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STATE AUDIT  
OFFICE OF HUNGARY

# R E P O R T

on the Activities of the State Audit Office of Hungary in 2009

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## TABLE OF CONTENTS

|   |    |
|---|----|
| INTRODUCTION  | 2  |
| 1. TASKS OF THE STATE AUDIT OFFICE OF HUNGARY IN 2009   | 3  |
| 1.1. Execution of the annual audit plan   | 3  |
| 1.2. Other tasks of the State Audit Office of Hungary   | 6  |
| 2. AUDIT FINDINGS OF THE STATE AUDIT OFFICE OF HUNGARY  | 9  |
| 2.1. Main findings classified by the subsystems of public finances                                | 9  |
| 2.1.1. The central budget   | 9  |
| 2.1.2. Separated state funds  | 16 |
| 2.1.3. Social security funds  | 18 |
| 2.1.4. Local governments  | 22 |
| 2.2. Major experiences of audits focusing on the fulfilment of state and local governmental tasks | 30 |
| 2.3. Utilisation of EU funds  | 37 |
| 2.4. Subsidies to organisations outside public finances   | 41 |
| 2.5. State property management  | 43 |
| 3. UTILISATION OF THE AUDITS  | 46 |
| 3.1. Discussion of reports by the National Assembly, resolutions and parliamentary relations      | 46 |
| 3.2. Enforcement of SAO recommendations   | 47 |
| 3.2.1. Utilisation of the recommendations at the level of the National Assembly                   | 47 |
| 3.2.2. Utilisation of the recommendations at governmental level                                   | 47 |
| 3.2.3. Utilisation of the recommendations at the level of the auditees                            | 47 |
| 3.3. Activities of the State Audit Office of Hungary related to law enforcement                   | 47 |
| 3.4. Publicity of the activities of the State Audit Office of Hungary                             | 47 |
| 4. RESEARCH AND DEVELOPMENT WORK RELATED TO THE AUDIT ACTIVITIES                                  | 47 |
| 5. IMPROVEMENT OF THE QUALITY OF THE AUDIT WORK   | 47 |
| 5.1. Quality assurance of audits  | 47 |
| 5.2. Human resources management and development   | 47 |
| 5.3. International relations  | 47 |
| 6. INSTITUTIONAL OPERATION AND FINANCIAL MANAGEMENT   | 47 |
| 6.1. Budgetary management   | 47 |
| 6.2. Infrastructural operations and developments  | 47 |
| 6.3. IT and telecommunication operations and developments   | 47 |
| 6.4. Internal audit   | 47 |

## **INTRODUCTION**

*The State Audit Office of Hungary (SAO) reports on its activities to the National Assembly on an annual basis. According to the current practice, the activity report was put on the agenda of several parliamentary committees, and was then discussed at the plenary session. After the discussion of the annual activity report, the National Assembly passed a resolution evaluating the SAO's activities and setting the future development trends. The SAO compiled its annual audit plan on the basis of this parliamentary resolution.*

*In 2009, the SAO prepared 57 reports. The parliamentary committees discussed 6 reports and 1 study on 46 occasions altogether. In line with the former practice, a few reports, e.g. the report on the execution of the budget, the SAO's opinion on the budget appropriation bill, and the annual SAO activity report were put on the agenda by several committees. In the SAO reports published in 2009 nearly 700 recommendations were made on the basis of on-site audits conducted at around 650 organisations.*

*The SAO annual activity report makes it possible to have a systemic evaluation of audit experiences, review measures taken as a result of the recommendations, and review the influencing factors. Due to the nature of the audit activity, the SAO's audit work pertains to the past, but the recommendations and findings published in the present aim at the tasks of the future, and are designed to prevent the reoccurrence of the revealed deficiencies, and to provide a background for the substantiation of future decisions.*

*Furthermore, the report presents the operation, financial management and development of the organisation of the SAO. In compliance with the Act on the State Audit Office of Hungary, the financial management of the SAO is audited by an independent chartered accountant mandated by the Speaker of the National Assembly following a tender procedure. The chartered accountant attached an unqualified opinion to the 2009 financial statement.*

*The data contained in the report reflect the situation as of 19 April 2010.*

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## 1. TASKS OF THE STATE AUDIT OFFICE OF HUNGARY IN 2009

### 1.1. Execution of the annual audit plan

In 2009, the SAO continued to perform its activities based on the approved audit plan, which was discussed by the National Assembly's Committee on Budget, Finance and Audit Office.

The annual audit plan for 2009 included a total of 69 topics. During the year one audit was added to, while two tasks were deleted from the audit plan, wherefore the amended audit plan included 68 audits. **The SAO completed the audit tasks scheduled for 2009, and published 57 reports.**<sup>1</sup>

The SAO's audit capacity has been gradually decreasing in the recent years. In 2009, the SAO fulfilled its audit obligations by using 54,814 direct auditor days, i.e. 1,003 days fewer than in the previous year. The reduction resulted from staff downsizing and financial austerity measures, as well as from increasing retirements.

Audits that are required **by the law to be performed with certain regularity** (annually, biannually and regularly) continue to represent top priority tasks of the SAO. The completion of these tasks absorbed 72% of the audit capacity of the SAO (compared to 64% in 2008), and resulted in the publication of 38 audit reports (versus the 32 reports published in 2008).

As a result of compliance with the **annual** audit obligations five reports were prepared (opinion on the fairness of the state budget, audit of the final accounts, audit of the operations of the Hungarian State Holding Company and the Hungarian News Agency Corporation, as well as on the audit of revenues to be shared between the Municipality and the district local governments of Budapest). Within these obligations the greatest task was the audit of the final accounts, which absorbed 38% of the annual audit capacity of the SAO.

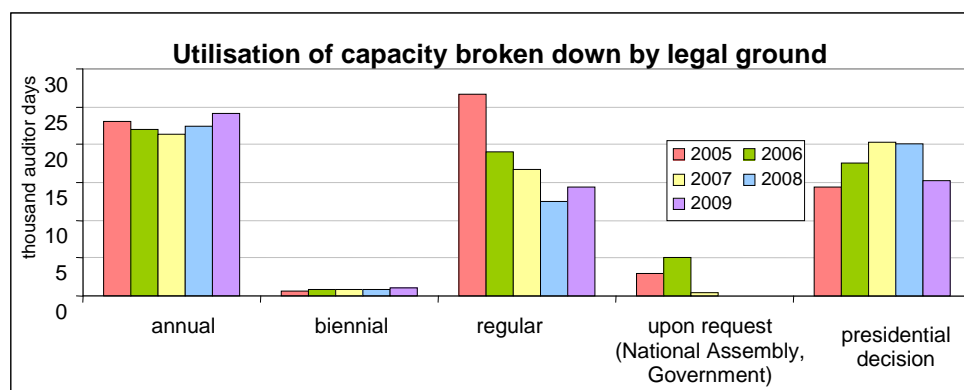
Within the framework of the **biennial** audit obligation, altogether eight reports were prepared on the financial management of five political parties and three party-affiliated foundations.

Within the framework of **regular audit tasks**, the SAO published 25 reports. The majority of this work (78%) was made up by the audit of the financial management of local governments. In addition to the report summarising the findings of the on-site audit of 109 local governments, separate SAO reports were drawn up on 16 local governments with significant budgets and property. From among the chapters of the central budget, a report was compiled on the comprehensive audit of the Chapters 'National Assembly' and the 'Ministry of Defence', which spanned several years. The following audits were conducted

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<sup>1</sup> The publication of the reports on three audits ('Audit of the modernisation of the central public administration system in Hungary', 'Audit of the lawfulness of the financial management of the Hungarian Justice and Life Party in 2005-2006' and 'Audit of the funds used for the deputy election campaign in the parliamentary by-elections held in February 2008').

within the framework of regular SAO tasks: 'Audit of the financial management of parties not eligible for central budgetary subsidies in the years 2005-2008', 'Audit of funds used for the organisation of the national preemptory referendum held on 9 March 2008', and 'Audit of the funds used for the deputy election campaign in the parliamentary by-elections'.



In addition to compliance with the legal obligations, as much as 28% of the annual audit capacity could be used for audits the frequency of which is not regulated by law. **Altogether 19 audit reports were compiled on such audits carried out on the basis of the decision of the SAO's President.**

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

The audits on the modernisation of the Hungarian central public administration system, the system of separated state funds, the system of housing subsidies and the operation of the treasury system aimed to promote the transparent and regular operation of public finances.

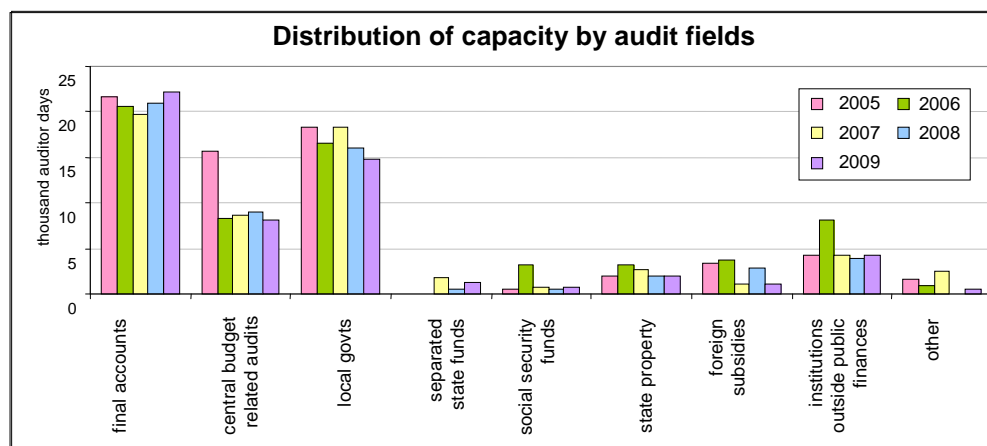
The audit of the implementation of priority waste water treatment projects funded from the Cohesion Fund and national resources, as well as the audit of the utilisation of subsidies granted for solid waste management projects focused on the utilisation of EU funds for the designated purposes.

The audits of PPP investment projects funded within the framework of the Sport XXI Programme, and the audit of motorway investment projects completed in 2008 aimed at the protection of state development resources, and at the detection of risks inherent in the relationships between public finances and the private economy.

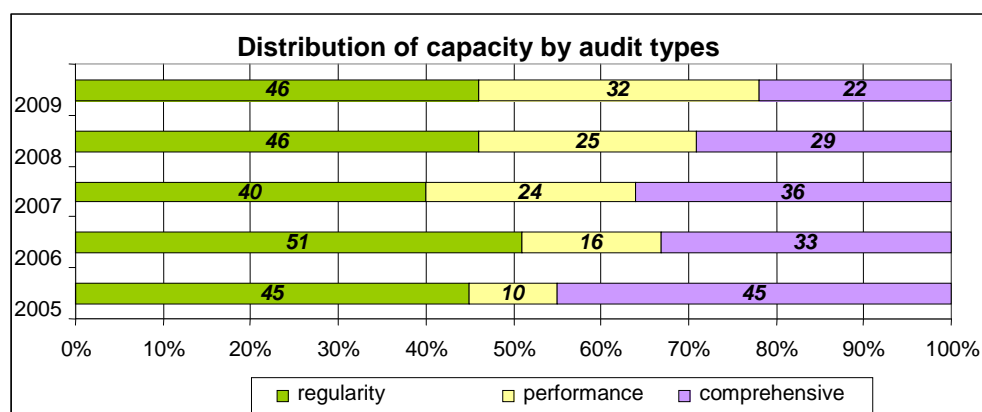
The audits of the development of emergency medical services, the outsourcing of certain hospital activities, the operation of the national audiovisual assets, the execution of the higher education act, as well as of the development and maintenance of greeneries owned by the local governments of the settlements aimed to ensure the efficient and effective performance of state tasks.

In 2009, the Prime Minister **requested** an audit on the causes of the error rate related to the voluntary donations made by the citizens using one per cent of

their personal income taxes, which the SAO intended to conduct in 2010, within the framework of the audit of the 2009 final accounts<sup>2</sup>.



The SAO classifies its audits according to three main types. In 2009, the SAO used 46% of its capacity on regularity audits (opinion on the budget appropriation bill, audit of the final accounts, audit of the financial management of political parties and foundations), 22% on comprehensive audits (local governments, ministries, the institutional system and appropriations of the central budget), and 32% on performance audits. This distribution represents a shift towards performance audits compared to the structure of the former years, due to the appearance of system audits attributed to this audit type.



<sup>2</sup> Pursuant to the provisions contained in para (6) of Article 5 of Act CXXVI of 1996 on the Use of a Specified Portion of Personal Income Tax in Accordance with the Taxpayer's Instruction, the tax authority can authorise the linkage of data from different sources (tax returns and statements of instruction to donate) only in the case of legal disputes affecting the execution of the statement of instruction, and during the procedure following the modification of the personal income tax returns as a result of self-revision or revision by the tax authority. This was reinforced by the position of the special state secretary of the Ministry of Finance. Para (6) of Article 5 of the Act CXXVI of 1996 on the Use of a Specified Portion of Personal Income Tax in Accordance with the Taxpayer's Instruction needs to be amended to allow the SAO to conduct the audit.

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## 1.2. Other tasks of the State Audit Office of Hungary

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

Pursuant to para (2) of Article 2 of Act XXXVIII of 1989 on the State Audit Office of Hungary, the **President of the SAO countersigns** the contracts related to the borrowings of the central budget. In 2009 no contract was countersigned on any credit line.

In 2009, in connection with the changes in the accounting rules the SAO exercised its **right to form opinion** provided by para (8) of Article 2 of Act XXXVIII of 1989 on the State Audit Office of Hungary due to the amendment of Government Decree 249/2000. (XII. 24.) on the special features of reporting and bookkeeping obligations of budgetary agencies, as well as Government Decree 240/2003. (XII. 17.) on the special features of reporting and bookkeeping obligations of treasury accounts.

For the 2009 business year, the President of the SAO made recommendations for the posts of **chartered accountants** three times pursuant to para (5) of Article 57 of the Act on Public Finances (at the Central Nuclear Financial Fund, at the National Cultural Fund, and at the Research and Technology Innovation Fund).

For six years, the SAO has been fulfilling its tasks related to the nomination of **supervisory board chairmen** within the scope of the Secretary General. The SAO's right to make recommendations for the appointment (and the recall) of supervisory board chairmen at certain state-owned business organisations was regulated by para (2) of Article 95/A of the Act on Public Finances, and from 2008 until 31 December 2009 by para (4) of Article 30 of the Act on State Property.

Pursuant to para (3) of Article 4 of the act on the prudent operation of publicly owned business organisations, since 1 January 2010 this scope has been extended to a wider group of companies, i.e. to publicly owned business organisations whose registered capital exceeds HUF 200 million.

According to the Nomination Regulation, applications are invited once a year to increase or supplement the list of persons apt for nomination to supervisory board chairmen. Since 2003 altogether 741 names have been included in the list. As of 31 December 2009 the number of potential nominees was 733. Due to the extension of the scope of nomination since 2010, applications were invited between 10 December 2009 and 31 January 2010.

From the start in 2003 until 31 December 2009, the **SAO evaluated requests submitted by a total of 364 business organisations**, and **made recommendations on 336 personal nominations**. As of 31 December 2009, as many as 129 persons were in position as supervisory board chairmen upon the SAO's recommendation. This number decreased continuously from 2003, which indicates that the number of business organisations subject to the



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act decreased year after year, primarily due to mergers and the reduction of registered capital. (Since 2003 around 60 companies were removed from the scope of nomination by the SAO.) In 2009 no recommendations were made for the recall of any person appointed to the post of supervisory board chairman.

Since 2003 the reporting year was the second time that the entity exercising ownership rights wished to deny (without indicating any cause specified by law) the appointment of the person recommended by the SAO. It happened several times that a person who was formerly recommended by the SAO for the post of supervisory board chairman was not reappointed for the new period, because he did not meet all requirements or had not fulfilled all of his obligations towards the SAO. The SAO does not support the nomination of the same person to posts at two or more business organisations.

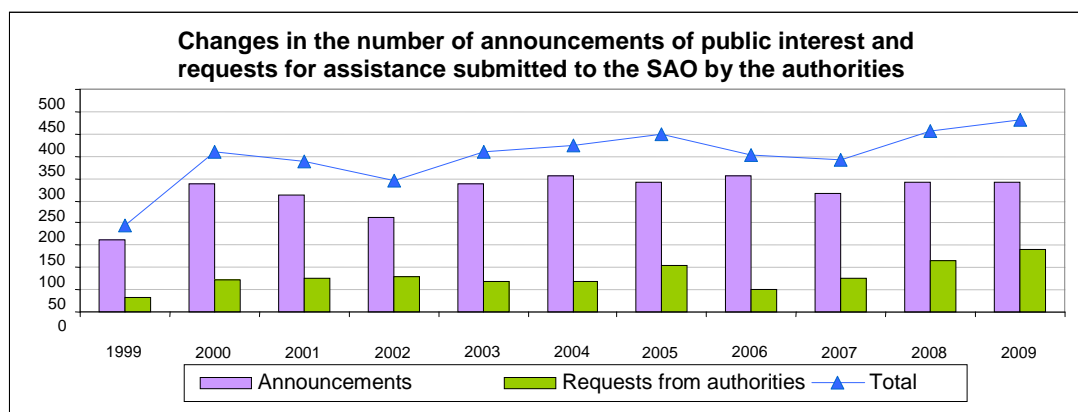
The National Assembly adopted Act X of 2008 on the amendments to certain legal regulations required for the transparency of the remuneration of state officials at the beginning of 2008. The act added a new Article 12/A to Act LVII of 2006 on central state administrative organs and the legal status of the members of the Government and state secretaries. Pursuant to the new Article, the SAO shall audit the **personal enrichment of state officials** every five years, or immediately after the expiration of their tenure of office, in compliance with the provisions of the Act on the Rules of Taxation.

The SAO did not have the opportunity to express its opinion on the bill to the proposer, wherefore the SAO could indicate to the National Assembly and the Government only after the adoption of the act that due to its shortcomings the new regulation cannot be enforced. In item 3 b) of Parliamentary Resolution No. 72/2008. (VI. 10.) on the approval of the SAO activity report 2007, the National Assembly requested the Government 'to review the provisions of Act X of 2008 on certain legal amendments required for the transparency of the remuneration of senior state officials, and to submit – on the basis of the results of such review – a proposal on the modification of the audit of the personal enrichment of senior state officials.' On 31 March 2009, then on 7 January 2010 the SAO called the chairman of the Constitutional, Judicial and Procedural Committee of the National Assembly to settle the issue. In February 2010 the Committee discussed the SAO's proposal for regulation, and finally submitted an independent committee motion to annul Article 12/A of the act. The former National Assembly planned to discuss the act on its last day in session, however the discussion did not take place.

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

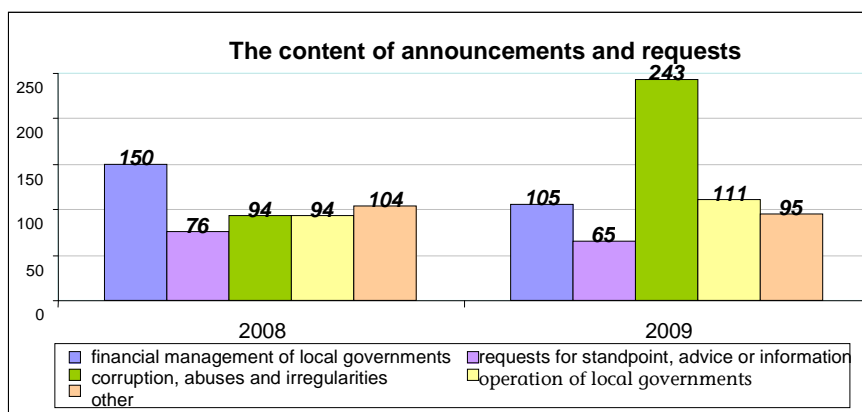
Complaints and announcements of public interest can be lodged by anybody – orally, in writing or electronically – to the agency authorised to conduct procedures in the given subject matter. The legal basis for procedures related to **announcements, proposals and requests of public interest** is provided by the articles of Act XXIX of 2004 pertaining to announcements, complaints and requests of public interest (Articles 141 through 143). The citizens have shown increased interest in the utilisation of public funds and the related issues, and a growing number of economic actors have contacted the SAO with questions, requests and recommendations. The number of contacts made by the authorities for further measures and information supply was also higher than ever.

In 2009, the number of requests from the authorities increased by 22%, however the number of requests submitted in connection with the financial management and operation of local governments decreased.



Announcements/requests related to corruption, abuses and irregularities significantly rose in number, and occasionally affected the mayors, representative bodies of local governments, or the senior officials of the institutions or business organisations of certain state agencies. The number of anonymous announcements on the anomalies of financial management also grew. The announcements were often linked to the personal enrichment of certain state or local governmental officials.

There was a rise in the number of requests submitted to the SAO for opinion or advice, often in relation to the interpretation of legal regulations, or announcements that drew attention to the difficulties of the practical application of legal regulations. Some of the complaints filed by the population pertained to tender procedures advertised for the modernisation of houses, or requested audits on the implementation thereof. Other complaints dealt with the negative aspects of the procedures of various credit and financial institutions. Some of the announcements of public interests suggest that the authors of the announcements wished to provide information to or draw the attention of the SAO.



If the contents of the announcements/requests fall within the audit scope of the SAO, they are utilised during the development of the audit programmes and within the framework of ongoing audits from time to time. Several announcements indicate expectations and misconceptions exceeding the SAO's scope and possibilities. Therefore, the SAO strives to provide letter-writers with information that facilitates orientations.

## **2. AUDIT FINDINGS OF THE STATE AUDIT OFFICE OF HUNGARY**

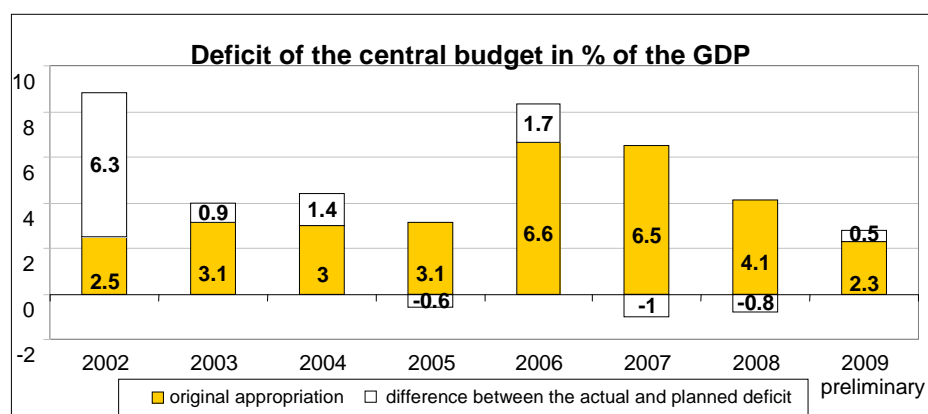
### **2.1. Main findings classified by the subsystems of public finances**

#### **2.1.1. The central budget**

##### ***Audit of the 2008 final accounts***

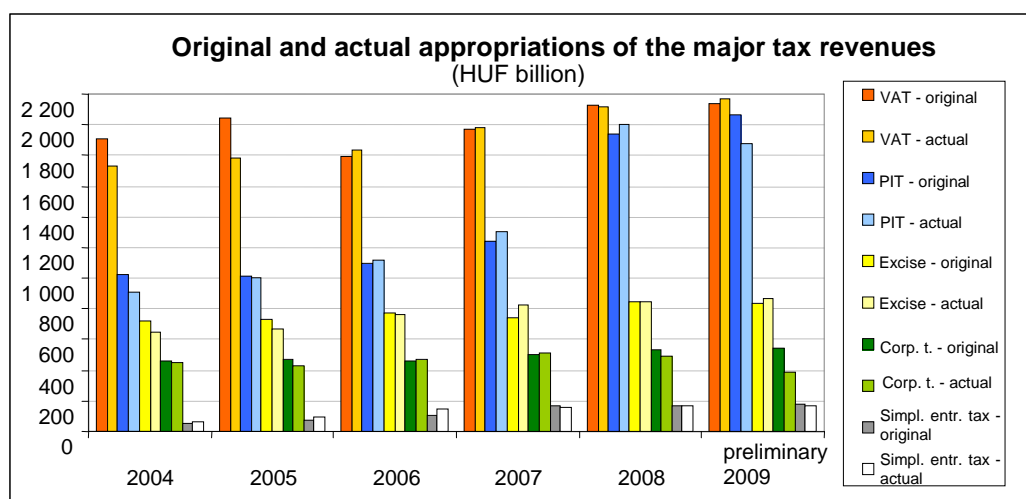
A major task performed in 2009 was the audit of the execution of the budget. The deficit of the central budget, which was set in the 2008 budget act, turned out to be significantly smaller than planned, which happened only twice in the past six years.

It points to planning inaccuracies and problems in the central budget – which were indicated by the SAO earlier, too – that similarly to the former years, in 2008 the deficit significantly differed from the planned deficit stipulated in the act, albeit this time the discrepancy was for the better.



Source: budget appropriation and final accounts acts, Ministry of Finance

More than three quarters of the revenues of the central budget come from tax types supervised by the Hungarian Tax and Financial Control Administration and the Hungarian Customs and Finance Guards. The tax revenue appropriations and their fulfilment indicate that that the substantiation of planning has improved in this area.



Source: budget appropriation and final accounts acts, Ministry of Finance

The deficit of the central budget was reduced by the surplus revenues that significantly exceeded the so called other revenue appropriation. The majority of the surplus revenues came from the one-off payment of the Hungarian Transmission System Operator Company Ltd. (MAVIR Zrt.) pursuant to its legal obligation.

Considerably smaller than planned **state property related revenues** were realised. The 25.6% of unyielded revenues resulted from the failure to realise revenues from the sale of governmental real properties, the complete cancellation of the rents payable by the central budgetary organisations in 2008, as well as the unrealisation of some of the revenues planned to be yielded from the infrastructure in relation to concession fees (due to payments brought forward to 2007).

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The suspension of the rent paying obligation of the central budgetary organisations for the years 2008 and 2009 is the result of an agreement concluded by the Ministry of Finance and the line ministries in 2008. The agreement violates the relevant legal regulations, since neither the budget act, nor the state property act were amended in relation to the legal obligations according to which the central budgetary organisations must pay rents for the use of state owned properties.

