



STATE AUDIT
OFFICE OF HUNGARY

R E P O R T

on the Activities of the State Audit Office of Hungary in 2010

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PRESIDENT'S FOREWORD

As in every year to date, the State Audit Office of Hungary submits its report on its 2010 activity to the National Assembly. This is also a good opportunity for us to reflect on our achievements and consider our options and difficulties.

In the context of the recent history of our audit institution, the past year was characterised by the predominant duality of changes and challenges. Virtually every organisation needed to respond to the new tasks and the changes in the Hungarian environment, brought about by the world crisis, especially those working to verify that public funds are used in a regular, efficient and effective manner, and to facilitate sound fiscal management.

Owing to the nature of the work of the State Audit Office, 2010 was shaped by the annual audit plan as well as by the need to accomplish goals and complete tasks previously set in its strategy. At the same time, in the spirit of conscious, prudent and innovative audit action, we arranged for and launched the processes which will shape the future in every aspect of our work.

The appointment of new management to the State Audit Office in mid-2010 provides an opportunity, in terms of both traditional and new tasks and duties, to adopt approaches that are different to those followed previously. For example, this Summary still covers comprehensive audits of the financial management of local governments, but the contents of our report on such work next year will be completely different, as the definition and publication of the State Audit Office's medium-term strategy marks the beginning of the development of responses following new approaches. In upgrading our working methods and procedures, we focus on the latest international standards in addition to Hungarian specificities.

Other than methodological development, organisational development also presents a number of tasks to be accomplished. Mindful of the preservation of values, our aim in the course of innovation is to enable the State Audit Office to make continuous progress based on the values of the Office and its achievements to date, while optimising its response to the challenges of the changing legal and economic environment. A generation change is taking place among State Audit Office personnel. In part, this involves recruitment of motivated graduates and their training in a newly developed internship programme, and in part employment of new experienced professionals.

Through consulting and the compilation of reviews, carried out in addition to and relying on traditional auditing by the State Audit Office, as well as through the exemplary promotion of best practices, we intend to enhance our contribution to the modernisation of the operations of general government.

The requirements for audited organisations are also enforced during our own institutional operations, as a result of which our fiscal management and the utilisation of our resources are characterised by austerity, efficiency and sustainability.

According to the report by the independent auditor, commissioned by the Speaker of the National Assembly, 'our annual financial statement provides a true and fair view of the assets and financial standing of the budget chapter for the State Audit Office as of 31 December 2010'.

1. INSTITUTIONAL OPERATION IN 2010

The State Audit Office is the organ of the National Assembly responsible for financial and economic auditing. Its President and Vice-President are elected by the National Assembly for 12 years.

As the supreme organ of state auditing, the Office is only subordinated to statutes and the National Assembly. Under the Constitution, it carries out its audits against the criteria of legality, expediency and efficiency. As a guarantee for economic constitutionality, the Office facilitates the National Assembly's exercise of its budgetary rights as well as the enforcement of its legislative and control functions. The provisions of the Constitution and the Act on the State Audit Office are aimed to ensure the independence of the Office as a major pillar of the democratic order of the state. Guarantees for such independence are provided in respect of the election and immunities of its President and Vice-President, in particular the management, governance and decision-making powers of the President, as well as the budgetary relations of the Office.

The State Audit Office is governed by regulations at three levels: its position within the organisation of the state is defined by the Constitution, its auditing requirements and powers by the Act on the State Audit Office and other statutes, while its operations and governance are subject to internal policies aligned with the statutory framework.

Under the Constitution, governance of the organisation is the responsibility of its President, who ensures fulfilment of the statutory commitments of the Office, approval and implementation of its audit plan, and submission of its reports to the National Assembly, as well as the publicity of such reports. Additionally, the President represents the State Audit Office in the National Assembly, with powers to attend and speak in plenary and committee meetings and take questions from representatives.

