STATE AUDIT
OFFICE OF HUNGARY

S U M M A R Y

Findings and Conclusions of the Audit on the Execution of the Budget of the Republic of Hungary for the Year 2009

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President

State Audit Office of Hungary
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PRINCIPAL EXPERIENCES

The planned revenue appropriation of the subsystems of public finances in 2009 amounted to HUF 16,514.9 billion; the expenditure appropriation amounted to HUF 17,299.6 billion, and the deficit was HUF 784.7 billion, corresponding to 2.8% of the GDP. The actual general government deficit was HUF 1,014.3 billion (3.9% of the GDP), exceeding the original appropriation by HUF 229.6 billion (29.3%).

The contributions by the components of general government to the increase in deficit were as follows:

General government deficit in 2009, on a cash basis
(HUF billion)

Description	Original appropriation	Actual performance	Difference
Central budget	-660.8	-743.7	-82.9
Separated state funds	19.0	-31.4	-50.4
Health Insurance Fund	-8.9	-149.5	-140.6
Pension Insurance Fund	0.0	-7.2	-7.2
Local governments	-134.0	-82.5	51.5
General government total	**-784.7**	**-1,014.3**	**-229.6**

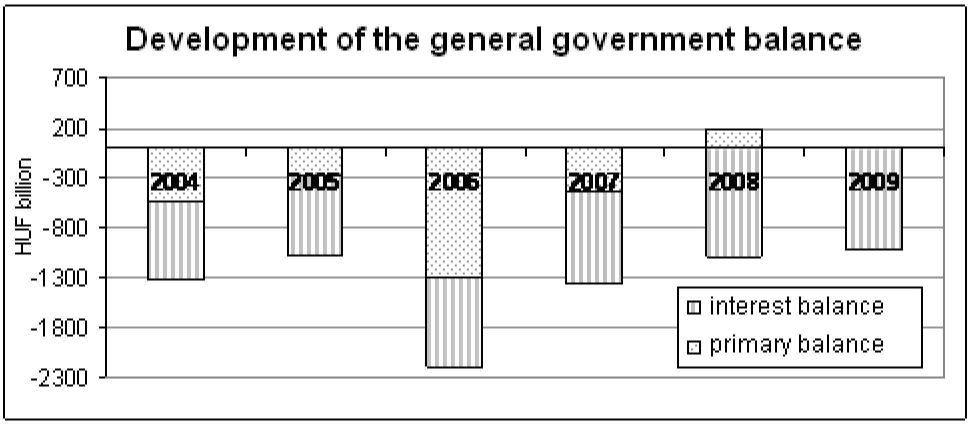
Source: the final accounts bill

The data of the actual performance, with the exception of local governments, exceeded the original appropriation of the deficit envisaged in the Act on the Budget. The balance of local governments became more favourable than the target figure in the budget, but their positive balance of 2008 (HUF 15.6 billion) turned negative by the end of 2009.

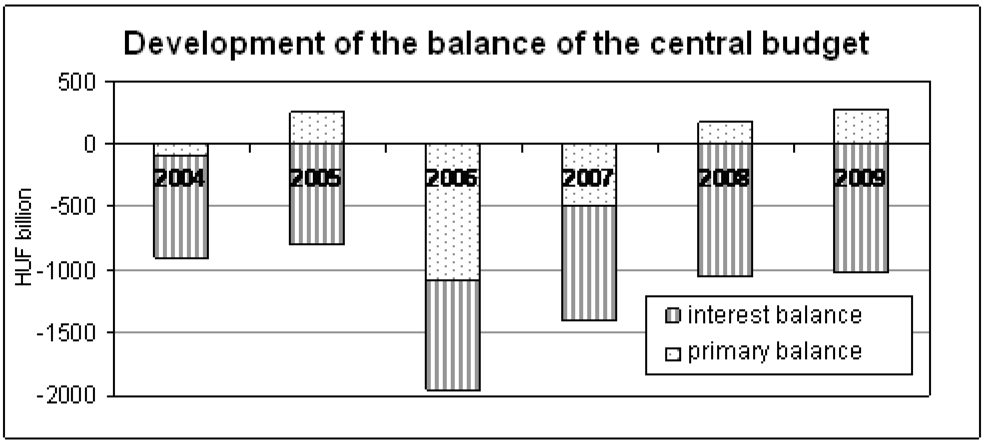
Similarly to 2009, it was also typical of the previous years that at the general government level there was a difference of several hundred billion forints between the actual deficit and the original appropriation (in 2007 and 2008 the balance was more favourable than planned).

As the developments in the planning environment, including those in the global economy, cannot be completely predicted, precise planning and responsible fiscal management are essential for attaining and maintaining the envisaged target deficit. Compliance with the set target deficit is of crucial importance in terms of the opinion formed on the credibility of the Hungarian national economy.

An important indicator in the shaping of budget policy and in the assessment of fiscal sustainability is the so-called primary balance, which expresses the result of the current financial management, and takes into account the expenditures without the interest burden of the debt accumulated in the past. According to its essence in terms of economic policy, it contains those revenues and expenditures, regarding which the Government may take measures in order to reduce total debt.



Source: final accounts bills



Source: final accounts bills

With the exception of 2008, no positive primary balance was attained at the public finance level. (On a cash basis, the primary balance of the public finance in 2009 amounted to HUF -9.8 billion, while that of the central budget was HUF 275.8 billion.) In the long term, fiscal sustainability requires the reduction of the debt ratio that is the total debt-to-GDP ratio. Primary surplus is one of the prerequisites.

FINAL ACCOUNTS

In terms of the conformity of the legal regulation and the statutory annexes, as well as the congruence between the general explanation and its annexes, the final accounts document has changed substantially and favourably over the years. The comparison between the data presented in the document and the consolidated data of the institutional financial statements shows a difference that is decreasing year by year. Occasionally the general explanation is supplemented by new and current informative elements.

While consistency in content is fundamentally typical, and there have been favourable changes, the prevailing regulatory environment has remained unchanged. Therefore, the SAO can repeat its earlier findings that **the current presentation system does not provide appropriate support for the constancy of the information content, transparency, comparison between years and the creation of a picture of the processes, including the traceability of objectives and their fulfilment as well as a summary, systematic presentation of long-term commitments.**

In addition to continuous amendments to the Act on Public Finances, its provisions concerning the final accounts document have remained unchanged, although the SAO has continuously indicated that they are incomplete, inaccurate, and consequently the fulfilment of these provisions is often insufficient or cannot be clearly judged.

The fulfilment of the provisions set forth by the Act on the Budget is difficult to oversee. The individual pieces of information are presented in different parts of the final accounts bill, in its legal regulations, legal annexes, general explanation and volumes of chapters, occasionally varying every year.

Based on audit experiences regarding the annual final accounts documents, it can be determined that substantial improvement in the quality of the presentation cannot be expected without regulating the compilation of the final accounts and determining the content and structure of the presentation.

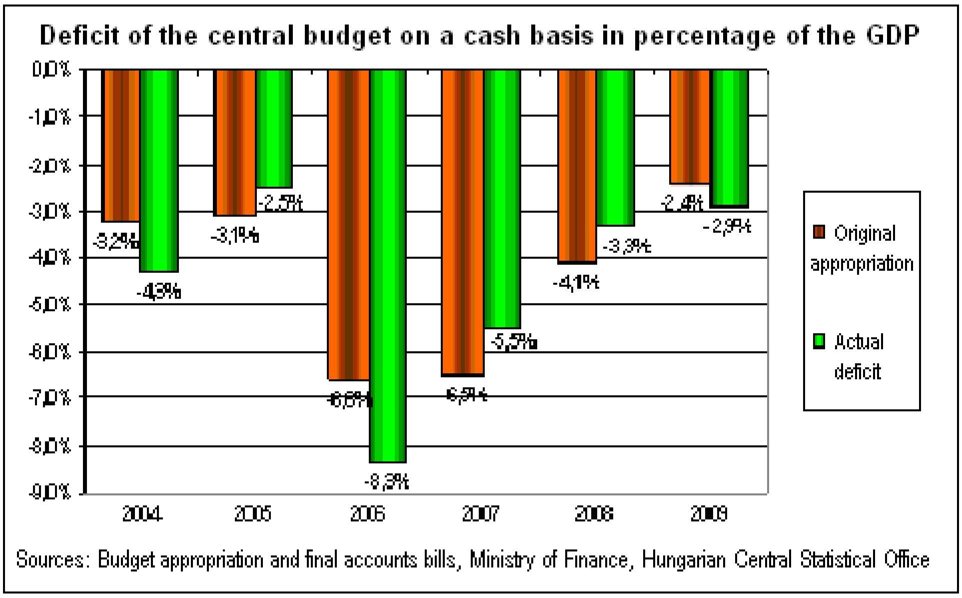
CENTRAL BUDGET

The **deficit** of the central budget in 2009 amounted to HUF 743.7 billion, exceeding the amount of the amended deficit by HUF 67.8 billion (10%). (The amended deficit was set forth by Act CXVII of 2009 on the Amendment of Act CII of 2008 on the Budget of the Republic of Hungary for 2009.) Upon forming an opinion of the deficit, it is justified to take into account that its amount is HUF 126.3 billion lower than the central budget deficit of the year 2008.

The deficit had essentially evolved by the end of the first half of 2009, as its half year amount equalled 96% of the year-end deficit.

Unfavourable developments in the central budget deficit compared to the figure set forth in the relevant act were experienced in five years out of the last eight (between 2002 and 2004, in 2006 and in 2009).

In 2004, the central budget deficit exceeded the planned amount by HUF 218.2 billion (32.6%). In 2005, it fell short of the appropriation by HUF 265.4 billion (32.6%), while it again exceeded the budgeted appropriation by HUF 40.3 billion (2.1%) in 2006. In 2007 and 2008, it was HUF 258.4 billion (16.6%) and HUF 247.6 billion (22.2%) lower than the budgeted amount, respectively.



The development of the deficit in 2009 was influenced by the fact that appropriations of decisive significance in terms of the budgetary equilibrium differed from the fulfilment of such to a lesser or greater extent.

It also affected the development of the deficit that based on three government decisions a total amount of HUF 101.2 billion was blocked (HUF 47.1 billion in January, HUF 54.1 billion in March and HUF 29.5 million in July). A government decision of July 2009 had required a total of HUF 535.2 billion as mandatory reserves to be retained by the institutions under government supervision (excluding social security funds[1]); then the government decision in October that amended the above decision changed it to a lower amount of HUF 527.3 billion. These measures mitigated the increase in the deficit.

It also contributed to the increase in deficit that the Agricultural and Rural Development Agency was unable to repay the loan of HUF 561.0 million borrowed from the advance payments account related to the Single Treasury Account, as the Central Agricultural Office failed to inform the Agency about the receipt of this amount from the EU, and did not take the necessary steps to transfer this amount to the Agency. Consequently, the aforementioned amount was not recorded as revenue under the title of EU subsidy for chapter-managed appropriations.

Tax revenues were a total HUF 415.6 billion below the amounts envisaged in the act (HUF 6,524.2 billion). The fundamental reason for this is that during 2009 the macroeconomic developments that serve as a basis for planning appropriations were significantly less favourable than projected.

> Instead of the envisaged 1%, GDP fell by 6.3%, the rate of decline in household consumption expenditure was twice as much as planned (-7.6%); gross fixed capital formation fell by 6.5% compared to the predicted 0.9%, while inflation was 0.3 percentage points lower (4.5%) than the planned rate of increase.

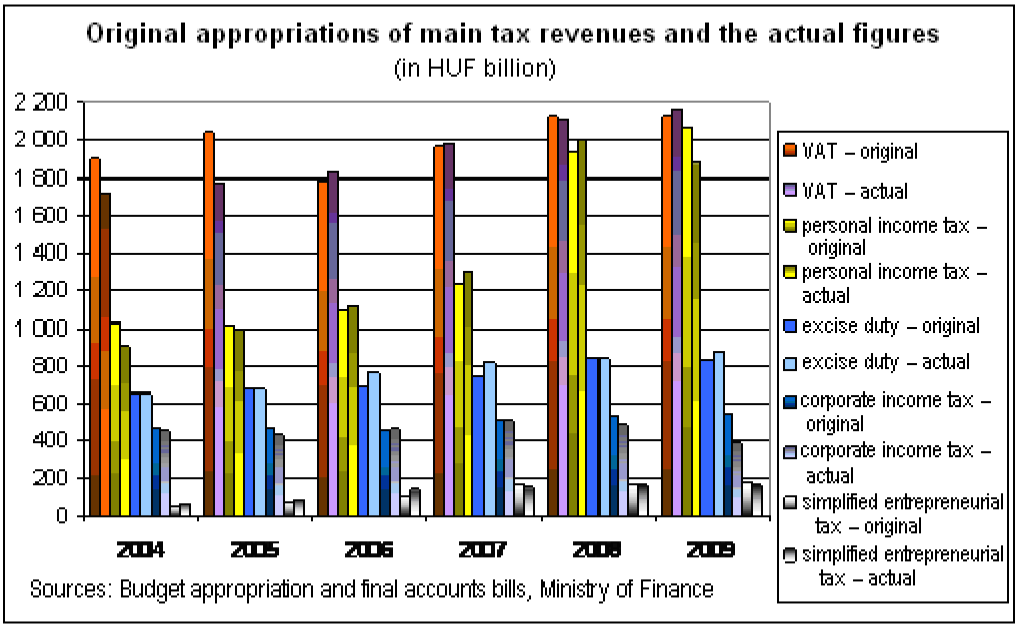
The shortfall of tax revenues was partly offset by the surpluses originating from other revenues (HUF 31.5 billion), the revenues related to the debt service (HUF 68.7 billion) as well as payments related to state property (HUF 46.1 billion). Concerning the payments related to state property, it is necessary to mention that (as in the previous years) most of the surplus payments originated from interim dividends and the settlement of dividends (HUF 35.0 billion). In addition, as a result of the dissolution of the Treasury Property Directorate the HUF 4.0 billion on the deposit account of the Hungarian State Holding Company was paid to the budget as a utilisation revenue after more than one and a half years in August 2009.