The on-site audit revealed serious deficiencies during the examination of state property related revenues. With the exception of revenues from concession fees, state property related revenues could not be audited with the financial audit method, because the Hungarian State Holding Company could not provide comprehensive documentation to support the accounting of 96.5% of the total of the technical chapter titled 'State property related revenues'. This was due to the fact that despite the legal regulations, the predecessor organisations failed to prepare the closing stock, asset balance and asset inventory as of 31 December 2007. After the predecessor organisations ceased to exist on 31 December 2007, Hungarian State Holding Company registered the opening stock of 1 January 2008 with a delay of nearly 1.5 years. In the absence of balance type registration, no comprehensive information was available on state property.

At the end of 2008 the **debts owed by taxpayers to the central budget increased to HUF 1,410.4 billion**, while the **arrears of the Customs and Finance Guard** decreased by HUF 2.1 billion compared to the previous year. Tax arrears recorded by the state tax authority rose progressively year after year. **The SAO called attention to this unfavourable phenomenon every year.** The amount of the accumulated outstanding tax receivables deserves special attention because it exceeds the budgetary expenditure spent on government debt service and interest repayment in 2008, or 70% of the central budgetary revenues from personal income tax, and equals twice the revenues from the realised corporate income tax and special tax.

The fast growth in outstanding receivables was coupled with the unfavourable composition of outstanding debts in terms of collectibility. In addition to the taxpayers' behaviour and the impossibility to collect, the rise in unpaid taxes is indirectly caused by slower economic growth, as a result of which business organisations incurred liquidity problems. Therefore, to ensure continuous operation, companies first of all strive to clear debts with the suppliers before they pay off their tax debts.

The Tax and Financial Control Administration tried to reduce the rise in outstanding tax receivables using the available tools. The impact of these efforts manifests itself in the increased revenues from tax collection.

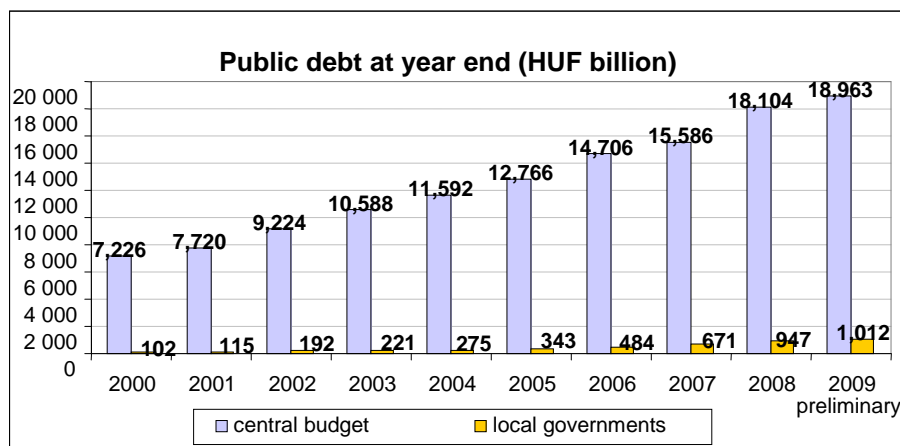
**The financing situation of the central budgetary organisations was characterised by permanently high debts**, which reduced significantly by the end of the year. Contrary to the past years a reduction in both the size and rate of financing problems could be witnessed, too. The qualified stock considerably shrunk. The debts were manageable by treasury tools, including tools available to the commissioner.

The entire amount – but HUF 8.3 billion – of the modified appropriations of the **central budgetary reserves** for 2008 was utilised. In line with the audit experiences of the past years, the utilisation of HUF 9.6 billion of the general reserves, i.e. nearly 33% of the reallocated appropriations failed to meet the legal regulations. For example, the population information campaign on the governmental reforms, the increase of the entertainment expenditure appropriation for the prime minister (i.e. the provision of funds for said purposes from the general reserves), as well as the utilisation of 12% of the amended appropriation in the last working days of 2008 **cannot be regarded as the utilisation of state funds**.

**Year after year the SAO has objected to the lack of regulation of the central balance reserves** (or other reserves serving the same purpose under a different name), since the general authorisation stipulated by the budget act provides the government in office unlimited and uncontrollable possibilities for the utilisation of such funds.

**Funding for the central budget, for the financial funds of the social security system, and for the separated state funds was ensured in 2008, too.**

At the end of 2008 the **gross debt** of the central budget was by 6.2% higher than planned, and exceeded the gross debt in 2007 by 16.2%.



Source: Government Debt Management Agency, Ministry of Finance

Together with the deposited portion of the loans extended by the IMF and the EU, the debt/GDP ratio was 68.4%, i.e. 7.1% higher than in the previous year. The growth was induced by the joint effect of several contradictory factors. In 2008, the financing needs of the central budget were more favourable than planned: they were by HUF 236.3 billion smaller than the 2007 December plan, however the deficit of the social security funds increased the funding needs by HUF 73.4 billion.

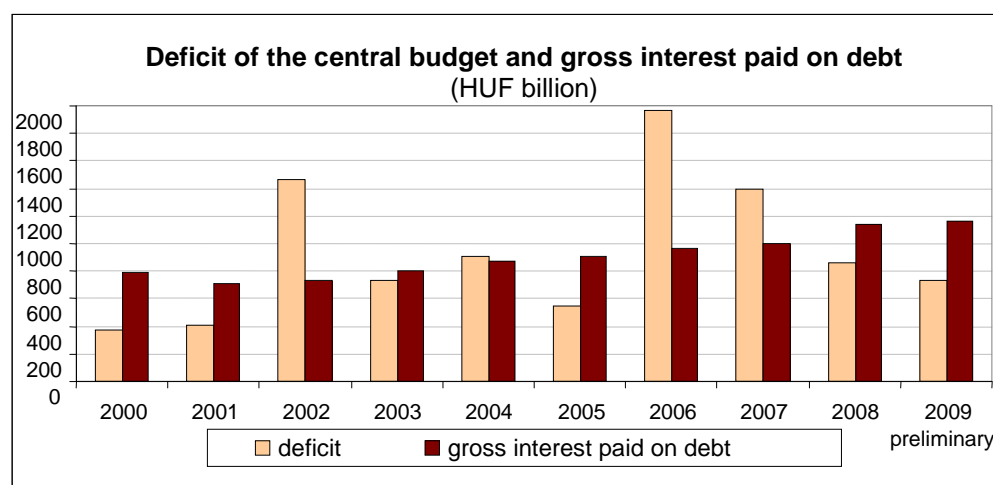
The liquidity of the Single Treasury Account was further deteriorated by the balance of EU settlements, which turned out to be less favourable than planned. The most important factor behind the growth in debts is the amount of HUF 1,824.8 billion drawn in the form of foreign currency loan, which was

not used for financing purposes, but was deposited at the National Bank of Hungary as foreign currency deposit. This amount accounted for 59.0% of the debt increment. The debt further increased due to the fact that the average foreign currency exchange rate was higher than the forecasted average exchange rate.

On the basis of preliminary data, by the end of 2009 the debt of the central budget grew by 4.7%, which means a lower growth rate than that seen in the previous year.

At the end of the year the gross debt of the central budget totalled 73.8% of the GDP, which means a higher debt ratio than that seen in the previous year. The loans extended to the banking system from the international loan package and the foreign currency deposits at the National Bank of Hungary decreased from the previous year. According to preliminary data, in 2009 as much as HUF 1,726.0 was drawn down from the international credit line.

In 2008, the absolute amount of the gross interest paid on the debt of the central budget grew compared to the previous year. The increasing current interest expenditure is related to the higher annual growth rate of the debt of the central budget, as well as to other factors.



Source: final accounts acts, Ministry of Finance

The audit of the final accounts at the chapters and the central budgetary organisations was influenced by the fact that **the structure of the government was modified**. In the process of governmental restructuring the appropriations, the staff, the chapter-managed appropriations as well as financial assets were handed and taken over, but some of the tasks were carried over to 2009.

During the audit of the **financial statements** the SAO revealed deficiencies in relation to the regulations, the balance sheet, the cash-flow report and the supplementary annex, too. Most deficiencies were detected during the audit of the balance sheets, primarily in relation to the commissioning and classification of assets, the lack of evaluation of liabilities, as well as the incorrect use of pending and transfer items.

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The SAO audits found two ministries where funding from chapter-managed appropriations made it possible to raise interests on the transferred subsidies, but the affected ministries failed to dispose of the utilisation of such amounts. The loss of public finances exceeds the interests, since the Government pays higher interests on international loans than the interests on the loans disbursed and deposited in Hungary.

At the Chapter 'Ministry of Environment and Water' the realisation of revenues and expenditures was influenced by the one-off revenue from the transfer of Kyoto units, which revenue was not used in 2008. Due to the delayed start of the Green Investment System, the unused revenue was accounted as appropriation residue.

**During the audit of measures taken for the elimination of deficiencies** revealed during the audits of the final accounts of former years the SAO found that the ministries had only partially completed the tasks specified in the recommendations, or task performance was still under way.

During the audit of the 2008 final accounts, based on regularity checks carried out by the SAO and the audit organisations of the chapters, the SAO **evaluated the reliability of 92% of the total expenditures of the central budget. According to the evaluations it could be stated that the cash-flow data of the bill on the final accounts of the central budget were in general reliable.**

As many as 83% of the financial statements audited by the SAO were granted approval, and 15% were given limited approval. The SAO audits detected errors and deficiencies exceeding the materiality threshold in 2% of the reports.

In the case of financial statements audited by the internal audit organisations of the ministries approval and limited approval were granted to 78% and 20% of the reports, respectively. The audits revealed errors and deficiencies exceeding the materiality threshold in 2% of the reports.

**Within the framework of the audit of the 2008 final accounts**, on the basis of preliminary risk assessments performed in relation to the central budgetary organisations and the chapter-managed appropriations, as well as on the basis of the findings of on-site audits **the SAO thoroughly analysed** the level of elaboration and operation of the internal control systems of the administrative titles of the chapters and of the chapter-managed appropriations in relation to the mitigation of risks influencing the reliability of budgetary reports.

The riskiest fields affecting the budgetary reports on the institutional and chapter-managed appropriations included the level of regulation and operation of the IT environment, the internal audit activity, as well as the functioning of the financial management control (FMC). However, it can be regarded as a positive element that the regulation of the financial and accounting system implied low risks.



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### **Opinion on the 2010 budget**

Contrary to the former years – due to the provisions of the Act on Fiscal Responsibility<sup>3</sup> –the SAO paid less attention to the evaluation of macroeconomic data during its opinion-forming activity. In fact, it evaluated such data only to the extent that was indispensable for the evaluation of the substantiation of the total revenues and expenditures.

The planned amount of **direct central budgetary revenues** for 2010 equals 99.1% of the total main central budgetary revenues.

Similarly to the former years, the SAO **could not fully assess the substantiation of the planned tax revenue appropriation** (the budgeting work), and the changes therein compared to the previous year. With the exception of a few cases, **the absence of certain data and detailed calculations** required for opinion forming **did not make it possible for the SAO to assess the realisability of the planned tax revenues and the inherent risks.**

In its opinion on the budget appropriation bill for 2010 the SAO drew attention to the following in relation to the taxes determining the revenues of the central budget:

- The risk factor of economic growth is not only the future development of the global economic crisis, but also the Hungarian environment affecting the Hungarian economy, including, among other things, the falling rate of investment projects experienced for years, the high rate of unemployment accompanied by a low employment level, the market shrinking effect of the unfavourable changes in income relations, and the significantly restricted lending activities of the banks.
- It is not justified to base the draft corporate income tax appropriation on profit generation equalling the forecasted current price GDP growth in 2010, since the profits of a company are influenced by several factors that have different impacts on even the profits of organisations functioning in the same industry.
- In connection with the realisation of the VAT revenue appropriation for 2010 it can be considered as a risk factor that the National Bank of Hungary forecasts the decrease in real incomes, while the Fiscal Council projects the drop in household consumption equalling the decrease in real incomes, as well as a further reduction of the GDP, which have unfavourable effects on employment and income generation.

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<sup>3</sup> Act LXXV of 2008 on Fiscal Responsibility established, as a new institution, the Fiscal Council, to support the legislative activities of the National Assembly. The Council's scope of power includes the preparation of macroeconomic forecasts, technical projections and methodological recommendations. It contributes to the forecasting of the expected effects during the discussion of bills with budgetary effects.

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**The direct expenditures of the central budget account for over 44% of the total central budgetary revenues** specified in the budget appropriation bill.

A significant portion of the expenditures can be exceeded without the modification of the relevant appropriations, or with restrictions in case EU subsidies are involved, too. The group of expenditures that can be exceeded without the modification of the relevant appropriations may pose a risk to the fulfilment of the deficit target specified in the budget appropriation bill. The risk can be mitigated by the reserves specified in the budget appropriation bill.

The SAO concluded that 86.9% of the direct expenditure appropriations were substantiated and necessary in the given structure and system of tasks of public finances.

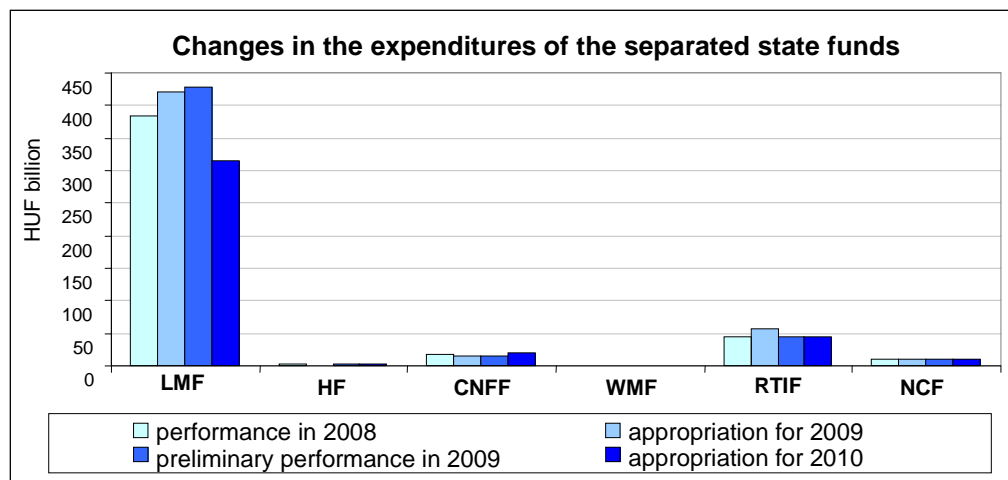
During the timeframe available for opinion forming, which was shorter than in the former years, the SAO could not conduct the audit. Therefore, instead of on-site audits covering all chapters the SAO primarily conducted thematic audits. The auditors could confirm the implementation of the planning tasks primarily on the basis of the declarations they received. Based on the audit of the documents a protocol was drawn up about the findings, which was then discussed with the ministries selected for audit after the supplementary on-site audits.

During the discussion of the Opinion with the state secretaries of the ministries around half of the comments related to the numerical modifications of the appropriations, which explains the (multiple) modifications of the subsidy appropriations as a result of the negotiations and discussions conducted between the line ministries and the Ministry of Finance.

**Based on the documents made available during the audit the SAO concluded that in general there were tensions between the tasks and the available resources.** During the audit no impact assessment studies were made available on the size and management mechanism of the discrepancy between the tasks and resources, or on the required restructuring.

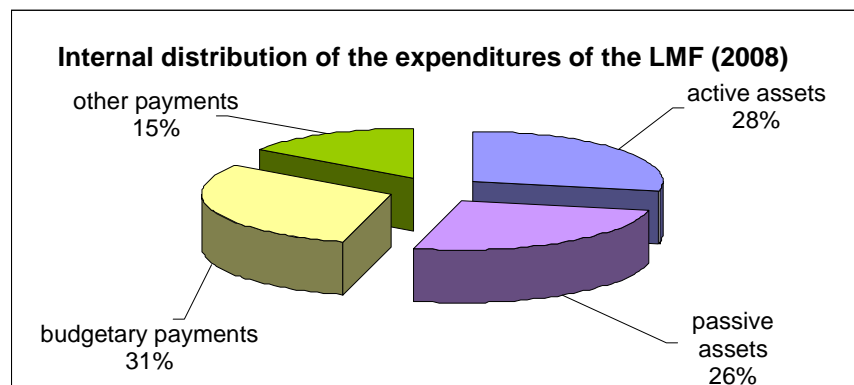
### **2.1.2. Separated state funds**

According to the experiences of audits conducted in 2009, **the financial position of the funds was balanced both in the individual funds, and in aggregate terms** in 2008, similarly to the former years. At the level of the subsystem more revenues were realised than expected, while expenditures were lower than planned. The positive balance of the funds favourably influenced the balance of the entire system of public finances, **and contributed to the smaller than planned public finance deficit.**

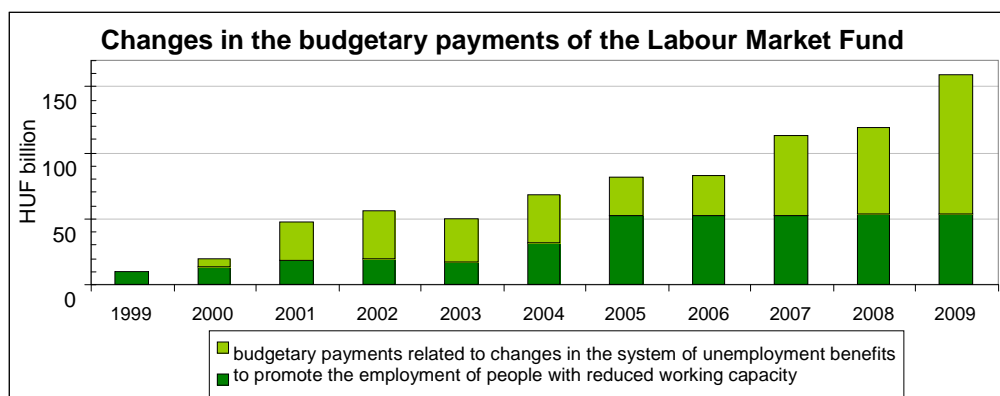


In terms of budget size, the **Labour Market Fund** is still the largest among the funds of this subsystem. It fulfils state tasks related to the promotion of employment and the management of unemployment through the national network of labour organisations.

The SAO audits have indicated for years that some of the changes that have occurred in the internal structure of the expenditures of the Labour Market Fund show unfavourable trends. However, the SAO's recommendations made for the review of the budget relations and legal background of the Fund have been only partly welcome so far.



**An increasing portion** of the Funds are made up of **fund transfers** specified in the budget act. A growing part of funds available for the Labour Market Fund are used to finance the operational costs of organisations, foundations and bodies that are directly or indirectly linked to employment.



The utilisation of active employment policy tools has become more transparent due to the restructuring of the Fund's budget, however resources available for active employment policy tools continue to be neglected, and **it is still difficult to measure their impacts on employment.**

The realisation of expenditures belonging to the passive employment policy tools fell short of the plans, **the impact of the financial crisis on the labour market could not yet really be felt in 2008.** Savings could be achieved in the case of passive benefits, active tools and wage guarantee payments alike. In its opinion on the budget appropriation bill for 2010 the SAO stressed that the change in the unemployment rate and the number of registered unemployed represent a risk factor for the expenditures of the Labour Market Fund, and for expenditures appropriated for job-seeking benefits, since during the calculation of such appropriations the Fund counted with the amount of aid appropriated for 2009.

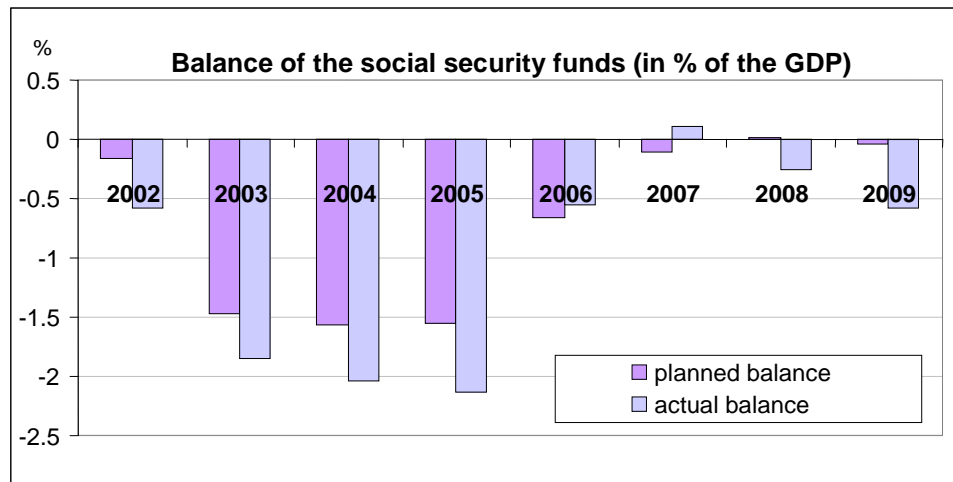
**The other separate state funds** (Homeland Fund, Central Nuclear Financial Fund, National Cultural Fund, Wesselényi Miklós Flood and Inland Water Compensation Fund, Research and Technology Innovation Fund) are less significant than the Labour Market Fund. As the SAO expressed in its opinion on the 2010 budget, the funds **do not pose any planning risk due to their weight**, however regarding the completion of the tasks assigned to them, **they fulfil specific tasks** in accordance with the objectives of the acts on the funds.

Despite the legal regulations, **the system of the operation and audit of the separated state funds** does not always ensure and the audit of the utilisation of resources from these funds. Therefore, the SAO recommended the heads of the organisations managing the funds to review the operation and audit system of the funds to ensure compliance with the audit obligations via the enforcement of the powers specified in the legal regulations.

### 2.1.3. Social security funds

According to the audits performed in 2009, the financial position of the social security subsystem of public finances had altogether shown a favourable trend in recent years. The Pension Insurance Fund closed the year with a negative balance, while the balance of the Health Insurance Fund showed surplus. The consolidated deficit of HUF 67.5 billion recorded by the subsystem deteriorated

the balance of the entire system of public finances, and increased the 2008 deficit.



Source: Final accounts acts, HCSO

The major sources of revenues for the social security funds were the social security contributions and individual insurance contributions, the aggregate rate of which altogether remained unchanged in 2008. The distribution of the contributions between the two funds was modified due to the reallocation of 3+1%, which provides coverage for disability pensions disbursed under the retirement age.

The contribution revenues of the funds are still paid to a joint account, which does not meet the requirement of transparency. Therefore, in the past years the SAO recommended the payment of employers' contributions and contributions payable by the insured to separate accounts. However, this recommendation has not been realised. The preparatory work was completed in 2008, but no decision was made, as a result of which the use of the joint account continued in 2009 and 2010 alike.

In its opinion on the budget appropriation bill for 2010 the SAO claimed that the revenues of the funds would probably decrease due to the modification of the rate of the social security contributions payable by the employers in several steps. Expenditures are somewhat restrained by the reduction of cash transfers, e.g. the elimination of the 13<sup>th</sup> month's pension, the reduction of the sick pay, as well as the tightening of the rules of the childcare benefit and childcare allowance.

The **Pension Insurance Fund** closed 2008 with a deficit of HUF 67.6 billion. The Fund could not reach a balanced position by the end of the year, because the growth in contribution revenues did not create the coverage for a pension rise, and the central budget transferred a lower than planned amount to supplement the amount of the membership fees paid by the private pension fund members. The equity capital of the Pension Insurance Fund continued to be in the negative, which is due to the loss of value of outstanding contributions.

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

HUF billion

| Year    | Compensation of deficit | Transfers from the central budget | Total (2.+3.) | Total expenditures of the Pension Insurance Fund | Index (4./5.) % |
|---------|-------------------------|-----------------------------------|---------------|--|-----------------|
| 1.      | 2.                      | 3.                                | 4.            | 5.   | 6.              |
| 2001    | 1.5                     | 51.8                              | 50.3          | 1,175.1  | 4.3             |
| 2002    | -14.2                   | 185.2                             | 199.4         | 1,405.9  | 14.2            |
| 2003    | -39.0                   | 115.9                             | 154.9         | 1,540.1  | 10.1            |
| 2004    | -80.2                   | 144.3                             | 224.5         | 1,707.0  | 13.2            |
| 2005    | -93.5                   | 187.3                             | 280.8         | 1,916.0  | 14.7            |
| 2006    | -19.5                   | 321.0                             | 340.5         | 2,113.1  | 16.1            |
| 2007*   | 0                       | 138.5                             | 138.5         | 2,354.1  | 5.9             |
| 2007    | 0                       | 138.5                             | 138.5         | 2,642.6  | 5.2             |
| 2008    | -67.6**                 | 143.4                             | 211.0         | 2,925.2  | 7.2             |
| 2009*** | -7.2                    | 217.5                             | 224.7         | 2,866.8  | 7.8             |

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

\*\* As much as HUF -9.1 billion resulted from the fact that the central budget transferred a lower than planned amount to supplement the amount of the membership fees paid by the private pension fund members.

\*\*\* Preliminary data.

The discrepancy between the actual and planned pensions payable from the Pension Insurance Fund is the result of changes introduced in the pension calculation rules, which resulted in a slower growth in automatic benefits. In 2008 pensions were raised three times, and pension adjustments due on 1 January 2008 were also implemented. The new pension calculation rules introduced with a view to ensure the sustainability of the pension system led to the reduction of pension expenditures already in 2009.

In its opinion on the budget appropriation bill for 2010 the SAO indicated that due to the **modification of the regulation of the pension system**, and due to the withdrawals from the private pension funds that trigger surplus revenues on the short run, the budgetary revenues are expected to rise temporarily, however the impacts on expenditures are not yet fully known. The new legal provision that allows citizens to return to the state pension system deserves special attention in relation to the transparency of the budget. As a result of withdrawals, the transfer of former payments accumulated in the private pension funds increase state revenues, however the expected rise in pension expenditures cannot be predicted yet.

Regarding the budgetary position of the **Health Insurance Fund**, since its establishment, 2008 was the second year when the Fund closed the year with a

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surplus of HUF 73.4 billion instead of a deficit, however this surplus was by HUF 1.9 billion smaller than appropriated.

The break-even budget of the Fund, and the attainment thereof in 2008 was primarily due to measures aiming at the creation of harmony between the expenditures and revenues. The issue of payment obligations for citizens who do not pay contributions was settled from 1 January 2007. After the increase of fees for pharmaceutical products, as well as pursuant to the measures introduced under the act on the cost-efficient use of medications pharmaceutical expenditures stabilised.

Some of the expenditures reimbursed by the Fund were originally planned as central budgetary expenditures, e.g. the amount spent on the wage policy measures of the healthcare institutions. This amount was not included in the care related expenditure appropriations of the Fund, but was indicated in a separate row as provisions. Expenditures related to the childcare benefit were formerly reimbursed by the central budget, but in 2008 it undertook to cover only half of such expenditures. At the same time, financing of the disability pension was removed from the Health Insurance Fund, and revenues ensuring coverage for such expenses were also reallocated to the Pension Insurance Fund.

