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STATE AUDIT  
OFFICE OF HUNGARY

# R E P O R T

on the Professional Activity and Operation of the  
State Audit Office of Hungary in 2013

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President



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# Presidential Address

Dear Reader,



The year 2013 was the second full year when the State Audit Office of Hungary (SAO) performed its tasks under the revised legal framework. Following the passing of the new SAO Act, which entered into force in 2011, the organisation was also forced to renew itself in order to be able to efficiently and effectively promote the transparency and accountability of public finances, thus increasing regularity. The new act on the State Audit Office of Hungary put an end to the era of audits without consequences; therefore, the work performed by auditors can now truly contribute to reforming the Hungarian public finance system.

The development and restructuring of several areas of institutional operation has taken place. This means that audit topic selection, planning, handling of complaints, audit processes, and the system of organisational-level internal controls were all revised. The development and innovative rethinking of these areas served a single purpose: to carry out audits of use for the society, which could become main focal points for the reformation of the public administration and public finance system.

The taking into account of factors impacting the rule formulating the decreasing of the

public debt set out in the Fundamental Law became a cornerstone during the selection of audit topics. Accordingly, we focused our audits, on one hand on factors impacting public deficit (factors impacting the central budget, local governments, and companies taken into account when calculating said budget), and on the other, factors impacting national income (factors impacting employment, vocational training and investments). In addition, focus was also placed on other topics which were previously not or were only partially audited by the SAO. These include the auditing of the local governments of small villages, the minority local governments of villages, local government public service providers, economic chambers, theatre business associations and research institutes. Some of the SAO reports on these audits are scheduled to be made public in 2014. Compared to 2012 (112 SAO reports), we continued to increase the number of audits, and as a result have made 192 SAO reports public for 2013.

The innovative way of thinking and the renewal and preservation of values integrated into the everyday life of the SAO serve the implementation of the Strategy adopted and expanded by the National Assembly. In 2013, the implementation of the Strategy also entered a new phase. The period ahead will be an era of fulfilment following the laying of foundations and the elimination of 'practical diseases'. After this renewal, permanence and dynamism must be enforced simultaneously. One of the most important elements of this is operating as a self-learning organisation.

In line with the fundamental values laid down in the Strategy, the SAO places great emphasis on the moral and pecuniary appreciation of personnel, equal opportunities

and continuous development. A number of programmes have been implemented that serve the development of organisational culture, as well as ensuring the fulfilment of the career model among auditors that guarantee the quality of the work performed by the organisation.

As part of its basic audit activity, the SAO plays a sort of ‘watchdog’ role, but is placing increasing emphasis on strengthening its advisory function, through which it is also looking to undertake a ‘herding dog’ role. Another significant area of this approach of strategic importance is the preparation of analyses and studies that provide professional support for the performance of tasks of the Fiscal Council (FC). By making these analyses and studies available to the FC, it is able to fulfil its constitutional role more efficiently and effectively, in other words, audit compliance with the regulations concerning the rate of public debt.

As part of its advisory activity, the SAO has prepared several analyses and studies, the majority of which dealt with budgetary processes and risks. In addition, in 2013, we also prepared a study that analysed the area which plays an important role in promoting the country’s competitiveness. The SAO performed its tasks using the authorisations bestowed upon it by statutes and by fulfilling its obligations.

Again in 2013, the State Audit Office of Hungary performed its tasks in compliance with laws, with increasing transparency and independent auditing, within the framework of substantiated accountability. In addition, we were not satisfied with simply performing our mandatory tasks. We performed our activities at all times in a manner that generates a noticeable impact in everyday life, in other words, making sure that the work performed creates added value. As part of our corporate social responsibility, every one in ten of our staff gained work experience as part of an internship programme for recent graduates. We played a role in developing Hungary’s financial literacy in a wider sense; to ensure that the decreasing of financial vulnerability is also perceived at an individual level, and for citizens and communities to possess the skills necessary to achieve this. We will carry on working in this spirit in the future as well in order to be of use for society and in the interest of Hungary’s development.

**László Domokos**  
*President*  
*State Audit Office of Hungary*

# 1. The past year of the SAO

The State Audit Office of Hungary is the only external audit body of the Hungarian public finance control system elevated to a constitutional level, which conducts its activities entirely independently from the government. It should be emphasised that with respect to public finances, the audit profession distinguishes three lines of defence, of which the third (final) and most important audit component is the State Audit Office of Hungary. This role does not simply represent obligations, but responsibility as well. Taxpaying citizens have every right to expect the National Assembly's supreme financial control body to keep an eye on public finances and, by focusing on the most acute economic and social problems, to provide guidance to the users of public funds.

## The second year

The second full year of operating under the revised legal framework allowed us to evaluate the impact of the new SAO Act on the public finance system. Our audits were increasingly utilised, at the levels of both legislature and audited entities; thereby supporting 'good governance' and the effective, efficient and economic use of public funds.

## Increasing utilisation

In 2013, we made 2,249 recommendations with obligations to take action to 347 addressees (296 addressees linked to local government SAO reports and 51 addressees linked to non-local government SAO reports). Of these, 68 concerned liability. Compared to previous years, we initiated the settlement of public finances in more instances and observed an increasing number of 'good practices' on the part of audited entities. Thanks to the new SAO Act, the SAO was able to impact

the operation of audited entities and the level of regulation of their internal processes considerably more effectively.

### WHAT ARE THE THREE LINES OF DEFENCE OF PUBLIC AUDITING?

In Hungary, the auditing of public finances is ensured by a system comprising three harmonised and overlaying lines of defence that are regulated by law, which system includes the internal control system of the various institutions, government auditing and external auditing.

## Utilisation in the work of the National Assembly

One of the priority areas of utilisation of our activity is legislature, as the main instrument of the supporting of 'good governance'. The implementation of the SAO's strategy would be unimaginable without a closer cooperation with the National Assembly and its committees. Accordingly, our primary objective is to, through the selection of audit topics, to generate SAO reports that can be utilised by both MPs and committees of the National Assembly. In 2013, MPs referenced SAO reports, findings and activity on 35 parliamentary session days. In addition, the various committees of the National Assembly discussed 47 SAO documents or the experiences thereof at 50 committee meetings.

## In unaudited areas

It is the SAO's strategic objective to audit areas of public fund utilisation as yet unaudited. It was for this reason that, among others, the minority local governments of villages and economic chambers were also audited. This objective also motivated the SAO to turn its attention to village local governments as prior to 2010, during the auditing of the local government sub-system, the approximately 2,800 villages were only included in a

given thematic audit to a limited extent. Moreover, during this time, the legality supervision of local governments was suspended for a period of almost two years, which in turn led to the expansion of grave irregularity processes. Reversing the weakening of the public finance system in the local government area has been a priority audit assignment for the SAO for the third consecutive year.

### **Focus on local governments**

Of the 192 SAO reports issued in 2013, 174 dealt with local governments, and the majority were the result of thematic audits. These thematic audits covered the most important local government topics: the development of financial standing, the compliance of the establishment of the internal control system, asset management, the financial management of minority local governments, and the business associations owned by local governments. In 2013, therefore, we continued to audit the financial standing of local governments, through which we assisted the audited local governments in establishing financial equilibrium. Government auditing related to the financial management of local governments and the internal control system helped to promote the quality of financial management. The auditing of business associations majority-owned by local governments contributed to uncovering open or hidden indebtedness, which sooner or later will influence the development of public debt. The selection of audit topics in the local government field was preceded by risk analysis, and the audits carried out confirmed the effectiveness of the revised topic selection system.

### **Efficiency, effectiveness**

We carried out our thematic local government audits using the so-called *'one-stop shop' overlaid organisational method*. With this particular method, the SAO was able to use its audit capacity, and

thereby taxpayer funds, more efficiently and effectively.

### **WHAT ARE THEMATIC AND ONE-STOP AUDITS?**

**Thematic audits** are audits that cover the main areas of local government operation and are carried out on the basis of uniform programmes that allow comparable auditing at multiple points, and during which the methods applied ensure the efficient performance of audits.

A *'one-stop shop' audit* is an audit implementation and organisation method based on various concurrent audit projects (programmes) at an audited entity typically with the same auditor, which requires a high level of organisation, coordination and guarantees and which also makes the data supply tasks of the audited entity more transparent and cost-effective.

### **The SAO's advisory activity**

In addition to the SAO's audit activity, in recent years the organisation's advisory and analysing function has moved increasingly into the foreground. Through these two activities we are able to efficiently and effectively support the renewal of the Hungarian public finance system, and the fulfilment of constitutional obligations concerning the reduction of public debt. The studies prepared by the SAO primarily serve to support the work of the FC and the legislature. The SAO was also present as an active player in several areas as part of its advisory activity. Without being exhaustive, this includes the establishment of integrity-based public administration, the dissemination of 'good practices' and the development of financial literacy.

### **Synergy between the Fiscal Council and the State Audit Office of Hungary**

In 2013, the SAO again paid particular attention to ensure that the synergy between the organisation and the FC is realised in practice as well. To ensure this, continuing the path commenced in 2012,

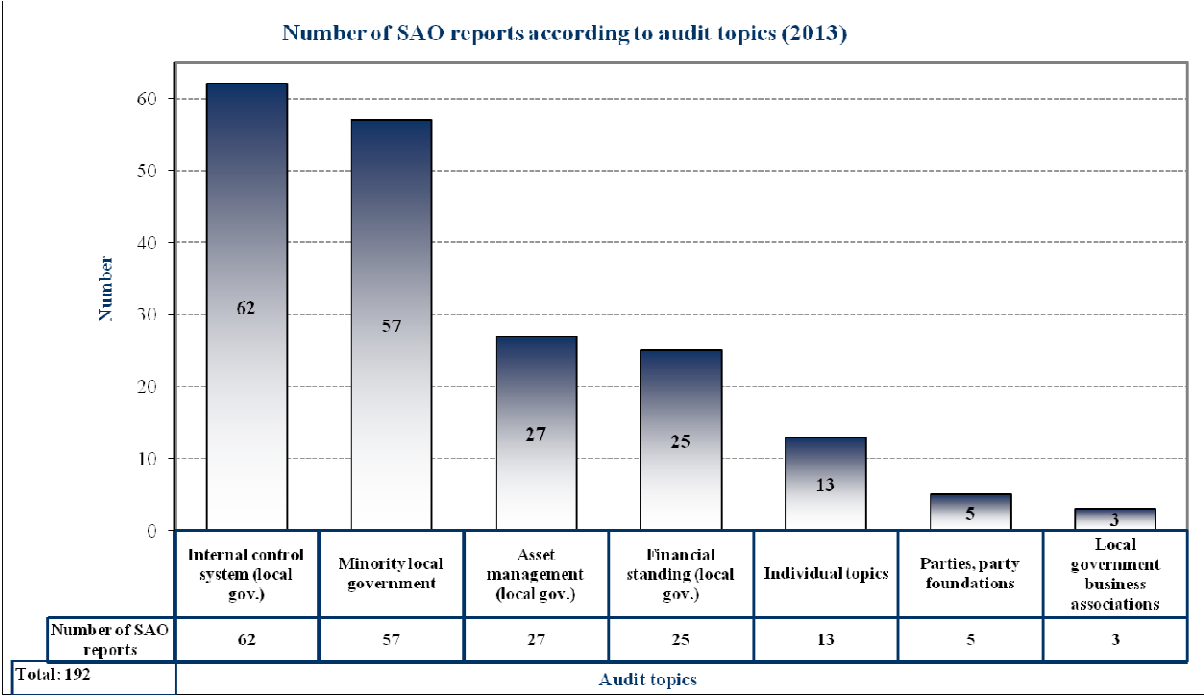


we took a number of measures aimed at increasing the efficiency of cooperation. The internal rules of preparing SAO analyses for the FC, which rules aim to increase efficiency and effectiveness, were institutionalised. In 2013, we prepared two analyses and three studies for the FC.

**The constitutional objectives related to public debt serve as a compass**

The constant reduction of the public debt indicator is a constitutional obligation set out in Hungary’s Fundamental Law, which fundamentally defines the SAO’s activity. The Fundamental Law lays down an economic policy goal, the accomplishment of which requires the contribution of the State Audit Office of Hungary. In 2013, we enforced this approach in all main areas of activity; in other words, the obligation to decrease the public debt indicator served as a compass of sorts. Accordingly, when compiling audit plans, areas that impact the

development of the public debt indicator moved into focus. Some of these areas – such as the financial standing of local governments or the financial management of business associations majority owned by local governments – represent hidden or open risk with respect to the development of public debt. Other audit topics focused on areas directly contributing to improving the country’s competitiveness and accelerating economic growth. Certain new directions of local government thematic audits (internal control system, asset management) are looking to improve the quality of financial management. These audits are able to effectively support the maintenance of financial management equilibrium. In summary, therefore, we can state that all SAO audits are in one way or another related to public debt.



**Chart 1**

## 2. The professional activity of the SAO in 2013

With the adoption of the new SAO Act and the Strategy by the National Assembly, the organisation underwent a fundamental change of approach, during which all activities became centred on utilisation. This led to the strengthening of advisory activity, increased participation in academic-professional life, increased focus on credible institutional communication and a renewal process impacting the whole of the organisation. All of the changes of the past two and a half years pointed in the direction of increasing utilisation, which in turn also meant increasing responsibility. The SAO considers improving the efficiency, transparency and level of regulation of the public finance system its mission.

**3** main dimensions, along which our professional activity emerges

Our Summary will approach the State Audit Office of Hungary's professional activity from three different, yet fundamentally related aspects. By presenting the measures taken and the utilisation of reports on the basis of audit findings, the performance of the audit tasks and the related supplementary advisory role, taxpayers and the National Assembly can be informed comprehensively. The SAO ensures that society is aware of how 'taxpayer forints' are utilised through its audits; therefore, ensuring clarity was a priority aspect when preparing the summary.

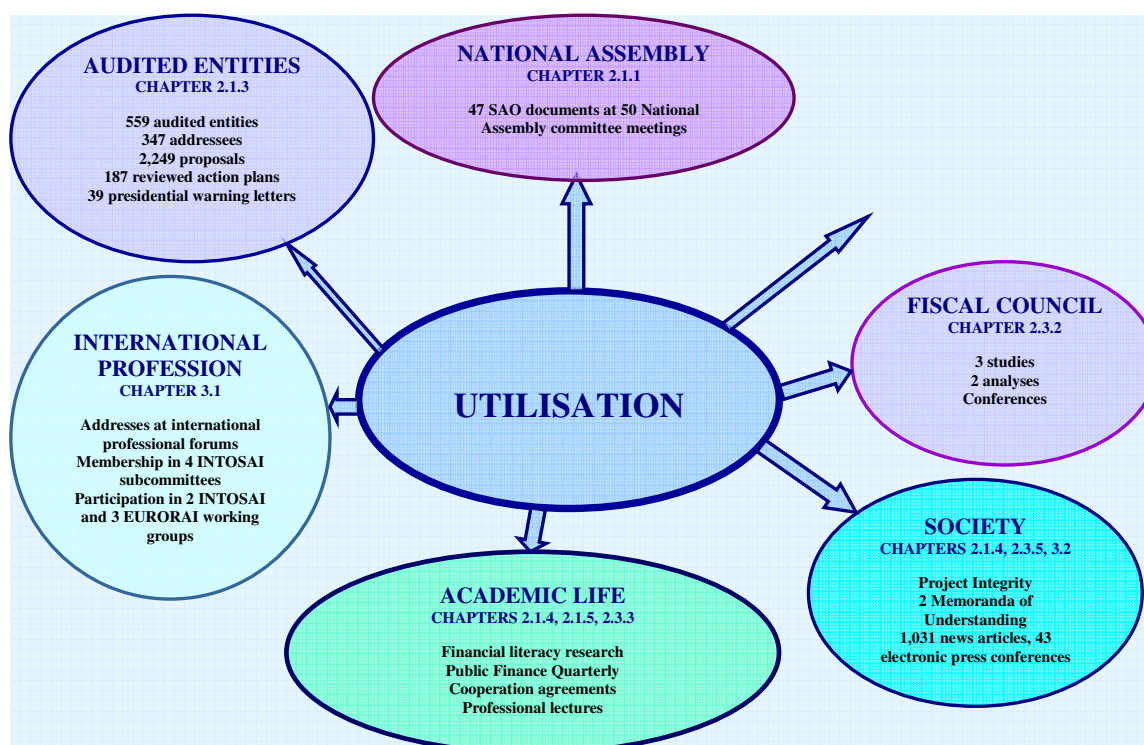


Chart 2

## 2.1. Utilisation of reports

Effectiveness is a basic requirement for all audits of the SAO, which effectiveness can only be fully realised if we are truly able to impact the operation of audited entities. This was made possible by the new SAO Act effective as of July 2011. This milestone was of strategic importance and not just for the SAO. The renewal of the system of public finances and the promotion of the transparency of the public administration system cannot be imagined without a strong and independent financial control body, which is able to support the regular, economical, efficient and effective utilisation of public funds and public assets through its findings and recommendations and the obligations to act therein. The conditions created by the new legal framework, therefore, has increased significance at the national economy level as well.

### 2.1.1. Utilisation in the work of the National Assembly

It is the primary aspiration of the SAO to support the National Assembly and contribute to ‘good governance’ through its audits and recommendations. As a result, National Assembly committees have discussed several SAO reports and documents.

#### Increasing levels of cooperation

In 2013, the SAO deepened its cooperation with the National Assembly. MPs have increasingly relied on the findings and recommendations contained in SAO reports in legislation and during the work of National Assembly committees. They referenced SAO reports, findings and activity on 35 parliamentary session days. Furthermore, the Honourable National Assembly discussed three SAO documents carrying a parliamentary document number. These all indicate that our activity is increasingly utilised in the work of the National Assembly.

#### SAO reports before National Assembly committees

The report on the SAO’s activities in 2012 was discussed by three committees before being debated by the plenary session of the Honourable National Assembly. A total of 47 SAO documents were submitted to National Assembly committees which

were discussed by MPs at 50 committee meetings. The SAO reports on the audits of the employment of disabled people, the operation of the National Bank of Hungary, the financial management and follow-up audits of parties, the utilisation of state assets and funds spent on the operation of hospital care and the execution of the 2012 central budget were submitted to National Assembly committees.

#### WHAT IS ‘GOOD GOVERNANCE’?

Based on the definitions of the UN and other international organisations, ‘good governance’ is a mode of operation of the state characterised by search for consensus, stimulation to participate, equal opportunity, transparency, accountability, effectiveness, efficiency and respect for the rule of law.

#### OUR PERFORMANCE IN NUMBERS

With respect to the supporting of the National Assembly

|    |   |
|----|---|
| 35 | session days where MPs referenced the State Audit Office of Hungary |
| 47 | SAO documents discussed by National Assembly committees             |
| 50 | committee meetings where SAO documents were discussed               |

The SAO opinion on the Bill on the 2014 Central Budget of Hungary was discussed by nineteen National Assembly committees. The SAO also supported the work of committees through its thematic local government audits, as in October 2013, the Audit Office and Budget Committee of the National Assembly

placed on its agenda and discussed the parliamentary utilisation of reports on the SAO audits of the internal control systems of local governments. At the committee meeting – in line with the nature of thematic audits – the President of the SAO presented the summarised experiences of 38 closed audits.

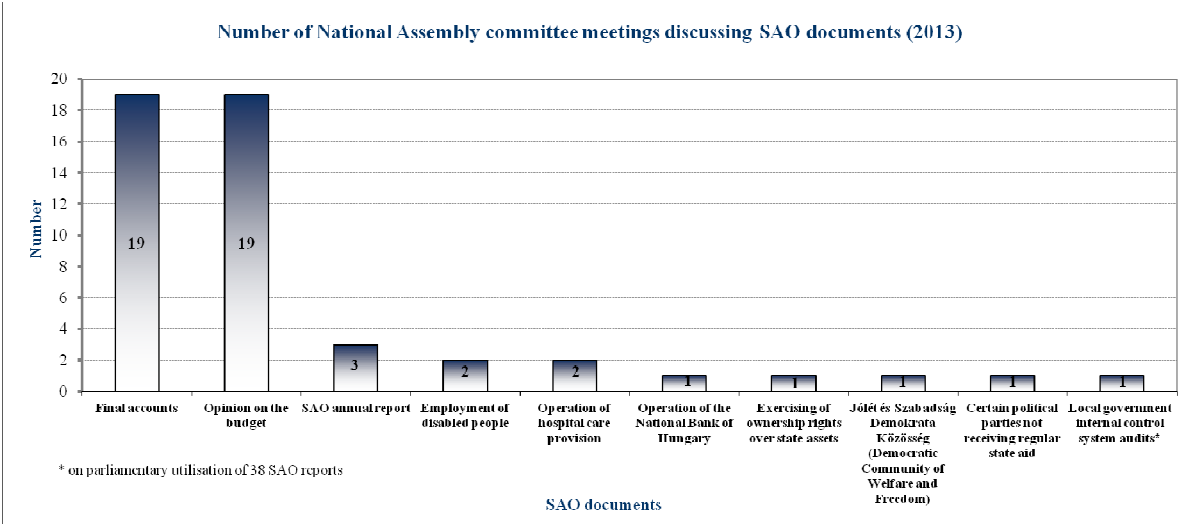


Chart 3

## 2.1.2. Utilisation in legislature

One of the main objectives of our revised planning system, in other words, of rolling planning is for the limelight to shift to audit topics that, by focusing on the most topical social and economic issues, are able to support the National Assembly in renewing the related legal environment. This, at the same time, also means that the utilisation of SAO work is often rolled over to the year after; thus the legislature typically utilises the findings of reports that have been issued the previous year.