In 2010, the State Audit Office of Hungary worked and carried out its audits in special circumstances. The mandate of its previous president expired on 9 December 2009, and the Office, which, contrary to the Constitution, had been functioning without Vice-Presidents for the eighth year, subsequently operated, due to the absence of a decision by the National Assembly, without an elected executive officer with full powers until July 2010. Regulation has provided a framework in which the Secretary General of the Office was enabled to govern its organisation for over six months. Subject to their restricted powers, the Secretary General had the right and the duty to take any action urgently required to meet the statutory obligations of the Office and to ensure its operations. Since, in accordance with their legal status specified in the Constitution, the Secretary General was not entitled to substitute for the President in their full powers, the operations of the State Audit Office also failed to meet the requirements of the Constitution in this period. Acting in their powers of substitution, the Secretary General was not entitled to submit recommendations to the National Assembly on the organisational structure of the State Audit Office and changes thereto; and was not entitled to approve the Rules of Organisation and Operation for the Office, or any amendments

thereto. The Secretary General was not entitled to exercise any powers to appoint and remove executive managers. In the course of auditing, Director Generals had no superiors, which left the State Audit Office without comprehensive management. The Secretary General had no powers to approve the annual audit plan and the annual report of the State Audit Office, or to substitute for the President in sessions of the National Assembly. These limitations on powers also contributed to the fact that the absence of elected executive managers prevented the State Audit Office from operating smoothly in the first half of 2010. Owing to limitations on the rights of representation and substitution, adverse budgetary measures were taken, affecting the work of the Office and undermining its power.

Although the conditions for operations were formally provided, the system of governance by the President could not prevail, preventing such key decisions from being taken as would have shaped the professional and organisational development of the Office. In this period, the absence of elected members of management carried constitutional and operating risks. Had these conditions prevailed any longer, the actual operations of the State Audit Office of Hungary would have been at risk: without an audit plan, to be approved by the President or the Vice-President in their powers of substitution, the Office would have failed to fulfil its constitutional and other statutory obligations.

In June 2010, the National Assembly adopted a decision with a major impact on the operations and governance of the State Audit Office of Hungary. With the election, and entry into office as of 5 July, of the new President and Vice-President of the Office, following an extensive period of non-compliance, its management has resumed operations to comply with the provisions of the Constitution. The primary task of new management was to restore the governance of the organisation. To that end, a review was required of the entire operations of the Office, its level of regulation, as well as the controls in support of the management. A number of decisions had to be taken, the lack of which adversely affected financial management and thereby the Office's discharge of its duties.

Prior to the entry into office of the new management, the headcount of the State Audit Office had fallen far below the permitted limit. Providing for and training a sufficient number of new and well-prepared staff remains a major challenge for the Office even today. Audits were carried out according to the audit plan adopted in late 2009. However, the plan could not be aligned with the most pressing requirements (audit of the financial management of the National Roma Self-Government, inclusion of the natural disaster recovery system in the audit plan) until the new President was elected.

Following the announcement of the newly elected President's professional concept, a new strategy was developed for the State Audit Office for the medium term. The new strategy ensures continuous progress, relies on the values and achievements of the Office, and at the same time identifies new priorities resulting from the concurrence of a number of changes in the environment and challenges. The mission of the State Audit Office is to promote transparency and regularity of public finances through value creating

audits, performed on a solid professional basis, thus contributing to ‘good governance’.

In contrast to earlier practice, the 2011 audit plan of the State Audit Office of Hungary was compiled in a public, bottom-up planning process. Making the audit topics compete was the most important element of the new planning process. During this process, the audit topics to be included in the plan were selected in a competition consisting of several rounds.

In order to meet the objectives, defined in the new medium-term strategy and 2011 audit plan of the State Audit Office, as well as to ensure the transparency of operations, work has started on organisational restructuring and the definition and establishment of audit systems, which ensure information flow and adherence to the rules concerning controlling, monitoring and work processes, both for audit-specific professional responsibilities and for supporting institutional responsibilities.

In order to establish active and proactive communication, since the second half of 2010 the State Audit Office has been applying efficient and up-to-date methods, making better use of the opportunities provided by the World Wide Web. The news portal, launched on the website of the State Audit Office of Hungary, is becoming an increasingly recognised and sought-after source of information for those interested.