Apart from the 2008 impacts of the restructuring of inpatient care in 2007 no major changes were made in the supply system.

The experiences of the past one and a half decades have shown that the pharmaceutical expenditures implied the greatest risk from among the expenditures of the Fund. In 2008, the stabilisation of expenditures could be witnessed in this field, which can be significantly attributed to the competition enhancing market conditions, administrative regulation as well as to the support to cost-aware choices on the demand side (physicians, pharmacists, patients). Following the measures introduced in the pharmaceutical sector, similar restructuring was undertaken in the sector of therapeutical devices, however the resulting competition has been significantly weaker than in the pharmaceutical sector.

The Minister of Health provided information on the restructuring processes of the healthcare system, and on the corrections deemed necessary within the framework of his reporting obligation stipulated in the act on the development of the healthcare system.

In its opinion on the 2010 budget appropriation bill the SAO stated that on the revenue side of the Fund reduction may occur due to the decrease in the in-kind health insurance contribution payable by the employers, and the elimination of the flat healthcare contribution, but the law allows the Government to intervene to manage the financial problems that may occur (reallocation of funds within and among the appropriations, as well as raising the appropriations.)

**The separated state funds and the financial funds of the social security system** were affected by the amendment of several legal regulations.

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Until 31 December 2009 the funds formed a separate subsystem of public finances. The reports of the funds were authenticated by a chartered accountant, and the SAO audited the funds within the frameworks of other regularity audits. Pursuant to the amendment of the Act on Public Finances effective since 1 January 2010<sup>4</sup>, the funds form part of the central subsystem, and pursuant to the amendment of a legal regulation<sup>5</sup> the reports of the funds must be checked according to a methodology developed by the SAO<sup>6</sup>.

#### **2.1.4. Local governments**

In 2009, the local governmental subsystem of public finances was made up of 3,194 local governments and 173 micro-regional associations. The review of state tasks, the reform of the large distribution systems, and the further considerable downsizing of public finances have been recurrent, unsolved tasks on the agenda for years. According to the SAO's experiences, the escalation of tensions between the state tasks and the funds available for implementation was in part due to the inconsistent specification of the mandatory tasks of the local governments, and the distribution thereof among the different local governmental levels, as well as to the lack of harmony between the tasks and financing, even if certain progress was made in this field. The review of public tasks was carried out in 2007 within the framework of the State Reform (task survey), but it did not lead to changes in the tasks and powers of the local governments either.

The system of local governmental resource regulation practically remained the same in the past year. It is still typical that the budget fails to provide sufficient resources for the completion of new tasks assigned to the local governments. The elimination or merger of certain subsidy or normative support legal titles – which aimed to widen the room for manoeuvre of the local governments – was rather of technical nature. In the absence of the comprehensive review of the tasks and scopes, as well as of the financing system of the local governments, the budget risks of the different local governmental levels continue to imply uncertainties.

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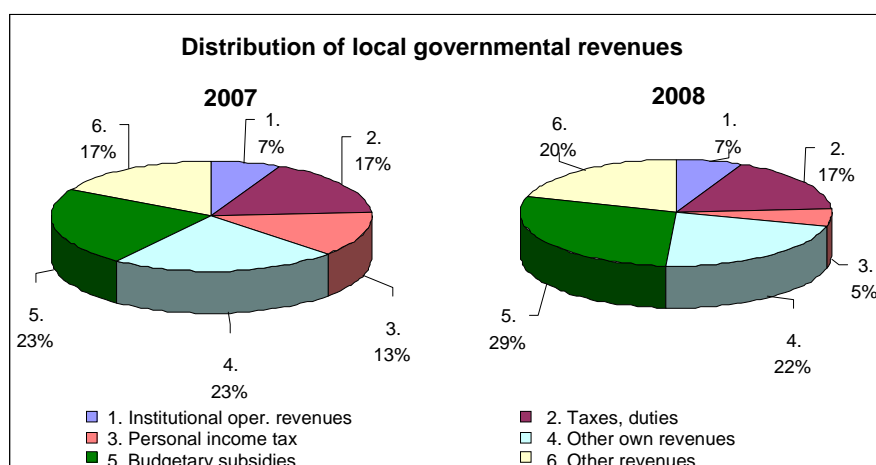
<sup>4</sup> Article 22 of Act LXXV of 2008 on Fiscal Responsibility.

<sup>5</sup> Para (11) of Article 2 of Act LXXXII of 2008 on the amendment of certain acts substantiating the 2009 budget of the Republic of Hungary amended para (3) of Article 57 of the Act on Public Finances, and para (22) of Article 2 of the act amended para (2) of Article 86/A of the Act on Public Finances.

<sup>6</sup> The change manifests itself in the fact that while formerly the chartered accountants formed a general opinion on the report and balance sheet showing the revenues and expenditures of the funds, and on the authenticity of the data, following the amendment of the legal regulation, the reliability of the fund's revenues collected by the Tax and Financial Control Administration are audited by the SAO within the framework of the audit it conducts, and the chartered accountants form opinion – based on the SAO methodology – only on revenues collected by entities other than the Tax and Financial Control Administration, and on the entirety of the funds' expenditures. Pursuant to para (8) of Article 29 of Act LXXXII of 2008, the SAO methodology must be first applied during the final accounts on the execution of the 2009 budget.



According to the preliminary figures, in 2009 **local governments realised a total revenue** of nearly HUF 3,572 billion, including loan and security transactions, too. Within this amount the dominance of local (own and transferred) revenues increased, while state subsidies and contributions (including PIT revenues transferred to the local governments in a normative manner) declined. Within own current revenues local taxes represent 16% (as much as 83% of which is made up of revenues from the local business tax). Within own revenues, the greatest increase could be witnessed in the interest revenues and VAT revenues. In the stagnant economic conditions the institutions could not increase their own revenues – which primarily come from fees payable for various services – wherefore the operational revenues were similar to those realised in 2008. The consolidated amount of cumulative purpose funds received from the EU – which appear among cumulative purpose and capital type revenues – and of the amount of national co-financing is four or five times higher than in the previous years (HUF 85 billion) according to the preliminary performance data, but is far below the amount planned by the National Assembly (HUF 240 billion).



As a result of the cost reducing measures of the local governments the share of current operational expenditures decreased within the **total expenditures**, but still represented nearly two thirds of the expenditures. Although the sum of cumulative purpose and capital type expenditures slightly grew compared to the previous year, their share (nearly 16%) within total expenditures decreased. Expenditures related to subsidies – especially to the socially needy – significantly rose. In 2008 local governmental tasks were performed by 40,000 civil servants and by 361,000 full-time public employees.

By the end of 2008, **the own property of the local governments** presented in the accounting balance sheet grew by 12.6% compared to 2005. This growth was primarily caused by the 8% rise in the value of real property and the related property rights, by the 7% rise in assets transferred for operation, management or concession purposes, as well as by the 23% in assets under property management. The stock of financial assets grew by 126% from 2005 by the end of 2008, primarily as a result of revenues from bond issuances in 2007 and 2008. In contrast with the growing real property value due to the investment projects it is unfavourable that the stock of liabilities at year end significantly grew every year, and by the end of 2008 it was double the value

recorded at the end of 2005. As much as 87% of the increase was caused by long-term liabilities, 63% of which was made up of bond issuances. Within the HUF 1,274.3 billion long- and short-term liabilities of the local governments presented in the accounting balance sheet at the end of 2008, liabilities incurred due to bond issuance totalled HUF 444.7 billion.

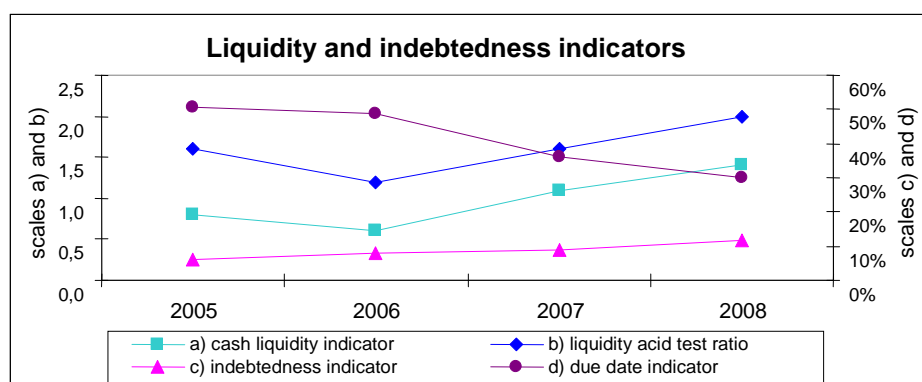
| <b>ASSETS OF THE LOCAL GOVERNMENTS AS PRESENTED IN THE ACCOUNTING BALANCE SHEET</b> |              |               |               |               |
|---|--------------|---------------|---------------|---------------|
| Assets  | 2005         | 2006          | 2007          | 2008          |
| <b>INVESTED ASSETS</b>  | <b>9,297</b> | <b>9,746</b>  | <b>9,992</b>  | <b>10,244</b> |
| Intangible assets   | 21           | 25            | 26            | 25            |
| Tangible assets   | 7,238        | 7,576         | 7,688         | 7,803         |
| Invested financial assets   | 556          | 558           | 557           | 592           |
| Assets transferred for operation and management purposes                            | 1,482        | 1,587         | 1,721         | 1,824         |
| <b>CURRENT ASSETS</b>   | <b>564</b>   | <b>554</b>    | <b>632</b>    | <b>855</b>    |
| <b>TOTAL ASSETS</b>   | <b>9,861</b> | <b>10,300</b> | <b>10,624</b> | <b>11,099</b> |
| <b>LIABILITIES</b>  | <b>697</b>   | <b>925</b>    | <b>1,088</b>  | <b>1,395</b>  |
| <b>OWN PROPERTY</b>   | <b>9,164</b> | <b>9,375</b>  | <b>9,536</b>  | <b>9,704</b>  |

In the years 2005-2008 more than two thirds of the local governments approved their **annual budgets** with a budgetary deficit. Contrary to the Act on Public Finances, in the period of 2005-2008, when determining the annual budgets, nearly four fifths of the audited local governments accounted their revenues from financial transactions related to the financing of the budgetary deficit as revenues modifying the budgetary deficit or budgetary surplus. Consequently, the budgetary decrees did not give a fair picture on the financial position of the local governments.

During the execution of the budget the realised revenues fell short of the budgetary expenditures at a significantly smaller portion of local governments than planned (at around one fourth). Among financial transactions contributing to the financing of the budgetary deficit the number of local governments that take out loans significantly dropped due to the spread of bond issuance.

No local government issued bonds in 2005, while in the period of 2006-2008 primarily the local governments of counties, towns with county status, the metropolitan districts of Budapest, as well as towns issued bonds, first of all for development and debt management purposes. The smallest and largest amounts of **bond issuance** were HUF 200 million and HUF 12,000 million, respectively. In 2007 and 2008 most of the audited local governments issued foreign currency based bonds with variable interest rates. The maturity in nearly eight tenths of the cases was 20 years. Bond issuance led to the growing

indebtedness of the local governments. According to the proposals submitted by the representative bodies, the resulting liabilities were planned to be repaid from operational purpose budgetary revenues. During compliance with their principal and interest payment obligations related to bond issuance, the audited local governments observed the upper limit specified by the Act on Local Governments, i.e. long-term payment liabilities were undertaken for one third of the bond revenues on average. In the first years of bond issuance nearly 95% of revenues realised from bond issuance were deposited, or spent on the purchase of short and long-term securities. Due to the changes in the exchange rate of the foreign currency to be repaid, as well as due to the changing interest conditions, bond issuance poses a risk for the local governments<sup>7</sup>.



In the long run, indebtedness unfavourably influences the financial position of the local governments. The financial indicators altogether point to the growing indebtedness of the local governments, and the unfavourable changes in the financial situation.

The original appropriations approved in the budget were increased by a growing rate of the audited local governments. The under- or overspending of the appropriations can be attributed to the deficiencies of the budgeting process. During the determination of the original appropriations two thirds of the local governments failed to plan the utilisation of residual funds for commitments carried over to the next year, wherefore their budgetary decrees indicated higher budgetary deficits than it would have been justified.

Nearly half of the audited local governments defined their respective IT strategies. In order to create the conditions required for the establishment and operation of modern, efficient and transparent e-public services, nearly one third of the local governments submitted applications for support from the EU. Nearly 90% of the audited local governments operated IT system providing e-public services.

<sup>7</sup> The macroeconomic effects of bond issuance by the local governments are analysed in the evaluative study (pages 74-77) published by the Research and Methodological Institute of the SAO in November 2008 on the analysis of the macroeconomic risks of budgeting for 2009.

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The publication of data of public interest in an electronic format has been mandatory since 1 July 2008, yet at three quarters of the audited local governments the town clerks failed to publish the publication lists in the structure and with the content specified by the law.

During the audit of the **establishment and operation of the controls of budgetary financial management** the SAO concluded that at more than half of the local governments the level of regulation of the budgeting and final accounts preparation processes altogether implied low risks for the adequate and regular implementation of the tasks, since the town clerks – utilising the SAO's recommendations made in former years – established the internal control mechanisms of the planning and final accounts related tasks in accordance with the provisions of the Government Decree on the operational rules of public finances, as well as in accordance with the capabilities of the respective local governments. Similarly to the previous year, at nearly one fourth of the local governments the town clerks failed to comply with their obligation to establish internal controls for the planning and final accounts related tasks, wherefore the regulatory deficiencies of the planning and final accounts preparation tasks implied high risks for proper and regular task performance. The reliability of internal controls established in the process of budgeting and final accounts preparation was altogether found to be excellent at 33% of the local governments. The internal control procedures functioned well at 25% of the local governments, and despite the deficiencies found they satisfied the expediency requirements in relation to the prevention, detection and correction of operational errors. The rest of the local governments failed to check the budgeting and final accounts preparation process, wherefore the reliability of the operation of the controls was weak.

At 30% of the local governments the level of regulation of financial management, finance/accounting and financial management control (FMC) tasks altogether implied a low risk for proper and regular task performance, since the town clerks established the internal controls in compliance with the legal regulations and the local capabilities. At 46% of the local governments the deficiencies of regulation posed medium risks, however the established internal controls – if operated adequately – provided protection against most of the potential errors. At 24% of the local governments – i.e. at fewer local governments than in the previous year – the town clerks failed to meet their obligations regarding the establishment of internal controls, wherefore the regulatory deficiencies implied high risks for the proper and regular implementation of financial management tasks.

Nearly one third of the offices of the local governments did not have operational and organisational rules approved by the body of representatives, and one fourth failed to prepare procedural rules for the regulation of the tasks of the business organisation. Despite the SAO recommendations reiterated year after year, nearly half (a still unjustifiably high portion) of the local governments failed to specify the method of stock-taking of assets transferred for operation and management purposes, as well as the group of persons authorised to make decisions related to the scrapping and utilisation of such assets. Nearly two thirds of the local governments failed to regulate prime cost calculation. Contrary to the provisions contained in the Act on Public Finances

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and the Government Decree on the operational rules of public finances the town clerks had not comprehensively develop the FMC system.

The reliability of professional performance certification and the countersigning of vouchers were found to be weak at a greater portion of the offices of the audited local governments, because they failed to fulfil their obligation pertaining to FMC tasks built into the operative financial management process. At these local governments the audits found regular deficiencies and omissions related to the functioning of the internal controls, several controls remained unrealised concurrently in the process of the same economic event. At nearly two thirds of the local governments the appointed persons did not, or did not correctly check the legality and amount of expenditures, and the performance of contracts, orders and agreements within the framework of financial management. The control tasks related to the countersigning of vouchers were not completed by nearly two thirds of the local governments. The countersigning of vouchers was a mere formality at around half of the local governments, since the countersignors did not comment on the deficiencies. According to the experiences of the SAO, the offices of the local governments encountered uncertainties in relation to the commitments due to the contradictory provisions of the Act on Local Taxes, the Act on Public Finances and the Government Decree on the operational rules of public finances specifying the group of persons authorised to undertake commitments.

Due to the deficient functioning of the internal controls, nearly one tenth of the local governments paid amounts other than those specified in the contracts, or effected payments to entities other than the rightful beneficiaries. A similar portion of the local governments effected payments in relation to commitments without appropriation.

In relation to the development, regulation and operation of the organisational and regulatory frameworks of internal audits some progress could be witnessed compared to the former years, especially in connection with the organisation of tasks, and the provision of the personal, organisational and regulatory conditions required for operation. The development of the organisational and regulatory frameworks of internal audits altogether implied low risks in the regular completion of internal audits at 50% of the audited local governments, since the organisational frameworks and operational conditions were regulated. The deficiencies of the organisational and regulatory frameworks of internal audits implied medium risks at 47% of the local governments, and high risks at 3% of the local governments in relation to appropriate task performance. The medium and high risks were caused by the inadequate specification of the legal status and tasks of the persons or organisations performing the audits. In the case of local governments involving external service providers – associations or entrepreneurs – for the performance of the internal audits, three quarters of the agreements did not specify the managerial tasks associated with internal audits, the completion of such tasks, or they did not or did not properly plan the audit tasks. The reliability of the internal audit system was altogether found to be excellent at nearly 14% of the local governments, and good at over 50% of the local governments. At one third of the local governments the reliability of internal audits was found to be weak, since they failed to comprehensively fulfil the tasks specified in the audit plan,

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and the internal audit capacity required for the performance of the planned audit tasks was not available. The associations failed to inform the clerks of the affected local governments about the implementation of the annual audit plan or about the possible deviations therefrom, or deviated from the annual audit plans without the prior consent of the clerk and the representative body.

Two thirds of the local governments failed to audit the compliance of the establishment and operation of the FMC systems operating within the frameworks of internal audits with the central and local rules. Three quarters of the local governments failed to audit the cost-efficiency, efficiency and effectiveness of the operation of the financial management and control system. Three quarters of the local governments that conducted public procurement procedures did not organise the audit of the execution of the public procurement procedures, the audit of resource management, of property protection, of the reliability of accounts at business organisations in which local governments had majority stakes, as well as at public benefit companies. As many as 5% of the local governments conducting internal audits revealed acts that served as a ground for disciplinary proceedings.

**During the audit of the execution of the 2008 budget of the Republic of Hungary** the SAO audited the accounting of normative subsidies, of transferred personal income tax revenues and of the normative, fixed purposed subsidies granted to multi-purpose micro-regional associations at 71 local governments and 16 multi-purpose micro-regional associations, while the cumulative purpose subsidies were audited at 30 local governments. As much as 28% of local governments and multi-purpose micro-regional associations accounting normative subsidies submitted fully accurate accountings, while none of the multi-purpose micro-regional associations accounting fixed purposed subsidies did so. In the case of normative subsidies the SAO found accounting errors exceeding the materiality threshold (2%) at four local governments. In 2007 the financing of the public education tasks of the local governments were put on new foundations, according to which the application conditions for normative subsidies and the assigned specific rate are now guaranteed for the academic year instead of the budget year. Since 2007, during the application and accounting of public education subsidies and contributions the provisions of the budget acts of two years had to be considered, which resulted in a further growth in the number of accounting codes (in 2008 there were 242 accounting codes versus the 230 in the previous year). Incentive subsidies to the multi-purpose micro-regional associations were provided by the central budget under complicated regulatory conditions. Multi-purpose micro-regional associations could fulfil their joint task performance obligations through organisational activities, too, the concrete content of which was not regulated. Subsidies were requested and accounted in the database system developed by the Ministry of Local Government, which was lengthy and intransparent, and its calculation method regarding the rules for the rounding of indicators was not in conformity with the provisions of the 2008 budget act.

During the audit on the regulation pertaining to the subsidisation of the local governments by the ministries, and on the award and accounting of the subsidies the SAO determined that in the last period of 2008 the Ministry of Local Government allocated subsidies, and disbursed payments to the local

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governments without signing subsidisation contracts. The deadline for the publication of the decree on the detailed rules pertaining to the eligibility conditions, disbursement, utilisation and accounting of the given centralised appropriation, as stipulated by the 2008 budget act, was missed in the case of four legal titles by the Minister of Local Government, in the case of three legal titles by the Minister of Education, and in the case of one legal title by the Minister of Transport, Communication and Energy, the Minister of Environment and Water, and the Minister of Social Affairs and Labour. The reasonable cases that should be taken into account regarding other subsidies available for unviable local governments were still not regulated in a unanimous manner.

During the audit of activities aimed at **the calculation of the fees payable for certain authorities** the SAO determined that the Municipality of Budapest, acting as a pricing authority, did not have a price concept, and nor did it determine the general principles pertaining to the pricing of public services, and the specific, medium- and long-term principles pertaining to the individual public services. Furthermore, in the public service contracts and cooperation agreements the Municipality of Budapest failed to give the public service providers guidance on how to prepare the requirements and contents of prime cost calculations. The fees payable for heat and water supply, sewage collection, solid and liquid waste management, as well as chimney sweeping services included costs that were directly or indirectly not related to the public services.

The development costs of distant heat supply were planned as a separate price element instead of depreciation for public service development in the given year, profits on public services, development purpose loan, or subsidy despite the fact that the Budapest Heat Supply Company (FŐTÁV Zrt). included a separate profit price element, too. In the case of the sewage collection public service the Municipality of Budapest included the need for own resources in the planned local governmental investment projects as development costs in the payable fees. When approving the development costs within the heat supply and sewage fees the Municipality of Budapest failed to enforce the consumers' interests, since it approved the coverage for development as a separate price element instead of profits. The Budapest Heat Supply Company, the Water Company, the Budapest Sewage Works, as well as the Budapest Public Area Maintenance Company paid a certain amount determined by the Assembly of the Municipality of Budapest – i.e. HUF 2,012 million in 2007 and HUF 1,846 million in 2008 – into the Network Foundation. When determining the amount to be transferred to the Network Foundation, the Municipality of Budapest did not enforce the consumers' interests, because instead of distributing the costs among the public service providers, the Municipality of Budapest and the consumers, it passed the entire costs of maintaining the solvency of household consumers onto paying consumers. The SAO believes that the Municipality of Budapest did not act with sufficient carefulness when determining the officially fixed prices.

Within the framework of the review of the local governmental decree on **revenues to be shared between the Municipality and the district local governments of Budapest in 2009** the SAO determined that

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disregarding the provisions of the Act on Local Governments about the types of revenues to be shared, as well as about the method of sharing, the act on resource sharing contained provisions that were contradictory to, or non-compliant with the Act on Local Governments. The distribution of revenues available to the district local governments of Budapest on the basis of percentages restricted the authorisation of the General Assembly pursuant to the Act on Local Governments, according to which the General Assembly has the right to determine the distribution proportions. During the elaboration of the decree on resource sharing the provisions of the act on resource sharing were applied, but the provisions of the Act on Local Governments were ignored. The amendment of the act on resource sharing in 2009 modified the definition of '*permanent population*', however the discrepancy with the population figure used for the calculation of the amount of normative contributions in the budget act persisted. The decree on resource sharing distributed revenues from normative contributions linked to the permanent population pursuant to the 2009 amendment of the act on resource sharing.

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

The development of the central public administration system was subjected to a system audit in 2009 for the first time. The SAO reviewed and evaluated the modernisation process of the **central public administration system** since 2006. The picture that can be drawn about the public administration system for 2008 shows progress compared to 2006. The measures initiated by the Government in the middle of 2006 to eliminate the deficiencies hindering modernisation had eliminated only part of the deficiencies, and were being realised as a result of the developments already started. The SAO determined that no real progress was achieved regarding the most important deficiency of the period preceding 2006 – creation of the regulatory and organisational frameworks of planning, strategy development, as well as ex-ante and ex-post impact assessments.

The scheduling, implementation of the individual measures, and the exploration of the professional correlations did not happen in a systemic approach. The starting and ending dates of the programmes were often assessed incorrectly. The modernisation process was not fostered by the fact that the relevant system of governmental responsibilities was modified on a continuous basis. The standardisation of certain functions of the ministries was implemented only in relation to the operational and supply tasks. For the lack of important decisions, the cost-efficiency expected from the centralisation of the activity was not achieved in several areas.

The evaluation of the performance of civil servants on the basis of new foundations, the more stringent selection criteria and the measures fostering the termination of employment relations in a more flexible manner were introduced gradually and continuously in the development of human resource management. Tendering obligations were widened, competition based selection and the mandatory probationary period were introduced, and the dismissal



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rules were harmonised on a continuous basis, but their impacts cannot yet be perceived in the improvement of efficiency and savings.

The modernisation of the public administration system includes two operational programmes of the New Hungary Development Plan: the State Reform Operational Programme (SROP) and the Electronic Public Administration Operational Programme (EPAOP).

Several projects of SROP are in delay due to the restructuring of governmental tasks in 2008, and have yielded less comprehensive results than planned. Organisation and process development has not been renewed at the ministries, and quality assurance is still given inadequate attention. The EPAOP projects involve billions of Forints, they are complex and interrelated both organisationally and technically. However, it would be necessary to institutionally divide the tasks and powers between the National Development Agency responsible for professional and technical coherence, and the government commissioner responsible for the IT solutions.

2009 was the first year in which the **treasury system**, established for the efficient and controllable utilisation of public funds, was subjected to a system audit. Former SAO audits extended only to certain areas of system operation. The organisations of the treasury system that are supervised by the Minister of Finance are the following: the Hungarian State Treasury, which is responsible for the financial execution of the budget as a main task (Treasury) and the Government Debt Management Agency responsible for the continuous solvency of the budget.

An increasing group of the public finance subsystems and financial management processes were included in the treasury system, which enhanced transparency and accountability. However, at the time of the SAO audit the local governmental system was still only partially connected to the system. The more comprehensive inclusion of the subsystem – which requires the amendment of regulations pertaining to the local governments – may contribute to the more efficient operation of public finances, and at the same time to the mitigation of corruption risks in this area.

The SAO audit determined that with the exception of staff reductions and organisational changes the need for the systemic review of the distribution of rights and powers among the macro-, medium and institutional levels representing the interests of public finances – to ensure greater expediency – was not formulated at governmental level. The different provisions contained in the regulations pertaining to institutions linked to the treasury system and the unjustifiably high number of exceptions significantly restrict the efficient operation of public finances. There were no centrally defined strategies regulating the treasury IT systems supporting the individual processes, or the development of such systems. It was typical that the IT systems were developed in an uncoordinated manner, and solutions of varying quality were applied. In relation to the reliability of the professional work it posed a risk and triggered extra costs that the assessment, systemisation, and security classification of the data content of the treasury information systems had recurred for years and were still incomplete at the time of the on-site audit.

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The continuously growing tasks of the Treasury – which employs nearly four thousand persons and maintains a regional network – especially justifies the reinforcement of the management activity of the Ministry of Finance, professional coordination outside the Treasury, and the stricter supervision of activities.