The surplus revenue of budgetary institutions and chapter-managed appropriations amounted to HUF 286.8 billion, but the expenditures of these appropriations, which were HUF 365.9 billion higher, resulted in a growth in deficit. It had a favourable effect on the developments in the deficit that although some of the expenditure appropriations (subsidies to subsystems of public finances, the enforcement of the guarantee undertaken by the state) were – lawfully – exceeded in an amount of HUF 23.2 billion, but the expenditures of other appropriations (debt service and interest payment, individual and normative grants, subsidies to families and social benefits, expenditures related to

[1] Government Decision 2007/2009. (VII. 29.) on the measures serving as a basis for the fulfilment of the obligation of central budget chapters to retain residual amounts in 2009 required the Pension Insurance Fund and the Health Insurance Fund to retain a residue of HUF 1.04 billion and HUF 3.28 billion, respectively. The amended government decision did not change the obligation of the Pension Insurance Fund, while it reduced the obligation of the Health Insurance Fund by HUF 5.6 million.

state property, extraordinary and other expenditures of the government as well as housing subsidies) were realised HUF 90.9 billion lower than envisaged.

On every occasion (including its Opinion prepared for the Budget, Financial and Audit Committee of the National Assembly on the bill submitted in September 2008, then withdrawn and resubmitted in October, as well as the Comments on its amendment in November)**, the SAO called attention to the risks of macroeconomic developments and the uncertainty of the realisation of the planned tax revenues.**



The SAO rated the realisation of the corporate tax, the personal income tax, the special corporate tax and the surtax of private individuals as highly risky. The shortfall in revenues from these taxes compared to the appropriation (HUF 2,827.5 billion) amounted to HUF 385.4 billion, which could only partly be mitigated by the value added tax and the excise duty, exceeding the appropriations by a total HUF 72.2 billion. The surplus revenue from the value added tax (HUF 33.4 billion) is attributable to the increase in the tax rate in the course of the year and an amount of HUF 164.9 billion lower in allocations compared to the previous year. The surplus revenue from the excise duty (HUF 38.8 billion) is a result of the unprecedented stock building of tobacco products at the end of the year that aimed at mitigating the demand reducing effect of the tax increase. Revenues from smaller taxes – with the exception of the environmental charge and household taxes – fell short of the planned figures.

In the 2009 final accounts bill, the fulfilment data of the direct revenues of the central budget, with the exception of revenues related to state property (the SAO qualified them as limited)**, are reliable**. In the case of the revenues under review, the Hungarian Tax and Financial Control Administration and the Hungarian Customs and Finance Guard (which realise 72.1% of the direct revenues of the central budget) executed all material taxation, duty collection, customs administration and excise activities in conformity with the relevant regulations and their own internal rules. Internal controls worked in an adequate manner.

The fulfilment data of the direct expenditure appropriations of the central budget, with the exception of the housing subsidies and the expenditures related to state property (the SAO qualified them as limited), **are reliable**. With regard to housing subsidies, the SAO has indicated every year since the audit of the 2005 final accounts, that some credit institutions, the circle of which varies, have been paying significant amounts of subsidies (HUF 12.9 billion in 2009) for several years without the new contract required by the relevant legal provision.

The balance sheet figure of the expenditures relating to the debt service provides a reliable picture of the fulfilment, with the exception of the appropriation of HUF 7.2 billion for the stand-by fee on the IMF loan and its fulfilment in the amount of HUF 0.3 billion, as they appear in a budget line other than the one corresponding to their content.

This is the first time that the general explanation of the final accounts gives an account of the receivables of the budget, the developments therein and the main reasons for the changes. The SAO has indicated the lack of this for years. The presentation of the receivables in the final accounts was also justified by their sharp increase in recent years. This is well illustrated by the fact that in the last five years the stock of tax arrears (and duty arrears starting from 2007) increased more than twofold from HUF 735.2 billion in 2005 to HUF 1,722.9 billion; within that the arrears related to liquidation tripled.

According to the financial analysis of the Hungarian Tax and Financial Control Administration, **the increase in arrears** was coupled with a continuous deterioration in composition; in 2007, 58.2% of the outstanding amount was attributable to non-operating taxpayers; the figure for 2008 was 64.8%, while the corresponding figure for 2009 reached 70%.

The data on unpaid taxes at the state tax authority were reliable, while the figure for unpaid duties (HUF 80.8 billion) is not exact due to the lack of complete documentation.

> 2-5% of the duty debt shown on taxpayers' current accounts and of the data accessible from IT systems did not match as a result of accounting errors and an unprocessed backlog, in spite of the fact that the tax authority processed 80% of the backlog in 2009.

The Hungarian Tax and Financial Control Administration used all its available opportunities (progressive increase of the number of enforcement procedures, development of IT systems, cancellations of stocks, cancellations because of assignment) to prevent the increase in arrears, but it could only reduce the amount of increase compared to 2008 (HUF 312.5 billion).

The total amount of overpayments (HUF 733.3 billion) decreased by 4.6% compared to the previous year, most of which did not present a payment obligation to taxpayers in 2009 either. The stock of overpayments mainly originated from the errors of taxpayers (incorrectly submitted, unprocessable tax returns, amounts transferred to the wrong revenue or collection account).

Balances of unpaid and overpaid taxes*

Description	2006		2007		2008		2009	
	HUF billion	2006/ 2005	HUF billion	2007/ 2006	HUF billion	2008/ 2007	HUF billion	2009/ 2008
Unpaid taxes	949.4	129.1 %	1079.7	113.7 %	1410.4	130.6 %	1722.9	122.2 %
Overpaid taxes	772.4	131.9%	836.5	108.3%	766.9	91.7%	733.3	95.6%

* Based on data supplied by the Hungarian Tax and Financial Control Administration

Compared to 2008, there was a significant improvement at the Hungarian State Holding Company in the extent to which revenues were processed, in the recording and accounting for specified revenues according to their actual title which increased reliability, and in data supply, including better documentation of individual transactions, which allowed a more comprehensive control of these transactions than in the previous year. The Hungarian State Holding Company has been processing the revenues related to **state property** on a daily basis since February 2009. As a result, there has been an improvement in assigning a public finances identification number to the revenues, in the identification of revenues according to legal title, in the extent to which revenues were processed and, accordingly, in the quality of the data supply to the Treasury.

However, compared to 2008, there was an unfavourable change in terms of expenditures.In 2009, the SAO rendered a limited qualification of both the revenues and expenditures related to state property.

Compared to the experiences of the audit on the final accounts for the year 2009, t**he essential framework of the utilisation of state property remained unchanged.** In 2009, **the Hungarian State Holding Company** continued to perform its tasks relating to the management of the state property that was entrusted to it **without having** orderly, **precise and complete property record** confirming state property with an itemised inventory containing the updated value of the shares of the state. (Based on the information from the Hungarian State Holding Company, inventory taking of the state property was in progress when the on-site audit ended.)

The SAO is taking this opportunity as well to call attention to the fact that the deadline for preparing the balance sheet of the Hungarian State Holding Company is 15 August 2010. Consequently, it is still not in conformity with the deadline of the reporting obligation related to the final accounts.

In 2009, the Hungarian State Holding Company was again unable to fully comply with its asset recording obligation set forth in Government Decree 254/2007. (X. 4.).

In 2009, as in the previous years, the SAO judged that – irrespective of the organisational framework – there is a lack of agreement between the envisaged revenues from real estate sale and the fulfilment of such.

The SAO indicated in several cases (with a total amount of HUF 165.5 million) that the accounts were not in conformity with the content of the revenue or expenditure. The Hungarian State Holding Company was unable to provide the complete, itemised content of revenues from other real estate sales of the amount of HUF 1.5 billion, and until the end of the on-site audit it also failed to record the content, composition and justification of an amendment amounting to HUF 119.7 million.

The SAO formulated objections in three cases (the sale concerning the property of the National Horseracing Ltd. in Dunakeszi-Alag, the investment implemented in order to accommodate the Hungarian Customs and Finance Guard and the contract signed with the Electronics, Logistics and Property Management Co. Ltd. of the Ministry of Defence).

In 2009, developments in the **funding[2] requirement of the general government** were less favourable compared to the financing[3] plan laying the foundation of the appropriations of the budget for 2009 and to the amounts in the amended financing plans of November 2008, January 2009 and March 2009, while compared to the amount in the financing plan of May the developments were more favourable.

In 2009, the net funding requirement of treasury institutions[4] amounted to HUF 921.3 billion, which was HUF 77.6 billion higher than the amount in the financing plan (HUF 843.7 billion) serving as a basis for the appropriation. The reason for this is that while the balance of the central budget was more favourable by HUF 114.7 billion, the social security balance was HUF 165.1 billion and the balance of the separated state funds was HUF 27.3 billion below the financing plan substantiating the appropriation.

The total net funding requirement[5] of 2009 amounted to HUF 885.8 billion, which was HUF 201.7 billion below the amount of HUF 1,087.5 billion envisaged in the financing plan substantiating the appropriation.

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[2] The annual funding need is determined by the renewal requirement of expiring debts, as well as the prevailing deficit of the central budget, the social security funds and the separated state funds. Furthermore, the funding requirement may be modified by changes in the Single Treasury Account balance and the equalisation reserve of the National Bank of Hungary, the granting of advance and liquidity loans specified in the Act on Public Finances and the share of advances related to EU payments and of privatisation revenues affecting the budget.

[3] The financing plan includes the net funding requirement and the financing of the debt. Debt management transactions include the borrowing and repayment of loans, the repayment and issuance of government securities as well as payments resulting from loan assumptions.

[4] The aggregated balance of the central budget, social security funds and separated state funds.

[5] The total of the deficit of the central budget, the funding need of social security funds and of separated state funds, the reserve accumulation of the National Bank of Hungary as well as of the pre-financing and reimbursement of EU agricultural subsidies, excluding debt assumptions.

The funding need of the central level of general government was ensured by a total net issuance[6] of HUF 916.4 billion, which was HUF 179.0 billion lower than the financing plan substantiating the appropriation (HUF 1,095.4 billion). This net issuance also includes the total amount of HUF 1,726.0 billion of foreign exchange loans drawn from the IMF on 30 March 2009 and 29 September 2009 as well as from the European Commission on 26 March 2009 and 6 July 2009. The net issuance excluding foreign exchange loans amounted to HUF -778.2 billion.

The loans drawn from the **credit lines provided by the International Monetary Fund** and the European Commission amount to HUF 720.1 billion and HUF 1,005.9 billion, respectively. The foreign exchange loan drawn in the amount of HUF 1,726.0 billion in 2009 was used by the state for repayments on maturing debt (repayment of expiring forint debt and foreign exchange bonds). Pursuant to Article 8/B (1) b) of the Act on Public Finances, from a portion of the 2008 drawing, the Hungarian State granted loans to three credit institutions (Hungarian Development Bank Private Limited Company *(MFB Zrt.)*, OTP Bank *(OTP Nyrt.)* and FHB Land Credit and Mortgage Bank Company *(FHB Nyrt.)*) in 2009; these amounted to a total of HUF 445.4 billion on 31 December 2009. The remaining amount – deposited at the National Bank of Hungary – was HUF 679.4 billion at the end of 2009[7].

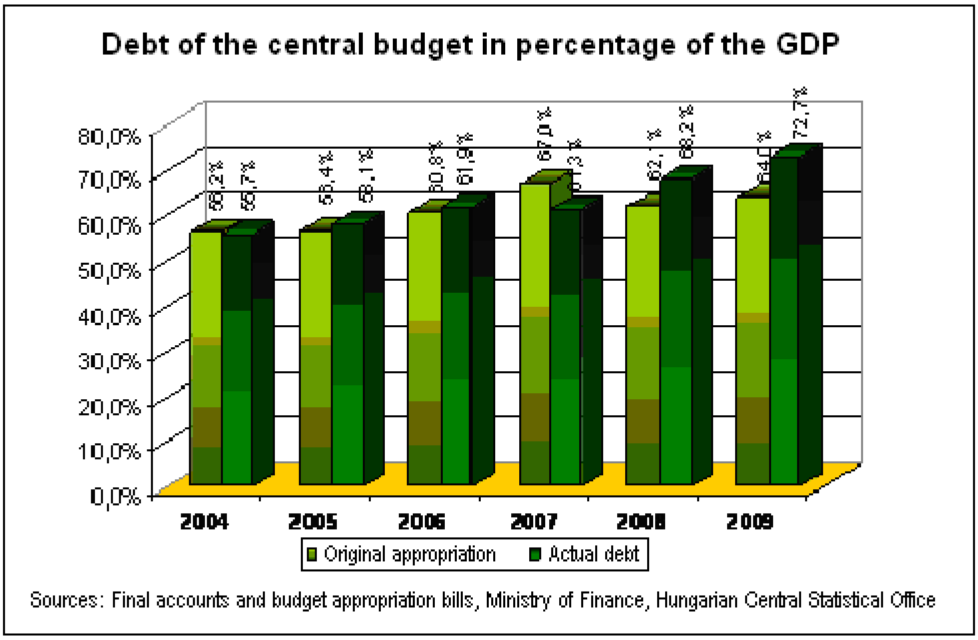
The foreign currency credit involved in the financing of public debt increases the amount of the bonds of the National Bank of Hungary in an indirect manner, since the National Bank of Hungary withdraws the excess liquidity from circulation by selling its own bonds. The interest rate spread between the forint and foreign exchange yield of the bonds is expected to have a negative impact on the profit of the National Bank of Hungary. Pursuant to the provisions of the Act on the National Bank of Hungary, the losses exceeding the balance of the accumulated profit reserve shall be paid directly by the central budget, which adds to the public debt and the deficit as well. No payment obligation of the budget was incurred in 2009. A payment obligation is expected to arise in 2012, which will debit the budget in the amount of HUF 49.0 billion.