2. PROFESSIONAL DUTIES AND ACHIEVEMENTS

2.1. Implementation of the annual audit plan – An overview

In 2010 the State Audit Office of Hungary (SAO) performed its activities in accordance with the audit plan approved by its previous President following discussion in the Budget, Financial and Audit Committee of the National Assembly.

The 2010 audit plan included a total of 65 topics. During the year, six new assignments were added to the audit plan of the SAO and three were cancelled¹, as a result of which the modified audit plan included 68 audits. The assignments scheduled for 2010 were completed. During the year, 46 reports

¹ New audits: (1) audit on the financial management of the National Roma Self-Government in 2009 and the first half of 2010; (2) audit on accounting for the funds spent on the parliamentary by-election in November 2009 at the nominating organisation obtaining representation; (3) audit of the systems established for the prevention and recovery of natural disasters and the elimination of their consequences; (4) audit on the financial management of the Hungarian Post, (5) audit on the expediency of the use of vocational training contributions; and (6) assessment of the effectiveness of the guarantee activity of Garantiqa Credit Guarantee.

Cancelled audits: (1) audit on the efficiency and effectiveness of collecting tax revenues due to the central budget from the vehicle registration tax; (2) audit on the operation of the central budgeting system; and (3) audit on the utilisation of introducing electronic public services and related expenditure.

were issued, six of which were signed, in the absence of elected management, by the Secretary General acting on behalf of the President. Resources were used as planned.

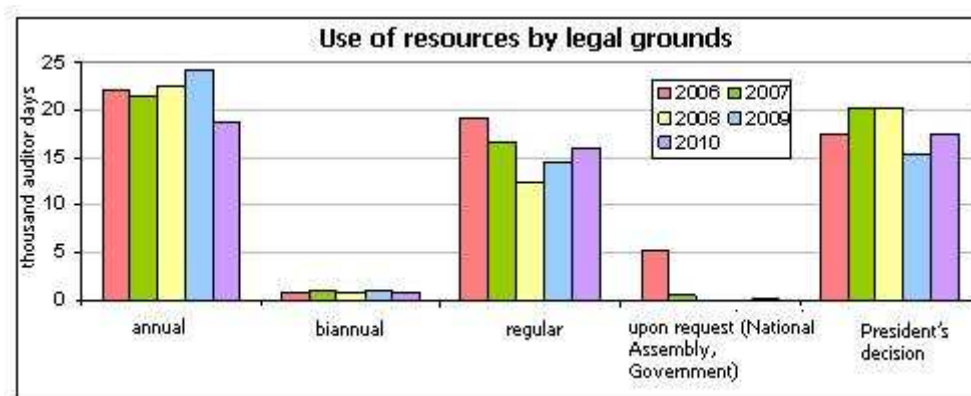
The assignments prescribed by statutes to be carried out at various intervals (annually, biannually and regularly) required 67% of auditing resources. 33 reports were compiled on such assignments.

35% of the resources were used for the fulfilment of annual audit duties (opinion on the substantiation of the state budget; audit on the final accounts; audit on the 2009 operations of the Hungarian State Holding Company and the Hungarian News Agency Corporation; audit on the distribution of revenues to be distributed among the Municipality of Budapest and the local governments of its districts).

In fulfilment of biannual audit duties, reports were compiled on audits of the financial management of two political parties and two foundations in support of political parties.

In fulfilment of regular audit assignments (the frequency of which is determined by the SAO itself), 24 reports were issued, using 30% of the resources. (Regular audit assignments include audits of the financial management of budget chapters, local governments, as well as social security and extra budgetary funds.)

Audits on the financial management system of local governments accounted for 76% of such assignments. In addition to the report summarising the findings of on-site audits of 119 local governments, the SAO compiled separate reports on 16 local governments with budgets and assets of a significant order (the local governments of 5 counties, 6 towns with county status and 5 districts of Budapest).