Ensuring/maintaining the optimum level of the monetary assets (liquidity management) is the result of the coordinated and interlocking tasks of the Government Debt Management Agency and the Treasury. The optimisation of payments is hindered by the fact that the Treasury does not have the legal authorisation, the technical conditions and sufficiently detailed information for liquidity management covering all treasury institutions. It means an extra burden for the financing of the budget that the monthly dates of the realisation of significant budgetary revenues and payments differ from one another.

The Treasury participates in the development of the Budget Management System, which was started with extremely large EU funds, as a professional supervisor. According to its objectives, the Budget Management System to be implemented as an EU project contributes to the IT foundations of more substantiated decision-making and of more efficient treasury operations. The unfavourable phenomena that occurred during the preparation of the project were in the meantime eliminated, in part as a result of the SAO recommendations made during a former audit.

In the audit period, between 2000 and 2007, the government programmes, the Convergence Programmes and the National Development Plan contained general housing subsidisation objectives, but no comprehensive, national housing policy programme was developed that would have contained the numerical objectives of the **housing subsidy system**. The Government did not comprehensively evaluate the operation of the system of housing subsidies, the implementation of housing policy objectives, or the impacts of the measures taken or changes made. In the operation of the housing subsidy system introduced in 2000 the directions and objectives of the role of the state fundamentally remained the same.

The short-term objectives of the subsidy system – increasing the number of house constructions, of housing loans and of rentable flats – were met. The number and amount of approved, state subsidised loans increased until 2003, but then, by 2008, the share of such loans decreased both in number and value within the total loan stock. The decrease was caused by the rise in foreign currency denominated loans in 2004.

The growth in foreign currency based lending was in part caused by the fact that in 2003 housing purpose state subsidies were curtailed, and the base and rate of interest subsidisation given to housing loans were changed. This entailed an increase in the interest payable by the clients on subsidised loans. One of the objectives of changing the calculations of interest subsidisation was to reduce the interest margin of the credit institutions. The set objective was achieved, but the credit institutions compensated the drop in loan interests by raising the costs and fees.

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The Government Decree regulating housing subsidies was amended 25 times between February 2001 and June 2008, which did not foster the predictability and manageability of the system of housing subsidisation. The organisational system performing housing policy related task was not stable. The professional, analysing and evaluating work was hindered by the fact that between 2000 and May 2008 housing policy related governmental tasks were carried out by five ministries.

In the tender based system of housing subsidisation tenders were invited on an ad hoc basis, the ministerial decisions pertaining to tender invitations were not documented, the quantified objectives achievable through subsidisation were not defined, and the monitoring system designed to track the implementation of such objectives was not developed.

**The audit of the system of separated state funds and of the implementation of the objectives specified in the proposals** concluded that at the level of acts the process of legislation was not consistent, wherefore certain funds were not allocated targeted, tax type revenues. Two funds received budgetary subsidies. The rules pertaining to the utilisation of monetary resources were frequently modified. The utilisation of revenues for professional purposes was restricted, and the use of reserves was prevented for several years. Regulation necessarily encouraged the spending of revenues yielded in the subject year. Despite their separate resources, the operation of the funds was not fully independent from the central budget.

The funds can also be used to cover operational expenditures. The costs of fund management cannot be determined, because the fund managers – that are engaged in other activities, too – did not separate these costs within their records. The parallel financing of state tasks from the fund and from sources outside the fund, as well as the parallel financing of budgetary organisations from the central budget and from the funds deteriorated the transparency of the budget, and hampered the introduction of task based budgeting.

It was typical that the legal regulations pertaining to the funds were frequently and significantly modified. The frequent change on the post of the minister in charge, and the related – or unrelated – organisational changes hindered the continuity of daily work, as well as the monitoring of the processes, the financial and professional audit of utilisation, as well as the determination of responsibility.

The minister in charge of the fund is the governmental supervisor of the area. The ministry (governmental office) under his management influences the operation of the fund and the utilisation of financial resources. The minister has the right to directly intervene into the operation of the ‘separated’ fund through the award of subsidies he is authorised to allocate (single single decisions), or by the appointment or recall of the board members.

The decision of the legislator, according to which state funds were created for the financing of six groups of state tasks, was not preceded by the preliminary assessment of the results and impacts expected from the operation of the fund. During the evaluation of the operation of the fund the professional and

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economic criteria were not defined. It would be necessary for the National Assembly to evaluate the need for the operation of certain separated state funds every four years, and to decide on the further operation of such funds on the basis of such evaluation.

The system audit of the implementation of the major provisions – sectoral management, training system, financing and financial management – of the **higher education act** was performed by the SAO for the period 2005-2008. The legal regulation which took effect in 2005 was preceded only by the elaboration of the conceptual professional programmes, and not by the preparation of a comprehensive, medium- and long-term strategy. The higher education system is overregulated; apart from the act it is regulated by over thirty, frequently amended Government Decrees and Ministerial Decrees. The professional programmes substantiating the act did not adequately count with the drop in the number of students due to the demographic situation, and with the need for the harmonisation of the student number and the teaching capacities.

In line with the objectives of the higher education sector, and pursuant to the act, Hungary switched to the multi-cycle training system, however this was not properly prepared. The development of the foundation and master training programmes did not coincide, which hampered the creation of an interlocking and consecutive structure of courses.

In the absence of labour market forecasts the training structure does not meet the labour market demands. At the end of 2008, the job mediation agencies indicated an oversupply of teacher, economist, manager, law and liberal arts graduates. No major progress was achieved in the development of the legally mandated, career monitoring system designed to foster the relationship between the higher education system and the labour market.

The twelve-semester long training period ensured by the legal regulation does not encourage students to finish their studies as soon as possible. This means squandering state subsidies and a decline in the quality of student performance. In the years of the audited period there was a difference of several tens of thousands between the number of last year students and students actually earning their degrees. The operation of the higher education information system, which envisages full-scale data supply, and is currently loaded to 28%, cannot be regarded effective despite the state subsidies, because its usability is heavily restricted.

In accordance with the provisions of the higher education act, higher education was financed in a multi-channel system. Normatives are determined as base financing depending on the number of students, instead of on the basis of the training costs or performance requirements. The legal regulations on financing were amended several times during the audited period. The performance requirements or the institutions are not standard or comparable. State commitments to preserve the real value of subsidies were not realised.

The full-scale restructuring of the training system and operational rules established by the new regulation has not been completed yet, and at its

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current stage it shows a decline in efficiency and effectiveness alike. The regulation of financing and financial management has not met the set competitiveness objectives.

**During the audit of the outsourcing of certain hospital activities** the SAO intended to explore the extent, forms and level of regulation of the partnership established with the private sector. The SAO determined that the sector has no strategy to determine the possible size, role and professional areas of private capital and private enterprises. The outsourcing of hospital activities was not regulated at the level of rules of law. The GDP proportionate expenditures of inpatient care from the Health Insurance Fund decreased by 2008. Hospital managements and the owner local governments responded to the growing financing and operational difficulties by increasing the involvement of private enterprises and private capital. They increased the outsourcing of certain hospital related background activities, the employment of physicians via contributor contracts, and transferred the entire hospital maintenance to private enterprises.

The SAO determined that in the fields of operational stability or the improvement of the implemented investment projects and care services the operators only partially fulfilled their contractual commitments. It became more complicated to assess the transparency of the real financial situation and the stability of the operating companies, which increased the risk of operation. The local governments did not call the operators to account on the professional quality of care.

The deficit arising from the lack of financing of depreciation could not be eliminated through the more efficient financial management by private operators either. The recovery of investment projects implemented with the involvement of private capital was predicated on revenues from fees payable for higher level and wide-scale healthcare services. During the SAO audit it was concluded that the group and quality of convenience services linked to inpatient care were not defined in detail. The SAO experienced the concentration of hospital operation, but at the same time the frameworks, conditions and possible sizes of hospital networks were not regulated by law.

As far as the employment of physicians is concerned, the number of physicians employed through entrepreneurial contracts increased at the audited hospitals, and the number of hours worked doubled. The outsourcing of background activities (laundry, cleaning, security, energy and catering services) was necessitated by the shortage of funds available for the maintainers and the institutions, the need for more cost-efficient task performance, the need for alleviating the burden on hospital management, and the shortage of human resources. Laundry services, followed by security and cleaning services were outsourced to the greatest extent. Concentration could be observed in relation to the background service providers, too.

The development of **emergency medical care** was included in the long-term programmes of the healthcare sector in several government cycles. Although in July 2005 the Government accepted the summary titled *'On the development of the standard system of emergency medical care'* issued by the Ministry of Health, it

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did not decide on the task plan that formed part of the proposal. *'The development program of emergency medical care in Hungary'* was prepared within the framework of the *'State Reform Programme'* in 2006, but was not announced for implementation.

The professional interpretation and practical organisation of emergency medical care is not unified. In the absence of the financing of emergency medical care wards created from subsidies, the development of the human resources of emergency medical care, the comprehensive quality development programme, performance monitoring, evaluation and programme communication implementation lacked complexity, and it first of all focused on infrastructure and assets development. The central organisational issues related to the provision of continuous care included the elimination of the 'on-call' form of out of hours primary care, the organisation of central emergency care units working in association with the ambulance services, the operation of on-call hospital rotas, and the requirement to create emergency medical care units or wards. The measures taken for the organisation, development and financing of emergency medical care led to the modernisation of out of hours primary care, the creation of central emergency units, and to the rise in the emergency care capacities of the hospitals in the new system. However, the action plan proposed by the Professional College for the modernisation of emergency medical care was not implemented in a complex manner. The geographical distribution and professional composition of the structure of care are heterogeneous.

During the audit of the implementation of **local governmental PPP projects** supported within the Sport XXI Facility Development Programme, and the audit of their impact on the performance of local governmental tasks the SAO concluded that the implementation of the programme in the 2004-2008 period was not effective, only around a quarter of the planned sports facilities were constructed by the end of 2008. In contrast with the 100 gymnasiums, 50 teaching swimming pools, and one sports hall per county 18 gymnasiums, 18 teaching pools and one sports hall were constructed. The PPP scheme proved to be an unsuitable investment method for the construction and operation of gymnasiums and teaching pools. The economy aspects could not be enforced, because on one hand no standard methodology was established for the comparison of this scheme and the traditional state investment projects at the level of public finances. On the other hand, the local governments did not have any other choice, since they received subsidies only for sports facilities implementable in the PPP scheme. Contrary to the expectations of the government agencies, in 93% of the projects no competition developed in the announced public procurement procedures.

The established operating practice, according to which the local governments representing the public sector and their business organisations took over all or part of the operational tasks from the private sector, contradicts the risk division provision specified in the contracts. It is unfavourable that at one third of the local governments the appearance of new operational expenditures increased the existing shortage of resources. The sports facilities realised through gap-filling investment projects exerted a favourable impact on task performance by the local governments. The level of utilisation of the

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gymnasiums is adequate. At half of the teaching pools the level of utilisation is good, where task performance covers the entire micro-region. The level of utilisation of the multifunctional hall is low; its operation is loss-making.

The **maintenance and development of greeneries**, which is a local public service task, is not regulated separately by any legal regulation. There is no standard definition for greenery in the different legal regulations. Due to the deficiencies of the legal regulations, the local governments differently interpreted, regulated and fulfilled their tasks undertaken in connection with the maintenance, renewal and development of greeneries. Only 24% of the local governments considered it as a mandatory task. The greeneries recorded in the real property cadaster do not cover all greeneries.

The objectives of the National Environment Protection Programme for the years 2003-2008 included the increase of the size of public greenery per urban inhabitant from 38.7 m<sup>2</sup> in 1999/2000 to 45 m<sup>2</sup> by 2008. However, the programme did not specify which greeneries of the towns count in this respect. Therefore, the achievement of the set objective could not be measured. On the basis of data contained in the real estate cadaster – for all towns – the per capita greenery covered only 22.25 m<sup>2</sup> in 2008. In the case of the audited town, capital and district local governments, the per capita greenery was significantly below the objective set in the 2<sup>nd</sup> National Environment Protection Programme in 2008, since it covered an area of 28.4 m<sup>2</sup> on average, and the scatter among the towns was large. The maintenance and development of greeneries was limited by the resources of the local governments, and the intensity of the tasks performed also varied.

To cover the expenditures of the **peremptory referendum** held on 9 March 2008 the National Assembly approved HUF 4,470 million in its resolution. According to the task based accounting, HUF 4,236 million was used (95% of the appropriation), and the residue totalled HUF 234 million. The election organisations registered revenues and expenditures incurred in relation to the referendum separately, which ensured the accountability and transparency of the funds used for the referendum. The overwhelming majority of the accounted expenditures related to the referendum, which was supported by the audited records.

### **2.3. Utilisation of EU funds**

**The Summary of Audit Reports on the Financial Management and Control of EU funds in Hungary** (Trend report), which was prepared by the SAO for the fourth time, presented the financial relations of Hungary within the European Union and the experiences of the 2008 audits on subsidies. Furthermore, it analysed Hungary's absorption capacity in an international comparison.

The SAO concluded that in relation to the Structural Funds Hungary committed all of the available funds, and that in terms of disbursement from the Structural Funds it was in the top range among the new member states (occupying the second place), and ranked tenth among the EU25. In relation to the Cohesion Fund, Hungary was in the middle range with a disbursement rate

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of 47.26%, and ranked sixth among the new member states in this respect. Hungary successfully utilised the resources provided from the Pre-Accession Funds and the Schengen Facility, and in case of the SAPARD programme even the financial closure took place in 2008.

The SAO concluded that the control system over the utilisation of EU funds fulfilled its role, however it contains overlaps and occasional redundant control activities. It is necessary to reinforce the financial management control (the so called first-level control functions).

In relation to the implementation of the National Development Plan (NDP) pertaining to the period of 2004-2006 it is favourable that the available funds were committed, and the rate of disbursement is altogether adequate. However, in the case of a few priorities some delay was experienced. This problem was solved when the European Commission (similarly to other member states) approved – upon Hungary’s request – the extension of the eligibility period until 30 June 2009 in relation to four operational programmes and the EQUAL Community Initiative. The precondition for the successful implementation of NDP is the avoidance of the loss of resources, as well as the regular and effective utilisation of funds.

Regarding the Cohesion Fund, the period was characterised by the protraction of project implementation, large-scale overspending, changes in technical content, as well as deficiencies – primarily in the field of public procurement procedures – revealed by the audits.

The SAO pointed out that in relation to the closing of the financial period special attention must be paid to the detection and monitoring of irregularities to the greatest possible extent, to the operation of efficient debt management, as well as to the mandatory operational monitoring of projects implemented from EU funds. The inadequate operation of the above may significantly extend the process of financial settlement and closure with the EU, which may adversely affect the budget of Hungary.

The first two years of the EU budget period of 2007-2013 were characterised by preparatory work and the slow start of the programmes. The institutional system of agricultural and rural development subsidies was accredited. The Operational Programmes of the New Hungary Development Plan (NHDP) were among the first programmes to be approved by the European Commission, and with the exception of the Transport Operational Programme and priority 2 of the the Central Hungary Operational Programme the accreditation procedures were successfully completed in 2008. Calls for proposals were launched for more than 50% of the funds available within the NHDP, and contracts were signed for 19% thereof. The favourable changes in the aggregate figures were largely influenced by the progress of priority projects falling into the exclusive scope of the Government.

The SAO pointed out that in the coming years utmost attention must be paid to the top priority transport and environmental projects of the NHDP to avoid the negative tendencies accompanying the implementation of the projects funded by the Cohesion Fund in these two sectors.



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In 2008 more funds were drawn down from the EU budget than in the previous year (EUR 66.6 million). However, due to the slow start of the programmes and the closure of the compliance procedures, in the case of several operational programmes and funds the applications for interim payment were submitted only in 2009.

As a result of **the audit of the utilisation of subsidies granted from the Cohesion Fund and national sources for solid waste management** the SAO pointed out that the utilisation of the resources was characterised by delays in the implementation of the set strategic objectives, by additional expenditures burdening the budget, as well as by several years' long delays.

The regulations designed to prevent waste generation (the regulations on deposits and on the environmental product tax) were not effective enough. In the evaluation of selective waste collection the deposit system was in general ignored. The original objectives were not achieved in relation to the product tax for commercial packaging, the amount of single-use packaging did not decrease.

Waste recycling was primarily influenced by market demand, but the system supporting utilisation and catalysing the domestic target market and background industry was not developed. As a result, the negative consequences of the drastic drop in demand and prices arising from the current global economic crisis affect the Hungarian market of secondary raw materials unattenuatedly. The marketability problems of selectively collected waste and the resulting loss of revenues jeopardise the sustainability of the selective waste collection systems.

The conditions for the utilisation of waste for energy generation purposes, and the waste pretreatment technologies were not ensured (lack of mechanical and biological pretreatment facilities). The combustion of waste in combustion facilities (without pretreatment) was hindered by capacity restrictions, since the combustion facilities contained in the National Waste Management Plan as a theoretical possibility were not constructed. Furthermore, the capacities and locations of the waste depots and combustion facilities were not coordinated, and there was no standard plan, broken down according to regions, for the cost-efficient and optimal organisation of the complex systems.

**In the course of the audit of the implementation of priority wastewater management projects financed from the Cohesion Fund and national resources** the SAO pointed out that the planning and implementation of the projects was influenced by the fact that they were implemented after and in parallel with intense national development, without the harmonisation and coordination of national and EU resources, and with a relative abundance of resources. Furthermore, implementation implied public procurement irregularities and the development of uncommitted capacity surpluses.

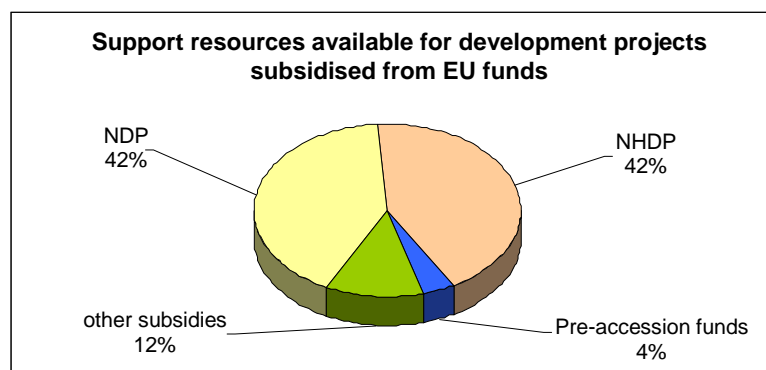
The enforcement of cost-effectiveness faded into the background, since the efficiency of resource utilisation was evaluated neither by the re-granter institutions, nor by the beneficiaries.

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Standard pricing and the preparation of reconstruction plans (and the concomitant depreciation plans) were not regulated nationally, which would have been necessary for the financial sustainability of water public utility facilities. In the absence of these measures the guarantees of financial sustainability were deficient, and there was no official price control.

During its audits carried out at the end of 2007 and at the beginning of 2008 the European Commission raised objections to the public procurement procedure of the Budapest Central Wastewater Treatment Plant in 2005. As a result of the process the Commission withdrew EUR 40.5 million (nearly HUF 10.5 billion) from the originally planned subsidy amount, which the Hungarian party had to raise. At the same time, however, the Commission authorised the utilisation of HUF 40.5 million for new facilities.

Within the audit of the financial management system the SAO examined the **level of preparedness of the local governments for the utilisation of EU funds**. It was concluded that the local governments determined their development objectives for the years 2005-2008. Nearly 80% of these objectives were based on status analyses, as well as the consideration of possible financial resources available for implementation. The proposals of the local governments related to the development objectives formulated in economic programmes, as well as sectoral, professional and regional development concepts. As much as 82% of the local governments did not prepare successfully for the use and utilisation of EU funds in relation to the level of regulation, while 17% did not prepare successfully in terms of organisation. At these local governments the regulations did not contain the information exchange obligations between persons in charge of tender monitoring and those authorised to make decisions or prepare decision-making; the communication rules between the mayor and those in charge of the implementation of the development task; and did not specify the ex-ante and post-FMC tasks. Furthermore, the risk analyses substantiating the internal audit tasks did not extend to development tasks subsidised from EU funds. The audited local governments ensured the personal conditions for tender monitoring and tender preparation within the organisation of the offices of the local governments, or with the involvement of external organisations. However, in case of nearly half of the contracts signed with external organisations the communication rules and the distribution of responsibilities between the proposal writers and the persons responsible for the submission of the proposals were not specified. As many as 98% of the local governments decided to use EU funds for the implementation of their development objectives. On the basis of that around half of the proposals submitted were awarded subsidies.



The causes of the rejection of applications included the lack of resources, the inadequate professional elaboration of the applications, content and formal deficiencies, as well as inadequate compliance or complete non-compliance with the tendering requirements. In their respective annual budget decrees for the years 2005-2008 the audited local governments ensured the availability of own resources required for the tender procedures. Nearly one tenth of these local governments planned to raise funds for own resources from bank loans or from revenues yielded from bond issuance. The share of own resources actually spent on objectives realised with subsidies was higher than originally planned due to the extra and additional works that emerged during implementation, and because of the expenditures of non-subsidised tasks. Deficient preparedness also contributed to the fact that in the case of the audited development tasks supported from EU funds during task performance more than two thirds of the subsidy contracts were amended due to delays in the deadlines, requests for advance payments, the reallocation of subsidies and expenditures between the years, as well as due to changes in the technical specification. On average there was a time span of half a month to one year between the submission of the request for payment and the actual payments, primarily due to the absence of supporting documents, as well as formal and content deficiencies in the invoices. In case of cca. three quarters of the audited projects the Intermediate Bodies effected payment upon the submission of complete requests for payment beyond a period of 60 days.

Nearly two thirds of the offices of the local governments performed the ex-ante and ex-post FMC tasks during the realisation of revenues and expenditures associated with tasks implemented from EU funds. However, at the overwhelming majority (98%) of local governments receiving subsidies the utilisation of the EU funds in the years 2005-2008 was not reviewed by the internal audit function. The implementation of development tasks supported from EU funds was audited by the Intermediate Bodies, the SAO, the Government Audit Office and the European Commission in case of cca. 80% of the audited local governments. The mayors took measures in response to the findings.

#### **2.4. Subsidies to organisations outside public finances**

The SAO audited the legality and regularity of financial management **at three public foundations established by the government**. In the case of two public foundations it was typical that they could not attract resources from

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outside the system of public finances for public task performance, wherefore their operation was almost entirely (beyond a proportion of 90%) funded from the central budget. Most of their own revenues came from the interests on temporarily unused fixed deposit of state funds at financial institutions. One public foundation used external resources (from international organisations) amounting to half of its revenues to fulfil its public tasks. The boards of trustees of the public foundations used the awarded subsidies for the implementation of objectives stipulated in their respective deeds of foundation. In relation to the regularity of the decision-making process of the boards of trustees the SAO criticised the practice of voting in writing, which contradicts the deed of foundation. In the case of one public foundation the SAO criticised the fact that contrary to the deed of foundation and the relevant legal regulation part of the subsidies were awarded without tender procedures.

The SAO audited the legality of **financial management of political parties** covering 5 audit topics, altogether in case of 39 parties. In the SAO reports that were made public the SAO established personal responsibility related to the representation rights of the presidents of ten non-parliamentary parties in connection with the multiple infringements of the provisions of the Act on accounting. Based on the SAO reports – upon the initiative of the public prosecutor – several criminal proceedings were launched. Apart from omissions in violation of the law the audits revealed illegal party revenues of around HUF 25 million, and a similar amount of unpaid taxes and contributions. Two thirds of the audited parties failed to publish the reports specified by the party act in each audited year. It is a serious problem that for the lack of sanctions the parties may go unpunished with non-compliance with their annual financial reporting obligation. The picture drawn of the annual financial management was distorted by the fact that 80% of the officially published reports were not deemed reliable and fair. Material errors occurred in part due to the fact that the reporting rules stipulated by the party act are not in harmony with the provisions of the accounting act currently in force.

The SAO ex officio audited the accounting of the funds used for the **parliamentary election campaign** at nominating organisations that obtained representation at the interim elections held in January 2009. The SAO drew attention to the fact that the Act on election procedures does not contain guarantee rules on the full closeness and identifiability of financing. Due to the limited scope of the SAO audits the SAO cannot entirely fulfil the role that the enforcement of the constitutional regulation and of the principles of the election procedure would require in relation to the transparency of the election campaign.

The SAO performed the biennial audits – required by law – of the legality of the financial management of **foundations** that were **founded by parliamentary parties** and are eligible for budgetary subsidies in harmony with the audits of the financial management of the parties. It was characteristic of the financial management of the audited three **party affiliated foundations** that the subsidies provided by the boards of trustees, as well as the programmes implemented within their own organisational frameworks were in line with the objectives stipulated in the deeds of foundation. However, the SAO found shortcomings in the regular accounting of

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the beneficiaries of the subsidies, primarily in relation to the compliance with the deadlines specified in the contracts, and the review of the utilisation of subsidies verified with background documentation.

Utilising the SAO recommendations, around six tenths of the audited local governments introduced accountability requirements regarding the proper utilisation of **subsidies granted** to organisations or private individuals **for specific purposes**. These local governments operated the audit system of accounting and utilisation, ordered the repayment of the subsidies used for purposes other than those specified in advance, or suspended the payment of further subsidies in case accountability was violated. At around 5% of the local governments the payment of subsidies by foundations was effected in the absence of a decision passed by the assembly, contrary to the Act on Local Governments.

## 2.5. State property management

A recurrent element of the audit of state property management is the audit of the operation of the Hungarian State Holding Company (MNV Zrt.), and of the financial management of the Hungarian News Agency Corporation (MTI Zrt.). At MNV Zrt. the shareholders' rights are exercised by the Minister of Finance, while at MTI Zrt. the rights of the founders, shareholders and general assembly are exercised by the National Assembly. The annual audit of these two organisations by the SAO is a mandatory task by law.

Based on the decision made by the President of the SAO, the SAO performed further audits in relation to state property management. The development of the transport infrastructure was audited annually, by means of audits on the motorway construction projects completed in the given year. This makes it possible to evaluate the expected changes – transparency and expediency – of the process. Last year the SAO audited the use of funds for the operation of the national audiovisual assets partaking of the national property, and the efficiency of the utilisation of public funds.

In the course of the **audits of the annual financial management of the Hungarian State Holding Company** the SAO called for the elaboration of a property act to increase the transparency of state property and systematise the formally fragmented property management. The adoption of the new property act can be regarded as a positive step, since pursuant to the act revenues and expenditures related to property management are concentrated in a single budgetary chapter, which creates the possibility of transparency.