### Transformed record-keeping system in health insurance

In June 2013, the National Assembly passed the bill package on the amendment of certain healthcare and health insurance-related laws, in which they remedied a number of operating anomalies that were brought to light by related SAO reports. The SAO published its report on the “*Audit on the operation of the record systems applied in the eligibility scheme of provisions and services provided from the Social Security Funds*” on 31 May 2012. With the decision of the National Assembly, the utilisation of the audit was completed as the new regulatory environment eliminated the processes that had an unfavourable impact on efficient and effective operation as uncovered by the SAO report, as well as clarified a number of concepts. AS a result of statutory amendments, the data supply obligation of employers was also simplified.

### *“The State Audit Office of Hungary audit accelerated the putting in order of the record-keeping systems of the pension insurance system”*

*Dr. József Mészáros, Director General of the Central Administration of National Pension Insurance*

### SAO report facilitates quality waste management

On 27 June 2013, the National Assembly passed the bill on the classification of waste management public utility activity, which serves to establish quality waste management public service provision. In the *new waste management public utility system*, the stability of service is facilitated by the determination of service quality. Within the new classification system, local governments have to pay increased attention to the implementation of the waste management programme, as well as the quality and security of the waste management public utility. In July 2009, the SAO published its report on solid waste management of villages which, among other things, found that four fifths of audited local governments paid no attention to assessing the accomplishment of objectives set out in local waste management plans or to preventing the accumulation of waste volume. Through the enforcement of the act, several contradictions – uncovered by the SAO – were eliminated and the utilisation of recommendations made is now guaranteed by law.



### SAO reports in the service of the efficient and effective utilisation of EU funds

The National Assembly passed Act CCXVI of 2013 on the Amendment of Act XXI of 1996 on Regional Development and Regional Planning on 13 December 2013. The amendment remedied several,



for the most part planning issues that were indicated and called to attention by SAO reports. Of these reports, we must highlight the SAO report *“About the audit of the evaluation of tendering, planning and preparation experiences of investment projects based on Government decisions and implemented with EU funding since 2007”*, published on 18 May 2012. In the report, the SAO made recommendations regarding the preparation of comprehensive legal regulations aimed at strengthening the planning of state development tasks, which would create institutional guarantees of task performance and include the uniform planning methodology for domestic and EU funds. Within the framework of the amendment, the rural development and coordination tasks, the plans directly and indirectly serving objectives and regional development planning activity were all defined in detail. The SAO’s recommendations were utilised through the adoption of the statutory amendment by the National Assembly. The SAO report entitled *“About the audit of the fund allocation activity of regional and micro-regional development councils”*, published on 8 August 2013, uncovered several deficiencies. The audit determined that in spite of the content of the National Regional Development Concept, between 2007 and 2011, the principle of subsidiarity was not enforced in the case of domestic and EU funds. By defining the regional development and regional planning tasks of the metropolitan and county local governments, the new statutory environment promotes the enforcement of the principle of subsidiarity. In the interest of sharing the unique experiences gained during audits and to prepare a more efficient EU development strategy, the SAO engaged in advanced communication with the competent persons concerning the utilisation of EU funds.

#### **WHEN IS THE PRINCIPLE OF SUBSIDIARITY ENFORCED?**

The **enforcement of the principle of subsidiarity** means that answers to local matters are generated in place, and local problems are handled at a local level.

#### **In the protection of works of art and collections**

On occasion, the recommendations made in SAO reports are only utilised many years later. This is particularly true for SAO reports which have been published prior to the entry into force of the new SAO Act. On 22 November 2013, the National Assembly passed Act CXCV of 2013 on the amendment of certain acts related to the return of properties of debated ownership kept in public collections, which by amending relevant statutes resolved the deficiencies uncovered by the SAO. The State Audit Office of Hungary published its report on the audit of the utilisation of funds spent on managing cultural public collections on 28 February 2007. This report contained a recommendation by the SAO concerning a follow-up audit related to an earlier report published in 2004. In the aforementioned SAO report, we recommended that the government review the regulation, procedural order and applied practice related to the ownership and management of works of art and collections. Furthermore, we also recommended the establishment of regulations and procedural order that would be able to make the ownership and management of all works of art and collections clear and transparent. The appropriate regulation of this field is of particular importance with respect to protecting state assets.

#### **Addresses**

In the interest of the maximum utilisation of SAO reports in legislature, the President and Vice President of the State Audit Office spoke at parliamentary debates on a number of bills, presenting relevant SAO

findings and experiences. Among other occasions, the President of the SAO spoke at the general debate on the execution of the 2012 central budget as well as the parliamentary debate on the amendment of the competition act. In his final accounts exposé, the President announced that given the institution’s advisory and analyst role, the SAO prepared a study entitled “The Macro-Economic Correlations of the 2012 Final Accounts and the Outlook for 2013”. Through the aforementioned study, the SAO has met arising needs according to which the final accounts report should analyse the economic and budgetary processes behind the figures. In the spirit of flexibility and the ability to react swiftly, the SAO shares its experiences when the National Assembly needs them most.

This is well reflected by the fact that on 30 October 2013, the President of the SAO, prior to making the related SAO report and the study prepared as part of the advisory activity public, shared the SAO’s experiences concerning the Hungarian Competition Authority with MPs.

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**OUR PERFORMANCE IN NUMBERS**  
**With respect to utilisation related to legislature**

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- 7** | SAO reports utilised directly in legislature
- 4** | statutes where SAO findings were utilised

## 2.1.3. Utilisation at audited bodies

At the level of audited entities, the cornerstone of increasing utilisation is the new SAO Act, which regulates the obligation to act of the given audited entity. The revised legal framework allows for the enforcement of grave sanctions if the audited entities do not meet their obligations to act.

### Action plans related to findings and recommendations contained in SAO reports

Compared to the 213 addressees in 2012, in 2013 the SAO made recommendations to 347 addressees, as in 2013 more audits of responsible financial management of state and local government funds carried out at audited entities. In 2013, the SAO made 2,249 recommendations to audited entities compared to 1,117 in 2012. In

2013, the SAO carried out the review of the compliance of 187 action plans. The review may conclude with the approval of the action plan only if a number of conditions are jointly met, and the aspects affective as on 31.12.2013 are shown in Chart 5. The SAO was forced to turn to the Prosecutor's Office in one instance due to the breach of the obligation to cooperate related to the failure of the audited body to forward the action plan to the SAO.

### OUR PERFORMANCE IN NUMBERS With respect to recommendations

**347** addressees that the SAO made recommendations to  
**2,249** recommendations made by the SAO

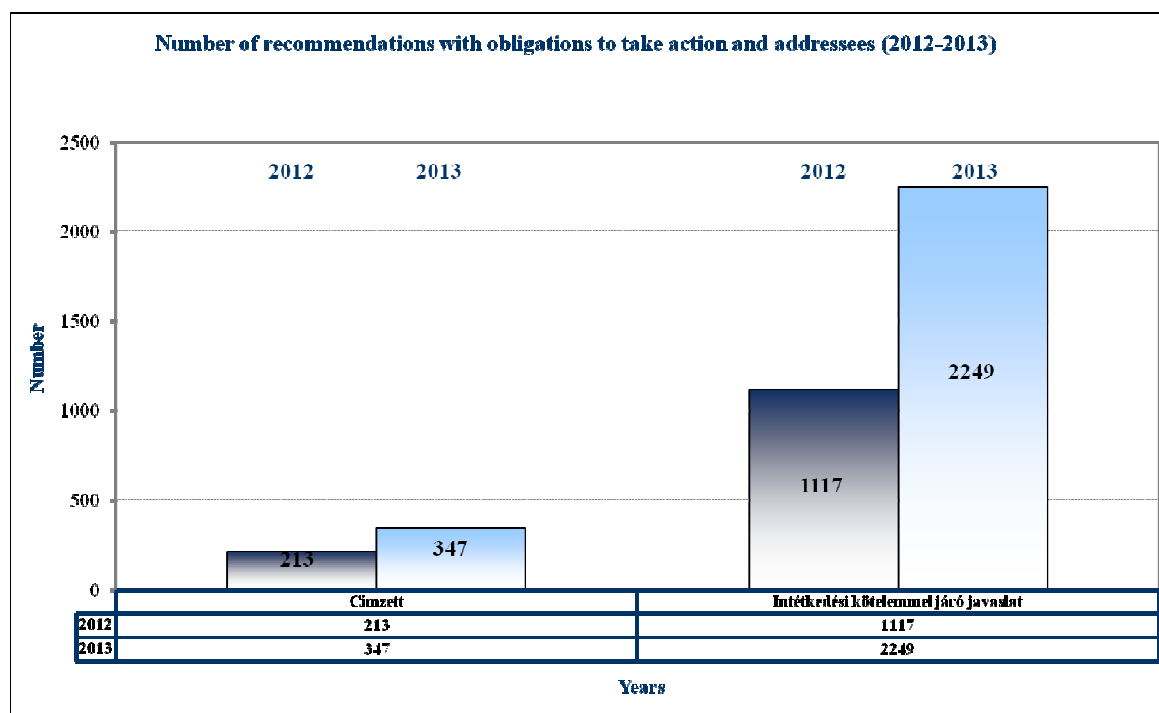
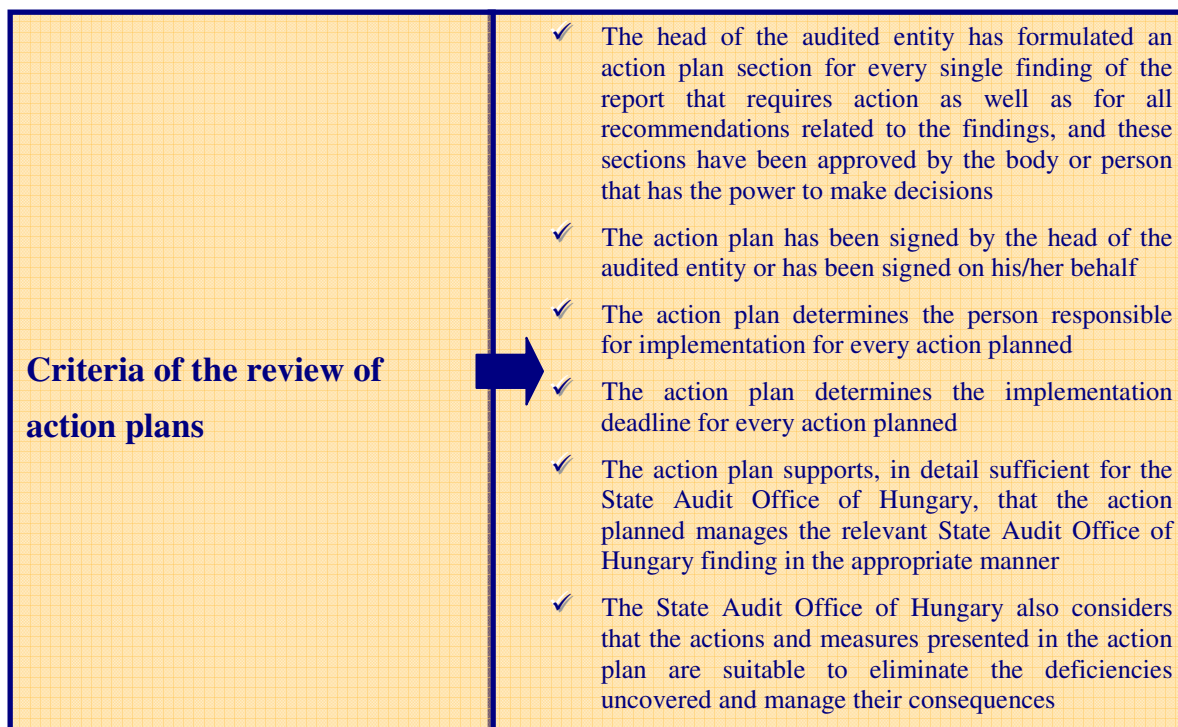


Chart 4





**Chart 5**

**‘Good practices’ at audited entities**

Following the adoption of the new SAO Act, a gradual change in approach was also observed at audited entities. Audited entities are becoming increasingly conscious of the fact that the recommendations of the SAO requiring measures to be taken serve their interests. In the past two years, we observed several ‘good practices’ on the part of audited bodies that are pointing in the direction of the accelerating utilisation of SAO reports. In November 2012, the SAO published its report on the audit of national parks, which uncovered a number of deficiencies regarding leasehold agreements. In the period of the on-site audit, the instruction issued by the competent Minister already set out uniform principles concerning the asset management activity of national parks. This means that the Ministry already took care of eliminating deficiencies in the reporting period. In connection with the final accounts audit, the SAO carried out an additional targeted audit at the National Development Agency (NDA), where we concluded that the NDA failed to set up sufficient controls for the enforcement of

the transparency requirement. The president of the NDA sent the president of the SAO the action plan concerning recommendations that require measures to be taken before the deadline. After this, the implementation of the action plan commenced immediately. An excellent example of ‘good practices’ for instance is that after receiving the SAO report, the NDA took the necessary steps without delay.

**Presidential warning letters**

In 2013, the SAO notified 39 addressees in connection with 10 SAO reports of a total of 87 findings in the form of presidential warning letters. On the basis of these warning letters, the audited bodies provided information on a total of 70 measures, the review of which we have carried out. With respect to measures taken related to findings contained in presidential warning letters, there was only one instance where the audited body was required — due to omission — to repeat its response after an additional deadline was set, as opposed to the 25 cases recorded in 2012.

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**OUR PERFORMANCE IN NUMBERS**  
With respect to presidential warning letters

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**39**

presidential warning letters

**87**findings contained in  
presidential warning letters**Follow-up audits**

Pursuant to the SAO Act, the SAO may check the implementation of the points of the action plan within the framework of a follow-up audit. This is another guarantee that serves to ensure that the SAO achieves veritable change through its audits in connection with the regularity of public finances. There are two ways the SAO carries out follow-up audits: either as an audit section contained in the audit programme, or on the basis of an independent audit programme that exclusively concerns follow-up auditing. Based on the follow-up audits carried out in 2013, we can state that making the preparation of an action plan mandatory by law has had a positive impact on the utilisation of our recommendations.

**Follow-up audits of parties**

In January 2013, the SAO published its report on the follow-up audit of certain political parties that do not receive regular state grants, which once again showed that the implementation of legality requirements cannot be accomplished without statutory guarantees.

**Regular follow-up audits**

In the case of audits repeated pursuant to statutes, follow-up audit aspects are integrated into the audit programme. As a result, the SAO regularly confirms the implementation of action plans prepared on the basis of findings contained in the SAO reports.

In the case of audits to be performed by law on an annual basis, follow-up audits are also carried out in every case. This means that follow-up audits are important parts of the auditing of final accounts, the exercising of ownership rights over state assets and the National Bank of Hungary. In the case regular, recurring audits, the enforcement of follow-up audit aspects is particularly important, as this allows the monitoring of the utilisation of SAO audits. Three of the six comprehensive recommendations made in the SAO report on the 2011 final accounts audit were utilised, and another three were realised in part or their realisation was in progress at the time of the conclusion of the on-site audit. The recommendations made in the SAO report on the 2011 audit of the National Bank of Hungary were implemented by the MNB in compliance with the schedule of the action plan.

**Follow-up audit experiences also show a positive tendency**

In 2013, we conducted several audits where we confirmed the implementation of the action plans within the framework of follow-up audits. The findings of the follow-up audits carried out during the auditing of the fund allocation activities of regional and micro-regional development councils showed highly positive tendencies. The recommendations made on the basis of Report No. 1108 on the performance audit on the system of development grants provided to local governments that was based on follow-up audits were taken into account within the framework of various government measures. The specific utilisation of measures in practice – with the exception of one – cannot be determined as yet. The planned measures set out in the action plans prepared on the basis of Report No. 1125 on the utilisation of funds used for the convergence of regions were 70% implemented, while 20% were implemented in part.

## 2.1.4. Publicity and utilisation at the social level

It is the fundamental right of citizens to be familiar with the operation and financial management of organisations utilising public funds and assets. In this respect, the SAO has a dual role. On the one hand, through its audits it ensures that society is aware of how public funds are used; on the other, the SAO also has to report on how the public funds spent on its operation are utilised. Accordingly, we place great emphasis on widely spreading the information gained from audit findings through credible institutional communication. After the revision of the 2012 statement, this approach of strategic importance was what justified the further fine-tuning of the 2013 statement, which aimed to increase clarity and readability. As a result, we are able to report to taxpaying citizens on our professional activities and the results achieved in a clearer and more comprehensible manner.

### Active communication is of key importance

The SAO's communication activity has been fundamentally revised in recent years. Conscious development is the result of the recognition that the main messages, the operation, the strategy, the audit directions of the organisation and the findings of SAO reports are primarily communicated to society and decision makers through the media. The placement of press relations on new foundations and the increasing of activity, therefore, are of key importance for the utilisation of SAO reports. The continuous development of the communication field is a conscious activity at the State Audit Office of Hungary that is unbroken to this day.

### SAO News Portal – News from a credible source

The SAO News Portal was launched two years ago with the objective of providing credible and professionally sound information to citizens. With the setting up

and constant development of the SAO News Portal, the operation of the publicly funded institution has become highly transparent at an international level as well. On the website, society can continuously monitor the audit process, from planning through implementation to utilisation. In addition, we also report on the internal operation of the institution, as well as the SAO's professional, academic and international relations.

### SAO News Portal revamped

In 2013, the SAO News Portal was revamped and as a result, new types of news articles, summaries and video interviews were published on the website. During the revamping, our goal was for the website to retain its integrity as well as its tried-and-tested functions, but we also strived to create a modern and user-friendly platform that can support the utilisation of the SAO's work at the societal level more efficiently. Accordingly, SAO reports, information on recent audits as well as summaries on the utilisation of audits are now prominently displayed on the site.

### Utilisation interviews on audits

Another new feature is the utilisation interviews column, where the heads of audited organisations speak about the results of the SAO audit concerning their organisation, and present how the SAO's recommendations contributed to more efficient and effective operation and financial management. These interviews published on the SAO News Portal contribute to sharing lessons learned and 'good practices'.

## OUR PERFORMANCE IN NUMBERS

With respect to provision of information

|       |                               |
|-------|-------------------------------|
| 1,031 | news articles on SAO websites |
| 43    | electronic press conferences  |

## Taking information to the local level

Several aspects had to be considered during the restructuring of communication activity. It was an important goal to ensure that the messages of the SAO reports reach local levels as well as citizens. One of the most important means of achieving this is the introduction of electronic (online) press conferences. In 2013, the SAO held 43 electronic press conferences. As part of these press conferences, we provided the option for local media to ask questions over the phone or via email regarding several SAO reports simultaneously. In addition, we sent targeted notifications to all county press organs geographically affected in the audit, and the sending of related press summaries was also targeted. In the case of locally involved audited entities, providing electronic press conferences has become standard practice since December 2011. Thanks to these electronic press conferences, the people living in the given place or region can receive direct and credible information about audits that impact them as well; for instance, they may be informed about the auditing of a local government or local institution from the local radio or television station.

## In the service of science

At the initiative of the Research Institute for Linguistics of the Hungarian Academy of Sciences, the electronic documents published on the SAO News Portal and the Public Finance Quarterly Online website are integrated into the Hungarian National Corpus by the staff of the HAS, processing these documents in a linguistically analysed form and making them searchable.

## Supporting the experts of the future

The SAO's cooperation agreement with 12 institutions of higher education indicates that the organisation wishes to play an active role in expanding and developing the public finance knowledge of young public service experts. Through this approach, the SAO will be able to support the growth and development of a new generation that, in line with the objectives set in the institutional strategy, can contribute to preventing corruption and increasing integrity. It was in this spirit that the President of SAO agreed to be the patron of the integrity advisor vocational further training at the Faculty of Public Administration of the National University of Public Service. Several senior officials of the SAO held lectures in renowned institutions of higher education, such the National University of Public Service or the Corvinus University of Budapest. We have also launched a visitation programme, within the framework of which university students had the opportunity to learn about the foundation and the beginnings of the independent audit institution through professional and historic lectures, and also received detailed information on the activities of the SAO and the current issues of public auditing. With this, the cooperation with students of higher education institutions arrived to a new chapter, supporting the deepening of professional relations.





