



STATE AUDIT
OFFICE OF HUNGARY



SUMMARY REPORT

for the National Assembly on the Professional Activity
and Operation of the State Audit Office of Hungary in 2018



STATE AUDIT
OFFICE OF HUNGARY



INDEPENDENCE
TRANSPARENCY
FINDING REPORTING
COOPERATION
EXPEDIENCY
LAWFULNESS
REGULARITY REPORTING PUBLIC FINANCES
ANALYSIS
EFFECTIVENESS
SUSTAINABILITY
PUBLIC FINANCES
CONTROL CONSULTANCY
INFORMATION PROVIDING STANDARDS
KNOWLEDGE SHARING
STUDIES MEASURE PERFORMANCE
QUALITY
TRANSPARENCY INDEPENDENCE ORDERLINESS
ANALYSIS VALUE CREATION UTILISATION
COOPERATION FINANCIAL MANAGEMENT
SUSTAINABILITY REGULARITY CONTROL
INTEGRITY
PUBLIC FINANCES
PUBLIC FINANCES

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May 2019

B/6003
www.asz.hu

László Domokos

László Domokos
President



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FOREWORD BY THE PRESIDENT

Dear Reader,

It is an honour for me to present the Summary Report on the work carried out by the State Audit Office of Hungary in 2018 and to give you, similarly to the previous years, a detailed overview of the events, audit experiences and advisory activity in the last year.

I believe that the basis of all performance is intention, the will that gives you motivation. It is for that very reason that I would like to present the past performances with belief and trust in long term perspectives, in accordance with the current activity focuses of the organisation. Therefore, the approach remains unchanged: the audit work of the State Audit Office aims at past events, while the evaluation of the experience aims at the tasks for the future, and provides background for founding the decisions to be made as a result of the audits.

The State Audit Office of Hungary primarily promotes the regular use and transparency of public funds and property, the effective, efficient and economical use of public funds with its audits, its proposals founded thereon and the evaluation of the action plans which are complied by the audited entities on the basis of the proposals. These thoughts inspired the mission of our institution, and the tasks stated based on the objectives constitute the basis of the state audit office's work.

The SAO carries out its work based on a half-yearly plan and a conscious analytical activity. This systematic technology enables the State Audit Office of Hungary to comply with its legal obligations and to set long-term focuses at the same time, taking into account the results of risk management results, a part of which has been targeting the same areas for several years. However, another significant part of the work, just like in case of other supreme audit institutions, is carried out by taking into account the current results of risk analyses and evaluations.

In addition to the audits, the so-called advisory and analysis is of particular relevance for the institution, by which the State Audit Office of Hungary contributes to the support of the well-managed state, and which task is also declared by the Act on SAO. By strengthening this function it can be achieved that the performance of the state audit office can have a measurable impact on the practice of the entities using public funds, and thus, for it to support the well-managed state, to have a direct impact on the macroeconomic factors, and last but not least, to support the work of the National Assembly on this basis.

The State Audit Office of Hungary, as the supreme financial and economic audit organisation of the National Assembly, is a key institution of the democratic institutional system. Its objective is to ensure that the typable problems appearing at system level and revealed multiple times come into the focus of the users of its work's results, i.e. the National Assembly, the society, the legislation, thus promoting the operation of the well-managed state. The system-level analyses, synthesis evaluations and specifically formulated opinion, proposals of the institution are expressly intended to support the work of the National Assembly and the Fiscal Council. The SAO has also supported the work of the Fiscal Council with several fiscal and macroeconomic analyses; in addition, it provides opinion on the budget appropriation bill submitted to the National Assembly each year, and prepares an analysis for the Fiscal Council for providing opinion on the budget appropriation bill and the version of the bill before voting. The SAO draws well-founded conclusions on the entirety of public finances from the execution of the central budget and the audit of the final accounts.

Over the last years the National Assembly entrusted the State Audit Office with new tasks in its decisions, which greatly define the direction of the perspectives on the future in terms of the audits and analyses. Similarly, the "SAO proposals" published in our previous Information show a direction, as they provide to the legislators responses to comprehensive and substantial requests for change.

I believe that the parliamentary decisions and invitations mean the recognition of the work of the State Audit Office of Hungary. The State Audit Office made significant achievements in 2018 as well.

The reports published expressed in numbers: 323 reports were made on audits, the work was carried out in terms of a total of 806 audited organisations. On the basis of this executed work, the SAO made 2161 recommendations and sent 212 warning letters to the auditees. Based on the recommendations the State Audit Office of Hungary provided opinion on a number of action plans prepared by the audited entities, promoting the better utilisation of the recommendations. With the conducted audits the State Audit Office of Hungary complied with its legal obligations.

Looking at the audit approaches it is important to underline that the National Assembly imposed the task on the SAO to improve the audit methodology of the entities conducting audits in the public finances system. Thus, the State Audit Office of Hungary is also entitled to audit the economic management of institutions which also carry out audit and supervisory activity themselves. In other words, as the activity of the auditors becomes more regular, efficient and transparent, the SAO is able to make a greater impact in promoting the regular, responsible and disciplined financial management of public funds. As a result, the Hungarian Central Bank and the State Treasury were given greater attention, as well as the audit of the DGAEF in order to promote the efficient and regular use of the EU funds. Furthermore, the internal audit of each entity receives continuous and systematic audit supervision.

The assets of state property play a primary role in the appropriate provision of public services. This area is in the focus of the SAO's audits, so the state-owned business associations are given particular attention, as well as the concept of responsible financial management of public property. The audit of the investments and the preparation thereof belong to this topic, as the size of the budget resources used, the national assets created through investments are of vital importance. As the practical implementation of the methodological development carried out in this area in 2017, in 2018 the State Audit Office of Hungary evaluated the identification of risks arising from the preparation of the decision to the start of the implementation and the enforcement of integrity aspects in case of ongoing investments of budget institutions and state-owned companies selected on the basis of a risk assessment system.

In parallel with the organisational renewal carried out over the last years, the State Audit Office of Hungary also developed methodologies as well. According to the credo of the SAO, quality-centered processes are needed, which define in themselves the standard of the state audit office's products. I believe that over the last years, by the development of a quality-driven operation and the methodological renewal, the SAO has become a principal auditing institution which is able to support the functioning of the well-managed state as a professionally unavoidable constitutional body enjoying the trust of the population.

The area of the central budget was defined as an unchanged focus as this is the largest subsystem of public finances which is responsible for the financing of the central subsystem. Its priority role is strengthened by the fact that it is here that the central resources of the local governmental subsystem are provided. The institutions of the central subsystem play a defining role in the use of public funds. Therefore, in addition to the audit of the final accounts, the financial and property management of certain institutions of the central subsystem was also assigned a role. The auditing experience of hospitals – involvement of audit experience of 17 institutions – as well as the financial management and the operation of higher education institutions in terms of 27 local governments were evaluated. Not only do these subjects have great topic value, but they are also of great interest among the population.

With regard to the operation of public finances, it must be seen that the local governments form a separate subsystem within it. It is, therefore, obvious that the compliance of their financial management and their potential financial deficits and debts influence the deficit and debt of the government sector. It is important to raise awareness, again and again, of the fact that the property of local governments forms a part of the national assets, its audit, therefore, constituted a priority task to the State Audit Office of Hungary in 2018 as well.

The operation of the internal control system of local governments was audited within the framework of so-called thematic audits so that the audits reach as large a coverage as possible, and their impact prevails as much as possible. As a pillar of a responsible and sustainable financial management the SAO evaluated the financial position and assets of the local governments. In addition to the areas above, follow-up audits started in 2018 the field of the local governments' debt settlement procedures.



Based on the auditing experience of state-owned and local government-owned business associations, the state audit office's recommendations regarding the change of approach had been made earlier in order to renew the management system of the economic entities concerned. As it had previously been established as a fact that the renewal of the management of state-owned business associations is indispensable, the SAO extended its leadership training programme to new areas in 2018.

Furthermore, it is important to pay attention to the transfer of the budget resources outside of public finances. This area may present an increased risk in terms of the use of public funds. Based on legislative authorisation the SAO may audit the use of subsidies granted from public finances by the beneficiary organisations.

It is a basic requirement for non-governmental organisations as well that they must use the public funds granted for the performance of their public duties in a transparent manner. In this area the SAO published 16 reports in 2018, in which a total of 75 recommendations were made to the non-state human service providers.

It is important to note that the State Audit Office of Hungary has been assessing the financial management of foundations and public foundations within the framework of auditing the use of public finances since 2016. The clarity of political life, the transparency and accountability of the financial management of political parties is a particularly sensitive area from both a methodological and social point of view. It is, therefore, crucial that the parties work exclusively with legal resources, their audit is, therefore, justified. Thus, as required by the law, the State Audit Office of Hungary audits the lawfulness of the financial management of political parties receiving budget support every two years.

Finally, dear Reader, I would like to share my thought with you about 2018:

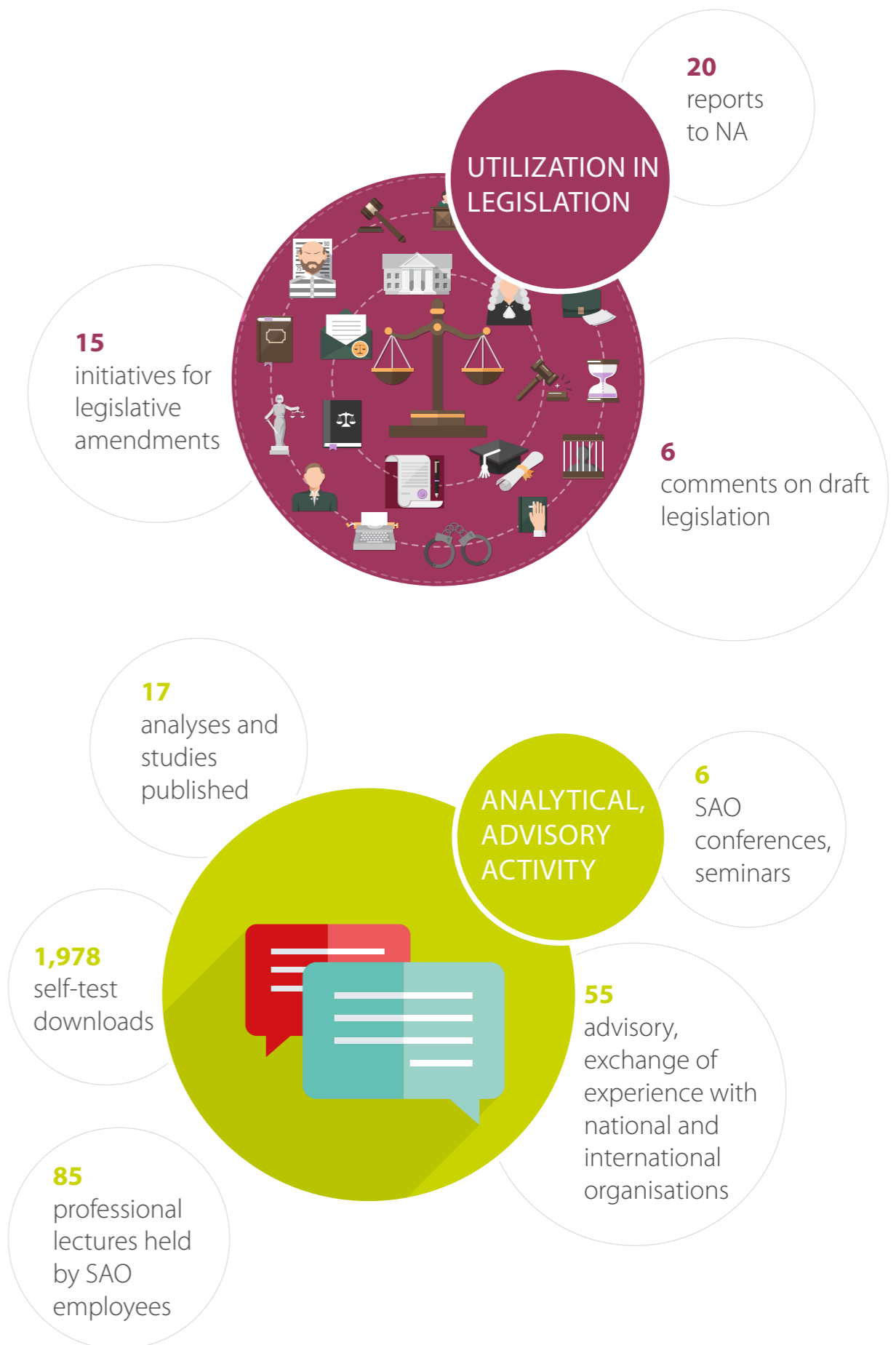
The unchanged objective of the State Audit Office of Hungary is to make the management of public property, the operation of public services and the financial management of public funds more transparent, clearer and more effective. In our everyday life we can see and feel that the world is developing, and I believe that this development is founded on foresight. I believe that quality, transparency, predictability and assessments, re-assessments, which are the cornerstones of the strategy of the State Audit Office of Hungary, contribute to this foresight while also making the development more tangible.

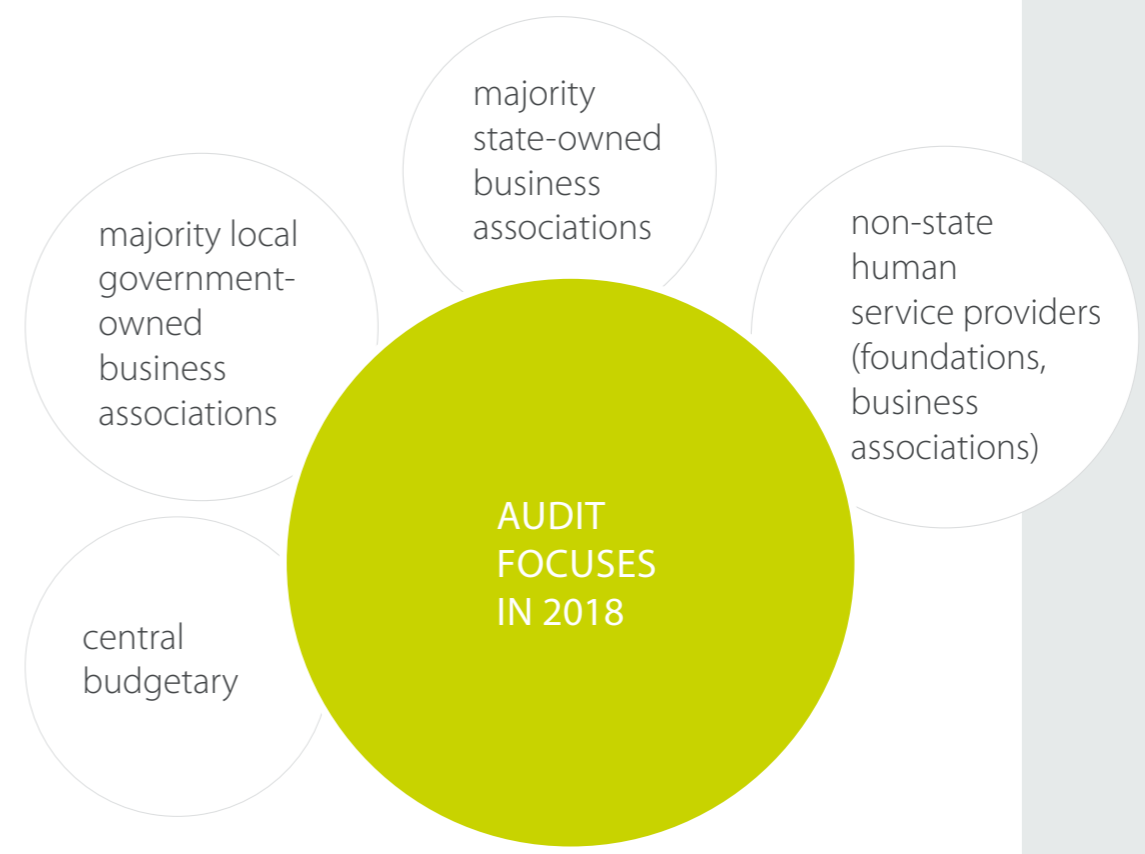
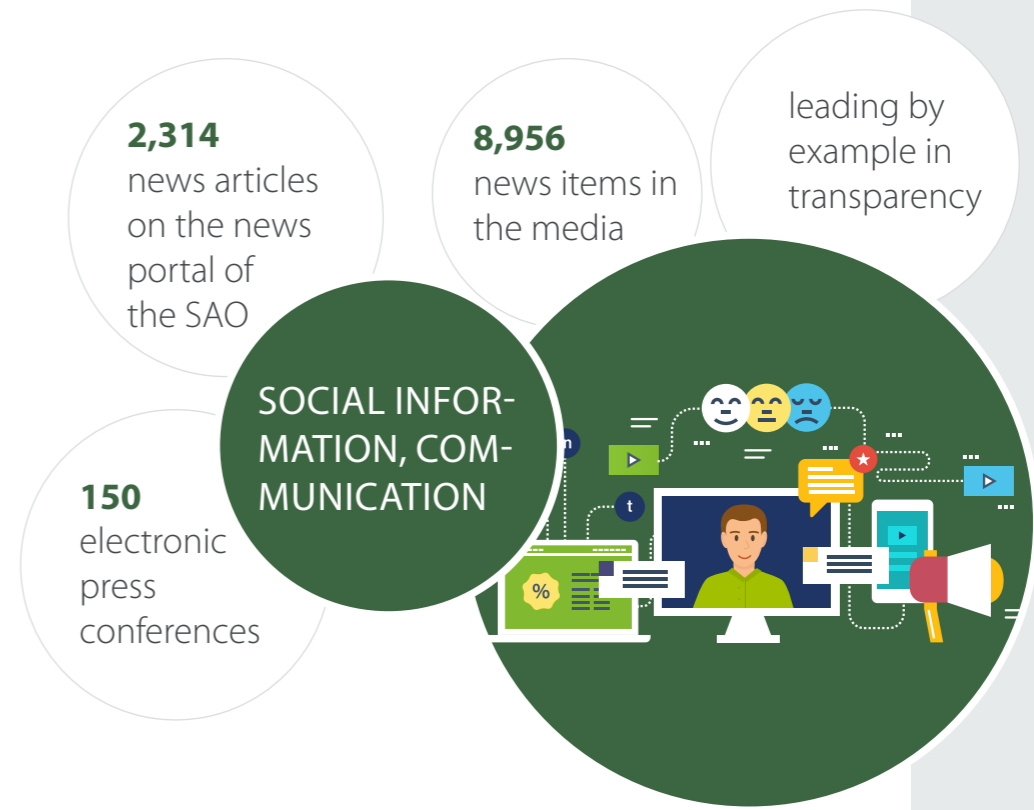
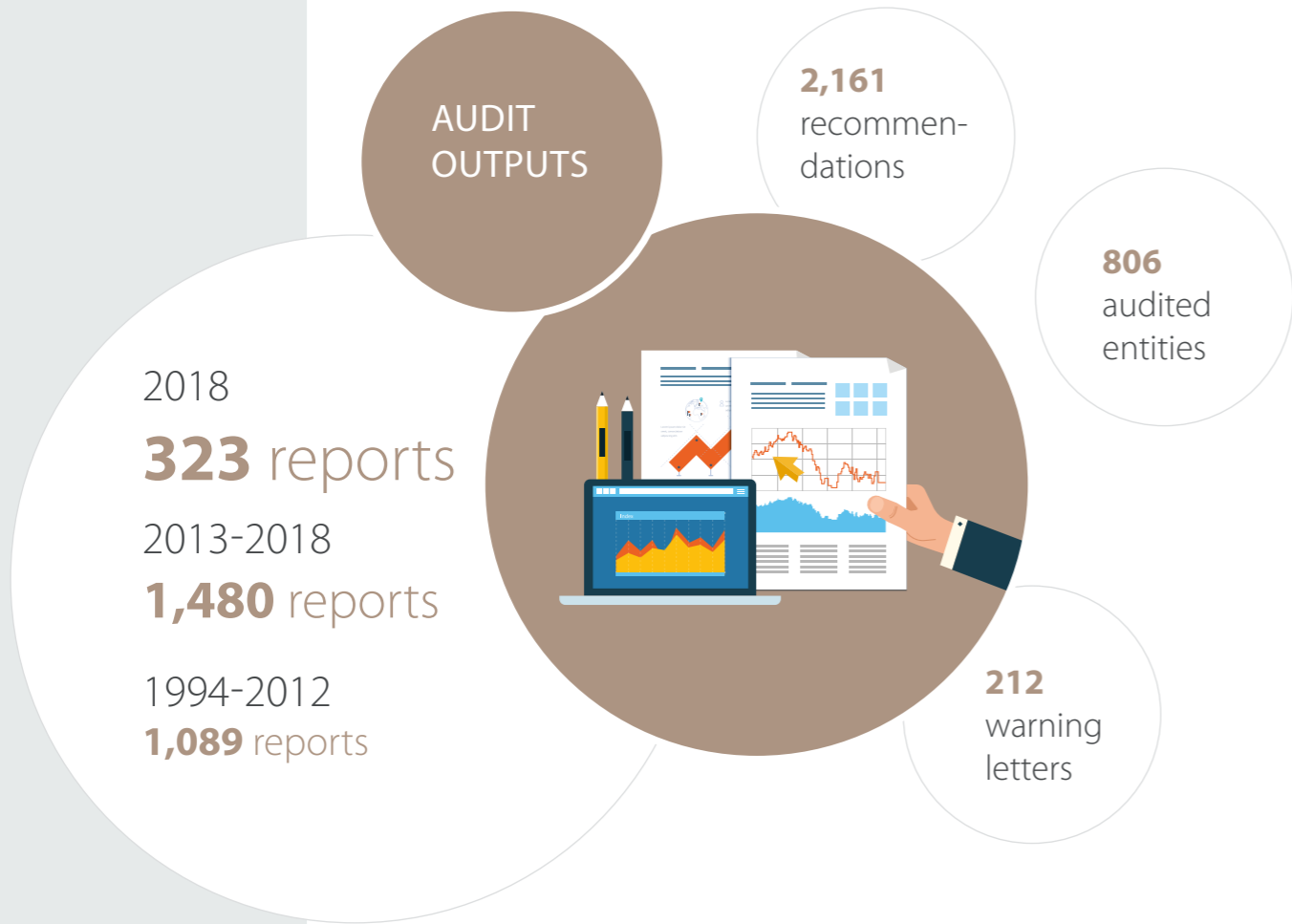
László Domokos
President
State Audit Office of Hungary



SUMMARY OF THE SAO'S OPERATION

The results of last year





The special events of last year



RENEWAL OF PUBLIC SECTOR MANAGEMENT – PUBLIC FINANCES LEADERSHIP TRAINING

In terms of the SAO's activity in this regard, in its decision No. 34/2015 (VII. 7.), the National Assembly supported that in terms of the entities involved in the financial management of public funds and public property the SAO may broaden its advisory activity relating to management systems and support the ethical public finances leadership training. In 2018, the SAO extended its leadership training programme to new areas, the detailed presentation of which can be found in part entitled Public sector management, responsible managerial conduct under subsection II/1.1.



CHANGE MANAGEMENT – INTEGRATION OF ORGANISATIONAL KNOWLEDGE INTO THE SYSTEM

In order for the State Audit Office of Hungary to manage changes in a more efficient way, it became necessary to elaborate a uniform change management framework system at organisation-level. After defining the change management principles, the change management project was launched in 2016, and its implementation took place in three stages. At the end of 2017, following thorough preparation, a framework system was developed, which was not only born as a theoretical methodology, but its set of criteria and process also improved through pilot programmes. As a result of the project implemented by involving competent organisational units, practical methodological guidelines were prepared in spring 2018, assisting organisational users.



INTERNATIONAL KNOWLEDGE-PRODUCT DEVELOPMENT – INTEGRITY CULTURE

In order to judge the integrity position of the Hungarian public sector objectively, the State Audit Office of Hungary prepared an information publication reviewing its activity carried out over the last years in order to cement the domestic culture of integrity. Adapted to the original objectives of the project, the SAO presents the results achieved in strengthening the integrity of the public sector through the area of legislation, institutional cooperation and education-knowledge sharing. The publication demonstrates the successive project stages, the analysis data obtained during the surveys and the measures at national assembly/, government/ and institution level by reflecting the system-level operation.



V4+3 MEETING ON PROSPECTIVE TOPICS

The subjects concerning the social challenges of the present was on the agenda at the V4+3 meeting of the presidents of supreme audit institutions. The topics discussed included the contact and efficient communication with citizens, the audit of the realisation of objectives relating to sustainable development in each country, and the assessment of government and SAO institutional capacities and the contribution thereof to the well-managed state. The two-day event was attended by the presidents of the Austrian, Czech, Polish, Slovak, Croatian State Audit Offices, and the Vice President of the Slovenian State Audit Office.

EURORAI INTERNATIONAL SEMINAR

The State Audit Office of Hungary hosted the subsequent EURORAI seminar, where the professional programme focused on the audit of business associations owned by local governments. The topic was of significant importance from the point of view of the financial position and indebtedness of local governments, which is a significant and current problem in several countries. During the professional event the participants had the opportunity to share their experience relating to the audit of business associations owned by local governments on the occasion of two sections. While the first part explored the aspects of financial and compliance audits, the second one addressed the relating performance audit issues. At the seminar the SAO also had occasion to present its experience regarding the topic, which was collected in the course of thematic audits conducted in the last years. The objective of the professional discussion was for the participants to gain and share knowledge in the topic through as many practical examples as possible.



RESEARCHES AND SURVEYS ON THE SOCIETAL UTILITY AND SOCIAL CURRENCY OF THE SAO

Based on the latest report of the international Open Budget Survey conducted every two years, the SAO acts adequately to guarantee the transparency of the central budget, and the content of the state audit office opinion (report) prepared on the budget is of an even better standard than the average of developed countries. The study summarising the survey declares that the SAO publishes its findings in detail and in due time, investigating the regularity of the management of public funds while also checking its efficiency. This is enabled by the legal environment, granting the necessary independence to the SAO, the financial and professional tools and assets as it operates entirely independently of the government.

A public opinion poll on the social currency and reputation of the SAO was conducted by Nielsen market research and analysis company at the beginning of August 2018. Comparing the results of the research completed in 2018 and the results of the research carried out three years ago, it is visible that the proportion of those members of the Hungarian society who know the institution and its activities is increasing, and more and more people trust the SAO's findings. The recent research also highlights the fact that a significant portion of those familiar with the State Audit Office of Hungary finds the work of the SAO important, and an increasing proportion of them also considers the SAO's activities to be effective.



INSTITUTIONAL RELATIONS IN THE SPIRIT OF ACADEMIC SHARING AND EXCHANGE OF EXPERIENCE

In 2018 again, the SAO initiated highest-level discussions with the leaders of historical churches in Hungary and with five associations of local governments. The SAO has organised bilateral consultations with church leaders for years, considering that during the audit of non-state human services providers, the financial management of church-affiliated institution maintainers as organisations using public funds is regularly audited. Regularly sharing the audit experiences with local governments that exercise proprietary rights helps auditees evaluate the findings and implement recommendations formulated during the audits, and these also provide useful information to entities that have not been audited yet.

In 2018, the delegation of the Organization for Security and Co-operation in Europe (OSCE), the ambassador of the Republic of France, the delegations of the Chinese and the Azerbaijani supreme audit institutions, and the delegation of the Korean Ministry of Justice were received at the headquarters of the State Audit Office of Hungary. This year the experts of the State Audit Office presented their knowledge at domestic professional events in the form of lectures more than 50 times, and they acquired new knowledge at conferences on several occasions.



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WWW.PENZUGYISZEMLE.HU

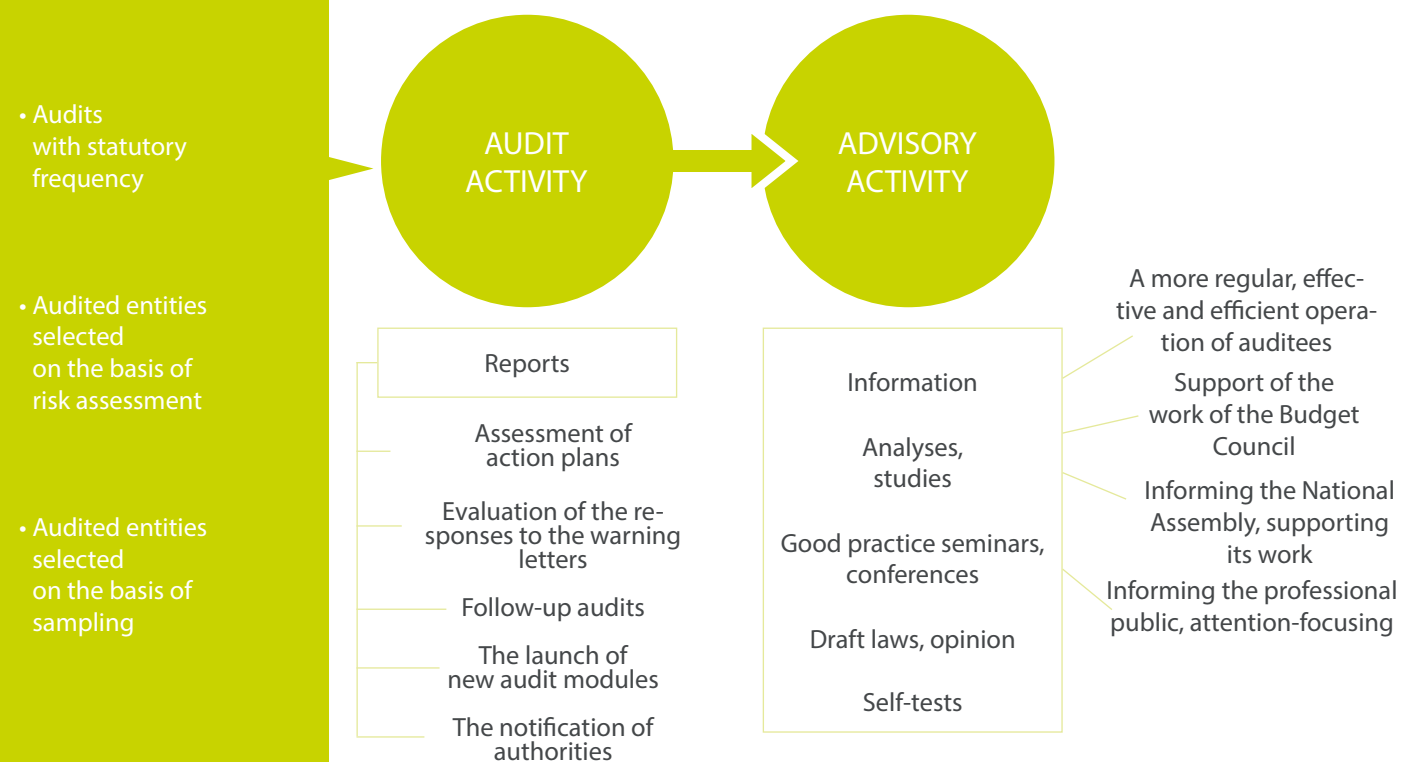
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Presentation of the focus areas of the operation

The State Audit Office of Hungary, as the supreme financial and economic audit organisation of the National Assembly, is a key institution of the democratic institutional system, and an active member of the international organisation of the supreme audit institutions. Its main task arising from its legal status and its mission is to support the legislative and audit activity of the National Assembly using its experience. The SAO has general competence to conduct the audit of the responsible financial management of public funds, state-owned and local government-owned property, and acting according to its statutory task, it audits the financial management of public finances, the execution of the central budget, the management of national assets and the use of the resources from public finances.

When selecting the audit topics the SAO analyses the inherent risks of the areas to be audited as well as the risks observed in the internal control system of the entities already audited, therefore, it has more and more information on the risks of public finances and those relating to the use of public funds and public property. Based on this information the audits of the SAO focus on the areas where they are needed most.

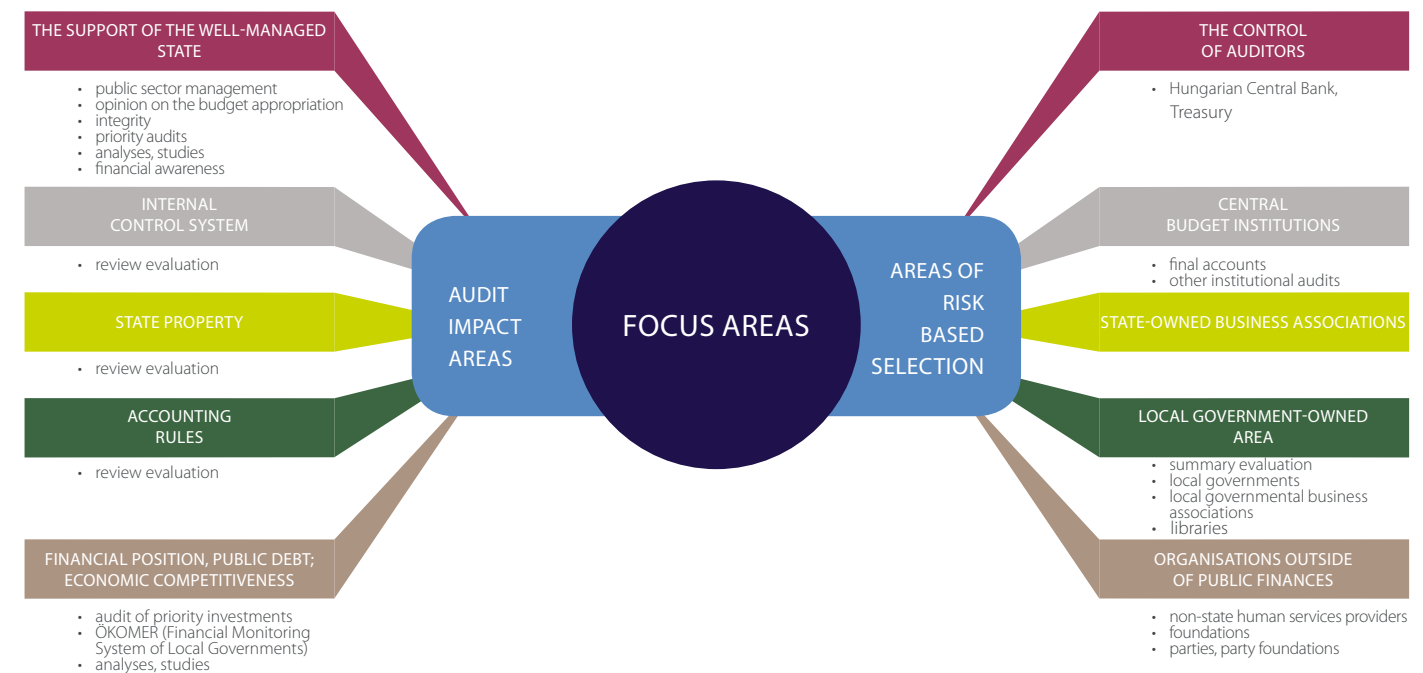
THE FORMS OF THE SAO'S ACTIVITY



The overlapping "lines of defense" of the different audit institutions and organisations existing in the Hungarian public law system are intended to ensure the audit of the use of public funds and public property. The Act on Public Finances names three areas in the audit system of public finances in order to ensure the regular, economical, efficient and effective financial management of the funds of public finances and the national assets, the proper compliance with the reporting and data provision obligations, and these three areas create the three lines of defense of the public finances. The first line of defense is the internal control system of public finances and the internal audit to which it belongs, the second one is the governmental and local governmental supervision and audit, and the third line of defense is the independent external audit, such as the audit carried out by the State Audit Office of Hungary.

