate without loans on around half of all calendar days of the year.

The SAO concluded that the expenditure and revenue appropriations of the Pension Insurance Fund were substantiated for 2009. The organisation also drew attention to the risks implied in changes in the economic situation, (drop in contribution revenues), and to the possible conflict with the constitution in relation to the restriction on the payment of the 13th month pension.

2007 was a turning point in the budgetary position of the **Health Insurance Fund**. Similarly to the former years, instead of the planned negative balance the Fund closed the year with a surplus of HUF 27.4 billion. Revenues rose by

2.3%, while expenditures dropped by 1% compared to the original appropriations.

The Fund financed HUF 22.6 billion in expenditures that was originally planned to be financed from the central budget (personnel costs and the related contributions of healthcare institutions paid in the subject year, 13th month pay, costs associated with downsizing).

To ensure its daily liquidity, the Health Insurance Fund needed interest-free loans provided by law just like in the previous years, however the daily amounts needed were significantly smaller than before.

Major changes affecting expenditures were made in the field of healthcare. One of the most significant steps in curative-preventive healthcare services was the restructuring of consolidated specialised healthcare services. Capacity regulation was justified both professionally and financially in order to ensure operability. The new institutional structure and the existing system of the so called performance/volume limits were hardly compatible. The 'clear-cut' system of performance financing was no longer in use in 2007, wherefore further adjustment factors were introduced in order to optimise financing. Managed care, in the form it was implemented, could not fulfil the concept of social security solidarity, and due to deficiencies in implementation – that were earlier criticised by the SAO, too – the budget act for 2009 no longer uses the term 'managed care'.

Measures that affected pharmaceutical subsidies led to a considerable reduction in expenditures, as a result of which the budget of the Fund can be kept under control in the longer run. Through competition among the pharmaceutical companies the reforms strengthened the bargaining position of the state, and made it possible to procure cheaper products, for patients, too. These results became more widely perceivable in 2008. In 2007 a drop in consumption and a growth in the burden on the population could be observed due to the reduction of subsidies.

In its opinion on the budget appropriation bill the SAO stated that the achievement of the revenue appropriations of the Health Insurance Fund in 2009 would depend on changes in the macroeconomic indicators, which are risky in the current economic climate. As far as in-kind expenditures are concerned, the most sensitive issues in connection with the objectives of the Convergence Programme and the objectives of the restructuring of the system of healthcare services include the expenditure appropriations of curative-preventive healthcare services, as well as of pharmaceutical subsidies, which the SAO auditors found tense, but not impossible to implement. For the management of possible financial problems the budget act allows intervention by the Government (for reallocation within and between the appropriations, as well as for increasing the appropriations).

2.1.4. Local governments

In 2008, the local governmental subsystem of public finances was made up of 3,194 local governments and 174 micro-regional associations. The amount of

revenues and expenditures of the local governmental subsystem have continuously grown in the past years. The average annual growth rate was 6 to 12%. However, while the share of local governmental expenditures (that make up 25-26% of the entire public finances) relative to the GDP was 12.2% to 13.5% in the past ten years, this share shrunk to 12.6% by 2008. It is striking that in the election years expenditures drastically rise both in public finances in general, and in the local governmental subsystem.

Tension between the local governmental tasks and the available funds has existed for years, and has been the subject of several SAO reports. Especially in the past few years the SAO has called attention to the causes jeopardising the financial balance of the local governmental system, the need for harmonising tasks and financing, the creation of financial stability, and the long-term risks arising from the indebtedness of the local governmental subsystem. In this relation actions must be taken by the Government. However, the SAO's audit experiences show that the escalation of tensions in financial management can in part be attributed to the uneconomical organisation of task performance, the low level of utilisation of institutional capacities, the undertaking of voluntary tasks over the load-bearing capacity, to planning errors, as well as to undertaking cumulative purpose expenditures in excess of the cumulative purpose revenues.

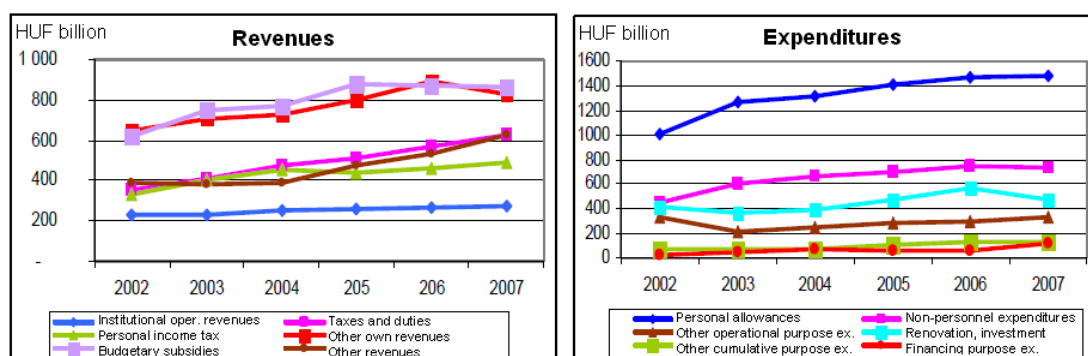
Financial management by the local governments is characterised by almost complete legal independence despite the fact that the required financial conditions are not consistently ensured. On one side it represents a remarkably large area of public finances, considerable public funds and public assets. On the other side, it is characterised by the extremely decentralised spending, utilisation of such funds and assets, and the operation of the institutional system.

The review of tasks and scopes ordered by the government decisions has not been implemented. The mandatory tasks of the local governments have been neither reviewed, nor the public tasks reconsidered or defined more accurately. The tasks and scopes of the local governments have been neither modified, nor reassigned in a differentiated manner. The debate about medium-level local governments (region, mandatory micro-region) has not been closed yet. The further development of resource regulation in coordination with the aforementioned has not been implemented. It is still typical that the budget does not provide all the necessary funds for the performance of new mandatory tasks assigned to the local governments. In the past years no considerable shift of emphasis has occurred in the principles and tools of local governmental regulations. The annual modification of the available subsidies makes the revenues of the local governments from the central budget unpredictable. The absence of an important precondition for transparency, i.e. the lack of a reliable and relevant financial information system in almost all fields, also hindered accountability, as well as the establishment and enforcement of performance criteria.

The fragmented local governmental system remained in place. In the reasonable concentration of tasks that serves professional and financial efficiency a shift was induced only by associations, which have lately begun to organise at the level of micro-regions, too. The most determining role was that

of financial incentives, however decision-makers were also influenced by compelling local economic reasons. Slow restructuring – burdened with contradictions and often squandering – can trigger a spectacular improvement in public services only in the longer run.

According to the preliminary figures, in 2008 local governments realised a total revenue of nearly HUF 3,500 billion, including loan and security transactions, too. Within this amount local (own and transferred) revenues represented a major share, while state subsidies and contributions (including PIT revenues transferred to the local governments in a normative manner) declined. Own revenues have by now amounted to 30% – including 16% in local taxes (as much as 85% of which is made up of revenues from the local business tax) – compared to 18% at the time of the political transformation of 1990, or 25% experienced ten years ago. The combined amount of subsidies and normative PIT revenues is 37% higher than the formerly typical 40 to 50% share. This is beneficial for local governments that possess income and wealth (however they represent only 10 to 15% of all local governments). However, the decline in economic performance may trigger a perceivable drop in revenues. This will jeopardise both the quality of public services and the availability of EU funds.



In the period of 2002-2007, coverage for the nearly 50% increase of personnel costs – primarily due to central wage measures –, and for the 66% and 42% rise in non-personal and cumulative purpose expenditures, respectively, was provided for by the 68% and 48% growth in local tax revenues and personal income tax revenues, respectively, as well as by the subsidies received and the aggregate increment (34%) of revenues from borrowings.

Within the revenues, the amount of local taxes and duties rose continuously and to the largest extent (by nearly three quarters), while the operational revenues of the institutions (most of which are fees paid for different services) increased to the smallest extent (by around one fifth).

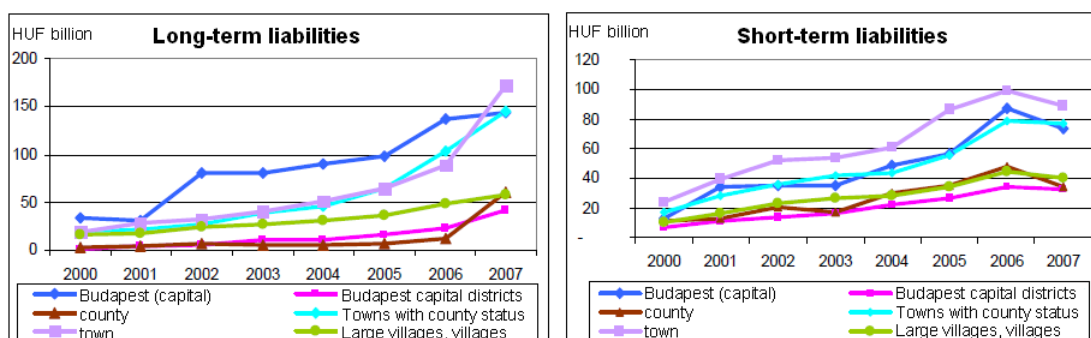
Nearly four fifths of the expenditures of the local governments are made up of current, operational expenditures. Personal allowances and contributions represent one third and one fifth of the total expenditures, respectively. The share of non-personnel expenditures is 25%. **The share of societal and social policy benefits increases from year to year.** The share of cumulative purpose and capital type expenditures is barely 20%.

By the end of 2007, the own property of the local governments presented in the accounting balance sheet nearly tripled (grew by 236%) compared to 2000. (In 2008, the own property continued to grow to a small extent; on the basis of the preliminary balance sheet figures it is expected to reach HUF 9,670 billion in value.) The strikingly high growth rate experienced between 2002 and 2003 was primarily caused by the determination of the value of real property that had either not been registered earlier, or had been registered without indication to its value. It is a positive development that growth experienced since 2004 was typically associated with investment and renovation projects. Unfortunately, in addition to the growing expenditure spent on investment projects, the stock of liabilities at year end almost quadrupled (grew by 330%), while the rate of current assets that could promote financial solvency shrunk by nearly one third. Within the stock of liabilities at year end, long-term liabilities increased from HUF 92 billion at the end of 2000 to HUF 620 billion by the end of 2007. This means an almost sevenfold rise, primarily due to development purpose borrowings and bond issuance.

Figures in HUF billion

ASSETS OF THE LOCAL GOVERNMENTS AS PRESENTED IN THE ACCOUNTING BALANCE SHEET								
Assets	2000	2001	2002	2003	2004	2005	2006	2007
INVESTED ASSETS	2,625	2,979	5,853	8,664	9,008	9,297	9,476	9,992
Intangible assets	5	6	9	11	16	21	25	26
Tangible assets	1,687	1,897	4,350	6,833	7,021	7,238	7,576	7,688
Invested financial assets	533	586	564	566	575	556	558	557
Assets transferred for operation, management purposes	400	490	930	1,254	1,396	1,482	1,587	1,721
CURRENT ASSETS	465	526	570	571	610	564	554	632
TOTAL ASSETS	3,090	3,505	6,423	9,235	9,618	9,861	10,300	10,624
LIABILITIES	253	338	490	518	589	697	925	1 088
OWN PROPERTY	2,837	3,167	5,933	8,717	9,029	9,164	9,375	9,536

In the same period, short-term liabilities grew from HUF 83 billion to HUF 349 billion, primarily as a result of the rise in the stock of short-term loans at year end by nearly five times, as well as due to the threefold rise in the amount owned to trade creditors by the end of the year.



The year-end stock of long-term liabilities grew in all types of local governments, wherefore the economic situation of the local governments deteriorated until 2006, and will significantly aggravate in the long run at the local governments of the counties and towns with county status.

From among the different types of credits and loans the local governments gave preference to credits in the period of 2000-2006, and then to bond issuance: according to the accounting balance sheet, the stock of bonds of the local governments hardly totalled HUF 23 billion at the end of 2000, however it is expected to total HUF 360 billion by the end of 2008. During the execution of the budget, primarily in 2007, as much as 4% of the local governments issued foreign currency based bonds with variable interest rates. The maturity in nearly two thirds of the cases is 20 years. The smallest and largest amounts of bond issuance were HUF 200 million and HUF 5,000 million, respectively. The grace period before the start of the repayment of the principal varied from 1 to 6 years.

Bond issuances indicated the growing indebtedness of the local governments.

Considering the average composition of revenues, the local governments complied with the upper limit specified by the Act on Local Governments regarding the principal and interest payment commitments, i.e. long-term payment liabilities were undertaken for one third of the revenues on average. The SAO's audit experiences show that 63% of the revenues from bond issuance were planned to be used for cumulative purposes, 15% for operational purposes, and 22% for the repayment of loans taken out earlier.

At the end of 2008 the gross debt of the local governments totalled HUF 835 billion², 40% more than one year earlier. The sum of total deposits grew even more, by nearly 70% within a year, primarily due to depositing a large portion of the revenues from bond issuance. Therefore, for the time being indebtedness does not cause significant tension in financial management, since the revenues from the interests on the deposits are sufficient even for some respite.

In terms of the indebtedness and bankruptcy of the local government, the future holds different challenges with regard to the following:

- the risk will spread across a longer period of time, especially at larger local governments; on top of that the foreign-exchange risk of bond issuance in a foreign currency, and the risk inherent in the assumed variable interest rate will also appear;
- especially the county local governments may face increasing financial difficulties in the coming years, since the coverage for principal repayment from own revenues that will commence after the expiration of the grace period (and equally, coverage for the ongoing interest payment) is not apparent in the current system of resources;

² Source: statement of the National Bank of Hungary about the end-of-month balance of the deposits and loans of the local governments and their institutions.

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- the risk is smaller, but not negligible in the case of the local governments of towns with county status. Although these local governments can generate sufficient local revenues, attention must be paid not only to outright indebtedness, but also to other increasing commitments (e.g. guarantees);
 - the loan and bond stock of small local governments is not significant; their financial management and public task performance can become paralysed – even in the short run – due to the payment of excessive liabilities to the suppliers.

Local governments that issue bonds and place the received amounts in deposits or government securities may – through these financial transactions – improve their short-term financial liquidity and stability at the expense of future liabilities, but this procedure may also mean the depletion of future resources. The utilisation of the local governmental deposits of nearly HUF 380 billion – in the year of performance – may altogether increase the general government deficit calculated with the ESA method even by 0.3 to 0.7%.

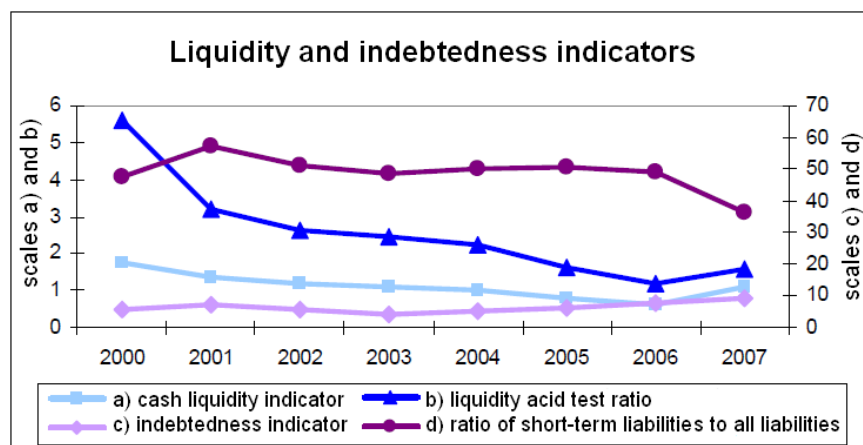
As it has been reiterated in the SAO reports of the past years, it is inevitable to comprehensively restructure the regulations pertaining to the scope, tasks and funding of the local governments, including especially the regulation of borrowings by the local governments, the elimination of the possibility of having a deficit in operational expenditures, and last but not least the reinforcement of financial and legality audits.

Liquidity and indebtedness of the local governments

The SAO audits have drawn attention to the increasing insolvency of local governments. The local governments must not go bankrupt. The Hungarian procedure applied for clearing local governmental debts is almost unique: since the relevant act took effect in 1996, fewer than 30 local governments have been subjected to this procedure (two have been affected twice). This small number is the result of equalising mechanisms in place in the regulation of local governments. Such subsidies exist everywhere, especially in countries the local governmental system of which is fragmented, yet vested with extensive tasks and powers.

In 2008, the central budget spent HUF 18.1 billion, less than in the former years, to support local governments with insufficient resources for operation.

The amount of normative subsidies transferred to local governments with financial problems through no fault of their own (so called ÖNHIKI subsidies), which makes up only 0.5% of the resources available in the subject year, equals only half of the amount disbursed in the former years (HUF 8.6 billion), and the number of beneficiary local governments also dropped to 60-70%. The decline resulted from the rules that enforce economy-of-scale and association requirements, and that restrict indebtedness and assets depletion. However, the achievement of cost-effectiveness and efficiency originally planned to be achieved by the Government was hindered by the preferential treatment of 'other operational subsidies' mid-year, obviously in order to reduce insolvencies to the minimum. Compared to the former years, in 2008 a multiple of these funds, HUF 9.5 billion was disbursed to 1,364 local governments.



The continuous rise in the debt indicator³ since 2003, and the drop in the due date indicator⁴ indicate that the share of long- and short-term liabilities increased among all resources. The drop in the due date indicator resulted in the fact that the stock of short-term liabilities grew to a smaller extent than that of all payment liabilities. Indebtedness has an adverse effect on the financial situation of the local governments in the long run. The liquidity indicators⁵ indicate deteriorating financial situation in terms of liquidity. Both the cash liquidity ratio and the liquidity acid test ratio decreased on a continuous basis, however the value of both indicators grew at the end of 2007 due to the large-scale bond issuance that took place in the last months of the year, as well as due to the fact that a larger portion of the borrowed funds were used for financial investments by the local governments.

Experiences of the audit of the financial management system

The publication of the SAO audit reports has significantly improved voluntary law abidance by the local governments, and has made it possible for the management of the local governments to learn about shortcomings that can be considered typical in the local governmental subsystem in relation to the exercising of regulatory, decision-making or financial management powers.

In violation of the provisions of the Act on Public Finances, when determining the annual budget nearly half of the audited local governments accounted revenues from financial transactions related to the financing of budgetary deficit as budgetary revenue modifying the budgetary deficit and the budgetary surplus. By doing so, the actual financial situation of the local government, the amount of the planned budgetary deficit or surplus, revenues and expenditures from financial transactions of financing purpose, as well as the resulting deficit or surplus were not presented by the proposers in the approved draft budgetary decrees.

³ Debt indicator = all liabilities – other passive financial accounts/total resources

⁴ Due date indicator = short-term liabilities/total liabilities-other passive financial accounts

⁵ Cash liquidity ratio = funds/short-term liabilities

Liquidity acid test ratio = receivables + negotiable securities + funds/short-term liabilities

Year after year, the planned operational purpose budgetary revenues could cover operational purpose budgetary expenditures at a decreasing number of audited local governments, while according to the performance data, such revenues could cover the expenditures at more local governments than planned. However, the share of such local governments is shrinking. Within operational purpose budgetary revenues institutional revenues and revenues from local taxes were underplanned, and residual funds were either not, or only a smaller than necessary portion of them were planned to be used for the original appropriation.

At nearly two thirds of the local governments cumulative purpose budgetary expenditures were planned in excess of cumulative purpose budgetary revenues. The SAO's experience shows that this trend did not change during the execution of the budgets either. Within all budgetary revenues operational purpose budgetary revenues were underplanned at nine tenths of the local governments, while cumulative purpose budgetary revenues were overplanned at almost half of the local governments. Due to the underplanning of budgetary revenues and the overplanning of budgetary expenditures more local governments planned higher budgetary deficits.

In relation to the preparation for e-public administration and the publicity of financial management data the SAO concluded that nearly three quarters of the audited local governments⁶ defined their respective IT and/or public administration strategies, in which one fourth of the local governments set the objective of providing comprehensive, two-way administrative processes, while one third of the local governments aimed to achieve a service level ensuring the launch of electronic administration. In order to prepare for such services nearly one third of the local governments submitted applications for support from the EU or other organisations. One third of the local governments of towns applied for funding in conjunction with other local governments. For the time being nearly one tenth of the audited local governments of counties, towns with county status, Budapest, capital districts and towns offer level 3 electronic services by ensuring the launch of electronic administration. The rest of the local governments offer level 2 equivalent services only by making it possible to download forms from their respective homepages for the arrangement of certain administrative matters. Developments were hindered by the lack of financial resources, human resources competent in information technology, as well as by the lack of the necessary software. Implementation was not encouraged by the need of the population either.

The local governments of the counties and towns with county status, and depending on the number of residents, the local governments of capital districts have been obliged to electronically publish data of public interest since 1 January 2007. Almost half of the local governments failed to publish their financial management data on their websites and in the traditional way, on the premises, in relation to figures related to the operational and development

⁶ The SAO did not investigate the performance of e-administration tasks by large villages and villages.

subsidies, as well as in relation to contracts governed by the Act on Public Finances. Furthermore, nearly two thirds of them failed to publish the narrative justifications of the financial statements. During the audit the SAO concluded that the legal provisions requiring the publication of data of public interest were not harmonised in terms of the definition of the deadlines for publication.

In relation to the controls of budgetary financial management the SAO concluded that at more than half of the top priority and town local governments the level of regulation of the budgeting and final accounts preparation processes altogether implied low risks for the adequate and regular implementation of the tasks, since the town clerks established the internal control mechanisms of the planning and final accounts related tasks in accordance with the provisions of the Government Decree on the operational rules of public finances, as well as in accordance with the capabilities of the respective local governments. Within this process, the clerks defined the control tasks to be performed, the deadlines and the responsible officials. The improvement from the previous years can be attributed to the fact that in 2003-2006 the SAO audited the level of regulation at local governments, and made recommendations for error correction, which recommendations were utilised by the local governments concerned. At one fourth of the local governments the regulatory deficiencies of the planning and final accounts preparation tasks implied high risks for proper and regular task performance.

The reliability of internal controls established in the process of budgeting and final accounts preparation was altogether found to be excellent at almost half of the local governments. The controls operated on a continuous basis, and fulfilled their functions related to the prevention, detection and correction of material errors, irregularities and weak performances. The internal control procedures functioned well at one fifth of the local governments, despite the deficiencies found they satisfied the expediency requirements in relation to the prevention, detection and correction of operational errors. There is close correlation between the utilisation of former SAO recommendations and the level of reliability in this field, too. As many as 35% of the local governments failed to audit their budgeting and final accounts preparation processes in violation of the Act on Public Finances. The reliability of the internal controls was low, which was caused by the lack of regulation by the town clerks at nearly three quarters of the local governments.