### **Financial literacy research comes to a close**

The SAO firmly believes that long-term order in Hungarian public finances is impossible without the widespread increasing of financial literacy. As a starting point, however, we must first be aware of the current level of development of financial literacy. It was in this spirit that the survey, based on international scientific standards, assessing the financial knowledge of young people in higher education with a new methodological approach was concluded. This represented the fulfilment of a cooperation agreement that was signed in February 2012 by the organisations participating in the study, in order to provide a comprehensive picture of the financial education of young Hungarians studying various disciplines in higher education. It was also a goal to create a method with the help of which it would become possible in the future to audit the effectiveness of programmes aimed at developing financial literacy. Scientific results could help the preparation of more efficient educational methods and curricula, thereby contributing to ‘good governance’.

### **Utilisation in flood protection**

In 2013, the SAO also contributed to the protection against the historically massive body of water that flowed down the Danube. The State Audit Office of Hungary published its report entitled “Audit of the systems set up to prevent and avert natural disasters and to eliminate their consequences” on 20 May 2011. The audit revealed that there are a number of

severe deficiencies in the system of Hungarian disaster management. The recommendations made on the basis of the findings of the SAO report also helped provide the foundation for the new Disaster Management Act which entered into force on 1 January 2012. The management of the National Directorate General for Disaster Management also utilised the SAO’s recommendations during the overhauling of the operating and organisational system. The new Disaster Management Act stood the test of the flood and, in an indirect fashion, the SAO’s work was also utilised in the results achieved. In line with strategic goals, through increasing utilisation SAO reports now have a tangible and perceptible impact on areas important for society, such as disaster management for instance.

### ***“The New Act was born through the utilisation of the findings and recommendations of the SAO”***

*György Bakondi, Director General of the National Directorate General for Disaster Management*

### **Auditors on the dams**

Called upon to do so by President László Domokos, on 7 June 2013 the staff of the SAO joined flood protection efforts at the Szigetszentmiklós city-limits, where hand in hand with volunteers, they built a temporary dam in order to protect homes and public assets.



## Handling of announcements of public interest

In addition to becoming familiar with the processes of reports and audits, the SAO considers it important for society to also have the **chance to make notifications and announcements, and the enforcement thereof within a legal framework.** In harmony with the above, the SAO has a separate internal regulation for handling announcements of public interest. It must be underlined, however, that the SAO is not an authority and tasks may only be assigned to it by the National Assembly and laws. In 2013, the State Audit Office of Hungary received a total of **318 announcements of public interest and complaints**, of which 151 concerned areas related to local governments. Nearly 38% of announcements and complaints concerning local governments were related to local government asset management. With respect to the fact that 65% of the submitters of announcements are private

individuals, we can state that this is another area where the SAO maintains an active relationship with members of society. In the spirit of transparency, the SAO provides regular information on the SAO News Portal on statistics related to announcements of public interest and complaints. The risk analysis-based topic selection system lays the foundation for half-year audit plans through the complex processing of information from internal and external sources. The risks uncovered and identified through announcements of public interest, which qualify as external information sources, have a decisive role in audit topic selection. The SAO, therefore, ensures that society does have an impact on audit programmes. In line with announcements of public interest and complaints, in 2013, the SAO again paid close attention to the auditing of the local government sub-system, in particular the auditing of local government asset management, financial standing and the setting up of the internal control system.

## 2.1.5. Domestic relations supporting professional activities

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Following the renewal of institutional relationships and the expansion of the framework of cooperations, the objective of the SAO is to develop the level of quality of the networks of contact, as a result of which the partnerships established with certain Hungarian institutions and organisations may be enhanced. In addition, the SAO also paid particular attention to increasingly utilise the opportunities provided by the existing cooperation with institutions that are training future generations. The key to the social utilisation of domestic relations is ongoing professional dialogue, a high level of academic recognition and active representation, which together increase the organisation's credibility.

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### Cooperation with professional organisations

In June 2013, the President of the SAO and the *President of the Association of Hungarian Internal Auditors* concluded an agreement on the further development of cooperation, which lays the foundation for improving the quality of the cooperation agreement signed in December 2010. In the interest of more efficient cooperation in the future, the two organisations will prepare the annual operating schedule of cooperation. Within the framework of the **existing cooperation** with the *Public Benefit Association of Hungarian Financial and Economic Auditors* (hereinafter: MPGEKE), representatives of the SAO have held lectures at a number of the association's departmental conferences, in such current

topics as audits related to national assets or social security funds. In recent years as well as in 2013, the SAO hosted several MPGEKE conferences.

### **Close cooperation with local government associations**

In the interest of improving the quality of the **cooperation agreement concluded with six local government associations** in November 2010, the President of the SAO holds professional consultations with the heads of these associations on an annual basis. The aim of these consultations is to provide regular information to local government associations regarding the SAO's professional ideas in connection with local governments, and to provide an opportunity for associations to raise other possibilities for cooperation.



### **Relations in the service of sustainable development**

The SAO places great emphasis on establishing closer cooperation with National Assembly committees. It considers it its mission to contribute to the accomplishment of environmental protection goals through its audit experiences, thereby supporting sustainable development. Accordingly, the president of the SAO and the chairman of the Sustainable Development Committee of the National Assembly – who is also the honorary chairman of the National Sustainable Development Council – have agreed to make cooperation tighter, in the interest of ensuring the realisation of sustainability goals.

### **Professional lectures**

The senior officers of the SAO attended several conferences as lecturers in order to disseminate SAO experiences as widely as possible. In 2013, the SAO attended, amongst others, the 21st National Accounting Conference; conferences organised by the National University of Public Service, the University of West Hungary and the University of Pécs; the 20th Hungarian Healthcare Days; MÁV Zrt's professional conference and the Asset Management Roadshow organised by MNV Zrt.

This shows that in 2013, we again shared our audit experiences at several professional forums, thereby supporting the promotion of the development of public finances.

### **Cooperation between SAO and the Hungarian Academy of Sciences in the spirit of science**

In addition to improving the quality of cooperation with various organisations and institutions, in 2013, the SAO also strived to expand its network of contacts. We must highlight the commencement of the preparation of the cooperation agreement with the Hungarian Academy of Sciences, the foundation for which was laid down by the meeting of the heads of the two organisations. Based on the cooperation objectives set out at the meeting, the contact persons began the preparation of the cooperation agreement by *sharing the experiences gained in methodological cooperation and institutional communication*.

### **Religious meetings**

The objective of the meetings with the senior officials of the *Catholic Church in Hungary*, the *Reformed Church in Hungary* and the *Evangelical-Lutheran Church in Hungary* was for the SAO to contribute to the effective and efficient management of public funds of institutions performing public tasks.

## 2.1.6. Procedures initiated during audits

The entering into force of the SAO Act required a change of approach on the part of audited entities as well, as the breach of cooperation obligations now carries grave sanctions. In line with the above, the Penal Code names the actual legal circumstances that comprise a breach of obligations as of 1 January 2012 related to state audit office audits. Pursuant to this, the SAO may seek assistance from the investigating authorities in relation to the breach of the obligation to cooperate. We must note that with the adoption of the new SAO Act, an agency-type supreme financial control body has been created. Accordingly, the SAO has no investigating powers or tools at its disposal.

### Obligation of cooperation

Pursuant to Article 28 of the SAO Act, the audited body is under obligation to cooperate during the full term of the SAO audit. In 2013, the SAO contacted the investigating authorities on two occasions on account of a breach of the obligation to cooperate during the audit phase. We can, therefore, determine that – given the revised legal framework – audited entities pay increased attention to fulfil their obligations to cooperate, thus an improving tendency may be observed.

#### WHAT IS AN OFFICE-TYPE SUPREME FINANCIAL CONTROL BODY?

**Office-type** supreme financial control bodies (state audit offices) have no direct sanctioning powers in connection with the audit findings; however, they may initiate the relevant proceedings to enforce the legal consequences at the competent body.

### Personal liability

Articles 1(5) and 30(1) enable the SAO to indicate to the competent investigating authorities if during any of its audits it discovers circumstances suggesting

personal liability. In 2013, the SAO sent indications to investigating authorities a total of 23 times. Following the indication by the SAO, these investigating authorities take matters into their hands and act.

### Close cooperation

The SAO supports the work of the investigating authorities, courts and other authorities by responding to official requests. In 2013, the SAO responded to 38 official requests.

### Opening of public procurement legal remedy proceedings

Pursuant to Article 23 (2) of the SAO Act and Paragraph b) of Article 140 (1) of Act CVIII of 2011, the SAO may initiate legal remedy proceedings in connection with the infringements brought to its attention in the scope of its activities. In 2013, the SAO initiated legal remedy procedures in eight cases, and in another eight cases this was not possible due to the expiration of the limitation period.

### Investigations in progress

There are 29 ongoing investigations after the reports filed and indications made by the SAO of Hungary to the Prosecutors' Office in previous years.

### Utilisation as a result of indication by prosecutors

The promotion of the regularity of public finances is an objective of the SAO set out in its strategy, and an essential condition of this is that public funds should only be used by organisations that operate in a transparent manner. The SAO sent its report on the legal compliance audit of a foundation's financial management for 2009-2010 to the public prosecutor's office, and requested that they open proceedings in a legal compliance supervisory capacity. The prosecutor's office examined the criteria of opening proceedings and determined that the



foundation in question is not in operation and has no actual registered seat. As a result of the prosecutor proceedings, the Metropolitan Court of Budapest, with its decision entering into force on 19 July 2013, terminated the foundation. This shows that SAO findings may also be utilised by way of proceedings initiated during audits, thereby establishing the regularity of public finances.

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**With respect to relations with investigative authorities**

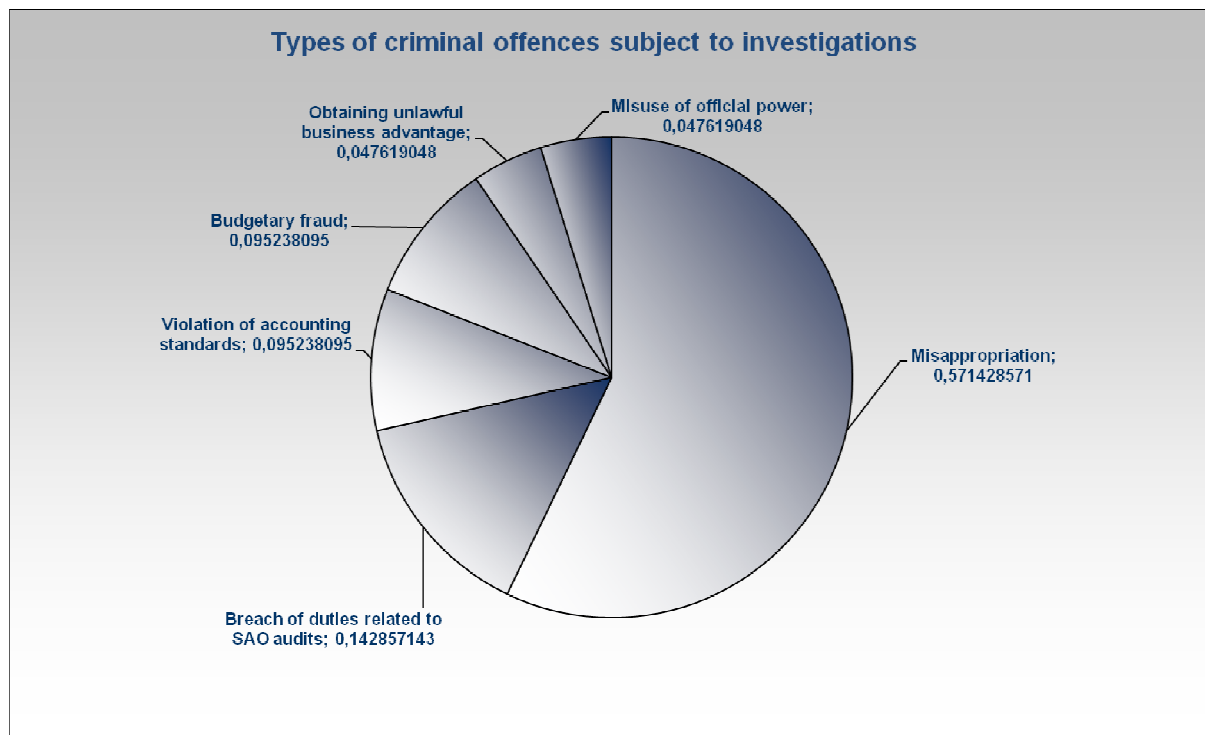
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|           |   |
|-----------|---|
| <b>23</b> | indications sent to investigative authorities |
| <b>38</b> | responses to official requests                |
| <b>8</b>  | legal remedy proceedings initiated            |

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**OUR PERFORMANCE IN NUMBERS**

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**Chart 6**

## 2.2. Government auditing

### 2.2.1. Audit topic selection and planning

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The SAO's revised topic selection and planning system takes the objectives set out in the strategy into consideration. Through their topic selection, approach and attained results, the audits must create added value. In order to accomplish this, targeted and timely audits must be carried out which, by focusing on current social and economic problems, are able to contribute to 'good governance' and the promotion of the transparency and regularity of public finances. Risk analysis-based topic selection reflects the holistic approach and continues to be one of the foundations of the preparation of audit plans.

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#### Topic selection based on risk analysis

In its institutional strategy, the SAO has set out that the selection of audit topics that relies more heavily on the findings of risk analysis and evaluation serves to improve audit quality and efficiency. Accordingly, a *new risk analysis system was developed*, which supports audit topic selection. This approach ensures that the preparation of audit topic selection and the compilation of audit programmes are performed according to a regulated, uniform and professionally sound process. The revised topic selection system lays the foundation for the preparation of SAO audit plans through the *complex processing of information* from internal and external sources. The internal information base is made up of the experiences of earlier and ongoing audits, as well as topic proposals for analyses. This is supplemented by external information, primarily from the National Assembly and the media. We view announcements of public interest, complaints and the results of public surveys as important external indications.

On the basis of this, the most emphatic foci of the auditing of various organisations are: finances, asset management, organisational control and the status of internal controls. Areas less quantifiable, such as integrity, were also integrated into the system developed, which area for example has been an emphatic area of the SAO's advisory activity for years. During the risk analysis of the various areas, we identified critical areas and topics that serve as a basis for determining the topics, objectives and focus areas of audits. As a result, areas that are timely and generate public interest, and that are most relevant for citizens and the entities involved can now be included in SAO audits. Last but not least, this serves as the foundation for the efficient utilisation of limited audit resources as well as the desired social utilisation of audits.

#### Risk Analysis Department

One of the most important elements of the renewal of the SAO was the setting up of the Risk Analysis Department (RAD). One of the main tasks of the RAD established in 2012 is also to operate the above outlined risk analysis system. In addition, risk analysis also supports the selection of audit sites. In addition to preparing the preliminary studies that serve as a basis for audit programme compilation, the RAD is also tasked with coordinating the preparation of analyses and studies. The objective of the latter is, amongst others, to map out priority areas of the public sector and public fund utilisation, the uncovering of internal and external correlations, and to assess regulatory, operating and structural changes and tendencies and to evaluate their impact. The utilisation of analyses can be observed on the one hand in audit topic selection and the preparation of audit plans and risk maps of the analysed areas.

In addition, these analyses contribute to reinforcing the professional reputation of the SAO.

#### WHAT IS A PRELIMINARY STUDY?

A **preliminary study** is an audit document that lays the foundation for the preparation of audit programmes, which presents all relevant information concerning the topic, uncovers the risks, determines the objective, focus areas, type and period of a possible audit, as well as the organisations involved and the expected utilisation of said audit.

#### Holistic approach

It is the SAO's goal to *conduct audits with a systemic/holistic approach* that are built on one another (exploiting the synergy effect), that allow summary evaluations. Accordingly, determining which topics the holistic approach can be applied to is an important aspect when selecting audit topics. The SAO first applied this approach during the auditing of the Hungarian disaster management system, which is among the most socially useful audits of recent years.

#### WHAT IS THE HOLISTIC AUDIT APPROACH?

In case of a **holistic audit approach**, we are talking about an audit that covers an entire system or an entire projection of a system, which — through the uncovering of system errors and findings that require action — is able to contribute to the efficient, effective and economical operation of the system.

#### Rolling planning

The SAO — in harmony with its strategy — has *transformed* its audit planning system into *rolling planning* as of 2011. This flexible planning method on the one hand makes risk analysis continuous, and on the other, is suitable to bring planning and implementation closer in time. As part of rolling planning, the SAO compiles its audit plan every six months.

#### WHAT IS THE ESSENCE OF ROLLING PLANNING?

**Rolling planning** is a flexible planning technology that, by making risk assessment and evaluation continuous, is suitable to provide a temporal approach to planning and implementation with a specific time period shorter than one year. From an audit perspective, this method allows for swifter utilisation, and the performance of audits that are more efficient, more effective and socially more useful.

#### Audit plans

The audit plan of the SAO for the first half of 2013 contained 41 audit titles, of which 16 were rolled over from the previous year. Of the 25 new audit topics in total, there were 11 audits to be performed by law on an annual (biennial) basis. The audit plan of the SAO for the second half of 2013 contained nine new audit topics.

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### OUR PERFORMANCE IN NUMBERS

With respect to audit planning

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|    |                       |
|----|-----------------------|
| 2  | half-year audit plans |
| 34 | new audit titles      |

## 2.2.2. Audit of the central subsystem

In compliance with its statutory obligation, within the framework of the auditing of the central sub-system, the State Audit Office of Hungary carried out the audit of the bill on the execution of the 2012 budget of Hungary. In line with its strategy, the SAO included new areas and new institutions in its audits, at the same time increasing audit coverage. Our objective was for the findings of our report on the final accounts audit to contribute, in line with the provisions and spirit of the SAO Act, to the establishment of a well-controlled state and the reinforcement of ‘good governance’. As part of the final accounts audit, we continued to place great emphasis on evaluating the establishment and operation of the internal control system. In the 2013 audit plans, several audit titles concerned the institutions of the central sub-system, the SAO reports on which will be made public in 2014.

### Results achieved

In recent years, the SAO revised the final accounts audit, and in 2013 it once again set as an objective to increase reliability and increasingly support ‘good governance’ through its audit. To this end, we also included new areas and new institutions in the audit selected on the basis of risk analysis. This allowed us to expand the range of institutions included in the accountability of public funds compared to the year before. As another step forward, it was the first time that we had reviewed the process of compiling the bill on the final accounts.

### Increasing coverage

Each year, the SAO strives to increase the coverage of the final accounts audit, thereby increasing the transparency of processes from year to year. The audit covered 97 per cent of the total revenue and 91 per cent of the total expenditure of

the central sub-system, and we also increased the audit coverage by more than HUF 140 billion compared to 2012. Contributing to this result was the fact that the final accounts audit also covered the whole of one of the most complex chapters, namely the Ministry of Public Administration and Justice (KIM) and its institutions (432 institutions and 37 chapter-managed appropriations).

### WHAT DOES THE SAO CHECK AS PART OF THE FINAL ACCOUNTS AUDIT?

As part of the **final accounts audit**, the SAO – pursuant to Article 5(7) of Act LXVI of 2011 on the State Audit Office of Hungary – evaluates the reliability of the bill on the execution of the Hungarian budget, as well as whether the financial statements and accounts that serve as the basis for the bill contain material errors that impact reliability. The SAO also audits whether the execution of the budget act was lawful and in line with regulations and whether the audited entities’ management of public funds was regular and within the frameworks of mandates granted.

### Substantiation and reliability

Our audit has concluded that the execution of the 2012 central budget was in compliance with regulatory provisions, and that the data of statements and accounts support the data contained in the bill. Based on this, we concluded that the final accounts bill was substantiated and data in the bill were reliable.

### Improving reliability

We audited a total of 105 statements and accounts in respect of 2012 and issued a qualified opinion in three cases. Our audit for the year 2011 also affected 105 statements and accounts, with five qualified opinions and one adverse opinion issued. This means that the regularity of the execution of the budget and the reliability of financial statements improved. This improving tendency shows that the SAO is heading in the right

direction and its audits do contribute to 'good governance'.