The funding of the central budget, the social security funds and the separated state funds was ensured in 2009.

At the end of 2009, the **gross debt of the central budget** amounted to HUF 18,964.9 billion, exceeding the plan by 6.9% and the corresponding figure for 2008 by 4.8%.

[6] The total of the balances of issuances in forint and foreign exchange, borrowings and repayments as well as foreign exchange deposit transactions.

[7] The data related to the profit/loss of the National Bank of Hungary are included in the SAO report of the audit on the operation of the National Bank of Hungary in 2009.



Total debt, including the deposited part of the IMF/EU loans, equalled to 72.7% of GDP, which is 4.5 percentage points above the value of the previous year (68.2%). The growth rate compared to the previous year was 9.5% in 2004, 10.1% in 2005, 15.2% in 2006, 6% in 2007, 16.2% in 2008 and 4.8% in 2009.

The growth of last year was a result of the drawing from the international loan package and the depreciation of the forint. In 2009, HUF 1,726.0 billion of the international loan package provided by the IMF and the EU was utilised. The development of exchange rates was also unfavourable, as they rose from HUF/EUR 264.8[8] to HUF/EUR 270.8[9].

The negative balance of HUF 94.0 billion of the advance payments of the EAGF subsidies from the Single Treasury Account contributed, even if only to a small extent, to the increase of the total debt in 2009.

> According to Treasury data, advance payments of the EAGF subsidies from the Single Treasury Account between 2004 and 2009 amounted to a total of HUF 1,322.1 billion, while the total amount refunded by the European Union was HUF 1,119.3 billion. Accordingly, the balance of the advance payments is a total of HUF -202.8 billion.
>
> In 2009, advance payments of the EAGF subsidies from the Single Treasury Account amounted to HUF 342.5 billion, while the amount refunded by the European Union was HUF 248.5 billion.

Within the total debt, the ratio of outstanding debt denominated in foreign exchange continued to increase from 37.6% in 2008 to 44.7% in 2009. This is due both to the counterbalancing of the considerable fall in demand for forint denominated government securities, compensated by the Government Debt Management Agency by partial use of the foreign exchange loans provided by the

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[8] Official rate of exchange on 31 December 2008. Source: National Bank of Hungary.

[9] Official rate of exchange on 31 December 2009. Source: National Bank of Hungary.

European Commission and the International Monetary Fund, and also to the weakening of the exchange rate of the forint to euro. At the end of 2009, the total foreign exchange debt of the central budget was HUF 10,476.2 billion, representing an increase of 25% compared to the end of the previous year.

The **financing position of budgetary institutions continued to be characterised by debts which were high** throughout 2009 **and increased significantly** in the second half of the year. The increase in outstanding debt resulted largely from compliance with the obligation to retain reserves ordered in 2009 and the postponement of payments undertaken to the debit of funds to be unblocked at a later date. Despite the high amounts, the debt can be considered temporary and liquid in nature.

> In the first half of 2009, the debt fluctuated between HUF 12.0-15.0 billion every month, which was similar to the level in the previous year. The average of the first six months is HUF 13.3 billion, which barely exceeds the average of the previous year (HUF 12.7 billion). However, the debt of central budgetary institutions increased significantly in the second half of the year. In August, the debt already exceeded HUF 20.0 billion, and was around HUF 30.0 billion in the last two months of the year. The average debt in the second half of the year was HUF 24.5 billion, which was nearly twice as much as the average figures for the previous year and for the first half of the year. Average annual debt in 2009 amounted to HUF 18.9 billion, which is nearly one and a half times the average of the previous year.

The average value of qualified debts (i.e. in excess of HUF 50.0 million or 3.5% of the original budget appropriation) amounted to HUF 2.2 billion, which was HUF 0.1 billion less than in the previous year. However, regarding the figure of the end of the year, the situation is much less favourable: in December 2009, qualified debt amounted to HUF 3.9 billion, reaching 2.8 times as much as the closing amount of the previous year.

> Most of the qualified debt is concentrated at two institutions: half of the year-end amount (HUF 2.0 billion) appeared at the State Health Centre belonging to the Ministry of Defence, while one quarter of it (HUF 0.99 billion) appeared at the University of Pécs.

The distribution of total debt by types of debt has not changed significantly. While other trade accounts payable continue to be decisive both in terms of their quantity and proportion, as a result of measures taken earlier and the functioning of the debt monitoring system jointly operated with the Hungarian Tax and Financial Control Administration as well as the introduction of the net financing order of the Treasury (which prevents the arising of new public debt), the unpaid taxes and contributions of institutions have essentially been eliminated.

The Office of Treasury Commissioners did not have to exercise its right to block in 2009 either.

The appropriation of the **central budget reserves** (general reserves, special reserve, stability reserve) for 2009 amounted to a total of HUF 192.0 billion. During the year, HUF 92.5 billion were reallocated to the chapters, of which HUF 2.1 billion were restored in 2009. Taking this into account, the total use of reserves amounted to HUF 90.4 billion (47.1%), while the **year-end residue** was **HUF 101.6 billion**.

The reallocation from the **general reserves** was not justified in an amount of 59.8% of the reallocated appropriation (HUF 27,844.8 million); the requisition did not comply with the provisions of Article 25 (1) of the Act on Public Finances. The findings of the SAO were identical with this in the previous years as well. In the case of certain tasks, the need of chapters for additional resources could have been anticipated and planned, and cannot be regarded as replaceable because of revenue losses due to appropriated, but unavoidable reasons (e.g. grant to the Ministry of Foreign Affairs for unpaid membership fees, additional subsidy for the annual budget of the Police and the Hungarian Prison Service, funding of the tasks related to the Hungarian EU presidency in 2011, etc.). The reallocation of HUF 14.2 billion amounting to 30.1% of the annual appropriation of HUF 47.2 billion was carried out in the second half of December 2009 (between 17 and 29 December).

From the HUF 66.8 billion appropriation of the **special reserves**, HUF 45.9 billion were reallocated as cover for various personal payments set forth in Article 4 of the Act on the Budget; HUF 2.1 billion of this amount were restored during the year on the basis of the accounting and reimbursement obligation. Accordingly, the fulfilment of the appropriation amounted to HUF 43.8 billion, while the year-end residue was HUF 23.0 billion. The main reason for the significant residue (34.4%) is that in the case of six legal titles out of the 11 in Articles 4 and 5 of the Act on the Budget no spending took place. The Ministry of Finance justified it with the economic situation and the fact that for these legal titles no request was received that could have caused disturbances in the functioning of the given institutions in case of non-fulfilment.

The Act on the Budget included an appropriation of HUF 78.0 billion as **stability reserves**, which were not used. Consequently, the year-end residue corresponds to the amount of the appropriation. In two cases – with Government Decisions 1096/2009. (VI. 19.) and 1108/2009. (VII. 10.) – the Government reallocated a total of HUF 1.1 billion from the general reserves instead of the stability reserves. The reallocation of appropriations was not carried out in compliance with the provisions set forth in Article 44 and Article 71 (2) of the Act on the Budget.

THE RELIABILITY OF THE FINANCIAL STATEMENTS

The Reliability of the Financial Statements Audited by the SAO

In line with the practice of previous years, we carried out on-site audits of the regularity of the implementation of the budget and the reliability of financial statements in the case of the chapters of the central budget (administrative title/subtitle, chapter-managed appropriations title) and its budgetary institutions with chapter rights. The audit of the financial statements was carried out on the basis of the methodologies outlined by the SAO in cooperation with the National Audit Office of the United Kingdom, also taking into account the INTOSAI audit standards and the standards related to the Hungarian auditing regulations,. We rated the audited financial statements by giving an opinion.

In the course of the audit on the 2009 final accounts, based on the financial regularity audits conducted by the SAO, we rated the reliability of 53.1% of the total expenditure of the chapters of the central budget.

The qualified opinion given on a financial statement can be an approving opinion (with an emphasis of matter paragraph), limited opinion or adverse opinion.

> An **approving opinion** on the financial statement can be given if it can be established with an assurance level of 95% that the financial statement was compiled with a consistent application of approved accounting principles, it complies with statutory provisions and other relevant regulations, and the statement provides a fair and reliable picture of the financial position and financial management.
>
> In the event that the audit detects any deficiency that does not influence the reliability of the statement, an **emphasis of matter paragraph** has to be attached to the approving opinion.
>
> The audit rates those financial statements with a **limited opinion** on which an approving opinion cannot be given, but the detected errors do not reach the materiality threshold, or the identified irregularities do not justify the rejection of the statement. The limited opinion has to indicate to what parts of the financial statement the limitation refers. The reasons for the limitation and, if possible, the quantification of their impact on the statement have to be explained clearly in the opinion.
>
> An **adverse opinion** has to be given on the reliability of the financial statement if, as a result of the effects of significant errors and irregularities that were identified during the audit which exceeded the materiality threshold and affected the reliability of the statement, it does not provide a reliable and true picture of the financial position.

Out of the 52 financial regularity audits carried out by the SAO, 39 statements received approving opinions, with an emphasis of matter paragraph attached to

26 of them. Ten statements received limited qualifications, and three statements received adverse qualifications.

We gave an **approving opinion** on the 2009 financial statements of the Chapters '**National Assembly'**, the **'Presidency of the Republic**', the '**Constitutional Court**, the '**Parliamentary Commissioners' Office of Hungary'**, the '**Courts of Justice**', the **'Prosecution Service of the Republic of Hungary'** and the '**Hungarian Competition Authority**'; the Administrative Titles/Subtitles of the Chapters **'Fiscal Council'**, the '**Administration of the Prime Minister's Office'**, the '**Ministry of Local Government'**, the '**Ministry of Defence'**, the '**Ministry of Justice and Law Enforcement**', the '**Ministry for National Development and Economy'**, the '**Ministry of Environment and Water**', the '**Ministry of Foreign Affairs'**, **'EU Developments'** (**National Development Agency**), the '**Ministry of Education and Culture'**, the '**Ministry of Finance'**, the '**Ministry of Social Affairs and Labour**', the 'Hungarian **Central Statistical Office'** and the '**Hungarian Academy of Sciences'**; subtitles within the title **'Civil Service for National Security'** the **'National Security Service'**, the '**Managing Authority'** and the '**Special Service for National Security'**; the institutions '**Hungarian Atomic Energy Authority**,' the '**National Communications Authority'**, the '**Hungarian Energy Office'**, the '**Health Insurance Supervisory Authority**', the '**Hungarian Patent Office'**, the **'Hungarian Financial Supervisory Authority'** and the '**Government Audit Office',** as well as the chapter-managed appropriations of the Chapters **'Ministry of Local Government**', the '**Ministry of Defence**', the '**Ministry of Environment and Water**', the '**Ministry of Transport, Telecommunication and Energy**', the '**Ministry of Foreign Affairs'**, the '**Ministry of Health'**, the '**Ministry of Finance'** and the '**Hungarian Academy of Sciences'**.

> In view of the deficiencies revealed during the audit – which do not affect the reliability of the financial statements – **we attached an emphasis of matter paragraph to our approving opinion** on the Chapters **'Parliamentary Commissioners' Office of Hungary'** and the '**Courts of Justice**'; the administrations of the Chapters **'Fiscal Council'**, the '**Ministry of Local Government'**, the '**Ministry of Defence'**, the '**Ministry of Justice and Law Enforcement'**, the '**Ministry for National Development and Economy'**, the '**Ministry of Environment and Water'**, the '**Ministry of Foreign Affairs'**, the '**EU Developments'** (**National Development Agency**), the '**Ministry of Education and Culture'**, the '**Ministry of Finance'** and the '**Ministry of Social Affairs and Labour**'; within the Title **Civil Service for National Security** the Subtitles '**National Security Service'**, the '**Managing Authority'** and the 'Special Service for **National Security'**; the Institutions '**National Communications Authority**', the '**Hungarian Energy Office**', the '**Health Insurance Supervisory Authority'** and the '**Hungarian Patent Office',** as well as the chapter-managed appropriations of the Chapters **'Ministry of Defence',** the '**Ministry of Environment and Water**', the '**Ministry of Foreign Affairs**', the '**Ministry of Health'**, the '**Ministry of Finance'** and the '**Hungarian Academy of Sciences'**.

The external chartered accountant attached an approving opinion to the statement of the **SAO**.