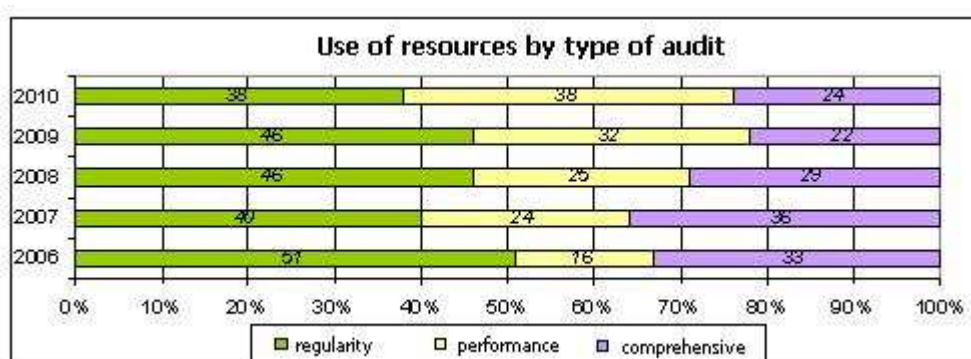
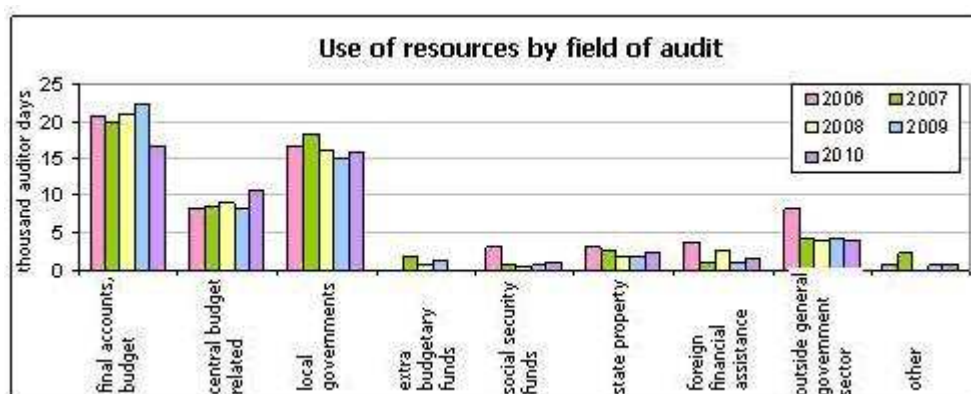


In 2010, the SAO audited the financial management of the National Roma Self-Government upon the request of the Government.

The fulfilment of statutory requirements allowed the SAO to use 33% of annual resources for audits on topics where the frequency of audits is not subject to

statutory requirements. They were selected by the President of the SAO and most of them were conducted following the performance audit methodology.

In consistence with the strategic objectives of the SAO, effective until the end of 2010, the audits conducted subject to the decision of the President of the SAO belong to one of three groups according to their focus: (1) use of EU funds and their utilisation for the purposes intended; (2) protection of state development funds; and (3) efficient and effective discharge of state duties.



2.2. Results of the audit of final accounts

As part of its audit on the implementation of the 2009 budget (final accounts) of the Republic of Hungary², the SAO applied the financial audit method to perform a full review of the accounts of the direct revenues and expenditures of the central budget, performance data on which, as included in the 2009 bill on the final accounts, are reliable, except for housing subsidies, and revenues and expenditures relating to state property, which are qualified with limitations.

The essential framework of the utilisation of state property remained unchanged in 2009. The Hungarian State Holding Company continued to lack orderly, precise and complete property records confirming state property with

² 1016 Audit on the Implementation of the Budget of the Republic of Hungary for the Year 2009

an itemised inventory that contained the updated value of the shares of the state. The Company was unable to provide complete, itemised accounts for revenues from the sale of other real estate in the amount of HUF 1.5 billion, and it also failed to record the content, composition and justification of an adjustment in the amount of HUF 119.7 million.

With regard to housing subsidies, every year since the audit of the 2005 final accounts the SAO has indicated that, for several years, some credit institutions – the circle of which varies – have been paying significant amounts of subsidies without the new contract required by the relevant provisions of law.