This role not only imposes obligations but also responsibility. Taxpayer citizens rightly expect the supreme financial controller body of the National Assembly to keep an eye on public finances, and to share its experience and good practices with the users of public funds focusing on the most imperative economic and social problems.

By using its further capacities in addition the audits carried out with frequency defined by its legal mandate and the law, the SAO focused its activity to the following areas in 2018.



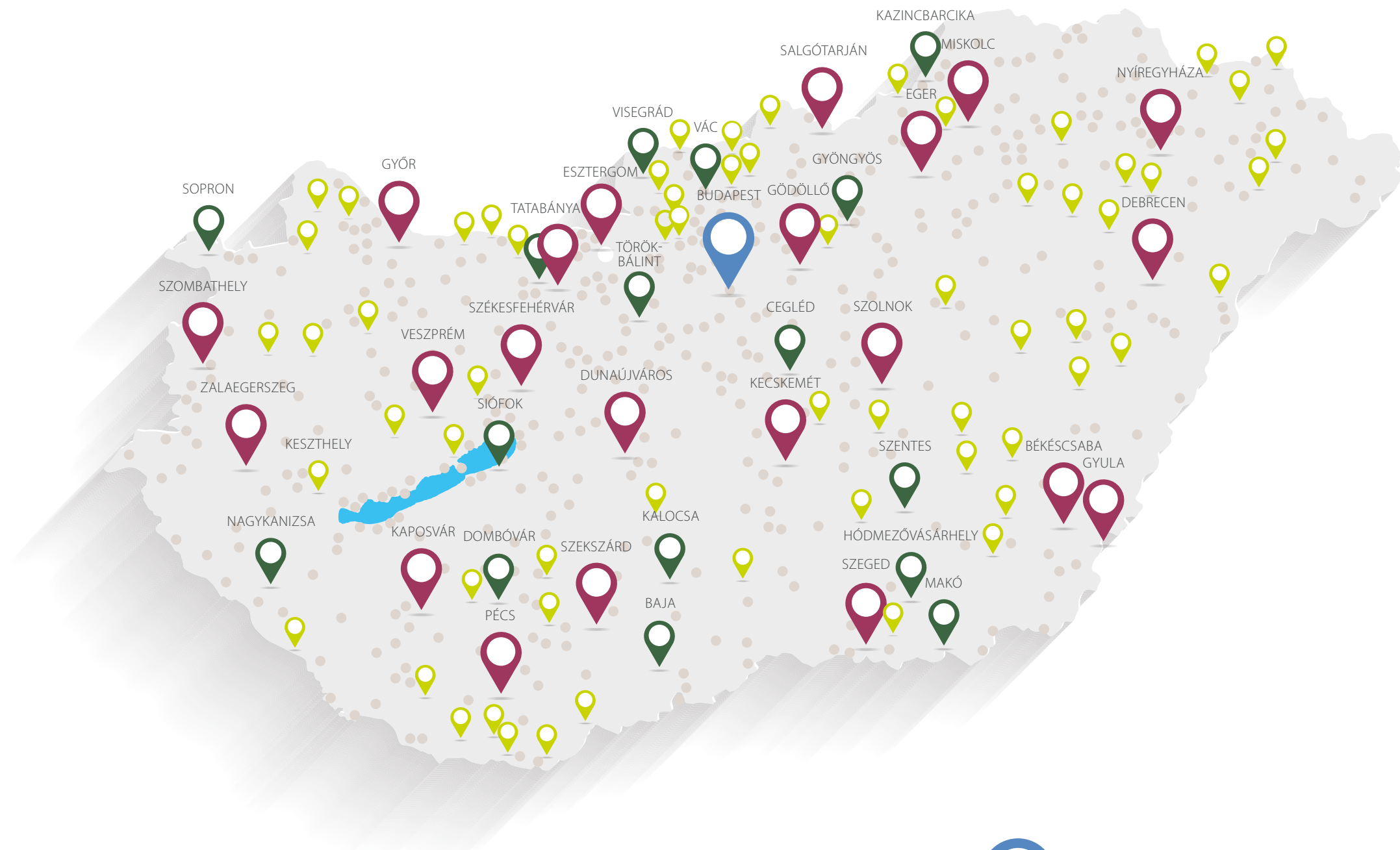
The focus areas of 2018 were founded on the experience of the previous years and the tasks defined by the Act on SAO, taking into account the current public financial risks. In order to maximise societal utilisation, the SAO extends its audits to more and more areas. So that the audits can cover the fields of use of public funds as comprehensively, effectively and efficiently as possible, the so-called thematic audits were given a prominent role in 2018 as well. The thematic audits specific to organisations carried out for years, on the basis of regularly renewed programmes, in specific topics concern both the different subareas of public finances and the groups of organisations closely connected to public finances but operating outside of it (for example: local governments, central budget institutions). In order to conduct audits of the highest possible usefulness, selected in accordance with the risks deemed emphatic, specific to the audited entities assigned as a result of risk analysis, the SAO also prepared targeted modular audit programmes, so-called topic-specific programme units, programme modules, for these audits.

Audited entities by settlement, 2013-2018



In the electronic version, clicking on the link will display changes across the year

TREND REGARDING THE NUMBER OF AUDITED ENTITIES BY MUNICIPALITIES BETWEEN 2013 AND 2018



100- 21-100 11-20 6-10 1-5

NUMBER OF AUDITED ENTITIES
(ENTITIES AUDITED MULTIPLE TIMES HAVE HIGHER NUMBERS)



Individual audit plans were created in new areas, the execution of which continues into 2019:

- the audit of the National Media and Infocommunication Authority,
- the audit of the Hungarian State Treasury's control activity,
- the audit of Magyar Villamos Művek Zrt.,
- the audit of the asset management related to state-owned cultural assets,
- the audit of the emergency medical service provider system
- the audit of the control system of public education
- the audit of the school meals scheme
- the audit of the National Tax and Customs Administration's duties related to corporate income tax
- the audit of the measures taken for the advancement of those living below the poverty threshold.

Within the scope of the audit of local governments, the SAO also performs the monitoring of the data available in the central database of the Hungarian State Treasury. By using this method, the SAO can also involve local governments in the evaluation which were not audited previous period. The SAO contributes to ensuring the sustainability of the financial management and task performance of local governments by evaluating the monitoring reports, identifying the risks affecting the financial equilibrium of local governments during the audits conducted on the basis of the financial monitoring system of local governments (ÖKOMER) developed by the SAO.

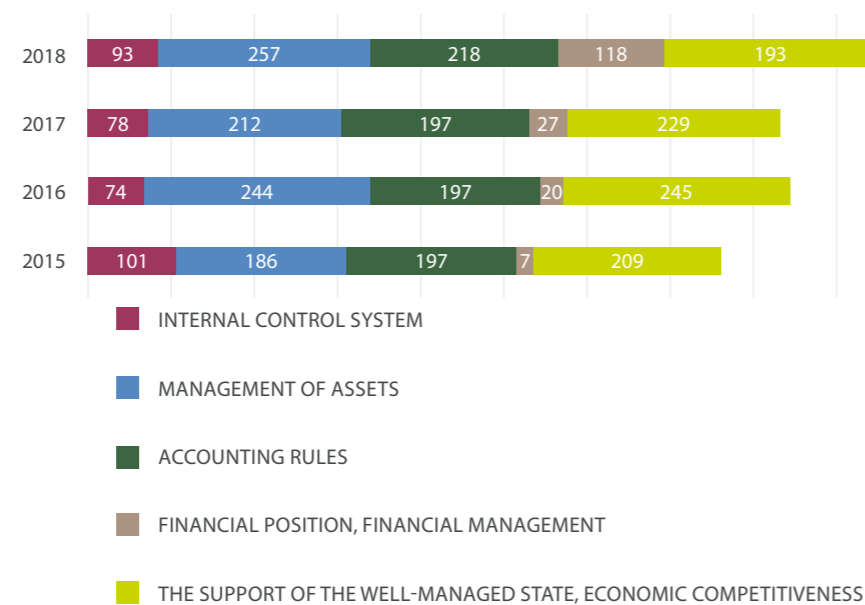
Within the framework of priority follow-up audits conducted in order to provide basis for the accountability included in the SAO's the strategic objectives and to strengthen utilisation, the SAO evaluated the execution of the action plans prepared based on the findings of its audit reports according to a uniform set of criteria.

By clicking on the link, and by downloading the QR code from the SAO's website (www.asz.hu) the trend of the number of SAO reports by audited entities between the specific years can be seen graphically.

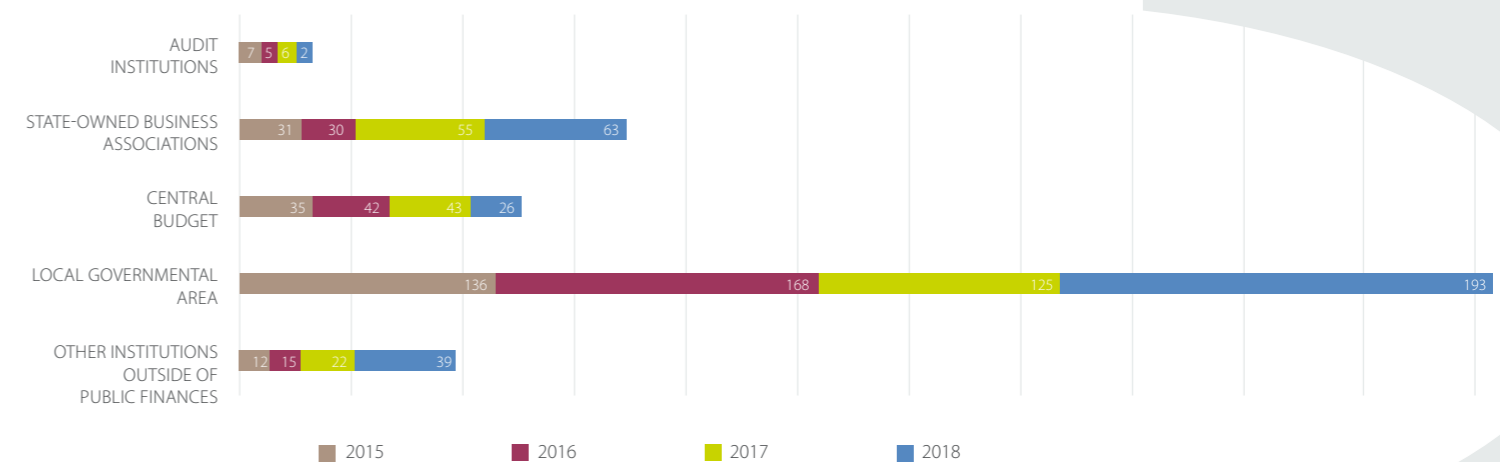


THE DISTRIBUTION OF SAO REPORTS BY AUDITED ENTITIES BETWEEN 2015 AND 2018 (PIECES)

THE DISTRIBUTION OF THE NUMBER OF SAO REPORTS BY AUDIT IMPACT AREAS BETWEEN 2015 AND 2018 (ITEMS)



THE DISTRIBUTION OF SAO REPORTS BY AUDITED ENTITIES BETWEEN 2015 AND 2018 (ITEMS)





THE SAO'S PROFESSIONAL ACTIVITY IN 2018

I. UTILISATION AREAS OF OUR ACTIVITY

UTILISATION IN LEGISLATION

The support of the National
Assembly

The appearance of SAO recom-
mendations
in legal regulations

Feedback on the execution
of legal regulations

UTILISATION BY ENTITIES USING PUBLIC FUNDS

Audits

Follow-up audits

Contribution to the improve-
ment of the orderliness of public
finances with legal assets

The rise of good practices and
ethical high quality leadership

SOCIETAL UTILISATION

Social information

Advisory activity

Contribution to
the public and academic life

1. Utilisation in legislation

1.1. CONTRIBUTION TO THE WORK OF THE NATIONAL ASSEMBLY

The highest level of utilisation of the constitutional function of the SAO is the support of legislation. With its auditing experience and advice the SAO supports the work of the National Assembly, thus making the utilisation of public funds more transparent for the members of parliament and the citizens. In the course of this activity the SAO contributes to high quality legislation which serves the interests of the citizens.

THE SUPPORT OF THE NATIONAL ASSEMBLY

20

reports to NA

14

requests for the amendment of legislation

7

recommendation for bills

14

comments on draft legislation

The indirect support of the work of the National Assembly is realised in numerous ways:

- sending reports and relating studies, analyses to the civil servants and members of the National Assembly,
- the support of the committee's work with state audit office information, background materials, communicating auditing experiences relating to the execution of the legal regulations,
- Recommendations prepared for the legislative programmes based on the related audits,
- recommendations for legislative amendments based on auditing experiences,
- the submission of the audit planning memorandum to the National Assembly,
- ensuring transparency for the entire society (SAO news portal).

1.2. SUPPORT OF LEGISLATION BASED ON THE AUDITING EXPERIENCES

Within the framework of the support of high quality legislation serving the interests of the citizens, the SAO can initiate legislative amendments based on its auditing experiences, which can ensure the elimination of the irregularities and deficiencies revealed by the audits at a system level, as well as the renewal of the legislative environment. For the even better utilisation of the auditing experiences, the SAO called the attention of the legislators to its numerous suggestions and recommendations supporting the legislation, including the SAO suggestions contained in the SAO reports of 2017.

Legislative plan

We sent 7 presidential letters in relation to the bills included in the legislative plan to the competent ministers concerning the following topics:



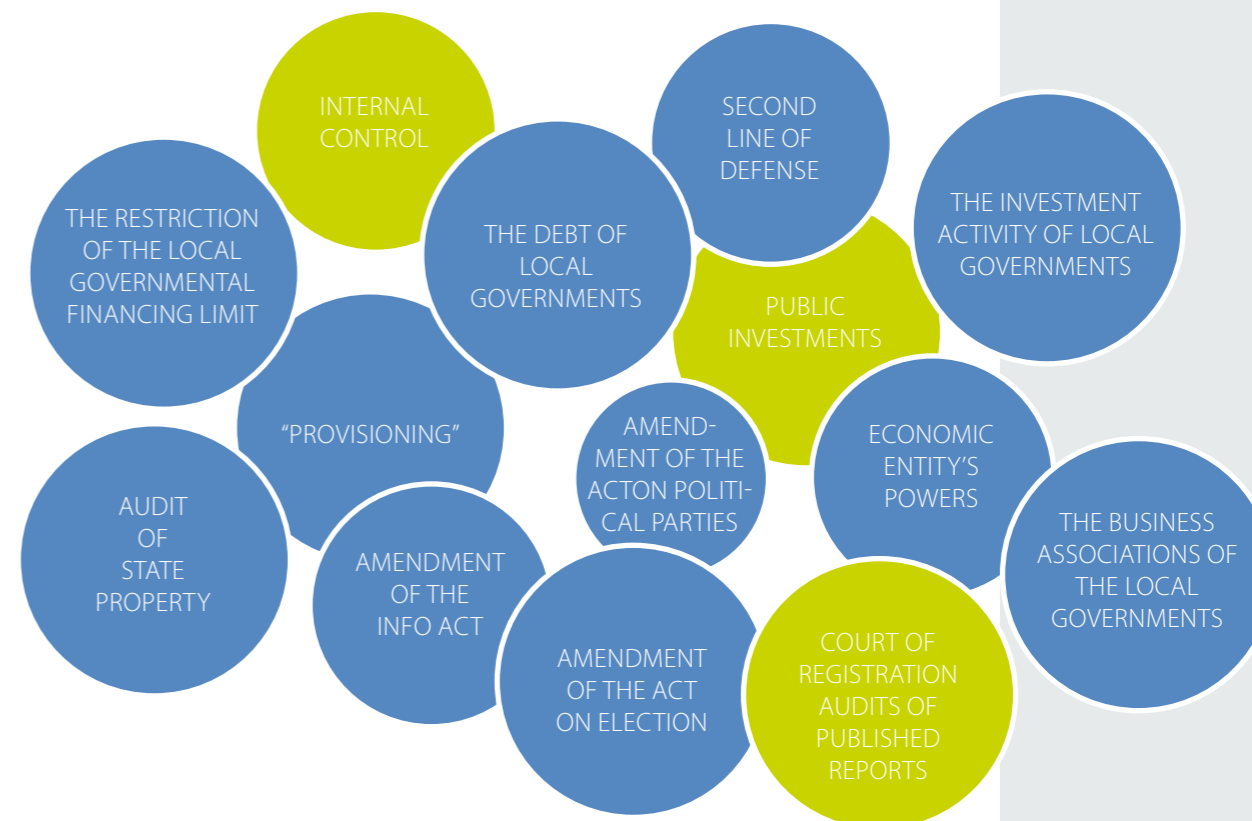
The colleagues of the SAO continuously monitored the bills concerning the SAO from their submission to their acceptance, prepared letters on the position of the state audit office on certain bills and, after issuance, they sent them to the those who made the proposal.

Other activities, information notes supporting legislation

In 2018 a total of 20 NA information notes were sent to the committees of the National Assembly by the colleagues of the SAO in alignment with the current committee agendas. The SAO prepared information notes to the Economic Committee on the experience gained in the audit carried out within the framework of the final accounts of the Hungarian Energy and Public Utility Regulatory Authority in 2018, and to the Cultural Committee on the experience of the audit carried out within the framework of the final accounts of the Administration of the Hungarian Academy of Science in 2015 and 2016. 6 information notes (AJBH, BGA, GVH, Curia, OBH and NAIH) were sent to the competent committees (Committee on Justice, Committee of National Unity and Economic Committee) on the auditing experience gained in the audits of the final accounts of 2017. Information notes were sent to the Committees of the National Assembly for the negotiations in the Parliament on the 2017 reports of organisation with reporting obligations. After May 2017 we repeatedly notified the Minister leading the Prime Ministeriate of our proposal made in the matter of significant investments, emphasising the importance of the topic and the contributory role of the SAO.

Initiatives for legislative amendments

The State Audit Office of Hungary initiated the amendment of several legal regulations in 2018, which concerned the following areas:



The utilisation of initiatives supporting legislation

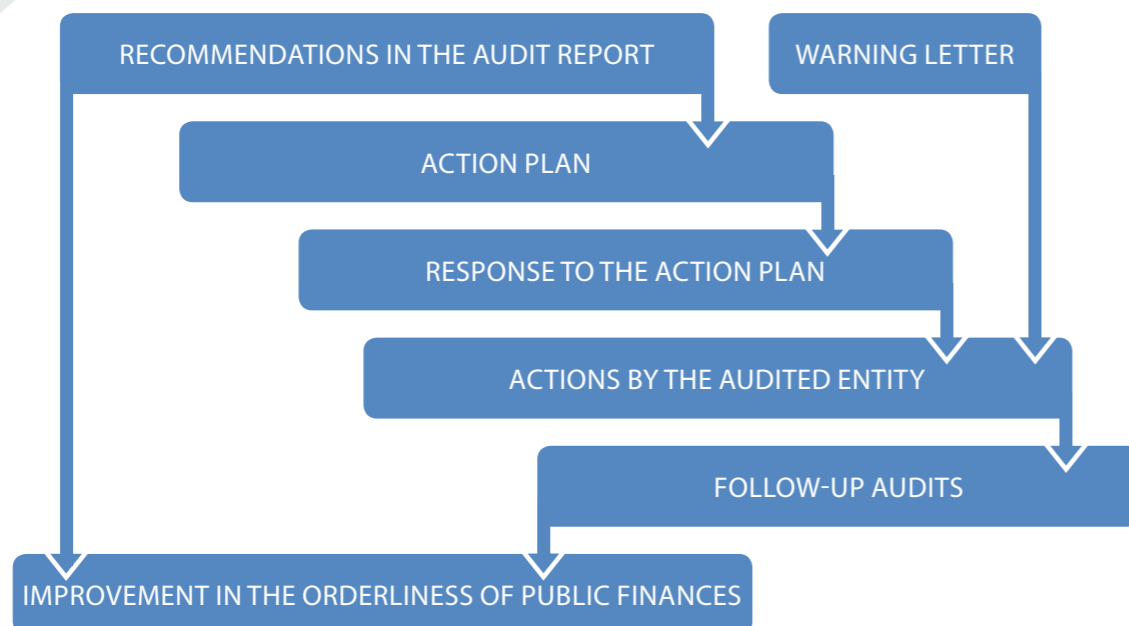
3 of the initiatives supporting legislation proposed to the legislators by the SAO in 2018 were accepted already in the same year:

- our proposals concerning the national assets in connection with state investments,
- our proposals made in the subject of the audit of the reports carried out by the Court of Registration
- and it was specified in section 2 of decision No. 22/2018 (X. 16.) of the National Assembly that the National Assembly "supports the proposal of the State Audit Office of Hungary included in its 2017 report stating that in order to remedy the deficiencies revealed by the State Audit Office of Hungary the findings of the State Audit Office of Hungary should have a greater impact on the internal audit in order to increase the effectiveness thereof." A specific realisation of previous comprehensive initiatives concerning state investments was the submission of bill No. T/3367 on the "implementation of civil construction state investments", at the general debate of which the president of the SAO also spoke. With the new law accepted by the National Assembly a new conception is used when managing the State's civil construction projects in Hungary, creating a uniform institutional system and set of tools to be the background of such investments.

Two of the initiatives of the SAO for the amendment of legal regulations in 2017 were accepted in their entirety. The act on campaign financing was amended, which sets out that the party setting up a party list is obliged to repay the budget support in case the party list does not reach at least 1% of the total valid votes cast for the party lists. Furthermore, the decree of the Ministry for National Economy means a guarantee for the collection of the prohibited aid provided to the parties, which sets out the obligation to the Hungarian State Treasury as authority to take measures.

2. Utilisation by entities using public funds

THE PROCESS OF THE UTILISATION OF THE STATE AUDIT OFFICE'S WORK AT AUDITED ENTITIES



2.1. RECOMMENDATIONS AND ACTION PLANS FOUNDED ON FINDINGS REQUIRING ACTION

Recommendations founded on findings requiring action

The quality management system of the SAO guarantees that the audit findings are based on objective facts, and that they are correct from a professional and legal point of view. The audit findings may be commented on by the leader of the audited entity within 15 days of the receipt of the draft report. The management of the comments is included by the SAO in the state audit report in a manner specified by the law, and reasons are given for non-acceptance.

The leader of the audited entity must prepare an action plan for the recommendations included in the reports in order to eliminate the irregularities and deficiencies, and the SAO will evaluate the acceptability of the action plan. The SAO may verify the fulfillment of the tasks contained in the action plan within the framework of a follow-up audit.

Providing opinion on the action plans based on uniform criteria

The monitoring of the utilisation of the recommendations made in the findings requiring actions helps the regular, economical and effective use and utilisation of public funds and public property.

The SAO made 2161 recommendations in connection with the audit findings to the leaders of the audited entities in the State Audit Office's reports published in 2018. For the execution and utilisation of the recommendations made in the SAO reports, the auditees are obliged to make an action plan and to send it to the SAO. The supervisory managers shall evaluate whether the actions undertaken are in alignment with the findings giving rise to the recommendations included in the state audit reports. The area fulfilling the risk analysis tasks supports the quality-driven operation of the SAO by providing opinion on the action plans and letters of response prepared by the supervisory managers based on uniform criteria. By implementing the action plan, the audited entities take steps to eliminate the errors and deficiencies existing in their financial management, which contributes to the improvement of the transparency and accountability of the use of public funds.

The compliance of the tasks required in the action plans, the fact of resending the action plans for supplementing, and the number of supplements may provide a basis for revealing the risks relating to the audited entity, which may be utilised when planning the follow-up audits.

Warning letters

The President of the SAO sent 212 warning letters in relation to the 323 state audit reports to the leaders of the audited entities. In these letters the SAO typically called the leaders of the audited entities to cease the unlawful practice revealed in the audits, which require actions. For example, the SAO also supports the realisation of Decree No. 1660/2015. (IX.15.) of the Government which sets out that the activity of the leaders of majority state-owned business associations must continuously be evaluated in terms of regularity, effectiveness and economy.

2.2. FOLLOW-UP AUDITS

In its strategy the SAO aimed to eliminate the errors, deficiencies and irregularities revealed by the previous audits. To this end, it carries out regular follow-up audits, which contribute to the improvement of the orderliness of public finances, the protection, increase and safeguarding of national assets. This allows the realisation of the audit entailing actual consequences.

RECOMMENDATIONS,
OPINIONS DELIVERED
TO THE AUDITEES

2,161 Recommendation

372 Addressee

212 Warning letter

What is a warning letter?

Based on the Act on State Audit Office the president of the SAO may send a warning letter to the leader of the audited entity to cease the unlawful practice, or the misuse or wasteful use of the state property, if the legal regulation does not provide for the application of a more severe legal consequence. The leader of the entity is obliged to judge the provisions of the warning letter within fifteen days, at the next meeting of the collegiate body, and to take adequate measures and notify the President of the SAO of this act.

For example, in case of state-owned and local government-owned business associations it is necessary to directly draw the attention of the owners to the financial management risks observed at the companies. They are in the position to take the appropriate steps under their competence to efficiently decrease the risks.

INITIATION OF ROCEEDINGS IN NUMBERS

11

Investigative authority notification

65

Notification of the Chamber of Auditors

10

Initiation of public procurement legal remedy proceedings

16

Notification of Government Offices

75

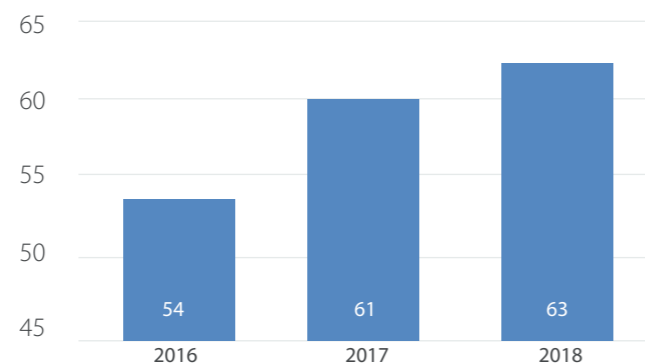
Notification of other institutions

The SAO continued to pursue follow-up audits in 2018 to assess whether the audited entity implemented the tasks specified in the action plan made in accordance with the findings requiring actions which were included in the audit report. The SAO carries out the follow-up audits independently, or in relation to and as part of an audit.

The follow-up audit system of the SAO enhances discipline and certifies that it is not allowed to wriggle out of the responsibility of regular operation in the financial management of public funds.

In terms of the follow-up audits 55 of them referred to the local governmental area and 8 of them referred to the area of the central budget.

THE TREND IN THE NUMBER OF THE FOLLOW-UP AUDITS BETWEEN 2016 AND 2018 (ACCORDING TO THE YEAR OF PUBLICATION)



2.3. CONTRIBUTION TO THE IMPROVEMENT OF THE ORDERLINESS OF PUBLIC FINANCES WITH LEGAL ASSETS

The legal consequence system of state audits was strengthened by the Fundamental Law, and its first cardinal act, the act on state audit office created by 2011. Therefore, the period of audits without consequences was definitely over in Hungary in 2011. The State Audit Office of Hungary has extensive tools to make an impact on the auditees for the realisation of the economical and regular use of public funds. Paragraph (5) of Section 1 of the Act on State Audit Office grants a general authorisation for the SAO to notify the authority entitled to act in a specific issue in case of a part of the irregularities identified during the audits.

The institutional mission of the SAO is to promote the transparency and orderliness of public finances with its value creating audits performed on a solid professional basis, and thus, to contribute to the operation of the well-managed state. The ultimate goal of the state audits is not error detection or reprimand, but to promote the prevention of errors, to orientate public finances in the right direction, to launch and maintain positive changes. In order to ensure the measurability of the utilisation and to define the directions of further developments, the State Audit Office of Hungary keeps a record of the authority notifications initiated by it and the feedback and effectiveness thereof.

It is important to emphasise that as the SAO is not an authority, it has no investigating powers or direct sanctioning opportunities in connection with the audit findings, it can only initiate the procedure to enforce the legal consequences at the body entitled to it in case of an unlawful act. In the event of a suspicion of criminal offence arising during the audits, the SAO is obliged to disclose its relating findings to the competent authority. Following the notification, the notified authority becomes the owner of the case, which will make a decision on the further actions at its own discretion. As a consequence, the SAO may not provide specific information on the stage or outcome of the cases in view of the interests of the investigative and other administrative procedure.

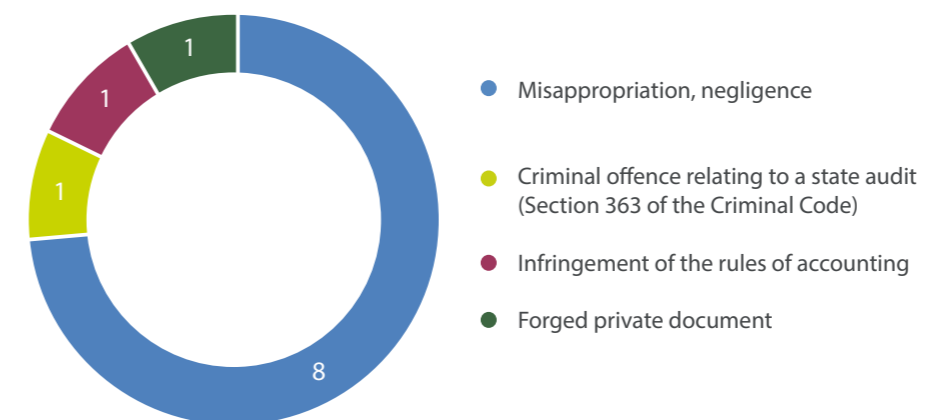
Furthermore, as each report of the SAO is public and available on its website, based on the findings included therein any authority can initiate proceedings at their own discretion.

59% of the notifications sent to the authorities related to the audit of state-owned, or local government-owned economic organisations, 24% of them related to the audit of local governments, 11% of them related to the audit of certain institutions of the central subsystem, and 6% related to the audit of other audited entities.

The notification of investigative authorities

In 2018 36% of the notifications of investigative authorities were made by the SAO in connection with the audit of business associations, 46% related to the audit of local governments, 18% related to the audit of other entities.

DISTRIBUTION OF THE REQUESTS FROM INVESTIGATIVE AUTHORITIES (ITEMS)



Notification of the Chamber of Auditors

In 2018 the SAO sent notification to the Chamber of Hungarian Auditors in complaint of the auditors of 65 audited entities. During the audits, the SAO found in many cases that the authenticity of the reports were not guaranteed despite the fact that the report was endorsed by the auditor. In this cases, therefore, the SAO sent a notification to the Chamber of Auditors.

Public Procurement Arbitration Board notification

The SAO exercised its right to appeal granted by the law in 10 cases in 2018, thus contributing to the promotion of the lawful execution of public procurements and the transparency of the spending of public funds. The most typical irregularity continues to be the non-application of the public procurement procedure, and in a smaller number the amendment of the concluded contracts contrary to the act on public procurement.

Based on the SAO's evaluation the Public Procurement Arbitration Board fulfilled its tasks adequately, thus, it decreased the risks of errors.

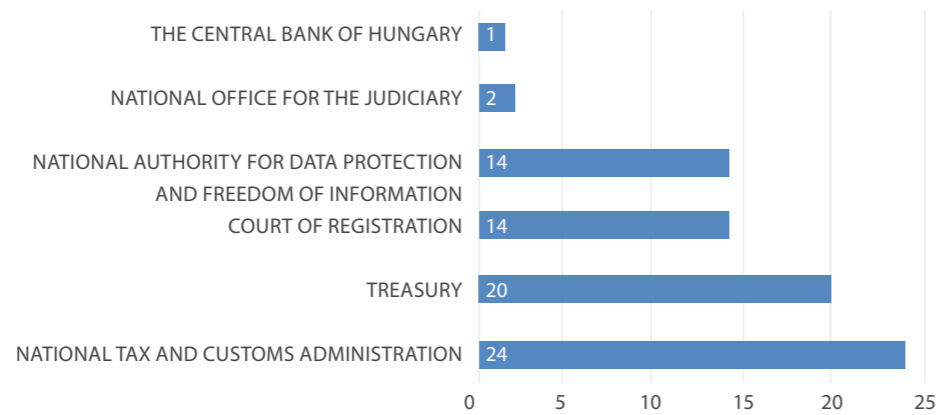
Notification of the Government Office

In 2018, in connection with the audit of local governments, the SAO notified the competent capital and county government offices exercising the legal supervision of local governments 16 times.