### **Improving indicators**

According to the bill on the final accounts, the 2012 cash deficit of the central sub-system of public finances was HUF 598.6 billion, which is one third of the 2011 deficit. Based on comparing data in every year, the central budget's primary balance (excluding interest revenues and expenditures), HUF 445.2 billion in 2012, was the most favourable since Hungary's accession to the European Union in 2004. The above support that, all in all, budgetary processes have developed favourably since the year 2011. The central sub-system's 2012 gross debts (HUF 20,720.1 billion) had a 73.3% share in GDP, down 1.8 percentage points (by HUF 235.4 billion) from the previous year. This contributed to the fact that, with respect to the decreasing tendency, public debt was in line with the provisions of the Fundamental Law and the Stability Act. Our audit contributed indirectly to the fact that Hungary's relief from the penalty of the European Union's excessive deficit procedure (ongoing since 2004) in June 2013 was substantiated even on the basis of the audited figures pertaining to 2012.

### **Progress regarding the internal control system as well**

During our audit, we assessed the establishment and operation of the internal control systems of institutions, where 85 per cent of the audited organisations achieved a partially or fully compliant qualification. After the implementation of measures by institutions undertaken to correct deficiencies, the assessment showed 100% compliance. The audit experiences confirmed that the SAO chose the correct direction when expanding the final accounts audit to the internal control system.

### **Accelerating payments**

The government took measures to accelerate the use of EU funds. The acceleration had a partial impact in 2012.

We gave warning that in the absence of measures, the outflow risk remains high in one third of the Operational Programmes (SRP, EAOP, EEOP, SoROP, and SIOP).

### **National Tax and Customs Administration**

Every year, as part of the final accounts audit, the SAO audits the activity of the National Tax and Customs Administration (NTCA), as a considerable portion of revenues is collected by this organisation. The final accounts audit highlighted areas of risk, the auditing of which will be considered a priority by the SAO. One such typical area is the management of delinquent debts, regarding which we concluded that NTCA failed to take measures to initiate tax collection proceedings in respect of HUF 261.8 billion active taxpayer debt. In 2012, the total delinquent debts managed by NTCA amounted to HUF 2,142.7 billion. One third of this was debts owed by active taxpayers, i.e. there is practically no chance of collecting two thirds of uncollected debts.

### **Recommendations**

In our report, we formulated structured comprehensive recommendations: to the president of the NTCA in the interest of setting up a uniform current account system; the Minister of National Economy for the establishment of a system of controls applied during the compilation of the final accounts bill; the Minister of Rural Development to set up an up-to-date registry for the National Land Fund Management Organisation; and finally, to the president of the National Development Agency to establish a document system verifying the aspects of transparency.

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## **OUR PERFORMANCE IN NUMBERS**

**With respect to coverage and recommendations**

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|            |  |
|------------|--|
| <b>140</b> | billion forints is what we increased audit coverage by |
| <b>5</b>   | structured, comprehensive recommendations              |



### 2.2.3. Audit of the local government subsystem

In 2013, the SAO continued thematic local government audits, which extended to the riskiest areas, such as asset management, financial standing and the internal control system. This triple audit focus together represents a unified whole, as finances can only be interpreted well and comprehensively together with assets and debts, and long-term responsible asset management is impossible without efficient regulation and control. In the interest of increasing efficiency, we carried out the auditing of minority local governments using the so-called ‘one-stop shop’ organisational method that was overlaid on thematic local government audits.

#### OUR PERFORMANCE IN NUMBERS

With respect to SAO reports related to the auditing of the local government sub-system

|           |  |
|-----------|--|
| <b>62</b> | SAO reports concerning the local government internal control system              |
| <b>57</b> | SAO reports concerning the financial management of minority local governments    |
| <b>27</b> | SAO reports concerning local government asset management                         |
| <b>25</b> | SAO reports concerning local government financial standing                       |
| <b>3</b>  | SAO reports concerning business associations majority owned by local governments |

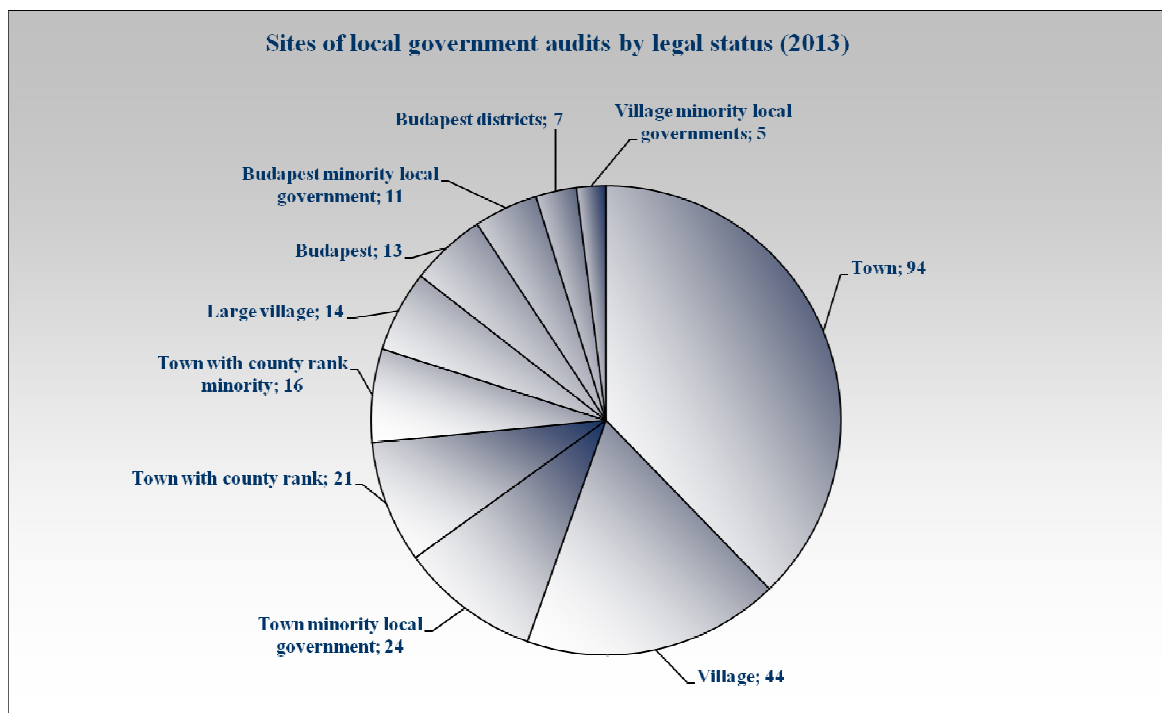
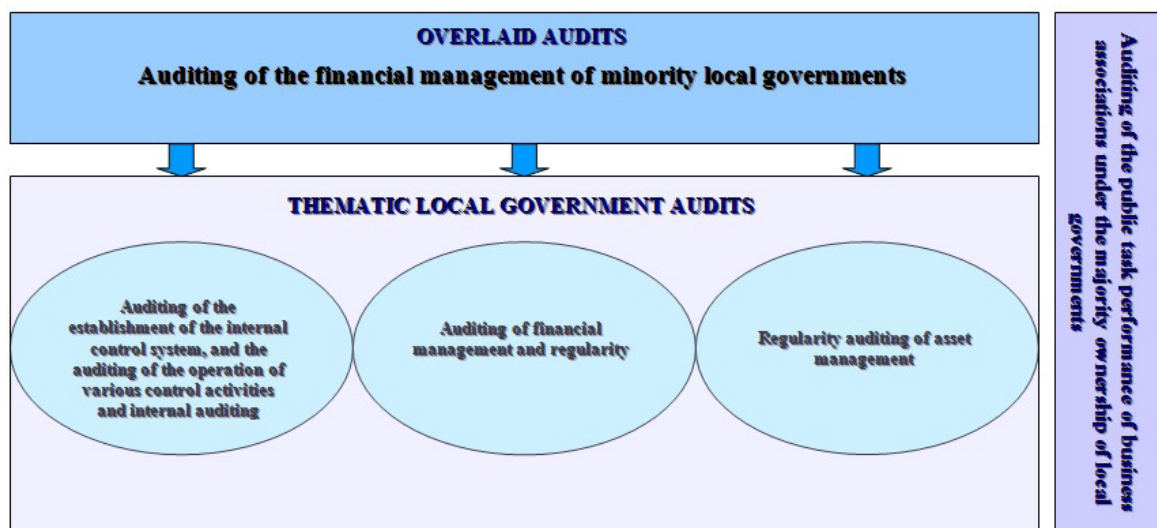


Chart 7



**Chart 8**

**Focus on local governments**

In respect of 2013, 174 SAO reports were issued with local government topics, which represents 90% of all reports made public. By way of our audits, in 2013 we were present at 249 sites. During our local government audits, we applied several methods that contributed to the efficient, economical and effective conducting of audits. In the case of a number of local government topics, the audited organisations had the option to fulfil data supply obligations via an online platform.

**Revised local government reporting format**

In the interest of transparency, clarity and the development of traceability, in 2013 certain elements of SAO reports regarding the local government internal control system were revised. As part of this revision, a clear and easy to understand format was used, which appears in both the summary and the detailed findings section. In the interest of traceability, the numbering of findings was adapted to the question numbers of the statements filled out by local governments. Through the revision of SAO reports in terms of content, we again wish to promote efficiency, as SAO reports are the

fundamental documents of the utilisation of SAO audits.

**Audit of financial standing**

In its medium-term strategy, the SAO set the goals during the audit of local governments of evaluating their financial-economic situation, exploring their risks, and selecting the audit sites on the basis of an objective system of indicators.

The financial management difficulties, increasing liquidity problems and indebtedness within the local government sub-system directed attention to the financial situation of local governments. In the interest of maintaining the budget deficit targets in coming years, it was justified to assign greater emphasis within SAO activity to the analysis of local government financial situations and explore risks impacting equilibrium.

**Goals and results**

The objective of our audit was to evaluate the financial situation and regularity of local governments, to explore the processes impacting the development of financial equilibrium, and to uncover the risks impacting the development of financial equilibrium. By summarising our findings, we presented the risks impacting

the financial equilibrium of local governments that exist in spite of debt consolidation. Through these findings, the audits provide assistance in assessing the financial standing of various local governments, and in taking the local government measures required to restore financial equilibrium. By summing up the information typical of the local government sub-system of public finances, we are able to support the work of the National Assembly in both legislature and the allocation of funds. In 2013, 25 reports were issued and the auditing of another 11 local governments commenced.

### **Risks**

Based on 2013 audit experiences, the four main financial risks impacting the financial equilibrium of local governments — operating, accumulation and default risks, and risks arising from the operation of majority-owned business associations — continue to be present. The following also constituted sources of financial risk: low capacity to generate an operating income, the lack of equilibrium of revenues and expenditures, voluntary tasks undertaken exceeding financial possibilities, and overdue trade payables.

### **After debt consolidation**

Debt consolidation clearly had a favourable effect on the financial equilibrium of local governments. Following debt consolidation, the prevention of the re-accumulation of debt is of key importance. In this respect, the primary task continues to be the establishment and maintenance of operating equilibrium. We support the accomplishment of these goals through our audits. For this reason, during the audits we formulated recommendations, the implementation of which could improve the financial standing of local governments and which, together with debt consolidation, could lead to long-term financial equilibrium. In order to accomplish these goals, in 2013 the SAO

began the scheduled follow-up auditing of towns audited in this topic in 2011. In addition to the above, we continue to point out areas of risk that endanger the establishment or maintenance of financial equilibrium. One such area of risk is indebtedness embodied by overdue trade payables. The audits have shown that due to the necessity of establishing operating equilibrium and the tightening of borrowing conditions, in case of lack of funds, local governments continued to view suppliers as a means of external financing. With respect to this, it was a general experience observed that mayors failed to inform the representative councils in each case about debts that were more than 60 days overdue, and failed to initiate debt settlement proceedings in spite of debts more than 90 days overdue.

### **Internal control system audits**

In line with its strategy, the SAO participates in the identification and application of the efficient and effective means of fight against corruption risks and corruption and in the dissemination of their use as well as in establishing an integrity based administrative culture. The auditing of the internal control system of local governments also serves the accomplishment of these strategic goals.

The performance of SAO audits related to the local government internal control system was justified and timely for several reasons. In recent decades, compliance of the establishment of the whole of the internal control system has not been audited at local governments. Auditing this previously unaudited area was in the interest of society. Decisions made at the local level also affect the everyday lives of citizens, and as such it matters within what internal regulatory framework they were made. One of the main goals of the audit was to promote the regular operation of local governments. In recent years, the SAO systematically audited the financial situation of local governments, and



promoted the establishment of financial equilibrium through its recommendations. The maintenance of this equilibrium, however, can only be accomplished in the long-term if the quality of the financial management of local governments improves. This in turn requires an appropriately established and operated internal control system. It was due to the above that the establishment of the internal control system has become a focus area of thematic local government audits.

## **62 SAO reports**

The SAO began auditing the establishment of the internal control system of local governments in July 2012. In 2013, a total of 62 SAO reports were issued, and in the case of another 40 local governments, audits were in progress. The audit foci selected on the basis of risk analysis confirmed the existence of the risks: with respect to the establishment of the internal control system, 2 out of 62 local governments were in compliance, while in the case of the operation of key controls, five local governments. The operation of internal auditing was non-compliant at 29 out of 62 local governments.

## **Value creating audits**

The objective of all SAO audits is to create value. This can be achieved in a number of ways. In the case of audits concerning the internal control system of local governments, it is added value that the level of regulation of the internal control system and the compliance of operation of audited local governments improves as a result. The operation of the internal control system, in turn, allows for the achievement of statutory objectives. The SAO continuously strives to disseminate ‘good practice’, through which unaudited local governments will also adopt the positive examples. News coverage of audits and reports have a deterrent effect with respect to irregularities, as local governments are realistically forced to take into account that

the probability of the SAO auditing them sooner or later is higher than before.

## **Auditing of local government asset management**

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In the interest of the transparency and publicity of public funds, the SAO considers the auditing of local government asset management especially important.

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Earlier audits – aimed at this particular area - only concerned a few elements of the asset management of local governments. Improving the quality of local government financial management, however, is inconceivable without transparent, appropriately regulated asset management. Accordingly, the SAO has determined a gap-filling audit focus when it directed its attention to the wider auditing of local government asset management. In 2013, the SAO’s audits already evaluated asset management itself, during which we examined the level of regulation of the asset management activity of local governments, as well as the regularity of decisions connected to asset management and changes in assets. In 2013, 27 SAO reports were issued in connection with the regularity audits of local government asset management, and the auditing of the asset management of another 5 villages and 8 Budapest districts was in progress. SAO reports on the auditing of the asset management activity of 7 Budapest districts and 20 villages in total were issued in 2013. According to our audit experience, the absence of the regulation of asset management was especially typical in the cases of local governments where the SAO has not audited internal controls in the past. This also supports the correctness of the triple audit focus (financial standing, internal control system, and asset management) defined by the SAO, as these areas, forming a unified whole, are able to set local government financial management on a sustainable path.

## **Regulatory, record-keeping and disclosure deficiencies**

The majority of the assets of local governments are made up of real estate; therefore, the compliance of real estate records plays a key role. In the majority of cases, there was no exact match between the land registry and the local government's real estate cadastre. We observed discrepancies at asset inventories primarily in the case of assets handed over for operation or management. For the most part, local governments made agreements exceeding HUF net five million public, thereby ensuring transparency. In most cases, however, itemised reports were not disclosed. The local governments essentially regulated the exercising of financial management powers; however, these regulations were often not enforced. Typical deficiencies were that there was no countersigning prior to the undertaking of commitments; issuers of the technical performance certificate had no authorisation; there was no remittance before incurrence of expenditures, and there was no prior written commitment for the given expenditure.

## **Focus on business associations**

The possibility of the comprehensive auditing of local government-owned business associations was established by the amendment of the SAO Act effective as of 2011. In 2011 the first SAO audit was that of the Budapest Transport Company. In 2013, the auditing of three transport companies was concluded with regard to Debrecen, Miskolc and Szeged.

In 2013, the SAO published three reports on the audits of business associations majority owned by local governments. All three business associations were founded in order to perform public transportation tasks. The SAO audited the performance of public tasks by business associations majority owned by local governments for the 2008-2011 period as well as quarters 1-3 of 2012. With its audits, the SAO provides an opportunity for owners to

reinforce ownership controls based on the findings. The **objective of the audit was to assess** whether the local government performed its task in a clear and accountable manner; whether it ensured the public assets required for the performance of the public function to the business association performing said function; did the business association accomplish the goals and perform the tasks set out by the owner through the regular utilisation of available resources; was the business association's operation and asset management supervised by the owners with due diligence; and furthermore, in the audited period, did the business association comply with the statutory provisions and local regulations concerning the management of assets.



During the audits, we determined that the public assets required to provide public transportation were ensured and available. During the audits, we also uncovered deficiencies related to the exercising of ownership rights as well as irregularities concerning investment.

## **Auditing of minority local governments**

Through the auditing of minority local governments and the recommendations made to them, the SAO wished to promote regular financial management in an area previously unaudited. Furthermore, it is also a priority objective of the SAO to audit areas the legal framework of which has changed. The launching of the audits, therefore, was justified by the fact that in recent years, the statutes governing the tasks, financial management and grant system of minority local governments were considerably amended.

In 2013, the SAO published 57 SAO reports and the auditing of the financial management and task performance of minority local governments was in progress at another 153 local governments. The objective of the regularity audit concerning the years 2011-2012 was to determine whether the establishment, financial management and task performance of the financial management framework of minority local governments was in compliance with effective statutes.

### **Typical errors and deficiencies**

Of the 57 audited minority local governments, four did not have effective agreements for cooperating with the local government; furthermore, close to two thirds of agreements were incomplete at minority local governments in terms of the tasks, persons responsible and deadlines related to financial management. The level of regulation of financial management and the establishment of operating financial management powers was inadequate at more than half of minority local governments.

As a result of regulatory deficiencies, the financial key controls did not function adequately, the notaries failed to ensure the internal auditing of implementation tasks related to the financial management of minority local governments.



One of the general errors was that in spite of the provisions of the government decree on grants, the audited minority local governments did not fulfil their accounting obligations concerning the utilisation of task-based grants. This was in part due to the fact that the utilisation and accounting of task-based grants was not verified by the bodies authorised to do so prior to the commencement of the SAO's audit.

## 2.2.4. Audit of the management of national assets

Pursuant to statutory requirement, the SAO audits the exercising of ownership rights over state property on an annual basis. In 2013, we carried out this audit with a new approach and focused on the control system of the exercising of rights. In 2012, the number of organisations exercising ownership rights increased by two, and as a result, the range of audited entities expanded compared to previous years.

### New approach

During the audit reviewing the year 2012, we employed a new approach by essentially evaluating the control system of the exercising of ownership rights over state property. The new approach provided a comprehensive picture on the status of controls of the exercising of ownership rights; the audit contributed to strengthening the control system over state property.

### Control system

We concluded that in 2012, the performance of activities related to the management of state assets and the control system of the exercising of ownership rights was supported only to a limited extent. We repeatedly raised objections that the content elements of the government statement on the operation of organisations exercising ownership rights, on the changes of the volume of state property and on the processes of the management of state assets were not defined clearly.

### Hungarian National Asset Management Inc.

Hungarian National Asset Management Inc. (MNV) regulated the controlling tasks concerning its asset management in detail; it identified the risks of the management of the corporate portfolio and took these risks into account when establishing the monitoring system. The MNV prepared the

asset management plan set out by law regarding the assets entrusted to it, which plan was approved by the Minister of National Development; at the same time however, the MNV failed to set up a management and control system to review and update asset management agreements concluded earlier with managers of state assets. It failed to assess the measures required to eliminate the deficiencies of the asset management contract portfolio, and did not comprehensively set up the controls of free assets transfers. The reporting system for organisations taking over real estate was also missing. The auditor attached a qualified audit opinion to the 2012 statement on the assets entrusted to the MNV.

### National Land Fund Management Organisation (NFA)

The establishment and operation of the internal control system of the National Land Fund Management Organisation improved compared to 2011, however, it was still not comprehensive in 2012 either. Due to deficiencies of form and content, the statement on the enforcement of land policy directives, the situation of the National Land Fund and the activity of the NFA were not comprehensive. The NFA did not regulate the accounting record policy for the assets entrusted to it; it failed to issue an IT security regulation or an internal data protection and data security regulation, and did not develop the procedures for the management of irregularities. As good practice, the missing regulations were completed. The long-term controls concerning the land managed by the National Parks and the asset management agreements concluded with 19 forestry companies were not established either.

### Hungarian Development Bank

The Hungarian Development Bank (MFB) has developed the data supply procedure



for companies that fall under the scope of its exercising of rights, and based on data supply and statements, it was already in possession of the information that serves as a basis for ownership control and decisions. The MFB has developed its strategic plan for 2011-2015 as well as its asset management plan for 2012. It also compiled the 2012 statement of the assets entrusted to it by the deadline set.