At nearly one third of the local governments the level of regulation of financial management, finance/accounting and **financial management control (FMC) tasks** altogether implied a low risk for proper and regular task performance, since in the process of financial management the town clerks established the internal controls in compliance with the legal regulations and the local capabilities. At nearly one third of the local governments the town clerks failed to meet their obligations regarding the establishment of internal controls – despite the provisions of the Act on Public Finances – wherefore the regulatory deficiencies implied high risks for the implementation of financial management tasks. Nearly one fourth of the offices of the local governments did not have operational and organisational rules, and one fifth failed to prepare procedural rules for the regulation of the tasks of the business organisation. At nearly half of the offices of the local governments the job

description of finance/accounting staff members did not contain the audit powers and tasks built into the financial management process. At two fifths of the local governments the town clerks did not specify the method of certification of professional performance, which should be a major type of internal control of cash management. In addition, nearly one fourth of the local governments did not appoint persons responsible for such certification. In nearly one tenths of the offices of the local governments the town clerks did not give written assignments for the performance of endorsing tasks. Furthermore, in the same percentage of written assignments the requirements pertaining to the level of education and professional qualification were not observed.

In violation of the provisions of the Act on Public Finances and the Government Decree on the operational rules of public finances, the town clerks of almost one third of the local governments failed to establish **the FMC system** with regard to the processes and specific features of local governmental financial management, since they did not prepare the audit trail. At three fifths of the local governments the procedural rules for risk management did not specify the identification of risks, or the persons responsible for such processes, and nearly three fourths of the local governments did not specify the acceptable risk limits. Nearly two fifths of the town clerks failed to define 'irregularity' in the procedural rules of the management of irregularities, and the obligation to detect irregularities. Furthermore, nearly half of them failed to require the follow-up and registration of the measures taken (procedures conducted) in case irregularities are detected. As a result of the utilisation of the former SAO recommendations the level of regulation of financial management, finance/accounting and FMC has improved, since the number of local governments that possess internal regulation complying with the legal regulations and the local capabilities is growing from year to year.

The reliability of **professional performance certification** and the **countersigning** of vouchers were altogether excellent at nearly one third of the local governments, since the internal controls functioned on a continuous basis, and despite the potential minor deficiencies they fulfilled their functions in the prevention, detection and correction of material errors, irregularities and weak performances. However, nearly two thirds of the local governments failed to fulfil their obligation pertaining to FMC tasks built into the operative financial management process, contrary to the provisions stipulated in the Government Decree on the operational rules of public finances, and the reliability of professional performance certification and the countersigning of vouchers was weak. Despite the provisions stipulated in the Government Decree on the operational rules of public finances, at nearly three fifths of the local governments the appointed persons failed to check the legality and amount of expenditures, and the performance of contracts and orders within the framework of financial management. At nearly one tenth of the local governments the persons appointed by the town clerks did not certify professional performance (by placing their signatures on the relevant documents). At another one tenth of the local governments the persons appointed for the certification of professional performance did sign the basic payment orders, however, contrary to the provisions stipulated in the Government Decree on the operational rules of public finances, the town clerks did not specify the method of performance certification in the internal

regulations, wherefore these signatures by themselves did not qualify as professional certification of the performance of audits prior to ordering actual payments, or the certification of eligibility, of the amount or of the performance of commitments (undertaken in contracts, orders and agreements).

The audit tasks related to the countersigning of payment orders were not performed at nearly two thirds of the local governments. The countersignors failed to check compliance with the financial management rules, and at around half of the local governments they did not make sure whether professional performance had been certified and endorsed, or not. Due to the deficient functioning of the internal controls, nearly one tenth of the local governments effected payments in relation to commitments without appropriation, from the residual amounts of other appropriations. This meant the violation of the provision on financial management within the approved appropriation, as contained in the Act on Public Finances.

The level of regulation of the **IT environment** altogether implied little risk for the safe performance of IT tasks at two fifth of the local governments, since the offices of the local governments did possess the regulations required for the safe performance of IT tasks. At two fifths of the local governments the reliability of the internal controls of the operation of the IT systems was altogether excellent. Reliability was good at nearly two fifths of the local governments, since the controls ensured the prevention and correction of operational errors, and the detected deficiencies did not jeopardise effective and reliable operation. The reliability of the internal controls was weak at one fifth of the local governments, since the offices of these local governments did not ensure automatic connection between the analytical records kept on computer and general-ledger accounting, and nor did they ensure the management of changes in the system of accounts, the retrieval of earlier financial and accounting data. Furthermore, they did not document the connections of data used in the financial and accounting software programmes.

The development of the organisational and regulatory frameworks of **internal audits** implied low risks in the regular completion of internal audits at 57% of the local governments, since the organisational and regulatory frameworks, and the method of performance were determined in advance, wherefore the internal audit organisation so developed – if functioning properly – provided sufficient protection against potential errors. In violation of the provisions of the Act on Local Governments and the Government Decree on the internal audit of budgetary organisations, one fifth of the local governments did not regulate the internal audit tasks. The deficiencies posed a great risk for the proper and regular performance of these tasks.

The organisational frameworks of internal audits were established in 98% of the local governments, in the form of association in four fifth of such local governments. Nearly nine tenths of the local governments of villages, large villages and towns performed internal audits within the framework of associations. The association agreements were deficient in nearly two thirds of the local governments, since in violation of the Government Decree on the internal audit of budgetary organisations they did not include the managerial

tasks associated with internal audits. At these local governments the deficiencies revealed in the internal audit system were caused by the shortcomings of the association agreements, the lack of distribution of tasks (among the local governments and the associations), the lack of the exact identification of the persons in charge, and consequently the lack of accountability in relation to implementation.

The reliability of the internal audit system was altogether found to be excellent at nearly one tenth of the local governments, good at two thirds of the local governments, since the deficiencies revealed did not hamper the internal audits from preventing, detecting and calling for the correction of material errors, irregularities and weak performances. At 53% of the local governments the reliability of internal audits was found to be weak, since they failed to fulfil the internal audit tasks related obligations despite the provisions of the Act on Local Governments and the Government Decree on the internal audit of budgetary organisations. Consequently, the internal audits did not fulfil their function related to the prevention, detection and correction of material errors, irregularities and weak performances.

As many as 11% of the local governments did not organise the internal audit of the office of the local government and of the local governmental institutions, and nearly one third of the local governments performed the tasks specified in the audit plan incompletely. Two thirds of the local governments did not plan for the audit of tasks considered as high-risk tasks, and the planned audits of high-risk fields were cancelled at two thirds of the local governments. The internal audit capacity was insufficient for the performance of the planned tasks at nearly one third of the local governments. During one tenth of the performed audits actions giving cause for criminal procedures, actions for damages, or disciplinary procedures were revealed. One third of the local governments failed to monitor the elimination of the deficiencies detected at the audited institutions. In violation of the Act on Public Finances, the town clerks of three fourths of the local governments failed to report on the operation of the financial management control (FMC) and internal audit systems within the framework of the financial statement. Contrary to the relevant provision of the Act on Local Governments, one third of the mayors did not report on the experiences of the audit of budgetary organisations when submitting the final accounts.

2.2. Major experiences of audits focusing on the fulfilment of state and local governmental tasks

Healthcare, social care

Healthcare and social care are major sectors of redistribution by the state, and as such affect the entire society. The SAO audited primary and specialised health care among public services affecting the population in general, along a strategy that had been developed since 1995.

Therefore, the audits covered GP and dental services for adults, outpatient specialised care provided by the local governments, the level of instrumentation in medical institutions, and the performance of certain diagnostic units. The SAO

audited the financial situation and financial management of local government owned hospitals, as well as healthcare projects and reconstructions funded from earmarked subsidies. The audits also extended to the utilisation of funds available for patient and social care by local government owned hospitals and residential social care institutions.

The SAO's experience shows that the healthcare reform and interim measures were not preceded by professional reviews, status assessments, impact modelling and analyses. In the first step this reform aimed to reduce the burden on more costly in-patient specialised care and to adjust capacities to the needs by reinforcing GP services. The financing system of GP services was primarily based on the number of patients choosing the given GP, and on the age composition of the patients, and not on the level of services actually provided by the GP. Contrary to the declared objectives, the system did not encourage prevention, screening and care. Due to the free choice of doctors certain districts became even more congested, and the system of night and weekend shifts has not been restructured.

The major institutions of the healthcare system and progressive patient care, as well as a large number of integrated hospitals/outpatient clinics were transferred to the ownership of local governments. A significant number of local governments did not, and still do not possess the financial resources required for exercising ownership rights, and with social security based financing in place the local governments did not always feel sufficient responsibility for the maintenance and management of healthcare institutions. The majority of hospitals and the local governments (owners) wanted to manage their financial and liquidity problems with the help of various, centrally awarded resources instead of establishing a cost-efficient and professionally coordinated hospital structure and capacity (number of beds, office hours for outpatient specialised care), and instead of the improvement of the organisation of healthcare services and cooperation. By today, hospital debts have multiplied despite the repeated debt clearances.

During the audit of the utilisation of funds spent on **oncological screening programmes** the SAO concluded that the national databases are operated separately from one another, wherefore the effectiveness and efficiency of the screenings cannot be measured and verified. The screening indicators, illnesses, healthcare services and the related funding data are not systemised, there is no controlled, integrated information system in place, the quality assurance monitoring part of the screening programme has not been developed, and the validity of data is not ensured either. The National Public-Health and Medical Officer Service (ÁNTSZ) is not authorised to collect or manage medical information related to organised screening, wherefore it cannot fully perform its supervisory functions, in part due to data protection issues.

The management, organisational and executive levels found in the organisational background of the screening programme are not clear, as a result of which task performance and the associated responsibilities are not regulated. The head of the healthcare sector failed to provide comprehensive decisions (on data management, methodology and information system) required for the management of the screenings.

Funding sources for the organised screening programmes had not been established by the time of introduction. Screening was introduced at the expense of the outpatient specialised care appropriation (which existed even before), however without the involvement of additional resources. The performance volume limit makes the institutions disinterested in conducting screenings and providing consequential treatment.

The SAO audited the utilisation of **funds available for patient and nursing care by local government owned hospitals and residential social care institutions** in 2008. The admission capacities of the two sectors are not coordinated. The regional and territorial characteristics of the system of social care (e.g. level of development and accessibility of primary services, services in lieu of hospitals) were not taken into account when the healthcare capacity needs were identified. The need for joint capacity organisation in the two sectors is also substantiated by the fact that social care and healthcare institutions are usually owned by those local governments that are responsible for the organisation of care services. Although computations had been made before hospital restructuring regarding the enhancement of chronic care capacity, the data collected in different schemes were not put together in a complex status analysis, or need assessment, and consequently, the territorial capacity needs were not calculated on this basis. The professional content of care provided on the increased number of chronic beds was neglected due to the operational problems.

The legal regulations that specified the operational conditions did not encourage cooperation among institutions of the two sectors. Furthermore, the lack of minimum conditions for identical activities, as well as the lack of standard rules for the licensing procedure and care supervision did not facilitate the elimination of unnecessary parallelisms and the absence of coordination in care services.

The social act stipulates that services based on the individual needs must be interrelated, however the use of services was not based on actually assessed needs for care, and transfers within the system of care were not possible either. In 2007 there were as many as 15,000 people on the waiting lists of social care institutions. One third of these people were capable of independent living, and applied for institutionalised care in part for the lack of basic services. Another third of the residents of social care institutions require permanent specialised care, for which the institutions are prepared neither with equipment, nor with qualified care personnel. Due to the lack of basic services and temporary residential care institutions the provision of care to people who needed 24-hour supervision but no hospital treatment burdened the healthcare system.

The Government Decision on the extraordinary tasks of the unification of the care system called the affected ministries to conduct impact assessments and further measures, the enforcement of which did not yield measurable results during the available time period.

Apart from auditing the healthcare system, in the past years the SAO regularly audited individual elements of the **social and child protection services**, too (monetary assistance, basic and specialised services). The provision of social

and child protection services is basically the responsibility of the local governments. However, in certain segments the involvement of the private sector is significant. The audits concluded that neither a long-term concept, nor an underlying impact assessment study had been prepared on the development trends of the social care system, including those of institutionalised care services. No information, survey or calculation is available on what would be the desirable level of services, and what tools, measures and resources could ensure the achievement of this level. No calculations were performed regarding the financial resources required for the attainment of the different levels of services, and for the alternative methods available for the attainment of these levels. The organisation of the supervision of the area, as well as its affiliation have changed several times in the past years. Due to structural changes and in the absence of long-term concepts the commenced processes have slowed down and have occasionally been modified.

The tasks of certain services regulated in the social and child protection acts (family assistance, child welfare services) are nearly identical and are difficult to separate. On the other hand, the personnel and non-personnel conditions linked to certain similar forms of care (crèche, family day-care) are different. The SAO reports have repeatedly drawn attention to the lack of harmony between the financial information system and the professional legal regulations, which hinders the presentation of the expenditures of task performance. For the lack of financial resources the local governments did not organise comprehensively the benefits and services prescribed by the acts of the profession.

The objectives stipulated in the child protection act were only partially implemented, and the restructuring of the system of specialised care institutions (development of assisted residential communities with a small number of residents) has not been fully completed either. Despite this fact the modified professional legal regulations prescribed new conditions, compliance with which required new resources. The assignation of the place of child care is basically determined by free places. Foster care placement, which is the optimum solution professionally, cannot be realised for the lack of foster parents, the required conditions, placement conditions and professional skills. Following the after-care service (which is provided until the age of 24), the housing problem of young adults is not solved for the lack of money and social rental flats. The level of services provided in assisted residential communities very much depends on the financial standing of the entities that maintain such communities. The aptitude and psychological test methods used to assess adopting parents are not standard across the country.

During the audit of **social day-care and temporary residential social services for adults** the SAO concluded that the institutional network is altogether unsuitable for the delivery of care to the increasing number of people in need. The social act clarified the tasks at the level of expectations, however the financial guarantees for the creation of the conditions could not be incorporated into the regulation.

In relation to cash benefits the social act requires the consistent application of the principle of need, and names the evidences thereof. However, this principle was not fully enforced on the basis of the reality content of the income

statements submitted by the applicants. Most of the local governments spent one fifth of non-specific normative social subsidies on other purposes. As a result of the introduction of the regular child protection subsidy regulated in the child protection act both the number of eligible children and the per capita amount have increased.

The extent of the obligation to provide long-term institutional social services is not defined clearly. There is no cooperation among the local governments that maintain such institutions. For the lack of power, right and information needed for the coordination of specialised institutional social services the local governments of the capital and the counties cannot fulfil their obligations. People looked after in homes for the elderly are extremely heterogeneous in terms of age and health condition (the number of people in need of care will rise following the introduction of the 'in need of care over four hours' category as of 1 January 2008). Institutions that have operated for years are also unable to meet the increasingly stringent personal and material conditions.

The development of services and institutions for homeless people is not coordinated, since the competent ministry did not have a medium- and long-term concept that would set the objectives and development directions of the homeless care system, and neither did it have up-to-date and reliable data and information on the supply system. The quantity and quality of services delivered by the local governments vary, the reason behind which is that no minimum quantitative and qualitative requirements have been set for such services. The problem of homeless families is not regulated either, since the social act does not identify any social institution in which homeless families with children can be accommodated. On the other hand, the number of places in institutions providing joint placement for families with children/siblings under the child protection act is not sufficient. In order to meet the no longer postponable healthcare needs of homeless people, specific healthcare services were introduced in the social care system, in parallel with the healthcare system. The ratio of non-state maintainers in the field of homeless care has been high since the very beginning. The current system of financing is not adjusted to the real needs of the care system in a flexible manner, and makes the continuous delivery of several services uncertain.

Education

In the past period Hungary's public education expenditure has been in line with the economic performance of the country, and has equalled the average expenditure of similarly developed countries. At the national level the reduction of the student-teacher ratio and the growth in per-unit public education costs were typically not accompanied by the improvement of student performance or by the enhancement of efficiency in public education. Due to the deficiencies of the information system, the transparency and traceability of public education funds are not fully ensured.

The SAO has audited different fields of public education for years. These audits have focused on compliance with the requirements of economy-of-scale, cost-efficiency, as well as the provision of equal opportunities, which represents one of the most important constitutional basic principles of the socio-economic

development. The drop in the number of pupils affected smaller settlements to a larger than average extent, since they have limited options to manage the impacts of the declining number of children. During the 2006 audits the SAO audited the conditions of primary school education in settlements with fewer than 1,000 permanent residents. It was concluded that in small settlements children (pupils) were trained and educated in fragmented institutional networks, in institutions with a low number of students. These settlements did not have properly qualified professionals to perform the management tasks of the maintaining entity. Within the fragmented education management system the relationships between the various levels of management, as well as with public education management and territorial regional development were weak.

The basic task of secondary school residence halls is to compensate disadvantages and support talented students. Although the educational government declared equal opportunities as a priority field, task performance by the residence halls was not included in the medium-term strategy of public education. The equalising 'Arany János Support Programme for the Gifted' affected fewer than 5% of all students. Due to the small-scale use of this form of equal opportunity creation, and due to the deteriorating conditions of accommodation, the number of students living in residence halls continuously decreased. The integration of capacities and coordination among the maintaining entities were not triggered by the inadequate utilisation of capacities either, which consequently led to a decline in the cost-efficiency of this activity. The existing problems collectively hindered the actual compensation of disadvantages, and hence the improvement of the quality of education.

It was apparent already in 2003, at the time of publication of the SAO report on the audit of school-based vocational training that vocational schools and training provided by vocational schools had to be renewed, general skills and knowledge had to be developed and the chances of entering the labour market had to be improved. The attainment of this objective was targeted by the three-year Vocational School Development Programme (VSDP) launched by the Ministry of Education in 2003. The Ministry appropriated HUF 13 billion for this programme, primarily for the development of the general skills and knowledge of students, for enabling them to master independently the requirements of state-of-the-art techniques and technologies, for the development of modern teacher training procedures, and for the renewal of school management methods. The evaluation of the realisation of VSDP across the country was hindered by the fact that no exact survey was developed to measure the feasibility of the methods recommended by the programme, and the impacts of such methods.

During the audit of the utilisation of funds spent on financing public educational tasks within the Chapter 'Ministry of Education and Culture', the SAO concluded that the objectives of the ministry related to the support of public educational tasks were fundamentally in harmony with the set professional objectives. Due to the method of distribution of the subsidies and the lack of requirements regarding utilisation, the implementation of these objectives could only partially contribute to the improvement of the effectiveness and efficiency of public education. During the provision of state

support to public education related human services in 2005 and 2006, the supplementary public education subsidy allocated to the churches was not in line with the provisions of the act concerning church financing, and with the Government Decree on the operational rules of public finances.

The principle of transparency was not enforced in the subsidy appropriations for state-run teacher training schools, since the normative subsidies available for public education institutions maintained by higher education institutions are included under the title 'Universities, colleges', together with the normative subsidies available for higher education institutions. Since 1998, the budget acts have provided twice the public education base normative subsidy for teacher training institutions. The substantiation of this practice was last measured in 2000, but no relevant calculations have been performed since then.

Multi-purpose micro-regional associations

The SAO has audited the organisational frameworks of local governmental task performance several times. In its 2004 report on the audit of the associations of local governments the SAO concluded that although task performance within the framework of associations were supported by the incentive elements of the financial regulatory system in several fields (investment projects and certain public services), no major progress was made in such collaboration, the rigid structural frameworks of task performance did not follow the quantitative and structural changes in the needs of those using such services.

Within the framework of the modernisation of the public administration system a major emphasis was given again to the promotion of coordinated development, and to the balanced improvement of public services provided by local governments. To this end, several multi-purpose micro-regional associations were set up. In the central budgets for the years 2004-2008 the National Assembly approved a total of HUF 89.5 billion for the direct incentive to establish and operate such associations. These resources contributed to the fact that by 2006 multi-purpose micro-regional associations had operated throughout the entire country, and the organisational frameworks of the associations had stabilised.

The experiences of the on-site audits showed that the local governments focussed their efforts primarily on the acquisition of additional subsidies, and the regulation of the terms and conditions of subsidisation made it possible to use such resources even when the services were not organised on a collective, more expedient and efficient basis. The incentive subsidy mostly meant an exchange of resources, i.e. that it was used in lieu of the local governments' own resources. Therefore, it promoted neither the enhancement of the quality of the given priority service, nor the regional equalisation of the quality of services. Furthermore, it did not adequately support the exploration of internal reserves. The indirect impact was neither presentable, nor transparent in relation to the performance of other tasks.

It was a major regulatory problem of the utilisation of incentive subsidies that multi-purpose associations could ensure joint task performance through organisational activities, while the concrete content of this activity was not

defined in the terms of the application for funding. Consequently, the multi-purpose associations could obtain subsidies for the local governments even without taking concrete actions. This reduced the effect of the regulations supporting the achievement of the associations' objectives, and delayed the start of changes and the process of the development of real collaboration. The utilisation of subsidies provided for special purposes according to the designated purpose could not be followed, wherefore the fixed-purpose nature of subsidies was not enforced.

In terms of the delivery of public services the sector's professional management did not prepare for the formulation of professional requirements that were capable of transferring the efficiency and economy-of-scale requirements, on the basis of which the achievements related to the quality of public services could be presented. In the absence of indicators – despite the increasing expenditures – no significant improvement can be shown in the quality and efficiency of a broader range of public services.

In public education the number of independent schools dropped, while that of member-institutions increased due to the establishment of multi-purpose micro-regional associations. Within the framework of basic social services the multi-purpose associations provided services either in their own institutions, or within the institutional associations. There is no doubt that the frameworks of multi-purpose micro-regional associations brought about improvement in the organisation of internal audit tasks.

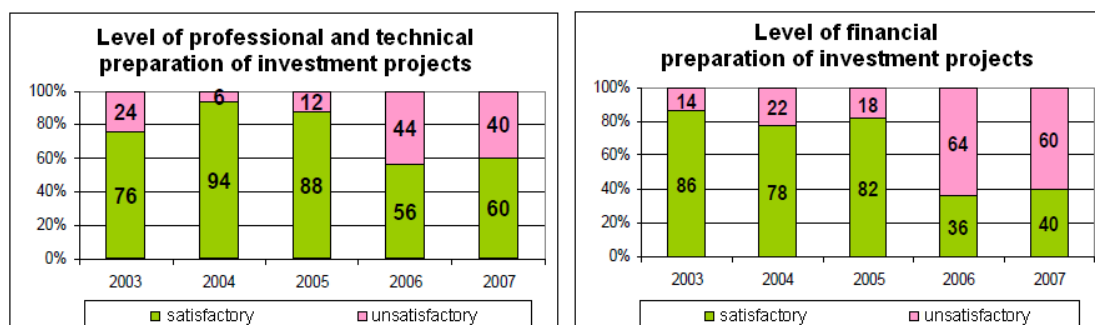
Infrastructure development and operation

A major part of the local governments' development subsidies was still made up of target and earmarked subsidies, however due to the increase of EU subsidies the appropriation available for new investment projects continuously decreased, and finally stopped existing for such purposes. The role of this subsidy was taken over by EU subsidies that replace the national resources and are linked to the implementation of development objectives specified in the Operational Programmes of the New Hungary Development Plan.