The notifications were justified by the fact that the auditors published findings for the remedy of which the capital or county government office exercising the legal supervision over the operation of the local government has more direct, and thus more efficient tools as a result of its supervisory power. Such irregularity was among others the absence of the economic programme, the Operational and Organisational Rules or the inventory regulation or the incomplete content thereof.

Following the notifications of the SAO the government offices applied a call for lawfulness within the framework of a lawfulness supervision procedure in several cases, and in numerous cases they provided professional assistance to the local governments concerned in order to eliminate the errors and deficiencies identified.

OTHER NOTIFICATIONS IN 2018 (ITEM)



Cooperation with investigative authorities

In accordance with Paragraph (1) of Section 261 of Act XC of 2017 on Criminal Procedure, the court, the prosecutor and the investigative authority may request data from a legal person or entity without legal personality.

In relation to the criminal proceedings ongoing at the investigative authorities, initiated not on the basis of the SAO's notification, there may be audit documents or information at the SAO which have significance from the point of view of conducting the criminal procedure. In 2018 the SAO gave response to 4 requests by investigative authorities, in which cases we effectively supported the work of the investigative authorities conducting the criminal proceedings by sending them the documents available to us.

Initiation of the disbursement of budget support

If the audit reveals misuse or wasteful use, or damage caused by the serious infringement of the rules applicable to the management of funds by the audited entity, or establishes the threat thereof, or the audited entity does not comply with its obligation to contribute (take action) the State Audit Office of Hungary may initiate the disbursement of budget support in order to prevent or mitigate the damage, and to enforce the contribution of the auditee. The disbursement of budget supports is considered as a measure protecting property in practice. It is important, though, that following the compliance with the obligation to contribute the suspension of the measure protecting property can be initiated. In 2018 the State Audit Office of Hungary used this possibility 24 times, alongside the enforcement of the principle of gradual approach, which proved to be an efficient tool in order to cease the irregular operation as soon as possible.



3. Areas of societal utilisation – information, advisory function

3.1. SOCIAL INFORMATION

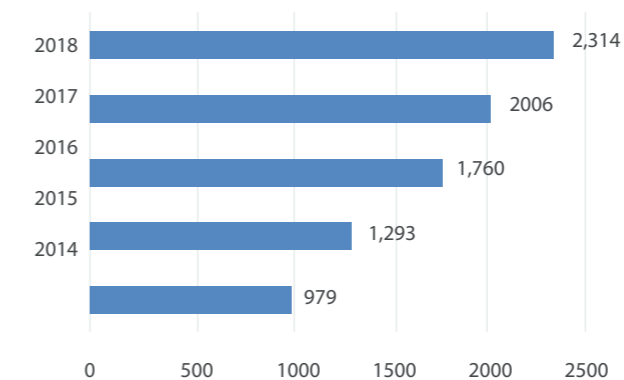
The State Audit Office of Hungary places particular emphasis on the utilisation of its work, which requires conscious, planned and proactive communication. The State Audit Office of Hungary conducts moderate and easily comprehensible communication when presenting its results and values.

Societal utilisation

The State Audit Office of Hungary endeavoured to focus its communication on the relevant and current audit events of public interest in 2018 as well. Consequently, the number of media appearances of the SAO was 8,956 in 2018, exceeding the previous year's data by more than 20 percent. Together with the increasing number of media appearances, the social visibility of the SAO is also improving, confirmed by a public opinion poll in August 2018.

The SAO news portal's version optimised for smart devices was completed. The results confirm that in 2018 again, the State Audit Office ensured a remarkable level of transparency regarding its day-to-day activities and tasks. This also means that the SAO is one of the organisations with the most transparent operation and the most active communication in the public sector in Hungary.

NUMBER OF ARTICLES IN HUNGARIAN PUBLISHED ON THE SAO NEWS PORTALS (ITEMS)



In addition to the articles in Hungarian, the SAO published 459 additional articles on the three foreign language sites of the News Portal in 2018.

Utilisation of complaints of public interest

The notifications of public interest are utilised primarily not in terms of the ongoing audits, but during the planning of the audits within the framework of the risk analysis activity, in the process of the selection of location. In 2018 nearly the fifth of the locations selected were concerned by a complaint of public interest. With regard to each audit topic and type of organisation, two thirds of the complaints of public interest which can be taken into account during the selection of locations arrived in connection with local governments.

OUR PERFORM-
ANCE REGARDING
COMMUNICATION IN
NUMBERS

8,956 News items
in the media

2,314 News articles on
the news portal
of the SAO

65 Press
releases

150 Electronic
press
conferences

8 Traditional press
conference

Academic utilisation

The SAO continuously makes sure to share the results of its audit, advisory and analysis activity with the professional-academic public. The SAO continued its summarising and analysing work focusing on groups of problems, published in studies within the framework of this activity, during which it published a public finance professional journal.

By publishing the Public Finance Quarterly the objective of the SAO is to provide an authentic image of the financial system, and on the principal features of the operation of the public sector and the national economy in the light of the most important financial connections. Another of our objectives is to support the debates on catching-up and future building endeavours and the relating professional debates, the dissemination of financial awareness and to contribute to the justification of financial-economic decisions.

In 2018 the Public Finance Quarterly published four issues. The issues focused on the following topics:

- The theory and practice of financial consolidation,
- public finances,
- sustainability and trust,
- economy and cash flow.

3.2. THE ADVISORY ACTIVITY OF THE SAO

A priority mission of the State Audit Office of Hungary is to support the already audited and potentially audited entities based on its auditing experience within the framework of its statutory advisory activity. In addition to analyses and studies, the SAO shares its experience at conferences, seminars, knowledge-sharing sessions and projects as well as trainings and self-tests with the wider professional public.

Analyses, studies

With its analyses and studies the SAO supports the work of the National Assembly and the efficient use of public funds for intended purposes. By analysing the results of the audit periods, the SAO can focus the attention of the legislators on the potentially arising financial regulatory anomalies in the sectors significant from the point of view of the national economy, which allows it to support the efficient operation of the state, the stability and sustainability of public finance management. The preparation of analyses and studies is one of the main pillars of the advisory activity of the SAO and a crucial tool of the support of good governance.

As part of its advisory activity, the SAO published 17 analyses and studies in 2018.

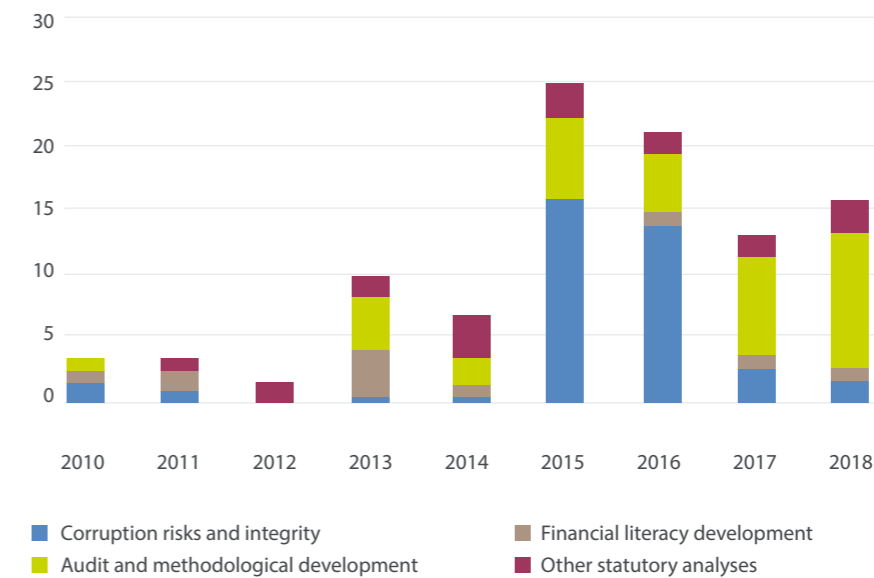
The analysis focus areas of the SAO

In order to widely disseminate integrity culture, between 2014 and 2016 the greatest proportion of the SAO's analyses was related to integrity, the analysis and examination of integrity problems. Given that as a result of the above the advisory role of the SAO prevailed to a large extent in the topic of integrity (for example, different trainings, international knowledge-sharing), the majority of the SAO analyses now focuses on new areas (of course, this does not mean neglecting, ignoring the old areas).

The endeavour of the State Audit Office of Hungary focuses more and more on analyses which analyse the comprehensive auditing experience of several organisations operating in the same sector. These studies demonstrate the irregularities and other risks hidden in the activities of the entities operating in the sector and audited based on the risk analyses of the SAO, which allows the SAO to draw the attention of the other organisations operating in the given sector to potential risks which have already been discovered in case of other organisations. This method results in a self-generating circle: the analyses building on the auditing experiences may highlight new, risky audit areas, and these auditing experiences can be summarised and used again, and so on.

The SAO primarily strives to harmonise its audits founded on risk analysis with its intention to probe into the exemplary or defining organisations with greater weight in case of the different sectors, as this allows it to reach a broader utilisation in terms of the entirety of the sector, and, therefore, it can contribute to the improvement of the economic competitiveness of the sector to a greater extent.

THE NUMBER OF THE ANALYSES MADE IN YEARS 2010-2018 ACCORDING TO THEIR DISTRIBUTION AMONG THE AREAS OF NA DECISIONS



The contribution of the SAO to economic competitiveness

In the financial management and operation of public finances creating an equilibrium in the financial situation, keeping the trends of public debt on a sustainable track and the promoting economic competitiveness are crucial. Therefore, the SAO has dedicated particular attention to the audit and analysis of these areas over the last years.

With its audits and analyses the State Audit Office of Hungary also focuses on the objective factors defining the competitiveness of the country. The basic requirements influencing Hungary's competitiveness the most, including the trends of public debt and deficit, were laid down in the Fundamental Law. The Fundamental Law sets out that as long as the public debt exceeds 50% of the GDP, the debt-to-GDP ratio (debt ratio) must continuously be improved. The Stability law determines the concept of public debt and the rate of the decrease (public debt rule). The requirements of transparency, lawfulness, expediency and effectiveness set out by the Fundamental Law must be observed by each organisation managing public funds and public property.

The improvement of sustainable economic growth may show correlation with the endeavours to guarantee the regularity of financial management and with the intent to stabilise the financial situation following the audits.

From the analysis experience of the State Audit Office of Hungary it can be concluded that the objective macroeconomic indicators of the Hungarian economy and, thus, its competitiveness improved. The public debt indicator follows a decreasing trend, and shows significant implicit reserves which guarantee some flexibility. The growing trend of the centralisation and redistribution ratio observed in the last years turned around, the unemployment rate decreased so much that the number of those employed was the highest since the regime change.

The increase in the competitiveness of the economy can be achieved by the development of the elements of economic performance. The tool of this development is capacity development, which promotes the enhancement of the organisation's performance and the added-value of the organisation. As a result, the utilisation of the SAO's work (audits and analyses) can expand through the growth of social trust and the increase of macro-economic indicators affecting the performance and effectiveness of the national economy.

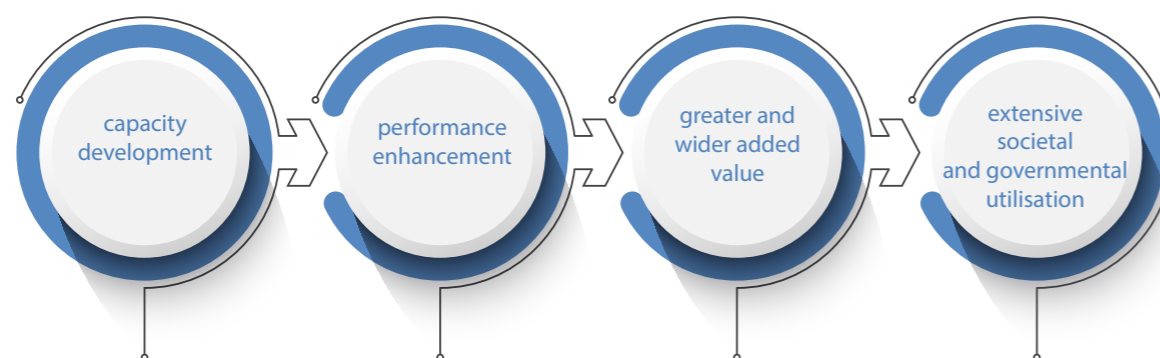


What does capacity development mean?

In general capacity means the totality of the elements determining the performance of a system. Capacity development means the development, renewal, modernisation of the already existing capacities, that is, different resources (knowledge, skills, technologies etc.)



The macroeconomic indicators influencing the national economic performance and effectiveness mean the totality of the elements of the national economy's performance capacity. These resources may be outside of the good practices of the organisation and optimisation of the methods or processes of operation, which contribute to an effective and efficient task performance. In the course of the work and advisory activity, the SAO may also highlight the areas of the governmental operation to be developed, thus, it can contribute to the good governance, the operation of the well-managed state, and therefore, to the improvement of economic competitiveness.



Knowledge-sharing at conferences and seminars

The statutory duty of the State Audit Office of Hungary is to support the audited entities within the framework of its advisory activities. The SAO also contributes to the transfer of expertise and experience with cooperation agreements, consultations and participation in common projects.

To this end, the State Audit Office initiated knowledge sharing in 2018 on an even bigger scale than before: the SAO organised 6 conferences, with 670 professionals in attendance; the auditors were invited to attend nearly 60 conferences in Hungary to present their auditing experiences and analytical results to the audiences.

Prioritised domestic trainings, seminars, conferences

In 2018, the leaders of 67 organisations using public funds completed the public finance management training programme provided by the SAO in cooperation with the University of Miskolc. The SAO, on its own initiative, shared its audit experiences at an institutional level with the leaders of four historical churches, five associations of local governments, and the professional organisation of internal auditors in the last year as well.

In the spirit of the academic utilisation of the state audit office's work, the SAO published its audit, research and analysis experience obtained in the areas in the centre of public interest, as well as its academic communications. Furthermore, it was involved in the publication of textbooks, volumes of studies and special issues, and supported the utilisation of the state audit office's knowledge at national and international level through lectures.

The series of events consisting of workshops organised by the National Protective Service continued in 2018 as well. The purpose of the workshops is to promote the value-based operation of local governments, the identification and management of corruption risks and to overall strengthen organisational integrity. Since its early days the SAO has strongly supported the nationwide round of events which also shares its audit experience. The further training of the Ministry of Foreign Affairs and Trade focusing on special integrity, integrity management and integrated risk management methods was supported by several public bodies including the State Audit Office. The SAO participated in all four training sessions, and it emphasised at the further trainings: the ability to identify the risks and learning the risk management methods is indispensable for a successful external service. It is an important task of the foreign affairs experts to report on their efforts made and results achieved for the dissemination of integrity based administrative culture at their location which allows them to contribute to the strengthening of the country's reputation.

Self-tests

Within the framework of its advisory activity, the SAO launched its self-test system in accordance with its integrity approach in November 2014, which have already been downloaded

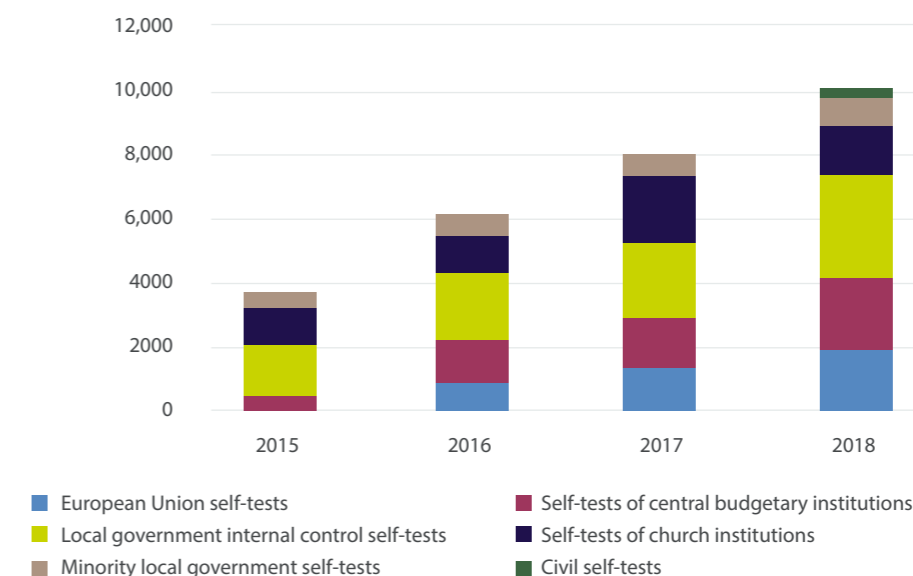
more than ten thousand times from its website. The development of the self-test system served the goal to allow as broad a range of entities as possible that are involved in the use of public funds to utilise the auditing experience of the SAO.

The self-test available since May 2018 was made to the leaders, controlling entities, organisations, institutions of non-governmental organisations, and it is a self-test promoting a regulated and regular operation, and the development and verification of the requirements necessary for the use and of public funds.

For an enhanced utilisation the SAO continuously develops and updates the self-tests based on its expanding auditing experience, in line with the changes of the regulatory environment. Within this framework the updated versions of the self-tests for 2017 have been available on the SAO website since October 2018. The different self-tests were downloaded by the organisations a total of 1978 times in 2018.

The continuously increasing number of the downloads of the self-tests proves effective utilisation. By using the self-tests of the SAO not only the auditees can assess their own situation, but also the entities not yet audited have the opportunity to adopt the "good practices", and to improve the regularity and compliance of their operation.

THE ANNUAL TRENDS OF SELF-TEST DOWNLOADS INCLUDING THE INCREASE IN THE YEAR OF DOWNLOAD (CUMULATED DATA)



Decision No. 35/2009. (V. 12.)

of the National Assembly for the strengthening of the SAO's role to map corruption risks

What does self-test mean?

Self-test is a set of questions supporting the assessment and evaluation of the task performance of organisations operating by using public funds, the regularity of their internal control system, which was prepared taking into account the given operational and regulatory environment and the specificity of the tasks, and it can be filled in by the parties concerned on a voluntary basis, for their own utilisation. The self-test is suitable for the respondents to form a comprehensive view of the regularity of their own operation, the status of their internal control mechanisms, and it can be used effectively to identify the deficiencies, risks and the opportunities to improve.



REPORTS, ANALYSES AND STUDIES PREPARED BY SAO IN 2018 BY FOCUS AREA

OUR PERFORMANCE IN NUMBERS SUPPORTING THE WELL-MANAGED STATE

323 SAO reports

17 Analysis, studies

20 Information reports to the National Assembly

7 SAO proposal

II. EXPERIENCES OF AUDITS AND ANALYSES

1. Supporting the functioning of the “well-managed state”

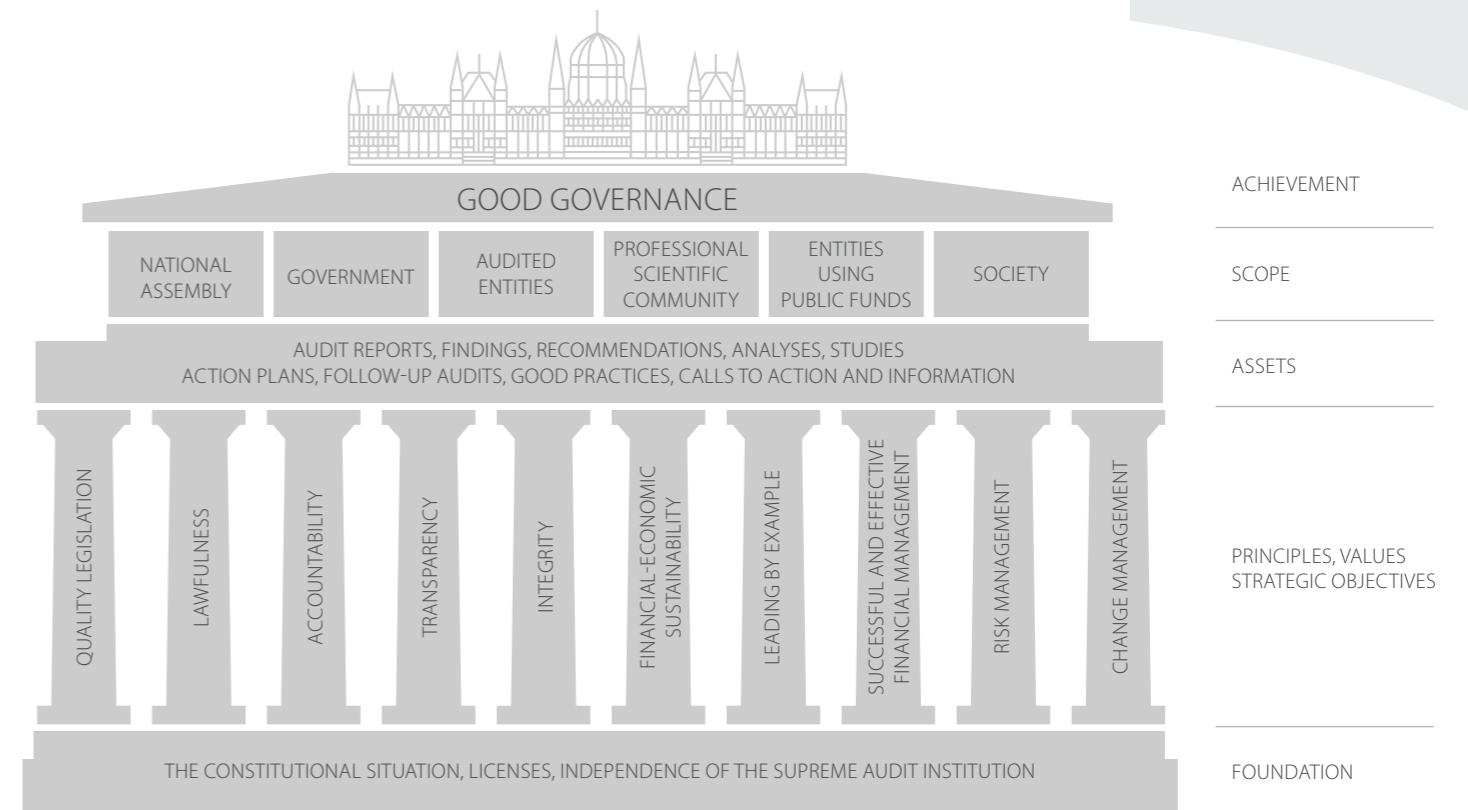
In accordance with its strategy, the mission of the State Audit Office of Hungary is to promote the transparency and regularity of public finances with its value creating audits performed on a solid professional basis, thus contributing to the concept of the well-managed state. Contributing to the well-managed state became a duty of the State Audit Office of Hungary as stipulated by Act LXVI of 2011 on the State Audit Office of Hungary. The objective can be described as the sustainable existence of the well-managed state.

Efficiency in the use of public funds is a key question with regards to efficient public sector management. In public sector management, therefore, every institution is required to continually supervise its own performance while performing its public duties using the public funds entrusted to them, and to associate efficiency and quality criteria with it. Basic principles may be associated with it which have relevance to the approach of the Hungarian model:

- order means value in matters related to public funds;
 - the provisions of the rules are worth only as much as the extent to which they can be enforced;
 - the rule that is not checked is not observed;
 - non-observance or violation of the rules must have consequences both for the leader of the public fund institution and at the level of the institution;
 - taking a step-by-step approach to development from the present to the future guarantees sustainability in public finances;
 - the responsible financial management by the leaders of the institutions and the principle of the rational use of public funds and public property mutually strengthen each other in matters related to public finances;
 - the realisation of accountability and transparency at every institution using public funds.
- The financial management of a well-managed institution strengthens the functioning of the state and its good reputation. Such institutions in large numbers create a well-managed state that is functioning and generate trust vested in the state. In this process the supervisory functions support the management of public funds, the enlargement of public property, the formation of a true opinion about the reliability of a reliable settlement. The State Audit Office of Hungary – in consideration of its authorisation and duties mandated by law – constructed a model to overview and systematise its contribution to good governance. The first static version of “The contribution of supreme audit institutions to good governance” model describes the basic requirements, principles, means and scope of supporting good governance, thus providing a theoretical framework for its own activity in support of good governance. The static SAO model that had been constructed provided the appropriate operating framework for the State Audit Office of Hungary in the past five years to support good governance.

However, as result of the changed and continually changing environment there is a constant intention worldwide to ensure the sustainability of a well-managed state, as there is in Hungary as well. In order to be able to meet this challenge, the static SAO model needs to be further developed on the basis of the continuous support provided to the well-managed state and the sustainability criteria. Taking into consideration the above, two new pillars have been added to the SAO model, risk management and change management.

CONTRIBUTION OF THE SUPREME AUDIT INSTITUTIONS TO GOOD GOVERNANCE HUNGARIAN MODEL



In accordance with its role of exemplary institution, the SAO model accomplishes continual improvement in the public funds scenario through continuous capacity and organisational development based on self-learning and through risk management and the change management relying on it. The model considers democratic political establishment and the constitutional state – as a competitive environment that encourages innovation – to be its fundamental operating framework and it attempts to integrate the concepts associated with the development of the state and its search for practical ways into a system-level conceptual framework. No such framework applying such a comprehensive approach has ever been constructed before.

The active state also encourages the supreme audit organisation to act, to accept role greater than before in supporting good governance, to contribute to the establishment of the sustainable welfare state by expanding its activities and functions, thus contributing to improving the life and security of citizens. The SAO, along with its strengthening advisory and analyst activities, also continues to increase the efficiency of its auditing function, in which the next level will be the transformation to the digital auditing environment. In order to increase efficiency, the SAO reviewed the methodology and practice of the audits and on the basis of this it considers using the methodology of the risk-based approach to have major significance. It launches initiatives towards the audited and auditing institutions to encourage its use. The coherence of the audit approaches can thus contribute to the transparency of public funds, and to the improvement of the public funds scenario.

Utilisation of the System-level Audit Experiences

The SAO, in its summary provided on its professional activity in 2017 and in its report on the operation of the institution, devised its recommendations for the National Assembly on the basis of its audit experiences in which the review of altogether 14 regulatory areas affecting public finances were mentioned, which were sent to the responsible ministers.

SAO Proposal

It may be recommended to integrate the methodology of the risk-based approach into the auditing of the central subsystem institutions.



The SAO proposals in 2017 affected the following areas:

The proposal related to the **financial management of the parties** urged measures to discontinue the misused, wasteful financial management affecting the use of public funds and public property, and also proposed to determine expediency requirements that should be interpreted at government level.

The proposal in connection with **increased transparency** suggested that, based on the communication experiences of the SAO, the National Assembly should address the institutions that have a reporting obligation towards the National Assembly to increase their social benefit and transparency, thus strengthening the credible informing activity of the institutions. The call to action may strengthen the society's trust in the state through the means of positive communication and can also contribute to the well-managed state.

According to the proposal related to the **internal control system**, the SAO conclusions should have greater effect on the internal control to enhance its efficiency and effectiveness for the purpose of eliminating the discrepancies that were discovered in the SAO risk analyses.

The proposal related to **responsible property management by the owner and to establishing the legal environment of the investments** emphasised that the strengthening of the exercise of proprietary rights and the supervision of control are of paramount importance, as well as further improving the owner's position in public sector management – including the strengthening of the regulatory environment of investments.

In connection with **the establishment of auditable state property**, the SAO proposal recommended to strengthen the listing of the state property as well as to audit it in order to ensure the safeguarding of assets, asset preservation and assets growth according to the Fundamental Law and to improve its safeguards.

In connection with **expert-made investments**, the proposal suggested that it may be reasonable to require the head of the local government office and the persons undertaking commitments and/or certifying accomplishment to possess professional qualifications in local governments where market-based securities transactions and financial investments are managed.

The proposal outlined in relation to **public finances powers** recommended a substantial decrease in the bureaucracy of the ongoing financial matters by rethinking the powers in public finances.

The proposal outlined in relation to the **levels of supervision in public finances** recommended that the legislative coordinating framework of the three supervision levels of the public finances be strengthened.

The proposal in connection with the **creation of reserves** pointed out that it may be necessary to create reserves in consideration of the factors of economic vulnerability.

The SAO proposal in connection with the **local government financing limitation** recommended that the local government financing limitation may be tightened in connection with the risks identified through the local government monitoring system created by the SAO.

The two SAO proposals outlined on the issue of **local government debt** on the one hand proposed to rethink the objectives of the act on debt settlement proceedings. On the other hand, it highlighted the fact that the local government debt may be reproduced despite the debt consolidation and therefore it may be justifiable to strengthen the public sector management in this area.

The proposal related to **local government business associations** suggested that a system of indicators be developed for business associations owned by local governments to measure the performance of public duties and services.

The SAO proposal in connection with **e-governance** recommended that parts of e-governance be expanded to the SAO to reduce bureaucracy.

1.1. PUBLIC SECTOR MANAGEMENT, RESPONSIBLE MANAGERIAL CONDUCT

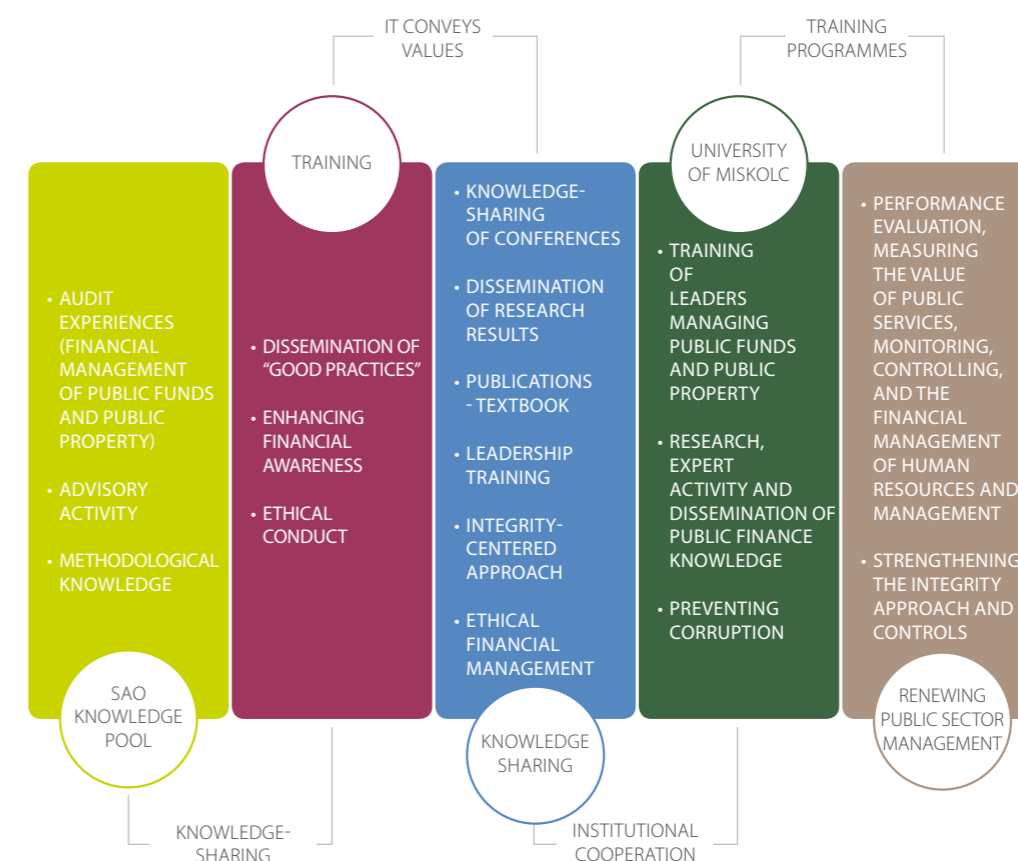
The well-managed state is a public interest that implies the setting up and operation of a performance evaluation system that improves the organisation's performance and contributes to taking advantage of development opportunities. The performance evaluation of managers is a significant factor in the resulting performance. Developing this is a timely issue, since establishing a system measuring the performance of the leaders contributes to the reform of public administration and to the implementation of the strategic goal of setting up an efficient national public administration system as set forth in Article XXVI of the Fundamental Law.

One of the purposes of the advisory activities pursued by the State Audit Office of Hungary – confirmed by the National Assembly, too – is to propagate knowledge-sharing and the dissemination of “good practices” by providing education and training, and to develop public finance and leadership skills among the organisations of the public finance system. To this effect, the SAO strives to work together with the other constitutional institutions and with higher education institutions.

The purpose of the advisory activity of the SAO is knowledge sharing, dissemination of “good practices” and developing public finance and leadership skills among the organisations of the public finance system. This goal was confirmed by the fact that in 2015 the National Assembly entrusted the SAO in its decision number 34/2015 (VII. 7.) to widen its advisory activities on management systems and to contribute to ethical public finance management training. To this end, in 2016 the SAO concluded a three-year cooperation agreement with the University of Miskolc, and in the framework of this it established the Public Service Management Institute Department. The joint department has multiple purposes. Besides the public service performance analyst course launched in September 2016, there is another course providing useful knowledge specifically to the top executives of budgetary institutions.

The 50-hour classroom-based and e-learning course focuses on ethical public finance management. The SAO, in co-operation with the Institute of Management Science at the University of Miskolc, formed its training thematically to provide useful lectures specifically for the top executives of budgetary institutions. The training focuses on ethical public finance management. In addition, the training includes the topics of value creation, ethical dilemmas in leadership, the establishment and strengthening of organisational integrity in the public sector, public service performance management and management control.

THE SAO'S CONTRIBUTION TO THE DEVELOPMENT OF PUBLIC SECTOR MANAGEMENT



What is the Audit of State Property?

The audit of state property, by definition, means enforcing the provisions of the Fundamental Law and the Assets Act relating to public property. Its audit, in the opinion of the SAO, should be integrated in a system level.

ANALYSIS OF THE STATE OF INTERNAL AUDIT

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Audit of the internal control system of local governments

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Audit of central subsystem institutions



The analysis can be accessed by clicking on the publication number in the box and may be downloaded from the SAO website (www.asz.hu) with the help of the QR code.

The SAO, jointly with the University of Miskolc and in view of the heightened interest and the positive feedback, will extend its training to other institutional groups and public finance areas in the near future.