In the case of state property the corporate form was also meant to serve the objective of implementing the entrepreneurial approach, although this could only partially be detected in the operation of the holding company. In the absence of an approved conceptional proposal, the property act was created within the framework of a forced pace legislative process, which led to several problems. The legal regulation of the property management system established by the act is ambiguous at several points, and its provisions are incomplete. This caused several problems in management and resolution making in 2008, i.e. in

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the starting year, and created the possibility to devise solutions that were rightfully objected to by the public prosecution bodies and the SAO.

The shortcomings of the act include, for example, that its scope does not extend to companies or the subsidiaries of companies indirectly owned by the state, wherefore at such companies state ownership exists only in the economic sense of the word, and the objectives specified in the property act – preservation and augmentation of state property – cannot be properly enforced.

The SAO concluded that in 2008 the activity of the Hungarian State Holding Company did not – in general – comply with the general objectives stipulated in the property act, and with the regulations pertaining to the assets assigned to it. The operation of the Company was not transparent. Taken as a whole, the interventions made by the institutional decision-makers (Government, those exercising the shareholders' rights, Minister of Finance, National Property Management Council, general director) were not adequately effective, and at times did not serve the objectives stipulated in the property act. Decision-making was not completely prepared, wherefore decision-making became a mere formality in many cases.

The accounting, financial and property registration of the Hungarian State Holding Company did not become unified, comprehensive and reliable. The rules of a transparent tendering system were not enforced during the sale of the property of the Hungarian Commercial Office in Moscow. The legal regulations pertaining to the National Land Fund were not unanimous, and consequently, the internal regulation could not be entirely clear either. The sale and lease processes were not fully transparent either. Exchanging the land plot in Sukoró (which belongs to the Land Fund) for the properties in Pilis/Albertirsa was neither regular, nor expedient.

**During the audit of motorway investment projects completed in 2008** the SAO determined that no legal regulations specify cost-efficiency expectations regarding state investment projects or requirements pertaining to state investors, and such expectations/requirements were not defined by the ministry holding the ownership rights either. Similarly to the motorway investment projects completed in former years, in case of the audited motorway projects the handover/takeover deadline was given priority over economy aspects. The legally set deadlines were in general unfeasible, and were substantiated neither by the actual state of preparedness, nor by the technically justified timeframe required for implementation. Year after year, the SAO reiterates in its audits that before the start of motorway construction projects no preliminary cost assessments or price calculations are performed on the basis of a detailed unit price analysis. The 'lowest price in general' stipulated in the public procurement act does not in itself mean the best offer for the national economy.

The legal regulations pertaining to the development of expressways do not require the preparation of a transport development concept in cooperation with the local governments and voluntary organisations for the given region, in the preparatory stage of the project; specifying the obligations of the concerned parties and, in the public interest, prohibiting any modification. In the absence of such a concept it could be witnessed at two motorway sections that the

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concerned parties were forced to continuously negotiate, local governments and voluntary organisations initiated legal actions, and that the parties kept appealing the issued permits and judgements, which hampered construction works and significantly delayed the projects.

During the **audit of the financial management of the Hungarian News Agency Corporation in 2008** the SAO determined that the risks implied in the shortcomings of regulation remained in 2008, too, as a result of the specific legal environment of the Corporation. The Corporation deficiently regulates the scopes and powers, the structure of responsibilities, and does not comprehensively define public service tasks. It fails to regulate the calculation of state subsidies required for task performance, and it does not ensure the transparency of the utilisation of public funds either.

The greatest risk is implied in the current method of state financing of public tasks, because it is not in harmony with the EU regulations. Another risk is implied in the fact that since the owners did not formulate their expectations regarding financial management, the strategy of the Corporation for the years 2008-2012 was planned without the National Assembly's approval.

Despite the organisational restructuring carried out in 2008, the size of the organisation was not adjusted to the public tasks to be completed. The SAO determined that managerial audit (controlling) did not provide adequate guarantee for the implementation of the set objectives, and for the regular performance of the financial management activity of the Corporation. Economy issues were not observed.

The **preservation and collection of the audiovisual assets belonging to the national cultural heritage** is an extremely important interest of the society, yet the current legal regulations do not provide standard rules on the preservation and registration of audiovisual values that form part of the national cultural heritage. The provisions of the Act on the National Audiovisual Archives are not consistent or unanimous either.

In the absence of the legal background and sufficient resources the National Audiovisual Archives could not acquire, systematise and store materials formerly collected and stored by other archives. The fact that pieces of audiovisual art purchased with budgetary support from companies owned by the state were not registered, or were registered with significant delays in the state registration system, can also be attributed to this shortcoming. The professional and supervisory management changed several times, and the system of interventions by the decision-makers was not unified either. The transparent and effective utilisation of public funds, the protection of property, as well as the monitoring of changes in the stock were not ensured.

Organisations possessing public audiovisual collections considered as national property functioned without standard professional concepts, without strategies based on management, regulatory and financing principles, as well as without annual task plans. The parallelisms that emerged during the management of the national audiovisual property, as well as the scatteredness of the storage

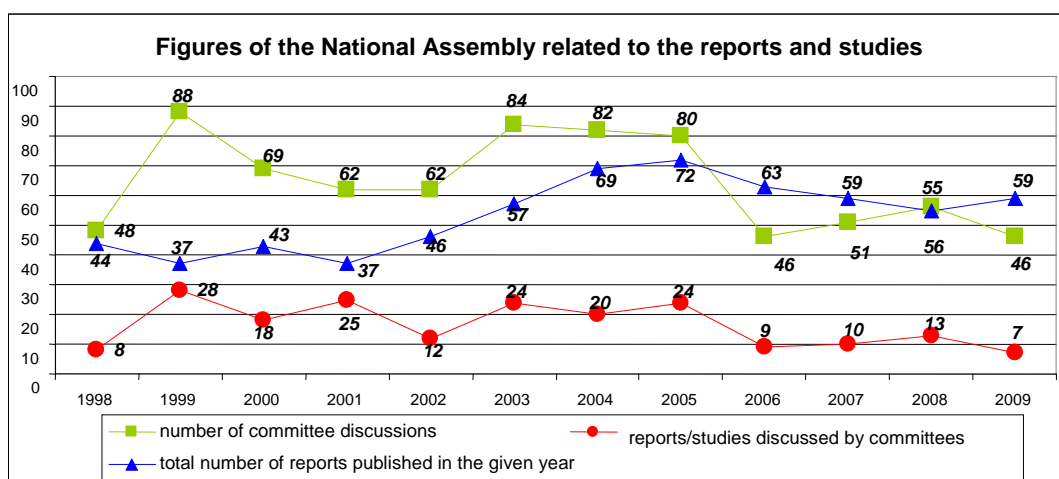
locations also hampered the concentrated and effective utilisation of the available funds.

Film industry companies owned by Hungarian State Holding Company do not belong to assets that are in permanent state ownership. The SAO determined that in the absence of a standard industry strategy and management, and due to the continuously changing owners' decisions the utilisation of state funds available for the film portfolio is inexpedient and ill-considered.

### 3. UTILISATION OF THE AUDITS

The primary users of the SAO reports are the National Assembly, the MPs, the governmental sector, the local governmental bodies and the heads of the audited organisations.

The government tasks related to the global economic crisis that emerged in 2009, as well as the proximity of the 2010 general elections may have also contributed to the fact that - compared to the former years - the number of SAO reports discussed by the committees decreased.



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

The SAO met its reporting obligations required by legal regulations by the deadlines in 2009, too (submission of its opinion on the budget bill, its report on the final accounts, as well as the annual reports on the financial management and activities of the Hungarian State Holding Company and the Hungarian News Agency Corporation to the National Assembly).

In 2009 the SAO published **57 reports**. The committees of the National Assembly **put 6 reports and 1 study on their agenda**. The number of committee events related to the SAO reports decreased in 2009; SAO reports or studies were included in the agenda of 46 committee meetings.



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The plenary sessions of the National Assembly put four SAO reports on their agenda (opinion on the budget bill, report on the final accounts, audit of the Hungarian News Agency Corporation, SAO Activity Report.).

In 2009, the committees did not discuss the suitability of the report on the audit of the 2008 activities of the Hungarian State Holding Company for discussion in a plenary session.

In 2009, six committees were selected to discuss the SAO Annual Activity Report (apart from the Budget Committee, the Economic Committee, the Committee on Local Governments, the Committee on Human Rights and the Committee on Environmental Protection the Committee on Employment also discussed the report). The National Assembly approved the SAO Annual Activity Report unanimously, with 343 affirmative votes.

The SAO report on the 2008 final accounts was discussed by all committees but the Committee on Immunity.

The SAO opinion on the budget bill was discussed by 17 committees. At the meeting of the Committee on Budget, Finance and Audit Office the deputies also received, for information, the RI study titled 'The expedient economic role of the state in the global economy of the early 21st century'.

Similarly to the former years, the SAO report on the financial management of the Hungarian News Agency Corporation in 2008 was discussed by the Committee on Budget, Finance and Audit Office, as well as the Committee on Culture and the Media together with the annual report of the Hungarian News Agency Corporation.

In 2009, the temporary committee monitoring the implementation of the New Hungary Development Plan discussed the report on the audit of the utilisation of EU funds within the framework of a separate agenda item, just like in 2008. The SAO report on the audit of the operation of the system of public health services was discussed by the Committee on Health, and the Committee on Youth, Social and Family Affairs. The RI study titled 'Financial risks within the system of local governments' was discussed by the MPs at the meeting of the Committee on Local Governments.

The **President of the SAO** represented its institution in person several times at the plenary sessions of the National Assembly, and at the parliamentary committee meetings. He held **four exposés** and attended **14 committee meetings**.

**In 2009 two questions were submitted in writing to the President of the SAO by MPs.** The SAO prepared and forwarded its responses by the legally set deadline in both cases.

### **3.2. Enforcement of SAO recommendations**

During its audits performed in 2009 the SAO made continuous efforts to facilitate the detection and elimination of risks implied in the audited organisations, systems and processes continued, the enforcement of regularity and the improvement of efficiency. The SAO made suggestions regarding the

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amendment, coordination and observation of legal regulations, too. It paid attention to the utilisation of its former findings and recommendations, i.e. it monitored whether the necessary measures were taken and implemented. It can be stated on the basis of the action plans of the affected chapters, as well as on the basis of the information summaries requested to be submitted to the annual activity report of the SAO that the SAO's recommendations were usually received positively.

It can be stated in connection with the last year, too that the SAO recommendations pertaining to correctional modifications as a direct impact of the financial audit, or those pertaining to certain regulatory issues that can be realised independently, as well as the recommendations aiming at the introduction of measures for the improvement of expediency and efficiency in the internal regulation, registration and accounting systems were received favourably. However, the SAO recommendations requiring systemic modifications or changes in attitude with a view to increase financial security were received less favourably.

**The common feature of unrealised recommendations is that while their expediency and justification were not questioned by those affected, they were typically not realised. These shortcomings include:** the lack of harmony between the tasks of the local governments and the resources, the failure to perform the comprehensive review of the scopes and powers, as well as the financing system, the failure to introduce the much needed new regulations pertaining to the limitation of loan terms, the lack of substantial measures upon the recommendations aiming to lay the strategic foundations for the modernisation of the public administration system, to improve governing skills, to create a more efficient state; the failure to evaluate the implementation of the objectives of the separated state funds, and the impact of fund-like operation on task performance; as well as the failure to regulate – in accordance with the EU rules – the disbursement of state subsidies to the National News Agency Corporation, and the audit of the utilisation thereof, in a manner that provides equal competition and transparency.

The political consensus required for the two-third approval of an independent proposal on the enhancement of the transparency of party financing could not be achieved at the end of 2009 either. For similar reasons, on 22 February 2010 the National Assembly did not accept bill No. T/11446 on making campaign financing transparent.

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

In its report **on the audit of the operation of the Customs and Finance Guard** the SAO recommended the Government to revise the retirement related provisions of Act XLIII of 1996 on the service relations of the career members of the armed forces to ensure that the retirement conditions of the career members would get closer to the general retirement conditions. The SAO called the Government to prepare calculations and analyses to determine the budgetary impacts of the different rates of discounts – with consideration to the aspects of human resource management – and initiate the amendment of the act on this

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basis. Act CXLI of 2009 on the amendment of the above act, which came into force on 1 January 2010, brought about changes in relation to the upper age limit of service pension, the rate of pension in case of dismissal due to medical unfitness, as well as in relation to the suspension of the service pension in the case of re-hiring.

The changes fundamentally mean gradual convergence with the rules applicable for civilians. They were determined not on the basis of concrete budgetary impacts, but on the basis of content, with consideration to the fact that the society formulates specific extra demands and restrictions for citizens subject to Act XLIII of 1996 on the service relations of the career members of the armed forces.

**In connection with the audit of the outsourcing of certain hospital tasks** the SAO recommended the Government to elaborate and prepare the regulation of inpatient care in the form of an act which must clearly determine the role of the private sector, with regard to sector neutrality. Act CLIV of 2009 amended Act CXXXII of 2006 on the development of the healthcare supply system as of 1 January 2010. The amendment contains detailed rules pertaining to contracts concluded by organisations responsible for public healthcare services for the provision of specialised care (i.e. on the so called 'outsourcing').

Pursuant to the SAO recommendations made on the audit of the review of the utilisation and accounting of funds received by the **local governments** and the local minority governments **from central budgetary relations**, Article 64/D of the Act on Public Finances was supplemented with the requirement of ex-post on-site audits of the accounting of budgetary subsidies granted to the local governments. The personal conditions for such audits have been made available gradually, since 2008. The reliability of the accounting of normative contributions improved due to the extension of the audit activity of the Treasury.

Based on the recommendations made pursuant to the **audit of the execution of the 2008 budget of the Republic of Hungary**, para (2) of Article 117 of the Act on Public Education was amended to create harmony with the budget act in relation to the calculation of the fees payable in the primary arts education institutions.

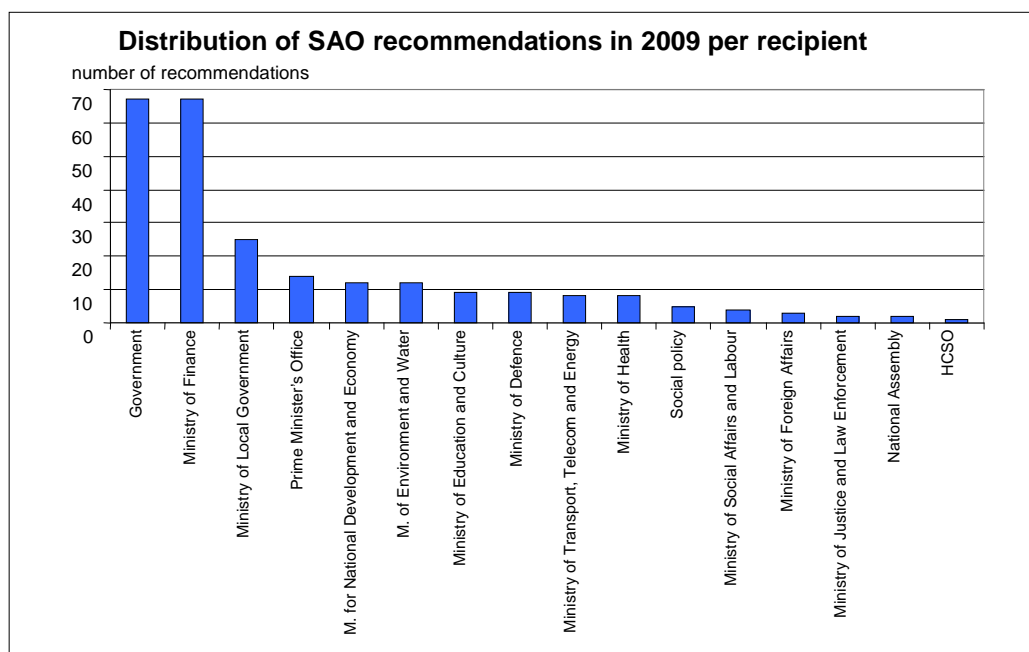
**In relation to the audit of the system of housing subsidies** the SAO suggested that the Government should initiate tighter state control over the lending activities of the banks, and should ensure that the risks implied in borrowing be more efficiently communicated to the public. On 14 December 2009 the National Assembly adopted Act CLXII of 2009 on consumer loans, as well as Act CXLVIII of 2009 on the amendment of certain legal regulations required for the improvement of the efficiency of the supervision of the financial mediation system. Act CLXII of 2009 regulates the entire process of lending. It contains requirements related to commercial communication, information supply before contract signing, the content of the contracts, the supply right and early debt repayment.

In part with consideration to the SAO recommendations formulated in the reports on the audit of **public foundations**, the National Assembly annulled Article 74/G of the Civil Code on public foundations, and thus prohibited the establishment of new public foundations. Unless stipulated otherwise by any act or a local governmental decree, since 1 January 2009 any public foundation whose revenues from sources outside the system of public finances have been lower than 80% for two consecutive years must initiate its own dissolution.

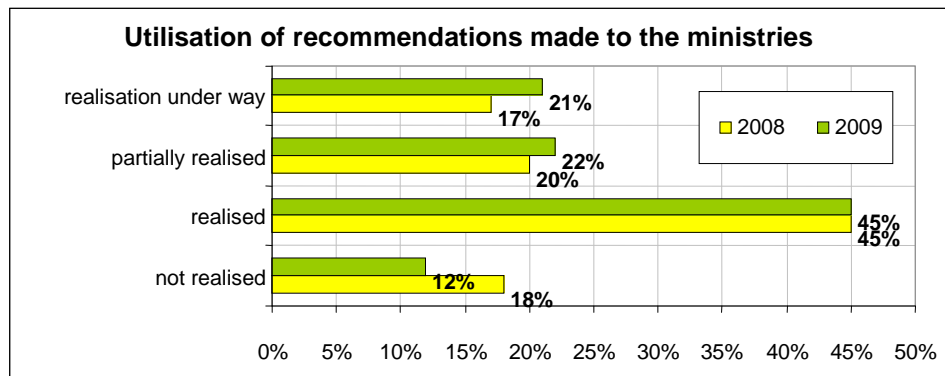
### 3.2.2. Utilisation of the recommendations at governmental level

In order to be able to follow the after-life of proposals and recommendations made during the SAO audits, the **SAO requested information from the Government and the Heads of Ministries on the utilisation of the recommendations in 2008, too, in line with the practice of previous years.** All parties contacted responded to the request. In their replies, several ministries indicated that the SAO had largely contributed to their professional task performance and financial management with recommendations made during the audits, and on the basis of the SAO's work they achieved progress in several areas in terms of regularity, level of regulation and efficiency.

The received information is important for the SAO, since apart from the initiation of the restoration of lawfulness there is no general legal requirement for the realisation of SAO recommendations.



The SAO recommendations were received more favourably in 2009 than a year before. The ratio of realised recommendations was the same as in 2008, but the ratio of unrealised recommendations decreased by 6%. Altogether 88% of the SAO recommendations reached different levels of implementation.



The share of **SAO initiatives for the amendment of legal regulations** was similar as one year earlier. As many as 38% of the initiatives were received positively, and the ratio of apparent rejections was 14%. These latter recommendations typically pertained to the elaboration of new acts, or the amendment of existing acts and other legal regulations. In a few cases the ministries considered the existing regulations adequate, while in others they did not consider themselves competent in making changes. The SAO recommendations for the harmonisation of legal regulations were received more positively than one year earlier.

The share of SAO recommendations aiming to improve **expediency, efficiency and effectiveness**, as well as to eliminate the revealed shortcomings and deficiencies was similar as one year earlier. As many as 87% of such recommendations were received positively, and half of them have already been realised.

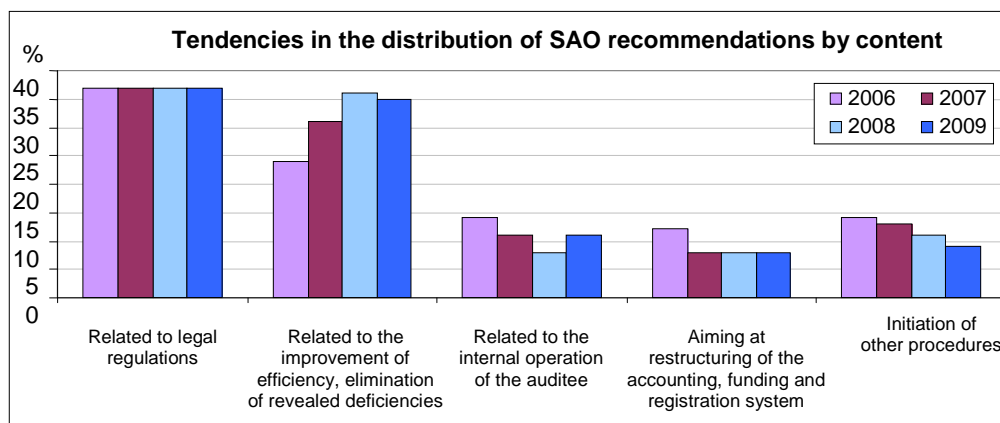
Concrete measures were taken in connection with 96% of the recommendations aiming at the review and further development of the **internal control system**, or the entities concerned have started to prepare the utilisation of the recommendations.

The share of recommendations aiming at the restructuring of the **accounting, financing and registration systems** compared to all recommendations remained the same as last year. The rate of positive measures taken in response to such recommendations was 79%. In the case of 21% of the SAO recommendations the chapters considered their existing practices appropriate.

**Other recommendations** that can neither be classified, nor included in the former categories due to their uniqueness accounted for 9% of all recommendations. Nearly 96% of such recommendations were accepted, and 39% had been implemented by the time the present report was compiled.

**Based on the review of the 2006-2009 period, it can be stated that** most of the SAO recommendations – 37% each year – pertained to legal regulations. The ratio of recommendations aiming to improve expediency, efficiency and effectiveness, as well as to eliminate the revealed shortcomings and deficiencies was similarly high – 31%, but growing in tendency. SAO recommendations aiming at the improvement of the internal control system made up 11% of all recommendations on average. The share of

recommendations aiming at the restructuring of the accounting, financing and registration systems was 9% on average. The ratio of other recommendations that can neither be classified, nor included in the former categories gradually decreased from 14% to 9%.



Based on the evaluation of the measures taken in response to the recommendations it can be stated that the SAO recommendations were received favourably in each of the past four years. On an annual average, as many as 87% of the recommendations reached various stages of implementation, and on average 49% of the recommendations were realised already in the first year. Apparent rejections totalled 12%. Since the responses given by the ministries became more and more comprehensive every year, the SAO received a feedback on almost all of its recommendations in the past two years.

In general it can be stated that in the past four years the recommendations aiming to improve expediency, efficiency and effectiveness, as well as to eliminate the revealed shortcomings and deficiencies were received the most favourably. More than 50% of such recommendations were realised already within one year. The reception of recommendations related to the internal operation of the audited organisations was similarly favourable and improving year after year. In the different years the reception of SAO recommendations related to legal regulations was relatively the worst: on average 16% of such initiatives were rejected. These recommendations typically pertained to the amendment of existing acts and other legal regulations. Realisation was much more favourable in the case of recommendations made for the observation and harmonisation of legal regulations.

**The utilisation of SAO recommendations is indicated by – among other things – the implementation of the following concrete measures taken in the previous year:**

**Based on the audit of the public health benefit system** the SAO recommended the Government to review how the size of benefits can be adjusted to the actual needs, and how the eligibility criteria can be standardised to a greater extent. Furthermore, the SAO recommended the Government to initiate the review of the data protection and social act in order to simplify the procedure and reduce the operational costs. In addition, it

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recommended the Government to review and modify the procedural rules to ensure that the eligibility criteria for the public health benefit be specified on the basis of the joint consideration of factual data known to the health insurance fund and the principle underlying pharmaceutical subsidisation.

Furthermore, the SAO recommended the Minister of Health to investigate whether it is possible to stop the prescription of pharmaceuticals that are not subsidised by the Health Insurance Fund at all within the framework of the public health benefit system, and to enhance the efficiency of professional control over the prescription of pharmaceuticals and therapeutical devices to the beneficiaries of public health benefit by the Health Insurance Fund. In his response given in February 2009 the Minister of Health stated that the impact assessment studies required for the modifications had been commenced and that certain legal regulations had been amended during the year. However, these measures did not cause any changes in relation to the SAO findings and in the system of public health benefit.

The adoption of Act CV of 2008 on the legal status and financial management of budgetary organisations, as well as the approval and entry into force (20 December 2009) of the new Government Decree 292/2009 (XII. 19.) on the operational rules of public finances, drafted on the basis of said act, meant the realisation of the **SAO recommendations made on the basis of the audit of the modernisation of the Hungarian central public administration system**. These recommendations called the Government to determine the mandatory elements of the operational and organisational rules of the ministries by the review and standardisation of the existing regulations, and to establish the standard procedural rules (deadlines, responsibilities, etc.) pertaining to the major organisational changes of the budgetary organisations (establishment, merger, demerger, etc.) in order to increase the efficiency of the state.

As a result of **the audit of the system of housing subsidies** the SAO recommended the Government to quantify the objectives of housing subsidisation, and take measures for the achievement thereof. Due to the effects of the global economic and financial crisis, as the first step of the measure – pursuant to Government Decree 12/2001. (I. 31.) on state subsidies for housing purposes – the major non-repayable and repayable subsidies supporting the purchase, construction and extension of new and used flats were suspended as of 1 July 2009.

Pursuant to the SAO recommendation to investigate the justification for state surety linked to foreign currency denominated loans, the decree cited above, as well as Government Decree 4/2005. (I. 12.) on the detailed rules of the assumption and enforcement of state surety linked to housing loans disbursed to young people modified the conditions of the so called Nest building loan programme. Since 1 July 2009 state surety can be used especially with loans denominated in Hungarian Forint.

In connection with the Nest building programme the SAO recommended that the legal regulation should state that the precondition for lending is that clients must be able to show existing savings within the own resources. Government

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Decree 125/2009. (VI. 15.), which modified the terms and conditions of the nest building loans, raised the rate of own resources required for borrowing from 10% to 30%. Furthermore, pursuant to Government Decree 4/2005. (I. 12.), the total amount of the loan cannot exceed 70% of the target property.

**On the basis of the systems audit of the execution of the higher education act** the SAO recommended the Government to develop a well-founded higher education strategy adjusted to the social and market conditions. Furthermore, the SAO recommended the Minister of Education and Culture to prepare the development plans of the higher education system, to review the training system with regard to the labour market forecasts, as well as to initiate the transformation of the financing system on the basis of quality performance requirements, and the development and operation of the higher education information system and the degree-based career monitoring system in accordance with the legal regulations.

The higher education training system was reviewed with the involvement of the competent professional bodies. The results of the study are summarised in the publication titled 'The first experiences of multi-cycle training in higher education'. The discussion of the SAO report was put on the agenda of the Rectors' Council, too. Based on the review it can be stated that the preparation of the amendment of the legal regulations is under way. Analyses aiming at the creation of the conditions for the better adjustment of higher education to the labour market both nationally and internationally are about the start.