Limited qualifications were given on financial statements with regard to certain appropriations and balance sheet items in the statements of the institution '**Central Services Directorate General'** of the Chapter **'Prime Ministeriate'**, in the financial statements of the Administrative Titles of the Chapters '**Ministry of Agriculture and Rural Development'** and the '**Ministry of Transport, Telecommunication and Energy'** and in the statements of the subtitle of the Central Administration of the **Ministry of Health,** as well as in the financial statements on the chapter-managed appropriations of the Chapters **'Prime Ministeriate'**, the '**Ministry of Justice and Law Enforcement'**, the '**Ministry of National Development and Economy'**, the '**EU Developments'**, the '**Ministry of Education and Culture'** and the '**Ministry of Social Affairs and Labour'**.

Adverse qualifications were given to the 2009 financial statements of the **Public Procurement Council** and the Subtitle '**Center for Coordination Against Organised Crime'** within the Title 'Civil Service for National Security', as well as of the chapter-managed appropriations of the Chapter '**Ministry of Agriculture and Rural Development'**.

Results of the reliability audits carried out by internal audit organisational units of chapters

In 2009, the audit organisations of 12 chapters (**Prime Ministeriate, Ministry of Local Government, Ministry of Agriculture and Rural Development, Ministry of Defence, Ministry of National Development and Economy, Ministry of Transport, Telecommunication and Energy, Ministry of Foreign Affairs, Ministry of Education and Culture, Ministry of Health, Ministry of Finance, Ministry of Social Affairs and Labour, Hungarian Central Statistical Office**) undertook to carry out the reliability audit of institutions under their management, complementing the audits conducted by the SAO. All in all, 59 of the planned 63 audits were realised. The audits undertaken were performed in full in the case of the Chapters **'Prime Ministeriate'**, the '**Ministry of Local Government'**, the '**Ministry of Agriculture and Rural Development'**, the '**Ministry of Defence'**, the '**Ministry of National Development and Economy'**, the '**Ministry of Transport, Telecommunication and Energy'**, the '**Ministry of Education and Culture'**, the '**Ministry of Health'** and the '**Hungarian Central Statistical Office'**. Based on their reliability audits, the internal audit organisational units of chapters qualified 9.3% of the total expenditures of the chapters of the central budget.

46 of the audits performed were concluded with an approving qualification. An emphasis of matter paragraph was applied in 21 cases; 6 statements received limited qualifications, and 7 statements were rejected.

The audit qualified the financial statements of the **National Institute for Sport Talent Care and Sport Services**, the **troop** financial statement of the **Support Brigade of the Hungarian Defence Forces**, the **central** financial statement of the **Infrastructure Agency of the Ministry of Defence** as well as the statements of the **National Transport Authority**, the **Hungarian**

Meteorological Service and the **National Office for Research and Technology** with **limited opinions**.

The audit resulted in an **adverse opinion** on the financial statements of the **National Institute for Sport Medicine**, the **Museum of Applied Arts**, the **troop and central** financial statements of the **Development and Logistics Agency of the Ministry of Defence**, the **central** financial statement of the **Hungarian Defence Forces Logistics Supply Centre**, and the **troop and central** institutions' statements of the **Hungarian Defence Forces 'Dr. Radó György' Military Medical Centre**.

THE UTILISATION OF FUNDS FROM THE EUROPEAN UNION

The aggregated amount of HUF 1,178.1 billion of the **items received from the European Union** (EU) and **appearing in the budget and the items outside the budget** was more than five times the amount of the fulfilled domestic payment obligations (HUF 223.7 billion).

The EU funds shown in the budget – not including the subsequent return on the EU subsidies – were 8% (HUF 72.3 billion) below the planned amount, while the utilisation of central budget assets exceeded the planned appropriation by 24% (HUF 43.5 billion), which poses a risk in terms of the fulfilment of the budget, since it works as a deficit increasing factor.

As a result of the shortfall in revenues from the EU and the exceeding of the expenditures from the domestic budget, the realisation of the appropriations containing the EU funds as well was altogether 16.1% (HUF 115.8 billion) below the planned amount. **The opposite trends in the utilisation of EU funds and domestic co-financing and their departure from the plan have different reasons in specific support categories.**

In the case of the **National Development Plan I**, in view of the financial crisis, the European Commission (EU Commission) extended the original closing date from 31 December 2008 until 30 June 2009. Accordingly, payments related to the National Development Plan I could be effected in 2009 as well, although no more funds were drawn from the EU.

Using the **Cohesion Fund**, contracts of more significant amounts were concluded in the transport and environmental sectors until 2009. In the case of certain Cohesion Fund projects the National Development Agency submitted amendments to financial agreements to the EU Commission. In addition to other changes in content, an extension of the accounting deadline was requested in order to allow adequate timeframe for the institutional system to successfully complete the projects.

In 2009, compared to the original Cohesion Fund appropriation of HUF 59.5 billion, there was a substantial excess of HUF 123.5 billion, of which the contribution by the EU amounted to HUF 67.5 billion. The reason for the excess was that a major portion of the end-2008 invoice slipped over to 2009.

The financial and economic recession affected the results of the projects supported by the Cohesion Fund reached until 31 December 2009.

> The coverage by work contracts reached 84% and 88% of the EU subsidy part of the expected total cost of transport projects and of environmental projects, respectively.

As opposed to the original expenditure appropriation of HUF 655.0 billion of the **New Hungary Development Plan** for 2009, payments were fulfilled in the amount of HUF 468.8 billion. Within this, the utilisation of EU funds amounting to HUF 390.6 billion was coupled with domestic grants of HUF 78.2 billion, which also includes the subsidy taken over from the Labour Market Fund. Fulfilment for the year 2009 fell short of the planned amount due to the time necessary to award the grants.

By the end of 2009, in the case of each operational programme the first payment requisitions were sent to the EU Commission, which was the condition for the Member State not to lose the already received advance.

In the case of the **Other structural assistance**, bilateral development programmes are implemented, along the internal borders of the EU, within the framework of the European Territorial Cooperation replacing the INTERREG Community Initiative programmes in the period between 2007 and 2013. The IPA (Instrument for Pre-Accession Assistance, for Croatia and Serbia) programmes were adopted by the EU Commission in March 2008. Payments fell short of the planned amount because of the two-round calls for proposals and the prolonged international negotiations.

In the case of the National **Rural Development Plan**, Hungary was allowed to use the fund of EUR 751.1 million set forth in Council Regulation 1260/1999/EC for the period between 2004 and 2006 until 31 December 2008. Consequently, the item 10/11/01 'National Rural Development Plan Measures' of the Chapter 'Ministry of Agriculture and Rural Development' no longer had an original expenditure appropriation in 2009.

In 2009, the revenue from the claims related to the grants utilised without entitlement from the completed programmes of the National Rural Development Plan amounted to HUF 762.6 million. The uncommitted residue of HUF 148.9 million, carried over from the previous year, was also added to it. Accordingly, the amended expenditure appropriation amounted to HUF 911.5 million.

Due to proceedings for legal remedy, a payment of HUF 149.6 million took place for National Rural Development Plan measures from the appropriation, and the amount of the residue (HUF 148.9 million) for the year 2008 was withdrawn. In addition to the above, the EU part, HUF 91.2 million, of the assets received in the first half of 2009 was transferred back to the EU Commission, and an operating expenditure equivalent to a grant in the amount of HUF 420.9 million was reallocated to other appropriations. In 2009, the total amount of expenditures spent was HUF 810.7 million.

In 2009, the EU Commission approved the report on the conclusion of the programme and the implementation report of 2008. At the end of 2009 and in 2010, the EU Commission transferred the 5% of funds retained from the overall amount of the programme in compliance with the rules.

Until 31 December 2009, grants amounting to HUF 184.5 billion were paid for the objectives of the **New Hungary Rural Development Programme**.

The commitments extending to several years launched from the funds of the National Rural Development Plan pursuant to Regulation 1320/2006/EC continue within the framework of the New Hungary Rural Development Programme in the period between 2007 and 2013.

In spite of the international and domestic economic and financial crisis, the programmes within the New Hungary Rural Development Programme were realised to a degree exceeding the original appropriation, to which two kinds of measures contributed. Hungary availed of the opportunity set forth in Council Regulation (EC) No 473/2009, pursuant to which the programmes financed from the European Agricultural Rural Development Fund (EARDF) were allowed to be paid with a maximum 10% higher EU funding ratio during 2009. In the fourth quarter of 2009, in the case of axes I and III, as well as the Technical Assistance measure, instead of 25% a 15% national contribution was paid, while in the case of axes II and IV only 10% instead of 20%. The increased funding by the EU allowed the payment of additional funds amounting to HUF 21.7 billion. In addition, in the case of certain measures of the New Hungary Rural Development Programme, pursuant to Government Decree 91/2009. (IV. 22.) on the grant advance to be paid in 2009, advances amounting to HUF 32.7 billion were paid under the legal title of New Hungary Rural Development Programme axis I investments. Until 31 December 2009, the amount of the advance accounted for was HUF 7.1 billion.

Pursuant to Government Decree 220/2009. (X. 8.) on advances provided for operational purposes for LEADER Local Action Groups within the framework of the New Hungary Rural Development Programme, advances amounting to a total HUF 1.5 billion were paid to the 96 local action groups. This amount equals up to 20% of the operating budget of the LEADER.

The **Fisheries Operational Programme** was adopted by the EU Commission in 2008; therefore, no payments for the programme were effected in that year. In 2009, the Ministry of Agriculture and Rural Development intended to accelerate the implementation of the programme with the introduction of an advance payment scheme and a new measure within axis II (direct payment). However, the opportunity for advance payment failed to be provided, and commitments were postponed to the end of the year due to administrative reasons (setting up the organisational system conducting the relevant procedure). Consequently, there were delays in payments as well. In 2009, only the expenditures of HUF 52.7 million related to setting up the executive agency of the Fisheries Operational Programme and to payments of wages were realised within the framework of the Technical Assistance measure.

The **SAPARD** programme did not have an original expenditure appropriation for 2009, as it had been completed in 2008. As a result of the settlement of claims and fulfilment of obligations stemming from the arrangement of earlier legal disputes, the appropriation was amended, and the payments and revenues were realised in the amount of HUF 183.8 million.

The purpose of the **Transition Facility** is to develop and strengthen the administrative capacities of Member States in implementing and enforcing Community Law and to facilitate the mutual exchange of good practices. The original expenditure appropriation for 2009 amounted to HUF 738.8 million, of which HUF 33 million was budget subsidy. The fulfilment in 2009 was HUF 1,464.3 million, of which EU funds amounted to HUF 882.8 million. The fulfilment of domestic subsidy payments exceeding planned payments was due to the use of reserves.

In terms of their amounts, the most significant of the **other EU subsidies** are the so-called TEN-T programmes (development of transport, energy and telecommunications networks), the grants from the Norwegian Financing Mechanism and the so-called other agricultural subsidies ('drink milk' programme, apicultural programme, support to certain special associations, control and elimination of certain animal diseases, VAT coverage of EU programmes). The originally planned expenditure of these programmes (HUF 18.8 billion) amounted to approximately three quarters of the sum of all the other EU expenditures. The expenditures spent on other EU subsidies amounted to HUF 15.3 billion in 2009.

With regard to the aforementioned subsidies, the deviation from the original expenditure appropriation for 2009 was usually a result of carrying over the payments of subsidies granted within the framework of various programmes to the next year and the slower than planned implementation of the subsidised projects.

Concerning the programmes, the commitment period of the EEA and the Norwegian Financing Mechanisms was closed in 2009, where the difference between the available funds and the actual commitments is the result of the deviation stemming from the exchange rate differences and the funds remaining from the projects called off following the expiry of the commitment deadline.

Extra-budgetary grants are funded from the Single Treasury Account. These subsidies include direct payments to producers (Single Area Payment Scheme) and agricultural market funding[10].

The amount of HUF 228.7 billion indicated as direct subsidies to producers includes the amounts paid during 2009 (HUF 181.8 billion) and on the legal basis related to earlier years (2004-2008) (HUF 46.9 billion) as well as the already paid items (HUF 31.2 million) that were not financed by the EU due to exceeding the limit of available funds.

> The source of the amounts not funded by the EU is the appropriation 'Exchange rate risk and other expenditures not reimbursed by the EU' of the Chapter 'Ministry of Agriculture and Rural Development' of the central budget.

Agricultural market subsidies amounting to HUF 91.4 billion include the HUF 1.6 billion paid on export subsidies, the HUF 74.0 billion paid as domestic market subsidies, the HUF 13.5 billion paid on other agricultural market subsidies (of which the amount not funded by the EU due to exceeding the appropriation is HUF 12.2 million[11]), the HUF 1.8 billion for the warehousing, transport and testing costs related to the intervention as well as the amount of the HUF 0.5 billion reimbursement of financing related to the intervention.

In the course of the intervention, the Agricultural and Rural Development Agency spent HUF 21.4 billion on advancing intervention purchases in 2009. In contrast, revenues collected from grain, sugar and alcohol sales amounted to HUF

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[10] The latter category comprises export subsidies, internal market subsidies, other agricultural market subsidies as well as the refunding of warehousing and transport costs related to intervention purchases and the refunding of financing costs.

[11] Its source is the appropriation 'Exchange rate risk and other expenditures not reimbursed by the EU' of the Chapter 'Ministry of Agriculture and Rural Development'.

0.6 billion. Accordingly, the result is a balance of HUF -20.8 billion. Contrary to the previous year, in 2009 a higher amount was spent on purchases than that collected from sales. The actual reimbursement (HUF 1,853.6 million) of warehousing, transport and testing costs related to the intervention was higher than planned (HUF 245.0 million), which is attributable to the lower volume of sales.