One of the characteristic features of local governmental investment projects is that the local governments are not able to implement their local projects by themselves, since they do not have enough own resources. Taken all this into account, the implementation of local governmental investments and the financing of public utility investments may involve, in addition to state subsidies, preferential loans offered by the public utility company, various housing savings fund schemes, etc. The shortage of funds at the local governments, and the almost intransparent, complicated regulation have led to the emergence of foundations that initiate financing and investment schemes linked to the unlawful utilisation of state subsidies.

In 2001- 2006, the local governments spent on average 13% of their expenditures on accumulation tasks. However, the experiences of the audits show that the developments were not implemented along a well thought-over concept, and they were not properly coordinated with the regional development ideas for the area. During the audits that the SAO has performed

in the past few years in relation to the investment projects implemented from target and earmarked subsidies – in connection with the final accounts – the SAO concluded that the local governments used the subsidies for the objectives and tasks specified in the applications for funding, and thus they improved the conditions of task performance. The professional/technical and financial preparation of local governmental investments – measured by the definition of the objective of development, the assessment of the needs of the population, cost-efficiency calculations, the timely availability of authority licences and technical plans, and the need for the modification of the technical content of the investment project – has weakened.



In order to resolve temporary shortages of funds for the investment projects the contractors assisted the local governments with interest-free loans, the temporary transfer of funds for cumulative purposes, and with financial guarantees. The local governments temporarily included the guarantees they received in cash (performance and high performance guarantee) in the financing of their budgetary expenditures (investment projects). Due to revenues received from organisations implementing the investment projects – pursuant to the relevant provision of the Act on Public Finances – there was a growth in the amount of subsidies that was used unlawfully and is therefore recommended to be reclaimed.

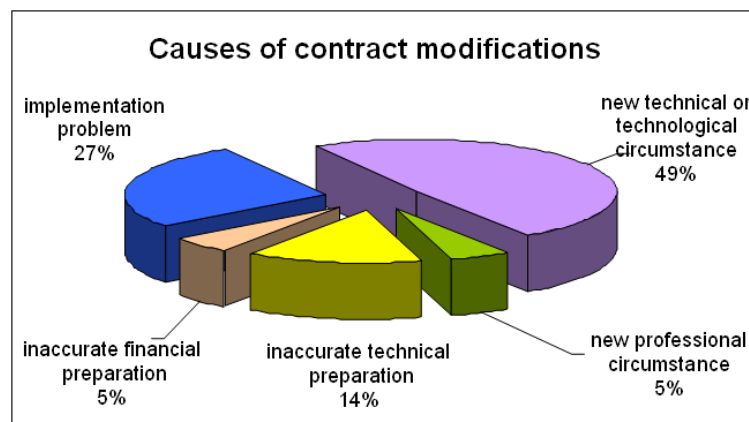
The SAO conducted a system audit of the entire process of investment projects within the framework of the audit of top priority investment projects⁷ beginning from project preparation to the operation of the completed facilities. The SAO compared the investment practices of the local governments and business organisations.

In terms of regulation and invitations to tender, more emphasis was given to elements that promoted the selection of more expedient and favourable projects by requiring the preparation of feasibility studies and business plans. The applicants first of all aimed to emphasise their capabilities, to present the best-case possibilities, and did not pay attention to the risk factors. In the selection of the participants involved in project implementation, the publicity requirement was not sufficiently observed in the case of planners, project administrators and technical supervisors. As many as 31% of the investors did not comply with their obligation to conduct public procurement procedures.

⁷ Report on the audit of priority investment projects in tourism by local governments (0823)

The lack of competition hindered the cost-efficient and transparent utilisation of public funds, and did not make it possible to investigate the conflict of interest of entrepreneurs or the enforcement of professional aspects in the decision-making process.

In the process of project implementation more than two thirds of the implementation contracts were amended, however amendments were not properly justified in 34% of such cases. When the technical content of the contract was amended, at nearly half of the investment projects the technical content was determined in a manner incomparable with the basic contracts signed with the contractors. The professional and technical preparation was inadequate at 41% of the investment projects, because – in violation of the law – the projects did not have the required final construction or water law implementation permits at the beginning of the implementation works.



At three quarters of the investment projects the continuous professional supervision carried out by the technical supervisors did not contribute to, or only partially contributed to the implementation of the projects in compliance with the legal regulations and the implementation contracts. Business organisations paid greater attention to the enforcement of their claims for penalty for breach of contract, while most of the local governments relinquished such claims. Operational problems emerged at 88% of the investment projects after the closure of the technical take-over/hand-over procedures.

The implementation of the investment projects did not comply with the plans, since in 94% of the cases the investors deviated from the schedules indicated in the submitted and approved tenders, and also from the technical content and the appropriated costs (53% and 82%, respectively).

The SAO formed opinion about the process of the investment projects within the framework of the audit of the project titled **European Capital of Culture**, too. The Local Government of Pécs, Town with County Rank won the European Capital of Culture 2010 title in 2006, within the framework of which it had the opportunity to implement five key projects – with a total value of HUF 34.6 billion according to the call for tender – which aimed at the development of the cultural and tourist infrastructure of the town. The increased interest from the society also justified that the SAO should form opinion on the project already in the preparatory phase. Investment projects

within the key projects can utilise EU funds for implementation, however the calls for tenders were started to be announced only in mid 2008. During the on-site audits the SAO concluded that the implementation of the European Capital of Culture project was lagging behind, in many projects the preparatory phase was much longer than envisaged by the tender, and at the time of the audit there were only 18 months left for implementation.

The operation of the public procurement system

Public procurements have a crucial role in the guarantee system of the lawful and reasonable utilisation and operation of public funds and public property, as well as in the audit of such utilisation and operation. The proper operation of the public procurement system can be a stable tool in the fight against corruption. The related system SAO audit basically aimed at the level of regulation of the procedures, the operation of the central institutional and legal remedy systems and of public procurements, the level of the available IT support, the extent of public procurements related monitoring and audits, as well as the supervisory, internal and proprietary control at the entities mandated to conduct public procurement procedures.

The establishment of the public procurement policy within the framework of Community legislation but within national competence can – by setting the development directions of public procurement – result in the expedient division of tasks among the non-governmental central institutions (such as the Public Procurement Council) and the government sector. This is why the SAO found it paramount, and this is why it recommended the Government to name the governmental official in charge of the development of the national public procurement policy and system, and to define his/her powers and tasks, which naturally required active cooperation from the Public Procurement Council.

Furthermore, the SAO encouraged the organisation of a monitoring system capable of measuring the effectiveness and efficiency of the public procurement system, the development of the conditions for a control/alarm system that would ensure the detection of public procurement irregularities and corruption risks. Here the SAO found it appropriate to adopt the regulatory background and practice of public procurement procedures related to the utilisation of EU funds.

Special attention was paid to the preparation of the proposal aiming to amend the act for changes in the procedural rules, the enforcement of the community and national objectives in the regulations, and last, but not least the fact whether the modernisation efforts improved the stability of regulation, as well as the predictability of economic processes. However, based on the experiences the SAO did not find it guaranteed that the legislators' objective would be attained, i.e. it would not become necessary to amend the public procurement act again in the longer run.

In connection with the local governments the SAO audited compliance with the requirements pertaining to the utilisation of target and earmarked subsidies, and compliance with the provisions of the Act on Public Procurement in relation to each thematic audit. After the Act on Public Procurement took

effect, the SAO audited the enforcement of the objectives of the act within the framework of two independent thematic audits.

In the thematic audit of 2008 the SAO concluded that significant progress was made by the local governments in terms of local regulation. As many as 97% of the audited local governments specified the procedural rules of their public procurement activities in the form of a regulation, defining the personal and material scope, and conditions of public procurements, and the tasks related to the conduct of procedures.

As much as 21% of the audited local governments failed to comply with the provisions of the act by implementing procurements without conducting the mandatory public procurement procedures. By selecting the contracting parties without competitive tendering, they violated the principles of the public procurement act, and did not ensure public and controlled decision-making. Public procurement procedures were primarily ignored in the case of renovation projects affecting several institutions, goods procurements, the use of banking services, as well as the procurement of food products. The ratio of legal remedy proceedings launched against local governments rose from 15% (as stated in the 2001 SAO report) to 59% by 2008.

2.3. Utilisation of EU funds

In line with the provisions of the relevant parliamentary resolution, the SAO prepared a **Summary of Audit Reports on the Financial Management and Control of EU funds in Hungary** for the third time. The Summary presented the financial relations of Hungary within the European Union and the experiences of the 2007 audits on subsidies. It analysed the utilisation of the funds – i.e. Hungary's absorption ability – and concluded that in relation to the Structural Funds Hungary committed all of the available funds, and that in terms of payments from the Structural Funds it was among the first half of the new member states (occupying the third place), and ranked 19 among the EU25. In relation to the Cohesion Fund, Hungary fully committed the commitment appropriations in 2006, and ranks second among the new member states in this respect.

The Summary evaluated the experiences and lessons learned in the ending programming period, and compared them with the audit findings about the activity of the new period.

Hungary successfully used the funds available from the Pre-Accession Funds and the Schengen Facility. The financial closure and financial settlement took place in relation to the SAPARD programme. As far as the Phare programme is concerned, the year 2007 was characterised by preparations for the final audits of the European Commission.

In relation to the evaluation of the utilisation of funds in the 2004-2006 programming period it is favourable that the funds available for the implementation of the National Development Plan are committed, but the implementation and payment processes must be accelerated in order to mitigate the risks inherent in the realisation of commitments, i.e. in payments.

The system of intermediate institutions and the legal environment were set up in parallel with the start of the support system, and were gradually transformed. The audit system over the utilisation of EU funds fulfilled its role, however it contains overlaps and occasional redundant activities of monitoring and auditing.

In relation to the development of the system of conditions of the Cohesion Fund, the period was characterised by protracted project implementation, much higher than planned expenditures, and changes in the technical content – in addition to the shortcomings described above.

Naturally, the rise in payments also means a rise in the number of audits conducted by EU and national audit institutions. The irregularities revealed by the audits may trigger financial consequences.

In order to close the financial programming period smoothly, utmost attention must be paid to the best possible detection of irregularities, and to the mandatory operational monitoring of projects implemented with the help of EU funds. The inadequacy of said activities may significantly lengthen the financial closure and accounting with the EU, which may have an adverse effect on the status of the Hungarian budget.

The first year of the 2007-2013 programming period was practically spent on preparations. The institutional system of agricultural and rural development subsidies has already been accredited. The Operational Programmes of the New Hungary Development Plan were accepted by the European Commission among the first programmes, and the accreditation of the institutional system was completed within one year, as required by the EU regulations. Due to changes in the system of intermediate institutions and in the legal environment, the implementation of the operational programmes started slowly, if started. The monitoring and audit systems established earlier need to be reinforced in all organisations and at all levels. At the end of 2007, the development of the IT system of the New Hungary Development Plan – designed to support the utilisation of subsidies – was not yet complete. Apart from the balanced draw-downs of agricultural subsidies, and a small amount paid for an operational programme, practically no funds were drawn down from the EU budget.

During the **audit of the National Development Agency** the SAO evaluated the planning and implementation of national strategies and programmes aiming to promote the utilisation of EU funds.

The SAO concluded that the national organisational, regulatory and implementation framework required for the utilisation of EU funds was established by 2006, however its operation was characterised by shortcomings in coordination, efficiency and cost-effectiveness. With a view to improve efficiency and cost-effectiveness, the National Development Agency was set up. The Managing Authorities were transferred to the jurisdiction of this Agency from the ministries, as a result of which the institutional system became more transparent and homogeneous, however it fulfilled its functions only in relation to the EU funds. The support mechanism was simplified, the number of Intermediate Bodies was reduced, efficient operation was ensured by the

adoption of standard procedural rules, and cost-based funding was replaced by performance-based funding.

The legislative basis of development policy is missing despite the fact that the need for such a basis was declared by a parliamentary resolution, and the responsible official was appointed by a government decision. For the lack of an act the rules of development policy were stipulated by lower level decrees, which may lead to the emergence of parallelisms and legal loopholes. The strengthening of the consulting activity supporting the applicants is indicated by the rate of rejected applications, and applications returned for requesting additional information. The SAO expressed its objections since only those complaints were taken care of that were specified by law. The protection of public funds was ensured through the audits and the initiation of repayments, however the security specified in the application was reduced to the amount of the subsidies, which does not cover expenditures. The SAO concluded that the operational costs could be rationalised on the basis of cost-effectiveness and expediency aspects, for instance through the review of high consultancy costs, communication expenditures and success fees paid to the Intermediate Bodies.

The professional tasks were determined by the implementation of the 1st National Development Plan for 2004-2006 and the planning and launch of the New Hungary Development Plan for 2007-2013. The strategy was prepared with the involvement of research places and was then subjected to broad social debate. The concept had to be fundamentally revised after the European Commission commented on it: both its objectives and the operational programmes were changed. A new element in implementation was that certain developments were regarded as top priority projects.

The results of the development policy cannot be evaluated yet. The implementation of the 1st National Development Plan is in delay. Late payments were eliminated by 2007, however the risk of losing resources is apparent in several programmes. Regional disparities were only slightly equalised despite the fact that per capita subsidy was the highest in the most underdeveloped regions. However, the largest amount of subsidies was awarded to the most developed region. It is a positive fact that in 2007 the Government launched the New Hungary Complex Programme with a view to strengthen the opportunities of severely underdeveloped regions.

Within the competitive sector larger organisations were given preference. Applicants that applied for funding for different objectives did not have equal chances; in the case of logistic projects financially stable companies started development already at the time of the submission of their applications, while financially less stable organisations had to wait until a decision was made. The efficiency of educational subsidies was deteriorated by the austerity measures that affected the schools concerned.

In the report of the audit on the utilisation of budgetary appropriations for INTERREG projects the SAO concluded that cross-border cooperation programmes in which Hungary was involved contributed to the achievement of the main objective, i.e. the development of border regions. However, the support objectives were too general and did not concentrate on

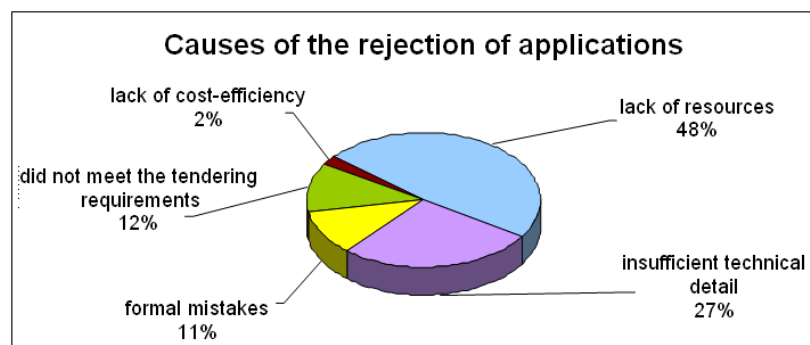
the major problems of the border regions. The programmes attracted much interest, however the more favourable utilisation of resources was hindered by several factors, such as the relative novelty of the programmes, the time required for, and the complicated institutional and procedural system of international cooperation, the delay in the creation of the institutional conditions in Hungary, and the high operational costs of the institutional system in comparison to the amount of subsidy.

The uncertainty in the operation of the audit system and in the management of irregularities is shown by the fact that on the grounds of forfeiture due to the delays no proceedings were launched in relation to public procurement procedures that raised the suspicion of irregularities.

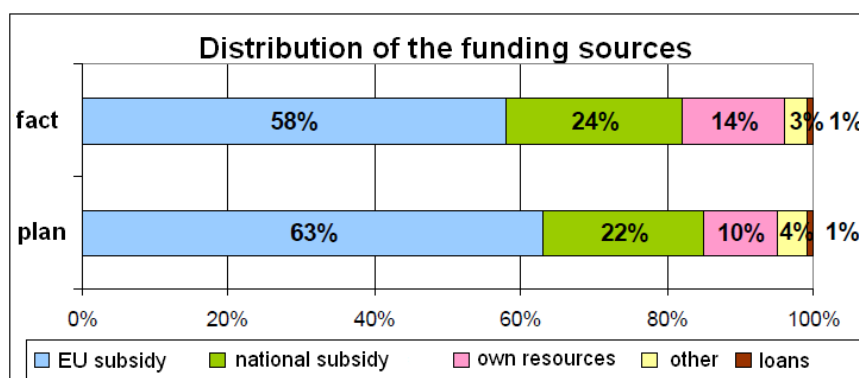
The voluntary opinion poll reflected the strengths and weaknesses of the INTERREG programme. The overwhelming majority of the respondents did not experience corruption, however the nearly 10% corruption indicator shows the importance of anti-corruption activities.

During the review of tenders related to the acquisition of EU funds the SAO audits carried out in the local governmental area concluded that most of them were linked to the development objectives specified in the economic programmes, sectoral, professional and regional development concepts and plans, as well as four fifths of the development objectives were linked to the performance of mandatory tasks. In response to the SAO recommendations reiterated for years, the major content requirements of the economic programmes were defined in the Act on Local Governments, and the number of local governments possessing economic programmes significantly rose. While 5-6 years ago the SAO determined the general absence of economic programmes, last year it was found only at around one tenth of the local governments that despite the provision of the Act on Local Governments they did not adopt the economic programme, or did adopt it later than the prescribed deadline. The SAO's experience shows that the expenditure requirements and the possible financial resources of development tasks were considered in the economic programmes by nearly two thirds of the local governments.

As much as 92% of the local governments did not prepare successfully for the use and utilisation of EU funds in relation to the level of regulation (tender monitoring service, tender preparation, submission of tenders, utilisation of the subsidy received, audit of utilisation, compilation of accounting), while 17% did not prepare successfully in relation to the level of organisation. They did not specify the tasks related to tender monitoring, tender preparation related to EU funds, the administrative tasks of developments supported from EU funds, and nor did they name the responsible officials. Furthermore, they did not regulate the tasks of coordination related to tenders aiming to win EU funds, the persons responsible for tender registration at local governmental level, the flow of information related to EU funds, and the audit tasks.



The funding resources of development projects supported with EU funding sources are the followings:



During the audits of development tasks supported from EU funds the SAO concluded that the implementation of nearly half of the supported tasks was not in line with the schedule specified in the support contracts. Almost 50% of the support contracts were amended due to delays in the deadlines, the reallocation of subsidies and expenditures between the years, the reallocation of partial sums within the project budget, as well as due to changes in technical content. At nearly half of the local governments there was a delay of one half to three quarters of a year between the submission of payment applications and the actual payments, primarily due to formal and content deficiencies in the supporting documents. The non-performances were in part caused by the shortcomings of the regulation and organisation of preparations, too. In their respective annual budget decrees the local governments ensured own resources for development tasks supported from EU funds. Furthermore, they complied with the advance payment requirement prescribed for development projects supported from the Structural Funds. The system of ex-post financing of subsidies caused financial problems at nearly one fifth of the local governments, one tenth of which took out liquidity and short-term loans to bridge such financial problems. For the implementation of development tasks nearly one fifth of the local governments had to use own resources to cover extra expenditures that were not included in the applications, yet were incurred in relation to task performance.

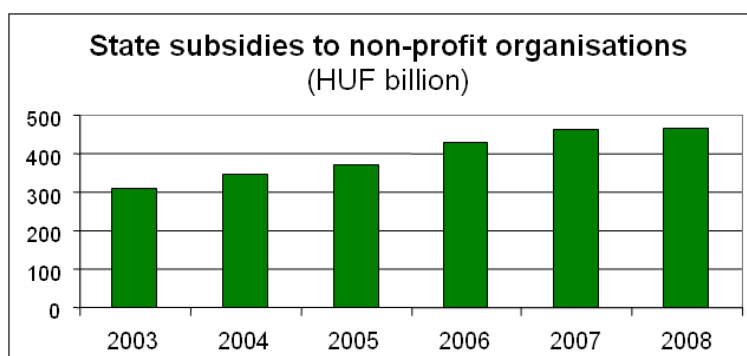
At the majority (86%) of local governments receiving subsidies the utilisation of the EU funds was not investigated by the internal audit system. The external audits of the implementation of development tasks supported from EU funds found deficiencies at three quarters of such tasks. In one tenth of the audits

conducted by the Intermediate Bodies such irregularities were reported as a result of which the payment of subsidies was suspended and repayment was ordered.

Within the framework of international cooperation the SAO carried out several parallel audits in 2008. For instance, in the audit coordinated by the EU Contact Committee Working Group on Structural Funds the SAO investigated the environmental utilisation of the Structural Funds, and the implementation of the European NATURA 2000 network. Furthermore, in conjunction with the other Visegrád countries the SAO audited the internal control system of national organisations concerned in the utilisation of the EU Structural Funds. Within the framework of the EUROSAI, the SAO audited tax allowances linked to the corporate income tax.

2.4. Subsidies to organisations outside public finances

As a result of the increasing public role of non-profit organisations in the society, state resources in the funding system of this sector increased to over 40%, i.e. by a steady growth from HUF 310 billion in 2003 to HUF 462 billion in 2007, and the same appropriation was approved in the budget for 2008.



The dynamic growth in the state subsidies provided for civil organisations imposes an increasing task and responsibility on SAO audits, within the framework of which the SAO regularly audits the financial management of public foundations, political parties and party affiliated foundations. Furthermore, in 2008 the SAO completed the audit of the four-year economic activities of the national minority self-governments.

The **public foundation** that was audited in the subject year implemented its programmes in the field of education, training and research and development with a view to realise the objectives specified in its deed of foundation. One fourth of the related costs were financed from national, and three fourths of the funds were financed from EU funds. The foundation utilised the state subsidies it received for the attainment of objectives specified in its deed of foundation. The board of trustees established the monitoring system monitoring the utilisation of subsidies disbursed by the foundation, within the framework of which it conducted professional and financial audits. The financial management of the public foundations complied with the relevant legal regulations and the internal control requirements. The legality and regularity of financial management was audited by the supervisory board appointed by the founder.

In the audit reports on the legality and expediency of the financial management of public foundations established by the Government the SAO regularly revealed the irregularities associated with the establishment and operation of such foundations. On this basis the SAO made several recommendations on the enhancement of the efficiency of this special system for the distribution of public funds. The original objective that motivated the establishment of public foundations – namely the involvement of funds outside public finances into the financing of public tasks performed by the state – has not been attained yet. The experiences of the SAO audits have indicated that enterprises and citizens do not contribute to the public service tasks performed by public foundations with donations. For the more efficient utilisation of public funds the SAO still finds it necessary to review public tasks to be performed by still existing public foundations expediently and cost-efficiently, as well as to further develop the financing system of such tasks.