In the course of auditing the 2009 final accounts, the SAO conducted 52 financial regularity audits, based on which it provided opinions on the reliability of 53.1% of the total expenditures of the chapters of the central budget.

**The SAO's audit of the 2009 final accounts
Results of financial regularity audits**

type of opinion	number of reports
unqualified opinion	39
emphasis of matter paragraph included	26
qualified opinion	10
adverse opinion	3

In 2009, the internal audit organisational units of 12 chapters conducted a total of 59 reliability audits, accounting for 9% of total institutional expenditures.

**The chapters' audit of the 2009 final accounts
Results of financial regularity audits**

type of opinion	number of reports
unqualified opinion	46
emphasis of matter paragraph included	21
qualified opinion	6
adverse opinion	7

The SAO found that the tasks specified in recommendations for the correction of the deficiencies identified in the audit of the final accounts for 2008 had been accomplished by the ministries only partly, with some tasks still being carried out. The SAO gave priority to problems which continued to exist in the period of auditing the final accounts for 2009.

The audit of key financial statements identified deficiencies in balance sheets, cash flow statements and notes alike (non-compliance with statutory requirements, no inventories to support balance sheet lines, long-term commitments without coverage, etc.), which influenced the reliability of the statements concerned.

The performance of EU funds as shown in the budget fell 8% short of plans, while the utilisation of central budget assets exceeded the planned appropriation by 24%, which, in terms of budget implementation, acts as a factor increasing deficit.

The audit of the 2009 final accounts of extra budgetary funds and social security funds involved the new task for the SAO to provide opinions concerning data on the revenue of the funds collected by the Hungarian Tax Authority (APEH). Auditors provided opinions on other revenues and expenditure data. Except for those auditing the Homeland Fund and the Innovation Fund for Research and Technology, auditors followed the SAO methodology in the course of their audit. Based on the findings of the audit, the SAO initiated a regulatory review on grounds that no transitional rules were defined at the time of amendment, and the difference between the terms 'auditing' and 'review 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 assignment were not clarified.

The conditions for the operation of extra budgetary funds were provided in 2009 as well. The aggregate balance of the funds for 2009 was negative, but was covered by accumulated residue.

The daily liquidity of social security funds was provided by means of an interest-free loan. The measures taken by the Government to cut expenditures and meet the budget deficit target were not sufficient to counterbalance a deficit exceeding the appropriated value.

2.3. Results of providing opinions on the budget

In the course of providing an opinion concerning the budget appropriation bill of the Republic of Hungary for 2011, the SAO was not able to give a comprehensive judgement as to the substantiation of the draft appropriations for tax revenues. However, progress had been made in that the ratio of tax revenues, concerning which the SAO had no means to provide an opinion, was reduced to 33%. The SAO rated 46% of the planned tax revenues as viable, with medium risk to the viability of 15% and high risk to that of 6%. The SAO deemed it necessary to warn that economic growth below the estimated 3% GDP growth could be an additional risk factor affecting the realisation of certain taxes.

The SAO rated 86% of the revenues planned for 2011 in relation to state property as viable, and 14% as involving high risk. In the absence of calculations, no opinion could be expressed as to the viability and

substantiation of appropriations for revenues and expenditures relating to the National Land Fund.

With the exception of resolving the ownership issues of former church property, the direct expenditure appropriations laid down in the budget appropriation bill were substantiated. For a considerable part of expenditure, the expenditure appropriations may be exceeded without any obligatory amendment (with EU grants, this is subject to limitations), which may be a risk factor to meeting the deficit target. Risk could have been reduced by means of the reserve for the extraordinary government measures specified in the budget appropriation bill. However, pursuant to the statutory amendment which became effective following closure of the audit of the budget for 2011, this type of reserve will supersede the general reserve rather than the stability reserve. As such, it cannot cover the risks indicated by the SAO.

In providing an opinion on the budget appropriation bill, the SAO pointed out that the changing structure of investments and savings, unfavourable developments in the willingness of foreigners to purchase HUF and foreign exchange bonds, the decline in the yields on the government securities market falling short of projections and unfavourable changes in the estimated HUF and EUR exchange rates may all be risk factors in the fulfilment of the 2011 financing plan.