The SAO, within its joint department with the University of Miskolc, is conducting preparatory work for a new course, the public service performance management course, and on the basis of its renewed agreement with the National University of Public Service it is planning to introduce a subject on change management and decision management.

ANALYSIS OF THE STATE OF INTERNAL AUDIT

In an analysis, the State Audit Office of Hungary evaluated the activities connected to the design and operation of internal auditing, relying on the experiences of SAO audits at local governments and institutions. The analysis pointed out that internal auditing, which is obligatory pursuant to legal regulations, could not fulfil its purpose as a first line of defense as it did not ensure the regularity of task performance and operation.

The Fundamental Law of Hungary requires that the principle of a balanced, transparent and sustainable financial management is enforced, and also that the national assets are used appropriately and responsibly. The SAO, in accordance with its strategic goals and on the basis of legislative authorisation, performs audits on the responsible management of public funds and assets owned by the state and local governments, as well as audits on compliance with accounting policies and the operation of the internal control system of local governments, and furthermore it supports the establishment of the integrity-based, transparent and accountable use of public funds.

The analysis pointed out that the internal auditing function has a key role as it evaluates and improves the efficiency of risk management, controlling and management processes through a systematic and regulated process. With that, it facilitates the accomplishment of organisational objectives, and the regular, economical, efficient and effective financial management of public funds and national assets.

On the basis of the 61 reports published in 2016, the findings of the SAO audits, in terms of the quality and compliance of the internal control system and internal control, showed in respect of the local governments and institutions that in the cases where the internal auditing function did not work adequately, irregularities and discrepancies were also found in the functioning of the internal control and in financial management. Therefore it can be concluded that internal audit impacts the lawful operation of the organisation as well as the lawful and responsible management of public funds and the national assets.

In its analyses, the SAO concluded that inadequately designed and operated internal audit – independently of the number of internal audits performed – did not contribute to a lawfully operating internal control system or regular financial and property management. Therefore the proper use of public funds is a risk within the current operating framework. This is supported by the fact that risk-based operation is an indispensable prerequisite for internal auditing based on which the organisation can identify the risk areas that have the highest potential impact on its operation and on financial management requiring control. In the public sector, the leaders of budgetary institutions need to design the internal auditing function in a way that the institution employs a management and control system ensuring regular task performance and operation.

Based on the analysis, it needs to be highlighted that the leaders of budgetary institutions are required to establish, operate and further develop an internal auditing function to support management within their integrational and management systems ensuring compliance with the rules, as in the absence of this the first line of defense cannot perform its function to protect public funds and to support management.

The Utilisation of SAO Proposals in Internal Control

The adequate design and operation of an internal control system has a key role in developing the integrity of the institutions, preventing, identifying and handling corruption risks. With a properly established and maintained internal control system the likelihood of errors and irregularities can be reduced to the minimum. Nevertheless, it is apparent that not even a well-functioning, i.e. efficient internal control system can prevent every error or irregularity, it can merely provide a reasonable level of defense.

The SAO, recognizing the risk in the regular use of public funds necessarily associated with the deficiencies of the internal control system and in addition to the widespread thematic audits focusing on the establishment and operation of the internal control system, regards the issues related to the establishment of the control environment and the functioning of the public finances controls as a fundamental element in its audit plan focusing on the central budgetary institutions, the local governments and the implementation of the central budget.

The SAO expects that as a result of the audits of the internal control system the commitment of the management of the audited entities will increase towards regular operation, transparency and accountability, and also the audit levels, the lines of defense in public finance will utilise the findings of the SAO audits, improving the efficiency of certain audit levels and therefore of the whole system. Contributing with all this to the regular use of public funds.

Exercising its general competence laid down in the act on the audit office, the SAO in 2016 began to review the auditing methods of the entities performing audits in the first and second lines of defense. The role of the SAO was to devise the methodological approaches for the auditing institutions on the basis of international standards.

In 2016, the SAO, as the third line of defense, called the attention of the legislators to the risks identified in business associations owned by the state or the local governments, and as a result the management system of state-owned business associations was transformed on the basis of the findings of the SAO audits.

The European Confederation of Institutes of Internal Auditors and the EUROSAI regarded the cooperation of the SAO and the first line of defense (The Institute of Internal Auditors – BEMSZ) in 2017 as an exemplary and good practice, even at an international level. The State Audit Office further strengthened its advisory role in relation to the audits of the first and second lines of defense.

In order to improve the area, the SAO submitted a proposal to the National Assembly which in return, when accepting the SAO report, entrusted the State Audit Office in its decision number 22/2018. (X. 16.) OGY to strengthen its influence on the functioning of that line of defense.

In 2018, the International Institute of Internal Auditors and the International Organization of Supreme Audit Institutions (INTOSAI) agreed that internal auditors and supreme audit institutions would cooperate in the future. The cooperation between the SAO and BEMSZ that started in 2010 is functioning well, as it is shown by the fact that an international survey in 2016 listed it as good practice.

THE STRUCTURE OF THE LINES OF DEFENSE



The Utilisation of the SAO Proposal

In order to improve the area of internal control, the SAO submitted a proposal to the National Assembly which in return, when accepting the SAO report, entrusted the State Audit Office in its decision number 22/2018. (X. 16.) OGY to strengthen its influence on the functioning of the line of defense.



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MANAGEMENT OF ASSETS

The Fundamental Law of Hungary determines the basic principles for the management of public funds and national assets. It states that the assets of the state and the local governments are national assets and in line with this the purpose of their financial management is to serve public interests. Economic organisations owned by the state or local governments shall manage their affairs in a manner determined in the law, autonomously and responsibly, according to the requirements of lawfulness, expediency and efficiency.

According to the law on national assets the fundamental purpose of the national assets is to perform public tasks. National asset management is responsible for ensuring that national assets are operated in accordance with their intended use, proportionately with the actual load-bearing capacity of the state and the local governments, primarily for the performance of public tasks and the actual needs of the society, on the basis of uniform principles and in a transparent, efficient and cost-effective manner, preserving its value, maintaining its condition, using it in a manner that increases its value, utilizing and expanding it, and the alienation of assets that become unnecessary for the fulfillment of the tasks of the state or the local government.

The most important and also most comprehensive adequacy requirement is proper use, for which regularity is a prerequisite, and which includes expediency, economy, efficiency and effectiveness. In addition to compliance with the regulations, these must also be observed for responsible financial management.

Based on this, economic organisations managing national assets are fundamentally required to ensure full compliance with the regularity requirements in their operations and to determine measurable criteria justifying that the proper, economical, efficient and effective use of the national assets, as well as its expediency.

In the absence of expediency criteria, the requirements of responsible and rational management of national assets cannot be properly realised, which may lead to the wasteful use or the elimination of the assets. The top executives of the economic organisations managing national assets are responsible for establishing the controls, as prerequisites for responsible and rational management, that minimise the risk of wasteful and improper use, thus ensuring the protection of the national assets.

Responsible management of national assets is based on a reliable, credible, comprehensive and modern registry. The registry of the assets – in consideration of the purpose of the national assets – does not primarily focus on the registering of the value of these assets but, in addition to the regularity criteria, the information that allow expediency, economy, efficiency and effectiveness to be measured.

The analysis of the State Audit Office pointed out that proper asset registry is not only a means to fulfilling registry purposes, but a system supporting the asset management activity which is capable of providing a sufficient amount of targeted information to support responsible decision-making. This conclusion can be universally implemented for any economic organisation managing national assets.

In addition to the fundamental regularity criteria of the asset registry system, further requirements can be defined that fall in the scope of adequacy, essentially the professional rationale and expediency criteria, for example realism, usefulness, the highest possible development level of informatics, modernness. According to the analysis, it is a fundamental requirement to fulfil the regularity rules and criteria before the entire operating system could be regarded as adequate and modern. This means that it will not become adequate if there is measurable improvement in only a number of adequacy criteria, e.g. in the field of modernness.

It is through the fulfillment of the regularity and adequacy criteria that a validated registry can be achieved, one that is verified in terms of being substantiated, valid and effective. The most plausible means to achieve corroboration is through a common professional and accounting approach and the inventory taken in a regulated manner. This latter on the one hand means that the starting state is surveyed and the monitoring of the changes is controlled at intervals.

SAO Proposal

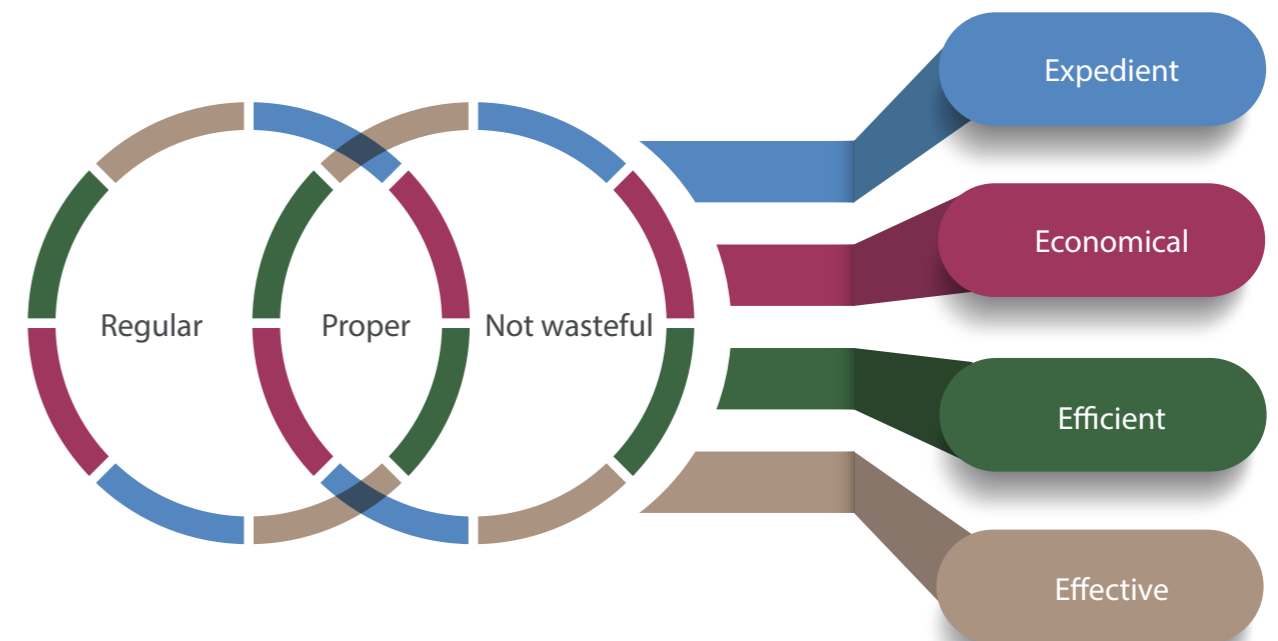
In order to promote responsible and accountable management of national assets, consideration should be given to requiring supplementary notes to ensure that the results of financial management complying with the provisions of the Fundamental Law and the Act on the national assets are presented.

The SAO audits repeatedly indicated that guideline is missing in connection with the national property to determine the general objectives, principles and guidelines related to the property right owners and the companies in state ownership. This would enable property right owners to define and coordinate the requirements expected of business associations in state ownership, to monitor and evaluate, on the basis of uniform principles, the performance of the portfolio, to manage risks at a system level, and it would improve the transparency of the operation and the functioning of the portfolio. It would also contribute to proprietary rights not being exercised with a focus only on the acceptance of reports, business plans, interim reports, but also on the fulfillment of these system of objectives.

The current regulatory environment, however, does not define performance criteria for asset management, it does not establish a system of criteria for the proper and efficient use of national assets or for the checking thereof. Without a statutory obligation, the property right owners did not devise performance measurement systems, in the absence of which the effective, economical, efficient use of public funds and public property and the performance evaluation of the leaders are not provided, only the regularity of the spending of the public funds can be inspected.

Based on the above audit experiences and in order to protect the national assets, the SAO initiated property protection measures permitted by the law in a growing number of cases during its audits. In accordance with the provisions of Act LXVI of 2011 on the State Audit Office, where the audit of the State Audit Office uncovers improper or wasteful use, the President of the State Audit Office may turn to the competent authority or organisation to initiate property protection measures in order to prevent or reduce the damage. This may mean freezing the appropriation (with the exception of the salaries), suspending the subsidy provided from any of the public finance subsystems, suspending the possibility of receiving a share of the 1% donations from the personal income tax, and as the most severe sanction freezing the assets that fall under the public finances. The law permits impounding the assets owned by or managed by the audited entity only in cases where criminal offence is suspected to have been committed.

The diagram below illustrates how these concepts are related to each other:



SAO Proposal

The SAO believes that it is worth considering that a portfolio of state-owned companies is created, and modified when necessary, so that the state manages only such property items that are absolutely necessary for the functioning of the state (either due to strategic or other reasons). As a result of this, the amount of outstanding debt originating from state participation can be reduced, it would be easier to keep records of and manage state property.

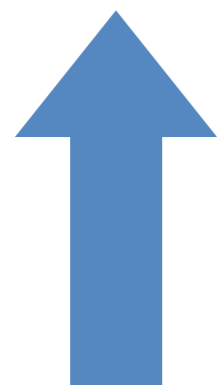
Based on this, regularity is not sufficient a requirement to ensure proper use in asset management (expediency, economy, efficiency and effectiveness are also necessary), and regularity does not mean that financial management is not wasteful. Regularity, therefore, is a necessary, however, insufficient requirement for proper financial management. The avoidance of wastefulness, and eventually responsible and rational financial management, can be accomplished by determining and fulfilling the expediency, economy, efficiency and effectiveness criteria. In order to avoid the wasting of assets, a move must be made towards the rational utilisation of funds and to this effect adequacy and the criteria thereof need to be determined and applied as a directive.

Analysis On the Audit of State-Owned Business Associations

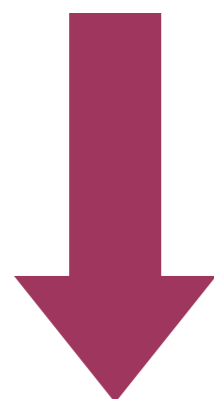
The SAO, on the basis of the basic and recurring problems experienced at business associations in state or local government ownership, prepared proposals in 2015 for the renewal of public sector management. According to this, it is important to evaluate the work of the executives of the companies in public ownership based on strict ethical and integrity principles, to transform their remuneration scheme, and to strengthen the exercise of proprietary rights.

The analysis processed the findings and the supporting documents of the audit reports of 62 state-owned companies for the audited period between 2011-2014, published between 2015-2017, complementing them on a case by case basis with data from the publicly available reports. The SAO used the data and the documents from the integrity survey, too.

Out of the business associations involved in the analysis, 53 participated in the SAO integrity survey in 2015 and 2017. Based on the evaluations, the intrinsic vulnerability of the companies to corruption was at an average level. The factors increasing the danger of corruption showed a higher-than-average figure due to the occurring EU subsidies, public procurement, organisational and regulatory changes. Nevertheless, the establishment of the controls reducing corruption risks (68.5%) was above average even according to the 2015 survey, which even improved by 2017. All in all, the internal regularity and the transparent, integrity-driven operation of the affected companies in state ownership paints a positive picture.



- the exercise of proprietary rights was regular
- the property right owners expanded the means to exercise proprietary rights, they made recommendations for responsible corporate governance principles, investment policies, liquidity planning
- the establishment of the internal control system was broad



- the audits uncovered shortcomings in the process and regularity of the inventory and hence in how the inventory corroborated the report, as well
- in most cases the registration of assets was not compliant with regulations, either

1.2. OPINION ON THE 2019 CENTRAL BUDGET BILL OF HUNGARY

The State Audit Office of Hungary, fulfilling its legal obligation, forms an opinion on the budget appropriation bill. In its opinion it highlights the areas whose appropriation carry implementation risks. Through this, it supports the work of the National Assembly in accepting a budget act that is compliant with the legislative requirements. The State Audit Office of Hungary, in the analyses related to the opinion formed on the 2019 central budget, formed an opinion about the 2019 budget appropriation bill, the procedures applied for designing the government debt indicator, and prior to the final parliamentary vote on the 2019 budget appropriation bill, the realisation of the government debt rule. The SAO pointed out in its opinion to the National Assembly that the 2019 budget appropriation bill contributes to maintaining the stability of the budget of Hungary and the sustainable whitening of the Hungarian economy.

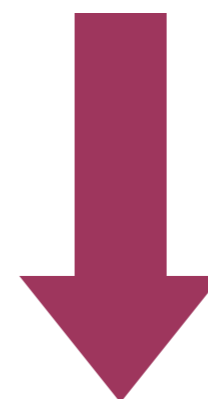
Findings, Conclusions

The SAO concluded that during the drafting of the 2019 budget appropriation bill, the organisations involved in budgetary planning acted in accordance with regulations and other internal rules. The structure and the content of the budget appropriation bill comply with legal provisions and thus fulfil the requirement of responsible fiscal management. The deficit-to-GDP and public debt-to-GDP ratios are with one exception in compliance with the legal requirements if the planned economic growth is achieved. The revenue appropriations in the central budget appropriation bill of Hungary for 2019 are fully substantiated, 92.5% of the expenditure appropriations are substantiated. The risks identified by the SAO can be managed by way of appropriate fiscal measures; moreover, the available resources in the Country Protection Fund provide sufficient safety reserve against the remaining budgetary risks.

The SAO, in its analysis prepared for the Fiscal Council, concluded that the findings in the audit opinion related to the government debt indicator and the government debt rule did not change as result of the proposed amendment.



- deficit-to-GDP and government debt-to-GDP ratios comply with the requirements
- the revenue appropriations are substantiated
- 92.5% of expenditure appropriations are substantiated
- averting the risks is ensured



- the findings in the audit opinion related to the government debt indicator and the government debt rule did not change as result of the proposed motions



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1.3. THE AUDIT OF THE USE OF FUNDS SPENT ON BY-ELECTIONS

The SAO found that the National Election Office, managing the chapter-managed appropriation titled "Conduct of by-elections and national minority elections", used the public funds entrusted to its care for the elections, and the establishment of its control environment ensured the conditions for compliant, transparent and accountable public spending. The appropriation was modified and reallocated in a manner compliant with regulations, the residues were reported and the reporting duties were carried out in compliance with regulations.

In compliance with its statutory obligation, the State Audit Office of Hungary, based on the law on electoral procedure, audited the use of funds for the preparation and conduct of the parliamentary by-elections held in 2015 and the municipal be-elections held in 2015 and in 2016. The audit focused on the regular use of the funds spent during the preparation and conduct of the by-elections.

The purpose of the audit was to establish whether the planning, use, accounting and control of funds spent on the by-elections of the members of parliament, and on the repeated voting of the election of local government representatives, mayors, and minority self-government representatives were compliant with regulations.

The National Election Office (NVI), managing the chapter-managed appropriation titled "Conduct of by-elections and national minority elections", used the public funds entrusted to its care for the elections, and the establishment of its control environment ensured the conditions for compliant, transparent and accountable public spending.

Recommendations

In its published report, the SAO outlined two recommendations in relation to the audit and it also called attention to the discrepancies identified during the audit. The audited organisation sent the notification to the SAO about its measures carried out in relation to the content of the warning letter within the deadline set in the SAO Act.



1.4. THE AUDIT OF THE ACCOUNTING OF FUNDS USED TO CONDUCT THE NATIONWIDE REFERENDUM HELD ON 2 OCTOBER 2016

The 2016 referendum in Hungary was a nationwide referendum held on 2 October 2016 where Hungarian citizens eligible to vote could express their opinion on whether the European Union could order the compulsory resettlement of non-Hungarian citizens to Hungary without the consent of the National Assembly. The National Assembly ordered a nationwide referendum on the compulsory resettlement quota in accordance with the Fundamental Law. In accordance with the law on electoral procedure, the State Audit Office of Hungary informed the National Assembly on the utilisation of funds provided by the central budget for the referendum.

The National Election Office – as an independent state administration body – was responsible for performing the central duties related to the preparation and conduct of the referendum. The SAO audit covered the National Election Office, the Central Office of Administrative and Electronic Public Services (KEKKH), the Ministry of Foreign Affairs and Trade (KMM), the regional election offices (TVI), and the sampled Parliamentary single-constituency election offices (OEV) and local election offices (HVI).

Findings

The SAO found that the financial resources provided by the state budget for the nationwide referendum conducted on 2 October 2016 were allocated and the appropriations were managed in a regular manner. The National Election Office transferred the financial resources to the nationwide referendum and fulfilled its obligation to transfer the appropriations within the time-limit.

The funds necessary to prepare and conduct the nationwide referendum – with minor deficiencies found at the regional election offices (TVI), the Parliamentary single-constituency election offices (OEV) and the local election offices (HVI) – were planned in a regular manner. Most of the audited organisations made the amendments to the appropriations related to the nationwide referendum in a regular manner.

The audit found that the funds available for the preparation and conduct of the nationwide referendum were utilized in a regular manner. In most of the election offices, the funds were accounted for within the time-limit. The National Election Office prepared the summary account after the deadline.

When preparing and conducting the nationwide referendum held on 2 October 2016, the heads of the National Election Office, the Ministry of Foreign Affairs and Trade and the Central Office of Administrative and Electronic Public Services fulfilled their obligation to control the utilisation of funds in a regular manner. In most of the regional election offices, single-constituency election offices and local election offices, the use of the funds was controlled in a regular manner.

Conclusions

The allocation of the financial resources provided from the state budget for the nationwide referendum, the management of the appropriations, the accounting and the fulfillment of the auditing tasks falling within the competence of the audited entities ensured the transparent use of public funds.

Recommendations, warning letters

In its published report, the SAO did not outline any recommendation requiring action in relation to the audit. The SAO addressed the heads of the 51 entities involved in the audit in a warning letter regarding the deficiencies identified by the audit who notified the SAO of the measures carried out in relation to the content of the warning letter within the deadline.



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1.5. IMPROVING INTEGRITY

The State Audit Office of Hungary has been attempting to establish, spread and strengthen a culture of integrity for ten years, as requested by the National Assembly. Evaluating the implementation of the integrity approach has a significant role in the SAO audits. Since 2011, the institution has prepared its survey assessing the integrity status of the public sector institutions every year with the aim of improving the internal control system, the surveys aim to provide feedback to the public sector institutions and to business associations on their integrity risks as well as on the establishment of the controls aiming to manage risks. As of 2015, surveys have been made for the state-owned business associations, too.

The SAO published a new analysis about the corruption risks and integrity status of business associations that are majority-owned by the state and by local governments for the year 2017. The questionnaire survey of the SAO with the participation of 752 business associations. Despite the fact that the integrity situation indicated an upward trend, the survey identified a number of risk factors and also pointed out that the so-called soft – i.e. promoting compliance with the internal regulations of the institution not required by law – controls which are important from the aspect of integrity but not mandatory by law are used by relatively few companies. The high number of smaller companies with weak control pose a serious integrity risk.

The companies in majority state and local governmental ownership utilise public property, use public funds, provide public services, and as a result their integrity and their immunity against corruption are influenced by several factors. Having regard to this, the State Audit Office of Hungary, following the integrity survey launched among the public sector institutions in 2011, expanded its survey first to state-owned and then to local government-owned companies in 2016-2017, and as of October 2017 it has assessed the integrity status of public enterprises in a consolidated survey.

The purpose of the survey was to map out the integrity risks of business associations in public ownership as well as their resilience to corruption and to uncover how these correspond to the main characteristics of the enterprises.

The survey found that the integrity vulnerability of companies increases in parallel with their size. The controls of companies with higher integrity risks, however, are generally more firmly established than those having smaller risks, but this relationship is moderate: in a number of companies with significant risks the controls ensuring sufficient resilience against integrity risks were missing. The survey also pointed out that the integrity risks substantially increased when a company received a significant European Union subsidy.

Having analyzed the data, the SAO found a positive link between how established the internal controls of a company were and how developed the integrity control system was. Similarly, companies that regularly submitted reports to the supervisory board or the owner have a higher level of control.

The frequency of the controls is the lowest in the area of corporate culture and ethical leadership, i.e. relatively few companies have established the controls that are not required by law but are important from the aspect of integrity.

The business associations scoring the highest results in the survey were at the top primarily because they had independent internal controls, they determined their audit plans based on risk analysis, they regulated conflicts of interest in a wide scope, and furthermore, they created their risk management system, determined ethical requirements and were in possession of a functioning ethical procedure.

By publishing the results, the SAO intended to call the attention of the leaders and the property right owners of the companies to the most typical integrity risks and the most frequently missing controls. Gaining awareness of these can make the companies more resilient to corruption. Publishing the survey results contributed to the fact that the corporate culture of integrity was further strengthened in this important field of the public sector as well as in the budgetary institutions.

Integrity at an International Level – Supporting the IDI Fighting Corruption Programme

The Development Initiative (IDI) of the International Organisations of Supreme Audit Offices (INTOSAI) launched a programme to strengthen the anti-corruption efforts of the supreme audit offices of developing countries. The main objective of the programme is to increase the effectiveness of the supreme audit offices in the fight against corruption. Currently, the most active component is delivering the cooperative performance audit on the institutional framework for fighting corruption.

On the invitation of IDI, two mentors of the SAO also provided help in 2018 in preparing the draft reports to the member supreme audit institutions of EUROSAI, AFROSAI-E and CAROSAI. Another component of the programme supports the supreme audit institutions in creating an exemplary ethical infrastructure. With respect to this programme component, in 2018 the SAO participated in the development of the study material to this end.

During the international integrity seminar held in 2018, the State Audit Office of Hungary moved to offer its budgetary savings for 2016 – about 29 million Hungarian Forints, the equivalent sum of about USD 110,000 – this time to the international IDI programme training young leaders in supreme audit institutions. This offer is based on a parliamentary decision. In 2015, the National Assembly called the SAO to widen its advisory activities on management systems and to support ethical public finance management training. With this current offer, the SAO elevated its training initiative to an international level, in addition to its domestic measures.

Spreading the Culture of Integrity Internationally – the EUROSAI Workshop

The objective of the initiative originated by the State Audit Office of Hungary is to raise awareness and strengthen the culture of integrity in the EUROSAI member states. During the workshop, the members of the working group built on international cooperation and knowledge transfer discussed their audit experiences in person.

The international EUROSAI project titled “The Role of SAI’s in Spreading a Culture of Integrity” aims to share knowledge related to integrity and to exchange experiences among the participating SAI’s (Albania, Austria, Bulgaria, Georgia, Croatia, North Macedonia, Portugal and the Ukraine). In the scope of the project, the project members published several professional materials related to integrity and the good practices of individual SAI’s on an online interface created for this purpose, and besides the project members these are also accessible to other interested SAI’s after a prior registration.

The SAO presented the results of the working group at the 9th Annual Meeting of the EUROSAI Audit and Ethics Task Force in October 2018. The event conducted with the participation of experts from 13 countries aimed to support the implementation of the ISSAI 30, to present the integrity products of different countries, to introduce the European directives applicable to the protection of whistleblowers of public interest, to present the role of audit institutions in spreading integrity of the public sector, and to develop a working plan and further directions for the Audit and Ethics Task Force.

International Integrity Seminar

The State Audit Office of Hungary organised its five-day international integrity conference and knowledge-sharing seminar in 2018 for the fifth time, this time with the title “From Sensitising to Auditing Integrity – The Integrity Model of the State Audit Office of Hungary”. The seminar was attended by 36 audit experts from nearly 25 countries. In a series of events taking place in Budapest and Szarvas, the participants arriving mainly from Asian, African, South-East European and South American developing countries were able to familiarise themselves with the best domestic and international practices that could help them in the future to contribute to the development of an integrity-based public administration culture.

The colleagues of the organisational unit and the presenters of the SAO presented the integrity survey in two tests, 14 presentations, six seminar workshops and in a simulated survey. It was the first time that a conference publication was prepared for the seminar in 2018 in accordance with international standards. It was also the first oc-



SAO proposal:

Eliminating cash usage in the public sector and petty cash should be considered.



casation that a former participant of the conference held a presentation at the seminar. By 2017, North Macedonia successfully adapted the integrity model of the SAO and the methodology of the survey, and the representative of the country presented the experiences from the first Macedonian integrity survey to those present.

The Evaluation of Control Mechanisms Suitable for the Management of Corruption Risks Related to Information Technology Public Procurements of Public Sector Bodies

The signatory countries to the United Nations Convention against Corruption will hold their world conference in December 2019 in the United Arab Emirates. One of the chief organisers of the conference, the State Audit Office of the United Arab Emirates (SAI UAE) invited the State Audit Office of Hungary to cooperate in preparing a study on managing the corruption risks of public procurement tenders for the purchase of information technology (IT). In the scope of this agreement, the experts of the SAI UAE collected and categorised the risks that most frequently emerge in connection with IT public procurement tenders and the SAO developed a questionnaire to identify how and to what extent the individual member countries established the controls that are suitable for the management of such risks. The starting point for developing the questionnaire was the UN Convention against Corruption and the compulsory and recommended anti-corruption measures provided therein, while the public procurement directives of the EU as well as the guidelines, analyses and other publicly available expert materials of certain European Union institutions and of the OECD regarding public procurement, especially public procurement for IT purchases, were also used. Practical examples were also used to facilitate the development of the questionnaire, as the SAI UAE compiled a summary of the audit experiences of individual SAI's gained in the field of IT-related public procurement tenders, thus significantly contributing to the identification of the key areas.

The questionnaire was sent to the points of contact of the signatory countries to the UN Convention against Corruption by the United Nations Office on Drugs and Crime (UNODC). Based on the assessment of the completed questionnaires, a study will be prepared that will be presented as a background material at the 8th World Conference of the states signing the UN Convention against Corruption.

1.6. SUSTAINABLE DEVELOPMENT

The European Union and its Member States make a joint effort for sustainable development, for efficient energy utilisation, for the reduction of environmental burdens and for the continued increase in the quality of life. Hungary, too, has undertaken international commitments to accomplish these goals the realisation of which largely depends on the participation of public institutions. The National Assembly made a decision about the National Framework Strategy on Sustainable Development in its decision number 18/2013. (III.28.) and assigned the State Audit Office of Hungary as an institution in its own competence to control compliance with the limitations applicable to economic resources.

Participation in Cooperative Audits

The State Audit Office of Hungary also participated in parallel audits (for example auditing the financial management of carbon dioxide quotas) and in audits falling in the second category of coordinated audits (for example auditing the air quality and auditing energy efficiency).

At the professional meeting of the EUROSAI Working Group on Environmental Auditing, the supreme auditing institutions participating in coordinated audits presented their audit results and conclusions and inferences were also discussed. "Does a governmental body show an example in energy efficiency?" is a key question of the ongoing joint audits within the framework of the forum in which the supreme audit institutions of 8 EU Member States, including the State Audit Office of Hungary, also participated.

At the meeting of the EUROSAI Working Group on Environmental Auditing held mid-June 2018, the SAO expert in his comment confirmed SAO's commitment to environmental and sustainability issues and the social utilisation of audits in relation to the ongoing coordinated audit in connection with air quality, and he also presented the Hungarian system for the protection against air pollution.

What is Sustainable Development?

Sustainable development is a development process or a management principle that "meets the needs of the present without compromising the ability of future generations to meet their own needs".

What is a Cooperative Audit?

Cooperative audits are audits in which two or more supreme audit institutions are involved. It has three types: parallel, coordinated or joint audits.

Audit on the Measures Aiming at the Protection of Air Quality

Air pollution is one of the most significant health risk factors. In Hungary, the most important issue relates to fine particle pollution, the source of which is transportation, the energy sector and, increasingly, heating, especially residential solid combustion. The aim of the compliance and performance audits was to assess whether the measures promoting the improvement of air quality and the fight against air pollution sources have been efficient. The SAO audited the issue of air quality protection in an internationally coordinated audit.

Findings

The SAO found that during the elaboration of the objectives, measures and indicators set for the protection of the air quality, the assessments and analyses on air quality had been taken into account. The organisations responsible for air quality had performed their activities in accordance with their scope of competence and responsibility. The Ministry of Agriculture established the necessary legal regulations, performed its supervisory and management activities appropriately, and complied with its duties related to data provision. Government offices carried out their official and supervisory tasks appropriately. The National Public Health Center regularly and fully assessed risk factors endangering the health state of the population and the health-related impacts of air pollution. The ministries involved introduced several measures for the attainment of the objectives and monitored the implementation of such measures.

The audit also found that the concentration and total emission of air pollutants showed a decreasing trend, and the long term efficiency objectives of National Environmental Protection programmes had been attained pro rata temporis. The limit values set for 2020 were accomplished pro rata temporis, with the exception of volatile organic compounds.

Audit on the Energy Efficiency in Public Buildings

By 2020, the European Union aims to achieve energy savings of 20% at an EU level. Buildings are responsible for 40% of the total energy consumption of the European Union. In parallel with the economic growth, the volume of investments in the construction industry is on the rise which may lead to an increase in energy consumption in the absence of measures that would increase energy efficiency. As result of this, the measures taken to reduce the energy consumption of buildings and to increase the ratio of energy used from renewable sources ensure that the energy dependency of the European Union and the emission of the greenhouse gases are reduced. The EU directives that were accepted to facilitate the realisation of the target set at EU level were transposed into Hungarian laws. In order to accomplish the EU targets, Hungary undertook a national level commitment in which the public institution have a decisive role.

Findings

The public sector needs to fulfil an exemplary role in the field of improving energy efficiency, too, therefore in case of public buildings special attention must be paid to the fulfilment of energy efficiency requirements and the fulfilment of statutory obligations. In relation to this, in 2018 the SAO audited the energy efficiency of public buildings as part of a coordinated (international) audit, which specifically aimed at determining whether the policy framework to increase the energy efficiency of public buildings had been established, (sufficient) financial resources were available to finance the devised plan/strategy, the monitoring system aimed to assess the realisation of the energy efficiency targets had been established and was in operation.