Within the framework of **regular party audits**, the SAO completed audit on the legality of the financial management of two parties as scheduled in the audit plan. In addition to the planned audits, the SAO completed the audit of the nominating organisation that obtained representation at the mid-term elections held in February 2008. The SAO's experiences confirmed again the unsustainability of the legal regulations that specify the requirements pertaining to party financial management and campaign financing, as well as the publicity thereof, in connection with which the SAO has urged for years the amendment of the legal regulations on the operation and financial management of the parties, as well as those on the election procedures. Upon the SAO's initiative the Government proposed the amendment of the relevant act (unsuccessfully, though) in 2006, and it could not achieve political consensus for the two-third approval of an independent proposal on the enhancement of the transparency of party financing (T/4190.) either.

The boards of trustees of the two **party affiliated foundations** – that were audited concurrently with the party audits – operated lawfully, the subsidies they granted and the programmes that they implemented within their own organisational frameworks were in line with the objectives stipulated in the deeds of foundation. The foundations possessed the accounting regulations as specified by law, however when amending such regulations they only partially considered the former SAO recommendations. For this reason said regulations regulated the accounting rules incomprehensively, and without consideration to the specific characteristics of foundations. Furthermore, the provisions were not fully enforced in practice.

By auditing the two **national minority self-governments the SAO fully completed the financial and economic audit of organisations eligible for regular budgetary subsidies**. The experiences of these audits indicate contradictions in the execution of the amendments to the Act on Rights of National and Ethnic Minorities effective since 25 November 2005. The transformation of the national offices for the minorities into budgetary organisations – by 1 January 2008 at the latest – was completed with several organisational and regulatory shortcomings. One minority self-government utilised part of the HUF 4.7 million subsidy available for institution establishment in violation of the law, not for the designated purpose.

Within the system of subsidies to organisations outside public finances the regularity of the normative financing of **public education institutions that are not run by the state or local governments** was audited for the first time by the SAO, in harmony with the audit of the education chapter. In 2007 more than one fifth of the funds available for non-profit organisations were spent on such normative financing.

The audit of the normative, public education purpose contributions and subsidies granted to foundations, public benefit organisations and social organisations that maintain public education institutions revealed significant deficiencies. **As much as 83% of the accountings of non-profit maintainers were not reliable**, and the SAO revealed a discrepancy of 13% compared to the accounted normative subsidies. Due to accounting practices violating the effective rules, non-profit maintainers utilised HUF 198 million illegally on one hand, while on the other they would have been eligible for HUF 79 million more in subsidies. Altogether HUF 118 million was disbursed as unjustified budgetary subsidy, 88% of which was linked to the funding of vocational training. In order to settle former subsidies and payments made without legal ground, the Ministry of Education and Culture initiated – upon the SAO's recommendation – that the Treasury should perform follow-up audits within the framework of its monitoring tasks of 2009.

2.5. State property management

The law requires that the SAO audit the operation of the Hungarian Privatisation and State Holding Company and its activities related to the execution of the central budget annually. Another objective of the 2008 audit of the Hungarian Privatisation and State Holding Company was the audit of the performance of tasks arising from the so called state property act of 2007. In compliance with the audit plan for 2007, the SAO also audited the modernisation of rail transport.

Within the **operation of the Hungarian Privatisation and State Holding Company** in 2007, the financial management of own assets was significantly affected by the imminent change of the legal status of the Company, and by the preparation for such change. In the 4th quarter of 2007 the Company had to perform a large amount of extra tasks arising from the shift to standard property management pursuant to the execution of the state property act. The performance of tasks was not sufficiently prepared, primarily for the lack of time. The registration of property items was not reliable. The regulations contained in the general acts (corporate, accounting, corporate law) either contradicts the state property act, or is incomplete, wherefore the guarantee elements are not enforced properly.

The application for and utilisation of state subsidies in violation of the EU regulations, as well as the inadequately regulated transfer of state property into subsidiaries continue to imply a significant risk in the regulation of the financial management of state property. Based on a certain interpretation of the effective legal regulations, all activities of state-owned companies can be outsourced to subsidiaries without any parliamentary control. After outsourcing is completed – on the basis of the same decision-making

mechanism – state property is privatised with corporate ownership being emphasised, and the revenues yielded are consumed by the parent company. The pledging of the assets of subsidiaries is another problem. Permanent state property becomes a denuded company deprived of its assets, functions and economic strategic significance alike.

Taken as a whole, the activity of the State Holding Company was in compliance with the legal regulations pertaining to the assets assigned to it in 2007, too. However, a lack of continuity occurred in the operation of the directorate between 30 June and 9 August 2007. After the state property act entered into force on 25 September 2007, the operation of the Company was not transparent – due to ambiguous legal regulations, the lack of harmony and due to contradictions between the state property act and other legal regulations, as well as due to dual task performance. The decision-making powers were not defined exactly, which posed a risk to the operation of the Company, and to the audit thereof.

The performance of companies that belong to the assets assigned to the Company significantly improved compared to the previous year.

However, in the case of the MALÉV Hungarian Airlines Zrt. it is a negative fact that the objective that was planned to be achieved through privatisation was not fully attained. Despite the low selling price the loans backed with state guarantees could not be fully settled, and the terms and conditions specified in the contract were only partially fulfilled by the buyer.

The sale of FHB Mortgage Bank Co. Plc. was adequate and financially successful compared to former bank privatisations. It can be objected however that no comprehensive survey was prepared about the future role of the bank, that neither the selection of the consultant in charge of the accelerated sale of shares, nor the transaction itself was transparent, and that the Hungarian Privatisation and State Holding Company did not fully enforce its interests when purchasing Class B shares.

State properties of utmost interest are the **state-owned companies of rail transport**. The SAO conducted a detailed analysis on rail transport for the third time. The audit extended to the utilisation of funds, organisational restructuring, the implementation of modernisation, decisions on branch lines.

In the audited period railway modernisation was included in several comprehensive development concepts, the common feature of which was the lack of sufficient resources. In the decision-making process railway development was not given sufficient attention, and the tasks related to the public service activity and the responsibilities were not specified in contracts. Overly complicated organisational management does not ensure the transparent and concentrated utilisation of development resources, and the current financing system of railway development is not efficient either.

The restructuring of the MÁV Hungarian State Railways Private Company by Shares (MÁV Zrt.) was made difficult by the fact that in the period of 2002-2007 as many as 32 people occupied position in the Directorate, the

composition of which was modified seven times, in part due to changes in concept. During that period five different operational and organisational rules defined the executive group (board of directors) of the company, in which 7-16 executive positions were filled by 50 different people, and the post of CEO was occupied by four persons. The management of the company accepted four different strategic materials under various titles and for various objectives.

In relation to the preparation of the competent ministry's decision on branch lines it poses a risk that the relevant profit and loss analysis is not reliable, and that no impact assessment study has been prepared about the long-term sustainability of the life and economy of the regions. Furthermore, the timeframe available for consultations and for the declaration of letters of intent by the local governments was too short.

The sale of the rail freight business was inexpedient and contradictory. With the sale of MÁV Cargo Zrt. the legislators' intention related to the assets that will remain in permanent state property was not enforced. The signed contract contains unjustified obligations for MÁV Zrt., too, while obligations undertaken by the buyer raise concerns, and in several aspects they are unreasonable for the Hungarian State.

In today's Hungary there is no standard registration system for rail vehicles, and it is not mandatory to perform regular vehicle checks (introduced in EU member states), which would make it possible to identify rail vehicles participating in domestic transport, as well as the regular and mandatory inspection of rail vehicles used in the country.

The technical condition of railway infrastructure has continuously deteriorated in the past decades. One of the fundamental causes of this decline is that the funds appropriated for maintenance, renovations and investments were not sufficient to maintain the state of repair either.

The real estate management of MÁV Zrt. is characterised by unsettled proprietary relationships in terms of real estates and structures, restrictions on the intransparent real estate assets, and frequent changes in concept and leadership affecting real estate management.

3. UTILISATION OF THE AUDITS

In relation to the reports it can be generally stated that the acceptance and utilisation of the findings and recommendations by the political entities and the general public alike have continuously improved during the nearly two decades long existence of the SAO.

The utilisation of the activities and reports of the SAO can in a certain way indicated by parliamentary (committee or plenary) events related to the published reports and categorised according to certain aspects.

**Figures relevant to the discussion of reports
by parliamentary committees**

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	total
Number of reports published in the year	44	37	43	37	46	57	69	72	63	59	53	580
Reports/studies discussed by committees*	8	28	18	25	12	24	20	24	9	10	13	191
Reports prepared and discussed in the subject year	6	24	13	17	10	12	12	13	9	9	13	-
Number of committees that discussed the SAO Annual Activity Report	-	5	6	7	3	8	12	7	6	8	5	-
Committee debates **	48	88	69	62	62	84	82	80	46	51	56	728

* In the 1998-2002 and 2002-2006 cycles there were 23 and 25 permanent committees, respectively, while the number reduced to 18 in 2006. ** Committee agenda that included SAO reports or studies.

In the past ten years the figures characterising the relationship of the SAO with the National Assembly and the parliamentary committees have also been significantly influenced by the fact whether the former committees were restructured or not in the subsequent parliamentary cycles.

3.1. Discussion of reports by the National Assembly, resolutions and parliamentary relations

Arising from its legal status and role, in 2008 the SAO maintained strong professional cooperation with the National Assembly and its committees. The working relations have continuously developed throughout the past years, and have become increasingly direct through the extensive utilisation of IT solutions. In the past years the President of the SAO has been invited several times to attend the Meeting of Committee Chairpersons, and has regularly met with the leaders of parliamentary factions, too. Apart from the National Assembly, the SAO maintains good relations with the Office of the President of the Republic and with the Prime Minister's Office.

The SAO met its reporting obligations required by legal regulations by the deadlines (opinion on the budget bill, report on the final accounts, annual reports on the financial management and activities of the Hungarian News Agency Corporation and the Hungarian State Holding Company). From among the 55 reports included in the 2008 Audit Plan, as many as **53 reports** were published **in 2008, 12 of which and one study were put on the agenda by parliamentary committees**. All of the discussed reports were published in 2008.

The number of committee events related to the SAO reports has been continuously growing since 2006. SAO reports or studies were included in the agenda of 46 committee meetings in 2006, of 51 committee meetings in 2007, and of 56 committee meetings in 2008.

The plenary sessions of the National Assembly put four SAO reports on their agenda.

In 2008 the Committee on Budget, Finance and Audit Office, as well as the Economic and IT Committee relied most extensively on the SAO report in their work (each of them put five SAO reports on its agenda). In 2008, the Committee on Human Rights, Minority, Civil and Religious Affairs discussed four SAO reports and a study of the SAO's Research Institute on the situation of the Romas.

It became a general practice in the parliamentary cycle of 1998-2002 that the SAO annual activity reports are regularly discussed by the plenary sessions – and by an increasing number of standing committees – of the National Assembly, which subsequently decides on the approval of said reports. The 2007 SAO Annual Activity Report was put on the agenda of five selected committees.

The SAO report on the 2007 final accounts, and the SAO opinion on the budget appropriation bill for 2009 were discussed by all committees but the Committee on Immunity.

The report on the financial management of the Hungarian News Agency Corporation in 2007 was discussed by the Committee on Culture and the Media, as well as the Committee on Budget, Finance and Audit Office together with the annual report of the Hungarian News Agency Corporation.

The report on the activities of the Hungarian Privatisation and State Holding Company in 2007 was discussed by the Economic and Information Technology Committee and by the Committee on Environmental Protection (from the four selected committees) in October-November, but it was not included in the agenda of any plenary session in 2008 either.

The report on the audit of the utilisation of EU funds in 2007 was discussed by the temporary committee monitoring the implementation of the New Hungary Development Plan on 7 October 2008, together with the informative report on the modification of funds stipulated in the action plans of the regional operational programmes of the Ministry for National Development and Economy.

The President of the SAO took the floor four times at the plenary sessions of the National Assembly, and attended 14 committee meetings discussing the annual report, the report on the final accounts, the opinion on the budget bill and the Annual Audit Plan. Apart from attending committee meetings that discussed the SAO reports, the executive officials of the SAO were also actively involved in meetings the agenda of which included the tasks and audits of the institution.

In 2008 the SAO represented itself at nearly 90 committee meetings. (At more than half of such meetings the SAO submitted proposals.)

In 2008 **parliamentary deputies addressed three questions** to the President of the SAO.

The SAO participated in the preparation of the **bill on fiscal responsibility** – which affected its own scope of activity – and actively monitored the after-life of the proposal aimed at the **amendment of the public procurement act**.

3.2. Enforcement of SAO recommendations

The SAO performs its audit tasks, and compiles and publishes the subsequent reports in strict ‘technological’ procedures. The auditor’s reports and the subsequent draft SAO reports are thoroughly discussed with the affected entities in the course of a contradictory procedure, based on the Act on the State Audit Office and the internal audit regulations. In case a difference in opinion is not resolved, it is indicated in the report to be published.

Without affecting the independence of the economic management and without taking over its responsibility the SAO recommendations regularly draw attention to the risks of economic decisions, indebtedness and the consequences of the foreign-exchange risk, the validity of which is confirmed by the subsequent processes.⁸

The SAO has recently witnessed a rise in the number of cases when the auditee – contrary to its former agreeing opinion – questions the findings and recommendations after the publication of the SAO audit report.

3.2.1. Utilisation of the recommendations at the level of the National Assembly

Most of the SAO recommendations addressed to the National Assembly, or affecting the legislative operations of the National Assembly were realised in 2008. The SAO recommendations and its ‘Theses’ published earlier also contributed to the supplementation of the legal regulations on public finances, to the transformation of the system of public finances into a two-level system, to the review of the state property act, to the modernisation of public funds related regulations, within the framework of which the Budget Council will soon start functioning.

Based on the recommendation made pursuant to the **audit of the execution of the 2007 budget of the Republic of Hungary** the Minister of Finance initiated the amendment of the Act on Public Finances. According to the provisions of certain acts that lay the foundations for the 2009 budget of the Republic of Hungary, as of 1 January 2010, the audits of the separated state funds and of the financial funds of the social security system in relation to the final accounts will be replaced with audits performed according to the SAO’s methodology.

In its report on the **audit of the operation of the Ministry of Finance chapter** the SAO recommended the Minister of Finance to prepare impact

⁸ (0743) Report of the Audit on the System of Implementing Public-Service Tasks Stipulated by the Act on the National News Agency and the Act on Radio and Television Broadcasting (0609) Report of the Audit on the Privatisation of Medical Services

assessment studies and analyses in the preparation for the decision-making process, to systemically explore the causes behind the occurrence of appropriation residues, and to make the necessary regulatory changes. Sections 5 and 6 of Act LXXV of 2008 on Fiscal Responsibility contain detailed requirements pertaining to the preparation of impact assessment studies. These regulations will take effect on 1 January 2010.

In the report on the same audit the SAO recommended – with a view to make audits more efficient – that the Minister of Finance should review the regulation of the internal audit system of public finances through the systemic reconsideration thereof. Act CV of 2008 on the Legal Status and Financial Management of Budgetary Institutions amended the relevant parts of the Act on Public Finances. Furthermore, the amendment of the Government Decree on the operational rules of public finances – which was also adopted at the end of 2008 – contains the individual detailed rules.

The parliamentary committees (Committee on Budget, Finance and Audit Office, as well as the Economic and IT Committee) that included the report on the **SAO audit of the operation of the public procurement system** in their agenda – together with the annual report of the Public Procurement Council – found said report useful and utilisable in the legislative process. However, this opinion is only partially reflected by the provisions of the amendment to the public procurement act – promulgated on 22 December 2008 in Act CVIII of 2008.

Since the 1999 amendment to the public procurement act, the SAO has been authorised to initiate legal remedy proceedings in relation to violations of law that come to its knowledge while performing its duties. Act CXXIX of 2003 significantly extended the timeframe open for launching such action – to one year from the time when the violation occurred, and to three years in case no public procurement procedure is conducted in violation of the law. Consequently, the number of legal remedy proceedings initiated by the SAO in the subsequent year quadrupled compared to the former years. The amendment to this act (effective of 1 April 2009) has reduced the forfeiture deadline to one year despite the fact that the SAO expressed its concerns about the reduction of the timeframe open for launching legal remedy proceedings.

The significance of the SAO audits was indicated by the fact that according to the figures on the year 2007, for instance, legal remedy proceedings had to be initiated at one fourth of the audited local governments due to the unlawful omission of public procurement procedures. Since apart from the SAO no other institution audits the public procurement procedures of local governments – beyond the audit responsibilities specified in the agreements related to the individual subsidies – the amendment of the public procurement act may adversely affect the exploration and possible sanctioning of the misuse of public funds.

Based on the experiences gained during the audit of the **financial management system of local governments** the SAO made one recommendation for the Government and 47 recommendations for the ministers in the period of 2003-2008. In response to the SAO's recommendation the National Assembly specified the content requirements of the economic programme, the standard minimum value limit for undertaking tender procedures mandatorily, the rules pertaining to public procurements centralised locally (at local governmental level), the mandatory publication of non-

normative, earmarked operational subsidies. Furthermore, the National Assembly completed the rules of the financial audit system, supplemented the content requirements of agreements signed with minority local governments, and clarified the mandatory social tasks of the county local governments.

In accordance with the SAO recommendation, when determining the upper limit of debt generating liabilities, the local governments took into account acceptance liabilities representing multi-year payment obligations, as well as the amounts payable to the suppliers in course of several years. By amending the Act on Local Governments and the relevant legal regulations, detailed ruled were established for the internal audit of local governments.

According to the information provided by the Ministry of Finance, the proposal on the amendment of the Act on Local Governments regarding the modification of the regulation of the borrowing limit (debt limit) has been submitted to the National Assembly. During the next amendment of the Act on Local Governments it will be proposed that the legal provisions pertaining to the disposal of not fully negotiable assets be clarified, and the amendment of legal regulations that affect – among other things – the information system of the local governments, should prescribe the mandatory presentation of the financial loss or surplus to the council of representatives.

When **forming opinion on the budget appropriation bills** the SAO has repeatedly (for the last time in relation to 2009) emphasised the need for harmonising local governmental tasks and financing, as well as the **lack of harmony between the sectoral acts and the resources made available to local governments**. In this respect only partial measures have been taken. For example, the public education performance indicator was introduced in the 2007-2008 school year⁹.

Earlier, in the report on the audit of the execution of the 2003 budget of the Republic of Hungary the SAO expressed its concerns about the fact that the personal income tax transferred to local governments were included in the budget acts neither as revenue, nor as expenditure despite the fact that the respective acts specified the method of utilisation of such funds. Off-budget management made registration and accounting complicated and did not foster transparency either. The related **SAO recommendation was realised in the budget act for 2008**, which included the amount of the transferred personal income tax as revenue and expenditure, too. The registration of subsidies and contributions has simplified at the level of the chapters and local governments, too (the funds do not have to be registered and accounted both separately, depending on the sources, and as an aggregate amount).

In the report prepared on the audit of the review of the utilisation and accounting of **central budgetary funds** by the local governments and local minority self-governments the SAO recommended the Minister of Finance to

⁹ In the future the coordination of tasks and financing will be fostered by a document issued by the Ministry of Finance in 2009, which contains the tasks to be performed in much more detail than before.

supplement Section 64/D of the Act on Public Finances with a provision requiring follow-up on-site audits on the accounting of budgetary subsidies extended to local governments. Furthermore, the SAO recommended that the Minister of Finance allow the Treasury to increase human resources required for the performance of the on-site audits.

During the amendment of the Act on Public Finances at the end of 2007, the act was supplemented with a provision requiring follow-up on-site audits on the accounting of budgetary subsidies extended to local governments. The human resource capacity of the Treasury was enhanced in 2007 to meet the needs of the on-site audits: Government Decision 2146/2007 (VII. 27.) provided for a staff increase of 335 for the performance of this task.

Following the audit of the application for and utilisation of public utility subsidies for **road and sewage development projects** by the local governments in the 2002-2005 period, para (18) of Article 7 of the Act XCIX of 2006 required the repayment of public utility subsidies unlawfully utilised between 2002 and 2005. Furthermore, para (19) of the Article 7 of the same act stipulated a new regulation to prevent the unlawful utilisation of subsidies. Pursuant to the SAO's recommendation, para (10) of the Article 101 of the Act on Public Finances was amended: in order to prevent abuses, the act more accurately specified the rules for the proportionate repayment of development subsidies – due to the receipt of funds by the local governments directly from the contractors or via other organisations.

The SAO recommendation on the amendment of the act regulating the vocational training contribution, which was made during the **audit of vocational training**, was realised. As a result, these funds basically serve the activity stipulated in the vocational training act, and the development thereof.

Utilising the experiences of former SAO audits, Act CLXXXI of 2007 on the Transparency of Subsidies Provided from Public Funds, and Government Decree 2233/2007 (XII. 12.) on the efficient utilisation of public funds stipulated the coordination of the **subsidy systems of civil organisations** and the award of non-profit central subsidies on the basis of performance indicators.

By adopting Act LXXXI of 2008, the National Assembly amended Act I of 2003 on the **National Civil Fund** with regard to the recommendations formulated in the 2006 SAO report. In order to eliminate professionally unjustified overlaps, the act precisely specifies entities that are not eligible for operational subsidies, and excludes applicants that violate the rules on incompatibility from the group of organisations eligible for support.

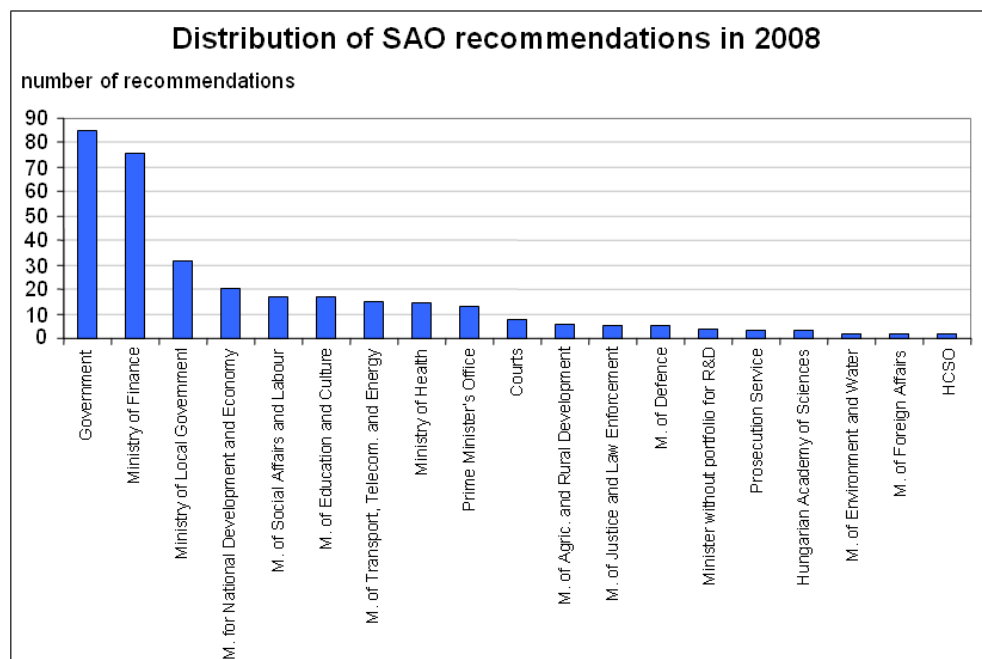
Within the framework of the renewal of the system of public finances, and in part by accepting the SAO's recommendations on the expedient and cost-efficient task performance by **public foundations**, the National Assembly annulled Article 74/G of the Civil Code on public foundations. Pursuant to the act, no new public foundation can be set up after 24 August 2006, and existing public foundations are governed by transitional rules.