According to the information provided by the Ministry of Education and Culture, proposals for the restructuring of the financing system of higher education will be elaborated after the approval of the document pertaining to the performance requirements. The performance requirements are planned to be elaborated on the basis of data requested on the completion of commitments undertaken for 2009, the international experiences, as well as the study of the Higher Education Scientific Council.

Based on the experiences of the operation of the higher education information system (FIR), and with regard to the opinion of existing and future users, the Educational Authority elaborated the directions of the further development of FIR, and the organisational objectives to be implemented with the help of this system. These will serve as a basis for the identification of differences between the current and expected functions, as well as for the preparation of the detailed specification.

The proposal on the pattern and standard application of institutional career monitoring, and on the operation of central data integration was not prepared by the deadline (31 January 2010) specified in the action plan. The head of the Ministry informed the SAO that the preparation of the proposal had been started. According to the standpoint of the Ministry, Act CI of 2007 makes it possible to generate the information required for decision-making in the sector, however this requires a functioning career monitoring system and standard data content.



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**In its report on the audit of the utilisation of subsidies provided from the Cohesion Fund and national sources for solid waste management** the SAO recommended the Minister of Environment and Water to develop more efficient and wide-scale programmes and regulatory system for the prevention of waste generation with consideration to the best international practice, too.

Pursuant to the new EU Directive 2008/98/EC proclaimed at the end of 2008 the national Prevention Programme will be elaborated by 2013. Irrespective of this, the National Waste Management Plan II in force until 2014 will also contain a comprehensive prevention programme, the implementation of which is linked to sectoral preventive measures. In addition, Act XLIII of 2000, to be amended by 12 December 2010, will contain preventive measures enforceable by law on waste management. As a component of the 2.1.4. environment centred technology development support priority of the Economic Development Operational Programme the call for proposals, which especially pertains to preventive development projects, was advertised again.

The effectiveness of the SAO recommendations, according to which the Ministry should elaborate a strategy for the utilisation of secondary raw materials generated as a result of selective waste collection, and should develop – in collaboration with the Ministry of National Development and Economy and the Ministry of Finance – a system of interest for the implementation of the strategy, can be evaluated at a later stage.

On the basis of the SAO recommendation made pursuant to the same audit, the Minister of National Development and Economy took measures to ensure that during the implementation of the operational programmes of the New Hungary Development Plan (especially the Environment and Energy Operational Programme, and the Economic Development Operational Programme) the objectives specified in the calls for proposals should support the completion of EU commitments.

Within the framework of the audit the SAO recommended the Government to examine, apart from the current provisions of the act on waste management, the enforceability of the increasing EU commitments, with regard to the fact that for the time being selective waste collection is only a possibility but not a requirement for the local governments and the population of the settlements. The Ministry of Environment and Water, which responded to the issue on behalf of the Government, indicated that the act on waste management would be amended and renewed by 12 December 2010 at the latest, and the EU commitments and the regulations serving the implementability thereof will be integrated into the national legislation.

In its report on the audit of **the realization of priority wastewater management projects financed by the Cohesion Fund and national resources** the SAO recommended the Minister of Environment and Water to review the state subsidy system of water and wastewater fees, since in the absence of standard price setting requirements and price controls the justification of the claims and the destituteness of the individual local governments of the settlements cannot be determined. According to the

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information provided by the Ministry of Environment and Water, the recommendation can be realised after the establishment of clear requirements for price setting, which requires further discussions.

The realisation of the SAO recommendation, according to which the Minister should take measures to assess that calculating with a ratio of 100% of those being connected to the wastewater system, which treatment plants have free capacities, is still under way. The Minister should provide professional guidance to the preparation and evaluation of wastewater treatment tenders to ensure that in the case professional and cost-efficiency conditions are met, in the first place the applicants use existing free capacities in a controllable way. The realisation of the recommendation has started under the supervision of the special state secretary of the Ministry of Water. The completion deadline is 30 June 2010.

On the basis of the SAO recommendations made to the Minister of National Development and Economy pursuant to the same audit several measures were taken. According to the information provided by the Ministry of National Development and Economy, during the evaluation of proposals submitted under the current Environment and Energy Operational Programme, and during the audits, the Development Directorate of the Ministry of Environment and Water examines the necessity of development, as well as the professional and cost-efficiency requirement as the most important elements of the detailed feasibility study.

**Based on the audit of the utilisation of funds spent on the operation of the national audiovisual property** the SAO recommended the Minister of Finance to arrange the transfer of the national film assets trusted to the Hungarian State Holding Company to the Hungarian National Film Foundation (MNFA), and to ensure the utilisation thereof. According to the report, the transfer took place in November 2009.

In line with the SAO recommendation made in relation to the **audit of the financial management of the Chapter 'Ministry of Defence'** the Government specified the operational rules of defence organisations different from the operational rules of public finances in the form of a decree, pursuant to the authorisation granted by the 2007 act on the national property among other authorisations.

In line with the SAO recommendation formulated in relation to the **audit of the operation of the Chapter 'National Assembly'**, within his supervisory competence, the economic director of the National Assembly ensures that during the parliamentary preparation of the necessary amendment of the act on the exploration of the secret service activities of the former political system the Historical Archives of the State Security Services should support the work of legislators and decision-makers by presenting the development needs and the budgetary impacts of operation.

**During the audit of the operation of the Treasury System** the SAO recommended the Government to examine, on the basis of the new legal regulatory environment and the new IT solutions available in the Budget

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Management System pursuant to the new regulations, the justification for the creation of a centralised (more centralised) budgetary management model based on a new approach, the conditions of implementation of such a model, as well as the possible amendment of tax and other acts ensuring public finance revenues, and on the expenditure side, the possible amendment of the acts that regulate the various social and social security benefits, in order to ensure harmony between the specified payment and disbursement dates.

According to the information received from the Prime Minister's Office, certain measures have been taken in some subfields pursuant to the SAO recommendations made to the Government (due to the modification of the payment of pensions, fluctuations on the Single Treasury Account were mitigated). In connection with the systems errors, corrections are expected pursuant to the execution of Act CV of 2008 on the legal status and financial management of the budgetary organisations, e.g. the enforcement of the consequences of the act in the sector specific legal regulations.

**Pursuant to the audit of the financial management of Hungarian State Holding Company in 2008** audits ordered for the investigation of the conditions of the sale of the property of the Hungarian Commercial Office in Moscow, as well as the investigation of decisions related to the headquarters of MÁV Hungarian State Railways Private Company by Shares (MÁV Zrt.) and the Hungarian Postal Services (Magyar Posta) have started with the involvement of the National Asset Management Council, the Hungarian State Holding Company and the Ministry of Transport, Communications and Energy, but have not been completed yet.

The SAO recommendation on the development of a medium-term strategy and the approval thereof by the Government was realised, since in December 2009 the Government approved the medium-term strategy on the development, utilisation and alienation of state property.

Based on the experiences of **the audit of the financial management systems of the local governments** the SAO made 11 recommendations to the ministers in 2009. Based on the SAO recommendations formulated during the audit of the financial management systems of the local governments the Government stipulated that during the preparation of the strategic internal audit plans and annual audit plans of associated local governments the written opinions of the town clerks of the affected local governments must be taken into account. Furthermore, the Government stipulated that associations performing internal audit tasks must prepare annual internal audit reports for each local government, and must submit such reports to the local governments before the deadline specified for the final accounts. The new Government Decree on the operational rules of public finances specified the persons authorised to assume liabilities against the budgetary appropriations of the office of the local government, but did not exclude the possibility that in addition to the possibility provided by the act, and without authorisation by the mayor, the clerks may assume liabilities in the case of expenditures incurred in connection with the elections.

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In accordance with the SAO recommendation made to the Government **during the audit of the utilisation of funds spent on the establishment and development of the system emergency medical care** an indicator system was introduced, for the time being as a pilot project. The representative of the Government indicated that in hospital-based emergency medical care financing that reflects the costs of availability and of the performed interventions, will be determined more precisely after the completion of the ongoing code maintenance. The patient bed occupancy registration system developed by the National Health Insurance Fund is designed to facilitate the organisation of more efficient patient paths. On 23 September 2009, in the Action Plan of the Social Infrastructure Operational Programme the Government approved the schedule of the utilisation of funds available for the development of emergency medical care under the New Hungary Development Plan.

The SAO recommended the Minister of Health to take measures to increase the citizens' primary first aid skills, and to define the tasks involved in the training of emergency specialist doctors and nurses in order to ease the shortage of human resources in emergency medical care. The SAO's recommendations were time-proportionately realised. The harmonisation of the legal provisions on emergency medical care is fostered by the modification of the professional minimum requirements for the provision of healthcare services, as well as by discussions on the registration of healthcare service providers and their operational permits, and on the modification of the requirements pertaining to the register of healthcare professionals.

**Based on the experiences of the audit on the development and maintenance of greeneries owned by the local governments of the settlements** the SAO recommended the Government agencies to prepare a separate framework act and an enforcing decree that clearly define the tasks and specify the mandatory tasks of the local governments, including greenery management. Furthermore, the SAO recommended the review and modification of the real property cadaster, too. Professional preparatory work has been started.

Pursuant to the SAO recommendations made during the audit of the **implementation of local governmental PPP investment projects** the Ministry of Finance took measures to ensure data supply on long-term liabilities arising from PPP projects from 1 January 2010, and supplemented the accounting rules with the valuation rules of the registration obligation. The Ministry of Local Government initiated the amendment of the contracts with a view to cancel provisions restricting the project host's audit rights. So far one third of the contracts have been modified.

Upon the SAO's proposal made when it formed **opinion on the 2010 budget appropriation bill** the Government indicated that the renewal of the budgetary rules, as well as the emphasis on medium-term budgeting will in the future make it possible to adopt the act on the amendment of acts substantiating the budget before the finalisation of the main figures of the budgetary chapters at the latest, which will, if necessary, allow for the

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correction of the impact on the main budgetary figures in the budget appropriation bill.

In accordance with the SAO recommendations made during the audit of the **execution of the 2008 budget of the Republic of Hungary**, during the amendment of Government Decree 249/2000. (XII. 2.) on the special reporting and accounting obligations of public finance institutions, as well as in accordance with the general accounting principles it was determined that the multi-purpose micro-regional associations should account for the used incentive subsidies broken down by tasks. Beginning from 2010, the reports must present compliance with the rules stipulated in the budget act on reallocations among the tasks, as well as on lawfully accounted expenditures and commitments.

In the report on the review of the local governmental decree **on the distribution of revenues due to and shared by the Municipality of Budapest and the district local governments** in 2008 the SAO recommendation on the determination of the number of permanent residents was only partially realised, since there is still some discrepancy compared to the population size applied in the budget act during the calculation of the normative contributions. The SAO recommendations pertaining to the definition of tasks to be considered during the revenue distribution calculations, the definition of population density for the area within the city limits, and to the administrative and public education tasks that generate exclusive revenues for the municipal local government were realised. In compliance with the SAO recommendation, during the distribution of resources in 2008 the data of the district local governments subjected to the audit, as well as the 2007 and 2008 revenues to be distributed were modified.

The SAO report made on the audit of the utilisation of funds for the organisation of the peremptory **referendum** held on 9 March 2008 contained five recommendations for the Minister of Local Government, one recommendation for the Minister of Local Government and the Minister of Finance jointly, and two recommendations for the Minister of Foreign Affairs. The Minister of Local Government approved an action plan for the utilisation of the recommendations. Through the implementation of the action plan, the SAO recommendations will be utilised both in the regulation and implementation of the general elections of 2010. The Minister of Foreign Affairs ensured the realisation of the recommendations by issuing an action plan.

In accordance with the recommendations made to the Government by the SAO during the audits of **public foundations** the affected ministries modified the deeds of foundation and organised the publication thereof. Within the powers of the Ministry of Finance measures were taken to reduce the subsidy granted to any political party – being a recipient of regular state subsidies – that accepted anonymous donations by the amount of such donations. In the case of the six parties that do not receive regular state subsidies, but accepted illegal donations, the Government initiated the collection of debts in the form of taxes due to non-payment by the parties.

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

**Pursuant to the audit of the financial management of the Chapter 'Ministry of Defence'** the Ministry revised the documents of the Central Controlling and Magisterial Bureau of the Ministry, which ensure the functional independence of the internal audit tasks in accordance with the SAO recommendation.

In December 2009 the Ministry issued an instruction to regulate the organisation and implementation of the elimination of hazardous wastes from revenues yielded from the disposal of unnecessary assets, and the rules for the comprehensive management of such revenues in accordance with the legal regulations. The regulatory and development tasks affecting the security and efficiency of the ministry-level IT system are specified in a ministerial instruction, which describe the tasks related to the development of the recruitment module and the Procurement Information System alike. The final deadline for completion was set as the end of 2010.

In order to eliminate the deficiencies revealed by the SAO, the Ministry issued a ministerial instruction on the long-term Human Strategy of the Ministry of Defence, as well as on the long-term directives on military recruitments. The establishment of the ministry level controlling system by the review of the operational and organisational rules of the Ministry of Defence is stipulated in a ministerial instruction, according to which the deadline of implementation is the end of 2010.

The measure issued by the general director of the Economic and Financial Agency of the Ministry of Defence in relation to the regularity of the accounting of wages and the related contributions called for regular target audits. According to the information supplied by the Ministry this year, as a result of the audits no unsettled balance (deviation) was detected in 2009 in connection with the ministry level transfer general ledger accounts. The general director of the Development and Logistics Agency of the Ministry of Defence issued an order to review the system and operation of logistics supply. To ensure the short-term efficiency of the utilisation of unnecessary assets, the ministry reviewed the circumstances influencing sales revenues and organisationally separated the value assessment tasks related to this activity. In parallel with this, the modernisation of the registration system of unnecessary assets was started.

**During the audit of the operation of the treasury system** the SAO recommended the Minister of Finance to take measures on the development of the medium-term professional strategy of the treasury system, on the creation of the conditions necessary for the efficient and effective application of the relevant management rights, on the management of the new risks implied in the Budget Management System project, as well as on the comprehensive screening of the operation of the Treasury.

According to the information provided by the Minister of Finance, the realisation of the measures related to the SAO recommendations pertaining to the treasury system is under way in the Ministry of Finance. The measures

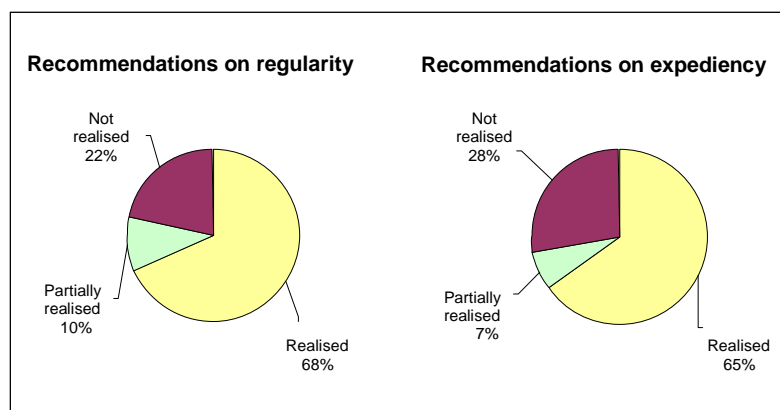
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contribute to the development of the professional strategies (Treasury IT Strategy) and to the mitigation of the risks implied in the implementation of the Budget Management System.

During the **former comprehensive audits** of the financial management of local governments the SAO made around 2,500 recommendations in its auditor's reports, 70% of which were utilised by the local governments. **As a result of the measures taken**, information supply by the representative bodies became more accurate and complete, and their decisions became more substantiated due to the submission of the budget concept, as well as the draft decrees on the budget and the final accounts by the given deadlines and with the given contents, and due to the presentation of draft decrees substantiating the proposed appropriations. The level of organisation of the financial management of the local governments, as well as the level of regulation of the financial and accounting activities of the local governmental offices and institutions improved as a result of the development of the standard accounting rules of the budgetary organisations, and pursuant to the updated and supplemented accounting policy and the related internal regulations. Progress was made in the development of conditions ensuring the regularity of property management through the specification of the methods and cases of the free transfer of the ownership and management right of property, and of the methods and cases of the relinquishment of receivables, as well as through the development of the regular registration of assets that form part, and of assets that do not form part of the core assets. Pursuant to the conclusion and supplementation of the cooperation agreements – in accordance with the SAO's recommendations – the conditions of cooperation with the minority local governments of the settlements became more compliant with the legal regulations. As a result of the realisation of the SAO recommendations and the enforcement of the provisions of the Government Decree on the internal audit of budgetary institutions, which took effect in the meantime, the conditions of the establishment and operation of the internal audit system improved through the functional independence of the auditors, the preparation and approval of the annual audit plans, and the compilation of reports on the audit findings.

Within the framework of the audit of the financial management system of the local governments the SAO determined that measures had been taken for the realisation of 90% of the 626 recommendations made during audits carried out in relation to the **final accounts** in 2003-2007. It was also concluded that measures had been taken to realise three quarters of the 400 recommendations made during other audits. These recommendations pertained to the regularity of the application for and accounting of normative, normative fixed purpose, and centralised state contributions and subsidies, to the lawfulness of the use and utilisation of subsidies granted to the investment projects of local governments, to the improvement of the regularity and effectiveness of the audited areas of local governmental task performance, and the more expedient organisation of local governmental tasks.

The over 3,500 recommendations formulated in the auditor's reports compiled during the SAO audits of the local governments were utilised as follows:



### 3.3. **Activities of the State Audit Office of Hungary related to law enforcement**

#### ***Contribution to criminal proceedings***

The imposition of criminal sanctions in relation to the irregular utilisation of public funds is in the interest of the entire society, and the SAO plays an important role in providing evidence on the basis of the audit findings. This is especially true in the case of local governments, since relevant information on the financial management of this sector can be provided almost exclusively by the SAO. The publicity of the SAO reports, their accessibility on the website also support the activities of organisations involved in criminal proceedings. Experience shows that the investigation authorities rely on the SAO reports while performing their duties, too.

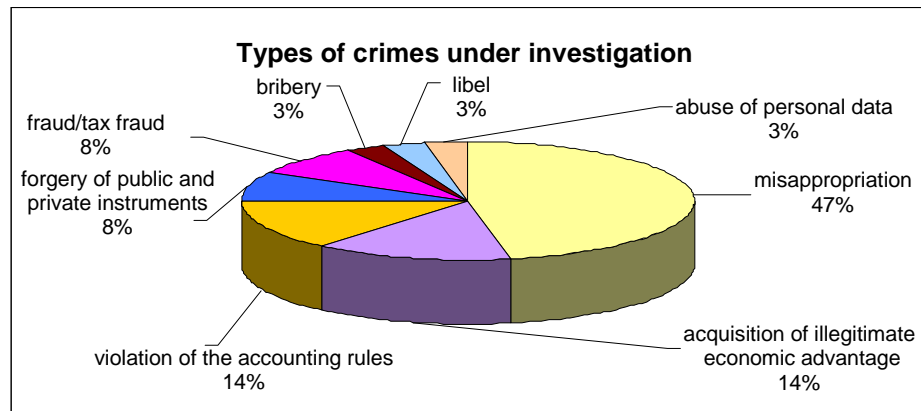
**In recent years the SAO significantly contributed to the work of the investigation authorities** (police, offices of the Hungarian Customs and Finance Guards, National Bureau of Investigation) **by responding to the growing number of requests for assistance submitted by the authorities.** From among the 43 requests submitted in the subject year 40 related to investigations initiated earlier by the SAO or other plaintiffs. In such cases the SAO complied with its data supply obligation by replying to the requests in writing, as well as by forwarding documents containing facts that came to its knowledge in the course of the audits.

It is a general experience that criminal proceedings launched on the basis of information submitted to the competent investigation authorities are protracted to the following years, too. For example, based on the SAO's reports the National Bureau of Investigation is conducting investigations in connection with the operation of the Bábolna National Stud Estate, the sale of the Kerteskö Farm, the property exchange in Sukoró, the sale of the share package of FHB Mortgage Bank Plc., as well as the sale of the ordinary shares of MOL Plc. In relation to the sale of the property of the Hungarian Commercial Office in Moscow criminal proceedings were launched by the Supreme Prosecution Service. The SAO assists the work of the investigation authorities on a continuous basis through personal consultations and the fulfilment of other requests for data supply.



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The most typical crimes under investigation include misappropriation (17), the acquisition of illegitimate economic advantage (5) and the violation of accounting rules (5).



In accordance with its obligations stipulated by law, the SAO notifies the competent investigation authorities about all of its findings that give rise to a reasonable suspicion of a crime in relation to the irregular utilisation of public funds.

Based on its findings made **in the subject year** during the comprehensive audit of the Local Government of Kunszentmárton – under the well-founded suspicion of **negligence** resulting in especially grave pecuniary injury due to losses incurred on certain investments of the local government – the SAO pressed charges against unidentified perpetrators, on the basis of which the Prosecution Service ordered investigations. After the completion of the investigation of charges pressed by the SAO in 2008 due to the well-founded suspicion of **misappropriation** resulting in grave pecuniary injury (payments made by the Local Government of Krasznokvajda without attestation of performance and the countersignature of the district clerk) the case reached the judicial stage in 2009.

#### ***Initiation of proceedings for legal remedy***

In accordance with the recommendation of the SAO, as a result of the former amendment to the public procurement act the 90 day **deadline** open for the initiation of proceedings for legal remedy beginning from the violation of law was extended to one year, **and to three years in case public procurement procedures are illegally ignored. As a result, there was a sharp rise in the number of such proceedings initiated by the SAO.**

**The rise in the number of such proceedings discontinued after the new amendment of the public procurement act took effect on 1 April 2009**, according to which if a public procurement procedure is not conducted, **proceedings for legal remedy can be initiated only within one year** from the date of the contract signed without the public procurement procedure.

Due to the amendment of the act, compared to the 36 proceedings initiated in 2008, in 2009 the SAO initiated only two proceedings for legal remedy: one because of the unlawful neglect of the public procurement procedure, and the

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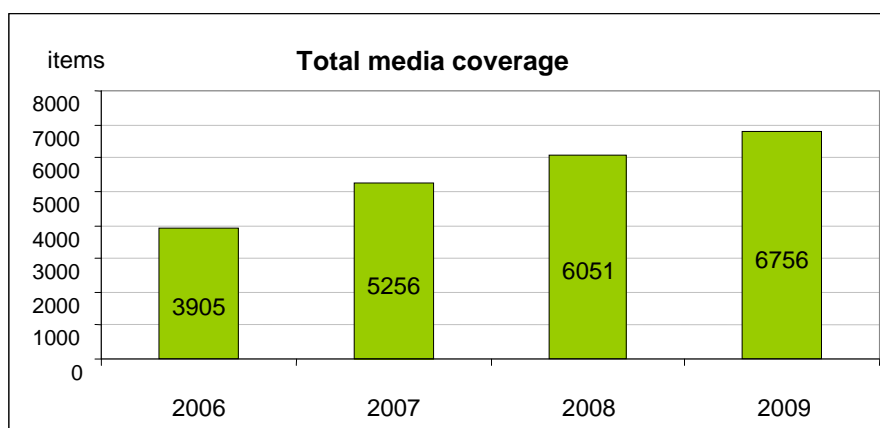
other because of the delayed preparation and publication of summary reports. In both proceedings initiated by the SAO for legal remedy the Public Procurement Arbitration Committee established the violation of law.

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

**Securing publicity for the activities of the SAO** is not only a legal obligation, **but also an opportunity to disseminate the audit experiences, findings and results in a greater community.** The SAO organises and develops its communication based on publicity, adjusting to the continuously changing environment and requirements, and observing the strictest austerity principles.

In line with the practice of the former years, **in 2009 one of the SAO's main tasks was to inform** and support the work of **the National Assembly** and of the parliamentary committees. This is done through summary letters sent to the members of the National Assembly as attachments to the SAO reports. Furthermore, the SAO staff members continuously monitor the work of the committees, and are actively involved in the meetings thereof.

In 2009, the SAO registered a total media coverage of 6,756 items (including news, articles, interviews and references) from 248 different sources in its media monitoring database.



In 2009, the SAO organised two presidential press conferences: one on the SAO's Audit Plan for 2009 and on the RI study titled 'Financial risks in the local governmental system', and the other on the audit of the activities of the Hungarian State Holding Company in 2008.

In November 2009 the Secretary General of the SAO held a press conference at the central headquarters of the SAO. The topic of the conference was the launch of the top priority EU project titled 'The mapping of corruption risks – the dissemination of the integrated public administration culture'.

The Directors General altogether held twelve press conferences in the country (in Miskolc, Zalaegerszeg, Pécs, Kaposvár, Nyíregyháza, Eger,

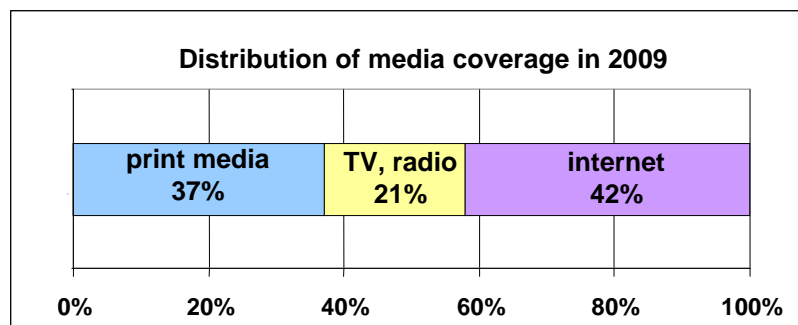
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Hódmezővásárhely, Sopron, Veszprém, Tatabánya, Nagykanizsa and Békéscsaba).

In July the SAO invited the representatives of the press to discuss the audit of the utilisation of subsidies granted from the Cohesion Fund and national sources for solid waste management, as well as the implementation of local governmental PPP projects funded within the framework of the Sport XXI Facility Development Programme, and the impact of such projects on the fulfilment of local governmental tasks.

In August journalists could ask questions – again in the form of a press discussion – about the audit of the utilisation of funds used for the establishment and development of emergency care system, as well as on the audit if the outsourcing of certain hospital activities.

In November the Director General of the RI held a press discussion on the following studies: 'The social-economic efficiency of the support system of individuals with changed working abilities', and 'The expedient role of the government in the global economy of the early 21<sup>st</sup> century'.



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

In 2009 the SAO registered nearly 90,000 visits to the homepage of its website. People interested in the SAO's work downloaded reports from the SAO's website nearly 72,000 times from external IP addresses, and English language reports were opened more than 1,000 times.