### **Support of the exercising of ownership rights**

The findings of ownership audits at the MNV and the MFB supported the exercising of ownership rights. The asset inventory providing reliable, authentic and comprehensive information that

comprehensively supports the control activities of the exercising of ownership rights of the management of state assets was again unavailable in 2012 at both the MNV and the NFA.

### **Recommendations in the interest of the appropriate establishment of the control system of the exercising of rights**

The SAO recommended that the Minister of National Development establish priority controls for the asset management of forestry companies, that the CEO of MNV Zrt. and the President of the NFA set up a control system that ensures the constant reviewing of asset management agreements, and that the President of the NFA develop the missing regulations.

## **2.2.5. Audit of grants from public funds at the beneficiary organisations**

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**In 2013, the SAO again placed great emphasis on auditing the utilisation of grants provided from public finances. The audits carried out covered a wide range of public function performance as well as the use of domestic and European Union grants.**

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### **Hospital diagnosis**

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The financial situation of hospitals, the changes impacting the healthcare system and the extraordinary grants provided to the sector justified that the State Audit Office of Hungary audit the utilisation of funds spent on the operation of hospital care provision.

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Regarding the period between 2009 and the first half of 2012, the SAO audited the utilisation of funds spent on the operation of hospital care provision at 20 hospitals. The report showed that the state consolidation carried out in 2010 and 2011 improved the financial equilibrium of hospitals, however, was unable to prevent the re-accumulation of debt in the long-term. The SAO supports the establishment of financial equilibrium at the audited

hospitals through its audits and recommendations.

### **Financial situation improves, but the replacement of instruments has not occurred**

All in all, the financial equilibrium of the audited hospitals was not ensured between 2009 and 2011. The liquidity problems and payment delays remained. At the same time, as a result of the increase of care financing, the measures taken to increase own revenues and decrease expenditures as well as consolidation grants, the financial situation of institutions improved. The vast majority of audited hospitals did not generate sufficient coverage to implement investments and developments. The fact that instruments were not replaced endangers the safe continuation of future operating activity. The missing funds were financed by certain hospitals from revenues from their own operation, putting secure operation at risk.

### **Public grants on the rise**

The amount of revenues serving to finance operations increased continuously between 2009 and 2011. The grants provided by the

National Health Insurance Fund were significant every year, and increased from 2009 to 2011 at all 20 hospitals (by 10%, approximately HUF 9 billion). The nominal increase in revenues from the Health Insurance Fund, at the same time, was unable to exert a positive effect on financial management as the real value of these revenues dropped by 58.8%. The total grants disbursed by the National Health Insurance Fund did not provide coverage at the majority of hospitals for the direct costs of economic activity, technical care provision and medical activity. This indicates operating risk.

### **Differing practices, missing prime cost calculations**

Hospitals employed different accounting methods and IT systems to book economic events and interpreted economically minded approaches in different ways. Due to the lack of prime cost calculations and follow up calculations, the actual costs of various healthcare services are unknown. The SAO wishes to support the establishment of transparent and substantiated prime cost calculation through its audits and recommendations. In the case of public services, this is an area of key importance as the prices of public services cannot be determined appropriately without well established prime cost calculations.

### **Recommendations in the interest of more efficient and transparent operation**

The SAO recommended that the Minister of Human Resources take steps in the interest of hospitals determining the cost of services offered by them using an economically minded approach and on the basis of standard prime cost calculation. The SAO recommended that the Director General of GYEMSZI (National Institute for Quality- and Organisational Development in Healthcare and Medicines), which was responsible for maintaining the institutions as of 2012,

examine the development activity of hospitals and take steps in order to uncover the reasons behind the lack of financial equilibrium. Based on these, the Director General should have hospital directors prepare action plans to establish equilibrium in financial management and supervise the implementation of these action plans.

### **Focus on economic chambers**

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Through its audits, the SAO is also looking to reach areas which, by way of increasing competitiveness, could contribute to GDP growth. With this new approach, the SAO would be able to promote the fulfilment of constitutional obligations related to the public debt ratio. One of the tools of the above is if students gain professional experience at enterprises, thereby acquiring competitive knowledge. In order for this to be realised, however, the objectives set by vocational training policy must be enforced in practice as well. One of the added values of the audit was the fact that during the auditing of economic chambers, we also audited the utilisation of vocational contributions at companies organising practical training courses. In this case, the SAO again audited an area where the auditing of the utilisation of billions of HUF in grants was incomplete or inadequate.

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Since the entry into force of the Act on Economic Chambers in 1999, the SAO has not audited the utilisation of budgetary grants provided for the performance of the public functions of chambers. Our 2012 report on the auditing of vocational contributions, at the same time, uncovered grave deficiencies in connection with the tasks of economic chambers related to vocational training. Based on the above, the auditing of the utilisation of budgetary grants provided for the performance of the public functions of economic chambers and the auditing of eligible costs during the performance of vocational contributions at business associations organising practical

training courses for the period 2009-2011 was justified.

### **Lack of conditions ensuring transparency and accountability**

The subsidy contracts concerning the public function performance of national economic chambers failed to establish the conditions of transparent and accountable public fund utilisation as they did not set out the audit tasks and regulations of the utilisation of budgetary grants for economic chambers. Of the randomly selected 87 audited economic organisations, in the case of 30, the regular attendance, absence and evaluation of students at practical sessions was not certified due to the lack of session logs or incomplete record-keeping.

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## **OUR PERFORMANCE IN NUMBERS**

**With respect to audited entities**

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|           |                                    |
|-----------|------------------------------------|
| <b>2</b>  | audited ministries                 |
| <b>2</b>  | audited national economic chambers |
| <b>16</b> | audited regional economic chambers |
| <b>87</b> | audited business organisations     |

### **Irregular use of grants**

At seven of the 16 regional chambers audited, the utilisation of grants was irregular due to the lack of separate records and the irregularities of remittance. As a result of the incomplete regulation of human resource requirements, the conflicts of interest of staff at two national chambers and one regional chamber were unregulated.

### **Infringements and audit deficiencies**

During the audit of the 87 economic organisations participating in practical training, the SAO uncovered infringements in connection with the declaration of vocational training contribution and related record-keeping at 50 organisations. In the

audited period, the organisations not keeping session logs or keeping incomplete logs booked approximately HUF 2.2 billion as performance of their vocational training contribution and as a result, reclaimed close to HUF 850 million. The declarations of vocational training contribution for 2009-2011 were not audited on-site by the National Institute of Vocational and Adult Education (NIVE), which only carried out formal and arithmetic control, which increases the risk of the collection of state revenues.

### **Focus on regional and micro-regional development councils**

The SAO wishes to promote the accomplishment of goals set out in regional development concepts through its audits. One of the main criteria of SAO audits is to audit areas of current relevance for legislature. The SAO report on the auditing of regional and micro-regional development councils was characterised by a high degree of utilisation by legislature. The findings and recommendations recorded in the related report were taken into account during the preparation of the amendment of the Act on Regional Development and Regional Planning. With the adoption of the amendment by the National Assembly, the utilisation of the SAO report was completed and it contributed to establishing a unified, overlaid planning framework that ensures the harmonised utilisation of domestic and EU funds.

As part of the auditing of the fund allocation activities of regional and micro-regional development councils, the State Audit Office of Hungary carried out on-site checks at two ministries, three regional development agencies and 22 multi-purpose micro-regional associations. The SAO audited the decentralised decision-making of development policy, as well as the allocation of close to HUF 50 billion in domestic funds. The objective of the audit was to assess whether the allocation of

funds with the participation of regional and micro-regional development councils was regular, and whether it contributed to accomplishing the goals set out in various level regional development concepts. The audit covered the years 2007-2011.

**The audited period was characterised by centralisation**

The SAO concluded that the enforcement of subsidiarity, decentralisation and regionalism, as set out in the National Development Policy Concept (NDPC) as basic principles of development policy, were not appropriately supported by the established organisational and regulatory frameworks in the audited period. Decentralisation and true regionalism were not realised. The development policies of regional and micro-regional levels were not assigned adequate emphasis in implementation. Despite the directions of development of institutions and tools set out in the National Regional Development Concept (NRDC), the expansion of the role of the regional level in development policy or the strengthening of the micro-regional level was never realised.

**Lack of a standard approach**

The audit concluded that in 2011, 63.2% of micro-regions had effective micro-regional regional development concepts, and 44.8% had medium-term regional development programmes. The deficiencies of statutory regulation contributed to the fact that at the multi-purpose micro-regional associations (MPMRA) audited, the regional development concepts were prepared at different times (between 2002 and 2009) and durations also differed (from three years to undefined durations). This showed that a standard approach was not ensured by statutes.

**Unrealised ministerial statement**

The regional development councils and the MPMRAs, responsible for micro-regional development council functions, prepared the statements set out by law as well as in the agreements concluded with the Minister responsible for regional development. In the audited period, the Minister responsible for regional development – disregarding the provisions of the act – failed to report annually to the Government on the operation of development councils.

**Inadequately audited task performance**

The legal compliance supervision of development councils primarily manifested itself in the review of records submitted and attendance at council meetings. The task performance of development councils was not systematically audited by external auditing bodies between 2007 and 2011. In this case, the SAO again audited an area where the auditing of the utilisation of public funds was not comprehensively resolved.

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**OUR PERFORMANCE IN NUMBERS**  
With respect to audited entities

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|           |   |
|-----------|---|
| <b>2</b>  | audited ministries                                |
| <b>3</b>  | audited regional development agencies             |
| <b>22</b> | audited multi-purpose micro-regional associations |



## 2.2.6. Audits with limited auditing powers

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This includes the legality audits of the financial management of political parties and party foundations, the utilisation of election campaign funds as well as the operation of the National Bank of Hungary (MNB). With respect to parties and party foundations, the problems arising out of the deficiencies of the legal framework and the contradictions of the various acts have been unresolved for years; therefore, in 2013, the State Audit Office of Hungary placed special emphasis on cooperation with the competent committee of the National Assembly. Based on its legal mandate, the SAO audited the MNB's financial management every year, with the goal of supporting more efficient and transparent task performance by the MNB and more economical use of public funds.

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### Focus on the financial management of political parties

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In 2013, the legality audits of the financial management of parties again confirmed the contradictions of the accounting and reporting system of political parties, which contradictions have been indicated for close to a decade.

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### Non-parliamentary parties

In 2013, the SAO also directed its attention to the financial management of non-Parliamentary political parties that do not receive state grants and determined significant insolvency risk. The State Property Act of 2007 ensured parliamentary parties at the time preferential loans of hundreds of millions of forints for the purchase of state property, regarding which the audit concluded that the parties losing state support completely or in part, having

disregarded repayment obligations and accumulated unmanageable levels of debt. In connection with this, the SAO determined the endangerment of state property, as the statutory guarantees of property protection, the preservation of property conditions and intended use are unregulated.

### Deficiencies of the Party Act

The legality audits of the financial management of parties confirmed the deficiencies of the Party Act. The annual financial statements that are required of parties by law do not ensure the transparency, comparability and evaluability of financial management as the provisions of the Party Act do not take the standardised requirement of the Accounting Act into account. There are provisions missing from the Party Act required for the reliable information of the public, such as mandatory audits, the employment of a certified accountant or the consequences of failure to comply with the publication obligations. The Party Act also has a number of deficiencies concerning non-parliamentary political parties that do not receive state grants. There are no rules currently in the Party Act governing the management of debts accumulated in the course of the financial management of these parties nor is there a procedure in place to handle the resulting insolvency and outstanding public debt payment obligations. In addition to requiring the audited entity to pay the illegal revenues discovered by the SAO into the central budget — due to the termination of the organisation's right to receive government funding — there is no way to reduce the government funding by the same amount.

## **WHAT ARE AUDITS WITH LIMITED AUDITING POWERS?**

In the case of **audits with limited auditing powers**, the law limits the SAO's auditing powers. In practice this means that in the case of the MNB, the SAO's audit cannot cover the core activity of the central bank or monetary policy. A similar restriction is enforced in the case of the auditing of the use of funds intended for the election of Members of Parliament as the SAO's powers only allow this at the nominating organisations. For understandable reasons, the scope of the legality audit tasks of the SAO do not cover the obligations of expedient financial management.

### **Auditing the financial management of party foundations**

In its reports on the legality audits of the financial management of party foundations, the SAO again pointed out regulatory deficiencies, including the fact that the law prescribes no sanctions for failing to disclose reports on annual activity.

### **Before National Assembly committees**

The Audit Office and Budget Committee of the National Assembly discussed two reports on party audits. At the committee meeting, the SAO presented to MPs the recommendations that would ensure transparency and comparability, and would improve the reliability of party statements. The State Audit Office of Hungary, therefore, through its audits supports the National Assembly in the revision of the Party Act.

### **Audit of the National Bank of Hungary**

The audit carried out at the National Bank of Hungary relied upon the methodology that was updated in accordance with the international standards. The SAO audited, for the first time, the MNB's exercising of ownership rights over the Pénzjegynyomda Zrt. and Pénzverő Zrt. fully owned (100%) by the MNB as well as the central budget-related accounting statements of these

companies. As a result, the audit directed attention to the deficiency of the legal framework concerning the responsible financial management of public funds, and pointed out two instances of unlawful operation.



### **Unlawful data supply**

The SAO concluded that there were two aspects in which the operation of the MNB was unlawful. The document handling practice of the MNB did not comply with the statutory requirements until December of 2012, and in addition, between 2008 and 2010, the MNB disclosed data, without authorisation, qualifying as business secrets to the IMF. The Bank's document management software did not have the required certification. It was unlawful how the MNB, violating the provisions of the Credit Institution Act, disclosed data qualifying as business secrets to the IMF concerning loans drawn down by the Hungarian state from international organisations.

### **Committee resolution on irregularities**

At its meeting on 25 February 2013, the Audit Office and Budget Committee of the National Assembly placed on its agenda the SAO report published on 13 February 2013, on the audit of the regularity of the operation of the MNB as well as the central budget-related accounting statements. Based on the justification of the resolution passed with 18 votes for and 4 against, the MNB violated the provisions of Article 49 of the Credit Institution Act when it provided data to the IMF on a

weekly basis on the financing situation, net foreign currency position and currency swap transactions of the seven largest banks.

### **Swift utilisation**

One of the main aspirations of the SAO is to make an actual impact through its audits on the given audited entity and to promote the effective and efficient utilisation of public funds. The outgoing management took measures to review the personal liability concerning the illegal handing over of data and the regularity of document management. In the interest of investigating the infringements uncovered by the SAO at the MNB, the new management of the central bank initiated the immediate and comprehensive audit of

the operating area. As a result, a 25 per cent reduction of the HUF 1 billion premium and bonus pool (objected to during the SAO audit) was initiated at the MNB. In the interest of reducing operating costs, the MNB proposed a 20 per cent cost reduction concerning the area of operation, which must be implemented within two years.

On the basis of the SAO report, the Board of Directors of the MNB decided to take further cost efficiency measures, which extend to terminating unnecessary external advisory agreements, suspending outsourcing and initiating the restructuring of the wage structure.

## **2.2.7. Performance audits**

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**The constitutional obligations set out in the Fundamental Law of Hungary aimed at reducing public debt and the public debt rules set out in the Stability Act all point in the direction that the era of overspending has come to an end, which at the same time also means that the users of public funds must shift their attention to quality criteria. Budgetary discipline requires that those managing public funds use available resources more efficiently, more economically and more effectively. Accordingly, the SAO has also paid special attention to performance audits.**

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### **Auditing in the spirit of sustainable development**

The SAO considers it its mission to contribute to the accomplishment of environmental protection goals through its audit experiences and analyses, thereby supporting sustainable development. In line with this approach, on 20 February 2013, the State Audit Office of Hungary published its report on the utilisation of

funds spent on the development of the cycle route network.

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### **Framework-type goals, lack of coordination**

The goals of cyclist infrastructure developments were laid down as a framework by the National Assembly, but no detailed action plan was prepared regarding implementation. The domestic and EU tenders that served the accomplishment of goals were not harmonised and were manifold. Between 2004 and 2012, a total of HUF 46.3 billion of EU and domestic grants were available to establish cycle routes. Of this, until the first half of 2012, 708.5 km of cycle routes were laid down using HUF 19.5 billion. Despite the fragmented tendering system, the completed investments contributed to the accomplishment of objectives set out in the various programmes and sectoral concepts.

#### **WHAT IS A PERFORMANCE AUDIT?**

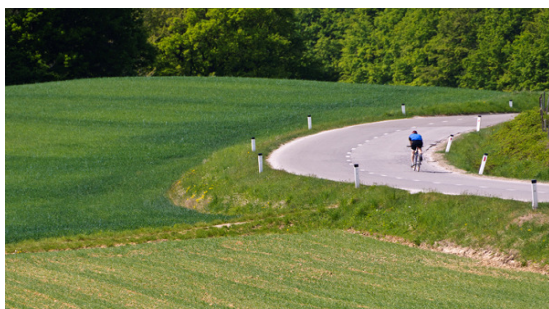
According to the relevant methodology that is also available on the SAO website, a **performance audit** is the evaluation of the utilisation of public funds that is carried out with a system-oriented qualification based on the criteria of economy, efficiency and effectiveness.

#### **Incomplete records and the indicator system**

In the absence of target values set, the effectiveness of the utilisation of domestic funds was impossible to assess. In the audited period, there were no effective legal provisions on the inventory of cycle routes. The records prepared were not comprehensive. As a result, the impact of realised investments on the environment, transport and tourism could only be partially assessed.

#### **Investments audited on-site**

The nine investments audited on-site were effective in serving the establishment of transport methods that are environmentally sustainable and the infrastructure of alternative urban transport. Cyclist developments contributed to establishing environmentally sustainable modes of transportation in the central areas of seven settlements, and in Szeged they helped the establishment of alternative urban transport.



#### **Focus on public works**

The SAO pays particular attention to auditing areas that have key significance with respect to establishing competitiveness. One such typical area is competitive knowledge, which is a key element of increasing employment. In line

with the above, during the auditing of public employment, in 2013 we also audited the efficiency and effectiveness of the subsidy scheme of related training programmes. Moreover, the expansion of employment contributes to keeping public debt in check as well as managing macro-economic risks. It was, therefore, also important from the aspect of public debt reduction that the SAO audited this particular area.

The objective of the audit was to assess whether the public employment system and the changes thereof, and the cooperation between local governments and labour organisations efficiently and effectively assisted the increased participation of the long-term unemployed with low-level academic qualifications who are able to work, in any public employment or training scheme. The audit extended to assessing the return to the open labour market as well as the changes of the labour market position of those concerned.

#### **Successful public employment**

The HUF 227 billion available at the central level between 2009 and 2011 for public employment programmes ensured the organisation of approved programmes; however, substantiated budget planning at local governments was hindered by a lack of information.

#### **WHAT IS AN 'EFFECTIVE' QUALIFICATION DURING AN AUDIT?**

We **assessed** the subsidy scheme of public employment and related training programmes **to have been effective if** the objectives were accomplished, if the funds required for public employment were ensured at both national economy and local government levels. Public employment is considered to have been effective if the establishment of organisational frameworks and the preparedness of participating organisations helped the implementation of programmes, if the information system of public employment was uninterrupted, up to date and reliable in its operation, if records and data supply were accurate and accessible, and if they ensured reporting and feedback to decision makers.



The number of persons involved in public employment doubled from 2009 to 2011, which means that the public employment system was effective in supporting the increased involvement of the unemployed in public employment, and in accomplishing the strategic objectives concerning subsidised employment. Public employment had a positive effect on the development of both the employment and unemployment rates. The subsidy scheme efficiently contributed to involving those of active age and receiving social benefits in employment.

**With respect to training programmes, the appropriate records and performance criteria were missing**

With respect to public employment, during the audited period (2009 - 2011) , no data was collected separately and regularly. In the absence of mathematical objectives and relevant data, it was impossible to measure the contribution of trainings to the effectiveness of the subsidy scheme. Furthermore, in the absence of data, it was not possible to assess within training programmes the taking into account and impact of regional employment opportunities to prevent social and economic marginalisation.



**The auditing of public service media**

The SAO strives to carry out audits in areas where the legal framework has been amended and the utilisation of public funds and the management of public assets carry risk. The SAO's audits concerning 2011-2012 have the added value of presenting

the effects and results of the restructuring of the public service media and news broadcasting system, in other words, whether the effects desired and expected by legislators have been realised. In addition, by presenting public financial management, it also provides information to the public.

With respect to 2011-2012, as part of the systems audit, the SAO assessed whether the organisational, financing and control system of public service media and news broadcasting launched in 2010 and established as of 2011 contributed to a more economical task performance, the more efficient utilisation of subsidies provided from public finances, and whether the financial management of the Hungarian News Agency Corporation was regulated and regular.