If accepted, **Bill No T/4190** (which is currently on the agenda of the National Assembly) would impose stricter rules on the financial management and campaign funding of political parties, and would increase the sanctions on unlawful financial management and forbidden campaigning. Furthermore, it would expand the scope of SAO audits, and – in line with the SAO's recommendation – would stipulate the annual financial reporting obligations of the parties in line with the accounting act.

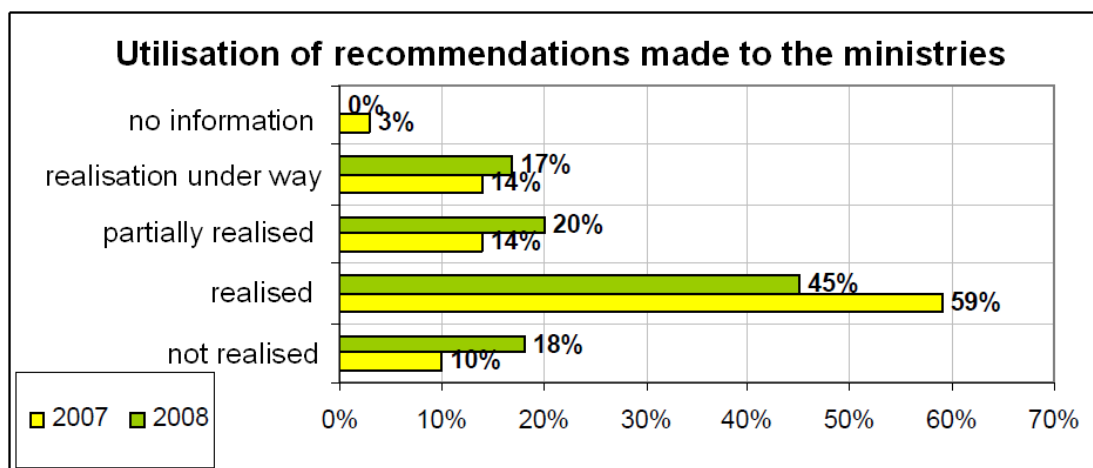
3.2.2. Utilisation of the recommendations at governmental level

In order to be able to follow the after-life of proposals and recommendations made during the SAO audits, the **SAO requested information from the Government and the Heads of Ministries on the utilisation of the recommendations in 2008, too, in line with the practice of previous years.** All parties contacted responded to the request. The received information is all the more important for the SAO, since apart from the initiation of the restoration of lawfulness there is no general legal requirement for the realisation of SAO recommendations.

In their replies, several ministries indicated that the SAO had largely contributed to their professional task performance and financial management with recommendations made during the audits, and on the basis of the SAO's work they achieved progress in several areas in terms of regularity, level of regulation and efficiency.



Despite this fact, the recommendations were received less favourably in 2008 than in 2007. Although 82% of the recommendations reached a certain level of realisation, **the ratio of unrealised recommendations increased – even according to the responses from the ministries.**



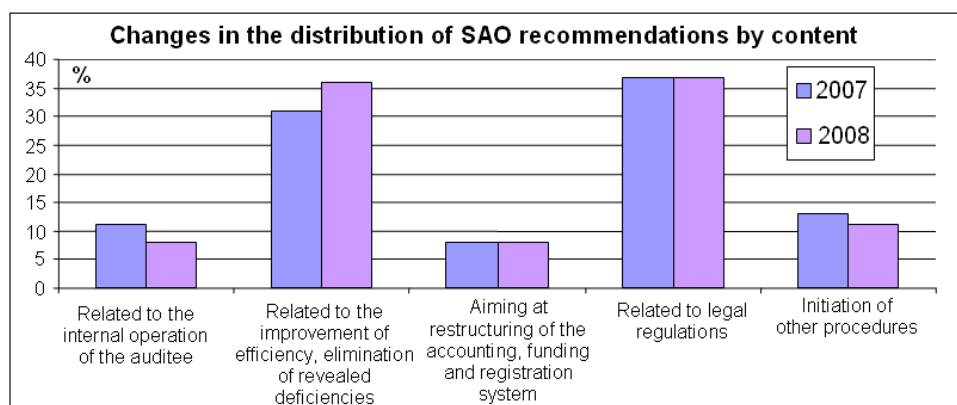
The share of **SAO initiatives for the amendment of legal regulations** was similar as one year earlier, however fewer of them were received positively (a drop from 54% to 37%), and the ratio of apparent rejections grew from 15% to 26%. These recommendations typically pertained to the elaboration of new acts, or the amendment of existing acts and other legal regulations. In a few cases the ministries considered the existing regulations adequate, while in others they did not consider themselves competent in making changes.

Following the trend of the previous year, the share of the SAO recommendations aiming to improve **expediency, efficiency and effectiveness**, as well as to eliminate the revealed shortcomings and deficiencies continued to grow (from 31% to 36%). As many as 84% of such recommendations were received positively, and 55% of them have already been realised.

Concrete measures were taken in connection with 91% of the recommendations aiming at the review and further development of the **internal control system**, and that of the chapter and internal audit system, or the entities concerned have started to prepare the utilisation of the recommendations.

The share of recommendations aiming at the restructuring of the **accounting, financing and registration systems** compared to all recommendations remained the same as last year. The rate of positive measures taken in response to such recommendations was 83%. In the case of 17% of these types of recommendations the chapters considered their existing practices appropriate.

Other recommendations that can neither be classified, nor included in the former categories due to their uniqueness accounted for 11% of all recommendations. Over 90% of such recommendations were accepted, and 26% were implemented by the time this report was compiled. As many as 39% of the recommendations were realised partially, while realisation was under way in relation to another 25%.



In course of its subsequent audits, the SAO monitors the implementation of the measures taken by the Heads of Ministries, and regularly comments on the implementation thereof in its reports.

The utilisation of SAO recommendations is indicated by – among other things – the implementation of the following concrete measures:

Pursuant to the audit of the operation of the Research and Technology Innovation Fund the SAO recommended the Government to discuss the annual reports prepared about the utilisation of resources by the Fund, and to initiate legal deregulation for the simplification of the operational process of the Fund, and for the clear definition of scopes and responsibilities. The report on the utilisation of resources by the Fund and on the activities of the National Office for Research and Technology in 2007 was completed. The minister without portfolio determined that the 2008 annual report should be submitted to the National Office for Research and Technology by the end of June 2009 at the latest. The 2007 and 2008 reports on the utilisation of resources by the Fund and on the activities of the National Office for Research and Technology are planned to be submitted to the Government concurrently, in the third quarter of 2009.

The text of the draft Government Decree on legal deregulation, and on the simplification of the operational process of the Fund has been prepared, and the members of the working group have made their relevant comments. After the inclusion of the comments and proposals, as well as after the clarification of still pending issues the text can be finalised and the draft government decree can be subjected to policy debate. The decree on deregulation is expected to be adopted in the second quarter of 2009.

In response to recommendations made to the Government pursuant **to the audit of the operation of the public procurement system** action plans were prepared by the Minister heading the Prime Minister's Office and by the Heads of the Ministries affected by the audit. The logical measures that have been formulated in connection with electronic public procurements, as well as with procurements affecting security and national security interests may provide a solution to the deficiencies detected during the audit. The accepted amendment of the Act on Public Procurement specified a longer deadline – than that

contained in the draft – for the mandatory introduction of electronic communication, however this has not eliminated all risks of execution.

Pursuant to **the audit of the modernisation of railway transport** the SAO made recommendations for the Government in relation to the regulation on railway development and rail transport, among other things. Furthermore, the SAO recommended the Government to initiate the harmonisation of the urban transport of the capital and the suburban transport of large cities, with regard to the developments and the transport associations. The legal regulations on integrated railway associations have been reviewed and amended.

Based on the audit findings made during the **audit of the institutional system of the central budget** the SAO recommended the Government to initiate the definition of tasks to be performed and financed by the state on a longer run. The Government took measures related to the review of public tasks in its decisions, however by the end of January 2009 it failed to submit a motion regarding the SAO's initiative. The SAO recommendation pertaining to the elaboration of the organisational models and performance criteria of state institutions has been partially realised by adopting the Act CV of 2008 on the Legal Status and Financial Management of Budgetary Organisations.

The recommendation made to the Minister of Finance called for keeping the Registry up-to-date, and for specifying detailed rules for registration and data supply. The regulation on the Registry was revised in the Act on Public Finances and in the Act on the Legal Status and Financial Management of Budgetary Organisations.

In relation to the **audit of the utilisation of funds spent on certain oncological screening programmes** the SAO recommended that the Minister of Health should enforce Parliamentary Resolution 46/2003 (IV. 16.), and within this framework he should establish the information system of oncological screenings and patient monitoring, and that he should initiate the amendment of the related data management legal regulations to ensure subsequent controls. On 3 October 2008 the Ministry of Health, the National Health Insurance Fund and the National Public Health Office initiated joint negotiations for the establishment of the information system of oncological screenings and patient monitoring. The process level plan of the information system, as well as the draft of the required amendment to the data management legal regulation have been prepared, discussions are under way. Further discussions with the data protection ombudsman are carried out on a continuous basis.

Furthermore, the SAO recommended to restructure the system of screenings for cervical and colon cancer. The reorganisation of cervical cancer screenings has started with the health visitor pilot programme. Reorganisation of colon cancer screening has commenced. The screening protocols have been developed for each type of screening in accordance with the current state of the field and with the international standards. The protocols have been revised, and subsequently discussed, commented and accepted by the individual professional colleges.

Pursuant to the **audit of the operation of state tools available for economic development** the SAO recommended the Minister of Finance to initiate – by the further development of the legal regulations and in compliance with the EU principle of reliable financial management – the planning and application of performance objectives and indicators related to the financial planning of the expenditure items of the budget. According to Section 1.2 of Summary No 8008/2008 issued by the Minister of Finance, the Minister will specify the content of the specific tasks and the system of indicators in the form of a Summary by 31 March 2009.

In addition, the SAO recommended the Minister of Finance to further develop the information system of public finances for the registration and monitoring of development purpose expenditures. Within the framework of the project titled ‘Central Financial Management System’, which would fundamentally modernise the information system of public finances, it will be possible to develop further categories and observation criteria. No other developments can be implemented in parallel with this project.

On the basis of the SAO recommendations made pursuant to the **audit of the financial management of the local governments** the Government amended the provisions of the Government Decree on the operational rules of public finances and of the enforcing decree, standardised the professional qualification requirements of persons performing enforcement tasks, and determined the content requirements of balance sheets and statements to be presented concurrently with the submission of the budget and the final accounts to the National Assembly. Within the framework of the amendments made to the Government Decree on the operational rules of public finances, the rules pertaining to the modification of appropriations related to minority self-governments were also supplemented.

The Minister of Finance supplemented the sample internal audit manual with the standard aspects of audits on earmarked subsidies. The currently effective system of special tasks was reconsidered within the framework of modernising the financing system of local governments in relation to the revision of the tasks and scopes of local governments. The number of special tasks significantly grew upon the modification of the system of special tasks in 2008. In the form of a circular the Ministry of Agriculture and Rural Development ordered the land registry offices not to register the change of title in the case of unmarketable properties.

In order to reinforce transparency, the 2007 SAO report on **the audit of the delivery of basic social services by local governments** recommended the Minister of Social Affairs and Labour to review the data content of the professional statistics of the sector, and initiate the modification thereof with a view to ensure the supply of material information regarding the entire supply system. Furthermore, the SAO recommended the Minister of Social Affairs and Labour to inform the Minister responsible for public finances about the need for the amendment of legal regulations pertaining to the financial information system of the local governments to ensure the transparency of task performance and the traceability of expenditures of the services defined in the act. Upon the initiation of the Ministry, the national registration system

managed by the National Office for Employment and Social Affairs was established, and the database of service providers and institutions was set up. Altogether the SAO believes that despite the measures taken so far, the local governmental information system must be further improved.

In the report on the **audit of healthcare investment and reconstruction projects funded from earmarked subsidies** the SAO called the Government's attention to the fact that it should order the restructuring of the current planning practice of healthcare developments, as well as the calculation of funds required for the implementation of the professional objectives, and the identification of the sources of such funds in order to develop a comprehensive, sector-neutral development policy. On the basis of extensive professional and social debates, the Ministry of Health prepared the Healthcare Development Policy Concept (valid for the healthcare system until 2020) in August 2005.

The Concept determines the planning and implementation of multi-year healthcare developments in a prudent, consistent and unified system, in harmony with the principle of progressive care, as well as the regional aspect.

In its report on the **audit of the utilisation of funds used for nursing care by hospitals and residential social institutions** the SAO recommended the Government to ask the Minister of Health and the Minister of Social Affairs and Labour to give account on the enforcement of the Government Decision on the out-of-order tasks related to the standardisation of the nursing care system. Furthermore, the SAO recommended that the Minister should determine the tasks to be performed by the ministry for the establishment of the standard system of nursing care tasks, for the elimination of existing parallelisms, for the expedient and transparent utilisation of resources available for this purpose, as well as for the coordination of social and healthcare tasks. The Ministry of Social Affairs and Labour and the Ministry of Health concluded an agreement on professional cooperation in the development of a 'mixed' nursing care pilot model for the possible standardisation of the system of conditions, for the monitoring of care recipients, as well as for the development of the conditions for mixed financing. In addition, a proposal was submitted to the Government on the tasks involved in the standardisation of the nursing care system.

With a view to achieve the objectives specified in the Act on **Multi-purpose Micro-regional Associations** of Local Governments, the 2008 SAO report recommended the Government to define the tasks related to the further development of the regulatory system of multi-purpose micro-regional associations, to determine the role of such associations in the structure of public services, and to ensure the harmony of the underlying regulation with the financing system of local governments. The Ministry of Local Governments is currently working on the preparation of the reform of the local governmental system. The Government is reviewing the questions and regulation of the operation of multi-purpose micro-regional associations in this respect. According to the Government, the current incentive system of multi-purpose micro-regional associations can be more pronouncedly integrated into the financial regulatory system of the local governments, and can be coordinated

with local government financing only after the role and operation of such associations is stabilised within the local governmental system.

The SAO recommended the Minister of Finance to develop procedural and competence rules that take into account the specific nature of internal audits to be conducted within the framework of multi-purpose micro-regional associations. Furthermore, it was recommended that the applications for and accounting of incentive subsidies available for multi-purpose associations should be made easier to analyse and audit within the financial information system. The Ministry of Finance will review the Government Decree on the internal audit of budgetary organisations during the 1st and 2nd quarter of 2009 (after a survey is completed on the status of internal audits at the local governments). As far as the accounting of subsidies is concerned, the 2009 budget for budgetary institutions and the report already contain the detailed requirements.

Pursuant to SAO recommendations, the Government wound up two **public foundations**, consolidated public foundations that operate in the field of education, and decided about the liquidation of three public foundations in order to improve the efficiency of the support system designed to promote the linguistic and cultural identity of ethnic Hungarians living outside Hungary.

According to the information provided by the Government, the recommendations related to the audit of the normative contributions and subsidies to non-profit organisations maintaining **public education institutions** are being utilised. The draft amendment to the Government Decree 20/1997 (II. 13.) on the enforcement of Act LXXIX of 1993 on Public Education contains regulations on financial management related competences; on the standardisation of dates on which non-state and non-local governmental entities maintaining educational institutions, as well as local governments are mandated to do a student count; as well as on the frequency of mandatory audits to be performed by the Treasury. Within the rules of performance-based financing, the 2009 budget act stipulates the funding rules for mixed and consolidated groups/classes. The Ministry of Education and Culture initiated that the Treasury should conduct a follow-up audit on discrepancies revealed in the accounting of non-profit organisations. This audit will take place within the framework of the 2009 monitoring programme.

During the 2003 and 2008 **audits on public education** the SAO recommendations basically pertained to the regulatory system and the improvement of conditions. From among the related recommendations those on the measurement of student performance, on the creation of institution-level publicity, on the elaboration of medium- and long-term plans for the development of vocational training, and on the reconsideration of competences were realised. The system of differentiated normative subsidies for practical training was modified according to trades/professions high in demand. The system of vocational training contributions has been revised, as a result of which the SAO recommendation on the mandatory accounting and audit of vocational training contributions directly transferred to the institutions has been realised. The coordination of educational statistics describing the structure of vocational training and labour market statistics has been realised partially.

In response to the SAO recommendation made pursuant to the **audit of residence halls** in 2006, the definition of public educational institutions as beneficiaries was already included in the Regional Operational Programmes in the 2nd National Development Plan. Pursuant to the SAO audit, measures were taken to summarise the experiences of the Arany János Talent Programme, and to ensure their distribution among all parties affected. The recommendations on the integration of the development of residence hall based activities into the public education development strategy, on the establishment of learning centres, as well as on the regulation of the internal arrangement of rooms and equipment supply of residence halls have not been realised yet.

3.2.3. Utilisation of the recommendations at the level of the auditees

In response to SAO recommendations made pursuant to the audits all auditees prepared their respective adequate action plans.

In the report prepared on the **audit of the operation of the chapter 'Ministry of Finance'**, in relation to the 'Central Financial Management System' project the SAO recommended the evaluation of the inherent risk factors, the justification of the budget, as well as the reconsideration of the relevant management and decision-making mechanism. The SAO found it necessary to create the conditions for the more efficient fulfilment of chapter-level IT management and supervisory functions in the Ministry of Finance, and to modernise the system of data exchange between the customs and tax authorities. Based on the measures taken by the Ministry of Finance in response to the recommendations, further categories and observation criteria can be developed within the framework of the 'Central Financial Management System' project, which would fundamentally modernise the information system of public finances.

Within the framework of the same audit the SAO concluded that the former recommendations were realised in that the heads of the affected institutions took measures for the realisation of the recommendations. No or only partial progress has been achieved in relation to recommendations that were made for the Government or the Minister of Finance on the reinforcement of the professional substantiation of budget planning, on the development of the internal financial audit of public finances, as well as on the review of the residual sums of the appropriations by the given deadlines.

Pursuant to the audit of the operation of the **Research and Technology Innovation Fund** the SAO recommended the Minister of Economy and Transport (currently Minister for Research and Development) to establish – with the involvement of the professional organisations – the objectives of the support programmes, and to assign target indicators that ensure the accountability and presentation of the achieved results. The strategic action plan of Research and Technology Innovation Fund for 2009-2010 contains the objectives, indicators and target values of the support programmes to be advertised.

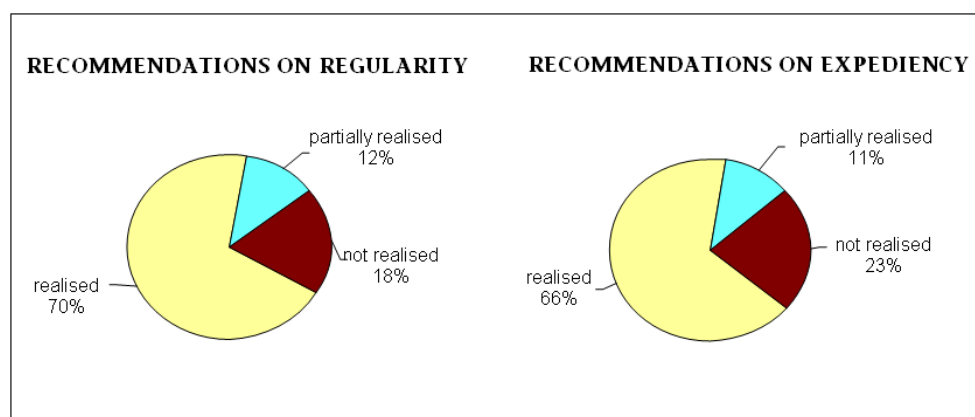
In accordance with the SAO recommendations made pursuant to the **audit of the modernisation of rail transport** several practical measures have been taken about the exact distribution of tasks between the railway infrastructure

company and the independent organisation in charge of distributing the rail capacity, and about the re-regulation of tasks. As of 1 July 2008, the task of compiling the timetable for the railway network was transferred to the organisation in charge of distributing the rail capacity. This change was also incorporated into the operational and organisational rules of the affected entities.

As of 1 January 2009, the so called Budapest Pass replaced the former passes of the Budapest Transport Company (BKV) and the Unified Budapest Pass, which is another step towards the establishment of a common tariff system. With the introduction of the new pass, the suburban services of Volánbusz Zrt. coach company and MÁV-START Zrt. rail company became available for all passengers for local travel within the city limits. The next step can be the tariff community outside the city limits, and the consolidation of local and long-distance tariffs in a so called zone system. Preparations are being made by the Budapest Transport Association (BKSZ Kht.).

The Minister responsible for transport prepared an action plan for the utilisation of SAO recommendations on the establishment of a single system for the registration and technical inspection of rail vehicles.

In the period following the adoption of the parliamentary resolution reinforcing the direction and frequency of the legality audits of the financial management of local governments **the SAO made recommendations by the thousand during the audit of the financial management system of local governments.** Nearly three quarters of the recommendations were utilised by the local governments, as a result of which improvement could be observed in the regulation of tasks related to the preparation of the budget and the final accounts, as well as financial management and finance/accounting. The timely approval and 'contentual presence' of the economic programme, the regularity of property registration and management, the development of the conditions required for the performance of internal audit tasks became a general practice. Local and central requirements were better observed and the completion of financial management control was widely ensured. As a result of the measures taken, the information supply to the councils became more extensive and accurate in relation to the budget concept, as well as the draft budget and final accounts decrees. The level of regulation of the finance/accounting activity improved. There was improvement in the conditions required for the establishment and operation of the audit system.



For several years now, the SAO has experienced that the local governments of counties, towns with county rank, as well as capital district local governments affected by the audit of their financial management systems accepted the comments and recommendations made by the SAO, and most of the revealed irregularities and deficiencies were corrected already during the on-site audits. In such cases the reports stated the existence and then the elimination of the omission or deficiency during the audit period, but contained no recommendations for future measures. After the reports were transferred to the auditees, each auditee prepared an action plan for the elimination of the revealed deficiencies, including the names of the responsible persons and the deadlines. The publicity of the SAO reports and the briefings held about the audits of the county local governments and towns with county rank also contributed to the general improvement of financial management.