The audit found that the governmental goals to increase the energy efficiency of public buildings and the tools that ensure the realisation of the goals were included in the strategic documents. The financial resources necessary for the investments and renovations to be carried out on central government buildings for the purpose of increasing energy efficiency were available. The monitoring system related to the accomplishment of the energy efficiency objectives had been established and was operated by the responsible entities. Based on the audit findings, Hungary performed the energy efficiency requirements for public buildings in accordance with the provisions of the European Union directives.



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International Aspects of Energy Efficiency

The international summary prepared about the audit – in line with the purpose of the coordinated audit – primarily emphasises the fact that through the Hungarian regulations and the other governmental measures Hungary created national regulations that comply with the provisions of the EU directives and accepted strategic and methodological documents.



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1.7. FURTHER KEY ANALYSES IN SUPPORT OF THE WELL-MANAGED STATE

In order to support the well-managed state, the SAO prepares analyses and studies in a growing number of various topics.

Analysis for the Fiscal Council on the Budgetary Processes of the 2nd Half of 2017

In accordance with the Stability Act, the Fiscal Council (KT) forms an opinion on the status of the implementation of the Central Budget Act and the status of the public debt. The State Audit Office of Hungary helps the President of the SAO to perform its duties as a member of the Fiscal Council – as per the provisions of the Stability Act – by providing the Fiscal Council with analyses on the issues discussed. By analyzing the budgetary processes of the 2nd half of 2017, the SAO supported the Fiscal Council in forming its substantiated opinion about the processes of the 2nd half of 2017. The purpose of the analysis was on the one hand to assess the impact of economic processes on budgetary targets based on the 2017 budgetary and macroeconomic data, and also separately based on data from the second half of the year. The other purpose of the analysis was to show which appropriations of the budget contained significant under- or overperformance by the end of 2017, and whether these jeopardised the fulfillment of the 2017 budgetary target deficit and the public debt rule.

The State Audit Office of Hungary formed an opinion on the 2017 central budget appropriation bill of Hungary. It concluded that 99.2% of the audited expenditure appropriations and 99.9% of the audited revenue appropriations were substantiated. It concluded that compliance with the regulations related to deficit and debt did not present a risk. Nevertheless, it pointed out that having 53.3% of the expenditure appropriations as so-called appropriations open from the top, i.e. ones that can be exceeded without an amendment of the law, posed a general risk to the fulfilment of the budgetary target. It also pointed out, however, that the risks identified during the audit can be managed with the use of these reserves and through budgetary reallocation.

The situation emerging after the amendment of the 2017 budget act was assessed by the SAO in its analysis prepared on the budgetary processes of the first half of 2017. It concluded that the mid-year appropriation amendments approved by the National Assembly took into consideration the changes in the macroeconomic factors and all in all improved the possibility of fulfilling the appropriations, and in total the budget. The analysis found it likely that the cash deficit would exceed the planned figure, highlighting the fact that its change is predominantly influenced by the balance of the revenues and expenditures performed during the year in connection with the EU subsidies.

The status of the 2017 budgetary processes show that the SAO realistically assessed the budget appropriation bill and the risks associated with the amendment of the budget act. By pre-funding the EU resources, the cyclic effect of the EU programmes could be diminished and important developments could be brought forward. The stability of the budgetary processes was founded on a dynamic economic growth the rate of which was close to the governmental forecasts.

Analysis for the Fiscal Council on the Budgetary Processes of the 1st Half of 2018

The analysis reviewed the macroeconomic processes of the 1st half of 2018 and, by taking into consideration this and the prorated fulfillment of the budgetary appropriations, it assessed the expected change in the balance of the budget and the public debt. The SAO analysis identified the budgetary appropriations whose fulfillment will likely significantly differ from the original appropriations determined in the budget act.

The SAO analysis pointed out that economic performance (GDP) was 4.5% up on the same period in the previous year. Final consumption expenditure increased, gross fixed capital formation significantly increased. The expansion of the export exceeded GDP growth. Trade surplus at the end of the half year was EUR 3.3 billion. The tax revenues were fulfilled appropriately in line with the favorable macroeconomic processes.

In respect of the budgetary expenditure, the SAO analysis found that in case of a few appropriations overperformance was likely but they were compensated for by savings in other appropriations. However, it was identified as a risk that the expenditures of central budgetary entities significantly exceeded the prorated volume that was only in part covered by the overperformance of their revenues. The other reason for the dynamic growth was the use of the significant residues in the 1st half of 2018 that had been created in 2017.

Significant reserves were available to manage budgetary risks at the end of the first half year, as HUF 31.9 billion from the Country Protection Fund and HUF 66.3 billion from the exceptional governmental measures appropriation had not yet been used up and chapter reserves were still intact.

Despite the overall favorable budgetary processes, the cash deficit of the central budgetary subsystem of the public finances was HUF 1,420.5 billion in the 1st half of 2018, exceeding the total amount of deficit planned for 2018 by 4.4%. This exceeds the prorated amount by HUF 740.4 billion. This amount is exceeded by the nearly HUF 800 billion deficit of the EU revenues providing partial coverage for the programmes realised with EU subsidies compared to the prorated volume. Therefore the fulfillment of the public debt rule by the end of the year is not at risk.

The debt of the central budget in the first six months of 2018 was up HUF 1,587.5 billion on the 2017 end-of-year amount, a 14.8% increase over the growth planned for the whole year. The increased financing demand was fully satisfied with the increased volume of HUF-based debt, while the volume of foreign currency debt decreased. This reduced vulnerability.

Besides the debt of the central budget, year-end public debt was also affected by the debt of the local governmental subsystem and the debt of other institutions listed in the governmental sector.

The Impact of Monetary Policy on Reducing Budget Risks

The analysis points out that as result of the central bank measures the budget risks of the monetary policy decreased significantly between 2012 and 2016, no reimbursement obligation emerged for the central budget, having regard to the fact that in 2013-2016 the central bank realised a profit and the amount of its losses in 2012 did not exceed the amount of the profit reserves.

By changing its normative assets and introducing new, non-conventional assets, the central bank contributed to the growing demand for treasury bills and thus to the increase of the internal financing rate of public debt which reduced the external vulnerability and foreign currency exposure of the country, making the financing of the public finances and the stability of the financial system more reliable.

The liquid assets of the commercial banks accepted by the central bank continuously decreased due to the volume limitation on the normative asset, while the financing ratio of commercial banks within the public debt increased. The ratio of foreign currency in public debt decreased. In addition to this, the reduction of the central bank base rate reduced the interest rates on treasury bills, and through that the costs of debt financing.

The central bank, in the framework of its Funding for Growth Scheme, increased the amount of central bank money circulating in the economy to boost lending and economic growth. With regard to its inflation targeting, the central bank reduced this amount of money with the performance of the self-financing programme.

Having regard to the fundamental restructuring of the monetary policy which took place between 2012 and 2016, and analyzing its effects on the indicators of the Maastricht convergence criteria, the periods involved in our previous and in our current analysis can be sharply separated. By renewing its central bank assets in 2013, MNB supported the fiscal policy in fulfilling the Maastricht criteria.

The monetary policy conducted in the audited period had a beneficial effect on the decrease of the financing costs of public debt and through that on the balance of the budget and on public debt, by which it also decreased the budgetary risks.



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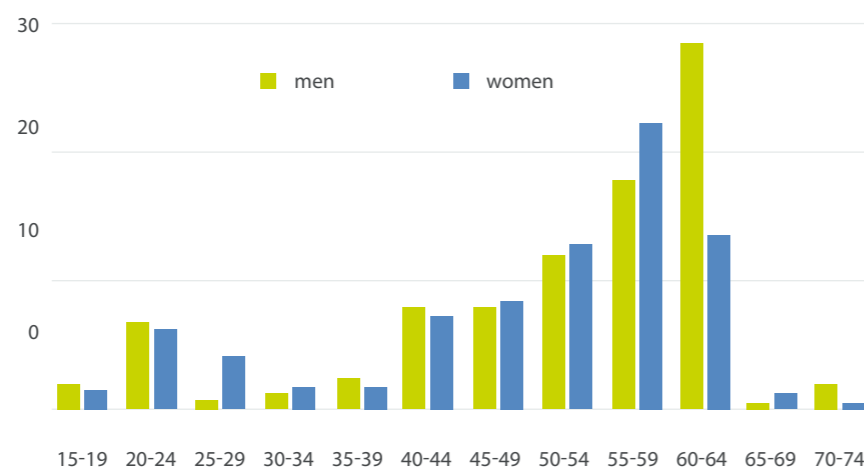
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Analysis on the Activity Rate

In its analysis published on the activity rate, the SAO presents the labor market processes that occurred between 2006 and 2016, the changes in the activity in the audited period in terms of both genders and every age group, and introduces in detail the major factors driving the change in the activity rate. In addition to the differences between genders and age groups, the analysis discusses regional differences, and the impact of changes in the activity rate on GDP and on the public debt indicator in the analyzed period.

GROWTH OF THE ACTIVITY RATE BETWEEN 2006 AND 2016 BY AGE GROUPS AND GENDER IN PERCENTAGE POINTS



The analysis shows the change in the economic activity of the Hungarian population in the 15-74 age group between 2006 and 2016, as well as its key characteristics. In 2016, the number of people in employment showed an increase of 10.8%, while the number of unemployed people showed a decrease of 26.3% over 2006. In parallel with this, the number of people economically inactive – pensioners, those receiving social care, and dependents – decreased by 15.8%. The major direct causes include the increase in the retirement age, the limitations on early retirement opportunities, the transformation of the supply system and the rehabilitation of disadvantaged workers, the tightening of the wage supplementing benefits provided to those in active age, the reduction of the compulsory schooling age. The analysis of the regional differences shows that in the audited period the activity of the population in the 15-74 age group increased in every region, apart from a temporal setback during the period of the crisis.

The analysis determined that the improvement in the public debt indicator was the result of the GDP growth. This underlines the importance of the fact that the growth in economic activity – starting from a low level of activity – expanded labor resources, thus contributed to the increase in employment and, through that, economic growth.

Analysis – On the Operating and Financial Management Processes of Orchestras Receiving Budget Support

The analysis aggregated the audit experiences of eleven orchestras in total, out of which three were in state and five were in local government ownership, while two operated as a foundation. The purpose of the analysis was to synthesise the audit experiences related to the operation and financial management of the orchestras and to draw conclusions. The conclusion of the analysis is that the exercise of proprietary rights at organisations that received support from public funds between 2012 and 2015 was, overall, compliant with regulations. However, shortcomings regarding the inventory, the implementation of the integrity approach and the failure to disclose data of public interest posed significant risks from the aspects of the preservation of state property and of ensuring transparency. The audits did not generate any universal conclusions that could be associated with the differing ownership backgrounds or the differing forms of operation of the orchestra organisations.

The recommendations the SAO reports outlined for the future were related to a more regulated financial management environment to ensure accountability and transparency.

1.8. FINANCIAL AWARENESS

A priority area in the corporate social responsibility of the State Audit Office of Hungary is the enhancement of financial awareness in the Hungarian population, with special regard to expanding the knowledge of the population about finance, public funds and the sharing of public dues, while improving the attitude towards and the conduct related to (public) finances. The SAO has taken an active role in developing the financial awareness of the Hungarian population since 2011, and the National Assembly confirmed this duty in its decision in 2014.

The SAO announced the Ambassadors of Financial Literacy tender again and 11 people submitted their applications, increasing the number of volunteer auditors to 24. In June, they participated in training to improve their written communication skills. The purpose of the training was to help colleagues prepare to write news articles in the areas of financial awareness and public finance awareness which contain key information or notices for common people or which simply share with them points of interests from the field of everyday finances.

Several Hungarian conferences and events deal with the issue of financial literacy where the SAO is regularly invited to participate. In these events, the SAO contributes to enhancing financial-public finance knowledge, raising awareness of the risks related to financial decisions, responsible and conscious financial decisions by keeping presentations.

On the basis of the tasks carried out in the working group responsible for preparing the National Strategy for Financial Awareness, we recommended news and articles that can be used – by the Ministry of Finance – for the launching of the website aimed at improving financial awareness.

Relevant NA decision
Decision 41/2014. (XI. 13.) of the National Assembly supporting the social contributions of the SAO to the development of financial literacy



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2. Audit of auditors

The Act on Public Finances names three areas in the audit system of public finances in order to ensure the regular, economic, efficient and effective management of the funds of public finances and the national assets, the regular compliance with the reporting and data provision obligations, which create the three lines of defense of the public finances. In 2017, the National Assembly imposed the task on the SAO to improve the audit methodology of the entities conducting audits in the public finances system. Thus, the State Audit Office of Hungary is also entitled to audit the financial management and the operation of institutions which perform auditing and supervisory activities themselves. As a result of auditing such institutions, the SAO is able to maximise its contribution to the establishment of a regular, responsible and disciplined financial management of public funds, as the results and findings of the SAO's audits (by increasing the regularity, efficiency and transparency of the activity of the supervisors) may be indirectly utilised in the operation of the entities supervised by the audited organisations.

2.1. THE AUDIT OF THE HUNGARIAN CENTRAL BANK

Based on the relevant statutory provisions, the State Audit Office of Hungary regularly audits the financial management of the Hungarian Central Bank (MNB) and its activities not included in the core tasks. Accordingly, in addition to assessing the MNB's financial management in 2016 and the regularity of its central budget accounts, the audit also covered the compliance of MNB's auditing, controlling and regulatory activities of the financial intermediary system, as well as MNB's tasks as a resolution authority.

Findings, Conclusions

The SAO's audit found that the MNB's management, reporting and auditing system operated in a regulated and orderly manner in 2016. The operation of the Supervisory Board complied with the requirements of legislation and the rules of procedure, the internal auditing organisation operated in a regulated and orderly manner. The exercise of proprietary rights of the MNB's majority and sole ownership companies complied with the legal requirements. Its supervisory, audit and regulatory activities related to the financial intermediary system were in compliance with the statutory requirements and it operated the public electronic information system in compliance with the regulations. The MNB performed its activity related to the supervision of the financial intermediary system in a compliant manner, it acted in a regular manner in its related authorisation activities and in the initiated consumer protection procedures. Of its responsibilities as a resolution authority, it performed its preparation of resolution planning tasks and resolution implementation tasks properly, but its activities related to resolution planning were not compliant.

The audit experiences of the foundations of the Hungarian Central Bank are included in section 6.2. Audit of Foundations and Public Foundations.

2.2. AUDITING AND ANALYZING THE FINANCIAL MANAGEMENT OF THE HUNGARIAN STATE TREASURY

Due to the importance of its financial and asset management activity and the performance of its tasks, the Hungarian State Treasury has a significant impact on maintaining the balance of the budget, on the proper use of public funds, on the reliability of the reporting data of public finances, on the quality of the management of state assets and on the transparency of the management of public finances.

The key significance of the operation of the Hungarian State Treasury justifies the fact that the SAO regularly audits the regularity of the financial and asset management of the organisation. In accordance with this, the audit of the financial management of the Hungarian State Treasury for the period between 2013-2015 ended in 2018, which also covered the Ministry of National Economy performing the duties of a governing body.

Findings

The SAO, in its audit of the financial management of the Hungarian State Treasury for the period between 2013-2015, concluded that the management system of the Hungarian State Treasury did not ensure accountability between 2013 and 2015. The Treasury's property management activities were not compliant with regulations, while its financial management was in accordance with regulations. The Treasury did not properly carry out the tasks related to the introduction and implementation of certain IT systems, and did not perform its regularity audit tasks regarding local governments in accordance with legal requirements. In 2015, the integrity controls established at the Treasury were inadequate in relation to the risks, therefore they did not provide adequate protection to manage corruption risks. The audit found that the Ministry of National Economy's performance of tasks as a governing body was also not compliant with regulations.

Recommendations

Based on the findings of its audit, the SAO put forward 16 recommendations to the President of the Hungarian State Treasury and three recommendations to the Minister of National Economy to eliminate the deficiencies. The recommendations primarily focused on the regularity of the establishment and operation of the internal control system and compliant financial and asset management. Action plans were prepared for the findings on which the recommendations were based, which the SAO acknowledged.

Analysis

In addition to the audit, the SAO summarised the experiences of the SAO audits affecting the Hungarian State Treasury (12 in total) in an analysis which contained findings in relation to the financial management and task performance of the Hungarian State Treasury for the period between 2008-2016. The Treasury was an entity audited in the framework of the audits of the final accounts and the opinion on the budget bill. In addition to the financial management activity, the audits focused on the performance of the public administration activity, the centralised payroll system, and the Treasury's activity in the operation of the public finance information system.

Based on the analysis, a typical deficiency according to the findings of the audits affecting the Hungarian State Treasury was that the regular changes in the organisational and task structures and the legislative changes related to widespread task performance were not integrated into the internal regulatory tools. The risks in the activity of the organisation were not identified and as a result no preventive measures were possible related to them. The Hungarian State Treasury did not endorse the regulations related to the functional independence of the internal control. The management system did not support the legitimate, verifiable and transparent use of public funds and the proper management of national assets.

An improving trend was observed in the financial management of the Hungarian State Treasury, which has been regular since 2011, however, asset management showed a deteriorating tendency and has not been compliant with the regulations since 2013. Between 2013 and 2015, the Hungarian State Treasury failed to meet its obligation to preserve the value of national assets, and the utilisation of national assets was not compliant with the regulations. Not enforcing security considerations properly in the development and operation of the IT systems that support task performance posed a further major risk.

Based on the above, the SAO proposed that the Treasury's President pay close attention to strengthening the management system in order to safeguard national assets and ensure a financial management compliant with the regulations. Based on the risks uncovered in the IT systems, the SAO considers it reasonable to have an immediate review of the IT systems and to take further measures depending on its results.



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2.3. AUDIT ON THE CONTROL ACTIVITY OF THE HUNGARIAN STATE TREASURY

The Hungarian State Treasury, in the course of its core activities, also performs audit assignments, including – among others – assignments pertaining to the auditing of state subsidies granted to the proprietors of religious, non-state, non-local government operated institutions providing human services. Accordingly, the audit shall cover the Hungarian State Treasury's compliance with the legal requirements governing its audit assignments.

Findings

The Hungarian State Treasury has properly developed its processes pertaining to the performance of its audit assignments and it has published internal standards governing audits pertaining to the proprietors of non-governmental human service providers operating social and public education institutions in accordance with legal requirements. In the course of its on-site audits, the Hungarian State Treasury adhered to the provisions of legal regulations and took appropriate steps in cases where subsidies were granted unduly, but have not performed audit assignments with the frequency prescribed by legislation and thus was unable to provide for the regular review of uses of budget support for non-governmental human services.

The audit was also meant to evaluate whether the Hungarian State Treasury has performed the tasks outlined in the action plans prepared based on the findings and recommendations of past audit reports. Of the 37 tasks outlined in the action plans, 17 were performed within, 11 were performed past their respective deadlines, while two were only performed partially, five were not performed at all, and two tasks became obsolete.

Recommendations

The SAO put forward two recommendations concerning the elimination of deficiencies to the President of the Hungarian State Treasury based on the findings of its audit. These recommendations concern the performance of audits with the frequency prescribed by legislation and the keeping of records on the implementation of the tasks outlined in the action plan in accordance with legislation. In order to ensure the performance of the tasks left undone, the SAO has sent a warning letter to the President of the Hungarian State Treasury. The Hungarian State Treasury has prepared an action plan in regard of the recommendations.

2.4. AUDIT OF THE DIRECTORATE GENERAL FOR AUDIT OF EUROPEAN FUNDS

The public function of the Directorate General for Audit of European Funds (DGAEF) in the context of EU financial funds is to perform the duties of an auditing authority, perform other audit assignments defined by the government and pertaining to EU and international subsidies, and to promote the efficient and proper use of EU subsidies.

In addition to the DGAEF, the European Union's management and audit organisations and Hungary's management organisations and authorities also participate in auditing concerning the use of EU subsidies. These audits ensure that risks associated with the proper use of EU subsidies are explored and continuously managed. The fact that the various organisations base their audits on differing criteria guarantee that the area is well-supervised.

As the auditing of organisations participating in the auditing of the use of EU funds is justified, this approach exponentially increases the benefits of the audits. The financial and property management audit of the DGAEF in respect to years 2014-2016 was carried out in this context.

As result of the audit, the State Audit Office of Hungary has submitted recommendations to the finance minister (as the head of the competent ministry starting from 2018) and the director general of the DGAEF obliging them to take action. Additionally, the President of the SAO notified the finance minister maintaining the institution.

The utilisation of the audit is demonstrated by the heads of audited organisations performing their obligation to prepare action plans.



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3. Management of Public Assets

The assets of state property play a primary role in the appropriate performance of the state's duties and the provision of public services. This is a key area for the audits of the SAO as the preservation of the value and the expansion of state property as well as the lawful management thereof are statutory tasks of key importance of all public institutions.

The SAO audits the exercise of proprietary rights over state property every year. In addition to this – due to the increased risks – it pays special attention to auditing the preservation and management of the assets handed over to state-owned companies outside the public finances.

3.1. AUDIT OF STATE-OWNED BUSINESS ASSOCIATIONS

In 2018, the SAO continued its work commenced earlier, auditing the business associations in (partial) state ownership. The key significance of the audits is based on the fact that the ownership share in the state-owned business organisations is national property. Audits were further justified by the fact that the majority state-owned enterprises have key significance with regard to the public tasks they perform, therefore their asset management influences the performance of the public tasks. Due to the reasons above, the transparent and accountable financial management of such business associations is an essential requirement.

In 2018, the State Audit Office of Hungary has published 62 audit reports pertaining to audits of state-owned economic organisations. In the course of the audits, it has been determined that more than 40% of the audited business associations did not conduct legitimate property management or registration of assets (taking inventory). Almost 40% of the audited business associations did not perform their obligation to disclose information in the public interest. Furthermore, more than 68% of the audited business associations did not adhere to generally accepted accounting principles.

Findings

Regarding the financial management of state assets, the exercise of proprietary rights is the task of ensuring the transparent, proper and responsible use of state assets. Based on experiences from previously completed audits, it can be ascertained that the majority of property right owners have established the conditions for the exercise of rights and have properly exercised said rights. Nevertheless, there have been multiple irregularities, wherein – due to a failure to meet capital replacement obligations – the value of the company's equity has not reached the value prescribed by legislation, the highest body of the company has not issued a remuneration policy, the supervisory board was not operated in accordance with legislative requirements, or the company's accounting report was not accepted in accordance with legal requirements.

With regard to companies, the majority of irregularities occurred in the field of regulation. Accounting regulations and records, which form the basis of reports and ensure accountability, were often missing or did not comply with legal conditions, thus, in such cases, the conditions necessary for legitimate operation were not provided for. Detected irregularities have increased the risks associated with financial management and have not provided for transparent and accountable financial management practices.

The audit report found that 42.9% of audited business associations employed irregular property management practices. Most of the irregularities detected in the field concerned the regularity of accounting for revenues and expenses. This posed a risk considering that the revenues and expenses indicated in annual records may have contained inaccurate data, thus the transparency and the compliance of accounts was not guaranteed.

As regards asset registry, items on the balance sheet were not verified by an inventory at 42.9% of audited companies. As result of the lack or irregular implementation of stock-taking activities, the authenticity of state property reported via the balance sheet reports was not confirmed.

39.7% of the audited business associations did not perform their obligation to disclose information in the public interest. Due to their failure to perform their disclosure obligation, the transparency of the operation, financial management and task implementation of companies was not guaranteed.

A typical irregularity of companies within the government sector was their failure to perform their reporting obligations towards the minister liable for public finances.

Recommendations

Recommendations made to property rights owners included the drawing up of regulations regarding the approval of the supervisory committee's rules of procedure, the acceptance of the annual report in accordance with legal requirements, and the remuneration of senior officers, members of the supervisory committee, and employees covered by labor law, guaranteeing the level of equity prescribed by law, and the clarification of liabilities concerning accounting regulation discrepancies and other shortcomings. The majority of recommendations made to the directors of business associations concerned regulatory deficiencies, property management, asset registry and transparency.

3.2. REGULARITY AUDIT ON THE ACTIVITIES RELATED TO THE EXERCISE OF PROPRIETARY RIGHTS OVER STATE PROPERTY

The State Audit Office of Hungary has determined that, in 2016, property right owners subject to the audit have performed their accounting, reporting and asset protection obligations concerning the state property entrusted to them in accordance with the requirements prescribed by the Fundamental Law pertaining to the responsible management of public property in an appropriate, transparent and accountable manner.

The State Audit Office of Hungary, in order to facilitate responsible management of public property and in accordance with its statutory obligation, annually audits the exercise of proprietary rights over state property, which covers a significant portion of national assets. While annual audits contribute to the improving trend of regularity in the exercise of proprietary rights, in 2016, during the period audited, there were discrepancies, primarily concerning the registration of assets under trusteeship.

Findings

Property right owners have performed their reporting obligations concerning state property in accordance with legal requirements. They have kept proper records of the state property entrusted to them – except for property they have placed under trusteeship. During property management, the handover of assets, the buying and selling of state property were properly conducted, the establishment and operation of regulatory controls supporting tasks concerning the exercise of proprietary rights were in accordance with legal regulations.

Property right owners have established and operated a system for proprietary control for property placed under trusteeship. The accurate, up-to-date tracking of the value of state property placed under trusteeship was endangered by discrepancies in the records of assets. The protection of state property placed under trusteeship, assigned for use was supported by a system providing proprietary control.

In order to enhance the responsible financial management of public property and to correct any errors, deficiencies, property right owners have utilised the findings of external audits in a responsible manner and have tracked the implementation of action plans.

Recommendations

Property right owners have created an action plan concerning the formulated recommendations, which was acknowledged by the SAO.



The audit reports made in relation to state-owned business associations are available by clicking on the link, and may be downloaded from the website of the SAO (www.asz.hu) with the help of the QR code.

REPORTS, ANALYSES AND STUDIES PREPARED BY SAO IN 2018 BY FOCUS AREA (SECTION 2)



SAO proposal:

The SAO proposes considering the implementation of the separation of the role of the client and the exercise of proprietary rights.



The audit report can be accessed by clicking on the publication number in the box, and may be downloaded from the SAO website (www.asz.hu) with the help of the QR code.

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3.3. EVALUATION OF DECISION-MAKING PREPARATIONS CONCERNING PRIORITY INVESTMENTS

Supervision of priority investments

The supervision of investments – considering the magnitude of utilised budget resources, the national assets established by way of such investments – is a priority to the State Audit Office of Hungary. The experiences gained from past examinations show that the basic cause of default in implementation and the significant increase of costs is discrepancies in the preparation of investments. The organisational structure and decision-making mechanisms did not ensure the cost-effective and efficient implementation of investments, the appropriate management of risks arising during the preparatory phase. In view of these factors, in 2017, the SAO has conducted methodological development concerning the implementation of its audit assignments, as part of which it has established an investment supervision module dedicated to the issue. In order to assist the effective implementation of investments, within the framework of this module, in 2018 the State Audit Office of Hungary evaluated the identification of risks arising from the preparation of the decision to the start of the implementation and the endorsement of integrity approaches in case of ongoing investments of budget institutions and state-owned companies selected on the basis of a risk assessment system.

The experiences gained during SAO examinations conducted in the previous years and concerning public investments have been confirmed by the SAO's 2018 examinations, according to which the effectiveness of investments is already determined during the preparatory phase. The quality of decisions made during the preparatory phase is of key importance. Indeed, some of the examinations have shown that, typically, the preparation of investment decisions and the definition of the investment process were not in accordance with provisions of relevant legal regulations, public organisational control tools and internal regulations. This highlights the fact that clear liability, accountability standards, a comprehensive internal control system and well-functioning functional procedures are necessary during the preparation of investments. The control system for the preparation and implementation of priority investments must be established in a way so as to ensure that risks are prioritised by allocating appropriate resources. This enables the implementation of corrections, enhancement of controls necessary for the elimination of deficiencies, irregularities of the investment process, thus reducing the risks arising during the implementation phase.

4. Central budget

The central budget is the greatest subsystem of public finances, which is responsible for the financing of the central subsystem. Its priority role is strengthened by the fact that it is the medium through which the central resources of the local governmental subsystem are provided. The institutions of the central subsystem play a defining role in the use of public funds.

Within the framework of the execution of central budget, the audit of the final accounts the SAO uses its comprehensive audit methodology to draw well-founded conclusions regarding the entirety of public finances. Through its audits and recommendations, the SAO can promote the enhancement of the financial and property management regulations of budgetary institutions, and it can get a comprehensive picture of the financial management deficiencies and good practices of budgetary institution within the central subsystem.

4.1. AUDIT OF THE FINAL ACCOUNTS

The State Audit Office of Hungary has concluded that the execution of the central budget of 2017 was in accordance with the legal requirements. Deficit and public debt was managed in accordance with legal regulations. The bill on the final accounts has truthfully shown the financial data and information related to the implementation of the budget, while its performance data concerning revenue and expenditure proved reliable.

Fulfilling its statutory obligation, the State Audit Office of Hungary has appropriately reviewed the implementation of the 2017 central budget. The aim of audit is to enable the SAO to support the Parliament in making decisions on the acceptance of the bill on the final accounts and to strengthen responsible financial management of public funds with its findings. Institutions of the central subsystem have significant effect on the correct implementation of the budget and the sustainability of budgetary equilibrium. Thus, it is important that the use of public funds is in accordance with regulations and that it is transparent and accountable. The management of appropriations and the determination of tasks through reverse engineering is a prerequisite of economic efficiency and increasing transparency in financial management.

In 2017, the revenue of the public finances' central subsystem was 19,223.3 billion HUF, while its expenditure was 21,056.7 billion HUF, leaving a cash deficit of 1,833.4 billion HUF.

The structure, elements and logic behind the compilation of the bill pertaining to the implementation of the central budget is defined by the act on public finances. This basically defines the methodology that the SAO may apply for auditing final accounts. In this context, during the 2017 audit of the final accounts, the SAO has used the methodology reinvented in 2015 as result of which the audit could cover 100 percent of central subsystem's expenditures and revenues. The sampling method ensured that SAO was able to provide a substantiated evaluation of the reliability of data presented in the bill in regards of all material issues concerning final accounts.

Analysis of the macroeconomic correlations of 2017 budgetary processes in the context of the audit of the final accounts

Simultaneously with 2017 final accounts the audit of the implementation of the 2017 central budget of Hungary, the State Audit Office of Hungary has prepared its analysis of the macroeconomic correlations of 2017 budgetary processes.

On the whole, the macroeconomic processes of 2017 have verified the expectations of the government, seeing that economic growth was even stronger than expected. The GDP growth rate was 4.1% compared to the previous year, which is 1.0 percentage points higher than forecast in the Act on the Budget of 2017.

The main drivers of economic growth were investments. The volume of investments in the national economy increased by 18.2% in 2017, construction investments increased by 21%, while machinery and equipment investments increased by 13%. In 2017, the value added by industrial output exceeded the 2016 data by 3.9%. The value added by construction (+31.6%) and services (+3.3%) increased significantly, however, the value added by agriculture plunged by 9.0%.

The six-year tax and wage agreement that came into force on 1 January, 2017, was a factor for improving competitiveness, since the significant increase of the minimum wage and the guaranteed minimum wage and other wage increases have increased the income of the employees, while as a result of reducing the social contribution tax and the corporate income tax, the burden on employers has decreased.

The number of employees in the private sector increased by 2.9%, while the number of public sector employees (due to the deliberate reduction of public employment) decreased by 3.5% and the employment rate reached 68.2%.

Among the tax policy measures of the government, the reduction of the social contribution tax by 5 percentage points and the introduction of the 9% corporate tax rate should be highlighted.

The measure also encouraged the establishment of capital-intensive investments capable of producing high added value. This is supported by the fact that in 2017 a record amount of foreign working capital investment, equal to 1000 billion HUF, came to Hungary, according to the data of the National Investment Agency.

In 2017, the tax system continued to favor consumption-type taxes, with the weight of income taxes falling. Reducing the VAT of some basic foods and the internet has contributed to an increase in household consumption, which has risen by 4.7% over GDP.



The audit report can be accessed by clicking on the publication number in the box, and may be downloaded from the SAO website (www.asz.hu) with the help of the QR code.

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By the end of 2017, the cash deficit of the public finances' central subsystem was significantly higher than the legal appropriation, partly because underperformance in the context of European Union revenues, partly because of conscious choices made by the Government. Operations performed for the management of public debt resulted in a 130 billion HUF increase in financing costs associated with public debt, due to the higher repurchase of government bonds, switch auctions and sells of treasury bills.

Risk relevant to 2018 and later years also arose due to a balance of 2,743.1 billion HUF left at central budgetary institutions and following chapter-managed appropriations, which is almost 20% higher than the balance in 2016. Although this has improved the balance of 2017, spending the committed 2,588.8 billion HUF balance will be a budgetary expenditure in the following year(s), meaning it will negatively influence the budget in the given year(s). Deficit in the government sector in 2017, as calculated using EU methodology and based on preliminary data concerning national accounts, was 2.2% of the GDP, 0.2 lower than planned. According to EU methodology, in 2017 the deficit indicator was in accordance with legal regulations.

The public debt regulation outlined by the Stability Act was again completed in 2017. The value of the public debt indicator for 2017 was 72.9%, 1.1 percentage point lower than the 2016 public debt indicator. At the end of 2017, based on EU methodology, the government sector's debt was 28,095.5 billion HUF, 73.3% of the GDP, 2.6 percentage point lower than the debt-to-GDP ratio of 2016.

4.2. FINANCIAL AND PROPERTY MANAGEMENT AUDIT OF SPECIFIC INSTITUTIONS OF THE CENTRAL SUBSYSTEM

The quality of the activities, financial management of the central subsystem's institutions influence responsible – compliant with the principles of accountability and transparency – management of public funds and public property and, by way of the public services provided through them, the quality of life of the population. Therefore it is justified for the SAO to evaluate the design and operation of the internal control system, the regularity of financial and property management activities, and the endorsement of the integrity approach in financial management processes by auditing the institutions of various institution groups within the central subsystem. The audit – in cases of certain institutions – also covers activity performed between the preparation of decisions on prioritised investments to be implemented from public funds to the actual commencement of their implementation.