**The effects of restructuring**

The audit concluded that the restructured organisational, financing and control system of public service media and news broadcasting contributed to more economical task performance and the more efficient utilisation of subsidies provided from public finances. At the same time, the audit also directed attention to regulatory deficiencies that affect the efficiency of financial management, asset management and planning. The downsizing made news production and own production more efficient, with per capita broadcast minutes increasing. As a result of eliminating superfluous overlaps, public service news production and news coverage became more cost-effective. The expense of news production per minute decreased. The restructuring of the public service media system was effective as it promoted the preservation and increasing of public media assets.

**WHAT IS A SYSTEMS AUDIT?**

**Systems audits** are part of performance audits, and examine effectiveness in a system-oriented approach. Systems audits examine if as a result of the interventions by the National Assembly, the government and local governments, the objectives they desired were accomplished economically and efficiently — through the allocation of resources, the establishment of budgetary institutions and organisations and creation of legislation — in order to realise the socio-economic and social changes planned.

**Regulatory deficiencies**

As the managing body of the Media Support and Asset Management Fund

(MTVA), the Media Council performed the basic functions set out by the Act on Media Services and Mass Media; however, with respect to a few issues, the level of internal regulation in particular, the audit uncovered deficiencies. It also uncovered deficiencies at the other audited entities. The MTVA for instance, despite the provisions of the Accounting Act, had no regulation concerning prime cost calculation, and failed to separate the costs and expenses related to the enterprise in its accounting records in spite of the provisions of the relevant government decree.



## 2.3. *Advisory role*

The reinforcement of the State Audit Office of Hungary's advisory activity is of great significance to the organisation for two reasons. On the one hand, the constitutional obligations set out in the Fundamental Law of Hungary aimed at reducing public debt and the public debt rules set out in the Stability Act, as well as the controls ensuring their enforcement required advisory activity to be made more emphatic. In this particular area, we must highlight the preparation of analyses and studies supporting the functions of the Fiscal Council and the making available thereof, and providing opinions on the budget appropriation bill. On the other hand, the activities performed in the interest of accomplishing and enforcing the goals and fundamental values set out in the strategy are also connected to the advisory role.

### 2.3.1. Opinion on the budget appropriation bill

In 2013, the SAO fulfilled its law-mandated obligation and provided an opinion on the bill on the 2014 central budget of Hungary. Every year since the Fundamental Law of Hungary entered into force, the SAO has carried out, in relation to the audit establishing the opinion on the bill on the Hungarian budget, targeted audits on completeness of the assessment of public debt and the substantiation of planning.

#### Opinion of the State Audit Office of Hungary

The SAO concluded that the bill complies with the Fundamental Law, the Stability Act, the public debt rule, as well as the requirements of legal regulations on public finances, and that it also provides for reserves.

#### Opinion, not macro-economic analysis

The opinion of the State Audit Office of Hungary on the budget appropriation bill is not macro-economic analysis. The SAO accepts the macro-economic path outlined by the Government, and provides no opinion on economic growth, inflation or other applicable indicators. The SAO audited 88.6% of the expenditures of the 2014 budget appropriation bill and 93.6% of its revenues.

#### WHAT DOES THE SAO PROVIDE OPINIONS ON?

When formulating its opinion, the SAO evaluates the regularity, substantiation and feasibility of the establishment of appropriations in the budget appropriation bill; the legal compliance of the compilation of the bill; the correctness of justifications; the enforcement of the debt rule; and the performance of tasks to be completed by the 31 July deadline set out in Article 13(4) of the Act on Public Finances.

#### Guideline

The SAO's opinion on the budget appropriation bill is a 'guideline' of sorts for the Government and Members of Parliament the aim of which is to promote the passing of the best and most substantiated budget possible.



#### Public Debt and deficit target

Pursuant to the bill, the public debt ratio will drop from 77.4% in 2013 to 76.9% in 2014; in other words, debt-to-GDP ratio will drop in line with the statutes. The

deficit target can be maintained with the 2 per cent GDP growth planned for 2014, but several risks must be taken into account.

### **Main risks**

In its opinion, the SAO, amongst other things, pointed out that in the case of the enforcement of the debt rule, lower than anticipated inflation, along with the development of deficit and debt in the local government sector, as well as the debt of other governmental bodies may constitute risk. Similarly to previous years, once again we had to conclude that the legislation for substantiating the budget was not fully available at the time of submitting the bill, with particular reference to the amendment of tax laws.

### **Improving quality of planning**

The 2014 budget appropriation bill does not contain any appropriations that would qualify as *unsubstantiated* according to SAO's methodology, which clearly indicates an improvement in the quality of planning. This result can be traced back to the utilisation of the SAO's advisory activity.

#### **WHEN IS AN APPROPRIATION SUBSTANTIATED AND WHEN IS IT UNSUBSTANTIATED?**

An appropriation is **substantiated** if it is supported and feasible (in case of revenues feasibility can be assessed, while in the case of expenditures, this aspect cannot). An appropriation is supported if the calculations, impact studies and strategies documenting the establishment of the appropriation are available, and the regulatory background is complete and ensured. An appropriation is feasible if it is in harmony with trends of the previous year and expected values. An appropriation is **unsubstantiated** if, based on the above, it is unsupported and/or unfeasible.

### **Revenues and expenditures**

Tax revenues of the 2014 budget are 52.6 per cent substantiated and 47.4 partially substantiated, with the latter including planned revenues from value added tax, the financial transaction levy,

telecommunications tax, itemised tax for small taxpayers and small business tax. Of the planned total expenditure of the 2014 central budget, 56.4% (HUF 9,528.2 billion) is uncapped expenditure appropriation, which represents a risk with respect to maintaining the planned deficit target. This risk is reduced by the fact that based on experiences from the previous year, the implementation of these appropriations did not significantly exceed the given appropriation, and in certain cases remained below.

### **Headings, funds, reserves**

The revenues and expenditures of headings and funds are substantiated. The headings, in order to reduce risks, generated reserves of HUF 4.7 billion. Pursuant to the 2014 budget appropriation bill, the total amount of central budget reserves is HUF 220 billion. The HUF 120 billion appropriation for the reserve for extraordinary government measures is substantiated. The HUF 100 billion appropriation of the Country Protection Fund is partially substantiated, the reason for which is that the justification of the bill fails to present the nature and extent of risks that were taken into account when determining the rate of the Country Protection Fund.

### **Continuous attention**

We must emphasise that after the SAO has prepared its opinion, it provides no further opinions on the given bill. This, however, does not mean that we take our eyes off the process of the preparation of the budget. In this phase, the SAO monitors the creation of the Budget Act in another area of advisory activity, namely through the supporting of the FC. In order for the FC to provide approval, the SAO compiles its analysis for the Council prior to the final vote on the bill. The analysis concerns the standardised version of the bill — arrived at after the passing of amendments but prior to the final vote — primarily concerning the enforcement of the debt rule.

## 2.3.2. Supporting the performance of tasks by the Fiscal Council

In order to support the performance of tasks by the President of the SAO as a member of the Fiscal Council, based on its legal mandate the State Audit Office prepares studies and analyses, which it makes available to the FC. The synergy between the Council and SAO has been realised in practice, and greatly contributed to the fact that all FC decisions were substantiated and made with consensus. In order to ensure efficient and effective cooperation, the SAO took several measures and also supported the work of the FC through studies and analyses. The studies prepared focused primarily on risks and the debt rule.

### Synergy realised in practice

In the interest of the more efficient supporting of the FC's work, the primary ambition of the SAO in 2013 was again to systematically integrate the results of its budget-related audits into the FC's decision-making process. The SAO regularly audits institutions that play a crucial role in preparing the budget, such as the State Treasury, the Government Debt Management Agency, local governments, hospitals and universities. In 2013, the SAO continued the systematic auditing of areas of risk and analysis of risks, the realisation of which increases public debt, in other words, has a negative impact on the fulfilment of the debt rule. These include the auditing of the financial standing of local governments, the auditing of the asset management of business associations owned by the state or majority-owned by local governments or the studies on the budgetary risks of monetary policy.

### Focus on budgetary risks

The SAO set the systematic uncovering of factors endangering the reduction of public debt as one of its objectives. It was as part of this process that the notion that monetary policy also has budgetary risks arose. Namely, if the implementation of monetary policy generates losses for the MNB, this must be compensated by the central budget. This represents veritable risk, something we cannot let slide, even if the SAO has no authorisation to audit monetary policy. For this reason, the SAO prepared a study to highlight related risks, to ask questions, and thus provide guidelines to reduce these risks. The SAO published its study entitled "*The budgetary risks of monetary policy, with special focus on the debt rule*" in February 2013. The SAO's goal in preparing the study was to analyse the public data of recent years and to present their correlations, and thus uncover the reasons that led to the compensation obligations of the central budget in order to replenish MNB reserves. The completed study was also utilised in practice, as the monetary policy pursued by the new management of the MNB takes the risks uncovered by the SAO into consideration. The study also showed that by taking the risks uncovered by the study into account, the rethinking of the methods used to calculate the public debt ratio may also become necessary.

## OUR PERFORMANCE IN NUMBERS

With respect to supporting the work of the FC

|   |             |
|---|-------------|
| 3 | studies     |
| 2 | analyses    |
| 2 | conferences |

## Studies leading to studies

The study published in February 2013 on the budgetary risks of monetary policy showed that the **current method of calculating the debt rule has a number of technical flaws**. At the recommendation of the State Audit Office of Hungary, the Council put the issue of correcting the public debt rule on its agenda, in relation to which the State Audit Office of Hungary prepared its baseline study which it made public in October 2013. The study on the theoretical and practical problems of applying the debt rule uncovered risks related to the calculation and application of the debt ratio. We also made 10 recommendations regarding the further development of the debt rule in line with the Fundamental Law. We made a recommendation that the calculation of public debt should follow EU methodology, that indicator methodologies should be made public, with professional compliance and international harmonisation to be ensured at the institutional level. The SAO also made a recommendation to eliminate the exchange rate identity rule. Furthermore, we recommended that the statute stipulate the minimum range of indicators required for the projections for the Government's annual and medium-term macro-economic path. We also proposed that the current debt formula in force should be replaced by a rule that would only allow the increase of nominal debt to an extent in line with the planned change of the price index. In addition, the study contains recommendations that in the budget act, the debt ratio should also be determined in the medium-term among annual objectives. We also recommended that the statutes should comprehensively contain the rules of content and procedure for cases that qualify as exceptions in the enforcement of the debt rule. We also formulated proposals in the interest of enforcing the debt rule during the year. These primarily concerned the necessity of the Government's obligations to provide

information, to take action and to provide responses, and the laying down of said obligations in law. In its study, the SAO thoroughly examined one particular area that fundamentally determines the macro-economic path to follow in coming years. It is through the uncovering and analysis of the theoretical and practical problems of the debt rule that the SAO wishes to promote that the indicators and formulas applied provide a picture on the development of public debt that is economically sound and encourages correct budgetary decisions.

## Other studies

The SAO does not just prepare studies and analyses in order to support the FC, but also in relation to audits. As part of these studies, we map out potential areas where our audits can generate the greatest added value. It is important to recognise, however, that these studies can also relate to public debt, particularly if they concern the topics of competitiveness and economic growth. In line with the above, the SAO indicated the state's market organising ability as an area of priority, regarding which the regularity audit of the activity and financial management of the Hungarian Competition Authority (GVH) commenced in 2013. Concurrently with the audit, the SAO also prepared a study which, of the three functions of the GVH set out in law, focused on competition advocacy and the development of competition culture. The analysis contained in the study published in October 2013 concerns the period between 2002 and 2011. The GVH's main competition advocacy activity is to provide preliminary opinions on competition-related statutes from a competition policy perspective. Based on the processing of the data of the GVH's annual report, the study concludes that in the period reviewed, this activity was practically non-existent. At the beginning of said period, the GVH sent written observations on more than 200 proposals per year. By the end of the



period, this number dropped: in 2009, 2010 and 2011, the GVH provided opinions on 48, 33 and 68 proposals respectively. The GVH report mentions 77 statutes passed in both 2009 and 2010 and 110 in 2011, which — though in the GVH’s opinion concerned the matter of competition — were not sent to it for opinions in advance. In the case of the other function analysed, the study concluded that the GVH carried out its competition development activity using very diverse tools, but at the same time, this activity was not performed according to a plan or along objectives determined in advance. The funds available fluctuated and the GVH failed to examine the efficiency of fund utilisation, and therefore, had no comprehensive evaluations on the matter. In both its studies and audits, the SAO pointed out that though regulations may seem to be adequate, in many cases they are not enforced in practice.

### **Conference of the Fiscal Council**

On 16 July 2013, the SAO hosted a seminar organised by the FC and the Hungarian Economic Association entitled “Budget policy - Economic growth”.



The event is part of a professional series, where the Fiscal Council presents the analysis and assessment of the budgetary processes of the recent period. As part of a sort of workshop, in addition to the Chairman of the Fiscal Council and the president of the SAO, several experts also held lectures at the seminar which provides support for the preparation of the tasks ahead in the coming period.

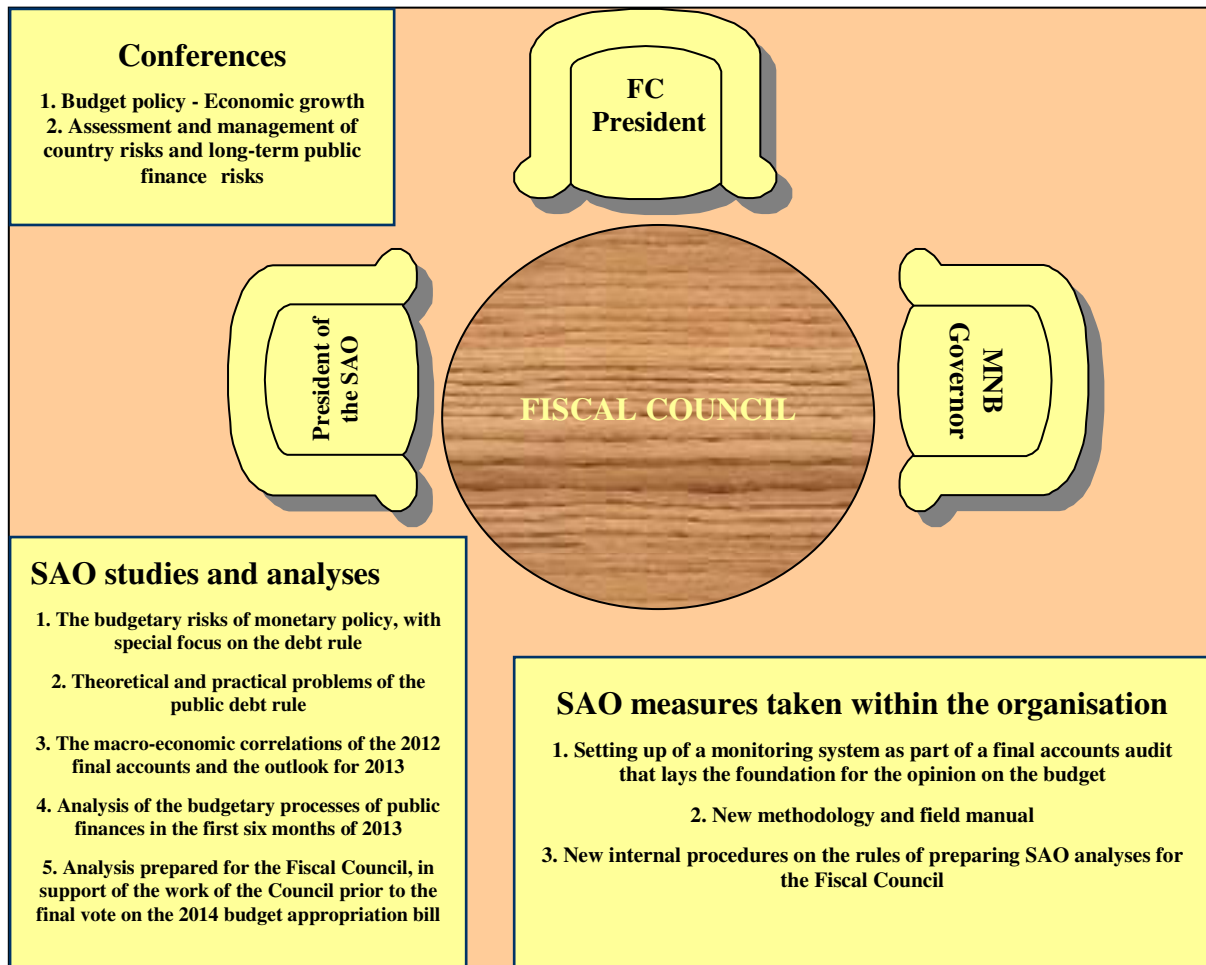
### **Supporting the work of the Fiscal Council**

In July 2013, the SAO published its analysis on the budgetary processes of the first six months of 2013, which relates to a function of the FC, pursuant to which and in accordance with the Stability Act, every six months the Fiscal Council provides an opinion on the status of the implementation of the act on the central budget as well as the expected change in public debt. In December 2013, the SAO published its analysis prepared for the FC, which supports the work of the Council prior to the final vote on the 2014 budget appropriation bill. With the analysis in question, the SAO practically tracks the events that occurred after the completion of its opinion on the budget appropriation bill. In addition to preparing analyses and studies and making these available, the SAO also systematically audits areas of risk and analyses risks, the realisation of which increases public debt, in other words, has a negative impact on the fulfilment of the debt rule.

### **Focusing on long-term risks**

At its seminar held in July 2013, the FC focused primarily on short-term risks. The position of the SAO, however, is that we cannot get onto a sustainable budget path without taking long-term risks into consideration as well. In this spirit, on 9 October 2013, the State Audit Office of Hungary organised a conference entitled “*Assessment and management of country risks and long-term public finance risks*”. At the event, high-ranking Hungarian and foreign lecturers sought to answer which risks affect public finance equilibrium and public debt in the long-term and to what extent these risks impact equilibrium and debt; also, in addition to ensuring sustainable development, what other management methods are available to decision makers.

## The activity of the Fiscal Council and the State Audit Office of Hungary (2013)



**Chart 9**



### **2.3.3. Promotion of the development of public finances**

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**The mission of the State Audit Office of Hungary, as set out in its institutional strategy, is to promote transparency and regularity of public finances through value creating audits, performed on a solid professional basis, thus contributing to ‘good governance’. Academic-professional activity is also required to accomplish this goal. As part of this activity, the State Audit Office of Hungary publishes the Public Finance Quarterly periodical and operates the Public Finance Quarterly Online portal, and also organises seminars in the interest of forward-thinking financial management solutions and good practices.**

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#### **Public Finance Quarterly, the public finance journal**

One of the main goals of the renewal of the publication, which began in recent years, was for topic selection to link and adapt to current SAO reports and strategic objectives. Accordingly, in 2013 the editorial department again placed great emphasis on publishing articles in the Public Finance Quarterly that can efficiently support audit activity and contribute to promoting the development of public finances. Following the beaten path, in the first half of 2013 the Public Finance Quarterly published a special monetary policy issue, the topicality of which was underlined by the fact that the elements of monetary policy changed as a result of the international financial and economic crisis. In 2013, the Public Finance Quarterly published four issues. Topics of focus were European crisis management, macro-economic risks and indebtedness, and the impact of economic legislature on real processes. In 2013, the reputation of the Public Finance Quarterly increased along with its prestige in the industry. The publication published several

studies and articles that have become points of reference in the search for directions of public policy. The Public Finance Quarterly has grown into one of Hungary’s most significant academic workshops, which provides a sound foundation for building the academic credibility and enhancing the reputation of the State Audit Office. The launch of Public Finance Quarterly Online at the beginning of 2012 greatly contributed to the fact that the raising of the publication’s academic prestige continued in 2013. As a new phase of this unbroken trend, the articles of the Public Finance Quarterly have become available in one of the world’s leading, subscription-based databases which transcends academic areas and has also been included in a dynamically developing open international database.

#### **Good practice seminars**

Pursuant to our strategy, in order to increase the efficiency of public administration, we make good practice public property, and transfer the information and knowledge obtained as a result of audits to the users of public funds. In the course of its audits, the SAO not only reveals shortcomings and deficiencies, but also encounters forward thinking financial management policies and best practices, through the widespread presentation of which it attempts to facilitate the improvement of the quality of the Hungarian public finance system, to make the operation of organisations more efficient and to make the utilisation of public funds more economical. The SAO and the Chamber of Hungarian Auditors organised a seminar in March 2013 entitled “Sampling in the practice of the Chamber of Hungarian Auditors and the SAO“, the goal of which was to share methodological

experiences, and thus contribute to the promotion of technologies that raise the quality and reliability of audits. In April 2013, the State Audit Office of Hungary organised a ‘Good practices’ seminar which focused on integrity and the internal control systems of local governments.