The SAO audits also drew the attention to the fact that at certain local governments the escalation of tensions in financial management can in part be attributed to the uneconomical organisation of task performance, the low level of utilisation of institutional capacities, the undertaking of voluntary tasks over the load-bearing capacity, to planning errors, as well as to undertaking cumulative purpose expenditures in excess of the cumulative purpose revenues. In response to the SAO's calls, progress was made at the local governments and at the institutions.

Pursuant to the recommendations made during audits conducted at public education institutions, the standards of accounting task performance related revenues and expenditures have improved, and the documentation of group sessions and exams have become more regular. Institution level surveys, evaluations and professional reporting before the assemblies have become more frequent.

3.2.4. Unrealised recommendations of the SAO

The common feature of these recommendations is that while their expediency and justification are not questioned by those affected, they are typically not realised.

In line with its approved strategy, the SAO focuses on the promotion of the modernisation of public administration and of the more efficient operation of public finances when formulating its recommendations. All this requires the reconsideration of the system of tasks, the development of the related planning and financing system, yet some of the related SAO recommendations still await realisation.

The SAO recommended to the Government to prepare – in harmony with Parliamentary Resolution 96/2005 (XII. 25.) on the National Development Policy Concept – comprehensive legal regulations aiming to reinforce the **planning of state development tasks**, which would create the institutional guarantees of task performance and include the standard planning methodology of national and EU resources. In the past years the Government took several initiatives to create the basic legal regulations on development policy. However, the lack of sufficient professional maturity and political

support has so far prevented these initiatives from being submitted to the National Assembly.

Based on the audit findings made during the audit of the institutional system of the central budget the SAO recommended the Government to initiate the **identification of tasks that should be performed and financed by the state on a longer run**. The Government took measures about the tasks related to the review of public tasks in its decisions, however it did not take the initiation that the SAO recommended by the end of January 2009. The SAO recommendation on the development of the organisational models and performance criteria of state institutions was in part realised by the adoption of Act CV of 2008 on the legal status and financial management of budgetary organisations. By February 2009 no measures were taken in response to the SAO's recommendation that called for the elaboration of the comparable public administration and statistical information on budgetary organisations.

The mandatory tasks of the state and the local governments were neither reconsidered, nor narrowed down. Furthermore, the prolific rules were not simplified to provide a clear-cut definition of intermediate level local governments (region, micro-region), and in line with this, to assign new tasks and scopes, to ease excessive decentralisation and to improve the quality of public services. Consequently, the financing system that would adjust to the new local governmental structure and task assignments, and that would shift the support and equalising mechanisms aimed to eliminate the fragmented nature of funds to the intermediate level has not been realised either.

In the report on the review of the local governmental decree on the distribution of revenues due to and shared by the Municipality of Budapest and the district local governments in 2007 the SAO recommended the Minister of Local Governments and Regional Development to initiate the amendment of Act CXXXIII of 2006 on **Resource Sharing between the Municipality of Budapest and the District Local Governments** in order to ensure harmony with the Act LXV of 1990 on Local Governments in relation to the tasks taken into account during the resource sharing calculations, and the determination of the respective shares in a normative manner. No considerable measure has been taken for the realisation of this recommendation.¹⁰

During the formulation of its recommendations the SAO paid attention to those fields, too, where the modifications may **foster the effectiveness of the audit work**. Further measures are needed for the implementation of the following recommendations.

The SAO recommended the Minister of Finance to keep the Register up-to-date, and define detailed rules for registration and data supply. The regulation was not published by February 2009.

¹⁰In its response the competent ministry indicated that the recommended amendment of law would not ensure harmony with the Act on Local Governments, and the distribution ratio is based on a consensus reached by the Municipality of Budapest and the district local governments.

The SAO made several recommendations related to the importance of transparency, **for the elimination of the deficiencies of the financial information system**, and for the enforcement of the accountability and performance requirements. Hence, in connection with the 2007 budget bill it recommended that the Government should ensure that the data on the appropriations and execution of chapter IX (Local government subsidies) should be managed by a single IT system – to ensure the principle of completeness and closeness. The Government did not indicate that it would consider any related measure.

No efforts were made to harmonise the provisions of the Act on the Legal Status of Civil Servants and those of Government Decree 193/2003 (XI. 26.) on the internal audit of budgetary organisations with a view to determine whether the internal audit of the financial management of local governments can only be performed by civil servants or also by duly authorised entrepreneurs.

During the audit of the role of the multi-purpose micro-regional associations of the local governments in the delivery of public services and regional development tasks the SAO recommended that the Ministry of Local Government should initiate – with the involvement of other ministries – the elaboration of economy-of-scale indicators that would allow for the evaluation of the work of multi-purpose associations and the results of joint task performance by the local governments. Although the Ministry agreed with the content of this recommendation, for the lack of power it did not find it feasible.¹¹

The SAO drew attention to the causes jeopardising **the financial balance of the local governments**, to the need for the creation of financial stability, and to the long-term risks of indebtedness especially in the opinions on the 2008 and 2009 budget appropriation bills. It was recommended that the Ministry of Finance should publish methodological guidelines for the local governments to help them substantiate their decisions on, as well as to assess and identify the risks of bond issuance. The Ministry of Finance rejected this recommendation on the ground that it was planning to compile methodological guidelines on the execution of the act regulating the legal status of budgetary organisations, which would allow for a more up-to-date regulation of budgetary financial management¹². In response to the recommendation the Government indicated that the risk implied in

¹¹ According to para ad) of Article 2 of Government Decree 132/2008 (V. 14.) on the tasks and power of the Minister of the Local Government, within his scope of responsibility for the local governments, the Minister shall prepare, first of all, the legal regulations on the associations of the local governments; according to para (1) d) of Article 5: ‘...shall ensure coordination and harmony among local governmental tasks that he is responsible for’; according to para (2) of Article 5, the Minister has coordination and contribution tasks; according to para e) of the same Article ‘he shall foster the further development of the local governmental system, and shall especially encourage task performance by associations, such as micro-regional associations’.

¹² Due to the real risks, the publication of methodological guidelines is inevitable both because of the large number of local governments and the volume of bond issuance. The guidelines on the legal status of budgetary organisations and on bond issuance by the local governments are not correlated, wherefore this response is not substantiated.

indebtedness is not so big that it would require immediate intervention for the operability of local governments. Furthermore, for the lack of support by two thirds of its members, the National Assembly did not include in its agenda the **bill on the amendment of the Act on Local Governments** (on amending the regulation pertaining to the debt limits).

The SAO has initiated in each of the past five years (to no avail to date) that the Minister of the Interior and his legal successors should clarify and supplement **the purpose of other subsidies granted to economically unviable local governments**, establish the criteria for granting such other subsidies and work out the methods for the consideration of the related applications.

From among the recommendations made regarding the financial management of the local government subsystem the recommendations pertaining to the clear definition of how loans are taken into account in the deficit calculations, to the publication of methodological guidelines on decision-making on bond issuance by the governments, to the regulation on the internal arrangement and equipment supply of residence halls were not realised. (The Minister of Finance is planning to issue methodological guidelines on what restricting and cost-saving measures can be enforced by the budgetary organisations in conformity with the changing economic environment). It has not been ordered that other economic events (that include cash flows) should be linked to an executive order and enforcement, and the requirements of an accounting registration system that would facilitate the separation of mandatory and voluntary tasks have not been set either. No measure has been taken to terminate the possibility of appointing a person authorised to exercise the right of pre-emption – for the business organisation tenant – in the case of facilities that serve non-residential purposes. Contrary to the relevant recommendation of the SAO, no manual has been published on the finance/accounting registration requirements of minority self-governments or on the system of operative financial management and internal audit tasks.

3.3. Legal realisation related activities of the State Audit Office of Hungary

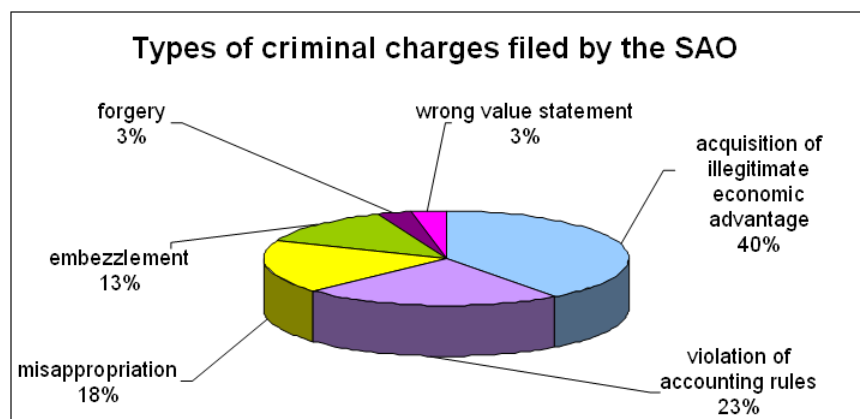
Criminal proceedings initiated by the SAO

The imposition of criminal sanctions in relation to the irregular utilisation of public funds is in the interest of the entire society, and the SAO plays an important role in providing evidence on the basis of the audit findings. According to the law, the SAO is responsible for performing audits, wherefore the primary objective of the audits is not to initiate criminal proceedings. Yet, the SAO notifies the competent investigation authorities about all of its findings that give rise to a reasonable suspicion of a crime in relation to the irregular utilisation of public funds.

In line with the types of audit carried out in the subject years, as well as with the data and information that could be obtained with the given audit tools, the number of criminal proceedings initiated by the SAO fluctuated in the past years. This fluctuation is well illustrated by the fact that while the auditors' reports that substantiated the ÖKOTÁM report of 2006 (Report on the audit on

the application and utilization of Public Utility Services Development Grants by local governments for municipal road and sewer system developments in the years 2002-2005) contained several findings that were linked to charges based on the reasonable suspicion of acquisition of illegitimate economic advantage, in 2008 none of the SAO audits yielded findings that would have laid the foundations for the suspicion of such a crime.

The criminal proceedings that were initiated by the SAO between 2002 and 2008 contained six criminal facts that can typically be revealed by audits.



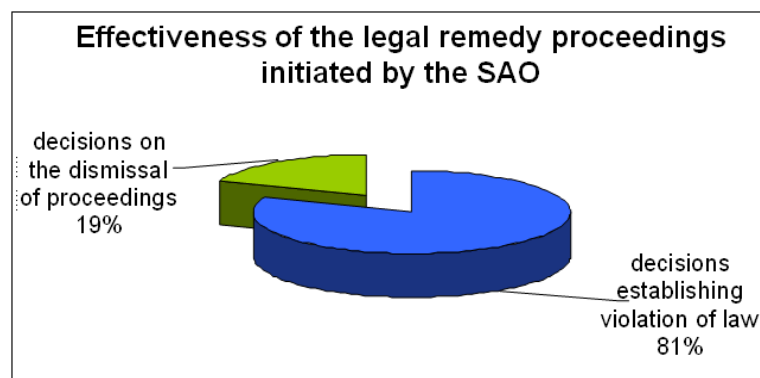
The SAO significantly contributed to the work of the investigation authorities by responding to the requests for assistance submitted by the investigation authorities in relation to ongoing proceedings. In such cases the SAO complies with its data supply obligation by forwarding documents containing facts that come to its knowledge in the course of the audits.

Last year the SAO was contacted 32 times with such requests. In the majority (63.3%) of the cases the SAO had conducted relevant audits, wherefore it could forward the authorities the documents that contained the findings of the on-site audits.

Initiation of proceedings for legal remedy

After the new public procurement act took effect on 1 May 2004, the deadline open for the initiation of proceedings for legal remedy was significantly extended. As a result, there was a sharp rise in the number of such proceedings initiated by the SAO. This trend continued in 2008, too – with 36 proceedings – since part of the SAO audits focused on the regularity of the public procurement system.

In most of the proceedings initiated by the SAO for legal remedy the Public Procurement Arbitration Committee established the violation of law, and ordered the payment of a total fine of HUF 52.2 million in the above period.



3.4. Publicity of the activities of the State Audit Office of Hungary

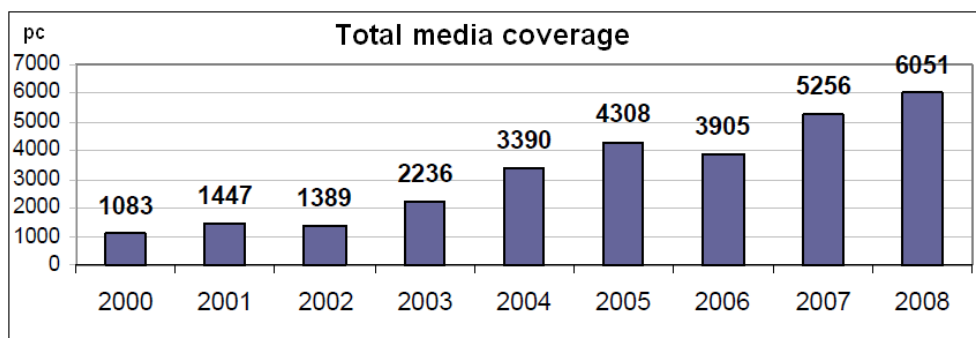
Securing high-level publicity for the activities of the SAO has been a top priority task in the past period of over a decade. In the beginning the objective was to ensure simple and easy access to the SAO's reports, professional and methodological publications for decision-makers, for people showing interest in the work of the SAO, for citizens and the audited organisations alike (thus ensuring the distribution of the audit experiences in the widest possible circle).

Using the benefits of the internet, the SAO established and has operated its website in this spirit. The website was restructured in 2002 and 2007, and is being continuously developed.

During the years the SAO has developed and shaped its communication based on this broad publicity, and on the comprehensive availability of our reports, keeping in mind the need for differentiation by target groups (In the SAO's strategy for 2006-2010 communication is devoted a separate section).

In line with the practice of the former years, **in 2008 one of the SAO's main tasks was to inform and support the control and legislative work of the National Assembly.** This is done through summary letters sent to the members of the National Assembly as attachments to the SAO reports. In addition, the SAO staff members are actively involved in the meetings of the parliamentary committees, too.

To ensure accurate and factual information supply to the general public, including information on the positions of public finances and the correlations of the processes that have evolved, **the SAO paid utmost attention to its relations with the media and the press.** The summary of the audit reports was sent directly to an increasing number of editorial staffs and journalists, and the wide possibilities of the internet were also utilised.



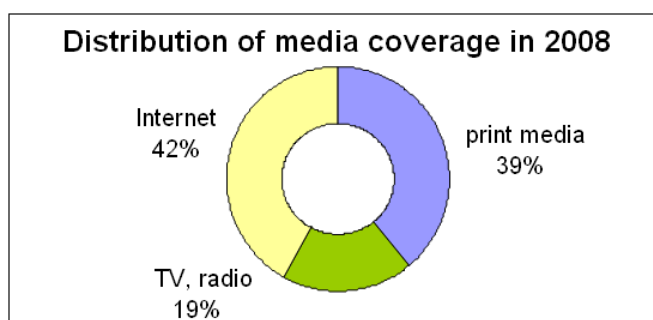
In 2008, the SAO registered a total media coverage of 6,051 items (including news, articles, interviews and references) from **261 different sources in its media monitoring database**. The values that increase from year to year indicate that media of the most different sizes and with the most different target audiences deal with the SAO's activities and reports, and raise the awareness of the entire society of the audit experiences.

In 2008, the SAO organised one presidential press conference: journalists could ask questions about the SAO report on the audit of the execution of the 2007 budget in the building of the Hungarian Parliament in September.

The Directors General altogether held twelve press conferences in the country: in January in Eger, Szekszárd, Tatabánya and Szombathely, in February in Győr, in July in Nyíregyháza, in September in Kecskemét and Szekszárd, in December in Szolnok, Debrecen, Szeged and Székesfehérvár.

In March the SAO invited the representatives of the press to the closing conference of the Twinning Light project titled 'Encouraging further development of anti-corruption measures and implementation of anti-corruption government strategy'. In June a book launch and press conference was organised to celebrate the publication of a coursebook titled 'Gazdasági kormányzás – Változás és alkalmazkodás a magyar gazdaságirányítás intézményrendszerében' ('Economic governance – change and adjustment in the institutional system of Hungarian economic management') Furthermore, the media was invited to attend the lecture given by the President of the Court of Accounts of the Kingdom of Morocco.

In accordance with the established practice, the summary reports and the personnel news of the SAO were published in the Official Newsletter.



Last year the SAO registered nearly 100,000 visits to the homepage of its website. **People interested in the SAO's work downloaded reports from the SAO's website 77,412 times** from external IP addresses, and as many as 1,082 English language reports were opened.

The SAO's strategy for 2002-2006 set the objective of providing wide opportunities for the population to establish contact with the SAO. It was in this period that the SAO established new, state-of-the-art forms of contact with the population, capitalising on the increasing use of the internet.

On the SAO's website the '**SAO Forum**' and the '**Meet the President Hour**' pages have welcomed questions from the general public since 2003. Those who choose this form of communication, may ask questions in public. Last year 42 questions were submitted to the 'SAO Forum'. The most frequent topics included the internal audit of local governments, the system of accounts, the elaboration of the operational and organisational rules, the multi-purpose micro-regional associations, normative school support, donations, acceptance of royalties, interpretation of law, Köröshegy Viaduct. Since its establishment in 2003, the 'Meet the President Hour' has been organised altogether 14 times. Last year visitors were offered the opportunity to have a live dialogue with the head of the SAO once, since the SAO sensed a decline in interest in asking questions in public.

Since April 2004 questions can be sent to the central e-mail address of the SAO, too. This form of communication ensures privacy, since the questions and answers can only be viewed by the asker and the responder. In 2008, altogether 383 letters were sent to the central e-mail address, i.e. 50% more than in 2006, and 27% more than in 2007.

The Speaker of the National Assembly invited applications from university and college students for the 'Parliamentary Scholarship in the Office of the National Assembly' in September 2002 for the first time. Within the framework of this training programme the students pay a visit to the SAO, too. In 2008, the SAO received such scholarship holders four times.

4. IMPROVEMENT OF THE QUALITY OF THE AUDIT WORK

4.1. Quality assurance of audits

In order to ensure the fulfilment of the constitutional role and mission of the SAO, to maintain the authenticity of the audit activity, and to ensure the professionalism of the audit work and the audit reports, a comprehensive, standard quality management system have been operating for years within regulated frameworks. This system provides the framework for continuous development, and plays a crucial role in ensuring that the audit reports prepared are reliable and of permanently high quality and that they serve the satisfaction of the users of such reports.

The results achieved in relation to the substantiation of audit findings, conclusions and recommendations, and thus in relation to the reliability of the audit opinions of the SAO were largely attributed to the two-level quality

control of the audit work and reports at the audit directorates, the operation of the system supervising compliance with the quality requirements, as well as to the financial management control activity performed by the Quality Assurance Department, which works independently from the directorates conducting the on-site audits. The SAO reports were signed by the President of the SAO only after the Quality Assurance Department issued certificates certifying the effective completion of the audits. This practice, which is unique and pioneering in the international arena – attracts widespread international interest.

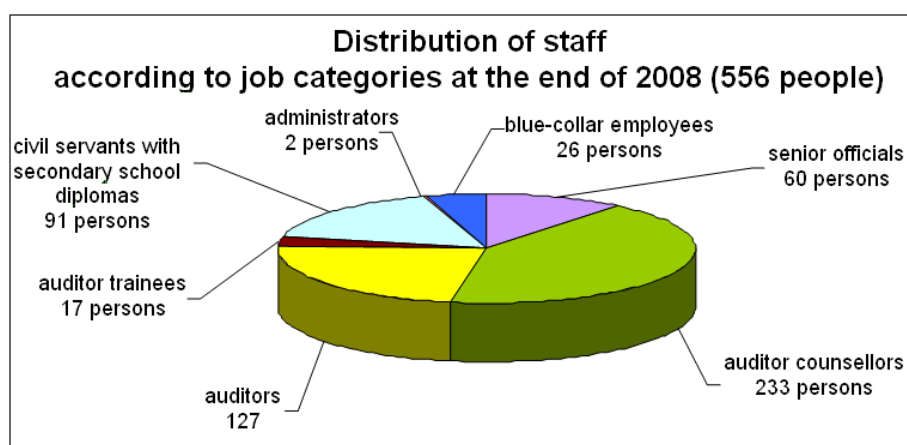
The experiences of the Quality Assurance Department (which is directly supervised by the President of the SAO) gained during the ex-post quality assurance reviews of audits closed in 2008 basically and altogether certified compliance with the internal rules of auditing and procedural rules pertaining to the given audit types, as well as the enforcement of methodological recommendations.

In order to maintain the high quality of the audit work and of the audit reports, in 2008 the SAO made continued efforts to improve the effectiveness and efficiency of the quality management system, and to implement developments by utilising the best international practices.

4.2. Human resources management and development

Personal conditions

In 2008, the SAO's staff dropped from 577 to 556 by the end of the year.

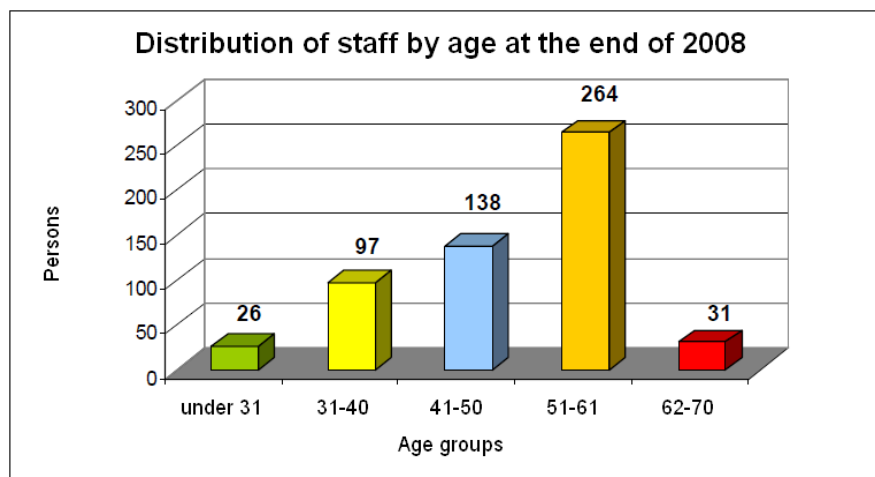


Primarily due to the favourable rules of early retirement, the number of retirements was higher (33) than in the previous year. Due to their long public service employment, the majority of retiring auditors were eligible for the longest, 8-month notice period, wherefore the SAO faced a significant loss of auditor capacity until the recruitment of new employees that are suitable both professionally and morally.