In 2009, within the framework of funding from the Single Treasury Account, HUF 228.7 billion were paid for the direct subsidies to producers reimbursed by the EU (Single Area Payment Scheme (SAPS)). This amount was complemented by a national subsidy (top-up) of HUF 87.5 billion funded from domestic resources.

As in previous years, the Ministry did not plan the top-up appropriation as an individual paragraph of the law despite the fact that the State Audit Office of Hungary had objected to it in the course of the audits of previous years.

SEPARATED STATE FUNDS AND SOCIAL SECURITY FUNDS

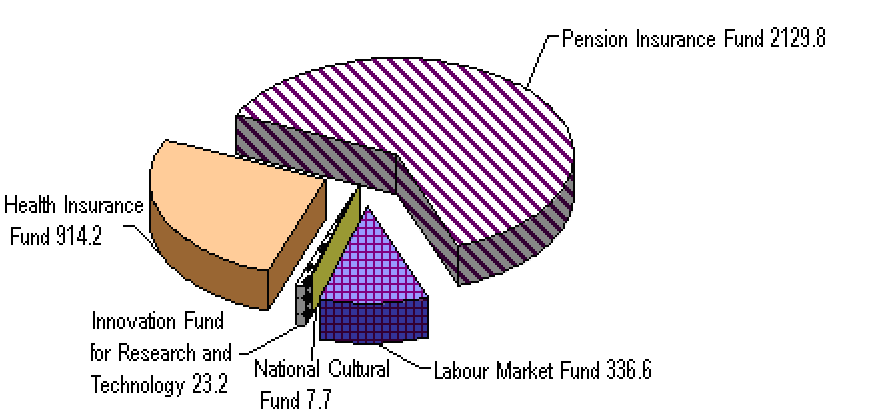
In the case of **the separated state funds and the social security funds** the Act on Public Finances requires an audit in order to qualify the financial statements. Pursuant to the amendment to the Act on Public Finances, starting from 1 January 2010, the financial statements of the funds have to be audited according to the methodology elaborated by the SAO. Based on the amendment to the regulation, the methodology already had to be applied during the final accounts process on the implementation of the 2009 budget.

Article 2 (11) of Act LXXXII of 2008 on the Amendment of Specific Acts Establishing the Year 2009 Budget of the Republic of Hungary amended Article 57 (3) of the Act on Public Finances, while Article 2 (22) amended Article 86/A (2) of the Act on Public Finances. The essence of the change was that while in 2008 the qualification of the financial statements of the funds had been carried out by independent chartered accountants, and we utilised the opinion in the other, regularity audit of the funds, in the course of the audit for 2009 the reliability of the data on the revenues of the funds collected by the Hungarian Tax and Financial Control Administration was qualified – due to data protection reasons – by the SAO, and the independent chartered accountants gave opinions on the other revenues and expenditure data of the funds.

The total revenue of the separated state funds and the social security funds in 2009 amounted to HUF 4,553.0 billion, of which a significant portion of the revenues (approximately 75%, HUF 3,411.5 billion) was collected in the form of contributions by the Hungarian Tax and Financial Control Administration. With regard to the reliability of the revenue data of the funds, we have conducted the audit at the Hungarian Tax and Financial Control Administration.

The Hungarian Tax and Financial Control Administration collects the contribution revenues of the Labour Market Fund, the National Cultural Fund, the Innovation Fund for Research and Technology as well as the Health Insurance Fund and Pension Insurance Fund.

The revenues of funds collected by the Hungarian Tax and Financial Control Administration in 2009 in HUF billion



We forwarded the SAO 'Opinion'[12] on the revenues of the funds collected by the Hungarian Tax and Financial Control Administration to the ministries and fund managers having the disposal of and supervising the funds by the deadline. Based on the experiences obtained during the financial regularity audit focusing on the reliability of the revenue data indicated in the **financial statements of the funds**, the 'Opinion' puts it on record that the **data on the revenues collected by the Hungarian Tax and Financial Control Administration show a true and fair picture.**

On the basis of the SAO methodology – **with one exception**, concerning two funds[13] – **the chartered accountants of the funds cooperated in the course of the audit** and utilised the SAO 'Opinion' on the revenues of the funds collected by the Hungarian Tax and Financial Control Administration in the assessment of the reliability of the financial statements of the funds.

The prevailing regulation is burdened by internal contradictions because no transitional rules were defined at the time of the amendment, and the difference between the terms 'auditing' and 'control of the financial statements' as well as the relationship between and liability of those participating in the process of auditing the financial statements (fund manager, chartered accountant, supervising minister, the Government, SAO) in carrying out the audit task were not clarified. Based on the experiences of the audit, **we initiated a review of the regulation**.

Separated state funds

The subsystem of separated state funds of the general government comprised six funds in 2009 as well: the Labour Market Fund, the Homeland Fund, the Central Nuclear Financial Fund, the National Cultural Fund, the Wesselényi Miklós Flood and Inland Water Compensation Fund and the Innovation Fund for Research and Technology. Each state fund constituted a chapter of the state budget.

The revenue of HUF 465.2 billion of the separated state funds amounted to 5.6% of the revenues of the state budget, while the expenditure of nearly HUF 496.5 billion of the funds constituted 5.4% of the budgetary expenditures. Based on its budgetary revenue and expenditure appropriations, **the role of the Labour Market Fund is decisive among the funds**; its share in the total revenues and expenditures of funds in 2009 amounted to 80% and 86%, respectively. The revenues of the remaining separated state funds constitute a small amount in the budget, although they perform specific and unique tasks in accordance with their relevant objectives set forth by law.

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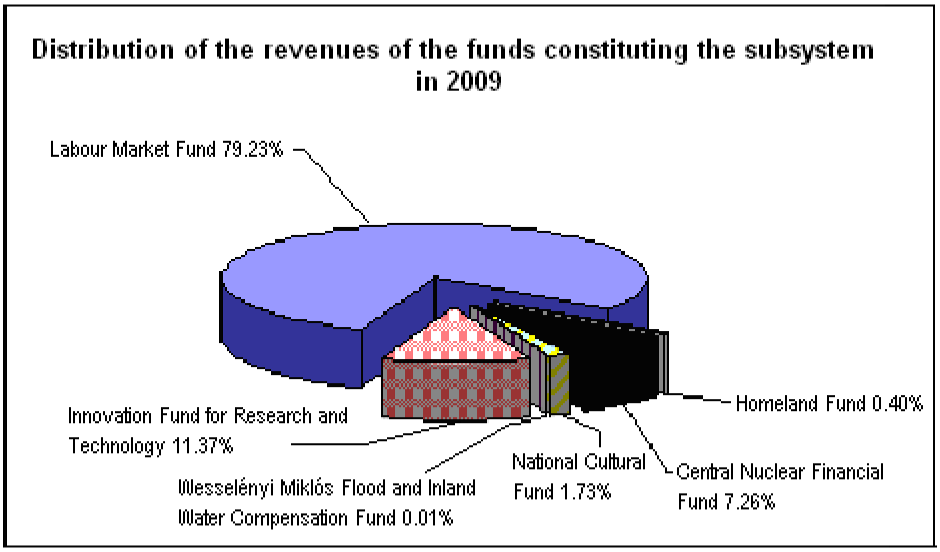
[12] The 'Opinion' on the reliability of the data on the revenues of the funds collected by the Hungarian Tax and Financial Control Administration is included in the Annex.

[13] Two funds – the Homeland Fund and the Innovation Fund for Research and Technology – have the same chartered accountant, who has not taken into account the change in legislation.



The actual aggregate balance of funds for 2009 amounted to HUF -31,363.0 million. The deficit was covered by the accumulated residue of the funds. At the subsystem level, actual revenues were less favourable than expected, while expenditures exceeded the plan. The subsystem paid HUF 143.6 billion to the central budget, while budget subsidies received by the subsystem amounted to HUF 40.6 billion. The difference meant HUF 103.0 billion to the credit of the central budget.

As a difference between the revenues and expenditures of **the Labour Market Fund** in 2009, a deficit of HUF 58,583.7 million was incurred. **In the year under review**, the Labour Market Fund **used up a part of its residue accumulated in the previous years** (HUF 70,350.7 million). As a result of the shortfall of revenues and a minor excess of expenditures, the 2009 GFS balance of the Labour Market Fund was negative, and its funds decreased to HUF 12,086.0 million, below the level of the liquidity reserves.

> Pursuant to Article 39/D of the Act on Job Assistance and Unemployment Benefits effective as of 1 January 2006, the closing balance of the funds available for the Labour Market Fund should not be lower at the end of the year under review than the liquidity reserves, which amount to 25/365 of the original appropriation of the total expenditures for the year under review. The amount of liquidity reserves valid for 2009 was HUF 28,718.38 million.

The Act on the Budget approved an expenditure and revenue appropriation of HUF 419,288.4 million for the Labour Market Fund. The 2009 amendment to the Act on the Budget [14] reduced total expenditures to HUF 404,288.4 million, within which it reduced the amount of payments to the budget by HUF 15,000.0 million. The actual total revenue of the Labour Market Fund was HUF 368,563.0 million, while its budgetary expenditure amounted to HUF 427,146.7 million.

The actual revenues of the Labour Market Fund in 2009 **were** HUF 50,741.7 million **below** the original appropriation. The decline in the gross wage

[14] Act CXVII of 2009 on the Amendment of Act CII of 2008 on the Budget of the Republic of Hungary for 2009.

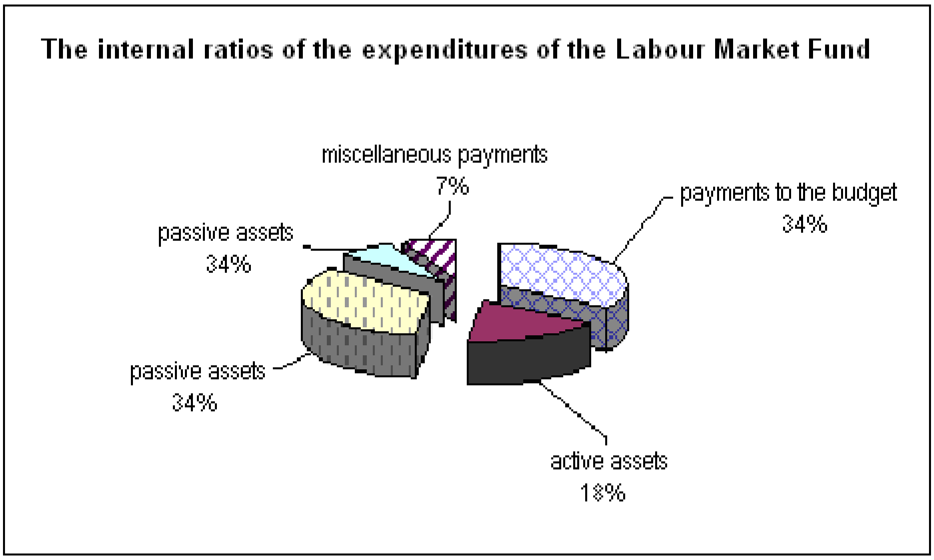
bill played a role in the fall in revenues, and further shortfalls in revenue resulted from the changes in the contribution rates: the employer's contribution and the entrepreneurial contribution were reduced as of 1 July 2009.

Revenues from contributions accounted for 75.4% of actual revenues; contributions amounted to more than 16%; an additional 6.6% of the revenues resulted from the reimbursement of the pre-financing of the Social Renewal Operational Programme, and around 2% from the wage guarantee repayment and other revenues.

The Government – pursuant to the summary prepared about its meeting on 11 March 2009 – called upon the minister overseeing the Labour Market Fund to achieve a HUF 23.0 billion balance improvement during the implementation of the 2009 budget of the Fund **in order to comply with the budget deficit target**. The **decisions were made by the minister overseeing the Fund**; therefore, as the Government did not block, reduce or cancel appropriations in the case of the Labour Market Fund in 2009, the Government did not have to meet its obligation to provide information as set forth in Article 38/A of the Act on Public Finances.

The expenditures exceeded the envisaged amount by HUF 22,858.3 million. Compared to the original appropriations, less was spent on active subsidies and payments for vocational training and adult education, while passive payments and wage guarantee payments exceeded the envisaged amounts as a result of the effect of the economic crisis.

The chart below depicts the changes in the composition of the expenditures of the Labour Market Fund:



The composition of expenditures shows that fund transfers set forth for the Labour Market Fund in the Act on the Budget continue to constitute a higher proportion. The increase was compelled by the need for funds of the *'Road to work'* programme related to the change in the social supply system. **The Act on the Budget** requires a **professional assessment to be prepared** about the utilisation of the amounts paid within the framework of the bill, but **the reporting was done only formally** in the case of the programme. Professional assessment about the transfer of funds was not prepared in the case of any of the programmes within the framework of the bill.

Possibilities of longer-term, concentrated use that serve the objectives of the Fund were overshadowed in 2009 by the priority of meeting the general government deficit target.

In order to manage the economic crisis, with regard to the subsidies aiming at the preservation of jobs and financed from the central fund part of the Labour Market Fund, in the case of the application procedures conducted by the National Employment Public Foundation **the personal conditions** related to the application programmes **were only partially ensured**. The audit did not find any major irregularities in the subsidy contracts. The minor inaccuracy found in the financial accounts was corrected during the time of the on-site audit. **The audit formulated a recommendation with regard to the minor problems detected in the regulation**.