**Unique lecture series**

The SAO and the Ministry of Public Administration and Justice launched a joint further training programme in 2013, the aim of which was to strengthen the integrity of local governments, and the appropriate and efficient auditing of local regulations and financial processes. The 20-stop nationwide lecture series was organised with the supervisory bodies controlling the operation of local governments, as well as mayors, notaries and financial officers in attendance. In addition, the objective of the seminar series is to promote the legal operation of local

governments. As a result of the lectures, the professional relationship between local governments controlling, supervisory bodies continued to strengthen.



Participants had the opportunity to become familiar with ‘good practices’ and all interested parties received replies to any professional questions they had. Audit experiences, the methods applied during audits and the correlations between the internal control system and internal audits were all presented at the various locations.

**Stops of the SAO-KIM seminar series and main messages (2013)**



**Chart 10**

### **The development of financial literacy is an area of strategic importance**

The SAO played host to a conference jointly organised with the Econvetio Kerekasztal Közhasznú Egyesület (Econvetio Roundtable Public Benefit Association), the central theme of which was also the development of financial literacy. At the conference, a memorandum of understanding on cooperation within the development of financial literacy was signed in Budapest by the President of the SAO, the Secretary of State of the Ministry of Human Resources responsible for public education, the Vice President of the NTCA, the Dean of the Faculty of Economics and Business Administration of the University of Szeged and the President of the Econvetio Roundtable Nonprofit Association. The objective of the SAO with this cooperation is to be an active participant and supporter of the various initiatives, as well as to raise financial literacy, and on a related note, to strengthen financial consumer protection.

### **The development of financial literacy**

In the interest of promoting the development of public finances, we must also return to the basics; in other words, financial literacy must be developed not just in public administration, but at the level of citizens as well. In this spirit, the SAO issued a joint Memorandum of Understanding on cooperation with the National Bank of Hungary and the Ministry for National Economy. The essence of the cooperation is for the three organisations to harmonise their activities in the field of financial literacy in the spirit of effectiveness and efficiency. The primary goal of this cooperation for financial literacy is to prepare and implement a Hungarian model of financial literacy development that could serve as an example at an international level as well.

## 2.3.4. Providing opinions on draft legislation

The SAO does not just support the National Assembly and its committees in legislature, it also provides opinions on draft legislation as part of its advisory activity. In this particular field, the State Audit Office of Hungary is primarily in close contact with ministries.

### Close cooperation

During the provision of opinions on draft legislation, the SAO is primarily in contact with the ministries as the bills are sent by these organisations to receive opinions. In 2013, the State Audit Office of Hungary received a total of 23 bills from six ministries, and provided opinions on each.

### Types of proposals assessed

In 2013, the State Audit Office of Hungary gave opinions on 7 bills, 9 draft government decrees, 1 draft government decision, 4 ministerial decrees, and 2 strategy papers sent by ministries.

### Topics of proposals assessed

The State Audit Office of Hungary gave opinions on a number of major bills in the most diverse range of topics. Amongst others, it provided opinions on the proposal to amend the Act on Public Finances and the government decrees related to the implementation thereof, as well as to amend the government decree on the internal control system and internal audit of central budgetary institutions.

### Tangible utilisation

The National Assembly passed the act on complaints and announcements of public interest, which entered into force on 1 January 2014, at its session on 14 October 2013. Pursuant to the relevant provisions of the SAO Act, the State Audit Office also participated in the administrative consultation of the bill prior to submission of the proposal to the National Assembly, and several SAO observations were integrated into the subsequent bill.

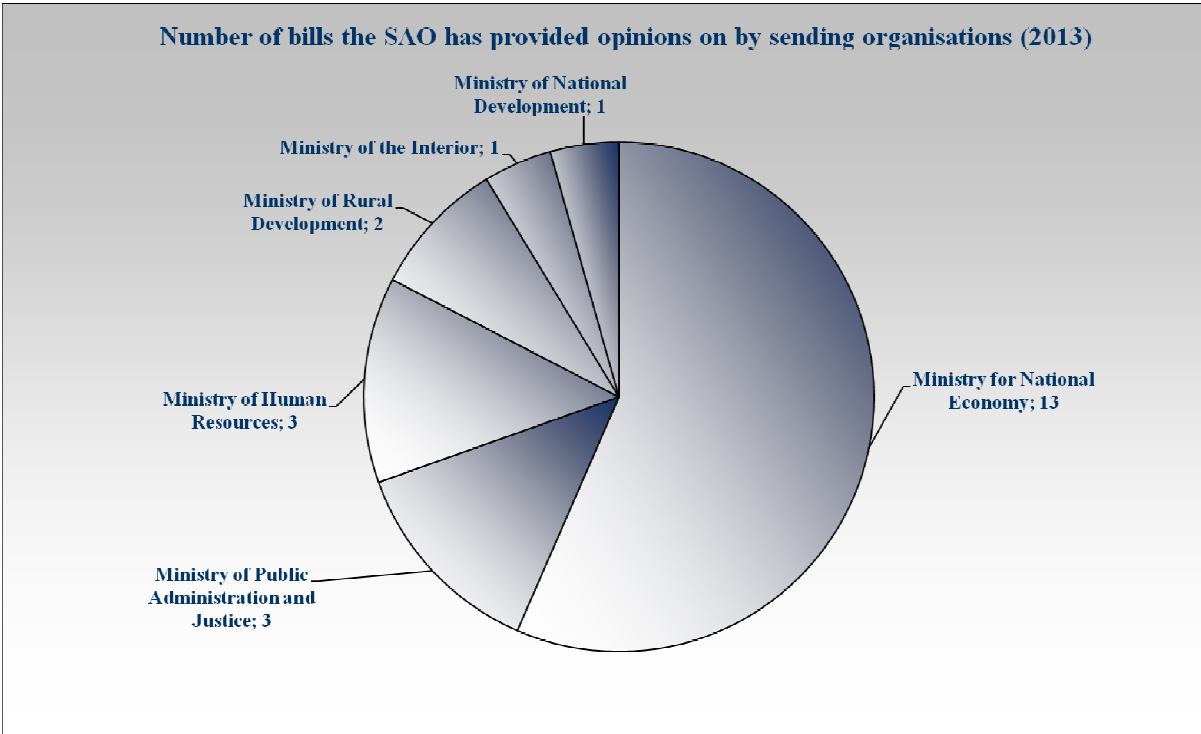


Chart 11



## 2.3.5. Fight against corruption and fraud

It is a basic principle laid down in the institutional strategy that the SAO facilitates the creation of the integrity-based, transparent and accountable utilisation of public funds. It is also among the strategic goals that the SAO participates in the identification and application of the efficient and effective means of the fight against corruption risks and corruption, and in the dissemination of the use thereof and of integrity-based public administration. The accomplishment of these goals has been at the centre of the organisation's advisory activity for years. This commitment manifests itself in cooperation based on joint declarations, the directions of methodological development, audit topic selection and, ultimately, in the organisation's own operation.

### **Increasing transparency and accountability within the SAO**

In 2013, the SAO continued with the internal processes that point in the direction of increasingly high compliance with the requirements of transparency and accountability. Within the revision of our internal regulations, we must mention the presidential measure on irregularity management, which placed the related internal regulation environment on a wholly new foundation. The management of irregularities is realised on two levels. On the one hand, the manager authorised to issue rules of procedure, within his/her own scope of powers and with respect to his/her own organisational unit, is responsible for the management of a given irregularity; on the other, the SAO's presidential measure on the management of irregularities provides an appropriate framework for, amongst others, the heads of units as well as clarifies the appropriate management of so-called 'hindering factors' – extraordinary events, situations, states that do not arise as a result of the

violation of regulations – that could impact the performance of the activity of the SAO within its scope of activities or its financial management. The new regulation contributes to ensuring transparency, creates a predictable working environment and at the same time, provides security to auditors and employees, ensuring them not just the possibility, but the obligation to indicate irregularities without suffering negative consequences.

### **Internal control system**

In its audits, the SAO pays priority attention to auditing internal control systems, as a well-established and properly operated internal control system is a guarantee of transparency and accountability. In line with the above, the auditing of the establishment of the internal control system plays a crucial role in the audits of both the central sub-system and the local government sub-system. The SAO, however, strives to not simply just point out the deficiencies and errors of the audited entities, but also lead by example. In recent years, the SAO has built up an internal control system that complies with the provisions of all applicable statutes, clarifies responsibilities, contains process descriptions as well as audit trails. In 2013, the SAO was again characterised by the constant revision of the internal control system, which in turn increased the organisation's accountability, transparency and integrity.

### **WHAT IS INTEGRITY?**

**Integrity** is a characteristic (or a requirement set for the following) of public finance organisations, persons working in public service, or the entire institutional system of the public sector as a whole, which represents the totality of qualities, abilities, attitudes and behavioural patterns, the aim of which is to serve public interest and ensure the intended, efficient and effective operation of public administration. Integrity can be interpreted as the opposite of corruption.



## Integrity Project enters new phase

Following the implementation phases, in 2012 Integrity Project entered a five-year maintenance phase. The objective of the project implemented with EU grants is to assess the operation of budgetary institutions with respect to corruption vulnerability, to uncover risks and to improve Hungary's auditing practice and public administration culture with integrity in mind. One of the changes compared to the two previous data recordings is that during the 2013 survey, besides the *indexes indicating vulnerability*, the *subject of the survey was* not the lack of controls, but *the level of existing controls*. The questionnaire structure has also changed, with the integration of a new question group focused on questions regarding human resource management.

### WHAT IS INTEGRITY PROJECT ?

The aim of the **Integrity Project** is to assess the exposure of public sector institutions to corruption risks as well as the level of controls that serve to reduce such risks. In previous years, as part of the project, national data surveys were carried out among institutions of the public sector on two occasions (2011 and 2012) using an electronic questionnaire that could be downloaded online.

One of the new elements is the proposal for cooperation made by the SAO, by accepting which, the institutions completing the questionnaire become members of the Circle of Integrity Supporters, and part of the effort aimed at establishing a culture of integrity. This at the same time means that members undertake to fill out the questionnaire annually. The agreement covers a five year period. The State Audit Office of Hungary is, therefore, planning for a long-term

cooperation as the objective is to introduce a change of culture among institutions of the public sector. We consider it an outstanding success that after being called upon to do so, of the 1,500 institutions completing the questionnaire, nearly 1,300 organisations joined, undertaking long-term cooperation.

## Progress and areas that require development

The data of the three surveys examined to date show that the ratio of budgetary institutions that apply so-called 'soft' controls (i.e. that for instance have a Code of Ethics, that regulate correspondence and contact with outside players, that shape their organisational culture consciously) has increased. At the same time though, according to survey data, no substantial changes have taken place in the areas of training against corruption, the regulation of the issue of conflict of interest and the regulation on the conditions of accepting gifts, invitations and trips.

### Circle of Integrity Supporters

The SAO made a proposal of cooperation to the organisations requested to supply data, by accepting which proposal, the organisations in question became members of the Circle of Integrity Supporters. Within the framework of cooperation, the respondent organisations receive user authorisation to the Forum on the SAO Integrity portal (also newly set up), which provides an opportunity for members to share experiences and exchange opinions.

### Commitment by state bodies

The SAO's strategic objective is to launch the fight against corruption in as many areas as possible, and to establish integrity-based public administration. In this spirit,

another forum was set up on International Anti-Corruption Day in order to support the fight, which has now become a common goal. The SAO played host to the founding meeting of the consultation body founded within the framework of the cooperation initiated with a view to reinforcing the integrity of local governments. The goal of the forum established is to provide an opportunity for participants delegated to the body to consult on the goal and possible means of cooperation and main expectations.

**International activity**

The SAO is also actively present on the international scene in the fight against corruption. By providing an opinion on the ISSAI (International Standards of Supreme Audit Institutions) 5700 draft guideline (prepared for auditing anti-corruption measures to be taken by government agencies), the State Audit Office of Hungary supported the competent INTOSAI working group. Furthermore, the SAO also gave its opinion on the guideline entitled “*Enhancing Good Governance for Public Assets*”, which presents the structures and procedures of ‘good governance’ that are recommended to employ at government institutions in order to assist the SAO’s audits aimed at

uncovering corruption. The State Audit Office of Hungary has also presented Integrity Project and its results at various international forums, thereby also contributing to sharing ‘good practices’.

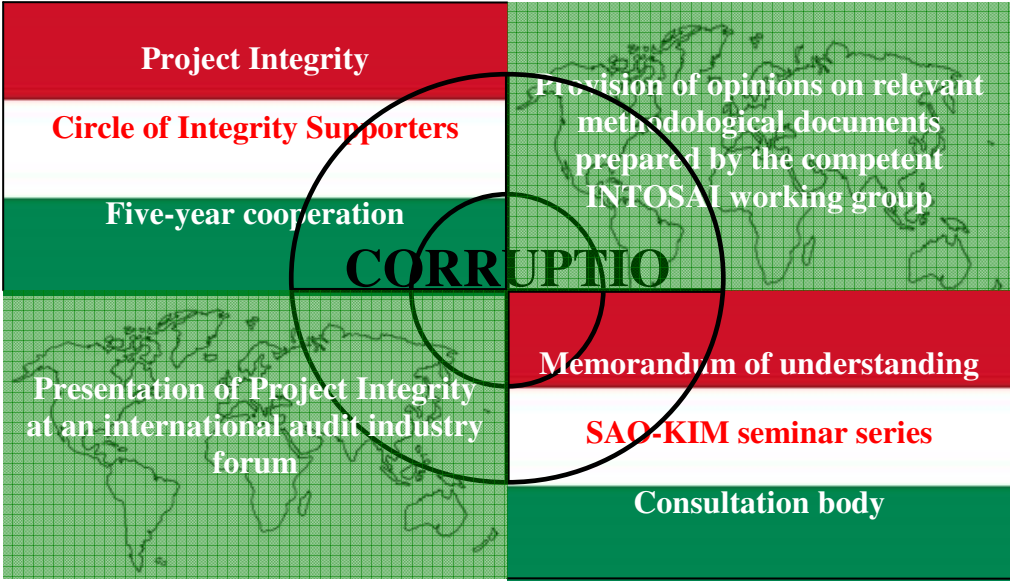
**Practical utilisation**

One of the most significant results of the State Audit Office of Hungary’s activity aimed at the fight against fraud and corruption is the creation of Government Decree No. 50/2013. (II. 25.) on the integrity control system of central administrative bodies and the order of acceptance of interest enforcers, which extends to central administrative bodies under the control, or supervision of the Government and their employees.

**OUR PERFORMANCE IN NUMBERS**  
With respect to the 2013 Integrity Survey

**155** questions contained in the questionnaire  
**1,500** completed, returned and processed questionnaires

**The SAO’s domestic and international anti-corruption activity (2013)**



**Chart 12**

## 3. The operation and development of the organisation

The goal of the restructuring process of the State Audit Office of Hungary launched in 2011 is to establish a flexible and efficient organisation that is able to adapt to a constantly changing domestic and international environment and meet the highest professional and social expectations. Based on the increasing professional recognition and continuous positive external feedback, we can safely say that the SAO is securely on its way to accomplishing its strategic objectives, namely becoming an institution with professional prestige that also has the confidence of citizens, which through its audits and advice can efficiently and truly assist the National Assembly and ultimately the whole of Hungary. Continuously developing innovative operation, made possible by the SAO's organisational changes in 2012 and the experiences gained, allowed 2013 to be a year of fulfilment, eliminating the 'infancy maladies'. Accordingly, this year saw the launching of internal processes that continued to reinforce efficient task performance, the ultimate goal of which processes is the emphatic dynamisation of the organisation and becoming a 'self-learning organisation'. As part of the implementation of institutional strategy, the process of harmonising sub-strategies was completed in 2013.

### 3.1. Professional results supporting operations

#### System of strategic documents

The State Audit Office's activity is supported by a multi-level strategic document system, which is well structured both in terms of content and purpose.

#### Harmonisation of sub-strategies

In the interest of implementing the strategy, the units involved prepared their operational plans adapted to functional sub-strategies. In 2013, the auditing of the internal and external consistency of operational plans on the basis of pre-determined principles was carried out. Based on the review of operational plans, we can determine that they are in harmony with the organisational strategy as well as functional sub-strategies. Following the comprehensive harmonisation of documents at the various levels of the strategy paper system, the tasks set out in operational plans reflect and specify the contents of the institutional strategy, thus ensuring the continuous building and development of the organisation.



#### The hierarchy of audit methodology rules

One of the cornerstones of the SAO's independence is that it works out the professional guidelines of audits and its methods on its own. When formulating the contents of the regulation, the SAO considers the INTOSAI international standards to be authoritative, and as such, the structure and hierarchy of SAO auditing methodology rules follows the structure of the global organisation's system of professional regulations.

## The structure of SAI auditing profession regulations

| System of documents that represent the theoretical basis of auditing profession regulations |  |  | Governing ISSAI   |
|---|--|--|---|
| Level 1   |  |  | ISSAI 1   |
| Lima Declaration  |  |  |   |
| The system of SAI auditing profession regulations   |  |  | ISSAI 10  |
| <b>Level 2</b>  | The principles of SAO operation<br>(2010 Johannesburg decisions) | Items guaranteeing independence <sup>1</sup>                                       | ISSAI 20  |
|   |  | SAI's principles of transparency and accountability <sup>1</sup>                   | ISSAI 30  |
|   |  | Principles of ethics <sup>1</sup>  | ISSAI 40  |
|   |  | Principles of quality-driven operation <sup>1</sup>                                | ISSAI 12  |
|   |  | Principles of the utilisation of SAI work <sup>1</sup><br>(2013 Beijing decisions) | ISSAI 100   |
| <b>Level 3</b>  | Fundamental auditing principles                                  | Fundamental auditing principles<br>(2013 Beijing decisions)                        | General auditing principles <sup>2</sup>                                    |
|   | (SAI auditing standards)   | Implementation guidelines  | Financial auditing principles <sup>3</sup>                                  |
|   |  |  | Performance auditing principles <sup>3</sup>                                |
|   |  |  | Compliance auditing principles <sup>2</sup>                                 |
|   |  |  | Implementation guideline for financial and compliance auditing <sup>3</sup> |
|   |  |  | Implementation guideline for performance auditing <sup>3</sup>              |
|   |  |  | Implementation guideline for compliance auditing <sup>3</sup>               |
|   |  |  | Other guidelines <sup>3</sup>   |
|   |  |  | Other INTOSAI guidelines*   |

<sup>1</sup> Published

<sup>2</sup> Approved for internal use

<sup>3</sup> Under preparation

**Chart 13**

### Methodological revision

In October 2013, at the Beijing Congress of INTOSAI, the international organisation of the world's supreme audit institutions, participants approved the ISSAI 100, 200, 300 and 400 professional standards, parallel to which in 2013, the State Audit Office of Hungary commenced the revision of its auditing methodology. During the year, viewing the international standards approved as authoritative, the basic principles of general auditing

(ISSAI 100) as well as compliance auditing principles (ISSAI 400) were prepared, which serve as trial principles for internal training. The revision of the basic principles of financial and performance auditing also began.

#### Focus on utilisation

In 2013, the State Audit Office of Hungary approved the methodology document entitled "*The Principles of the utilisation of SAI work*" and elevated it to its official professional regulations. The document in

question was prepared by fully taking the relevant international standard (ISSAI 12) into account. The basic principles of utilisation of the State Audit Office of Hungary fall into three groups. The first group is the strengthening of public finance accountability, integrity and transparency, in the interest of which the SAO has taken several measures in 2013. The second group is the presentation of the added value of the SAO's work. The third group reflects the SAO's aspirations to become an exemplary institution.

### Revised action plan

Based on the experiences, the SAO revised the function and content of the action plan for 2013. The action plan was given an active role in setting up the entire organisational culture and supporting the renewal of the institution. The revised action plan was defined in the context of a consciously devised and sound task structure. Accordingly, it includes twice as many tasks as last year, which reflects the increasingly intensive internal activity of the office.

#### WHAT IS THE ANNUAL ACTION PLAN?

The **annual action plan** is a document for internal use, which includes key tasks concerning the performance and development of audit activity aimed at the public sector and the "professional infrastructure" assisting the audit work.

The SAO's system of strategy papers, the audit plan prepared in the rolling planning system, the annual action plan, and executive temporary plans and programmes: these are the documents that represent the foundation of the organisation's transparent, measurable and quality-driven operation in the given year.

### Revision of the internal regulation on auditing principles

As a result of the process aimed at the review and reforming of auditing procedures, in 2012 we developed the principles defining the tasks to be implemented in the various phases of

audits. In the first half of 2013, we **reviewed the principles and amended them based on practical experiences.** One focus of the auditing activity of the SAO is on organisations that are present in the country in large numbers (local governments for instance); therefore, the system of principles is supplemented with procedures concerning the preparation of thematic audits. The contents of said supplement facilitate the launching of thematic audits.