In 2009, the SAO created a so called 'obstacle free' version of its website that meets the special needs of the blind and visually impaired.

Capitalising on the possibilities provided by the use of the internet, the SAO developed three communication channels to facilitate communication with the public. The on-line forum accessible on the SAO's website, which was launched in 2003, offers two possibilities for visitors to the website: the 'Meet the President Hour' and the 'SAO Forum'. Another form of contact is the central e-mail address of the SAO ([szamvevoszek@asz.hu](mailto:szamvevoszek@asz.hu)), which was established in 2004, and where those interested may send electronic mails.

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Since its launch in 2003, the ‘Meet the President Hour’ has been organised altogether 14 times. Due to continuous decline in the interest in this form of communication, no ‘Meet the President Hour’ was organised in 2009.

The number of questions submitted to the SAO Forum significantly dropped in 2008, by 40% compared to the previous years. No increase was witnessed in interest in 2009 either, when the SAO received around 40 questions. The most frequent topics included accounting problems, abuses experienced in various fields, the interpretation of legal regulations, the preparation of applications and contracts, the payment of benefits to deputies, as well as loan financing.

The central e-mail address enables citizens to express their opinions, make comments and ask questions in private. In recent years, the number of e-mails sent to the SAO has been continuously rising. In 2009, altogether 300 letters were sent to the central e-mail address (containing requests for the interpretation of legal regulations, for assistance in resolving concrete problems, complaints, remarks, opinions and reports on issues experienced in the locality and on the general condition of the economy).

#### **4. RESEARCH AND DEVELOPMENT WORK RELATED TO THE AUDIT ACTIVITIES**

In 2009 the **Research Institute of the SAO** (RI) primarily continued its research related to the competitiveness of the public sector and the efficiency of public financing while keeping in mind the strategic objectives of the SAO. On the one hand it prepared comprehensive studies on the interactions between the competitiveness of the public sector and that of the economy, on the expedient economic role of the state, on the possible renewal of national economic planning, on the financial risks implied in the financial management of local governments. On the other hand it prepared analyses on the effectiveness and efficiency of concrete policies (system of subsidisation of people with reduced working abilities, adult education, tourism, culture).

In 2009, the RI issued the following publications:

- Financial risks within the system of local governments,
- The social-economic efficiency of the support system of individuals with changed working abilities,
- Expedient role of the government in the global economy of the early 21<sup>st</sup> century,
- The efficiency of adult education systems in an international comparison.

The RI will publish a publication on the results of the other research projects mentioned in 2010, after the closure of the projects. The publications attracted great interest from professional entities: the contents of the publications were discussed in several newspaper articles, as well as TV and radio programmes. Based on the studies, the staff members of the RI published several papers in professional journals, and presented the major messages of their research projects at international and national scientific conferences.

**The study titled ‘Financial risks within the system of local governments’** undertakes to map the financial risks arising from the

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operation of the local governments, to explore the causes triggering the risks, and to formulate recommendations for the possible management thereof. The study analyses these risks in relation to the system as a whole, and to its individual segments, too. The major findings of the study are the following:

- The local governmental sector, which accounts for around one fourth of public finance expenditures carries increasing fiscal risks. The risks may appear in the form of the lack of resources, liquidity and creditworthiness.
- The local governmental sector cannot be regarded homogeneous in financial terms either. Small local governments (villages), large towns (mainly towns with county status), county local governments, as well as the local governments of the capital and the capital districts all belong to different segments.
- In the segment of the village local governments the most important problem is the lack of resources. This leads to the lack of liquidity or creditworthiness only in a few cases, since this can usually be prevented by the Government using discretionary tools. For this reason, and because of its financial weight this segment does not carry major, macroeconomic level fiscal risks for the compliance with the budget rules. However, the permanent lack of resources has a serious impact on the population of such settlements.
- The local governments of large cities have accumulated debts at an increasing pace. Open indebtedness occurred primarily in the form of foreign currency based bond issuance. On the one hand, this poses a significant exchange rate risk, on the other hand it leads to the accumulation of a considerable amount of free financial assets at such entities. Only a small portion of funds realised from bond issuance was spent on investment projects. Part of the resources was used to cover the operational deficit, while another part was deposited as monetary reserves. The fast utilisation of these funds poses a risk at macroeconomic level, too.
- In the case of the county local governments the above risks are augmented due to the fact that the counties have accumulated debts despite their modest fiscal capacities. In their cases the SAO cannot see the financial surplus that will provide coverage for the repayment of the bonds.
- The indebtedness of the municipality of Budapest cannot be neglected. It is worth mentioning that while the capital is 'impoverishing' and its financing position is deteriorating, some districts are relatively 'well-off' and are in a stable financial position.
- The fundamental cause of the risks that appear in the sector is the Hungarian local governmental model, and its continuous deformation. The local governmental sector functions as a 'container of conflicts'. The other causes of the risks include the weakness of the information management system, the resource regulation system, and the current rules of borrowing.
- The current system of rules and institutions is not suitable for the management of the risks implied in the sector. Risk management is possible within the framework of the current Constitution, e.g. by the reinforcement of the financial discipline.

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The study formulates concrete recommendations in relation to the modernisation of the information management system, the application of the modern planning methods, the transfer to the treasury system, the more consistent application of the Act on the debt settlement of local governments, the regulation of the borrowing practice of the local governments, the institution of the local governmental loan guarantee, as well as the reinforcement of financial audits.

**The study titled ‘The social-economic efficiency of the support system of individuals with changed working abilities’** evaluates the social and economic efficiency of the subsidies primarily in terms of employment. The major findings of the study are the following:

- The potential target group of the support system is estimated to include 250-300 thousand people, while currently 110-130 thousand people receive employment promoting subsidies or services on an annual basis.
- The support system does not differentiate between the basic cases of successful employment rehabilitation (full rehabilitation, partial rehabilitation, protected employment). The system does not provide adequate support to full rehabilitation under integrated conditions, but generously supports partial rehabilitation and protected employment. Therefore, it creates adverse interest in full rehabilitation.
- The currently available budgetary appropriations could be used to support the employment of a significantly larger number of individuals with changed working abilities, if
  - employment was integrated to a greater extent,
  - protected organisational employment could be replaced with protected employment or social employment,
  - after the end of the rehabilitation of a individuals with changed working abilities the regulation would require the evaluation of the rehabilitation measure, and would allow for the extension of the period of subsidisation only in extremely justified cases.
- It is very important to create and extend the rules that encourage employees with damaged health and their employers to maintain the employment relationship. Employers would need to receive more professional assistance in the creation of jobs ensuring full rehabilitation. The terms and conditions of accreditation should be determined in a way that would urge thousands of employers to accept them. Protected employment could be more efficiently fostered by the creation of protected markets.
- Based on the evaluation of the complex rehabilitation model of people eligible for rehabilitation allowance it is necessary to develop a rehabilitation system that can efficiently support the rehabilitation and subsequent employment of 50-70 thousand people annually.
- The current system of medical rehabilitation does not guarantee that the injured people receive the necessary rehabilitation services. Consequently, a significant number of such people do not ever become fit for employment.

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This also contributes to the fact that these people seek the security of disability and social allowances rather than full rehabilitation.

- **The study titled ‘Expedient role of the government in the global economy of the early 21<sup>st</sup> century’** presents the logical chain related to the role of the state, the international trends and the major experiences of the past 20 years of the operation of the Hungarian State, and then outlines the changes required in the roles undertaken by the Hungarian State. The major findings of the study are the following:
  - Maintaining its position in today’s global competition sets new challenges for the state, one of which is the market perfecting function. Globalisation has created a new situation in the relationship between the economy and its environment, too. The requirement of sustainable growth – in environmental terms, too – has come into the focus. The current crisis has made these challenges evident. The prevention of similar crises requires strong nation-states.
  - The current condition of the Hungarian economy is not the result of a sudden, short-term crisis situation, but has emerged as a consequence of longer unfavourable processes and accumulated tensions. The study attempts to highlight this process by analysing the paths Hungary has followed since the political turnaround. The final conclusion of the study is that despite the fast integration of Hungary into the institutional system of the developed Western countries the convergence of the Hungarian economy has not been complete. Foreign companies that settled in Hungary are more organically attached to the global than to the Hungarian economy, wherefore they did not really act as a driving force for the entirety of the national economy. The cornerstone of next years’ economic policy that would most significantly determine the development of the Hungarian economy in the coming years is the following: how can a reasonable rate of foreign direct investments be maintained while inducing the strengthening of small- and medium-sized companies?
  - The public finance reforms linked to the change of the political regime created the important institutions of the modern market economies, but the political forces could not reach a consensus about the target model of the state. Therefore, some of the new institutions function with serious internal contradictions. Decision-making processes affecting the systems of public finances have tried to evade conflicts involving restructuring. Instead they have tried to encourage more efficient financial management at the institutions and their maintainers by cutting down on financing. The downsizing of resources without restructuring has led to the depletion of assets and to the poor performance of the too many public tasks.
  - The reform of the governmental sector requires pragmatic solutions and the appropriate mixture of the various reform strategies of the public sector. The most important task of the Hungarian State is to put the country on a new development path that can be sustained in economic, social and ecological terms alike.

**The study titled ‘The efficiency of adult education systems in an international comparison’** summarises the results of a research project the

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goal of which was to provide background information and standpoints to the SAO audit titled 'The conditions, effectiveness and role of adult education in meeting the workforce demand of the economy'. The study presents the strategic objectives and the action programmes of the EU in terms of adult learning. It presents the characteristic features of the adult education systems of the Netherlands, Poland and Germany. It seeks to determine to what extent the Hungarian institutional system complies with the EU objectives. A serious problem of adult education in Hungary is that

- only 3.1% of the 25-64 year-old Hungarian population is involved in life-long learning in contrast with the average 9.6% of the EU25;
- within the system of adult education vocational training and professional further training courses are dominant. The number of so called 'general purpose' adult education courses is low, although these forms of training could make up for the deficiencies in basic education, which could be a precondition for the mitigation of social disadvantages;
- the training supply does not respond to changes in demand in a sufficiently flexible manner.

Apart from satisfying the labour market needs as much as possible, the social policy objectives of adult education, i.e. the promotion of equal opportunities and social inclusion are also very important. Adult education is the tool with which the spiral of exclusion can be broken.

**The continuous development activity supporting the practical audit work** is an indispensable concomitant of the operation of the modern supreme audit institutions. Its goal is to contribute to the modernisation of the audit methods in accordance with the international standards, and to the adaptation of the best international practice. The strategy of the SAO gives special priority to the operation of the quality management system, the quality centred development of the regulatory system, as well as to the further development of the existing quality management system.

In 2009 an evaluative overview was prepared on the operation of the quality management system of the SAO, as well as on the relationship between the quality requirements and performance evaluation. At the same time, recommendations were formulated for the further development of the quality management system of the SAO.

In accordance with its strategic objectives, the SAO examines areas implying corruption risks. Within the framework of the New Hungary Development Plan the SAO undertook to prepare the corruption risk map of the Hungarian public sector, which will in the future help audit organisations in the compilation of their audit plans. In 2009, in its resolution the National Assembly agreed with the implementation of the Government-backed project aimed at the mapping of the corruption risks.

Within the framework of the project, which was funded by the EU, an internationally substantiated and proven risk assessment method was adapted in Hungary, based on the end result of the twinning project completed in 2008



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by the Netherlands Court of Audit and the SAO. The objective of the method is to make regular risk analysis – extending to the corruption aspects, too – a general approach and practice during the operation of budgetary organisations. Within the framework of the project the SAO conducts a survey at selected public administration institutions about the institutions' exposure to corruption. Then it will record the measured results in a database that will be accessible for the general public via the internet (corruption risk map).

After the elaboration of the detailed project plans and the approval of the proposal documentation by the evaluation committee, at the end of 2009 – pursuant to the relevant instruction of the President – the officials in charge of the project were appointed, and the procedural rules and deadlines of the project were specified. The implementation of the two-year development project, the total budget of which equals HUF 286.5 million was started on 1 December 2009.

In accordance with its strategy, the SAO continuously develops the professional rules of SAO audits on the basis of practical experiences obtained during the audits, and on the basis of the best international practice. In 2009 it continued the modernisation of methodologies prepared in former years for the main audit types, and the review of the relevant manuals based on the audit experiences. Within this framework it was especially important to process and utilise the experiences obtained from the first-time application of the newly developed methodological guidelines on system audits. In addition to updating the professional rules, new documents of the audit profession were also produced (methodologies, manuals), e.g. the methodology on the financial regularity audits of the financial funds of the social security system and of the separated state funds.

Under the Methodology Committee, which meets on a regular basis, the Terminology and Translation Proofreading Working Group was established. Within its scope of activities the working group started the translation of the major international documents of the audit profession, the proof-reading of the existing Hungarian translations from the professional aspect, as well as the updating of the content of the existing glossary of the audit profession (Glossary).

In 2009, the involvement of the SAO in the accelerated development of audit standards within the framework of INTOSAI meant considerable methodological and professional development activities for the SAO through the presentation of opinions and recommendations regarding the draft standards and guidelines. Although these drafts are expected to be approved or take effect only in the autumn of 2010, the important yield from the significant amount of work spent on the elaboration of the opinions and recommendations is that the SAO could directly learn about and follow the international development of the audit profession and the tightening of the quality and standard requirements set for the audits. On the other hand, the SAO could utilise already the draft versions of these documents in the implementation of its methodological development tasks.

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The **President's Advisory Board**, which is a consultative work organisation assisting the management activities of the SAO's President, performed its activities on the basis of its annual working plan in accordance with the established practice.

The professional consultations and discussions first of all focused on the planning, quality management, methodological, international relations and public finance research tasks related to the SAO audits, on the relationship to be developed with the Fiscal Council, as well as on the content related issues of the preparation for the renewal of the medium-term strategy of the SAO, including the review of the lessons drawn from the survey on the implementation of the current strategy. In addition, the Advisory Board put several studies written by the RI on its agenda.

In its Resolution No. 43/2005. (V. 26.) the National Assembly found it necessary that the SAO should publish a modern public finance journal, in part linked to its basic activity. Four years later, in its Resolution No. 35/2009. (V. 12.) the National Assembly acknowledged that the SAO had turned the **Public Finance Quarterly** into a quality journal, and in the same resolution it called the SAO to continue the compilation and publication of the journal.

In accordance with its objective expressed in the imprint, in 2009 the journal put into the limelight the effects of the global economic (financial) crisis on the Hungarian economy and public finances, investigating them as a set of problems topical and important for the operation of the national economy and the financial system. In this context it also paid attention to topics such as the relationship between the financial crisis and the crisis of financial institutions, financial stability and the banking system, as well as certain issues of SAO audits (the position of the SAO in the system of the branches of power, consultation within the framework of the activities of the SAO, cooperation of the European Court of Auditors with the major supreme audit institutions of the EU).

Similarly to the previous years, the authors ranged from regular and correspondent members of the Hungarian Academy of Sciences through university lecturers, state officials, and experts to Ph.D. students (including, for instance, the President of the Constitutional Court, the President of the European Court of Auditors, and an economic expert from the OECD).

## **5. IMPROVEMENT OF THE QUALITY OF THE AUDIT WORK**

### **5.1. Quality assurance of audits**

In the past years activities and procedures designed to ensure high quality work were established and are now functioning in all major stages of the audit work.

Within the framework of the quality management system the proper operation of the quality controls built into the audit work processes ensures that during the planning, preparation and implementation of the audits, as well as during the preparation of the audit reports the auditors

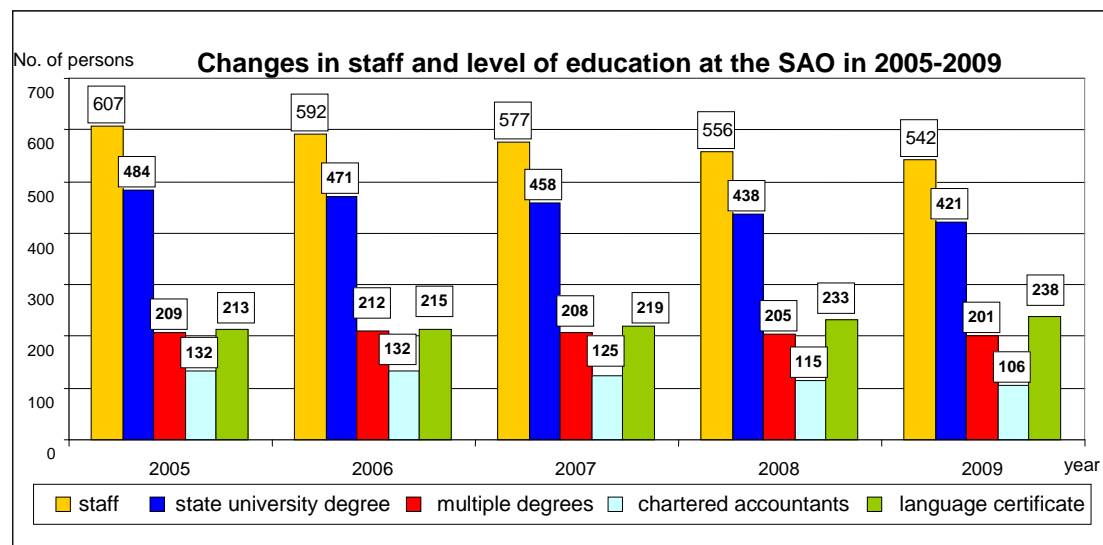
- observe the fundamental requirements of the SAO audits,
- apply the special rules, methods, techniques and internal controls pertaining to the different audit types,
- receive feedback on the quality of the work performed, and complete the tasks required for the improvement and development of the audit work.

In addition, the SAO reports, as well as draft SAO reports that implied the question of personal responsibility were subjected to two independent reviews to determine the audit professional and legal substantiation of the findings, conclusions, recommendations, and personal responsibility. The separate Quality Assurance Department, which is directly supervised by the President, and performs independent reviews, performed ex-post quality assurance reviews to determine the professional and methodological adequacy of the entire processes of audits conducted and closed during the year. The experiences of the review – which altogether certified that the works complied with the professional norms and quality requirements (as well as its subsequent recommendations made for professional and methodological development and the improvement of efficiency) – were discussed by the presidential meeting. The evaluation summarising the experiences was made accessible for the entire staff of the SAO via the Intranet.

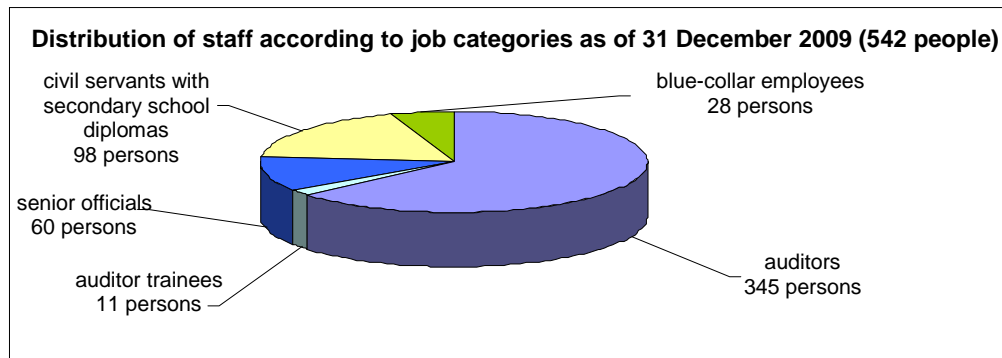
## 5.2. Human resources management and development

### *Personal conditions*

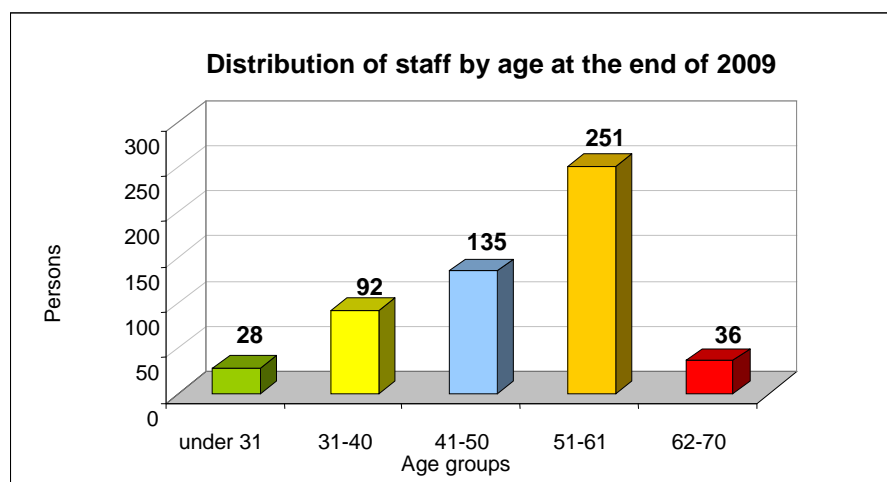
As of 31 December 2009, the SAO's staff totalled 542, which means a continuous and significant decrease compared to the staff (607) employed at the beginning of the SAO's strategic cycle. Many elderly experts chose retirement due to the relatively favourable rules of retirement, wherefore in a period of four to five years nearly one fourth of the staff retired. The recruitment of young professionals could hardly keep pace with this tendency due to the indispensable financial and audit experience requirement.



In 2009 the service relationship was terminated in 50 cases, including 40 retirements, primarily upon the employees' request. The SAO recruited 28 new colleagues to the 50 vacancies.

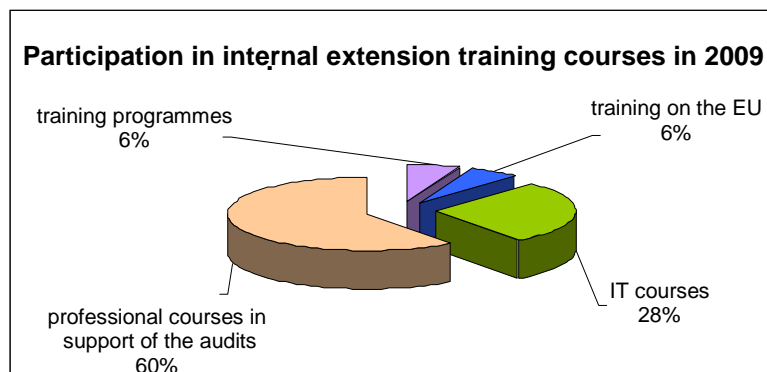


The financial auditor career requires versatile and sound knowledge. The conduct of audits is often burdened with conflicts, wherefore the auditors must be aware of and must be able to manage the different audit situations. Consequently, the SAO finds it natural that the average age of the staff members is relatively high (48-50 years) despite the continuous recruitment of younger professionals.



### ***Extension training***

The 2009 extension training programme of the SAO included professional training courses designed to develop the employees' methodological, IT and quality assurance knowledge, as well as communication and cooperation skills. As a result, internal preparatory and extension training courses were organised in 35 subjects on 55 occasions on 99 training days.



Apart from teaching the audit methodologies, the SAO provided a comprehensive overview about the INTOSAI standards, as well as the ethical requirements and expectations in the framework of lectures. The topic of the European Union was presented in a new format – in three modules – ranging from the basic information to the latest audit experiences in an updated manner. Pieces of information that can be utilised on a continuous basis during the daily audit work (legal updates, changes related to the legal regulations on taxation) were included in a separate block.

Auditors who are members of the Chamber of Hungarian Auditors could collect most of their credits for mandatory audit extension training at in-house training courses.

The SAO staff members attended 69 conferences and professional events organised in over 50 topics. For economy considerations the number of staff members delegated to conference type national events (Itinerant Meeting of Economists, Itinerant Meeting of Legal Professionals, Town Clerk and Public Administration Conference) was reduced. On the other hand, the participation fees significantly rose for courses organised for IT professionals in special programming.

The SAO continued to make use of the discount language courses offered by the Goethe Institute and the French Institute for Hungarian civil servants. In terms of foreign language training the SAO efficiently cooperates with the modernised Government Centre for Public Administration and Human Resource Services. In the first half of the year 25 colleagues completed the 'e-learning' course that was carried over from the previous year, and another 22 persons completed successfully the course that lasted until the end of the year.

For years the SAO has been given the opportunity to delegate participants – through the ITEC scholarship of the Ministry of Foreign Affairs of the Republic of India to the international audit courses organised annually by its **Indian partner institution**. In 2009 the staff members of the SAO participated in the training programmes organised in the fields of environmental audits, audit of state companies, as well as performance audits. In addition, the SAO represented itself in the scholarship programme organised by the US State Department under the title 'Accountability in the Governmental and Private Sectors'. The SAO pays attention to the National Expert tender procedures, in which the applications of two auditors have been accepted. A SAO employee's

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application for the Robert Bosch scholarship available for young manager candidates is being evaluated.

Apart from the 'e-learning' language teaching contracts the SAO signed six new study contracts, less than a year before. At the end of 2009 as many as 22 live contracts were in force.

Austerity considerations and the tense audit tasks make both the senior officials and the staff members thoroughly consider enrolments into the different courses. Per capita training expenditure totalled HUF 37,210 in 2009.

### **5.3. International relations**

In 2009 the SAO continued its involvement in the international audit community in line with its strategic objectives. It strived to continuously contribute – through the mediation and promotion of the utilisation of the acquired experiences – to the development of the domestic external audit activities, including especially the modernisation of audit methodologies and techniques, and to encourage the development of efficient forms of cooperation among the audit institutions.

In 2009, the SAO's bi- and multilateral international cooperation was mostly determined by the commitments arising from Hungary's EU membership. In addition, the SAO has been actively involved in the international organisations of the supreme audit institutions. Preserving the respect it won through its chairmanship in the Governing Board of the International Organisation of Supreme Audit Institutions (INTOSAI), the SAO has been continuously shifting its focus to the professional forums of the European Organisation of Supreme Audit Institutions (EUROSAI).

The primary goal of bilateral cooperation with the partner institutions is to transfer modern audit and institution development principles, to support activities in this respect, as well as to provide practical assistance. In accordance with this, the SAO also kept in mind the utilisation of opportunities and advantages implied in bilateral relationships built on the mutual exchange of experiences.

#### ***Multilateral professional cooperation***

The SAO is actively involved in the rejuvenation of **INTOSAI** both at institutional and expert level. In 2009 it continued to fulfil its obligations arising from its membership in the Governing Board and the Finance and Administration Committee. Furthermore, it was involved in the working groups that deal with important issues related to the implementation of the strategic plan of the world organisation.

The SAO actively participated in the INTOSAI subcommittees that deal with the professional standards, the internal control standards, as well as peer reviews. It continued to represent itself in INTOSAI's Working Group on Privatisation, Economic Regulation and PPP, at the meeting of which it presented the

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experiences of SAO audits on the provision of public tasks through the cooperation of the public and private sectors.