Similarly to the previous year, **the audit activity aimed at the Labour Market Fund did not comply with the provisions of law in 2009 either.** With regard to the Fund, neither the minister[15], nor the Audit Department of the ministry carried out any audit required by law. Operating an independent internal audit regarding the Labour Market Fund in compliance with Government Decree 193/2003. (XI. 26.) on the internal audit of budgetary institutions is the task of the Ministry of Social Affairs and Labour. The utilisation of the funds of the Labour Market Fund was examined by the audit organisational units of the National Employment and Social Office and the regional employment centres. With regard to the training fund part, the National Institute of Vocational and Adult Education also performed an audit. **Our recommendation regarding the review of the audit system of the Labour Market Fund made** during the 2008 final accounts **is still topical.**

The independent chartered accountant gave an unqualified opinion on the annual financial statements of the Fund for 2009.

The Act on the Budget adopted an expenditure and revenue appropriation of HUF 1,000.1 million for the **Homeland Fund**. Revenues from voluntary payments and grants amounting to HUF 0.1 million as well as budget subsidies of HUF 1,000.0 million were planned as revenue appropriation; no other revenues were envisaged. **The revenue appropriation changed** to HUF 3,410.4 million in the reporting period, resulting from unplanned, other revenues. **The SAO objected to the practice of budgetary planning**, because upon compiling the budget for the Fund, the fund manager had not taken into account revenues specified in the act. The other revenues originated from fund transfers from the Labour Market Fund and from the utilisation of remaining funds from the previous year. Actual revenues amounted to HUF 1,881.8 million.

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[15]Act LVII of 2006 on the Central Administrative Bodies and the Legal Status of the Members of Government and State Secretaries does not allow the transfer of powers regarding efficiency and financial audits.

As a result of the amendments to the appropriation during the year, the expenditure appropriation also changed; actual expenditures amounted to HUF 2,763.5 million, of which HUF 2,376.3 were spent on the financing of subsidies.

100% of the subsidies granted from the Fund was used within the framework of public tenders. Contrary to the practice of previous years, **the annexes to the application for grants required by law were requested to be submitted simultaneously with the conclusion of the contract and not in advance.** The calls for tenders contained the elements specified in the act on the Fund in full, with the exception of the existence and magnitude of own funds.

The minister supervising the Fund and the manager of the Homeland Fund are responsible for attending to the audit tasks of the Fund and within that for carrying out the financial and performance audits. The fund manager did not have an audit organisational unit. The internal audit assignments were performed by an external organisation on the basis of an entrepreneurial contract. **The audits did not cover the assessment of the operation of the tendering system and the utilisation of funds**; no performance audit was carried out. **The independent chartered accountant gave an unqualified opinion on the annual financial statements of the Fund** for 2009.

The revenues of the **Central Nuclear Financial Fund** amounted to HUF 33,751.4 million in 2009, exceeding the original appropriation (HUF 32,915.1 million) by 2.5%. The revenues of the Fund originated from the payment prescribed for the Paks Nuclear Power Plant Ltd. in the Act on the Budget, the occasional payments of waste producers, the budget subsidy ensuring the stability of value of the accumulated funds of the Fund and other revenues. At the end of 2009, the Fund closed with accumulated funds amounting to HUF 149,379.4 million to cover future activities. **The independent chartered accountant gave an unqualified opinion on the financial statements of the Fund** for 2009.

The expenditure and revenue appropriation of the **National Cultural Fund** specified in the Act on the Budget was HUF 8,815.0 million, of which cultural contribution revenue amounted to HUF 8,700.0 million and other (non-tax) revenues amounted to HUF 115.0 million. Actual revenues of the National Cultural Fund amounted to HUF 9,841.2 million (the actual cash flow revenue was HUF 8,041.2 million, while the utilisation of the residue from the previous year as revenue without cash flow amounted to HUF 1,800.0 million), with expenditures reaching HUF 9,668.4 million. The Fund spent 8.7% of its expenditures in 2009 on operating expenses. The Fund's accumulated residue of appropriation for the year 2008 amounted to HUF 3,946.8 million, of which, with ministerial approval on the basis of Article 55 (1) of the Act on Public Finances, HUF 1,800.0 million were used to make up for the shortfalls in cultural contribution revenues and for the fulfilment of commitments carried over from previous years. The residue from 2009 was HUF 172.4 million, while the accumulated residue was HUF 2,319.1 million. **The independent chartered accountant gave an unqualified opinion on the financial statements of the National Cultural Fund** for 2009.

The revenue and expenditure appropriation of **the Wesselényi Miklós Flood and Inland Water Compensation Fund** (Wesselényi Fund) was specified by the Act on the Budget as HUF 23.4 million, of which HUF 6.0 million was envisaged as regular payment (fee payments of compensation contracts) and HUF 17.4 million as budget subsidy. The Act on the establishment of the Fund ensures the acceptance and classification of the voluntary, non-regular payments and donations as revenue, but there were no such payments in 2009. The total amount of payments by those who have compensation contracts was HUF 6.0 million, while actual total revenues amounted to HUF 23.4 million. With regard to the Fund, the Act on the Budget did not contain any expenditure appropriation related to cases of damage; due to a case of damage arising during the year, the fund manager re-allocated HUF 1.5 million of appropriations (to the debit of the operating expenditures), thus the expenditure appropriation remained unchanged. The lower utilisation of the appropriation compared to previous years was attributable to the uncertainty surrounding the future of the Wesselényi Fund and the assumption of the payment of the wage and overhead expenses from the budget of the Treasury for 2009.

The Fund did not have any liquidity problems. The accumulated residue of previous years (HUF 287.1 million) was further increased by HUF 15.8 million by the residue of appropriations not used during the year, resulting in an increase in the residue to HUF 302.9 million. **The independent chartered accountant gave an unqualified opinion on the** annual **financial statements of the Fund.**

For the expenditures and revenues of **the Innovation Fund for Research and Technology,** the original and amended appropriation specified in the Act on the Budget was HUF 55,909.6 million. The actual revenues of the Fund reached HUF 52,927.9 million, including budget subsidies of HUF 28,695.1 million and innovation contribution revenues of HUF 23,179.0 million. Following a partial relief from the balance keeping obligation of HUF 20.0 billion ordered during the year, the actual expenditures of the Fund amounted to HUF 43,035.8 million, i.e. 77% of the original appropriation. HUF 37,573.0 million of this was spent on funding domestic innovation, HUF 2,515.9 million on the task performance of the fund manager, while the remaining HUF 2,946.9 million on other purposes specified in the Act on the Budget. The Fund was operated by the minister responsible for research and development, in cooperation with the National Office for Research and Technology. **The independent chartered accountant certified the financial statements of the Fund. Upon the audit of the financial statements, the accountant failed to take into account the legislative changes,. C**onsequently, based on the experiences of the final accounts for 2009, we did not support the hiring of the chartered accountant for 2010.

Most of our recommendations made in the report on the implementation of the budget of the Republic of Hungary for 2008 **to the ministers supervising the funds and to the fund managers of the funds were utilised.**

Social security funds

The social security subsystem of public finances comprises the Pension Insurance Fund and the Health Insurance Fund. The actual total revenues of the social security subsystem of public finances in 2009 amounted to HUF 4,128.9 billion; total expenditures reached HUF 4,285.6 billion, while the consolidated deficit was HUF 156.7 billion. Due to the economic crisis, the expenditure reducing government measures taken in order to meet the budget deficit target were unable to offset the deficit, which exceeded the envisaged HUF 8.9 billion by HUF 147.8 billion (arising from the decline in revenues resulting from the reduction implemented in the contribution rate regarding the Health Insurance Fund and the deterioration in the willingness and ability to pay contributions).

Based on a government decree[16], the Prime Minister designated treasurers for the **funds**. **The appointment of treasurers was legal in the case of the separated state funds, but in the case of the Health Insurance Fund and the Pension Insurance Fund it did not comply with the prevailing regulations**, as the relevant provision did not apply to the social security funds. **The change in the relevant regulation introduced in the meantime**[17] now ensures compliance.

The financial statements of the social security funds were certified by chartered accountants; the prevailing regulation was only partially complied. Owing to the different interpretation of Article 86/A of the Act on Public Finances, and also bearing in mind the methodology of the SAO, the chartered accountant of the Pension Insurance Fund carried out the audit according to its own methodology, which is in line with the international and the Hungarian auditing standards. In the assessment of the reliability of the revenue data of the Health Insurance Fund, the chartered accountant of the Fund utilised the SAO 'Opinion' issued on the revenues of funds collected by the Hungarian Tax and Financial Control Administration and examined on the basis of the SAO methodology.

Decisive sources of revenue of the social security funds are social security contributions and the **contributions** paid by individual insurees. Their **total share as a proportion of wages amounted to 44.5%, before declining to 41.5% following the reduction of the health care contribution on 1 July 2009.**

[16] Based on Article 152/A (1) of the Government Decree on the Rules of Operation of Public Finances and Articles 152/A-152/C entering into force on 27 August 2009 pursuant to Government Decree 169/2009. (VIII. 26.).

[17] Pursuant to Article 47 of Act XC of 2010 on the Framing of Certain Economic and Financial Laws, amending Article 46/A of the Act on Public Finances, the system of treasurers – with a significant change in tasks – will be replaced by a fiscal supervisory system, and this change in the rule will resolve the problem of the lack of harmony observed in the course of the audit.

The social security contribution to be paid by the employer had been 29%; the contribution paid by the individual insuree had been 15.5%. Following the reduction of the percentage of the health care contribution to be paid by the employer on the portion not exceeding double the minimum wage on 1 July 2009, the employer's contribution decreased to 26%, while the percentage to be paid by the individual insuree did not change.

The distribution of the revenues from the START card, which allows employment with a favourable percentage of contribution to be paid, also changed between the two funds; pursuant to the relevant provision of law, the social security funds are reimbursed for the shortfall in contributions by the Labour Market Fund.

In our opinion, the requirement of transparency has still not been met. According to the contested practice, the specified shares from contribution revenues due to the Pension Insurance Fund and the Health Insurance Fund are transferred to a consolidated account, instead of the individual accounts according to contribution type applied earlier. In view of the intention of the Government to simplify taxes, we cancelled our recommendation[18].

The Pension Insurance Fund closed **with a HUF 7,221.3 million deficit in 2009.** In spite of the expenditure reducing measures taken, the Pension Insurance Fund did not reach an equilibrium position by the end of the year because, due to the economic crisis, there was a shortfall in contribution revenues compared to the planned amount, and the Ministry of Justice and Law Enforcement did not perform its fund transfer obligation specified in the Act on the Budget in full. (The amount of non-payment by the Ministry of Justice and Law Enforcement equalled nearly 13% of the total deficit.) For lack of a relevant provision of law, **the balance sheets of the Pension Insurance Fund do not contain the amount of overdue contributions and overpayments related to the START card and the simplified contribution to public revenues as well as the value of the assets ensuring the use of the services provided** by the Electronic Government Backbone Network because of the service provider's failure to perform in accordance with the contract.

Based on the provisions of the Act on the Budget, **the daily liquidity of the Pension Insurance Fund** and the uninterrupted transfer of pension expenditures **were ensured by an interest-free loan from the Single Treasury Account**. The Pension Insurance Fund had a debt on each working day of the year under review. Borrowing was basically in accordance with regulations, and followed the rolling schedule updated monthly.

By law, the revenue appropriation of the Pension Insurance Fund for 2009 amounted to HUF 2,999.3 billion, while actual revenues were HUF 2,859.5 billion. As reported by the Hungarian Tax and Financial Control Administration, **at the end of 2009, overdue contributions owed to the Pension Insurance Fund amounted to HUF 165.1 billion, of which 72.9%** (HUF 120.4 billion) **was accounted for as loss in value**. The actual contribution of the central

[18] The arguments contained in the final accounts report of 2008 remained unchanged, and in our opinion the system of payment to the Health Insurance Fund, which changed as of 1 January 2010 and contains further consolidation, did not reduce the administrative burden on entrepreneurs.

budget was close to the appropriation of HUF 599.9 billion, reaching HUF 599.1 billion.

Total expenditures of the Pension Insurance Fund in 2009 amounted to HUF 2,866.8 billion, which was HUF 132.5 billion below the appropriation set forth by law. The appropriation for **pension payments** was HUF 2,974.4 billion, while the actual figure was HUF 2,841.1 billion, with **pension expenditures amounting to 99.8%** of the expenditures.

The appropriation of pension expenditures chargeable to the Pension Insurance Fund equalled HUF 2,967.9 billion, and the actual figure was HUF 2,834.4 billion. **Payments were** 2% that is **HUF 57.2 billion below the pension expenditures** of 2008 (HUF 2,891.7 billion) **because**, based on the recommendation of the **Government**, the National Assembly **took austerity measures** with a total effect of HUF 143.8 billion, regarding the Pension Insurance Fund. The appropriation planned in the budget, but reduced by the measures not taken shows a value of HUF 2,875.3 billion.[19] Accordingly, the actual expenditures amount to 98.6%, with savings of HUF 40.9 billion.

In 2009, pensions were raised only as of 1 January for all persons who retired before 2009. In order to improve the general government balance, based on the Government's recommendation, the National Assembly first limited and then terminated the 13th month pension, and postponed the next stage of the pension correction measure to 1 January 2010. The complicated, bureaucratic system of the **pension increasing rule for those who work parallel to receiving their pensions –** which was criticised in previous years – remained unchanged; **we** continue to **maintain our arguments for** the necessity of a **change.**[20]

Declining funds were available for the operating expenditures of the Pension Insurance Fund. The pension insurance sector was able to carry out its additional tasks stemming from the continuous changes in legislation and necessary for the provision of the relevant administrative and IT background required by these changes by working overtime continuously – while the permitted headcount limit remained unchanged – and conducting a strictly organised and controlled financial management.