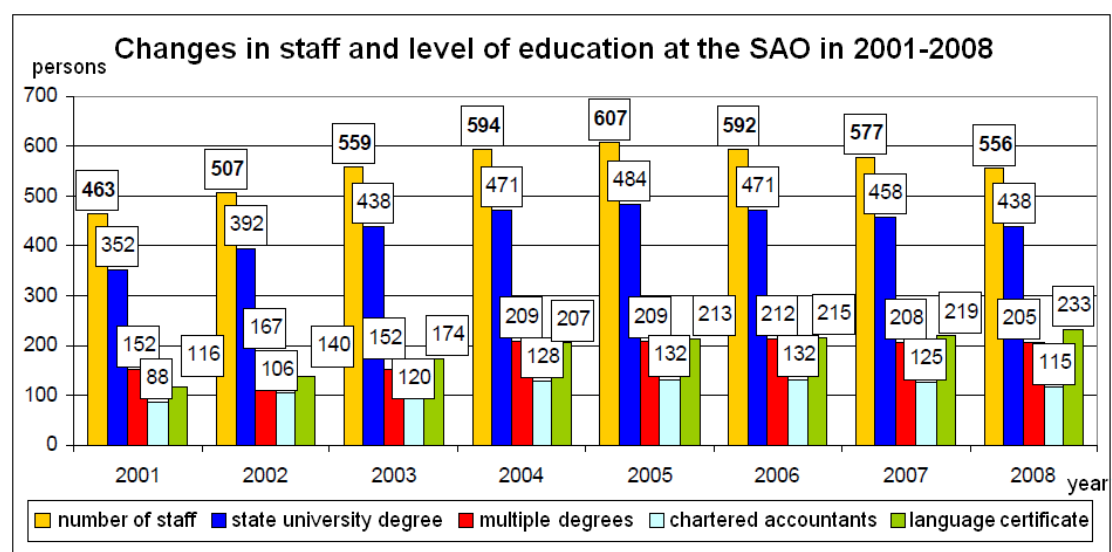
In addition to the retirements, the service relationship of eight people was terminated with mutual consent, and two persons left the SAO after the expiration of their fixed-term contracts. The employment relationship of two colleagues was terminated due to death. The public service relationship of two

employees was terminated by dismissal, and transfer to another job, respectively. In the recruitment process to the vacant positions the SAO considered staff and wage related savings, too: part of the lost capacities was compensated through performance enhancement and organisational restructuring.

In the recruitment process colleagues that are considered to be qualified both professionally and morally are selected in a multi-stage interview. Career starters are not hired at all, and those with little professional experience are hired in exceptional cases. In 2008, three persons were appointed to trainee auditors, 19 persons joined the SAO as auditors, two persons as auditor councillors, and another two as heads of department senior counsellors.



Despite the large-scale retirements in the past years, the major indicators of education levels within the core staff are still noteworthy, and the number of staff members with foreign language skills is rising on a continuous basis. It must be noted here that similarly to the previous years, neither serious professional or ethical misconduct, nor disciplinary offence was reported in 2008.



Despite the positive receipt of the skill indicators and the audit reports, the continuous control of performances is of utmost importance. Individual performance evaluations and ratings provide important feedbacks on both

sides of job competence, on personal activities, as well as on the conditions of task and work performance. At the executive forums of the SAO held in 2008 the requirements pertaining to the objectivity, thoroughness and justification of individual performance evaluation ranked high on the agenda.

In 2008, job promotion for the auditors could primarily be realised through positions and wage reserves that became available after the retirement of auditors in the previous year. As a result, on Civil Servants' Day as many as 9 employees were appointed to executive positions (including 3 new senior officials), 12 and 11 colleagues were promoted to the positions of senior advisor and advisor, respectively, and 28 auditors were appointed counsellors. In addition, 16 auditors were awarded the 'Salamon Gajzágó Prize' founded by the President of the SAO.

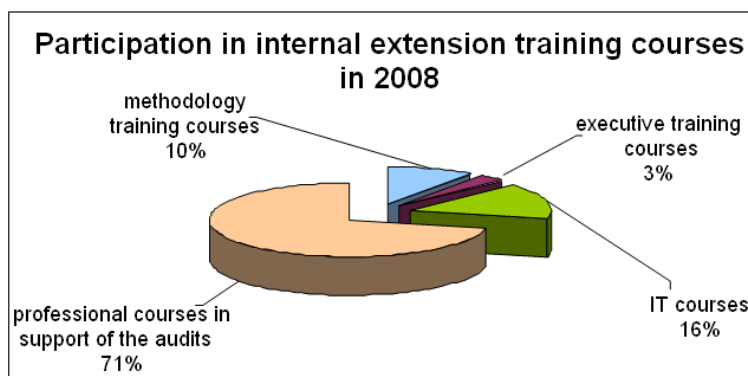
As of 1 January 2008, a new comprehensive regulation entered into force on the obligation of civil servants to submit a declaration of personal wealth. Declarations of personal wealth had to be submitted by the senior officials of the SAO, the SAO auditors in charge of on-site audits, and certain civil servants with secondary school diplomas, i.e. by altogether 380 persons. The affected persons complied with this obligation by the given deadline.

Extension training

During the preparation of the 2008 Training Programme the SAO extensively assessed the training needs, retrieved and analysed information available on the participation of staff members in external and in-house trainings and lectures in the past few years. The professional content requirements had to be harmonised with efficiency and reasonable cost-saving factors. In 2008, courses were organised in 34 subjects on 39 occasions on 63 training days. The subjects practically remained the same as in the previous years, but the number of training days and occasions was determined with regard to the decline in audit capacity due to changes in the staff of auditors.

The programme of internal training courses includes the material of the second, revised edition of the 'Audit Manual'. Six training courses were organised with a view to transfer new, up-to-date professional skills e.g. on the amendment of the state property act and on large construction projects. Furthermore, lectures on the financial management control (FMC) relations were held by highly respected external speakers, with increased interest. Trainings that provide in-depth, expert-level information on the annual amendments of PIT, VAT and public procurement related rules continue to attract a large number of participants.

Lectures and sessions in which the heads of the audit teams prepare the auditors for efficient audit work prior to, or in the initial phases of the audits were also included in the annual Training Programme. Most of the IT training courses were presented to the staff with revised titles and contents. IT extension training courses are gradually restructured: most of the applicants now need to learn special applications. Preparations have been started for the operation of the Audit Documentation IT System (ADITS) project, which is designed to support audit documentation. The first session was held for senior officials and the audit managers.



Progress was made in educational cooperation with the Chamber of Hungarian Auditors. While in 2007 SAO auditors could collect credits for mandatory audit extension training at one third of in-house professional training courses, last year credits could be awarded for almost all courses organised by the SAO. The SAO maintains close working relations with the Government Centre for Public Administration and Human Resource Services, which coordinates the personnel and extension training needs of the central public administration organisations. Their courses – self-awareness and problem solving training courses, legal skills development courses, language courses – were often visited by the SAO auditors.

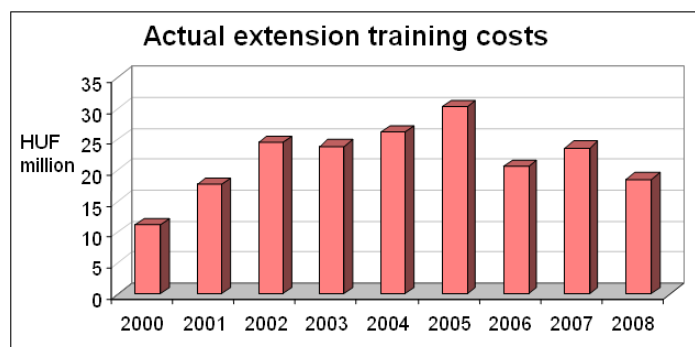
The SAO staff members actively participated in external educational and extension training courses, too. They altogether attended 62 conferences and professional events. Through managed applications and the better organisation of the exchange of information presented at such professional events the SAO could achieve that its training costs did not significantly rise despite the otherwise high and usually increasing participation fees.

The system of grants supporting language learning was significantly transformed. Most of the younger colleagues join the SAO with good foreign language skills (including the knowledge of the technical language) since the possession of a language certificate at least in one major language is a key selection criterion during the recruitment process. The SAO no longer supports elementary and intermediate level language learning or language exam preparation courses, however it does invest into discount language courses that the language institutes occasionally advertise, e.g. in the case of the French language in order to increase the knowledge of French among staff members even at pre-intermediate level. In a few special jobs the SAO supports the development of proficiency level technical language skills by assuming the payment of the tuition fees.

The new legal provisions on the PIT determine the maximum amount of benefits that can be given to employees tax-free as a wage supplement. These provisions affect study grants that the employer may give. In some cases the SAO, reasonably, cannot take over 50% of the tuition fees as was accustomed earlier. However, it will continue to support studies useful for the organisation as much as it can. In 2008, 33 new study contracts were signed, fewer than in the former years.

Due to the above mentioned cost-saving and audit capacity protection considerations, expenditures spent on extension training further shrunk in

2008. Per capita expenditure totalled HUF 33,000 compared to HUF 41,000 in 2007. This reduction is in part due to the application of state-of-the-art training methods and techniques that reduce the amount of organisational work and costs alike. A significant portion of the professional knowledge (e.g. the methodology of regularity and performance audits) is now available and can be mastered on-line, through the ‘e-learning’ distance learning programme.



The internal forms of education and lectures, conferences, professional and language programmes advertised by external institutions successfully contributed to the professional progress of the SAO's staff members and encouraged them to undertake more self-study initiatives. In addition, the ideas about the modernisation of the content and organisation of education and extension training programmes still rank high on the agenda of the executive forums of the SAO.

4.3. International relations

While developing its system of international relations, and in line with its strategic objectives, in 2008 the SAO strived to improve the quality of the domestic audit culture, to contribute to the modernisation of audit methodologies and techniques, and to encourage the development of efficient forms of cooperation among the audit institutions through active involvement in the international audit community.

In 2008, the SAO's bi- and multilateral international cooperation was mostly determined by the commitments arising from Hungary's EU membership. The joint activity of the national supreme audit institutions of the EU Member States and the European Court of Auditors (ECA) continues to have great significance both at the presidential level, and within the working groups set up for the different professional fields.

The SAO continued to use the audit methodologies acquired through its active chairmanship (2004-2007) in the Governing Board of the International Organisation of Supreme Audit Institutions (INTOSAI), just like the innovation transfers that contributed to the adaptation of 'technology', and itself contributed to these international developments. However, the focus of the SAO's activities in the international organisations was increasingly shifted to the professional forums of the European Organisation of Supreme Audit Institutions (EUROSAI). The exchange of experiences related to the

management of the impacts of the global financial and economic crisis has also become an important element in international relations.

Multilateral professional cooperation

After the SAO successfully organised the XVIII **INTOSAI** Congress, it was decided that the SAO should get involved in the international professional cooperation aiming to implement the strategic plan of the world organisation through participation in the work of a few working groups dealing with issues of key importance. Furthermore, the SAO fulfilled its obligations arising from membership in the Governing Board and the Finance and Administration Committee.

The SAO continued its active participation in the INTOSAI subcommittees and working groups that deal with the professional standards, the internal control standards, peer reviews and privatisation.

The SAO also joined the work of the INTOSAI Working Group on Key National Indicators, which was set up in 2008 with a view to promote the application of key national indicators to be elaborated in economic, social and ecological fields. The Research Institute of the SAO is developing and coordinating a three-year pilot project in relation to key national indicators describing the processes of the knowledge-based economy and society.

The SAO is actively involved in the activity of the INTOSAI Task Force Global Financial Crisis, which was established to elaborate responses and solution to the global financial and economic crisis. Through the work performed in this Task Force the SAO can obtain experiences and knowledge that can not only help in the elaboration of solutions to the Hungarian challenges, but can also make it possible to provide factual and constructive feedback about the specific Hungarian features, positions and on the steps of crisis management at major international forums.

The SAO continued to play an active role in **EUROSAI**, which is the European Regional Working Group of INTOSAI. At the VII EUROSAI Congress organised in Krakow on 2-5 June 2008 the SAO chaired Theme 1 of the event ('Establishing an Audit Quality Management System within a Supreme Audit Institution'). In preparation for the discussion of this theme at the Congress, on the basis of the preliminary document elaborated in cooperation with the assisting supreme audit institutions, the SAO coordinated the discussion of the theme, and contributed to the preparation of the Congress Proceedings that summarise the conclusions and recommendations of the Congress Themes. The SAO has continued cooperation with the assisting partner institutions even after the Congress. The working group has been mandated to compile a good practice guide that aims to improve quality management.

In 2008, the SAO completed its activity in the Coordinated Audit on Tax Subsidies Working Group, which was set up at the VI EUROSAI Congress in May 2005. The Working Group's report, to which the staff members of the SAO actively contributed by heading the subcommittee that examined the efficiency

and effectiveness of tax subsidies related to the corporate income tax, was presented at the VII EUROSAT Congress.

Furthermore, the SAO continued its participation in the IT and Environmental Working Groups of EUROSAT. Within the framework of the latter the SAO was involved in a parallel audit that focused on the implementation of the Natura 2000 Network.

Within the framework of the EUROSAT Training Committee the SAO actively contributed to the development of the training strategy of the organisation. Furthermore, our organisation is continuously involved in the development of the guidelines supporting the organisation of seminars, and questionnaires used for the evaluation of the effectiveness of the training courses. The EUROSAT seminars that have been organised with the involvement and support of the Committee have several times provided opportunities for the SAO's staff members to acquire new knowledge and exchange experiences in the subject of the audit of social security systems, or the management of supreme audit institutions, for example.

The staff members of the SAO attended the events of the European Organisation of Regional External Public Finance Audit Institutions (**EURORAI**) last year, too. The subject matters of these events included the institutional status of public sector audit institutions, as well as the audit of public subsidies. During the conferences and seminars organised by EURORAI in the past years good cooperation was established between the representatives of the Regional Chamber of Audit in Bydgoszcz and the Hungarian participants. With a view to strengthen this relationship, the President of the Chamber paid a visit to Hungary, in the course of which the Polish partner could get to know the experiences of the State Audit Office of Hungary gained in relation to the audit of local governments.

The **Contact Committee**, which is the institutional and regular cooperation network set up by the Heads of the Supreme Audit Institutions of the European Union, and of the European Court of Auditors, aims to provide a forum for the exchange of professional experiences related to the operation of the Community at the level of the heads of the institutions, the liaison officers and experts.

Following the traditions, the SAO attended the annual meeting of the Contact Committee, which is comprised of the heads of the Supreme Audit Institutions. Since the current chairmanship of the contact forum is held by the SAO, and in 2009 the Committee will meet in Budapest, the SAO took the necessary steps to ensure the proper venue and technical conditions, and for the compilation of the professional programme.

Apart from coordinating the work of the professional working groups, the cooperation network of liaison officers also places great emphasis on increasing the efficiency of cooperation within the network and information exchange. In connection with this, the evaluation of the activities of the working groups carried out in 2007 and 2008 with the active involvement of the SAO's staff members was completed with the preparation of an analysing study. At the same time, the Contact Committee mandated the evaluation subgroup to

elaborate – on the basis of the results of the evaluation carried out in 2007 and 2008 – a document that presents the experiences of the working groups and summarises the good practices for the utilisation of the professional findings presented by the working groups of the Contact Committee and the national audit institutions.

The activity of the professional working groups functioning within the framework of the Contact Committee is focused on the audit of the utilisation of EU funds. The SAO's experts undertake an ongoing and active role in the activities of all working groups (Working Group on Structural Funds, Working Group on National SAI Reports on EU Financial Management, Working Group on Activities on Value Added Tax, Working Group on Common Audit Standards). Cooperation among the EU Member States is also carried out in the form of coordinated audits. For example, the Working Group on Structural Funds finalised its report on the coordinated audit of the utilisation of EU funds in the areas of employment and environment in Budapest in 2008.

With a view to expand their professional knowledge, the staff members of the SAO attended **several seminars organised by EU institutions and organisations**, the topics of which included the national declarations of the Member States, corruption in the public sector, as well as the system of audits related to the Structural Funds in the new programming period.

The Heads of the Supreme Audit Institutions of the **Visegrád countries**, as well as Austria and Slovenia held their annual meeting in Austria in 2008, where – in addition to discussing topics of mutual interest – they approved the report on the coordinated audit of the internal control systems of national institutions affected by the utilisation of the EU's Structural Funds, which was started in 2007. The EU Contact Committee was informed about the results of the work led by the SAO and the audit experiences gained.

The SAO attended the meeting of the **International Board of Auditors for NATO** held in Brussels, at which the representatives of the national audit institutions of the member states discussed the annual report of the Board.

In 2008, the President of the SAO gave a talk again at the annual International Conference of the International Consortium on Governmental Financial Management (**ICGFM**) in the United States. He also attended, for the first time, the Annual Meeting of the **Trilateral Commission**, which includes the leading economists of the world.

Bilateral international relations

In 2008, the SAO intensified its long-established bilateral professional relations with several partner institutions. In line with the development strategy of Hungary, too, cooperation between the SAO and the **Office of the State Audit of Vietnam** continued with the involvement of the Hungarian International Development Assistance Non-profit Company (HUN-IDA), which functions under the aegis of the Ministry of Foreign Affairs. Within the framework of this programme the Vietnamese auditors came to Budapest several times to study the details of the professional work performed by the SAO.

Professional relations maintained with the **UK partner institute** have been of distinguished significance for the SAO for a long time. In 2008, the SAO exchanged experiences and held consultations in several subject matters (e.g. audits in the field of education and healthcare, quality assurance of audits) two times with its UK counterpart.

The programme processing the topical issues of the fight against corruption, which was launched in 2007 and was supported by the EU was successfully completed with the involvement of the staff members of the **Netherlands Court of Audit**.

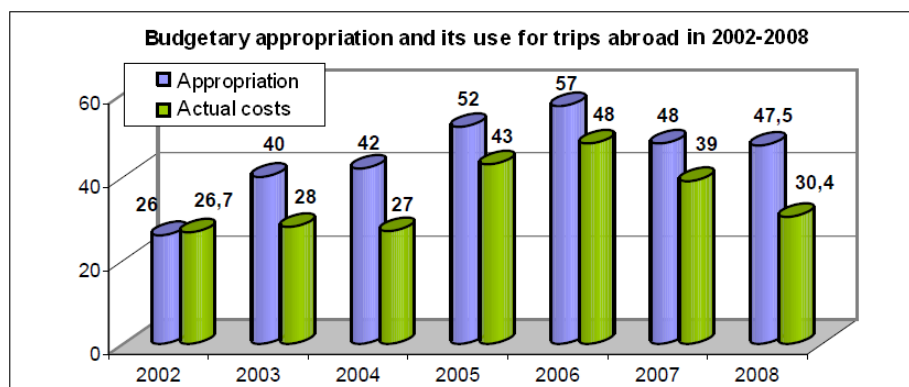
In 2008, **the SAO received presidential and vice-presidential delegations from Albania, the Czech Republic, China, Morocco, Moldavia, Mongolia and Vietnam**. In addition to the high-level meetings organised for the review of the audit system and the tasks of the audit institutes, the SAO participated in many ad-hoc **expert consultations**, primarily in relation to the Central and Eastern European partner institutions. For example, the **Slovak** colleagues obtained information of the practice of performance audits, human resource management and local government audits of the SAO, while the **German** colleagues could get to know the IT system and certain IT solutions of the SAO.

The budgetary aspect of the SAO's international relations

The International Relations Plan for 2008 appropriated HUF 47.5 million for **trips abroad**. Altogether, the SAO envisaged HUF 36.1 million for travel, accommodation and insurance costs; HUF 7.5 million for per diems in relation to the trips abroad, and in 2008 it could also form a reserve of HUF 3.9 million¹³. The actual costs of the trips abroad were in line with the appropriated figures, in accordance with the expectations. During the year a total of HUF 30.4 million was paid for such purposes, which equalled 64% of travel costs planned for 2008, and 78% of the actual travel costs incurred in 2007.

Changes in the amounts appropriated and utilised for maintaining international relations between 2002 and 2008 also reflect the development path that the SAO has trodden in the past decade in relation to its tasks undertaken in the international audit organisations.

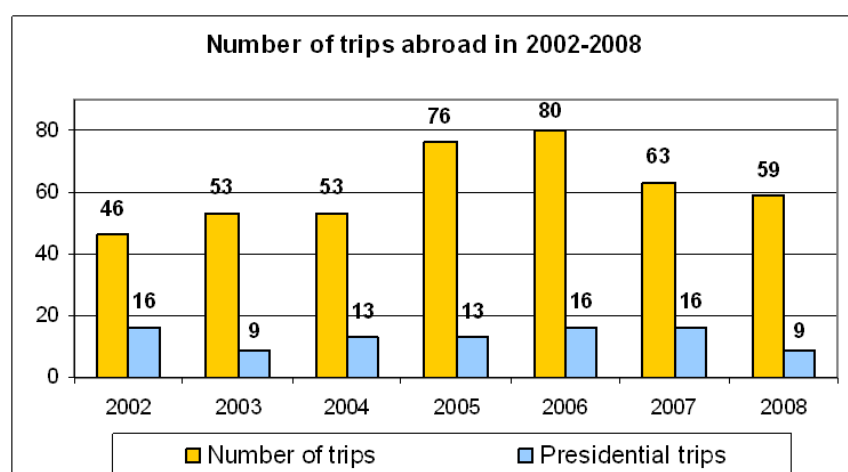
¹³ In 2009 the formation of a similar reserve is an essential precondition for planning due to changes in the foreign currency exchange rates following the evolution of the international economic crisis.



Last year the staff members of the SAO participated in 59 trips abroad. This meant that 110 delegates spent 283 days outside the country. (The plan envisaged 63 trips for 133 delegates.) In 2008, each business trip abroad lasted for 3.7 days on average (as opposed to four days in 2007), not including the long-term training courses¹⁴. The average cost for a working day spent on a business trip abroad totalled HUF 140,000 in 2008 (compared to HUF 136,000 in 2007), which was due to major savings to offset the impact of price rises.

In 2008, the President of the SAO made nine trips abroad for a total of 37 days (as opposed to 15 trips in 2007, for a total of 62 days). The plan included 12 trips for 41 days. The average costs of a presidential trip in 2008 equalled HUF 563,000, and the average daily costs totalled HUF 137,000 (versus HUF 490,000 and HUF 104,000 in 2007) due to the relatively longer meetings of the INTOSAI Governing Board and other meetings.

The number of all trips abroad and presidential trips realised between 2002 and 2008 are shown in the following figure.



The size of the costs is largely influenced by trips overseas. In 2008, six such trips were organised for seven persons (In 2007, seven trips were made overseas, with the involvement of 16 staff members). The SAO spent 18% of all travel

¹⁴ Two trips abroad involved participation in training courses lasting for a total of 66 days.

costs, i.e. HUF 5.3 million on these business trips (compared to 25% or HUF 9.8 million in 2007).

The 2008 budget of the SAO allocated HUF 8 million for the reception of foreign **guests** (compared to HUF 10 million in 2007), of which HUF 4.2 million (52% of the appropriation) was actually used.