The use of public funds by the central subsystem of public finances, the diversity of public tasks carried out by the institutions and the scale of the assets assigned to the performance of tasks have required the State Audit Office of Hungary to continuously perform audits pertaining to the financial and asset management of institutions within the central subsystem and to investigate any irregularities, systemic errors in financial management, including property management.

In 2018, 11 reports concerning financial and asset management audit of specific institutions of the central subsystem have been released.

According to Act LXVI of 2011 on the State Audit Office of Hungary, the report published by the State Audit Office of Hungary may not contain any classified information or other secrets protected under law. The report drawn up regarding the audit of the Constitution Protection Office and the Information Office has been published as classified information – with regard to the documents considered classified information by the audited entities, as the classified information designation was reapplied by the State Audit Office of Hungary in accordance with Act CLV of 2009 on the Protection of Classified Information. Accordingly, the SAO has recorded its findings in a record that was not made public and which was sent to the directors general of audited organisations and to the ministers performing duties associated with managerial bodies.

The SAO – in the cases of certain institutions – has supplemented the audit of the institutions of the central subsystem with an investment module to assist in the effective implementation of ongoing investments by identifying risks arising between the preparation of decisions and the actual commencement of implementation and evaluating the endorsement of the integrity approach.



The audit reports made in relation to the financial and property management of certain institutions of the central subsystem are available by clicking on the link, and may be downloaded from the website of the SAO (www.asz.hu) with the help of the QR code.

REPORTS, ANALYSES AND STUDIES PREPARED BY SAO IN 2018 BY FOCUS AREA (SECTION 3)

Findings

The audits have highlighted the fact that there is a correlation between the compliance of the design of the institutional internal control system designed by the head of the institution and the quality of professional task performance and financial management. At institutions where the internal control system was not properly developed, the internal control system designed by the head of the institution did not provide for the requirements of proper, transparent and accountable use of public funds – including the requirements of financial and property management.

In the area of financial management, deficiencies were found in the use of expenditure appropriations and the exercise of managerial powers, while in the area of property management, deficiencies concerned the registration of asset management rights in the land register, the utilisation of assets, the individual qualification of receivables in the balance sheet, and the verification of items on the balance sheet by an inventory.

Recommendations

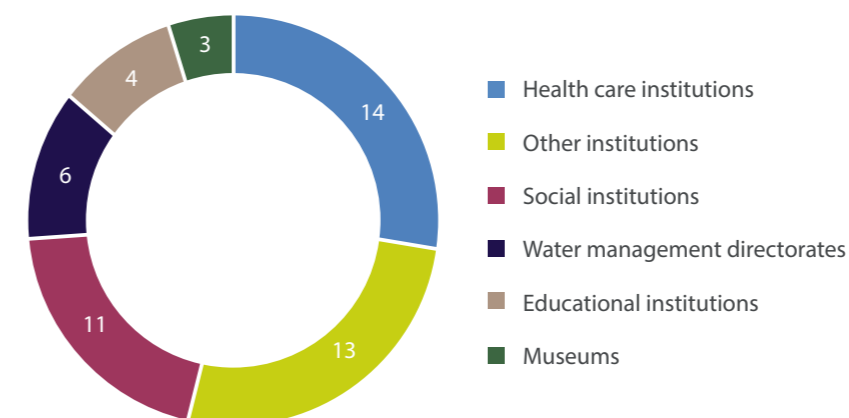
While auditing the 9 institutions of the central subsystem, the SAO put forward 239 recommendations with regard to the findings on which said recommendations are based on – ten recommendations to the ministries operating the institutions, one recommendation to the National Healthcare Services Center which performs the duties of a mid-level managerial body, and 228 recommendations to the heads of audited organisations. Audited organisations have performed their obligation to prepare an action plan, action plans sent by the ministries operating the institutions and by the heads of mid-level managerial bodies in regards of 6 audits have been deemed adequate, while the supplementation, amendment of action plans – performed by the audited organisations – in regards of eight audits was underway on 31 December, 2018.

In order to cease the unlawful practice revealed through auditing – in accordance with Paragraph (6) of Section 33 of the Act on the SAO – with regard to seven audits, in ten cases the President of the SAO notified the proprietors of the institutions, mid-level managerial bodies and the heads of audited institutions.

Analysis – Performance review of the economics and logistics of the institutions of the central subsystem, based on the auditing experiences of the State Audit Office of Hungary

Starting 2014, the State Audit Office of Hungary have performed, in addition to the regularity audits, performance audits of 51 budgetary institution within the central subsystem. The SAO, in the course of performance audits, sought to determine whether institutions have efficiently prepared with regard to their financial management practices for the endorsement of efficiency and economical requirements.

INTRODUCTION OF AUDITED ORGANISATIONS BASED ON SECTOR (ITEMS)





The analysis can be accessed by clicking on the publication number in the box, and it may be downloaded from the SAO website (www.asz.hu) with the help of a QR code.

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The analysis has shown that the majority of audited organisations have not prepared with regard to their financial management practices for the endorsement of efficiency and economical requirements. Despite legal regulations outlining clear and unambiguous requirements, the majority of budgetary institutions have not taken any steps to develop criteria for economical, efficient and effective task performance in the course of their financial management, which would have been essential for creating economical financial management practices. Only 11 of the 51 organisations have developed such criteria for some areas of financial management.

Several of the heads of the 11 organisation have implemented these processes in an inconsistent manner, as they have not set any organisational objectives, not developed any indicators to represent the implementation of these objectives, or not provided for the tracking of the achievement of the objectives.

Conclusions

The heads of budgetary institutions have not established a conditionality for transparent and accountable financial and property management – despite regulatory requirements –, which means significant risk for the actualisation of responsible financial management. As result of the audits, it can be ascertained that neither the management organisations, nor the independent internal audits have implemented the legally required audits relevant to this area, and have thus not supported the development of performance criteria for institutions. The institutions of the central subsystem are obligated to ensure that public funds and public property are utilised not only while employing legal financial management practices, but in an appropriate and efficient manner. Failure to adhere to these principles may result in a wasteful, improper use of public funds and public property, thus giving justification to the State Audit Office of Hungary to initiate withdrawing budget support from the institutions concerned.

4.3. AUDIT ON THE STATE-OWNED INSTITUTIONS OF HIGHER EDUCATION FROM THE ASPECT OF STUDENT UNIONS, ANALYSIS CONCERNING PUBLIC HIGHER EDUCATION

The State Audit Office of Hungary audited the financial management and operation of state-owned institutions of higher education several times. However, it was the first time that an audit was conducted on the 27 state-owned institutions of higher education from the aspect of student unions. The operation of student unions affects a significant portion of the next generation, more than 200 thousand full-time students, uses a significant amount of public funds and also affects the day-to-day operation of state-owned higher education institutions. The activity of student unions permeate the essential aspects of the management of the given higher education institution. According to law, student unions have right of consent in regards of the approval and amendment of organisational and operational policies, reimbursement and benefit policies, regulations concerning the appraisal of teachers by students, and academic and examination policies. Thus it is essential that they operate in a regular, transparent manner.

The representation of the students' interests and the operation of student unions in higher education institutions is provided for by Act CCIV of 2011 on National Higher Education. According to this act, the right to exercise the rights of student unions is subject to lawful foundation. These rights include the assets ensured for their operation, and decisions on the use of state subsidy and own revenues. Higher education institutions shall guarantee the conditions necessary for the operation and task performance of student unions and are obligated to supervise compliance with such conditions and the lawful operation of student unions.



The audit report can be accessed by clicking on the publication number in the box, and may be downloaded from the SAO website (www.asz.hu) with the help of the QR code.

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Findings

The audit has revealed that, in the years 2013-2016, student unions were not founded in a lawful manner, as it has been proven that, contrary to legal requirements, at least 25% of full-time students did not participate in student union elections and student unions did not have approved statutes. Thus, student unions were not authorised to use public funds. The operation, use of resources and financial management of student unions was not regular, the transparent and regular use of public funds was not ensured.

Higher education institutions did not carry out any audits concerning whether student unions could exercise their rights provided for in law or whether their operation was lawful. The internal control system of institutions of higher education did not provide appropriate protection against the unjustified and unlawful use of public funds.

Steps taken to eliminate irregularities

The institutions were instructed to eliminate irregularities by the State Audit Office of Hungary in writing. Of the 27 audited state-owned higher education institutions, rectors of eight have not submitted any notifications regarding the elimination of irregularities within the 15-day deadline prescribed by law, thus the misuse of public funds has continued at the institutions in question. In the case of these eight higher education institutions, the SAO has initiated with the Hungarian State Treasury, based on legislative authorisation, the suspension of the payment of the one percent state subsidy higher education institutions are entitled to and are obligated to spend on student unions in accordance with the normative rights of students.

Analysis

The analysis has examined the option to attract private capital to higher education. The financing structure has changed and, in regards of the duration of education, the Bologna dual, multi-cycle, three-leveled model was introduced. The restructuring of the higher education system was expected to establish an educational system better suited to economic requirements and cheaper for the state. The analysis has concluded that the hypothesis, according to which companies would contribute significant funds to the development of educational courses, and which would have meant public finances saving on such expenditures, was incorrect.

4.4. EVALUATION OF THE EXPERIENCES GAINED THROUGH THE AUDITING OF HOSPITALS

Audits carried out by the State Audit Office of Hungary regularly focus on hospitals. The analysis, by summarising audit experiences and drawing conclusions, on one hand creates an objective review of the public financial status of hospitals, on the other it highlights justifications for implementing measures for the elimination of irregularities. According to the evaluation of the analysis based on the findings of audits disclosed to the public between 2016 and 2018 and concerning 17 hospitals, the financial management of audited hospitals proved to be irregular in significant areas, their approach to integrity typically required development.

The SAO, in the framework of its advisory activity, has prepared an analysis based on audit experiences, in which it summarises the discrepancies, irregularities revealed through the auditing of health care institutions included in the category of "Auditing the financial and property management of the institutions of the central subsystem", identifies good practices, and introduces findings relevant to the tasks of managerial bodies. The Ministry of Human Resources, which performs the duties of a governing body, has complied with legal requirements when exercising its rights as employer, and have approved the budgets and reports of hospitals.



The analysis can be accessed by clicking on the publication number in the box, and it may be downloaded from the SAO website (www.asz.hu) with the help of a QR code.

T/444

In the cases of seven hospitals, the National Institute for Quality- and Organizational Development in Healthcare and Medicines, which performs the duties of a mid-level managerial body, and later the National Healthcare Services Center, has approved organisational and operational policies with inappropriate content. In the audited cases, the legal amendment, supplementation of the asset management contracts concluded with hospitals was not provided for. The errors, discrepancies revealed in the financial management of the hospitals show that the mid-level managerial body has not exercised its supervisory, auditing powers in an adequate manner.

The establishment and operation of the internal control systems established at the majority of audited hospitals were not compliant with regulations. The majority of hospitals also did not perform their regulatory obligations concerning data of public interest. At the majority of audited hospitals, there were discrepancies concerning the design and operation of the risk management system, control activities, the information and communication system as well as the monitoring system.

In several cases, the rules of procedure governing the management of irregularities and the integrated risk management policies applicable from 1 October, 2016, were unregulated. At the majority of hospitals, the risk associated with their activities and financial management were not evaluated or defined, there were no up-to-date records and specimen signatures of persons with financial management related powers, and disclosure obligations concerning data of public interest were insufficiently performed. The internal audits employed – as part of the first line of defense – did not substantially contribute to the development of hospitals' internal control systems.

At the majority of hospitals, financial management was irregular. This is illustrated by, for example, the lack of public procurement procedures, and the record-keeping of commitments not being in compliance with legal requirements. Legal requirements were regularly disregarded during financial countersigning, commitment, verification of completion, endorsement and remittance.

The audit has revealed discrepancies concerning the financial management of state property at all hospitals. Inventories of assets and funds did not comply with legal requirements. At some hospitals, no inventory showing the quantity and value of assets and funds available on the balance sheet date in an itemised, verifiable manner were prepared.

The integrity approach became more prevalent at hospitals, but the discrepancies revealed by the auditing of hospitals show that integrity control methods did not perform appropriately.

No system-level conclusions applicable to all hospitals may be drawn based on the audit experiences – as selection for audit was based on risk-level –, but error types relevant to certain areas have been revealed as result of the audits.

Based on the audit findings, the SAO put forward 16 recommendations to the Minister of Human Resources performing the duties of a governing body, 21 recommendations to the director general of the mid-level managerial body, and 404 recommendations to the directors general of the hospitals. In several cases, in order to eliminate revealed unlawful practices, the President of the SAO has sent warning letters to the heads of the audited organisations.

The SAO has conducted a follow-up audit evaluating the utilisation of past audits at five hospitals and the Ministry of Human Resources. It has established that two hospitals did not implement the measures necessary to perform the tasks they themselves have determined in the action plan, which resulted in risks concerning the operation of the hospitals and the behavior of their accountable managers. One hospital did, overall, implement the tasks undertaken as part of the action plan, however, a quarter of the tasks have been performed past their respective deadlines. Two hospitals did perform the tasks undertaken as part of the action plan for increasing revenue and decreasing expenditure, but only one of them was able to carry out the tasks in accordance with the plan.

Conclusions

The findings of the SAO's audits show that the financial management of audited hospitals did not comply with requirements pertaining to the use of public funds. The discrepancies and irregularities typical of the audited hospitals' financial management show that the directors of the hospitals did not give due consideration to the area of financial management, despite this being their unambiguous, primary responsibility.

The internal control systems "reporting on the immune systems" of the organisations and the internal audits of the monitoring system were irregular and ineffective. The inadequate operation of the internal control system, which is a part of the management system, is due to the shortcomings of measures taken by the hospital directors liable for designing and operating said system. Deficiencies in the internal control system indicate that integrity risk is high and the management of corruption risks has not been verified. The state of the internal control system is an indicator of the quality of management.

Irregularities in financial and property management are due to deficiencies and irregularities in the design and operation of the internal control systems of the audited hospitals.

The irregularities, deficiencies detected by the SAO in the financial management of hospitals – particularly irregularities within the exercise of powers pertaining to financial management – carry risks regarding the improper uses of funds.

5. Local government sector



The audit reports made in relation to local governments are available by clicking on the link, and may be downloaded from the website of the SAO (www.asz.hu) with the help of the QR code.

REPORTS, ANALYSES AND STUDIES PREPARED BY SAO IN 2018 BY FOCUS AREAS (SECTION 4)

Local governments constitute a dedicated subsystem within the area of public finances. The potential financial deficiencies, debts resulting from their financial management influence the deficit and debt of the government sector. Additionally, the assets of local governments constitute national assets. This provides justification to the SAO to regularly audit the financial management of local governments, in the context of which it focuses on areas most in need of auditing based on identified risk factors. The conduction of audits based on the new risk-based monitoring system of the SAO represents a new approach which increases the efficiency of audits.

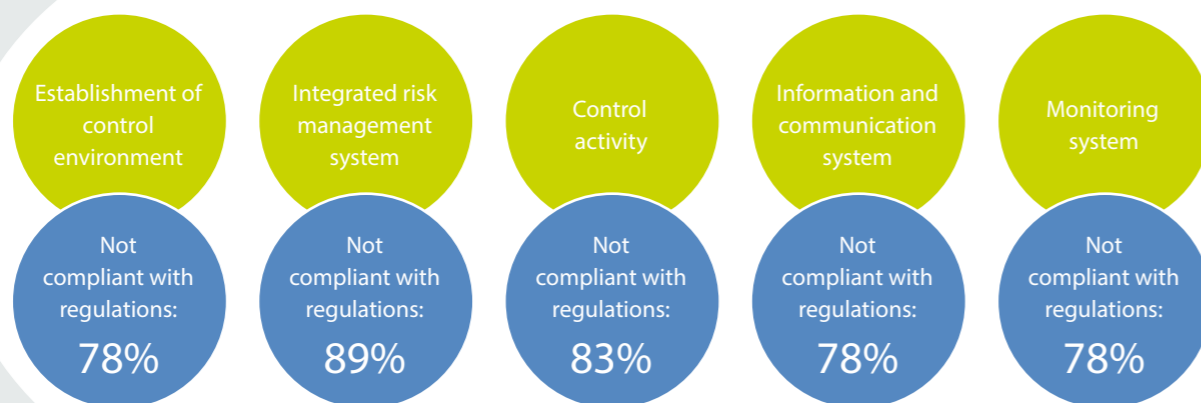
5.1. AUDITING THE INTERNAL CONTROL SYSTEM, INTEGRITY OF LOCAL GOVERNMENT

The strategic goal of the State Audit Office of Hungary is to promote an integrity based, transparent and accountable use of public funds, which it implements, in the course of performing its essential duties, by examining the structure and operation of the internal control systems of budgetary institutions, particularly local governments. The regular use of public funds, the proper and responsible financial management of national assets cannot be ensured without the design and operation of an internal control system, thus, in the case of business organisations managing public funds, the SAO assigns priority to auditing the adequate operation of internal control systems.

Throughout 2018, the SAO has continued – in the context of an independent thematic audit – the targeted audits of the design and operation of the internal control systems of local governments, as it puts great emphasis on the auditing of internal control system, which serve as a basis for regular operation and financial management and provide protection against corruption related hazards. The 18 audited local governments were selected based on risk assessment – as in previous years. The SAO has evaluated the compliance of the design of local governments’ internal control systems with legal requirements and the regularity of their operation based on pillars – control environment, risk management system, control activities, information and communication system, monitoring system – and in a summarised manner. In the framework of the audit the SAO also evaluated the structure of integrity controls for the management of corruption risks linked to local governments and whether the integrity approach has been applied.

Findings

In 2016, the design and operation of internal control systems was irregular at 94% of audited local governments selected on a risk basis, as it did not ensure the regular use of public funds, the transparency of operation, and the responsible management of national wealth at the local government level. In the course of the audits, numerous typical deficiencies, irregularities have been identified with regard to various pillars of the internal control system. Thus, the evaluation of the regularity of the design and operation of internal control systems has shown identical or similar results.



During the audits, the SAO has found results supporting selection on a risk assessment basis. During the audits, the SAO has found results supporting selection on a risk assessment basis.

In the cases of eight local governments, the SAO has also examined whether the established control environment ensured that investment activities were properly conducted in the years 2012-2016. Not a 100% of these local governments had control environments designed in accordance with legal requirements, so proper performance of investment activities was not ensured in the years 2012-2016, thus the transparent and responsible financial management of invested state property was not realised.

The establishment, enhancement and operation of an integrity based culture within the public sector is closely intertwined with the operation of an internal control system, accordingly, the audit includes the evaluation of the influence of the design and operation of the internal control system on the effectiveness of the integrity approach.

At 78% of audited local governments, the establishment of integrity controls did not correspond to the level of arising risks. Local governments operated integrity enhancing controls not prescribed by legal regulations. The internal control system did not support the endorsement of the integrity approach. Furthermore, the integrity approach was not endorsed and an integrity control system was not established at 23% of local governments, and local governments have not operated the controls enhancing integrity prescribed by legal regulations. Considering that the proper design and operation of an internal control system plays a key role in terms of integrity in preventing and discovering fraud and managing corruption risks, local governments must implement additional measures to appropriately endorse the integrity approach in order to ensure the efficient management of corruption risks arising in the course of the operation of local governments and the task performance of their offices.

Recommendations

In order to eliminate irregularities, the SAO put forward more than 252 recommendations obliging local governments to take action, in response to which stakeholders prepared action plans.

Analysis

Among audited local governments, there were municipalities with smaller and larger populations, lower and higher total budgets and with lower and higher investments. Accordingly, the forms of investment chosen by local governments painted a varied picture. Our audits also covered short- and long-term investments with higher and lower risks.

Our audit experience has demonstrated that a properly structured and well-functioning internal control system is a prerequisite for the regular and transparent investment of municipal public funds.

At local governments where the internal control systems were set up and operated irregularly, investment related decision making, the execution of decisions, the accounting and registration of investments also proved to be irregular. Investments, which were contrary to procedural laws and local rules, have not been enforced through transparent and responsible management of national assets, thus endangered the preservation and enhancement of public assets.

As a consequence of the bookkeeping, registry and accounting deficiencies, the accounts of the local governments concerned did not represent accurately the invested public assets.

After 2014, the amount of assets invested in the local governmental subsystem increased. Therefore, it is of utmost importance to invest properly and safely in the interest of preserving and enhancing public wealth.

The general management rules also apply to investment activities of the local government subsystem. The internal control system gives the local governments the right tools for regular and safe management.

Consequently, it is essential that some pillars of the internal control system also extend to investment activities. In the preparation and implementation of investment decisions, the risk of a particular investment must be proportionate to the controls that provide adequate security to preserve and enhance public assets.

However, the preservation of invested public assets depends, in addition to prudent investment activity, on the proper fulfilment of accounting tasks. Classification and evaluation tasks should be carried out in accordance with the law in order to enable the detection of real asset value in the information systems, and thus allow for the regular recording of the existence of the invested asset.

5.2. AUDITING THE FINANCIAL AND PROPERTY MANAGEMENT OF LOCAL GOVERNMENTS

The evaluation of the financial and property status of local governments contributes to the promotion of the responsible and sustainable financial management of local governments and the more accurate assessment of their financial situations, as the SAO reveals discrepancies in the regulations governing financial management at the local government level, which areas of financial management are not covered by regulation, and any irregularities in financial and property management.

In 2018, the SAO disclosed four reports made of the audit of four local governments concerning financials and property management. As part of its audit covering the years 2014-2016, the SAO has evaluated the financial and property management of local governments, the achievement of financial equilibrium, financial management on basis of the accounting of economic events and the regularity of financial management practices, the performance of the duties of property right owners and managerial bodies, and the endorsement of the integrity approach as protection against corruption related hazards.

Findings

While examining the adequacy of the financial and property management of local governments selected on basis of risk assessment, the SAO has determined that regular and transparent financial management of public funds was not guaranteed in the years 2014-2016. Local governments did not develop a regulatory framework for financial and property management, for example, despite legal requirements, they did not have documentation systems, so they could not guarantee the regularity of accounting in financial management or the responsible implementation of financial management. The balance sheets of financial statements were not verified by inventories, thus violating the principle of balance sheet authenticity. Decisions resulting in changes in assets were properly conducted, however, the implementation of such decisions, the exercise of financial management related powers, and the utilisation of assets through selling or leasing was not regular. Records of assets were not kept in accordance with the legal regulations.

During the exercise of proprietary rights pertaining to business associations in majority local governmental ownership, proprietary obligations were not performed properly in the case of two local governments. The integrity based operation of local governments was not guaranteed, while the level of established controls did not correspond to the level of corruption risks, hazards.

Recommendations

In its published reports, the SAO put forward 17 recommendations to mayors, 58 recommendations to notaries regarding the audits.

Analysis of debt settlement at the local government level

In its analysis of debt settlement at the local government level, the SAO has evaluated whether the debt settlement procedure was initiated, conducted in a regular manner, whether the financial management of local governments complied with legal requirements during the debt settlement procedures, and whether participants of the procedures – particularly the financial guardian – have acted in accordance with legal regulations throughout the debt settlement process. Furthermore, it has examined and evaluated whether the debt settlement procedure has achieved the objectives prescribed by law.

More than half of the local governments were insolvent based on the fund liquidity index.

Local governments with trade payables more than 90 days past due should, in accordance with effective regulation, have initiated the debt settlement procedure, but they failed to fulfil such obligation.

The ratio of local governments without improper fund solvency and indebtedness index decreased after debt settlement, but approximately one fifth of such local governments still did not have an appropriate financial index.

Only one third of the debt portfolio of local governments existing upon the initiation of debt settlement proceedings was enforced by creditors in each case, the remaining two third of debts was not involved in the proceeding, therefore, the endless dependence of local governments on credits remained.

The economic, legal environment, which defines the operation of local governments, has significantly changed in the past years, although, in terms of the law on the debt settlement procedures of local governments, it has been unchanged for more than 20 years. Not achieving the objectives prescribed by the law on the debt settlement procedures of local governments constitutes a financial risk and may result in the reemergence of debt stock, thus the auditing of the realisation of legislative objectives became justified. The goal of the analysis was the support of legislative work through the review of the operation of the regulatory system and the overview of systemic problems and their respective consequences.

According to the calculations performed as part of the analysis, of the debt settlement procedures concluded between 2009 and 2016, by the end of year of the given procedure's completion, more than half of the local governments were insolvent based on the fund liquidity index. Approximately 10% of the sum of creditors' claims set out in settlement agreements, judicial allocations of assets have not been paid, which also meant that the solvency of the local governments in question did not recover in the short term. Furthermore, the State Audit Office of Hungary has found that, in the years 2012-2016, 514 local governments have had debts that have been overdue for more than 90 days. In accordance with effective regulation, these local governments should have initiated a debt settlement procedure, but they failed to fulfil such obligation. In the given period, less than 10% of those affected, 45 local governments have conducted debt settlement.

The ratio of local governments without improper fund solvency and indebtedness index decreased after debt settlement, but approximately one fifth of such local governments still did not have an appropriate financial index. Contributing to the unfavorable development of index numbers, only a third of the debt existing upon the initiation of debt settlement proceedings was enforced by creditors in each case, the remaining two third of debts was not involved in the proceeding, therefore, the endless dependence of local governments on credits remained.

The failure to meet the creditors' claims suggests that the agreements concluded are unsubstantiated, which stems from the shortcomings of the programme and the lack of assessments of financial options. Local governments did not use the programme to find a way out of the financial crisis, to reevaluate their financial management opportunities, but only complied with legal requirements in terms of formality. As key actors in the proceedings, shortcomings in the task performance of financial guardians endangered the effective implementation of the procedure and have not promoted prudent and responsible financial management in local governments.

Reproduction of the debt portfolio

SAO proposal:

We recommend the elaboration of a solution pro-rated to responsibility for the purpose of satisfying creditor claims, the pro-rated division of the same, and for the reduction of the financial liability of the state.



The analysis can be accessed by clicking on the publication number in the box, and it may be downloaded from the SAO website (www.asz.hu) with the help of a QR code.

T/435

SAO proposal:

It is justified to condition the initiation of the proceeding on a threshold due to responsible management of public funds and the effect of the same on the operation of the local government. It is also justified to regulate the fees paid to the financial guardian, and to examine whether the local government is, in fact, insolvent.

Based on the findings of the audits and the analysis, the debt settlement procedures of local governments did not fully achieve the objectives prescribed by law. In its recommendations concerning the correction of systemic errors, discrepancies, the State Audit Office of Hungary emphasised proper and timely intervention. In order to ensure that the consequences of such omissions are enforced and the participants of debt settlement proceedings are not left uncontrolled, legal supervision must be better targeted.

Debts at the local government level must be restructured to ensure the transparent, balanced financial management of budgets.

Experiences gained from the financial-monitoring-based audit of local governments

The audit of financial management of municipalities is a statutory duty of the SAO; its strategic objective is the evaluation of the financial and economic situation of local governments and the detection of risks. The debt accumulated by the local governments of Hungarian municipalities between 2002 and 2008 were consolidated by the government between 2011 and 2014. As result of the consolidation of debts, the task performance of local governments was restructured, their financial status was restored at a systemic level. However, due to the hazards resulting from the financial management of local governments, the SAO continues to pay particular attention to the monitoring of risks affecting the financial equilibrium of local governments, processes causing financial vulnerability, and system integrity risks affecting the local governmental subsystem.

In the interest of its implementation, the SAO has developed a risk-monitoring system for local governments (ÖKOMER). Utilising the data of annual financial statements submitted by local governments and available via the central information system of the Hungarian State Treasury, the SAO, through the evaluation of monitoring reports, has contributed to the exploration of risk areas requiring intervention in order to ensure the financial equilibrium of local governments. In its report disclosed to the public in 2018, the SAO has evaluated the sustainability of the financial equilibrium, the risk of indebtedness, and the certainty of the preservation of asset value of 132 local governments of large municipalities based on indicators. The evaluation of risks associated with the financial management of 322 local governments of cities was initiated mid-year.

Findings

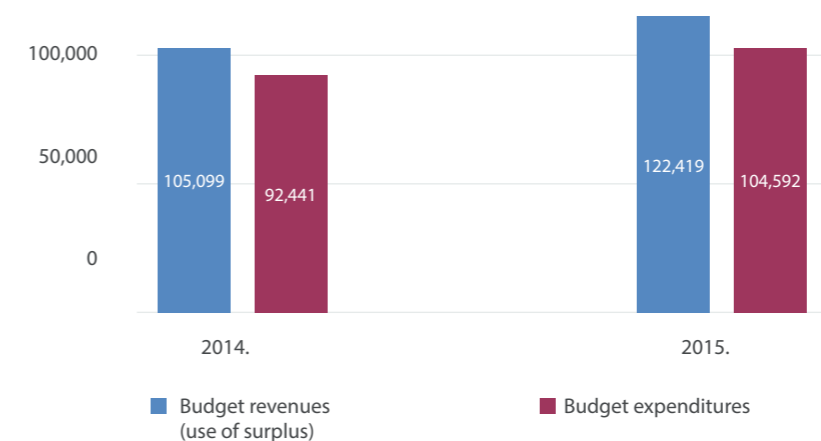
As result of the evaluation of risks pertaining to the financial, property status and indebtedness of the 132 local governments of large municipalities concerned in the 2014-2015 period, the SAO has determined that financial risks concerning local governments of large municipalities did not increase, their financial and property management provided for the performance of their legal obligations. The sustainability of the financial management of the local governments of large municipalities was ensured; there was no risk of accumulating excessive debt. Operational revenue provided coverage not only for operational expenditures, but also for debt service expenditures; the operational budget was also used to pay for accumulation related expenditures. After debt consolidation, there was no risk of re-indebtedness and the financial position developed favorably. The property of local governments of large municipalities have increased, the replacement of assets, the preservation of the value of the property were ensured.

While evaluating the risks associated with the financial management of the 322 local governments of large municipalities concerned in the years 2015-2016, the SAO has determined that their financial equilibrium and the preservation of the value of their property were ensured. The financial management of the local governments of cities were found to be stable. The audit has revealed that there was a risk of debt settlement proceedings being initiated at nineteen local governments of cities, which also carried a high risk in terms of task performance.

Conclusions

Risks identified in the field of property management of local governments of large municipalities do not necessitate immediate and system-level remedy. However, based on the audit findings, risks arising from the increase of the volume of liabilities of majority-owned business associations, and obligations related to the maintenance of state property shall be remedied in the medium term.

THE FINANCIAL EQUILIBRIUM OF LOCAL GOVERNMENTS (MILLION HUF)



In the course of the audit, unique risk areas affecting individual local governments were identified, of which the concerned local governments were notified. In cases of material risk, we carried out additional audits. This meant that individual audits of an additional 4 local governments were carried out in 2018.

The financial management of the local governments of cities were found to be stable, with no need for a system-level remedy. However, maintaining the financial management of the local governments of cities without any alterations carries risk in terms of the financial equilibrium of local governments, thereby also of said local governments becoming over-indebted.

5.3. FOLLOW-UP AUDIT OF LOCAL GOVERNMENTS

In 2018, the SAO has continued its follow-up audits concerning the establishment and operation of an internal control system and the area of financial and asset management. This year, the SAO has also started performing follow-up audits pertaining to the debt settlement proceedings of local governments. The SAO has reviewed the utilisation of past audits at 42 local governments.

Follow-up audits carried out at 42 local governments have included 11 cases concerning the regularity of financial and property management, 5 cases concerning the evaluation of financial management status and the regularity of financial management, 8 cases concerning the regularity of property management, 17 cases concerning the design and operation of the internal control system, and 1 case concerning the debt settlement proceedings of a local government.

Experiences reveal that 47.5% of tasks obliging stakeholders to take action were implemented (within or past the relevant deadline), but 49.2% of said tasks were not or not fully implemented, which continues to pose a risk in terms of the regularity of the design and operation of the internal control system of local governments, the accountable and transparent financial management of public funds, and responsible conduct of executives. Local governments have informed the President of the SAO of their proposed measures for the elimination of such discrepancies.

5.4. AUDIT OF LOCAL GOVERNMENT-OWNED BUSINESS ASSOCIATIONS

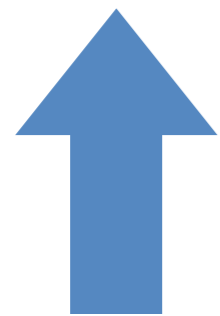
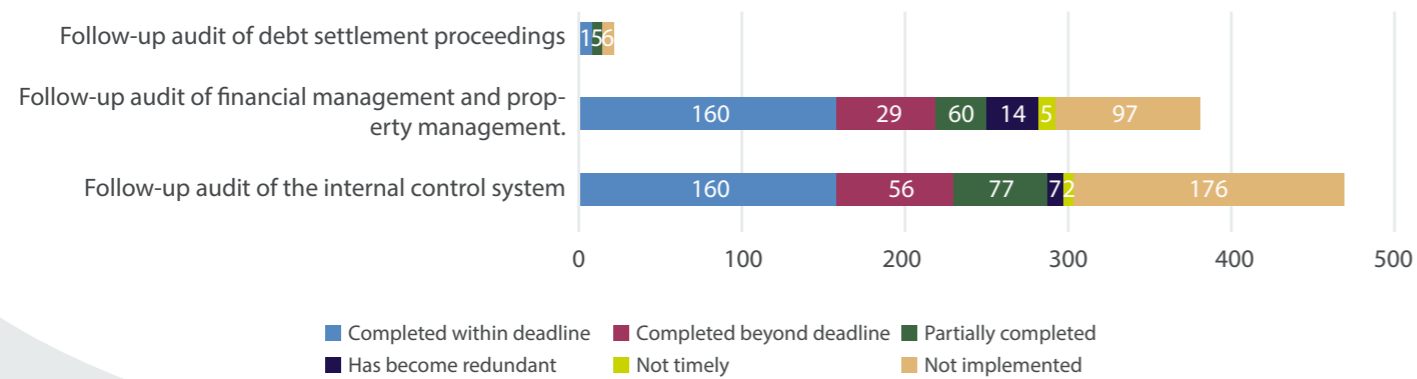
The local governments of Hungary, in the course of performing their obligatory and voluntary duties, employ task performance using non-budgetary funds more and more widely, thus – in addition to non-profit organisations – local government-owned business associations have gained a key role. The key objective of the SAO is to contribute to the use of public funds also by organisations operating outside public finances, in a transparent and orderly manner by revealing the financial risks inherent in the management of local governments, budget support outside public finances and free asset allocations, as well as audits of the performance systems operating outside the state budget. The SAO has deemed the auditing of business associations under majority local governmental ownership to be particularly important for the protection, preservation of state property.