A treasurer was appointed to the Pension Insurance Fund, as of 28 August 2009, **in a manner contrary to the provisions of law**. There was a 127 day difference in time between the entry into force of the government decree[21] introducing the treasurer system and the provision of law serving as a legal basis for it[22]. Furthermore, the treasurer was appointed to the Pension Insurance Fund

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[19] HUF 2,967.9 billion -HUF 9.3 billion -HUF 83.4 billion= HUF 2,875.3 billion

[20] Article 22/A of Act LXXXI of 1997 on Social Security Pension Benefits

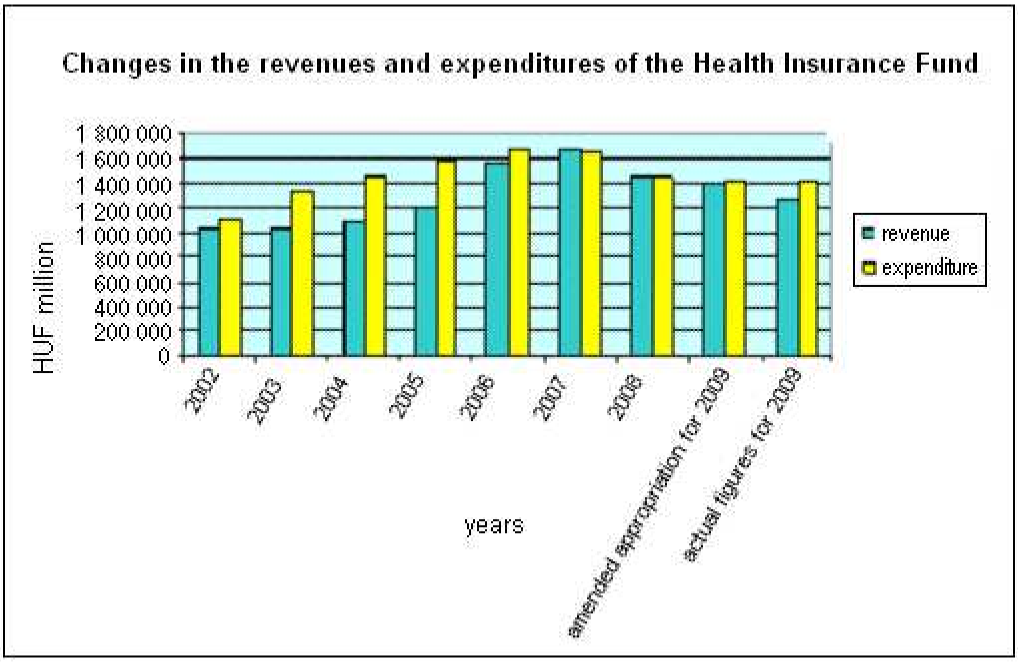
[21] Government Decree 169/2009. (VIII. 26.) amending the Government Decree on the Rules of Operation of Public Finances

[22] The treasurer was appointed to the Pension Insurance Fund as of 28 August 2009.The government decree was not adopted simultaneously with the amendment to the Act on Public Finances. Articles 2 (26) and (62) of Act CIX of 2009 amending the Act on Public Finances entered into force only as of 1 January 2010.

despite the fact that the relevant regulation did not apply to the social security funds. All this indicates a lack of harmony between the objectives to be achieved with the regulation and the related processes, and inadequately considered legislation. **The treasurer's activity** at the Fund did not constitute any material help; it only **resulted in additional administrative work.**

The audit system of the Pension Insurance Fund operated adequately in 2009 as well.

In 2009, there was a lack of equilibrium between the revenue and expenditure sides of the Health Insurance Fund. Actual total revenues amounted to HUF 1,269,366.2 million, while actual total expenditures reached HUF 1,418,842.1 million. **Contrary to the deficit of** HUF 8,852.1 million **adopted in the budget, a nearly seventeen times higher deficit of** HUF 149,475.9 million **developed** in the Health Insurance Fund.



The actual deficit of the health sector is in fact higher than the one shown at the Fund, as due to the deficit in its balance, **the Fund** did not have to cover[23] **the amount of wage policy measures** (HUF 10,342.8 million) **paid from the central budget** (from the special reserve of the Prime Minister's Office) **to the health sector**; therefore, this amount did not appear among its expenditures.

In 2009, on the revenue side, **the termination of the reimbursement of the child-care benefit expenditure, while** on the expenditure side the **appearance of a new title**, the pension insurance contribution of the

[23] Pursuant to Article 24 (2) of the Act on the Budget.

recipients of child-care benefit **contributed to the less favourable budgetary position compared to the previous year**[24].

The significant deviation between the actual deficit in 2009 and the planned one was a result of the underperformance of the revenue side. Revenues were 9.9% (HUF 139,347.8 million) less than envisaged. **The shortfall** compared to the planned amount **is the highest in the case of contribution revenues**: HUF 146,317.4 million (14%). The main reason for the deviation is that the employer's contribution revenue appropriation did not include the effect of the decrease in the contribution rate in July. [25] The actual revenue from the employer's contribution was HUF 104,898.9 million below the planned amount. The contribution rate to be paid by insurees remained unchanged, but the fulfilment is lower than planned in this appropriation as well; the shortfall amounted to HUF 39,710.8 million. **Compared to the corresponding figure in 2008, the decline in revenue** is 5.2%, which is **nearly identical to the decrease in the gross income**[26].

Due to the shortfall in revenues, the expenditure side had to be held. Accordingly, additional expenditures only amounted to 0.1% (HUF 1,276.0 million) compared to the original appropriation. On the expenditure side, the appropriations of cash benefits, funding for medical devices and accounts related to EU Member States were exceeded.

There was a tightening of the expenditures on curative and preventive care in the form of reallocating HUF 13,050.0 million to the legal title of the operational cost advance, but due to the rules of spending, the National Health Insurance Fund was unable to use it to fund health care, thus the measure corresponded to a withdrawal of funds (blockage). Due to compliance with the reduced appropriations, in the consolidated specialised care, it became necessary to change the accounting rules[27]. Consequently, the funding of health care decreased considerably. In view of the difficulties arising in the financial

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[24] The termination of the child-care benefit reimbursement resulted in a HUF 42,046.5 million decline in revenues, while the pension insurance contribution expenditure of child-care benefit recipients resulted in additional expenditures amounting to HUF 21,605.0 million.

[25]As of 1 July 2009, the rate of the health care contribution to be paid by employers and insured individual entrepreneurs was reduced from 5% to 2%, up to a contribution base corresponding to double the minimum wage.

[26]The decrease in the gross income amounted to 5% in 2009 (Hungarian Central Statistical Office, HCSO data). According to the data release of the HCSO, the percentage of the change in the gross income is to be understood on the basis of the figures relating to full-time employees, enterprises with more than four people, central and local budgetary institutions, social security and designated non-profit organisations.

[27] With Government Decree 58/2009. (III. 18.) on the amendment of Government Decree 43/1999. (III. 3.) on the financing of health care services from the Health Insurance Fund, the performance volume limited financing established for 2009 became void, and a combined method was introduced, comprising the two kinds of settlement of the performance funded with a predetermined basic fee and the performance above that. Although all performance (not only the pre-etermined performance volume) was accounted for in the new financing system, not all performance was funded in full.

management of institutions, the professional organisations and the ministry concluded a separate agreement about the use of additional resources (HUF 4,500.0 million in 2009[28]) to fund the active inpatient and outpatient care and about amending the settlement period from three months to two months[29].

Of the services provided with price subsidies, pharmaceutical subsidy expenditures remained essentially within the planned amount; following the stagnation in previous years, an increase of 5.4% was observed. Due to underplanning, the appropriation for medical devices was raised by HUF 7,329.9 million. **The appropriation of the subsidy for medical devices has been adjusted to the financing possibilities** for years; therefore, **the appropriation is maintained** by alternating restrictive and mitigating measures **based on budgetary, and not professional, aspects**. In 2009, the fund manager prepared a professionally substantiated, system-level reorganisation, which resulted in a decrease in subsidy outflows in the last quarter of the year, and thus the expenditure was HUF 3,427.6 million lower than the amended appropriation.

The development in total outstanding loans of the Health Insurance Fund in 2009 was characterised by a steady growth of increasing magnitude. There was no borrowing in the second half of the first three months and for six days in April. Borrowing took place each day starting from May.

As a consequence of the processes in 2009, it became even more urgent to create harmony between revenues and expenditures. In connection with the draft budget for 2010 we indicated that '*one of the means of the measures aimed at creating harmony between revenues and expenditures is that pursuant to Article 86 (9) of the Act on Public Finances the Government has to submit recommendations to restore the equilibrium to the National Assembly, if the revenues of the Fund do not cover expected expenditures permanently*'. No recommendation was submitted in 2009 either. **The statutory obligation was repealed by the National Assembly** as of 1 January 2010, pursuant to Article 51 (1) d) of Act CIX of 2009 on the amendment of certain statutes substantiating the budget for the year 2010.

[28] Pursuant to Government Decree 232/2009. (X. 16.) on the amendment of Government Decree 43/1999. (III. 3.) on the financing of health care services from the Health Insurance Fund.

[29] Pursuant to Article 8 of Government Decree 291/2009. (XII. 18.) on the amendment of Government Decree 43/1999. (III. 3.) on the financing of health care services from the Health Insurance Fund.

DEFICIENCIES (SYSTEM FAULTS) AFFECTING THE FINANCIAL MANAGEMENT OF CHAPTERS AND THE UTILISATION OF SUBSIDIES FROM THE EUROPEAN UNION FOR SEVERAL YEARS

With regard to the financial management of chapters, in the course of the financial (regularity) audit we pay special attention to the subjects which already arose during the previous final accounts process and concern almost all audited organisational units.

Since the entry into force of the Act on State Property, the financial (regularity) audit on the implementation of the budget took place for the third time. During this audit, **each year we determined problems relating to the entry into force of the Act on State Property** (transfer of company shares, conclusion of property management contracts, transfer of assets free of charge). We formulated our findings in the SAO reports, and indicated the fact that external factors independent of the financial management of the institutions had played a role in the development of the problems.

The **review of the valid property management contracts** concluded with central budgetary institutions as set forth in Article 59 (5) of the Act on State Property **and their amendment in compliance with the provisions of law did not take place in 2009 either.** Most of the draft property management and lease contracts sent by the Hungarian State Holding Company to budgetary institutions were not signed.

In 2008, statutory provisions did not allow the transfer of assets free of charge within the general government. As of 1 January 2009, statutory provisions already allowed the transfer of the property management right, but legal uncertainty evolved with regard to the existence of VAT payment obligation, as the provision of law (Article 109/F (4) of the Act on Public Finances) laying down the exemption from taxes and duties of budgetary institutions was no longer in force. The head of the Directorate General for Central Services requested an opinion from the Ministry of Finance in order to settle the situation. According to the opinion of the Ministry of Finance dated 30 November 2009, – due to the treatment as a non-taxable person – there was no obligation to pay taxes in connection with the transfer of property management rights.

The central budgetary institutions audited by the SAO concluded only two contracts (Chapters ‘Ministry of Defence’ and ‘Hungarian Central Statistical Office’) until 31 December 2009. In the period of the on-site audit, progress was made in two cases in connection with property management contracts (Institution ‘Hungarian Energy Office’ and Chapter ‘Ministry of Local Government’).

Due to the failure to completely implement the transfer of assets related to organisational changes carried out in previous years, with the Directorate General for Central Services taking over the tasks, **the accounting disorder that had developed earlier continued to exist in 2009 as well.**

Most of the ministries concerned (Ministry of Local Government, Ministry of Agriculture and Rural Development, Ministry of Justice and Law Enforcement, Ministry for National Development and Economy, Ministry of Environment and Water, Ministry of Foreign Affairs, Ministry of Education and Culture, Ministry of Social Affairs and Labour) indicated the assets included in the property management contracts and service provision agreements concluded with the Directorate General for Central Services, but not yet transferred, in their balance sheets as their own assets; the Ministry of Finance kept records of them in the '0' class of accounts.

According to accounting records, in 2009 the **Directorate General for Central Services** took over properties from the **Ministry of Local Government** and the **Ministry of Finance** in connection with the transfer of the property management right implemented prior to the entry into force of the Act on State Property, not settled in full at that time.

The process that started with the implementation of the earlier government decree and government decisions adopted in order to establish the integrated central service – and was also affected by the change in the task performance system (the failure to build the government quarter) – was significantly hindered by the provisions of the Act on State Property and the lack of conformity (repealing the exemption from VAT and the related shortage of funds) with other relevant legal regulations (Act on Public Finances, Act on VAT). Following changes in the statutory provisions and the completion of an adequate statutory interpretation, no time remained – until the finalisation of the report – to carry out the transfers of assets that had not taken place earlier. **Creating conformity between the relevant legal regulations continues to be necessary for a regular statement on the financial situation.**

The Directorate General for Central Services performed its tasks set forth in legal provisions and the agreements with the chapters in 2009 as well, but the organisations concerned continued to indicate problems related to the continuous supply, the inadequacy of data supply and the absence of purchases and renovations. A part of the problems that arose, stemming from the emergence of demands exceeding the transferred appropriations, was treated with further transfers of appropriations (total HUF 202.2 million).