In 2008, as much as HUF 2 million, i.e. half of these expenditures was spent on the organisation of bilateral presidential meetings. The SAO received 25 persons as members of presidential delegations (versus 16 in 2007). A significant portion of trips abroad is linked to the SAO's involvement in the activities of international audit organisations. In 2008, the SAO spent HUF 1.2 million on the organisation of international forums, and altogether 47 persons representing various international organisations were received (versus 70 persons in 2007). The SAO spent HUF 900,000 on the transfer and exchange of audit experiences at expert level. The foreign partner institutions sent 17 staff members to Hungary for changing experiences, and for further training and educational purposes (as opposed to 30 persons in 2007).

5. RESEARCH AND DEVELOPMENT WORK RELATED TO THE AUDIT ACTIVITIES

The **Research and Development Institute of the SAO** (hereinafter: Institute), the name of which was changed to **Research Institute of the SAO** as of 1 January 2009, completed its research plan. It triggered a significant change in the activity of the Institute that the methodology related tasks were reassigned to the SAO as of 1 July 2008. The following is a list of the major research projects conducted by the Institute in 2008:

- Upon the initiative of the National Assembly the Institute prepared a study on the 'Size and efficiency of subsidies allocated for the improvement of the situation of the Romas in Hungary since the political transformation', which was discussed by the Parliamentary Committee on Human Rights, Minority, Civil and Religious Affairs. The study, which was found informative and useful by the committee, triggered loud professional and press reactions. The widely accepted findings of the study serve as benchmarks in the policy debates.
- The Institute continued the analysis of the macroeconomic risks of budgeting. In May 2008 it prepared an evaluation study on a few correlations of the macroeconomic leeway of the budgeting process for 2009. The subsequent study published by the Institute in October highlighted the serious macroeconomic risks of the first budget appropriation bill submitted by the Government. Therefore, the President of the SAO forwarded the study to the National Assembly and the competent leaders of the Government despite the fact that the Government repealed the bill. Then the Institute evaluated the macroeconomic risks inherent in the second budget appropriation bill, as well as in the comprehensive amendments thereto prepared by the Ministry of Finance. This evaluation was incorporated into the official opinion of the SAO. In November 2008, the Institute issued a

publication under the title 'Analysis of the macroeconomic risks of the budget for 2009', which incorporated the findings of the two risk analyses.

- Within the framework of the PHARE Twinning Light project titled 'Encouraging further development of anti-corruption measures and the implementation of anti-corruption government strategy' an analysis methodology was developed (mapping corruption risks, integrity self-assessment), which facilitates the identification of corruption risks and areas that are especially exposed to the risk of corruption.

In 2008, the Institute issued the following publications:

- Analysis of the justifications and efficiency of utilisation of subsidies provided in the 17 years since the political transformation for the research of the Lake Balaton region from the perspective of the tourist industry
- Size and efficiency of subsidies allocated for the improvement of the situation of the Romas in Hungary since the political transformation
- Evaluation study on a few correlations of the macroeconomic leeway of the budgeting process for 2009
- Corruption risk mapping in the Hungarian public sector
- Analysis of the macroeconomic risks of the budget for 2009
- Knowledge-based society and economy

An indispensable attribute of the activity of audit institutions is the **continuous development of methodology** in support of the practical audit work and in compliance with changes in environment and the international trends. The objective of this development is to contribute to the modernisation of audit methods in line with the international standards, and to the creative adaptation of the best international practice. This allows for the further development of the applied audit methodologies, field manuals, audit methods, procedures and techniques on the basis of international development results and own practical experiences.

INTOSAI has accelerated its activity aimed at the development of modern professional rules and standards complying with the requirements of our age. The latest, XIX INCOSAI held in Mexico City in November 2007, approved the novel framework of modernised audit rules and international standards (in line with the strategic plan), further actions needed for the renewal of the system, including those that support the practice of 'good governance'. Within this new, so called ISSAI system, the number of approved and future guidelines totals around 80. Where appropriate, the ISSAI documents (may) also include the description of the applied best practices. The SAO participates in the preparation of the new rules, and in formulating the related opinion.

The standardisation of professional requirements on an international scale, and the need for compliance with the international expectations have increased the value of the professional regulatory activity at the SAO, too. Furthermore, the SAO's strategy gives priority to the operation of the policy development and quality management system, the quality centred

development of the regulatory system, as well as to the further development of the existing quality management system.

The organisational frameworks of the **policy development and professional regulatory activities** were unified in 2008 through the establishment of the **Policy and Methodology Division** within the Organisational, Management and Operation Directorate. Therefore, since mid 2008 policy development and methodological tasks required for the operation of the SAO have been performed and coordinated within the organisational frameworks of the Policy and Methodology Division.

In 2008, the most important policy development task was participation in the preparation of the Act on the Reasonable Public Economy and on Fiscal Responsibility, since this act enforces the implementation of the SAO's recommendations summarised in its 'Theses on the Regulation of Public Finances', which were submitted to the National Assembly in 2007.

Policy development tasks also include participation in the fight against corruption. As a result of an EU-funded project that was completed by the SAO and the Netherlands Court of Audit in 2008, Hungary adapted a risk assessment method with which a so called corruption risk map can be prepared. The SAO plans to prepare – within the framework of the New Hungary Development Plan – the corruption risk map of Hungary, which will help audit organisations in the compilation of their audit plans. Preparations for the new project were started in 2008.

By 2008 the SAO completed the revision of its **Audit Manual**, which provides a systemic description of the audit related professional rules, as well as the main audit principles and requirements.

In parallel with the revision of the Audit Manual, the SAO started to **revise its methodological guidelines** issued in former years for the major audit types, and to develop guidelines, as well as to review the related field manuals. The second, revised edition of the methodology of performance audits, and the methodological guidelines on comprehensive audits were also issued in 2008. Furthermore, methodological guidelines were prepared on system audits, and the audit directorates published several field manuals.

A detailed material on the comprehensive analysis of the methodological activity will be prepared in 2009. Within this work, for the required modernisation and further development the SAO has systemised its audit-related documents, as well as the already published and expected INTOSAI documents.

In line with INTOSAI's revised system of audit-related documents, the revision of the domestically and internationally produced documents of the audit profession has started on the SAO's website.

For the methodological development of the documentation of SAO audits, and for the standardisation of the practice followed within the organisation, the documentation of the audits will be performed in a different structure from

2009 on, for which the required groundwork development was carried out in 2007 and 2008. As a main direction of development the SAO established the IT system supporting audit documentation, as well as the related internal regulatory environment, which will jointly determine the standard practice of documentation, irrespective of the audit types.

The **President's Advisory Board** first of all focused its activities on the promotion of the SAO's adaptation to the rapidly changing economic conditions, to the new challenges, on the provision of support to audits designed to foster the evolution of budgetary consolidation, to the research projects of the SAO's workshop, and the involvement of the SAO in the preparation of the modernisation of the system of public finances (and the related regulations). The Advisory Board paid special attention to the evaluation of the implementation of the key tasks formulated in the SAO's Strategic Plan for the 2006-2010 period, to the annual SAO activity report, and to the activities of the Research Institute of the SAO. Furthermore, the Advisory Board reviewed the major content issues related to the editing of the Public Finance Quarterly.

In 2008, the SAO issued 58 publications in the Public Finance Quarterly, the only bilingual (Hungarian-English) public finance journal in Hungary. In terms of subject matter the main intention was to put the public sector and public finance processes, the renewal of the budgetary system and the related 'boundary areas' into the limelight. Beside the fiscal system attention was also paid to the monetary sector. Due to the timeliness of the topic, thematic blocks were devoted to the tax policy and tax system in two issues. Acceptance speeches made at the Hungarian Academy of Sciences were also published. In accordance with the objective and *ars poetica* of the journal expressed in the impressum, the SAO illustrated with book reviews how the Hungarian professional literature handles the problems of fiscal policy and the system of public finances.

6. INSTITUTIONAL OPERATION AND FINANCIAL MANAGEMENT

6.1. Budgetary management

Since the amendment of the Act on the State Audit Office in 2004, the SAO itself is responsible for the compilation of the proposal on the budget of the central budget chapter 'State Audit Office', and the execution thereof. The Government submits this proposal to the National Assembly – without making any changes – as a part of the budget appropriation bill and the bill on the final accounts.

The independent chartered accountant appointed by the Speaker of the National Assembly upon a public procurement procedure audited the financial statement of the Chapter 'State Audit Office' of the central budget with an accounting date of 31 December 2008. The audit was completed on the basis of the Hungarian National Audit Standards and other legal regulations on audits by using the Financial Audit method of the SAO. The audit included the sampling based audit of documents supporting the factual figures of the

annual financial statement, as well as the evaluation of the applied accounting principles and that of the annual financial statement.

On this basis the chartered accountant obtained sufficient and adequate proof of the fact that the annual financial statement was prepared in accordance with the provisions of the accounting act and Government Decree 249/2000 (XII. 24.) on the reporting and accounting obligations of public finance institutions, as well as in accordance with the general accounting principles.

According to the chartered accountant, the annual financial statement gives a true and fair picture of the financial position of the Chapter 'State Audit Office' as of 31 December 2008.

Due to the greater responsibility arising from legal authorisation, the SAO has always found that the chapter's budget appropriation bill should present the SAO's basic strategic objectives in detail, the professional tasks arising from these objectives, focussing especially on audits that are contained in the Annual Audit Plan of the SAO, and are legally required to be performed at regular intervals. Furthermore, audits to be performed on the basis of presidential decisions were designed. In addition, the SAO presented – in the form of a separate programme – those professional and operational tasks that can be classified as distinct groups, and determined the resources required for implementation.

The draft budget plan, which the SAO compiled based upon the above written principles and extensive negotiations, and with consideration not only to the planning circular of the Ministry of Finance, but also to the provisions of acts that fundamentally affect audit and other tasks, and also to the relevant resolutions of the National Assembly, was submitted to the National Assembly by the Government as part of the central budget. The SAO strove to ensure that it comply with its legal obligations – to the greatest possible extent – in a prudent and cost-efficient manner, and with regard to the economic conditions of the country.

In the budget act the National Assembly approved HUF 7,874.8 million for the SAO to perform its tasks in 2008, HUF 7,814.6 million of which was granted in the form of subsidies and HUF 60.2 million was provided from the SAO's own revenues. Compared to the original appropriation of the previous year, this meant a growth of 3.4%, due to the increase in audit tasks, the start of the modernisation of the central heating system of the headquarters in Apáczai Csere János Street and the tasks related to the implementation of two EU supported projects. The scope of action in utilising budgetary resources was again reduced by the fact that around two thirds of the professional tasks of the SAO are determined by legal provisions, and as a concomitant, by the mandatory nature of personal allowances, public dues and non-personnel expenses.

All this required that while fulfilling professional, institution maintenance and operation tasks the SAO should enforce austerity measures and observe economic aspects even more efficiently than before. To this end, the SAO strove to make use – as much as possible – of the saving possibilities provided by

public procurement procedures conducted centrally or within the SAO's own competence.

From the total amount of expenditures the appropriations for personal allowances amounted to HUF 4,779.1 million, contributions payable by the employers totalled HUF 1,492.4 million, non-personnel expenses equalled HUF 1,109.2 million, institutional investment costs totalled 260.1 million, renovation appropriations totalled HUF 13.7 million, and the chapter's general government reserves equalled HUF 220.3 million.

The approved appropriation was increased by HUF 1,081.1 million due to the interim modifications, including the following items:

- HUF 354.7 million spent on the use of the residue of the committed appropriation from 2007,
- HUF 178.0 million spent on the payment of the second instalment of the 13th month pay,
- HUF 26.9 million spent on the modification required by the extra revenues from the EU grants,
- HUF 163.8 million spent on salary increases in 2008,
- HUF 71.2 million spent on the technical modification required by the accounting rules of EU grants (due to which the appropriation doubles at chapter level),
- HUF 3.6 million spent on the disbursement of housing loans from the repaid instalments,
- HUF 26.9 million spent on the salary supplement of the employees of budgetary organisations,
- HUF 13.3 million incurred in relation to the employment of a national expert,
- HUF 220.7 million allocated for certain payments related to the dismissal of civil servants eligible for early old-age pension benefits,
- HUF 22.0 million yielded from extra revenues.

After these modifications as much as HUF 8,955.9 million was available.

Altogether HUF 8,505.7 million was utilised, which accounted for 95.0% of the modified expenditure appropriation. Personal allowances and contributions payable by the employers totalled 79.4% of the expenses (HUF 6,753.3 million). Non-personnel expenses and expenditures for cumulative purposes accounted for 14.6% and 5.2%, respectively, while grant-like expenditures totalled 0.8%.

In contrast with the planned revenues of HUF 60.2 million, the SAO realised HUF 180.5 million in revenues. As much as 74.3% of the extra revenues were made up of EU grants disbursed for two projects, and of grant-like revenues according to the accounting rules pertaining to such funds. The rest came from

the fees for studies prepared by the Research Institute of the SAO, from penalty for late performance, and from the sale of unnecessary equipment.

Budgetary subsidies totalled HUF 8,417.3 million, while the used appropriation residue equalled HUF 354.7 million.

The amount of the residue formed in 2008 totalled HUF 446.8 million. As much as 95.1% of the appropriation residue was committed, resulting from the rescheduling and postponement of committed tasks, performances to 2009. The free residue amounted to HUF 21.7 million.

Due to considerable thoughtfulness and austerity measures, the available appropriations altogether ensured the operational conditions required by the institution to perform its tasks smoothly.

6.2. Infrastructural operations and developments

The most significant development in 2008 was the start of works related to the modernisation of the central heating system in the SAO's Headquarters in Apáczai Csere János Street, built in the 1930s. After the completion of the project (end of 2009) the SAO's heating system will be disconnected from the existing old and inefficient network, and its operation will become more modern, cheaper and independent from the block that houses the headquarters. In addition, the air-conditioning needs can also be met. In the subject year the heating system was developed with separate furnaces installed on the 4th and 5th floors of the building, as well as the cooling system of the 3rd, 4th and 5th floors was completed. In the second half of the year plans were produced for the second phase of refurbishment of the heating system.

Upon the request of the Republican Government Guard, the number of surveillance cameras in the SAO's building in Apáczai Csere János Street was increased, and the surveillance system was modernised.

In the office building in Lónyay Street only smaller refurbishments were performed.

The refurbishment of two county audit offices – the Audit Office of Borsod-Abaúj-Zemplén County and the Audit Office of Szabolcs-Szatmár County – was completed. The works included the replacement of all electrical wiring, the painting of the offices, the repair of finishes, as well as the rebuilding of the sanitary blocks.

In the subject year the SAO spent a total of HUF 179.3 million on building renovation and reconstruction. In order to maintain the quality of equipment supporting the audit activity and improving the working conditions, the SAO spent HUF 34.3 million on the procurement of Xerox machines and furniture.

Within the framework of the scheduled renewal of the vehicle fleet six vehicles were replaced, and vehicle parts and accessories were purchased for a total of HUF 39.6 million.

6.3. IT and telecommunication operations and developments

The main objective of the SAO's IT activities is to support the implementation of the SAO's strategic mission and tasks in a versatile and efficient manner. IT and telecommunication developments in 2008 were also carried out – considering the developments of the former years – in accordance with the project plans specified in the SAO's annually updated, detailed IT strategy, approved by the presidential meeting.

Due to the dynamic developments carried out in the past years, today the SAO possesses continuously maintained, developed and controlled infrastructure that can flexibly respond to the changing communication needs, a standard network telecommunication system, as well as a training and conference room equipped with state-of-the-art equipment.

The IT budget approved for 2008 ensured the implementation of projects and development tasks specified in the annual plan.

Since 2006 all SAO sites have been connected to the Electronic Government Backbone Network (EGB). The logically separate and classified virtual private network (VPN) is monitored by the SAO's experts. Last year desktop management was introduced at all work stations connected to the national network of the SAO. In addition, other software development and updates were performed for the protection of the SAO's equipment and data connected to the network.

Another important element of the IT infrastructure is the construction and continuous development of the SAO's hardware units at the required level, the provision of staff members with hardware components – first of all desktop computers and/or notebooks – for the efficient fulfilment of their tasks, and for the use of state-of-the-art IT services. In line with the SAO's strategic objectives, the rate of notebook users increases year after year among employees involved in on-site audits.

In order to increase work efficiency, since December 2008 as many as 100 notebook user auditors have been authorised to access a few central services (e.g. e-mail system, distance learning) from outside the SAO's network.

In July 2008, the Symantec intrusion detection system was replaced with another system, since a product ensuring a larger network bandwidth was required to suit the access speed of servers installed in the VPN zone.

In the past year, a total of **105 desktop computers and 65 notebooks** were purchased through a centralised public procurement procedure. Within the framework of the scheduled replacement of equipment, ten medium capacity printers were installed in various branch offices of the SAO. To provide quality support to the dynamically growing computer services, **three new server computers were purchased**. The replacement of two servers was required due to the frequent breakdown of the old server computers at the branch offices in Lónyay utca and Bécsi utca, as well as the need for the safe storage of and fast access to the data stocks of the staff members of these offices. The third computer works as a stand-by server in the SAO's headquarters.

In addition to the procurements the SAO made significant progress in the optimisation of resources by the further reorganisation of the functions of the server computers.

In 2008, the SAO could reduce its expenditures on **wire telephone services** by 42%. As a result of the public procurement procedure announced in October 2008, the annual service fee is expected to drop by another 4% on average in 2009.

The **top priority IT project of the SAO** is the development of the electronic system designed to support the documentation of the audit work, and to file and store the documents produced or collected during the audits, for which the SAO submitted a successful application for EU Transition Facility in 2006.

The first phase of programme implementation includes software development, for which the Central Finance and Contracts Unit (CFCU) conducted an open public procurement procedure in 2007 with the involvement of the SAO, in accordance with the rules pertaining to the EU Transition Facility. The tender was won by Bull Hungary Ltd., and the costs of development totalled EUR 195,836 (HUF 50 million). The contract was signed by the CFCU, Bull Ltd. and the SAO on 21 January 2008. Upon the request of Bull Hungary Ltd., the parties extended the final deadline of the contract by one month on 13 January 2009. Thus, the deadline for project completion is the end of March 2009. In the second phase of programme implementation the CFCU announced a centralised public procurement procedure with the involvement of the SAO's expert for the procurement of the hardware components of the system. The five server computers and the related equipment were installed by the deadline, which means that the infrastructural conditions are available for the fast and safe operation of the documentation system.

System development expects to entail the improved efficiency of audits – especially that of preparation –, the reduction of time spent on the preparation of audits, and improved efficiency of executive quality control and quality assurance due to the on-line accessibility of audit evidence. The system improves the efficiency of groupwork, as well as the broad utilisation of the knowledge produced during the audits (auditors' knowledge base). As a result of the introduction of the documentation system, the method of audit documentation can be standardised, too. During the development of the system the creation of the security conditions for remote access were also taken into account.

In 2007, the SAO introduced an on-line **HelpDesk system** for the reporting, documentation and management of errors and problems related to the SAO's IT services. Based on the experiences of the past one and a half years it can be stated that the SAO is able to ensure that problem management and error correction are documented and performed expediently. The IT managers have up-to-date registration about the reported errors, the current status of error corrections and work instructions, on the capacities of experts providing the services. The system was linked to the network based active device management software, wherefore error messages from the network monitoring system and the management thereof are also documented. The system efficiently supports the evaluation of the performance of the operational staff, too.

The SAO has been using a computer assisted **tracking and filing system** since 2000 to support document management. In 2007, the fully accredited version of the electronic tracking and filing system (OFFICE.GOV) was prepared and introduced in pursuance of Decree 24/2006 (IV. 29.) issued jointly by the Ministry of the Interior, the Ministry of Informatics and Communication, and the Ministry of National Cultural Heritage on document management software used by organisations providing public services, in accordance with the amended document management regulation approved by the National Archives of Hungary.

The services of the SAO's website are extended and updated on a continuous basis. Documents and information specified by the law are shown in full under a separate menu point. Pursuant to the relevant legal regulations, documents stored in the **Public Data Search** system operated by the Ministry of Economy and Transport are also automatically updated on a continuous basis with the help of a software programme developed by the SAO's experts.

As a result of developments carried out in the past years, the **Intranet** system of the SAO ensures electronic access for all SAO staff members to the up-to-date versions of all information and documents of public interest. The fast and accurate publication of all SAO data of public interest on the SAO's website is made possible by an electronic authorisation and approval procedure, which was incorporated into the Intranet system last year. The new system has a structural navigation interface that supports quick searches through the various, ever-growing documents.

The **SZEKRETER audit registration and monitoring system**, which has included all material information about the SAO audits from planning through the resources spent on the audits to the realisation of recommendations since 2002, is developed on an on-going basis and is modified according to the management's needs. From this system the Audit Plan of the SAO, the recommendations formulated in the reports and the responses thereto can also be accessed on the Internet website of the SAO.

The SAO regularly uses various electronic databases containing the transaction information of the audited budgetary institutions for its audits. With a view to increase the efficiency of the audit activity, as a result of cooperation among the Hungarian State Treasury, GIRO Zrt. and the SAO, data required for the financial audits will be available – from next year on – at the central budgetary institutions in a standard structure, appropriate for the auditors' needs.

In the subject year the SAO spent HUF 63.1 million on the procurement of applications and security softwares, and HUF 55.5 million on the purchase of IT and telecommunications devices and equipment. In 2008 altogether HUF 66.9 million was spent on the purchase of hardware and software components for ongoing development projects under the EU Transition Facility.

6.4. Internal audit

In 2008, one internal auditor performed the internal audit tasks of the SAO.

The internal auditor performed his tasks in line with the relevant legal regulations and the internal management tools – more specifically the Internal Audit Manual of the SAO – on the basis of the medium-term strategic and annual work plan approved by the Secretary General.

The personal and material conditions for the internal audit were adequate during the year; functional independence was fully maintained in the internal auditor's work.

The internal auditor regularly attends the executive meetings held by the Secretary General, as well as the Secretary General's meeting organised on the basis of the semi-annual working plan. This significantly facilitated up-to-date orientation in issues related to the financial management of the SAO, as well as the more effective implementation of audit tasks.

The audit objectives envisaged in the annual work plan were completely achieved. Among other things, audits were conducted in relation to the management of human resources and personal allowances, occupational health, real estate renovations, and the fire protection of buildings. The audit of the SAO's public procurement activity performed in the previous year was also completed as scheduled.

Based on the experiences of the audits performed in the reporting period:

- Similarly to the previous years, the financial management of the SAO was in line with the legal and internal requirements, as well as the austerity measures in the audited fields;
- In the course of the audits there was no suspicion of any act, negligence or deficiency that would have served as a ground for criminal, misdemeanour or disciplinary proceedings, or actions for damages;
- In order to eliminate minor deficiencies revealed during the audits, and to further mitigate financial management related risks, the internal regulations need to be supplemented and updated regarding certain details.

The implementation of recommendations contained in the internal auditors' reports that were prepared during the subject year is under way. Some of the recommendations were realised by the end of 2008. Recommendations related to the amendment of regulations will be realised by mid 2009 on the basis of the approved action plans, as well as with regard to changes in the external legal environment.