What is ÖKOMER?

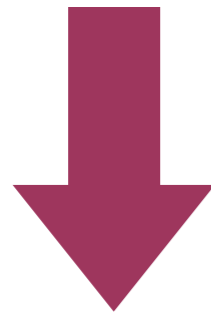
The SAO, for the better coverage of audits, continues to carry out its large scale audits, in the framework of which it strives to broaden the audits concerning local governments. To this end, the SAO established the financial monitoring system of local governments (ÖKOMER) that allows the detection of risks having an impact on the financial equilibrium of local governments and the presentation of the processes and trends related to the same.



THE DIVISION OF THE IMPLEMENTATION OF TASKS SET OUT
IN THE ACTION PLANS OF LOCAL GOVERNMENTS BY EVALUATION CATEGORIES IN 2018 (ITEMS)



• the risks inherent in the operation of local governments in compliance with regulations decreased as a result of the tasks implemented within and beyond the deadline



• they continue to pose risks to an extent specified in the action plans, and the tasks not implemented yet still pose risks in terms of the regularity of the establishment and operation of the internal control system of local governments, the accountable and transparent financial management of public funds and responsible conduct of executives

In 2018, following the completion of audits conducted at business associations under majority local governmental ownership and the local governments acting as proprietors, the SAO has published a total of 94 reports. Our audits were conducted with the purpose of utilising the recommendations drawn up based on the findings to eliminate revealed discrepancies.

The audited period was the years 2013-2016 in case of 97% of business associations, the years 2012-2015 in case of 3% of business associations. 80% of audited businesses were owned solely by local governments, 20% of them were under majority local governmental ownership. 21% of businesses held shares of other business associations. 15% of businesses had assets under trusteeship. 89% of audited business associations performed public functions, typically in addition to other activities, on a contractual basis. 58% of business associations performing public functions carried out health care, cultural and social assignments, 31% municipal development, municipal operation, housing and space management related assignments, 11% waste disposal, water utility services.

Findings

The findings of the reports have revealed that accountability, the appropriate protection of public property, the transparency of operation and financial management, the protection of the value of state property, sustainable management, the endorsement of the integrity approach were often not ensured in the financial and property management of the business associations.

Property management proved irregular at three-quarters of business associations, two-thirds of business associations did not verify their balance sheets with an inventory and have thus not guaranteed the application of the principle of balance sheet authenticity, which in turn meant a failure to protect, preserve state property and have endangered the protection of state property and accountability. Erroneous reports did not provide a comprehensive, reliable review for owners.

Due to the lack of administration concerning revenues, expenses and expenditures related to managed assets and the discrepancies apparent in certain areas of financial management – revenue, expenditure –, accounting was irregular at two-thirds of the companies and the protection, accountability of assets, the protection of asset value was not provided for.

Three-quarters of business associations did not comply with their statutory disclosure and reporting obligations, so the transparency of its operation was not ensured and fundamental rights concerning information were not provided for.

At three-quarters of business associations in the government sector, the managing director did not develop a system for tracking the implementation of objectives and monitoring activities, so the transparency of processes was not ensured and the endorsement of the integrity approach was not supported by the establishment of integrity controls.

Property rights were not exercised appropriately, as the supervisory systems of a third of the local governments acting as proprietors proved insufficient, the decisions necessary for the regular operation of the company were not made, the implementation of decision were only partially overseen, thus the transparency of the performance of contractual duties was not ensured and the sustainable financial management of the company was at risk. Fragmentary ownership control contributed to the growth of operating risks of companies.

Conclusions

According to our auditing experiences in 2018, the level of exercising proprietary rights and that of the financial management and property management of companies further deteriorated.

We have concluded based on our audit experiences that the reduction of the risks of companies in terms of financial management and operation qualify as urgent tasks. Improvement in quality continues to be a requirement addressed to owners, with regard to the responsibility of local governments over the financial management of national assets. The more efficient work of management is essential for improvement, and, in order to achieve the same it is necessary for the owner to set out a set of criteria and to account for performance. On account of the development of the systems of the companies related to regulation, execution and monitoring, the supervisory and audit bodies also contributed to the reduction of the operating and financial management-related risks of companies.

Recommendations

Based on the findings, the SAO proposed a total of 842 recommendations in the subject of the elimination of detected regulatory deficiencies and the practices not in compliance with rules. The action plans for the recommendations were prepared by the audited entities.

We addressed 70% of our recommendations to the executives of business associations, which were aimed for the establishment of accounting regulatory environment and accounting registers, the supporting of reports with proper inventories, the implementation of inventories, the accounting of revenues and expenditures in compliance with rules and the proper separation of the same, the fulfilment of the disclosure obligation and the establishment of a system ensuring the monitoring of the implementation of activities and objectives.

Our recommendations addressed to the persons exercising proprietary rights (forming 30% of the total of recommendations) were related to the establishment, operation and activity of a supervisory board, the establishment of a remuneration policy, the settlement of issues regarding capital, and, last but not least, the clarification of the responsibility related to the negative points experienced in the operation of the business association.



SAO proposal:

The strengthening of the activity of exercising proprietary rights is worth considering in terms of continuous presence of proprietors, control, audit, continuous monitoring of business associations, planning and implementation of the activities of companies and also in terms of accounting for implementation.

5.5. PERFORMANCE AUDIT ON PUBLIC LIBRARY SUPPLY

According to its goal declared by law, maintenance and development of library services are necessary for the citizens and the society as a whole, while state maintenance of library and information services is of strategic importance. Libraries safeguard invaluable national assets, as well as documents and collections related to universal culture. With the findings of particular audits and the analysis of audit results of a given period, the SAO can draw the attention of legislators to financial or regulatory tensions potentially arising in the local government sub-system or a sector of the same.

The SAO commenced the audit of the operation of public library supply in 2018. The amount of public funds used for the maintenance of libraries, the diversity of entities maintaining public libraries, the large number of public libraries and points performing tasks, the special scope of assets managed by libraries, as well as the risks identified regarding the topic all supported the necessity of auditing public libraries. The period audited was the years between 2014 and 2016, while, in terms of internal control system, it was the year 2016.

Findings

The proprietors of libraries exercised the founders' rights in compliance with regulations. Proprietors performed their tasks in terms of regulation and control properly, except for one library. In the case of one library, the proprietor did not perform its other controlling task. The establishment and operation of the internal control system of libraries were not compliant with regulations in 2016. It was found on several occasions that the establishment of the risk management system, the information and communication system as well as the monitoring system did not take place, or the establishment of the control environment or the performance of control activity was not compliant with regulations. This meant that institutions did not take measures for the management of corruption risks and for the averting of corruption perils, and did not take action for the enforcement of the integrity approach.

In the audited period, the management of national assets in compliance with regulations was not ensured in the case of three libraries, as they did not substantiate balance sheet items included in reports with inventories, in spite of statutory requirements.

Recommendations

The SAO formulated 61 recommendations for the elimination of the existing irregularities, out of which five recommendations pertained to the performance of the tasks of proprietor in compliance with regulations, 44 recommendations addressed the establishment and operation of an internal control system compliant with regulations, four recommendations were aimed for the establishment of proper financial management, and eight recommendations pertained to the establishment of management of assets in compliance with regulations.

5.6. AUDITING INSTITUTIONS INVOLVED IN THE MAINTENANCE OF LOCAL GOVERNMENTS OF MINORITIES

Article XXIX of the Fundamental Law of Hungary sets forth that Hungarian minorities are constituent elements. They have the right to use their native language, to use their names in their native language, to nurture their culture and to receive education in their native language. Minorities may establish local and national governments. A cardinal act specifies the detailed rules pertaining to the rights of minorities in Hungary. The state central budget provides subsidies for the performance of minority public functions. The subsidy may only be used by minority local governments for the performance of such public duties.

In 2018, the SAO audited 13 institutions maintained by minority local governments.

Findings

In the framework of audits, the SAO also evaluated the operation and financial management of institutions besides the performance of proprietor's tasks, in the course of which SAO found that the rights of controlling bodies are exercised in compliance with regulations only in the case of 46% of the proprietors, and SAO did not find a single audited institution where regularity as well as financial and asset management were compliant with laws jointly.

The heads of institutions did not take proper action for the establishment of the internal control system; it was not compliant with laws and internal regulations in the case of 92% of the audited institutions, and, thus, the conditions of using public funds in compliance with regulations were not established. The audits detected irregularities in terms of the collection of revenues, the use and accounting of budget expenditure appropriations as well as the preparation of financial statements and inventories. In addition, the control activities of financial management powers were not carried out in compliance with laws either.

Conclusions

As a result of the irregularities detected in the field of financial management, the reliability of the accounting registers prepared by the institutions and the authenticity of reports were not ensured, while the absence of inventories posed a risk on the enforcement of the criteria of transparent and responsible management of national assets (specified in the act on national assets): the safeguarding of national assets, the protection of its value and its preservation, its efficient and cost-saving operation and utilisation based on unified principles could not be implemented.

Follow-up audit of the financial management of minority local governments

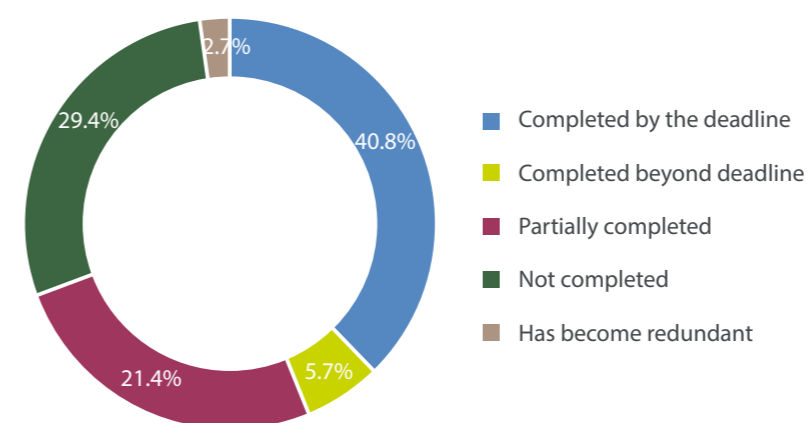
Findings

The experiences of follow-up audits show that the auditees performed more than 40% of the duties included in the action plan within the deadline (40.8%), but the rate of actions not taken was also high (29.4%). In the case of follow-up audits, there were examples both for the local government implementing the tasks specified in the action plan fully, and for the local government not implementing a single task within the deadline.

Conclusions

The regularity of the property management activity and the operation of the such activity improved in the case of several minority local governments.

IMPLEMENTATION OF THE TASKS SPECIFIED IN THE ACTION PLANS IN 2018 (%)





The audit reports made in relation to the use of budget supports are available by clicking on the link, and may be downloaded from the website of SAO (www.asz.hu) with the help of the QR code.

REPORTS, ANALYSES AND STUDIES PREPARED BY SAO IN 2018 BY FOCUS AREAS (SECTION 5)

6. Audits on the utilisation of budgetary subsidies

The transfer of budget resources outside of public finances poses increased risk from the point of using public funds. The SAO may audit the use of support provided from public finances pursuant to laws at beneficiary organisations. If the beneficiary organisation receives support from public finances (not including the transfer of a certain part of income tax based on the decision of the taxpayer) or receives gratuitous allowance, the entirety of its financial management activity may be audited.

6.1. AUDIT OF NON-GOVERNMENTAL HUMAN SERVICES PROVIDERS

It is a basic criterion also against non-governmental organisations that they use the public funds provided for the performance of their public duties in a transparent manner. The budget acts in effect from time to time provided significant annual financial support to non-governmental institutions maintaining entities performing public educational and social tasks for the purpose of the performance of their public duties.

In the framework of the thematic auditing of non-state institution proprietors performing public education and social tasks, SAO disclosed 16 reports to the public in 2018. Compliance audits were carried out for years 2014-2016. In the course of the audits, SAO evaluated whether the proprietors created the conditions necessary for the transparent and accountable use of budget supports through the establishment of a compliant operational and financial management environment, and whether the proprietor used the supports received from the central budget for the operation of its institutions in compliance with regulations, and whether transparency was enforced in the course of the performance of public duties.

Findings

The audited non-governmental human service providers performed proprietary public educational and social or solely public educational public duties.

The majority of the proprietors of institutions managed to ensure the basic criteria of the operation of their institutions.

In terms of proprietors, a typical deficiency was that they did not register the use of budget supports separated by each basic task in the audited period (in spite of statutory requirements), and they did not take measures to establish a register in which the purposes for which the supports were used can be concluded, and, thus, on many occasions, the accountable and compliant use of the state support received by them for the performance of their public duty was not ensured.

The majority of the audited non-state human service provider proprietors failed to fulfil their obligation regarding the disclosure of data of public interest in terms of the public funds used for the operation of their institutions, therefore, the criterion of transparency was not implemented in terms of the used public funds in their case.

Recommendations

A total of 75 recommendations were prepared for the 16 audited non-state human service providers. The audited organisations prepared action plans based on such recommendations.

6.2. AUDIT OF FOUNDATIONS AND PUBLIC FOUNDATIONS

The State Audit Office of Hungary has been assessing the financial management of foundations and public foundations in the framework of auditing the use of public funds originating from public finances since 2016. Pursuant to its statutory mandate, the SAO is entitled to audit foundations and public foundations that have received subsidies or funds granted free of charge for specific purposes from public finances. The SAO, by performing the audit of the budget support granted to entities outside public finances and gratuitous transfer of assets, contributes to the transparency and accountability of public funds used by non-governmental organisations.

The SAO disclosed reports made of the audit of three foundations in 2018. The basic goal of the audit was to assess whether the foundations observed the relevant legislation in the course of their financial management, whether they used the budget subsidies according to the respective requirements and whether the controlling and record keeping systems serving the purpose of the operation of the foundation were functioning in compliance with regulations.

With the presentation of the irregularities detected in the course of the audit of non-governmental organisations, the audit contributes to the correction of such irregularities and it also allows the society to gain an insight into the operation of foundations. The utilisation of recommendations made by the SAO promotes the sound financial management of foundations, which indirectly helps building public trust regarding the use of public funds.

Findings

It was a typical deficiency in terms of foundations that they did not ensure the framework of transparent financial management of public funds, and, in spite of statutory requirements, they did not fulfil their obligations regarding the protection of data and the disclosure of data of public interest, and, therefore, the transparency of the use of public funds was not ensured. The audit of the SAO also found that foundations tended not to substantiate the balance sheet items of reports with inventories, thus they did not ensure the transparency and accountability of their financial management.

Recommendations

The SAO formulated 30 recommendations in relation to the audits in the reports disclosed, including, amongst others, recommendations regarding the preparation of statutory policies, establishment of procedural rules, bookkeeping, preparation of inventories for substantiating balance sheet items, proper fulfilment of annual reporting obligations and keeping separate books and records.

Experiences of auditing the foundations of the Hungarian Central Bank

The SAO audited the financial management of six foundations of 2016: Money Compass – Foundation for Financial Awareness, the Pallas Athéné Domus Animae Foundation (PADA), the Pallas Athéné Domus Mentis Foundation (PADMA), the Pallas Athéné Domus Scientiae Foundation (PADS), as well as Pallas Athéné Geopolitical Foundation (PAGEO). In the course of the audits, the SAO assessed whether the foundations complied with applicable statutory provisions in the course of financial management, and the audits also covered the assessment of the regularity of the controls, monitoring and registration systems serving the operation of the foundation.



Findings

The SAO found that the financial management of the audited six foundations all in all complied with the applicable requirements and they managed to create the transparency of their financial management. The audited foundations did not receive support from public finances, and did not receive any other subsidies or donations in 2016. The amendment of Act CXXXIX of 2013 on the Hungarian Central Bank that came into force on 6 May 2016, however, authorises the SAO to audit the foundations of the Hungarian Central Bank. The SAO concluded that the foundations established the organisational framework of their financial management in accordance with applicable legislation, and their internal financial management policies complied with the relevant legal provisions. Their involvement in business organisations was in compliance with laws. The Pallas Athéné foundations accounted the investment-renovation expenses in compliance with regulations, the accounting of costs and expenditures was in compliance with the provisions of the Act on Accounting except for PADMA. At Pénziránytű foundation, the accounting of investment/renovation expenses as well as the accounting of costs and expenditures did not comply with the provisions of the Act on Accounting.

The registration of assets provided for the foundation's purposes was compliant with regulations in 2016 in the case of all six foundations. The foundations fulfilled their reporting obligation in accordance with the regulations, and the reports were substantiated by inventory. In the case of PAGEO, due to the non-compliant accounting of the donation received in 2016, the profit and loss account contained a significant error. The supervisory boards of the foundations fulfilled their control tasks related to the adoption of the reports properly.

Recommendations

The SAO formulated a recommendation to the chairman of the board of trustees of PADMA, PAGEO and Pénziránytű foundations respectively regarding the observation of the Act on Accounting. The action plans were prepared by all three foundations within the statutory deadlines.

6.3. AUDIT AND ANALYSIS OF PARTIES

Pursuant to the Fundamental Law of Hungary, the parties take part in the establishment and expression of the people's will indirectly. Therefore, parties have a special relationship with public authority compared to other social organisations, since it is the express goal and task of parties to take part of public authority through their representatives.

It is a basic factor from the point of the clarity of Hungarian political life, the reduction of corruption risks, and the use of public funds and public assets available for parties that the financial management of political parties be lawful, accountable and transparent. It is important that citizens get a reliable and true image of the financial management of political parties through the financial reports of the same. It is important that citizens get a reliable and true image of the financial management of political parties through the financial reports of the same. Accordingly, as required by the law, the State Audit Office of Hungary audits the financial management of political parties receiving budget support in every two years.

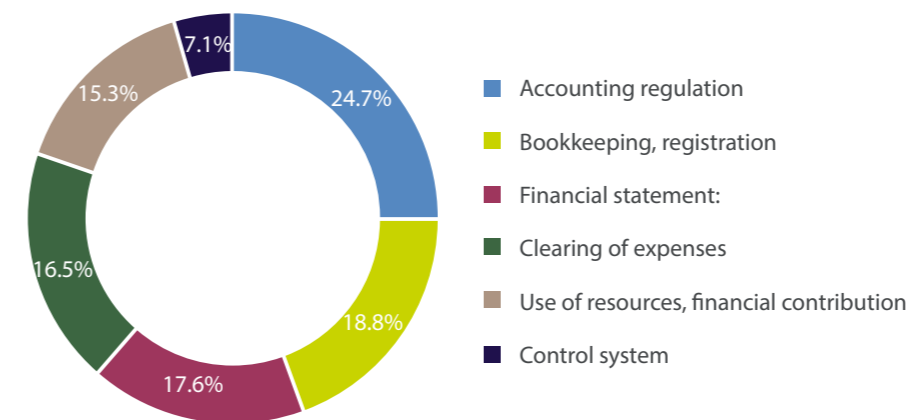
Pursuant to Paragraph (3) of Section 10 of Act XXXIII of 1989 on the operation and financial management of parties (the Act on Political Parties), we audited the lawfulness of the financial management of seven parties receiving budget support in 2017 (Movement For A Better Hungary, Hungarian Socialist Party, Democratic Coalition, Together – Party Of Era Changers, Politics Can Be Different, Hungarian Liberal Party – Liberals, Dialogue For Hungary Party) and we disclosed the prepared reports in January 2018 to the public. The analysis compiled of the experiences of party audits performed regarding years 2012-2016 were published in February 2018.

The purpose of the audits was to assess whether the lawfulness of the financial management of parties was ensured; whether the financial statements complied with the statutory requirements, whether the accounting and management policies were in compliance with the relevant legal and internal regulations; if the Democratic Coalition and the Hungarian Liberal Party – Liberals used resources and subsidies that can be properly used for their operation.

Findings

In the course of the audit, one party failed to certify the lawfulness of its financial management, the compliance of its financial reports and the fulfillment of its disclosure obligation in compliance with regulations. The division of findings made in the course of auditing the remaining six parties is illustrated by the following figure.

DIVISION OF FINDINGS BY CATEGORY (%)



In the course of auditing the six parties fulfilling their data provision and cooperation obligation, the SAO found that the lawfulness of financial management was not ensured in the case of five parties, since the regulatory environment of the same was not established in accordance with statutory requirements, therefore, they did not create the basis necessary for transparent and accountable financial management of public funds. The SAO detected recurring errors in the accounting of particular expenses and revenues confirming the deficiencies and irregularities detected in the course of auditing the regulatory environment (deficiencies of the registration (bookkeeping) system, deficiencies of the accounting policy, budget supports and other economic events were not accounted in compliance with accounting regulations). Due to the irregularities in financial management and registration, the annual reports and financial statements contained more errors and irregularities (the report and financial statements were not in compliance with the provisions of the Act on Parties in the case of five parties, five parties did not fulfil their obligation in terms of inventories), as a result of which the financial statements (except for one audited year of one party) did not ensure the transparency of financial management and financial standing.

In the course of the audit, the SAO found that five parties failed to present their revenues in accordance with the economic events in spite of the provisions of the Act on Accounting. In opposition to the provisions of the Act on Parties, the parties failed to ensure the evaluation or the determination of the value of the financial contributions not provided in cash. The audit found that all parties accepted prohibited support in violation of the provisions of the Act on Parties.

Based on the experience of the audit, five parties failed to operate their control systems in compliance with regulations, and, therefore, such control systems did not promote lawful use of public funds.

Recommendations

Based on the findings of the audit, the parties were compelled by laws to prepare an action plan (similarly to other audited organisations). All parties fulfilled such obligation.



The analysis can be accessed by clicking on the publication number in the box, and it may be downloaded from the SAO website (www.asz.hu) with the help of a QR code.

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6.4. AUDIT AND EVALUATION OF PARTY FOUNDATIONS

The SAO, pursuant to the authorisation granted by the Act on Party Foundations, audits the lawfulness of the financial management of party foundations that receive support from the central budget in every two years. The SAO, by performing the audit of budget supports granted to entities outside public finances, ensures the transparent and accountable use of public funds by non-governmental organisations as well. In the course of auditing party foundations, the SAO assessed the lawfulness of the financial management of the particular party foundation, the compliance of annual accounting reports and annual activity reports with the legal requirements, as well as compliance with the relevant statutory provisions and internal regulations in the course of bookkeeping and financial management. The SAO prepared an analysis of the audit experiences on political party foundations receiving budget support.

Laws set forth unambiguous and mandatory provisions for party foundations, the compliance with which creates the transparency and accountability of the financial management of party foundations and the use of budget supports. In the course of auditing the lawfulness of the financial management of party foundations, the State Audit Office of Hungary audits compliance with the statutory provisions applicable to the financial management of party foundations.

In 2018, the SAO disclosed state audit reports on the audit of the lawfulness of the financial management of seven party foundations of years 2015-2016 to the public. In relation to party foundations established in 2014, the SAO also assessed the fulfilment of the obligations to prepare an annual report, financial statements and the obligation to disclose related to the operation of the party foundation for 2014. In the case of three party foundations, the audit covered also the assessment of the implementation of the tasks specified in the action plan drawn up by the audited organisation in accordance with the findings requiring action in the previous SAO report.

Findings

In the course of the audit of party foundations, the SAO found that the party foundations established the organisational framework of their financial management. The SAO detected deficiencies in the case of three party foundations related to the establishment of the internal regulatory environment pertaining to financial management, the accounting policy and the codes to be prepared in the framework of the same.

In terms of the lawfulness of bookkeeping and financial management, the SAO detected deficiencies related to the establishment and level of detailedness of the bookkeeping system in three cases. Two parties failed to comply with statutory requirements related to the acceptance of supports, as they accepted supports in excess of the threshold specified in the Act on Party Foundations and they failed to disclose the data set forth in such Act within 30 days from the receipt of the support. The party foundations, observing the provisions of the Act on Party Foundations, did not provide financial contribution to the party founding them.

A major deficiency in terms of the lawfulness of the annual report on the operation of party foundations and the accounting report was that, in spite of the provisions of the Act on Party Foundations, two party foundations failed to fulfil their disclosure obligation in terms of the annual reports and three party foundations failed to fulfil such obligation in terms of the accounting report. The audit found in the case of five party foundations that they did not substantiate the accounting report with inventories specified in the Act on Accounting.

In the case of the three party foundations concerned by the audit of the implementation of the tasks set out in the action plans, the regularity of bookkeeping and financial management improved through the implementation of the tasks assumed in the action plan.

Recommendations

The State Audit Office of Hungary formulated a total of 29 recommendations for party foundations in 2018 recommending, amongst others, that the concerned party foundations prepare the policies, substantiate the report with inventories as well as prepare and disclose the same, fulfil the annual reporting obligation, register economic events and data in accounting registers and fulfil the disclosure obligation in terms of supports. All seven audited party foundations sent their action plans within the statutory deadline in relation to the findings substantiating the recommendations.

Evaluation

The evaluation pertaining to the audit experiences related to party foundations was prepared on the audit of the financial management of ten party foundations, and elaborates the audit experiences of a total of eighteen state audit reports disclosed between 2015-2018. The evaluation presents the important fields that are fundamentally necessary for the financial management of party foundations to be lawful and for their operation to be transparent and accountable.

The evaluation contributes to the strengthening of lawfulness, accountability and transparency in terms of the financial management of party foundations.

Based on the experiences of the evaluation, progress can be observed in the past years, the recommendations of the SAO were utilised by party foundations, which contributed to their lawful and transparent operation and their financial management of public funds and public assets in compliance with regulations.



The analysis can be accessed by clicking on the publication number in the box, and it may be downloaded from the SAO website (www.asz.hu) with the help of a QR code.

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III. ORGANISATIONAL AND METHODOLOGICAL PROGRESS

The State Audit Office of Hungary, as declared in its Strategy, is deeply committed to quality-oriented operation. Accordingly, the main goal of the SAO in terms of organisational development is to establish an optimal organisational system in accordance with the tasks to be fulfilled. With regard to the foregoing, the SAO formulates and develops its organisation on a continuous basis.

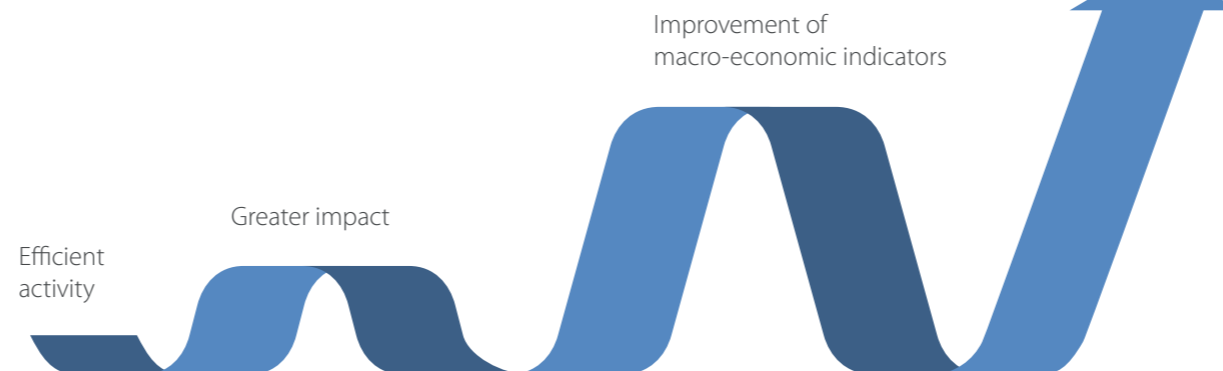
If necessary, the SAO, by regular reviews, renews its applied methodology and procedures as well, in order to be able to conduct objective audits bringing useful results besides efficient use of resources by using state of the art methods.

1. Opportunities of capacity development

The SAO, as an exemplary organisation, develops its available capacities on a continuous basis in order to use public funds and operate in an efficient and effective manner. Capacity development promotes the increase of the organisation's performance and the added-value of the organisation. As a result, the utilisation of the work of the SAO (audits and analyses) can expand through the growth of macro-economic indicators affecting social trust, performance of the national economy and effectiveness. In the course of such process, the State Audit Office of Hungary also contributes to the reduction of risks in terms of national economy. Processes the occurrence of which are may bring a negative impact on the performance of the national economy with an unknown probability or to an unknown extent.

The SAO continues to strengthen its consultancy activity pursued in the field of identifying national economy risks with its audits carried out based on the evaluation of the risks of the particular sectors in terms of exposure to threats.

THE MAJOR METHODOLOGICAL DEVELOPMENT OF THE PAST FOUR YEARS



1.1. PREPARATION OF THE TRANSFORMATION TO DIGITAL AUDITING ENVIRONMENT

Appropriate and efficient use of public funds is a requirement for all state organisations. The SAO, along with its advisory, analyst activities, also continues to increase the efficiency of its auditing function, in which the next level will be the transformation to the digital auditing environment.

The SAO, owing to the optimisation of human resources and work processes, could nearly triple the number of its audits. This way, a state audit report or analysis was scheduled for every single day, practically.

Through the development of risks analysis, audits are carried out with a targeted audit programme tailored to the unique risks of the auditees, thus, the SAO will audit the specific aspects of each particular organisation from which the greatest utilisation ratio can be expected based on the preliminary risk analysis.

With the application of new methodologies introduced in the recent past and new audit approaches (through the increase of performance), the audit coverage can be immensely expanded: the SAO can audit the financial and property management of a large number, even hundreds of auditees at the same time.

Procedures decreasing the duration of audits were integrated into the audit process. With the change of the method of data requests and on-the-spot audits, the time spent on the spot decreased significantly, with which the SAO could contribute to the reduction of the excessive workload of audited entities. Digitisation, methodological developments, systematic work, the application of a materiality approach, emphasis on the risk-based approach and shortening the route of audit documents all contributed to the reduction of the excessive workload of audited entities in the course of fulfilling their obligation to provide documents.

As a next step in increasing the efficiency of audits, SAO has set itself the task of creating the digital auditing environment.

1.2. ELABORATION OF THE METHODOLOGY OR ORGANISATIONAL PERFORMANCE MEASUREMENT

The SAO, in accordance with international trends, established its organisational performance measurement framework, since organisational control based on decisions substantiated with up-to-date, relevant and reliable information and the measurability of the utilisation of the work of the audit office is of utmost importance for all audit offices.

All organisational processes contribute to the achievement of the mission of the "well-managed organisation" fit to support the well-managed state. Strategic management relies on the data of monitoring and measurement of organisational processes from different aspects as well as the information created from the same starting from the creation of the target system, through managing implementation and the operation of the monitoring and feedback system. By that logic, performance management covers the entirety of the operation of the organisation.

The processes ensuring the operation of the organisation can be divided to three groups of activities as follows:

- 1) Management
- 2) Financial management
- 3) Performance of professional tasks

The Balanced Scorecard (BSC) is the second dimension of the model, being a means of management system applying a strategic approach. First, it divides the strategy to goals, than assigns tasks and indicators measuring the same to the different aspects, which are the following:

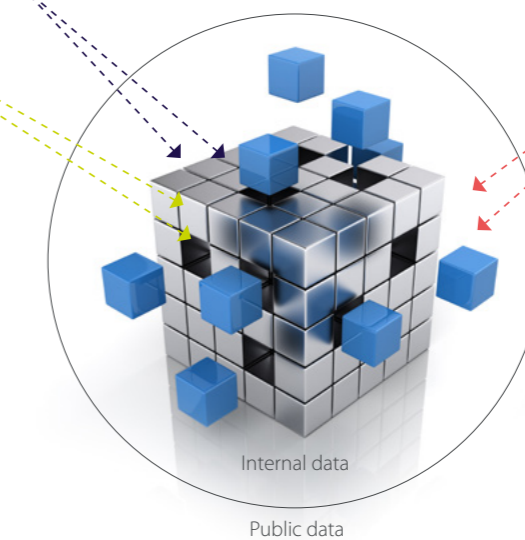
- 1) Financial performance
- 2) Internal operating processes
- 3) Organisational knowledge, continuous development
- 4) Stakeholders



1. Dimension: ORGANISATIONAL ACTIVITIES

- Management
- Financial management
- Performance of professional tasks

2. Dimension: BALANCED INDICATOR SYSTEM



3. Dimension: PERFORMANCE CATEGORIES

- Economy
- Effectiveness
- Efficiency
- Efficacy

The third dimension of the model consist of performance categories, which are the following:

- 1) Economy
- 2) Efficiency
- 3) Effectiveness
- 4) Efficacy

1.3. RENEWAL OF THE FULFILMENT OF CONTROLLING TASKS

The core values of the State Audit Office include being committed to quality-oriented operation. In order for the even greater implementation of the foregoing, the SAO unified all controlling processes on an organisational level in 2018.

The State Audit Office, in accordance with its Strategy, strives to achieve an efficient, effective and sustainable operation. So that the foregoing may be ensured, and so that decisions can be substantiated better, experiences and information can be handled, their flow can be ensured, and that resources can be managed in a systematic manner, the SAO operates a controlling and monitoring system.

The SAO commenced the renewal of its human resources controlling system on an organisational level back in 2017, as an autodidact entity, in the spirit of continuous development. The new controlling system started its operation based on the final concept in 2018 after a lengthy preparation period.

The new system, building on existing elements and processes, allows for the more conscientious and planned staff policy, supports the making of decisions related to the changes of the labour market and contributes to reinforcing the quality-oriented operation in the field of human resources management.

What is GAP-method?

It is a methodology developed for supporting organisational performance measurement. The essence of the method is that it contributes to the measurement of organisational processes from several aspects along three dimensions (organisational activity groups, balanced indicator system, performance categories).