The SAO continued its involvement in the INTOSAI working groups that were set up in 2008. It contributed to the activity of the Working Group on Key National Indicators as the coordinator of a pilot programme on the national performance indicators describing the processes of the knowledge-based economy and society. Furthermore, the SAO contributed to the activities of two subgroups of the Task Force Global Financial Crisis established under the management of the Supreme Audit Institution of the United States. On the one hand, the SAO employees became active members in the subgroup studying the initiatives that were launched with a view to stimulate the real economy and mitigate the negative effects. On the other hand, the SAO undertook an opinion-forming role in the subgroup examining the challenges supreme audit institutions must face.

The representatives of the SAO attended the joint professional event organised by the INTOSAI and the UN on a regular basis. In 2009 the topic of the event was 'The Value and Benefits of Government Audit in a Globalised Environment'. At this symposium the SAO presented its experiences gained in the fight against corruption.

Within the framework of the activities of **EUROSAI**, i.e. the European regional organisation of INTOSAI, the SAO continued to coordinate the activity of the international working group in charge of the compilation of a guide that presents the good practices of the establishment and operation of quality management systems at the SAIs. (The working group was mandated to compile the document as a continuation of the theme of the Congress of the organisation held in Krakow in 2008, which dealt with this issue.) The draft guide was completed in 2009. The final document will be approved by the Governing Board of EUROSAI at its next meeting.

The SAO continued its participation in the activities of the Environmental and IT Working Groups of EUROSAI. Within the framework of the latter the SAO implemented its self-assessment pertaining to IT audits on the basis of the methodology elaborated by the working group. The goal of the self-assessment was to explore how the IT audit field could more efficiently support the general audit objectives of the SAOs.

The SAO was actively involved in the EUROSAI Training Committee, too. It contributed to the development of the operational plan and procedural rules of the Committee, and – being the coordinator of the task – it continuously updates the Committee's working plan, and contributes to the compilation of a guide aiming to assist the organisation of seminars. Staff members of the SAOs have attended several professional seminars organised for example on performance audits and on the international standards of the supreme audit institutions (ISSAI).

At the VII EUROSAI Congress the SAO joined the working group set up for the audit of funds appropriated for the prevention of disasters and the mitigation of their consequences. At the first meeting of the working group the

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representatives of the SAO presented the organisational structure and operational principle of Hungarian disaster management. After that the SAO employees were involved in the preparation of a 'Glossary' serving as a basis for the exchange of information.

The staff members of the SAO attended the seminars of the European Organisation of Regional External Public Finance Audit Institutions (**EURORAI**) last year, too, where they also held lectures. The participants of the seminars discussed issues related to welfare benefits and environmental audits.

The annual chair's meeting of the **Contact Committee**, which is the institutional and regular cooperation network set up by the Heads of the Supreme Audit Institutions of the European Union, and of the European Court of Auditors, was hosted by the SAO in 2009. Being the acting chair of the network, the SAO made the necessary professional and organisational preparations, and successfully hosted the event. The participants of the meeting discussed the role of the SAIs in supporting the measures that can be taken by the governments in response to the financial and economic crisis. Furthermore, in addition to the agenda items discussing the different possibilities of cooperation among the SAIs of the EU member states, the members of the Contact Committee held discussions about the independence of the SAIs. As a result, they drafted a statement in support of initiatives aiming to ensure the independence of the SAIs.

The SAO continued its involvement in the cooperation network of liaison officers responsible for the preparation of the meetings of the Contact Committee, as well as for the coordination of the activities of the professional working groups and for the improvement of cooperation within the network.

The SAO also represented itself in the working groups functioning within the framework of the Contact Committee and dealing with the different issues of the utilisation of EU funds. Last year the SAO was continuously and actively involved in the activities of several professional working groups (Working Group on Structural Funds, Working Group on Value Added Tax, and the Working Group on Common Audit Standards). In 2009 the SAO organised the annual meeting of the Working Group on National SAI Reports on EU Financial Management. Furthermore, the SAO's staff members attended the professional workshop organised about the audit scope, role and experiences of the SAIs in the EU member states in the light of the financial and economic crisis.

Pursuant to a resolution adopted at the 2008 meeting of the Contact Committee, one of the tasks to be completed in 2009 within the framework of cooperation is the audit of the TEN-T V. corridor (Lyon-Trieste-Koper-Ljubljana-Budapest) railway development project funded by the EU, which is carried out under the guidance and with the participation of the SAO. As a first step of the task, before starting the individual on-site audits, and for the finalisation of the common audit programme, the SAO organised a working meeting for the representatives of the concerned partner institutions (the SAIs of France, Italy and Slovenia). The deadline for the completion of this coordinated audit is the end of 2010.



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Also within the framework of the activities of the Contact Committee, the staff members of the SAO became involved in the work of the knowledge networks established in relation to audits linked to the fiscal policy and the Lisbon Strategy.

The Heads of the Supreme Audit Institutions of the **Visegrád countries**, as well as Austria and Slovenia held their annual meeting in Poland in 2009, where the discussion of the issues related to the accountability of the SAIs was given great emphasis. The representatives of the SAO attended the international seminar titled 'Information systems audit and application of the INTOSAI auditing standards', where they also presented the experiences of the self-assessment of the IT audit carried out at the SAO.

The SAO attended the meeting of the **International Board of Auditors for NATO** held in Brussels in 2009, too. The participants of the meeting discussed the annual report of the Board.

The President of the SAO attended the Annual Meeting of the European Group of the **Trilateral Commission**, which includes the leading economists of the world. One employee of the RI was given the opportunity to attend the **3<sup>rd</sup> World Forum of the OECD** and give a lecture on the key national indicators describing the processes of knowledge based economy and society.

### ***Bilateral international relations***

In 2009 the SAO continued to maintain its relations with its traditional partners in the framework of bilateral cooperation. Cooperation between the SAO and the **Office of the State Audit of Vietnam** continued, which forms an integral part of Hungary's international development strategy. Within the framework of this project the experts of the SAO assisted the supreme audit institution of the Asian country – which is undergoing restructuring – in the development of a methodology related to opinion forming on the draft budget by transferring professional knowledge. Furthermore, the staff members of the SAO hosted the representatives of the **privatisation organisation of Vietnam**, too.

At expert level the SAO officials conducted discussions with the representatives of the **Slovak partner institution** about the practice and experiences of performance audits performed at the local governments. The SAO represented itself at the seminar organised by the SAI of Denmark on the training activity of the SAIs, as well as at the conference titled 'Strengthening the use of performance frameworks in the public sector' organised **by the British partner institution**.

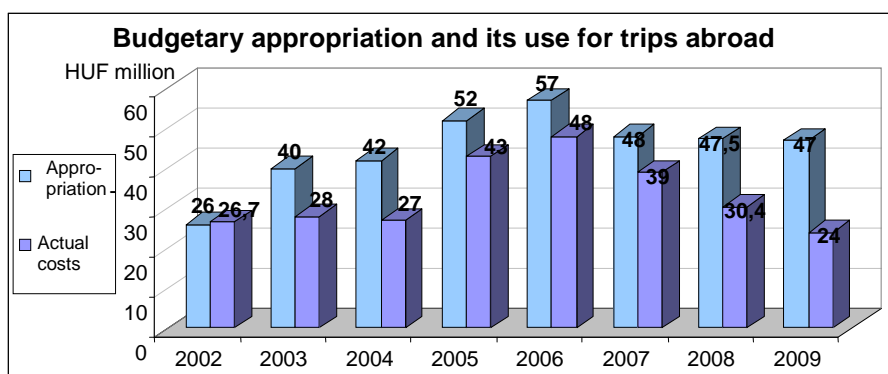
In 2009 public administration experts from **Pakistan**, representatives of the **OECD** department responsible for the country reports, as well as staff members of the Korean Anti-Corruption and Civil Rights Commission visited the SAO with a view to participate in expert level consultations.

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### ***The budgetary aspects and statistics of the SAO's international relations***

The International Relations Plan for 2009 appropriated HUF 46.7 million for **trips abroad**. Altogether, the SAO envisaged HUF 39 million for travel, accommodation and insurance costs; and HUF 7.7 million was planned for per diems in relation to the trips abroad. On top of that, in 2009 the SAO formed an exchange rate reserve of HUF 1 million.

Due to careful planning, as well as the strict and consistent implementation of the plan, the actual costs of the trips abroad were in line with the appropriated figures. Altogether HUF 23.9 million was spent on trips abroad.



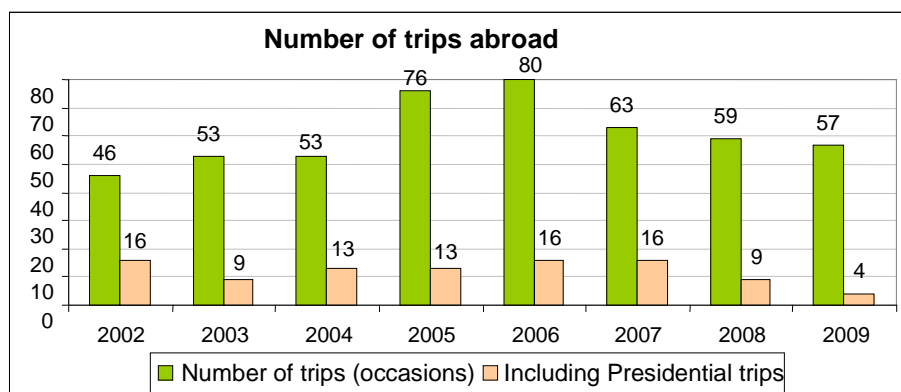
As a result of unrealised trips a reserve of HUF 15.5 million was formed in 2009, while HUF 9.1 million was saved on completed trips, compared to the preliminary calculations. Within the total expenditures HUF 22.1 million (92 %) was spent on planned trips. In 2009 as many as six unplanned trips were made abroad (compared to 13 in 2008), the costs of which totalled HUF 1.8 million.

Last year the staff members of the SAO made 57 trips abroad. This meant that 85 delegates spent 476 days outside the country. (The plan envisaged 70 trips for 157 delegates for 566 days.) In 2009, each business trip abroad lasted for four days on average, not including the long-term training courses<sup>8</sup>. The average cost for a working day spent on a business trip abroad totalled HUF 101,000.

In 2009, the President of the SAO made four trips abroad for a total of 10 days. He did not make any overseas trips. (The plan included 12 trips for 41 days.) The average costs of a presidential trip in 2009 equalled HUF 392,000, and the average daily costs totalled HUF 40,000. The number of all trips abroad and presidential trips realised between 2002 and 2009 are shown in the following chart.

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<sup>8</sup> Four trips abroad involved participation in training courses lasting for a total of 124 days.



The size of the costs was also influenced by trips overseas. In 2009, ten such trips were organised for 12 persons. The SAO spent 23% of all travel costs, i.e. HUF 5.7 million on these business trips.

In 2009 the SAO envisaged HUF 2.4 million to be used **for receiving guests and giving gifts** in connection with concrete events, however the actual costs equalled HUF 1.2 million. The difference between the planned and actual costs was the result – among other things – of the fact that smaller delegations arrived from abroad, less expensive catering facilities were chosen, and the costs of the gifts given to the guests were incurred in 2008, at the time of purchase. Over 80% of the expenditures, i.e. HUF 1 million was spent on meetings and work conferences organised within the framework of cooperation among the SAIs of the EU member states and the European Court of Auditors. The costs related to the cooperation with EUROSAI totalled HUF 180,000, while altogether HUF 20,000 was spent on the exchange of experiences at expert level.

In 2009 the **annual meeting of the EU Contact Committee** was organised by the SAO. The event was attended by 95 foreign guests. The budget prepared for the event included HUF 20 million, of which HUF 15.4 million was actually used. Savings could be achieved due to the fact that less than planned money was spent on the translation of the professional documentation, and on the rent of technical and IT equipment required for the implementation of the event.

## **6. INSTITUTIONAL OPERATION AND FINANCIAL MANAGEMENT**

### **6.1. Budgetary management**

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

The independent chartered accountant appointed by the Speaker of the National Assembly upon a public procurement procedure audited the financial

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statement of the Chapter 'State Audit Office of Hungary' of the central budget with an accounting date of 31 December 2009. The audit was completed on the basis of the Hungarian National Audit Standards and other legal regulations on audits by using the Financial Audit method of the SAO. The audit included the sampling based audit of documents supporting the factual figures of the annual financial statement, as well as the evaluation of the applied accounting principles and that of the annual financial statement.

On this basis the chartered accountant obtained sufficient and adequate proof of the fact that the annual financial statement was prepared in accordance with the provisions of the accounting act and Government Decree 249/2000 (XII. 24.) on the reporting and accounting obligations of public finance institutions, as well as in accordance with the general accounting principles. **According to the chartered accountant, the annual financial statement gives a true and fair picture of the financial position of the Chapter 'State Audit Office of Hungary' as of 31 December 2009.**

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

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

In the budget act the National Assembly approved HUF 7, 224.4 million for the SAO to perform its tasks in 2009, HUF 7, 179.1 million of which was granted in the form of subsidies and HUF 45.3 million was provided from the SAO's own revenues. Compared to the original appropriation of the previous year, this meant a reduction of 8.3%.

The causes of the changes are the following:

Reduction

- Withdrawal of the coverage for two months' separate benefits in the amount of HUF 796.5 million payable pursuant to the Act on the State Audit Office of Hungary,
- Subsidy reduction in the amount of HUF 135.5 million due to the changing macroeconomic conditions,

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- Decrease in EU subsidies by HUF 14.9 million.

#### Growth

- HUF 163.8 million spent on salary increases in 2008,
- HUF 27.0 million covering the continuation of the modernisation of the heating system of the SAO headquarters in Apáczai Csere János utca,
- HUF 30.0 million resulting from tasks connected to the replacement of the lift equipment in the office building in Lónyay utca and to related works,
- HUF 75.7 million spent on the increased employment of external experts.

Pursuant to para (11) of Article 14 of Act XXXVIII of 1989 on the State Audit Office of Hungary (as amended), all SAO employees are entitled to a two months' salary as separate benefits. The amount serving as the coverage for such benefits was reduced during the parliamentary debate of the 2009 budget bill, after the approval of the motion to amend the act. Since the Act on the State Audit Office of Hungary remained in force unamended, the SAO had to fulfil the provisions therein – including the payment of the two months' salary as separate benefits.

The room for manoeuvre in the management of budgetary resources was further narrowed by the fact that nearly two thirds of the SAO's tasks are stipulated by law or by parliamentary resolutions, and in this context, by the determination arising from the automatic concomitants of personal allowances and public dues, as well as non-personnel costs.

All this required that while fulfilling professional, institution maintenance and operation tasks the SAO should strongly enforce austerity measures and observe economic aspects even more efficiently than before. To this end, the SAO strove to make use – as much as possible – of the saving possibilities provided by public procurement procedures conducted centrally or within the SAO's own competence.

From the total amount of expenditures the appropriations for personal allowances amounted to HUF 4,459.1 million, contributions payable by the employers totalled HUF 1,365.1 million, non-personnel expenses equalled HUF 1,056.8 million, institutional investment costs totalled 219.6 million, renovation appropriations totalled HUF 13.7 million, the chapter's general government reserves equalled HUF 84.8 million, and the development of the audit documentation system equalled HUF 25.3 million.

The approved appropriation was increased by HUF 562.4 million due to the interim modifications, including the following items:

- HUF 446.8 million spent on the use of the residue of the committed appropriation from 2008,
- HUF 5.7 million spent on the modification required by the extra revenues from the EU grants,
- HUF 27.9 million spent on the technical modification required by the accounting rules of EU grants (due to which the appropriation doubles at chapter level),

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- HUF 4.8 million spent on the disbursement of housing loans from the repaid instalments,
  - HUF 5.6 million incurred in relation to the employment of a national expert,
  - HUF 71.6 million advance subsidy for the project titled 'The mapping of corruption risks...' to be implemented from EU funds.

After these modifications as much as HUF 7,786.8 million was available.

Altogether HUF 7,498.1 million was utilised, which accounted for 96.3% of the modified expenditure appropriation. Personal allowances and contributions payable by the employers totalled 79.1% of the expenses (HUF 5,927.6 million). Non-personnel expenses and expenditures for cumulative purposes accounted for 14.5% and 6.0%, respectively, while grant-like expenditures totalled 0.84%.

Despite the fact that the appropriation was withdrawn during the planning process, the payment of the separate allowance equalling two months' pay by the deadlines specified by the Act on the State Audit Office of Hungary was made possible from savings generated from unoccupied positions, sick leaves and other items of personal allowances, as well as from the amount of the bonus appropriation.

In contrast with the planned revenues of HUF 45.3 million, the SAO realised HUF 139.9 million in revenues. The extra revenue of HUF 102.0 million was made up of EU grants disbursed upon tender procedures, and of grant-like revenues according to the accounting rules pertaining to such funds. The SAO's own revenue was HUF 7.4 million smaller than planned.

Budgetary subsidies totalled HUF 7,184.7 million, while the used appropriation residue equalled HUF 446.8 million.

The amount of the residue formed in 2009 totalled HUF 278.1 million. As much as 85.7% of the appropriation residue was committed, resulting from the rescheduling and postponement of committed tasks and performances to 2010. The free residue amounted to HUF 39.9 million.

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

## **6.2. Infrastructural operations and developments**

In 2009 the modernisation of the heating system in the central office building of the SAO was completed in full after years of protraction due to the lack of resources. In parallel with this, the offices of the building were equipped with air-conditioners. The first stage of modernisation was started in 2008, and included the installation of separate furnaces on the 4th and 5th floors of the building, the development of the cooling system of the 3rd, 4th and 5th floors, as well as overdue office refurbishments and electrical installation works. The planning works for Stages II and III of the modernisation of the heating system, as well as the technical and public procurement plans related to the

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engineering system of the basement, the ground floor, the mezzanine, as well as the 1<sup>st</sup> and 2<sup>nd</sup> floors were also completed in 2008. The architectural, statical, interior design and electrical plans required for the development and implementation of the independent heating engineering system of the 3<sup>rd</sup> floor were also prepared in 2008. According to the plans, Stage III should have been implemented in 2010, however due to the low efficiency and reliability of the heating system of the block Stage III was started in the second half of 2009, and was fully completed by the beginning of the heating season.

Following the completion of the modernisation of the heating system in the Apáczai Csere János utca property, the offices are heated by controllable, modern furnaces installed on different floors of the building. According to the SAO's calculations, this technology will reduce energy consumption by 50% compared to the obsolete system operated jointly with the block of flats. Considering the savings that can be achieved according to the calculation of heating costs at the 2009 price level, the investment will pay off in around 16 years. After the commissioning of the new system there were no more disruptions in heating, deficiencies in the pipelines or the radiators, and the building stopped being overheated (due to the fact that the old system could not be controlled).

In the office building in Lónyay utca the lifts were replaced with new, microprocessor controlled ones, and due to the refurbishment of the shafts new lift doors were installed.

In the subject year the SAO spent only HUF 276.7 million on building renovation and reconstruction.

The renovation budget was used only for smaller works performed out of technical necessity in the amount of HUF 1.7 million. The SAO plans to spend the remaining amount – together with the 2010 appropriation – for the comprehensive refurbishment of the office block at 5 Bécsi utca. For this purpose the SAO launched a public procurement procedure in December 2009.

For the higher level completion of tasks the SAO spent HUF 31.1 million on the procurement of Xerox machines and a heat binding machine among other things.

Within the framework of the scheduled renewal of the vehicle fleet two vehicles were replaced, and vehicle parts and accessories were purchased for a total of HUF 19.2 million.

The amendment of the SAO's property management contract continued in compliance with the provisions of Act CVI of 2007 on state property. Due to its specific position, including its tasks, legal status and independence, the SAO cannot accept the original idea of the Hungarian State Holding Company, according to which the property management contract currently in force should be transformed into a lease agreement containing rents corresponding to the general market conditions. The senior managers of the Hungarian State Holding Company and the SAO met several times during the year to discuss this matter.

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After the amendment of Act CVI of 2007 on state property entered into force on 9 July 2009 – which does not require rent payment in return for property management rights – the Hungarian State Holding Company prepared its new draft property management contract, which left the property management rights with the SAO. In the rest of the year discussions about the finalisation of the contract continued both in person and in writing. Most of the SAO's proposals for modification were accepted. Preparations regarding the final draft contract acceptable for both parties are under way. The draft contract can be submitted to the National Property Management Council for approval and can be subsequently signed in the first half of 2010.

### **6.3. IT and telecommunication operations and developments**

The main objective of the SAO's IT activities is to support the implementation of the SAO's strategic mission and tasks in a versatile and efficient manner. IT and telecommunication developments in 2009 were also carried out – considering the developments of the former years – in accordance with the project plans specified in the SAO's annually updated, detailed IT strategy, approved by the presidential meeting.

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

The IT budget approved for 2009 ensured the implementation of projects and development tasks specified in the annual plan.

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

A top priority IT project of the SAO is the development of the electronic system (VIDOR) designed to support the documentation of the audit work, and to file and store the documents produced or collected during the audits, for which the SAO submitted a successful application for EU Transition Facility in 2006. Software development was carried out by the winner of the public procurement procedure, i.e. Bull Hungary Ltd. The development of the IT system was completed in May 2009. Development and the preparation of the system were carried out with the intense involvement of our directorates, and under professional guidance by the audit fields.

In the course of development the Central Finance and Contracts Unit (CFCU) conducted an open public procurement procedure with the involvement of the SAO's experts for the procurement of the hardware components of the system. The five server computers and the related equipment were installed by the



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deadline, which means that the infrastructural conditions are available for the fast and safe operation of the documentation system. During the interim performance evaluation, which was performed by Europe Ltd. twice upon assignment by the National Development Office, project performance was found to be excellent.

Automated data connection was developed between the SZEKRETER audit registration and monitoring system and the VIDOR system to ensure single data entries and the enforcement of the appropriate eligibility system. The commissioning of the system was completed in May 2009. The SAO successfully closed the project. Training for the users of the VIDOR system is carried out on a continuous basis in the form of classroom training, as well as through videos presenting the functions of the system. The system, the use of which is regulated by a Presidential instruction, documents audits that were launched after 15 June 2009. System development expects to entail the improved efficiency of audits – especially that of preparation –, the reduction of time spent on the preparation of audits, and improved efficiency of executive quality control and quality assurance due to the on-line accessibility of audit evidence. The system improves the efficiency of group work, as well as the broad utilisation of the knowledge produced during the audits (auditors' knowledge base). As a result of the introduction of the documentation system, the method of audit documentation can be standardised, too. During the development of the system the creation of the security conditions for remote access was also taken into account. The system is planned to be further developed on the basis of the users' experiences and needs, in accordance with the decisions of the senior officials of the SAO.

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

In 2009 the management of the SAO decided to join the Central Electronic Service System pursuant to Act LX of 2009 on electronic public services.

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

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Archives of Hungary. In 2009 the SAO started to prepare the system for the use of the office portal.

The services of the SAO's website are extended and updated on a continuous basis. Documents and information specified by the law are shown in full under a separate menu point, in compliance with the relevant requirements. Pursuant to the relevant legal regulations, documents stored in the Public Data Search system operated by Neumann Nonprofit Ltd. are also automatically updated on a continuous basis with the help of a software programme developed by the SAO's experts<sup>9</sup>. In 2009 the SAO prepared web pages for the visually impaired in accordance with the recommendation of KIETB.

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

The SAO continues to regularly use various electronic databases containing the transaction information of the audited budgetary institutions for its audits. With a view to increase the efficiency of the audit activity, as a result of cooperation among the Hungarian State Treasury, GIRO Zrt. and the SAO, data required for the financial audits are available – from 2010 – at the central budgetary institutions in a standard structure, appropriate for the auditors' needs.

Since 2006 all SAO sites have been connected to the Electronic Government Backbone Network (EGB). The logically separate and classified virtual private network (VPN) within EGB is monitored by the SAO's experts. In 2008 remote desktop management was introduced at all work stations connected to the national network of the SAO. In addition, other software development and updates were performed for the protection of the SAO's equipment and data connected to the network. In 2009 the SAO purchased hardware components to increase the operational speed of its internal network.

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

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<sup>9</sup> Research projects studying the enforcement of the act included the SAO among the best performing organisations.

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In order to increase work efficiency, since 2009 all notebook user auditors of the SAO have been authorised to access certain central services (e.g. e-mail system, on-line company information system, Audit Documentation System) from outside the SAO's network, by the application of proper hardware security tools (RSA keys).

In the past year, a total of 80 desktop computers and 90 notebooks were purchased through a centralised public procurement procedure. Within the framework of the scheduled replacement of equipment, twenty medium capacity printers were installed in various branch offices of the SAO. Due to the introduction of the audit documentation system, the tasks related to the digitalisation of paper-based documents have increased. Therefore, all SAO sites were equipped with scanners of the required capacity. Altogether 25 office scanners were commissioned.

To provide quality support to the dynamically growing computer services, two new server computers were purchased, one of which was installed in the computer room in Lónyay utca. On the other high capacity server, by using the VMware software (virtual infrastructure), 3 or 4 virtual servers can be operated on one physical server, which means that storage place, installation time and operational costs can be saved.

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

In 2008, the SAO could reduce its expenditures on wire telephone services by 42%. Pursuant to our contract signed in December 2009, from January 2010 no traffic fee must be paid for telephone calls and voice data traffic among the SAO sites. The SAO's staff members work in 24 different locations, therefore expenditures on wire telephone services are expected to further decrease in 2010.

In the subject year the SAO spent HUF 34.1 million on the procurement of applications and security software products, and HUF 40.1 million on the purchase of IT and telecommunications devices and equipment. In 2009 altogether HUF 47.1 million was spent on the purchase of software components for development projects completed under the EU Transition Facility.

#### **6.4. Internal audit**

Similarly to the former years, in 2009 one internal auditor performed the internal audit tasks of the SAO.

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

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The personal and material conditions for the internal audit were adequate during the year; functional independence was fully maintained in the internal auditor's work. As a permanent invitee due to their scope of activity, the internal auditor attended the presidential meetings, participated in the Secretary General's meeting organised on the basis of the semi-annual working plan, and regularly attended the executive meetings held by the Secretary General. This significantly facilitated up-to-date orientation in issues related to the financial management of the SAO, as well as the more effective implementation of audit tasks.

The audit objectives envisaged in the annual work plan were achieved. Audits were performed in relation to extension trainings, foreign business trips and tasks arising from the new property act. The audit of the utilisation of entertaining expenses was also commenced as scheduled.

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

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

The implementation of recommendations contained in the internal auditors' reports is under way. Most recommendations were realised by the end of 2009. Due to the large-scale changes in the external legal environment, recommendations related to the amendment of regulations will be realised by mid 2010 on the basis of the approved action plans.