### International competency

In the interest of making available the appropriate resource capacity involved in the strengthening of its international role, the State Audit Office of Hungary has established an international competency sub-centre within the organisation. Taking on international roles that support professional task performance has always been important for the SAO, as such roles promote the exchange of experiences with foreign SAIs and help the SAO to become familiar with foreign 'good practices'.

#### WHAT IS COMPETENCY AND THE SUB-COMPETENCY RANGE?

A **competency** is the totality of knowledge, skills, abilities, qualifications and behavioural norms, based on which a given employee is suitable to effectively perform decision-making and/or implementation functions and tasks assigned to him/her.

The **sub-competency range** is a virtual resource base comprising a pre-defined auditor range with specific competencies, thus suitable to perform tasks requiring a special skill set or know-how.

### Ready and prepared

For years, the State Audit Office of Hungary has urged the introduction of accrual-based accounting in public administration at a number of forums. In addition to active communication that supports this effort, after a preparatory analysis, the State Audit Office of Hungary ensured appropriate preparation through continuous activity in 2013. Through discussions that formed part of this



activity, the State Audit Office of Hungary became familiar with the Swiss experiences regarding the introduction and operation of accrual-based public accounting, as well as the practice of the auditing of the Swiss federal final accounts.

### **International activity**

With respect to the professional results achieved in 2013, it is of key importance that the State Audit Office of Hungary was increasingly active on the international stage. This activity appeared at two levels in the organisation's life. The senior officers of the SAO were in constant consultation with the heads of the SAIs of a number of countries regarding the deepening and development of professional cooperation. The president of the SAO gave a lecture on the timeliness of audits at the UN-INTOSAI Symposium, as part of which he presented the risk analysis system employed at the SAO to select audit topics. The delegation led by the president of the SAO also attended the

meeting of the SAI heads of V4+2 countries, which focused on current EU issues and risk assessment. The president of the SAO attended the meeting of the Contact Committee and the XXI INTOSAI Congress. The president of the SAO gave lectures at all three events, and spoke of the role of the Fiscal Council as well as the organisation's related tasks and results achieved. In addition the president of the SAO also attended the EUROSAI-ARABOSAI Conference, where he presented the most recent developments in relation to strengthening the SAO's independence, transparency and accountability. In harmony with its international strategy, the SAO also took part in several industry events within the framework of INTOSAI, EUROSAI, EU and other multi-lateral and bi-lateral relations. The SAO's Integrity Project made its debut at the seminar for the EUROSAI working group for ethical auditing.

## ***3.2. Organisational results supporting operations***

### **Internal control system**

It is now an objective of the SAO that is manifested at the level of basic principles to become an exemplary institution. An indispensable element of this is to also lead by example in establishing the internal control system that is at the centre of SAO audits. In the medium-term, the frameworks of our task performance are determined by our strategy, while at an annual level, by our action plan. The internal regulations that make up the **control environment** were reviewed and updated by the SAO in relation to operational experiences and statutory amendments, and concluded that they support processes with adequate efficiency. The Rules of Procedure, of which audit

trails form an integral part, were also amended, thus ensuring the tracking and follow-up auditing of activities. The human resource management system set up, along with documents prepared therein (job descriptions, task-specifying executive orders, and job description supplements), provided adequate support for the performance of tasks, and at the same time also represented an appropriate basis for the performance assessments carried out regularly during the year. Ethical expectations are laid down in writing. In accordance with its **risk management regulation**, the SAO prepared its institutional-level registry of risks endangering strategic objectives, which forms the basis of the summarised annual report on the review of risks (which is

prepared parallel to the report on the SAO's activity). The principles – which based on the general control objectives are part of directive controls – amended as a result of the review carried out during the reporting year play a priority role in the **control activities** pillar. These relevant controls provide adequately efficient support to the regular and appropriate implementation of audit phases, and at the same time, also ensure the required efficiency of operation monitoring activity that is part of the **monitoring system pillar**. The 'four eyes principle' of quality control and the use of financial powers were implemented as set out in applicable statutes and internal control tools. The Presidential Meeting, the Presidential Senior Officer Meeting, the Presidential Group consultation and the related decision registry system (which all operate as part of the **information and communication pillar**) provide adequate support to the SAO's performance of audit tasks realised within the framework of audit strategy, audit supporting, audit supplementing, audit leading, audit supervising, audit controlling and audit implementing functions. Based on the document management regulation operated within the pillar, the documents (cases) can be tracked. In addition to operational monitoring, the functionally independent internal audit also supported the efficient operation of our internal control system through the assessment performed during control monitoring.

### **Independent internal audit**

Within the framework of its own internal control system, the State Audit Office operated an organisationally independent internal control system under the direct supervision of the President of the SAO in 2013. Functional independence was ensured and was not violated during the period under review. Internal audit assignments in 2013 were again implemented in accordance with the annual audit plan — prepared on the basis of risk assessment and approved by the president

of the SAO — with the consistent utilisation of the available internal auditor capacity. The objectives of the annual work schedule were accomplished. In addition to internal audits, advisory activity became more emphatic than initially planned. The internal auditors organised their activities independently, free of any outside influence, discharged their duties impartially and objectively, and compiled the audit report containing their findings, conclusions and recommendations in the structure and content stipulated by law. The proposals and recommendations have been utilised by the implementation of the measures scheduled in the action plans approved by the president of the SAO. During the year under review, the Rules of Procedure ensuring the detailed rules of the operation of internal auditing activity was revised, and in addition, the Strategic Internal Audit Plan, the Risk Management documentation and the Internal Audit Manual were also reviewed.

### **Quality-driven operation and monitoring system**

The State Audit Office of Hungary has revised and enforced in practice the quality control principles adopted in December 2012, which were developed on the basis of the guideline issued by the INTOSAI, "Quality Control for SAIs (ISSAI 40)", which was viewed to be authoritative. Today, quality control is present in all elements of the work performed by the State Audit Office of Hungary. Through this, quality-driven operation contributed to all sub-activities of the SAO serving the quality of the core activity, namely, the implementation of audit tasks. Accordingly, in each operating area of the SAO, employees are expected to enforce, within their own scope of competence and responsibilities, the principles of quality-driven operation as well as the requirement of prudent planning and consistent implementation, and the requirement of controlling the implementation and performing the necessary adjustments

accordingly. The requirements of quality control were integrated by the SAO last year into the ‘safety net’ it has already been operating. The aim of the ‘safety net’ is for the State Audit Office of Hungary to reduce the extent of risks impacting audit work to a minimum through the identification and management of risk factors. For each element of the audit process, the president of the State Audit Office of Hungary has defined clear responsibilities, thus the rules pertaining to the quality-oriented supervision and review of the work performed. Before publication, the SAO’s reports are always subject to rigorous quality review. In order to ensure the quality of its audit activity, the SAO operates a controlling and monitoring system that guaranteed regular, by-deadline and resource efficient performance of audits.

### **The legal compliance analysis**

In order to enforce the guidelines set out in the ISSAI 40 international standard, the SAO is continuously developing the organisation’s quality-driven operation. The objective of the SAO is to establish guidelines and procedures that are suitable to assess, reduce and prevent quality-related risks arising from the performance of audits. One of the tools to accomplish this is to carry out a risk-based, widespread and quality-oriented review, in other words a legal compliance analysis. The president of the SAO regulated the scope of tasks and power of legal compliance analysis in detail. The legal compliance analysis, among other things, also extends to auditor working papers, selected by way of a sampling procedure. During the legal compliance analysis, the SAO’s highly experienced experts evaluate whether the auditor working paper is on track according to the audit programme, and assess the substantiation of findings in the auditor working paper, as well as the quality of the multi-level review of said working paper. This is how the SAO ensures the improvement of quality,

encourages good quality and prevents work of inadequate quality.

### **The detailed regulation of handover/takeover within the organisation**

During the SAO audit, the president of the SAO regulated in detail the task and liability procedures between audit phases, as well as the handover/takeover procedures of professional working papers within phases. This ensured transparency and accountability in all audit phases.

### **New systems in the service of monitoring**

The SAO has set up a newly developed, proprietary executive decision registry system. The aim of the system is to provide instant information on executive decisions, to track deadlines precisely and to provide feedback on task implementation. The application of the system ensures the provision of instant information following executive decisions, as well as adherence to deadlines and feedback on the implementation of the given task.

### **Implementation of competency-based resource planning**

In the interest of establishing flexible resource management that supports more efficient operation, the SAO has set up an authentic competency-based database based on academic qualifications and experience, the first step of which was a competency survey conducted among auditors.

#### **WHAT IS COMPETENCY-BASED RESOURCE PLANNING?**

**Competency-based resource planning** ensures that staff members suitable to perform a given pre-determined task successfully are selected from a competency range pre-defined on the basis of knowledge, skills, abilities, qualifications and behavioural norms.

### **Introduction of electronic work-time records**

The first half of the year saw the successful conclusion of a project launched in November 2012, the aim of which was to introduce a web-based electronic work-

time record-keeping system. Live use of the system commenced in March 2013. The aim of the change was to simplify the approval process within the organisation that supports project-centred work by overcoming geographical distances, and to replace paper-based attendance sheets with a **modern electronic registry**, thereby facilitating and supporting everyday work. Through the introduction of the system, the SAO has also minimised the possibilities of error arising from data recording, and has also realised the automatic handover of data that serve as the basis for payroll calculations.

### **Curriculum development project**

In 2013, the State Audit Office of Hungary paid special attention to developing professional knowledge, as task performance by auditors requires special knowledge and special expertise, only parts of which can be obtained in traditional training. As the very first step of the training system becoming a key organisational area, in the first half of 2013, **the directions of curriculum development** (integration of new staff members, auditing know-how, and IT applications) **were determined** and the preparation of the operational plan for the development of the curriculum commenced. The State Audit Office of Hungary firmly believes that the organisation is only able to develop through people who desire to learn, in other words, organisational learning is impossible without individual learning. This, at the same time, is also the foundation of becoming a self-learning organisation.

### **Training concept**

In 2013, a five pillar-based training system was introduced at the State Audit Office of Hungary. The first pillar comprises the trainings for new entrants, while the second level is aimed at acquiring the appropriate auditor competencies. The third pillar of the training system serves to prepare auditors participating in on-site check projects for the given audit. The

fourth level comprises individual trainings, which focus on the areas to develop within performance assessment. The fifth pillar ensures the up-to-date knowledge of auditors.

### **Revised performance assessment system**

At the end of the first half of 2013, the setting up of the **new Performance Assessment System** was completed which, in line with the provisions of the organisation's human resource strategy, focuses on excellent performance and quality through the unambiguous wording of requirements and accountability regarding their fulfilment. During so-called 'immediate assessment', which follows the implementation of auditor tasks and the projects, in addition to professional and personal competencies, partial auditor works and the assessment of results achieved were given greater emphasis given that these form the basis of outputs that are the basis of utilisation. The content of the new system was expanded with the assessment of compliance with behavioural norms, the indicators of which are based on the behavioural norms of the Code of Ethics adopted by the INTOSAI (ISSAI30).

### **Integration programme**

In harmony with the organisation's tenet that one can only become an auditor within the SAO's walls, the organisation placed increased emphasis on integrating new entrants, which integration is performed as part of a multi-layered programme which lasts for the duration of a six month term. Pursuant to the education-training concept, in the first term new entrants take part in preliminary training; in the second term they visit various organisational units to become familiar with their tasks and acquire the basics of audit methodology during related training; while in the third term, they take part in actual audits. At the end of the six-month project, programme participants have to take part in a knowledge assessment test.



### **Internship programme and recruitment**

In the spirit of corporate social responsibility, the SAO launched its internship programme in 2011, the aim of which is for recent graduates to have a greater chance on the labour market after gaining experience at an organisation with high professional standards. The programme's dynamic development remained unbroken in 2013, and at the end of the year, one in every ten employees were interns. The SAO continues to view its internship programme to be of strategic importance, and for this reason has developed a concept which, within the framework of a multi-step application process, made the programme an integral part of workforce continuity and supply. Based on the system of criteria developed for the further employment of interns following a successful application period, talented youngsters who have met auditor requirements can stay on and build a career at the SAO, which ensures the supply of future auditors with outstanding professional know-how.

### **In the spirit of equal opportunity**

In harmony with its equal opportunity plans for 2013-2014, the SAO took several measures in 2013. Equal opportunity

aspects were built into the hiring process, and as such, the organisation for instance paid increased attention to give priority to four-hour jobs. On a related note, the concept concerning employees approaching retirement age was also developed, which includes a number of programmes and measures that facilitate the preparation for retired life and the transition to retirement. The SAO also organised in-house programmes for employees expecting children, thereby contributing to creating a family-friendly workplace.

### **Headcount progression**

In 2013, the headcount limit authorised for the performance of SAO tasks remained 598 persons. In 2013, the average statistical headcount was 556 persons. The labour law closing headcount on 31 December was 581 persons. The number of entries during the year was 81 and the number of exits was 73 persons. The internal ratio of auditors was also improved upon, and as a result, auditor headcount increased from 487 to 516 from 2012 to 2013. This represents an improvement of about 5% with respect to the ratio of auditors.

## ***3.3. The transparency of the organisation***

The SAO is also looking to lead by example in the field of transparency by fully enforcing the provisions of the ISSAI 10 and 20 international standards. The transparency of the SAO's operation is realised at two levels: at the statutory and the organisational level. The SAO Act passed in 2011 served as an example to follow for the international community in this aspect as well. The Act stipulates that all SAO reports are public; thus, while the SAO itself determines the audit methods applied, all Hungarian taxpayers have the right to learn about the findings of the audits. In the interest of total transparency, besides making all SAO reports and audit plans public and accessible to anyone, in

keeping with the expectations of the 21st century, the reports can be searched and downloaded on the SAO website. The basis of the measures taken at an organisational level was the approach that the appropriate provision of information to the public is a cardinal point in establishing transparency. It is the fundamental right of citizens to know how their 'taxpayer forints' are spent. In order to ensure this, in the spring of 2011 the SAO set up the SAO News Portal, which allows the tracking of the audit process. We also provide constant updates and information on action plans and the more significant steps of utilisation, thereby ensuring transparency concerning the SAO's activity.



## 4. Financial management of the SAO in 2013

The SAO compiles its report on the implementation of its budget itself, which is then submitted without any changes by the Government to the National Assembly as part of the bill on the execution of the central budget. The financial management of the State Audit Office is audited by an independent auditor selected and appointed by the Speaker of the National Assembly in a public procurement procedure. When presenting financial management, we fully took the relevant international standard (ISSAI 20) into consideration.

### The audit opinion

According to the auditor's report, the SAO budget heading managed its financial resources within the limits prescribed by the Act on the Budget, in consideration of the range of appropriations and in

At the SAO heading, the key budget appropriations and their performance were as follows:

| Name of priority appropriation               | Original appropriation | Amended appropriation | Performance    | Performance/ amended appropriation |
|--|------------------------|-----------------------|----------------|------------------------------------|
| Personal allowance                           | 5,017.4                | 4,959.3               | 4,871.2        | 98.2%                              |
| Contributions payable by employers           | 1,340.9                | 1,308.9               | 1,284.9        | 98.2%                              |
| Non-personnel and other current expenditures | 1,107.6                | 969.5                 | 876.1          | 90.4%                              |
| Other operating expenditures                 | -                      | 605.1                 | 451.9          | 74.7%                              |
| Renovations                                  | 41.9                   | 136.7                 | 93.0           | 68.0%                              |
| Investments                                  | 173.0                  | 549.6                 | 345.6          | 62.9%                              |
| Other non-operating expenditures             | -                      | 1.9                   | 1.0            | 52.6%                              |
| Financing expenditures                       | -                      | -                     | - 4.4          |                                    |
| <b>Total expenditures</b>                    | <b>7,680.8</b>         | <b>8,531.0</b>        | <b>7,919.3</b> | <b>92.8%</b>                       |
| Operating revenues                           | 18.0                   | 12.3                  | 12.6           | 102.4%                             |
| Capital income                               | 2.0                    | 9.0                   | 9.0            | 100.0%                             |
| Accumulation-purpose assumed funds           | -                      | 1.9                   | 1.0            | 52.6%                              |
| Central grants, grants from managing bodies  | 7,660.8                | 7,684.7               | 7,684.7        | 100.0%                             |
| Use of residue from the previous year        | -                      | 823.1                 | 823.1          | 100.0%                             |
| Financing revenues                           | -                      | -                     | - 0.3          |                                    |
| <b>Total revenues</b>                        | <b>7,680.8</b>         | <b>8,531.0</b>        | <b>8 530.1</b> | <b>100.0%</b>                      |

compliance with regulations and internal policies.

The 2013 annual financial statements of the budget heading for the State Audit Office of Hungary as of 31 December provide a true and fair view of the assets and financial standing as well as the results of the financial management of the year ending on the above date, in line with the contents of the Accounting Act.

### Coverage of task performance

In the Act on the Budget, the National Assembly allocated HUF 7,680.8 million for the discharge of the SAO's duties in 2013, of which HUF 7,660.8 million was covered from budgetary subsidies and HUF 20.0 million from the SAO's own revenues.

## Execution of the budget

Based on the data of the 2013 statement, the expenditures of the SAO heading amounted to HUF 7,919.3 million in 2013, with revenues amounting to HUF 8,530.1 million. Expenditure and revenue appropriations were met 92.8% and 100.0% respectively. The combined amount of personal allowances and contributions payable by employers accounted for 77.7% of expenditures, with 11.1% spent on non-personnel expenses, 5.6% on non-operating expenditures and 5.7% on other operating expenditures within total expenditures. Pursuant to amendments during the year, the original appropriation was increased by a total of HUF 850.2 million, thus the amount of expenditure and revenue appropriations changed to HUF 8,531.0 million, of which:

- HUF 823.1 million for the use of the appropriations residue from 2012,
- HUF 19.2 million in reimbursement of employer costs related to the ‘prime years’ programme,
- HUF 4.7 million in wage compensation paid pursuant to Government Decree 371/2011. (XII. 31.),
- HUF 1.9 million in employer housing loan repayment instalments,
- HUF 1.3 million from the amount of the amendment due to the transfer of the remaining available limit on the employer housing loan account held by OTP to the appropriation master account.

Overall, the expenditure appropriations available provided the operational conditions required by the SAO for the uninterrupted discharge of its basic duty. In 2013, a total of HUF 606.7 million was accumulated in residues, of which HUF 444.8 million is to cover commitments arising from procurements ordered but not paid and public procurement procedures launched, while residue available in 2013 is HUF 161.9

million. Of this the uncommitted residual amount was HUF 8.7 million at the SAO Economic Organisation, and HUF 153.2 million on the chapter-managed appropriation line, as a result of the chapter reserve requirement fulfilled until 30 June 2013, as required by Article 7(3) of Act XCII of 2013 on the amendment of Act CCIV of 2012 on the Central Budget of Hungary. In its settlement of the residual amount, the SAO requested to keep the available residual amount in the interest of implementing the procurements that had not materialised as a result of the fulfilment of the chapter reserve requirement in 2013, and in order to replenish internal resources planned to be used for the auditing of the 2014 general elections.

## Investments and developments

The book (net) value of the institution’s fixed assets increased by HUF 191.2 million from HUF 3,219.5 million to HUF 3,410.7 million thanks to investments and developments realised during the year. The institution spent a total of HUF 438.5 million in 2013 on investments and renovations. Owing to the organisational and operational transformation commenced in previous years, conditions for efficient work have improved. As a result of the development and renovation of real properties owned by the institution, among others, open-plan offices were constructed on various floors of the Lónyay Street office building in several phases over the course of 2012 and 2013, which allowed a greater number of employees to work in a cultured work environment with the same floorspace as before. As a result of the cost reduction programme launched in 2011 – following the termination of the lease agreement for the 4th floor of the Dunaház building – approximately 550 square metres of leased space was handed back. We completed the modernisation of the heating-cooling system of the Training centre, and we expect the replacement of all the windows and doors at the Apáczai

Csere János street headquarters to bring a reduction of energy costs. The procurement of security software and renewal of licenses for such software enabled us to ensure the integrity and confidentiality of data generated and stored at the SAO. The transformation (the modernisation of the IT networks of sites with staffs of over 100) began the previous year was concluded, during which we replaced the backbone network with an optical network, and replaced the network's active tools with modern tools that also support IP telephony. We also concluded the development of the SAO's IP-based telecommunications system, thereby ensuring the possibility of making remote access telephone calls to 400 persons.

The IP telephone system is complemented by a fax server that communicates with the filing system. We have concluded the migration of the computer network connections at our sites to the NISZ Zrt. network, which increased computer data transfer speeds at all our sites. In the past year, the procurement of 44 notebooks and 500 encrypted pen-drives was completed, and the replacement of outdated office equipment was performed.