We consider that the smooth performance of tasks requires continuous consultation between the Directorate General for Central Services and the institutions receiving the services as well as the review and subsequent adoption of the draft legislation, pertaining to norms, prepared by the Directorate General for Central Services in 2008.

In its audits, the SAO has been dealing with the **Centralised Payroll Calculation System** for years; it was introduced in order to create a single labour, administrative and information system of the organisations under government control. We had called the attention to the deficiencies of the system in previous years' audits as well, but some of these deficiencies continued to exist in 2009 too, and further problems also arose.

Based on agreement, the payroll accounting tasks were taken over from the institutions by the Regional Directorates of the Treasury, but the Treasury performed the tasks and met the deadlines fixed in the agreement with significant delays. The operation of the Centralised Payroll Calculation System was not smooth after the transfer of the tasks to the Treasury either. Both programme errors and payroll accounting deviating from the data supply were observed.

The monthly tax returns of institutions usually did not match the accounting report prepared by the Treasury. Therefore, there were differences between the figures of the accounting and net financing; the relevant attestations were prepared in a period between one week and one and a half months following the termination of employment; the access of organisations to data and certain functions is limited, and they cannot query or recover data, which hampered the data supply of employers.

A deficiency of the regulatory activity of ministries determined several years ago is that the operational and financial management regulations applying to the period under review are prepared late, with retrospective effect on the year under review, or are not updated (due to legislative and organisational changes), and all this has an adverse effect on regular financial management.

The **annually** recurring deficiencies and system failures **detected in connection with financial management** are manifold, but by themselves they do not affect the reliability of the financial statements, or influence it only occasionally.

Contracts of agency or contracts for invoiced intellectual activity are concluded to perform tasks that can only be carried out in employment as a civil servant pursuant to the effective Act on the Legal Status of Civil Servants. It often happens that in the contracts the task description is general; the performance of the task cannot be documented and thus cannot be verified. The settlement of advance payments for business trips abroad is often carried out with a delay, and the relevant statutory obligations (tax and contribution payment) are not fulfilled either. In the case of chapter-managed appropriations the audit found that appropriations were used for purposes other than the target. Occasionally, the documentation of residues of appropriations burdened with commitment was incomplete or inadequate.

The most frequent and annually recurring problem of the **balance sheet** of the financial statement is the complete or partial lack of inventory-backed support of individual balance sheet lines as well as the evaluation of certain balance sheet items which does not comply with the prevailing legal regulations and internal rules.

Among the active and passive financial accounts, there were items shown that do not belong there and ones that had not been settled for years.

The deficiency of the **Supplementary Annex** of the statement is that it does not indicate data and facts that are specified by legal regulations and are important in the evaluation of the statement.

Every year, during the financial (regularity) audit of the financial statements of institutions and chapter-managed appropriations, and thus within the framework of the audit on the final accounts for the year 2009, we assessed the **development and operation of the internal control systems** from the standpoint of mitigating the risks influencing the reliability of financial statements.

The occurrence of errors and irregularities affecting the reliability of financial statements **among institutions** was related to the inadequate development of the internal control system, the deficiencies of the Financial Management Control (FMC) and the unsatisfactory functioning of the controls supporting the use of financial powers. Regarding the **chapter-managed appropriations**, the errors and irregularities affecting the reliability of the financial statement occurred due to the inadequate IT support of the accounting system and the defective operation of the controls related to the use of financial powers. As a result of all the above, we gave a qualified opinion on the financial statements of nearly 20% of the institutions and 50% of the chapter-managed appropriations due to the detected errors.

In the course of its operation, the **internal audit** did not contribute to the improvement of the internal control system sufficiently,. Consequently, it did not facilitate the reduction of risks effectively.

Due to the deficiencies in the coordinated development as well as in the consistent and continuous operation of the internal control systems, as detected during the audit, they did not serve as efficient means of mitigating the risks influencing the reliability of the financial statements of budgetary institutions and eliminating the occurrence of errors and irregularities.

During the final accounts audit of **EU funds,** the SAO has been raising objections in vain for years against the system failure that the analytical records of commitments are kept in a global manner, from which the extent of annual commitments cannot be established. This does not comply with the provisions in Article 134 (13) of the Government Decree on the Rules of Operation of Public Finances. Another recurring finding of ours is that in the case of the financial statements on the operational programmes of the New Hungary Development Plan and on the INTERREG, the procedures followed were not in line with the provisions of Articles 135-138 of the Government Decree on the Rules of Operation of Public Finances, as no remittance note was prepared about the transfer from the transaction account.

A regulatory deficiency concerning the utilisation of EU funds, which was objected to last year as well, is that in the case of developments where the investment had first been funded from the domestic budget, then replaced with EU grants, there is no unambiguous regulation generally applicable to all those concerned that complies with the domestic fiscal regulations of commitments, and at the same time facilitates the transparency of the utilisation of EU grants and budgetary appropriations, also taking into account cash flow and non-cash flow items.

We detected it as a system failure that the general ledger statement after closing was not available. In the absence of this, we were not able to establish whether the principle of balance sheet authenticity prevailed; we audited the data on the 'Reserves' on the basis of the data of the general ledger statement prior to closure.

We also considered it to be a system failure that the National Development Agency carried out the reconciliation of outstanding debt (or had it carried out by intermediate bodies) in 2009 as well, but, contrary to the previous years, not with the accounting date of 31 December 2009 as set forth in the Evaluation Regulation, but with regard to the position on 30 October 2009. Consequently, it is not the receivables confirmed by the debtors that are included in the financial statements. The change in the amount checked on 30 October was taken into account on the basis of the analytical records.

An error in the case of almost all operational programmes is that although in 2009 the intermediate bodies had settled the liabilities already kept on record in the accounting since 2008 with the managing authorities (accounted for the utilisation of the advance), until the preparation of the financial statements – at the level of the programmes – it was not settled. Accordingly, the balance sheets included paid out advances that had already been accounted for in 2009, but the amounts concerned had not been cancelled from the assets until the financial statements were prepared.

BUDGETARY RELATIONS OF LOCAL GOVERNMENTS

In the Act on the Budget, the appropriations of subsidies and contributions payable to local governments, local minority self-governments and multi-purpose micro-regional associations were set out in Annex 1, Chapter IX 'Subsidies and assigned personal income tax to local governments'. Based on this, local governments were entitled to HUF 1,290.0 billion in 2009, which was HUF 58.7 billion less than in 2008.

The appropriation amendments took place in governmental and chapter competence and **in compliance** with the provisions specified in the Act on Public Finances and the Act on the Budget. By the end of the year, the appropriation changed to HUF 1,311.1 billion. The modified appropriation of the subsidies and assigned personal income tax of local governments exceeded the original appropriation by 1.6% (HUF 21.1 billion). The actual figure amounted to HUF 1,308.5 billion, which is 1.4% higher than the original appropriation and 0.2% lower than the modified one.

In 2009, with its Decisions 1212/2009. (XII. 15.) and 1222/2009. (XII. 29.), the Government created three new budgetary titles with a total amount of HUF 62.0 million. In all three cases, the decision entitled the Minister of Local Governments to make the subsidy payable immediately. It also set out the obligation to conclude a contract and the possibility of subsequent settlement (before 31 December 2011). However, it did not include the deadline for concluding the subsidy contract in any of the cases. The contracts were signed in 2010 (two on 15 February, one on 13 April), albeit the subsidy had already been paid in 2009.

The SAO already indicated in its report on the audit of the final accounts of 2008 (although then the amount was more significant, HUF 17.1 billion) that **it considered the procedure of the Ministry of Local Government irregular**, as the latter had provided subsidies in the last days of the year **without concluding a contract for the subsidies before payment.**

The National Assembly allocated **state subsidies for a specified purpose as centralised appropriations** for the duties to be fulfilled, listed in Annex 5 of the Act on the Budget, by local governments, local and regional minority self-governments and multi-purpose micro-regional associations. The number of centralised appropriations increased by two in 2009. Based on the Act on the Budget, the consolidated original appropriation for the 30 titles under centralised appropriations was HUF 142.3 billion. The amended appropriation equalled HUF 159.6 billion, while its actual utilisation was HUF 137.4 billion. Actual fulfilment was 3.4% below the original appropriation and 13.9% below the amended one.

The HUF 17.3 billion growth in the original appropriation was mainly related to the increase of the appropriation of the title 'Subsidies of additional expenditures associated with local organisational measures' by HUF 4.1 billion and adding HUF 10.8 billion to the appropriation of the title 'Subsidies for supporting wage policy measures'.

Annex 5 of the Act on the Budget designated the minister responsible for the issuance of the decree that details the rules for utilising these subsidies, outlining the related conditions, decision-making, payment, utilisation and accounting procedures. With regard to the centralised appropriations, the Act on the Budget ordained 26 decrees to be issued. **The deadline for the issuance of the decrees**, which was set forth in the Act on the Budget, **was not adhered to by sector ministers in 24 cases** (e.g. normative grant to local public transport – Minister of Transport, Telecommunication and Energy and Minister of Local Governments; subsidies for financial incentives for teachers within the framework of the New Knowledge-Education Programme – Minister of Education and Culture; subsidy for public water and sewerage services – Minister of Environment and Water).

The actual fulfilment of the year 2009 subsidy appropriation of HUF 9,500.0 million for the construction of **Metro Line 4 of Budapest (between Kelenföld Railway Station and Bosnyák Square)** [30] amounted to HUF 13,890.1 million, exceeding the planned amount by 46.2%. The reason for the overspending was the decision of the European Commission not to provide EU funding for the 11 contracts related to Section I. Consequently, the share of the state from the missing funding had to be provided from this title.

Upon the preparation of the remittance note, the Ministry of Local Government did not have an audit option from a professional or a financial standpoint in 2009 either. Consequently, the Ministry of Local Government did not comply with its audit obligation set forth in Article 51 (5) of the Act on the Budget. The Ministry of Local Government in 2009 was not in a position to enforce its remittance responsibilities, since, just as in the previous years, it had neither the insight into nor the power to influence the funding process. The SAO indicated this shortcoming during the audits of the final accounts of 2006, 2007 and 2008 as well.

In 2009, the Treasury sent information on a quarterly basis to the Ministry of Local Government on the payments effected in the given period. As the information was not available to the Ministry of Local Government on each day when there was a payment transaction, an up-to-date matching of the remittance notes against the payments was not possible.

According to the audit carried out by the SAO, the audit on the management and fulfilment of the appropriation of the Budapest Underground Line 4 investment has to be shown among the liabilities of the chapter that is responsible for the professional implementation of the investment. The SAO indicated it during the audits of the final accounts of 2006, 2007 and 2008 as well. An amendment to the Act on the State Subsidy for the Construction of the Underground Line would allow the relevant change.

Pursuant to Article 2 (2) of Act LXVII of 2005, the State is allowed to spend an annual amount of not more than HUF 50.0 million from the state subsidy to make use of expert services facilitating the practising of the control position.

[30] The investment is examined in the SAO report on the Audit of the Development Project Metro Line 4, to be published in October 2010.

Similarly to previous years, this allocation was not used in 2009 either. Until the on-site audit conducted by the SAO was completed, the call for applications regarding the recruitment of a '*State Specialist*' had not been announced.

Pursuant to Point 9 of Government Decision 1059/2005. (VI. 4.) on the state subsidy for the construction of the Budapest Underground Line 4 (between Budapest Kelenföld Railway Station and Bosnyák Square), the Government entrusted the president of the Government Audit Office with controlling the implementation of the investment and reporting on it to the Government once a year. In Point 10 the Minister of Finance and the Minister of Economy and Transport were requested to inform the Government on the progress of the Budapest Underground Line 4 project biannually. In 2009, all the bodies concerned, with the exception of the Minister of Economy and Transport, complied with their respective obligations to report and inform in line with the provisions of law.

As of 15 May 2008, the tasks of the Ministry of Economy and Transport were transferred to its two legal successors, the Ministry of Transport, Telecommunication and Energy, and the Ministry of National Development and Economy. According to the audit performed by the SAO, as we have already indicated it upon the final accounts of 2008 as well, it is necessary to clarify Point 10 of Government Decision 1059/2005. (VI. 4.), because this is the point that sets out which legal successor ministry is responsible for reporting on the underground investment.

The magnitude of the amount to be spent on the investment project warrants a more intense controlling activity by the Ministry of Finance entrusted with the representation of the Hungarian State than what was experienced during the SAO audit of the final accounts of 2009 and the previous year. In addition to informing the Government, the more intense professional control also has to include a direct review of the implementation process.

Pursuant to the contract between the Municipality of Budapest and the Budapest Transport Company on attending to the investor's tasks of the section between Budapest Kelenföld Railway Station and Budapest Keleti Railway Station of the Budapest Underground Line 4 concluded on 19 January 2004 and amended on 17 August 2005, the Budapest Transport Company is obliged to commission an *'Independent Control Engineer'* to check the investment decisions taken during the investment and the implementation of the investment. Point 6.09 of the financial contract concluded between the Municipality of Budapest and the European Investment Bank on 18 July 2005 also requires the employment of *'an independent engineer with international experience'*. The *'Independent Control Engineer'* would perform his or her tasks in accordance with the conditions specified by the Budapest Transport Company in agreement with the Capital, but – similarly to the previous years – until the closure of the SAO audit, no engineer was employed for this task.