2. Institutional Strategy Review

The State Audit Office of Hungary has carried out the comprehensive annual review of its strategy, as the renewal and continuous adaptability thereof is a constant requirement from the aspect of adjustment to the external and internal changes as well as of the continuous development of the organisation.

The strategic document system of the SAO, similarly to that of other institutions, is based on the logical framework of "mission-vision-goals-objectives." This logical scheme is applied to the framework plans projecting to the next 2-3 years, in the details of which more and more new strategic goals appear on a continuous basis, and, thus, in each year reducing the amount of strategic goals the implementation of which has not yet started. In the course of the review, the strategic goals not yet implemented and those the inclusion of which in next year's framework plan is justified are also examined.

Starting from the self-learning organisational model, the organisation measures the implementation of objectives and planned tasks as well as the efficacy and efficiency of implementation on a continuous basis. The changes of external environment, the changes of task performance and internal impulses urge the organisation to keep up and change on a continuous basis. So that the SAO can manage such changes in a more efficient manner, a change management framework system has been developed on an organisational level.

In the course of the review of 2017, the responsible field detected such changes in the IT environment (digitisation, IT technical development) that justify the review of IT partial strategy. An important task for 2018 and 2019 is the development and further incorporation of the methods of organisational performance measurement and to the processes of strategic planning and strategic management so that we can make the implementation of strategic goals even more explicit and concrete.

3. The adjustment of request for information for addressing the challenges of Digitalisation

It is an essential condition for audits to be conducted that audited entities should provide authentic documents suitable for the audit to the SAO by the statutory deadline. In order to facilitate data provision and to make it cost-effective (paperless, and, thus, requiring less public funds), the SAO established an Electronic Data Provision System. The findings of the audits are made based on the documents requested and qualified in this manner.

Based on the powers granted to it by the Act on the State Audit Office, the SAO is authorised to request the audited entity to submit the data and documents necessary for the performance of the audit. It is an essential condition for the SAO to be able to conduct an objective audit that the audited entities submit the data and documents requested for the audit and to provide the related information to the SAO within the statutory deadline (urgently, but at latest within five business days). The SAO will conclude its findings based on the authentic evidence and documents submitted to it in the course of the audit.

Data request is implemented based on unified principles, using template documents and observing quality assurance. The current system of SAO ensures the division of data request and the conclusion of the audit findings, and, thus, the independence of the latter. It also contributes to the reduction of the excessive workload of audited entities, since owing to this, the SAO could also reduce the time spent on the spot significantly.

The audited entity is required to issue a completeness and authenticity statement in all phases of the data request, which is fundamentally necessary for the data provision to be qualified as authentic by the SAO, and, thereafter, for it to be properly evaluated by the same.

4. The implementation of GDPR at organisational level

The Regulation (EU) 2016/679 (General Data Protection Regulation – GDPR) effective as of 25 May 2018 brought several significant innovations to the legislation on data protection. The smooth introduction of GDPR required a broad and proactive preparation from data processors, including the State Audit Office in the field of the examination of legal compliance related to data processing.

In the interest of the protection and confidential processing of personal data, the SAO considers compliance with the provisions of the General Data Protection Regulation of the EU to be of prime importance. The SAO processes personal data in compliance with the GDPR and the applicable Hungarian legislation: the Act on the State Audit Office, the Act on Public Service Officials and the Act on the Right of Informational Self-Determination and on Freedom of Information in all cases. For the purpose of compliance with the provisions of the GDPR, in the past years, the SAO has prepared a comprehensive inventory of its data assets, planned and arranged the cleaning of its data, and renewed its IT Security Policy and Data Protection Policy.

In compliance with the provisions of the GDPR, a Data Protection Officer has been appointed at the SAO, and the National Authority for Data Protection and the Freedom of Information has been notified about the person fulfilling such office.

In its Data Protection Policy, the SAO enforced the principle of processing personal data only to the extent necessary and justified in the course of the audits. If the processing of personal data is necessary during the implementation of the audit in accordance with the programme, the personal data officially received and processed by the SAO during the audit may also be processed according to the provisions of Sections 27-28 of the Act on the SAO, serving as legal basis for the processing of personal data. Personal data are processed by the SAO separately from other data, in a traceable manner and in compliance with the principle of accountability.





THE SAO'S FINANCIAL MANAGEMENT IN 2018

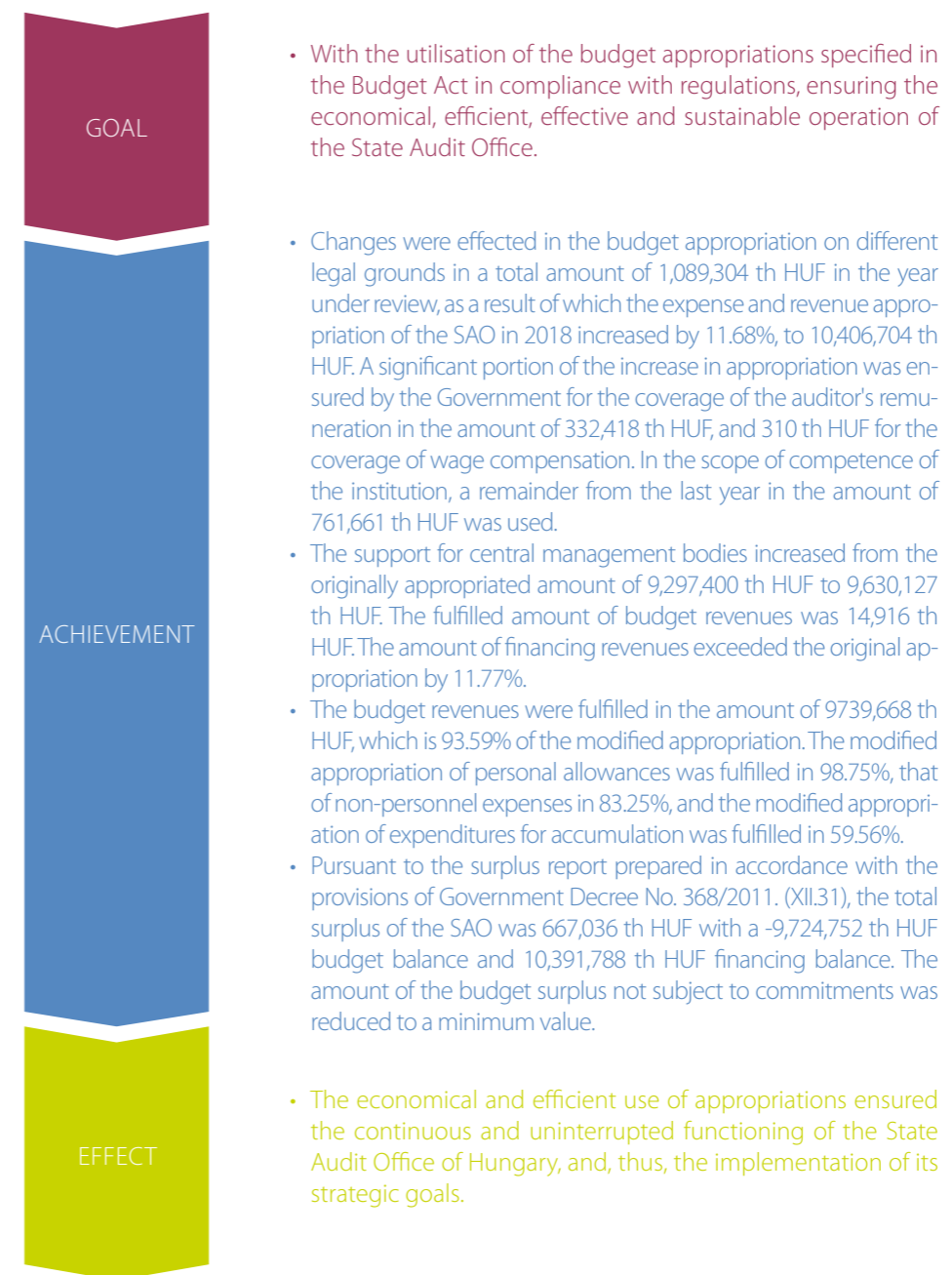
1 Budgetary Statement of the State Audit Office of Hungary

The State Audit Office of Hungary carried out its basic activity in compliance with external and internal controls, using its appropriations included in the Budget Act of 2018 in an economical, efficient and effective manner.

Based on the independent auditor's opinion, the annual financial statement provides a true picture of the performance of the 2018 budget of the SAO, the financial position of the same as of 31 December 2018, and the result of the financial management carried out in the year ending on such date.

THE FINANCIAL POSITION OF THE STATE AUDIT OFFICE IN 2018, ASSETS, SOURCES, SUSTAINABLE DEVELOPMENT

CHANGES IN APPROPRIATION, REVENUES, EXPENSES, REMAINDERS



GOAL

- Preserving the value and responsible management of the assets owned by the SAO as well as national assets managed by the same.
- For the purpose of achieving sustainable development, to contribute to the protection of the environment in the course of its renewals and procurement of assets in excess of safeguarding national assets through economical energy consumption and sustainable operation.

ACHIEVEMENT

- The balance sheet total of the SAO decreased to 4,046,886 th HUF from the previous 4,132,965 th HUF (balance sheet total of last year). The change is due to the negative value of retained earnings, caused by the increase of expenditures in the year under review.
- The value of investments belonging to national assets increased by 24,672 th HUF as a result of the 26.69% increase in the value of intangible assets. The majority of SAO's investments were provided by the softwares enhancing the efficiency of audit work as well as the procurements necessary for the preparation of digitisation processes and due to the wear of assets. The amount of investments and renewals carried over to 2019 was 326,291 th HUF as part of the surplus of 2018, which ensures replenishment of property.
- The total change of the funds, other specific items, receivables and accrued revenues and deferred costs meant a 110,752 th HUF decrease compared to year 2017.
- The equity decreased as a result of the retained earnings of 2018. The closing balance of liabilities decreased with 38,355 th HUF, and the registered amount of deferred revenues and accrued costs grew with 365,371 th HUF compared to the previous year.
- The SAO took several measures in 2018 for the sustainment, prevention and expansion of the four basic resources specified in the National Sustainable Development Framework Strategy, in compliance with national and international commitments.

EFFECT

- The balance of investments belonging to state assets increased as a result of the responsible financial management of the SAO.
- The measures taken in 2018, as well as those initiated earlier and continued during the year, and incorporated by SAO into its operation all contributed to the achievement of the objectives of sustainable development.



APPENDIX NO. I:

Duties of the State Audit Office of Hungary

Statutory tasks of the State Audit Office of Hungary

The Act on the State Audit Office highlights the following in terms of the fields to be audited:

The SAO audits:

- in the framework of auditing the financial management of public finances: the operation of the body managing the central budgetary chapter and the budgetary bodies categorised into such chapter, the centrally managed appropriations belonging to the chapter and the use of such appropriations, as well as the financial management of the local government, minority local government and their association.
- in the framework of the resources originating from public finances: entities using the central budget for their financial management and the utilisation of subsidies or funds granted free of charge for specific purposes from public finances,
- in the framework of auditing the management of national assets: the management of assets within public finances, financial management of the assets, the activity of organisations owned by the state (or owned partially by the state) or majority-owned by local governments in the field of preserving and increasing assets, compliance with rules applicable to the alienation and encumbrance of assets within public finances, and may audit the asset management of organisations owned by the state or local governments (or owned partly by the same),
- the final accounts prepared on the implementation of the central budget,
- the activity of the state tax administration and local governments in terms of taxation, other revenue generating activities of the same as well as the activities of the customs administration,
- the financial management of the Hungarian National Bank and the activities thereof not included in the scope of its core tasks, as well as the financial management of the foundation established by the same.
- financial management of parties and party foundations,
- the utilisation of subsidies granted to church organisations from public finances for purposes other than religious life.

The State Audit Office of Hungary also provides an opinion regarding the bill on central budget as a specific task.

Pursuant to Paragraph (7) of Section 5 of Act LXVI of 2011 and Section 90 of Act CXCV of 2011, the SAO audits the final accounts presenting the implementation of the central budget on an annual basis. Already in the audit carried out for year 2015, 100% of the expenses and revenues of the central subsystem could be covered by the audit, owing to the introduction of the new audit methodology. The audit of the implementation of the budget of 2016 also achieved this coverage. Pursuant to Paragraph (1) of Section 5 of Act LXVI of 2011, the SAO provides an opinion regarding the planning of the central budget on an annual basis, as well.

Due to the prime importance of exercising proprietary rights over state property, the SAO carries out audits pursuant to Subparagraph a) of Paragraph (4) of Section 5 of Act LXVI of 2011, Paragraph (4) of Section 3 of Act CVI of 2007, and Paragraph (1) of Section 14 of Act LXXXVII of 2010 on an annual basis.

With regard to the fact that audit experiences showed, amongst others, that the enforcement of proprietary rights in the case of local governments and business associations owned by the same are, on many occasions, weak, the majority of local governments do not control



ANNEXES

the operation of entities properly, the audit of task performance is typically omitted and that the use of funds provided for the task performance of internal audit is not subject to proprietary control. The State Audit Office of Hungary proposed a recommendation for the comprehensive and conceptual renewal of this field. The recommendation was also supported by the Government. Besides the foregoing, the SAO developed a unique self-test system. The peculiarity of such system lies in the fact that it also allows local governments not yet audited by the SAO to also improve the regularity of their operation.

The State Audit Office of Hungary continues to audit the regularity of the financial management of parties receiving budget support pursuant to Paragraphs (1) and (3) of Section 10 of Act XXXIII of 1989 in every two years in the framework of lawfulness audits. In relation to the foregoing, based on the experiences gained in the past years, the scope of its audit obligation continued to expand in 2003: in the case of foundations engaged in scientific, academic, research and educational activities in support of political parties, the SAO conducts biannual audits on the lawfulness audit related to the financial management of foundations that have been granted subsidy from the central budget pursuant to such law.

The scope of the statutory audit obligation of the SAO continued to expand in 2013: emphasis was laid on the transparency of the campaign costs of the election of members of the parliament (Paragraph (1) of Section 8/B and Paragraph (2) of Section 9 of Act LXXXVII of 2013) and auditing the costs of election proceedings. Pursuant to regulations, the State Audit Office shall carry out such audits per each election. The costs of implementing state tasks related to the preparation and conduct of elections and the other costs related to the activities of the electoral organs are to be provided from the central budget to an extent determined by the National Assembly. The State Audit Office of Hungary shall inform the National Assembly of the use of such funds.

The amendment of Act CXXXIX of 2013 on the Hungarian Central Bank of 2016 set forth that the financial management of the foundation established by the Hungarian Central Bank is to be audited by the State Audit Office of Hungary. In excess of its audit tasks, the SAO also fulfils other duties. Thus, the Act on the Hungarian Central Bank sets forth that the chairman of the Hungarian Central Bank shall request the opinion of the president of the State Audit Office prior to the election of the auditor of the Hungarian Central Bank and the initiation of the removal of such person.

The State Audit Office audits the financial management of the Compensation Fund set forth in Act CCXIV of 2015 on certain damage compensation measures taken in order to strengthen the stability of the capital market (Quaestor Act), which was established to protect the owners of bonds and which is managed by the Board of Directors of the Investor Protection Fund (as of 2014, SAO also audits the Resolution Fund pursuant to Section 130 of Act XXXVII of 2014).

Decisions of the National Assembly

Changes in the economy, the well-defined, but ever expanding scope of activities of the SAO as well as the expansion of tasks caused by the economic environment poses challenges to SAO on a continuous basis. The National Assembly defines the special audits and professional support needs, in the course of which the work of SAO may bring added value to the improvement of financial management with public property, as well as the use and protection of the same in regulations.

In Resolution No. 35/2009. (V. 12.) of the NA and Resolution No. 34/2015. (VII. 7.), the National Assembly recognised the implementation of the activity of SAO aimed to map corruption risks and the activity of the same carried out for the spreading of integrity-based organisational culture. As the development of the foregoing, the National Assembly supported that in terms of the entities concerned by the financial management of public funds and public property the SAO shall broaden its consultancy activity relating to management systems and support the ethical public funds leadership training.

In Resolution No. 35/2009. (V. 12.) of the NA, the National Assembly agreed that the SAO audit the fields posing corruption risks in accordance with its strategic goals and imple-



ment the headline project for the mapping of corruption risks already approved (Integrity Project). The National Assembly also declared that, by implementing the provisions of Resolution No. 43/2005. (V. 26.) NA, it transformed the Public Finance Quarterly into a quality journal, in relation to which it invited the SAO to continue its consultancy and professional influencing activity and curating the Public Finance Quarterly.

In Resolution No. 41/2013. (V. 27.) NA, the National Assembly supports the SAO's participation in the activity of the INTOSAI Development Initiative (IDI) of the International Organisation of Supreme Audit Institutions (INTOSAI), and SAO providing professional support as donor, with particular attention to Hungarian foreign affairs strategy.

In Resolution No. 41/2014. (XI. 13.) NA and Resolution No. 21/2016. (X.13.) NA, the National Assembly recognised and supported the social responsibility assumed by the State Audit Office of Hungary in the development of financial culture and the expansion of financial awareness to the entire society.

The State Audit Office of Hungary fulfilled the professional support request pertaining to the organisation of the 2024 Olympic Games in Budapest (Resolution No. 31/2015. (VII. 7.) NA, in 2016 and 2017.

In Resolution No. 11/2017. (VI. 14.) NA, the National Assembly imposed the task on the SAO to improve the audit methodology of the entities conducting audits in the public finances system and to review the study materials concerning the audits.

APPENDIX NO. II:

The major changes in the provisions relating to party funding, campaigns and elections

2017

The Campaign Act
The Campaign Act (Act LXXXVI of 2013) was modified, and was amended with the following provision:
Paragraph (2a) of Section 8/B. The State Audit Office of Hungary shall conduct an ex officio audit within one year from the general election of MPs in the subject of the use of support at parties establishing a party list the party list of which obtained at least 1% of the total votes cast validly.

2013

The Campaign Act
A new act (Act LXXXVII of 2013) on the transparency of campaign costs:
Paragraph (1) of Section 1 At the general elections and by-elections of the Members of the National Assembly, each representative candidate for a single mandate constituency shall be entitled to support from the central budget amounting to one million HUF. Paragraph (1) of Section 2/A The candidate for a single mandate constituency, nominated by a party setting up a party list entitled to the support defined in Section 3, may make a written statement to the Treasury, at the latest on the day following their registration becoming effective, on waiving their right to use the support according to Section 1 and on making it available for use by the party nominating them. Paragraph (1) of Section 3 At the general election of the Members of the National Assembly, the parties setting up a party list shall be entitled to support from the central budget. Paragraph (1) of Section 8/B Within one year from the election, the State Audit Office of Hungary shall, ex officio, perform a compulsory audit at the Treasury or, if necessary, at the candidate or, in the case according to Section 2/A, at the party nominating the candidate, concerning the use of the support according to Section 1 with respect to the candidates who have obtained a mandate in the National Assembly. The State Audit Office shall communicate its audit findings to the treasury. If the State Audit Office of Hungary reveals methods of use that do not comply with the provisions of Sections 1, 2 or 2/A, then the candidate or, in the case according to Section 2/A, the party nominating the candidate shall pay to the Treasury an amount determined by the Treasury, which must be commensurate with the infringements related to non-compliance with any of the criteria for support according to Section 1, but not more than double the amount of support according to Section 1.

Paragraph (2) of Section 9 The use of state and other funds according to the Act on the Operation and Financial Management of Political Parties spent on the election shall be audited by the State Audit Office of Hungary with respect to the candidates who have obtained a mandate in the National Assembly and their nominating organisations ex officio, and with respect to other candidates and nominating organisations at the request of other candidates or nominating organisations.
Paragraph (4) If a candidate or a nominating organisation violates the provisions set forth in Section 7, they shall pay back to the central budget double the amount by which they have exceeded the total maximum amount that may be spent on the election according to Section 7 within 15 days after receiving a notice from the State Audit Office of Hungary.
Paragraph (5) If the candidate or the nominating organisation fails to meet their obligation described in Subsection (4) by the deadline, the State Audit Office of Hungary shall communicate its audit findings to the Treasury. The Treasury shall adopt a resolution on the payment obligation described in Paragraph (4), against which no appeal shall lie. The payment shall be due on the fifteenth day after the court has approved the resolution adopted by the Treasury or after the deadline for initiating the procedure has expired without a procedure being initiated.

Act on Political Parties	Act on Electoral Procedure
The provisions pertaining to prohibited support were modified in the Act on Political Parties (Act XXXIII of 1989):	A new act (Act XXXVI of 2013) on the electoral procedure, the existing provisions concerning the State Audit Office (Section 12) were amended:
Paragraph (2) of Section 4 Asset contribution may not be given to a political party by legal persons and organisations without legal personality, and a political party cannot accept any asset contribution from any legal persons or organisations without legal personality. Paragraph (3) A party may not accept any asset contribution from any other states. A party may not accept asset contribution from any foreign organisations, regardless of the legal status of the same, and natural persons without Hungarian citizenship. A party may not accept any anonymous donations; donations of this type have to be paid in for the purposes of the foundation that is mentioned in Paragraph (1) of Section 8.	Paragraph (2) of Section 148 If a press product wishes to publish political advertisements, it shall send to the State Audit Office a price list for its advertisement services within five working days after the call for elections. The State Audit Office shall enter the price list into its records and publish it on its website. Paragraph (3) Political advertisements shall only be published by press products which have had their price lists registered with the State Audit Office. Political advertisements shall only be published in return for the consideration indicated in the registered price list. Paragraph (4) The press products shall inform the State Audit Office of published political advertisements within 15 days after the day of voting. This information shall contain a list of advertisements published for each candidate and nominating organisation, the customer who ordered the advertisement, the consideration paid, the time of publication and the volume. The State Audit Office shall publish this information on its website.

1997

Act on Electoral Procedure

A new act on electoral procedure (Act C of 1997), however, the provisions concerning the State Audit Office (Section 5) remained unchanged.

1993

Act on Political Parties

The provisions pertaining to prohibited support were modified in the Act on Political Parties (Act XXXIII of 1989):

Paragraph (2) of Section 4 Asset contribution may not be given to a political party by any budget organisation, moreover, by any state company or company operating with state participation, any foundation that receives direct budget subsidy or budget organisation subsidy, and a political party cannot accept any asset contribution from any budget organisation, moreover, from any state company, or company operating with the participation of the state, or from any foundation that receives direct budget subsidy or any budget organisation subsidy.

Paragraph (3) A party may not accept any asset contribution from any other states. A party may not accept any anonymous donations; donations of this type have to be paid in for the purposes of the foundation that is mentioned in Paragraph (1) of Section 8.

1989

Act on Political Parties	Act on Electoral Procedure
Act XXXIII of 1989	Act XXXIV of 1989
Provisions pertaining to prohibited support:	One provision concerned the State Audit Office:
<p>Paragraph (2) of Section 4 Asset contribution may not be given to a political party by state budget organisations and state companies, and a political party cannot accept any asset contribution from any state budget organisations and state companies.</p> <p>Paragraph (3) A party may not accept any asset contribution from any other states. A party may not accept any anonymous donations; donations of this type have to be paid in for the purposes of the foundation that is mentioned in Paragraph (1) of Section 8.</p>	<p>Paragraph (1) of Section 50 The costs of implementing state tasks related to the preparation and conduct of elections are to be provided from the central budget. The State Audit Office of Hungary shall inform the National Assembly of the use of such funds.</p>



APPENDIX NO. III: LIST OF ABBREVIATIONS

Institutions

ÁEEK	National Health Care Services Center
SAO	State Audit Office of Hungary
EMMI	Ministry of Human Capacities
UN	United Nations
EU	European Union
EUROSAI	European Organisation of Supreme Audit Institutions
GVH	Hungarian Competition Authority
GYEMSZI	National Institute for Quality and Organizational Development in Healthcare and Medicine (as of 1 March 2015, ÁEEK)
INTOSAI	European Organisation of Supreme Audit Institutions
IDI	INTOSAI Development Initiative
KEKKH	Central Office for Administrative and Electronic Public Services
KKM	Ministry of Foreign Affairs and Trade
KSH	Central Statistical Office
KT	Fiscal Council
Treasury	Hungarian State Treasury
MNB	Hungarian Central Bank
MNV Zrt.	Magyar Nemzeti Vagyonkezelő Zrt.
NAV	National Tax and Customs Administration
NAIH	National Authority for Data Protection and Freedom of Information
NGM	Ministry of National Economy
NVI	National Election Office
OECD	Organisation for Economic Co-operation and Development
OEVI	Parliamentary Single Member Constituency Election Office
NA	National Assembly
TVI	Territorial election office

Regulators

Government Decree	Government Decree No. 1660/2015. (IX. 15.) on the Renewal
No. 1660/2015. (IX. 15.)	of the Remuneration System of Senior Officers of in Majority
Act CLV of 2009	State-owned Business Associations
Act CCIV of 2011	Act CLV of 2009 on the protection of classified information
Act CXXXIX of 2013	Act CCIV of 2011 on national higher education
Fundamental Law	Act CXXXIX of 2013 on the Hungarian Central Bank
Public Finances Act	The Fundamental Law of Hungary (April 25, 2011)
SAO Act	Act CXCIV of 2011 on public finances
Ávr.	Act LXVI of 2011 on the State Audit Office of Hungary
Government electronic	Government Decree No. 368/2011. (XII. 31.) on the Implementation of the Act
GDPR	on Public Finances
Privacy Act	Decree No. 451/2016. (XII. 19.) on the detailed rules of administration
Act on Civil Servants	Regulation No. 2016/679 of the European Parliament and the Council
National Assets Act	on the protection of natural persons with regard to the processing of personal data
Act on Political Parties	and on the free movement of such data
Stability Act	and repealing Directive 95/46/EC (General Data Protection Regulation)
Accounting Act	Act CXII of 2011 on informational self-determination and freedom of information
Act on Electoral Procedure	Act CXCIX of 2011 on the civil servants of public services
Other	Act CXXVI of 2011 on national assets
ÁROP	Act XXXIII of 1989 on the operation and financial management of political parties
GDP	Act CXCIV of 2011
BA	on the economic stability of Hungary
ISSAI	Act C of 2000 on accounting
IT	Government Decision No. 1660/2015
ÖKOMER	Act XXXVI of 2013 on electoral procedure
SAI PMF	State Reform Operative Programme
V4+3	Gross Domestic Product
	business association
	International Standards of Supreme Audit Institutions
	Information Technology
	Risk Monitoring System Targeted to Local Governments
	Supreme Audit Institutions Performance Measurement Framework
	The countries of the Visegrad Group: Hungary, Czech Republic, Poland, Slovakia (V4), joined by Austria, Croatia and Slovenia

APPENDIX NO. IV: AUDITOR'S REPORT

INDEPENDENT AUDIT REPORT



and

INFORMATION TO THE CHAIRMAN OF THE NATIONAL
ASSEMBLY

on

THE ANNUAL REVIEW OF THE FINANCIAL STATEMENT OF THE BUDGET CHAPTER
of the State Audit Office of Hungary of year 2018

PREPARED BY:

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19P00488KER-01-01#_EN_LE_LZ

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----- INDEPENDENT AUDITOR'S REPORT -----
----- TO THE OFFICE OF PARLIAMENT -----
**ON THE AUDIT OF THE REPORT ON THE FINANCIAL MANAGEMENT OF THE
----- STATE AUDIT OFFICE AS A BUDGETARY CHAPTER IN 2018 -----**

Opinion:-----
I have audited the annual closing report dated 19 March 2019 on the financial management of the State Audit Office (hereinafter: SAO) as a budgetary chapter in 2018. According to that report, the total income was HUF 10,406,704,000, while expenses totalled HUF 9,739,668,000. The total residual amount pursuant to the residue statement for 2018 was HUF 667,036,000. Based on further reports (settlements) and the balance sheet for 31 December 2018, assets and liabilities equalled at HUF 4,046,886,000. The profit and loss statement for the budgetary year ended on the same day indicates a net loss (HUF -413,095,000). These accounting data have been determined pursuant to the effective Act C of 2000 on Accounting (hereinafter: Accounting Act) and the effective Government Decree 4/2013 (I. 11.) on the accounting of the system of public finances (hereinafter: Public Finances Accounting Decree).-----

In my opinion, the annual budget report of the State Audit Office for 2018 provides a true and fair view of the financial management and income of the State Audit Office in the examined period, as well as of the entity's assets, liabilities and financial position as of 31 December 2018.

Furthermore, the attached annual closing budget report of the State Audit Office for the budgetary year ended on 31 December 2018 and the accounting information contained therein have been compiled, from all material aspects, in compliance with the effective Act CXCV of 2011 on Public Finances, the Accounting Act, the Public Finances Accounting Decree, the effective Government Decree 368/2011 (XII.31.) on the implementation of the Act on Public Finances (hereinafter: Implementation Decree), and Act LXVI of 2011 on the State Audit Office (hereinafter: State Audit

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Office Act). Consequently, it is my opinion that the annual closing budget report for 2018 is suitable for acceptance. -----

Basis for the opinion: -----

I conducted the audit pursuant to the National Accounting Standards of Hungary, based on the laws and other statutes relevant to financial audits and applicable in Hungary. My responsibilities arising from those standards are detailed in the section titled "The auditor's responsibility for auditing and providing an opinion on the annual closing budget report". -----

I am independent of the organisation of the State Audit Office as stipulated in the relevant legal regulations applicable in Hungary, in the "Regulations on the Behavioural (Ethical) Rules of the Audit Profession and Disciplinary Procedures" by the Chamber of Hungarian Auditors, and, concerning any issue not regulated by the above, in the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA Code), and I meet the ethical requirements defined in the same norms.-----

Pursuant to the ethical requirements applicable in Hungary and relevant to my audit of the annual closing budget report, I am independent of the State Audit Office, and I meet all other resulting ethical requirements.-----

I am convinced that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.-----

Other information: -----

"Other information" consists of information in the annual closing budget report as well as related non-accounting information, including the contents of appendices. The leaders of the State Audit Office (hereinafter: "management") are responsible for the compilation and presentation of other information. My opinion on the accounting information in the annual closing budgetary report, as provided in the section titled "Opinion", is not relevant to such "other information", and I express no assurance conclusion thereon. In connection with my audit of the annual closing budget report and the appendices thereto, my responsibility is to read the other information and, in doing so, consider whether it is materially inconsistent with the financial statements or my knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work I have performed, I conclude that there is a material misstatement in this other information, I am required to report that fact. I have nothing to report in this regard. -----

Responsibilities of management and the persons charged with governance for the annual closing budget report: -----

Management is responsible for the compilation and submission of the annual closing budget report

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pursuant to the effective Act CXCV of 2011 on Public Finances, for the preparation and presentation of the accounting information in the report pursuant to the Accounting Act, the Public Finances Accounting Decree, the Implementation Decree, and the State Audit Office Act, as well as for the internal controls that management considers necessary for the compilation of an annual closing budget report without material misstatements arising from fraud or errors.-----

The persons charged with governance are responsible for supervising the process of financing reporting by the State Audit Office. -----

The auditor's responsibility for auditing and providing an opinion on the annual closing budget report: -----

My objectives during the audit procedure are to obtain reasonable assurance about whether the accounting information in the annual closing budget report as a whole is free from material misstatement due either to fraud or error, and to issue an independent auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the National Accounting Standards of Hungary will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions made by users based on the accounting information in the annual closing budget report. -----

As part of an audit in accordance with the National Accounting Standards of Hungary, I exercise professional judgment and maintain professional scepticism throughout the audit. I also: -----

- Identified and assessed the risks of material misstatements in the annual closing budget report, due either to fraud or error; designed and performed audit procedures responsive to those risks; and obtained audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. -----

- Evaluate the appropriateness of the accounting policies used at the State Audit Office, and the reasonableness of the accounting estimates and related disclosures made by management. -----

- Obtained an understanding of the internal controls relevant to the audit in order to design audit procedures that are appropriate under the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal controls. -----

- Reviewed the accounting information in the annual closing budget report, including especially the budgetary balance sheet of the State Audit Office presented in the annual closing budget report, the

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change in its liquid assets, its debts and asset statement, the quantified impacts of decisions with long-term effects, as well as the financial obligations of the State Audit Office. -----

- Concluded on the appropriateness of management's use of the going concern basis of accounting concerning the annual budget report for 2018 and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the ability of the State Audit Office to continue as a going concern, especially in view of any changes in its organisation or responsibilities, including the effects of future events and changing conditions. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may affect the ability of the State Audit Office to continue as a going concern. -----

I communicate to those charged with governance, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in the State Audit Office's internal controls identified during my audit. I have not identified any material deficiency at the State Audit Office during my audit. -----

Budapest, 12 April 2019-----

Signature of the audit company's representative: *Dr. J. Detrich, Executive Director* -----

SZENCZI DIVIZOR KFT. -----

1088 Budapest, József krt. 19. III/6-----

Registration number: 000852 -----

Budgetary qualification number: KM002171 -----

Signature of auditor of Chamber membership: *Dr. J. Detrich*-----

Registration number: 002728 -----

Budgetary qualification number: KM000199-----

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Budapest, 13. 06. 2019

Kollós Ildikó
For the Director General
KOLLÓS Ildikó



A HITELESÍTÉSI ILLETÉK LERÓVA
ATTESTATION FEE PAID



TRANSPARENCY

REPORTING

FINDING

EXPEDIENCY

COOPERATION

LAWFULNESS

REGULARITY

REPORTING

PUBLIC FINANCES

ALITY

INTEGRITY

EFFECTIVENESS

ANALYSIS

FINANCIAL MANAGEMENT

CONTROL

CONSULTANCY

SUSTAINABILITY

PUBLIC FINANCES

SHARING INFORMATION

PROVIDING STANDARDS

PERFORMANCE

IES

MEASURE

QUALITY

ENCY

INDEPENDENCE

ORDERLINESS

ANALYSIS

VALUE CREATION

UTILISATION

OPERATION

FINANCIAL MANAGEMENT

CONTROL

NABILITY

REGULARITY

INTEGRITY

PUBLIC FINANCES



PUBLIC FINANCES



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