Both the ministries' planning work and auditing such work faced significant difficulties owing to the constantly changing legislative environment, restructuring still in progress, and the fact that at the time of elaborating the bill, the estimated effects of legal regulations yet to be passed were also considered in the course of defining appropriations. The bill submitted to the National Assembly after the on-site audit contained several changes concerning revenues, expenditures and centralised revenues of the chapters, pertaining to the content, reasons or substantiation of which the SAO did not have any information.

The SAO warned of the widening gap between the increasing duties of local governments and the financing of such duties; the difficult financial situation of local governments as a result of the above; the recently doubled debt; and the long-term commitments undertaken by the economic entities of local governments on an increasing scale. The SAO considered it necessary to highlight enhanced consistency of tasks and financing, as well as the responsibilities of local governments.

In comparison with previous years, several elements of the budget appropriation bill indicated a positive change. However, the SAO also identified recurring problems in certain fields, such as failure to elaborate appropriations for the three years following the year concerned or to adopt legal regulations on which the budget should be based. As in previous years, the SAO considered it important to reiterate the need for a comprehensive public finance law to specify the structure and contents of the annual budget, the duties of the organisations involved in its planning, and data supply to the SAO.

2.4. Results of regularity and comprehensive audits

The SAO audited the **financial management system of local governments** at the local governments of 4 counties, 6 towns with county status, 6 districts of Budapest, 66 towns, 4 large villages and 32 villages. From 2006 to 2009, about 80% of local governments failed to secure the equilibrium of their budgets: with budgeted revenues insufficient to cover budgeted expenditures, they planned to make up for the difference by taking loans. In the course of budget implementation, a smaller part, about a third, of local governments ran financial deficits in annual terms. Over two thirds of the audited local governments issued foreign currency bonds at variable interest rates. The grace period for principal repayment varied between six months and five years. Owing to fluctuations in exchange rates and the variable interest rates stipulated, bond issues are a risk to local governments.

Close to 75% of local governments failed to prepare successfully for claiming and utilisation of EU funds. About 90% of audited local governments had IT systems in place to provide electronic public services. 80% of such systems enabled users to download the forms required for administration and to complete the forms electronically. The publicity of financial management data of public interest remained insufficient, with approximately a half of the local governments failing to disclose, despite statutory obligations to do so, such data on contracts exceeding HUF 5 million and specific-purpose support as specified by law, and narrative justification for their financial statements.

In the course of its audit on the level of regulation, the SAO found that nearly two thirds of the audited local governments of counties, towns with county status, Budapest districts and towns, there was a low risk from the processes of budgeting and the preparation of final accounts, and from arrangements for the organisational and regulatory framework. With about a half of audited local governments, compliance of operating the controls introduced in the processes of budgeting and the preparation of final accounts was found to be excellent on the whole. In the fulfilment of the duties of financial management and of finance and accounting, compliance of the attestation of professional performance and the mechanism of countersigning vouchers was found to be poor with about a half, and excellent with nearly a third of audited local governments.

Arrangements for the organisational framework of internal audit and regulation of its operating conditions was of medium risk with nearly a half, and low risk with about a third of the local governments to the regular fulfilment of audit assignments, because the methods of internal audit had been defined and the required staffing, organisational and regulatory conditions had been provided. Compliance of the controls introduced in operating the internal audit was found to be good with nearly a half, and on the whole excellent with a third of the local governments.

In its 2010 audit of operating the internal controls introduced in the fiscal management of the Municipality of Budapest, the SAO found that the regulatory deficiencies of financial management duties and in-process controls posed a medium-level risk to the adequate and regular fulfilment of

such duties and controls. Internal controls key to fiscal management in the performance of budget expenditures (attestation of professional performance, countersigning vouchers) were operated poorly in terms of compliance. On grounds of the deficiencies and irregularities detected, the SAO brought a criminal complaint and initiated disciplinary action. The SAO recommended that the General Assembly should order a review of the circumstances and legality of the execution of contracts of engagement, as well as a review of whether the persons, designated or authorised to exercise the powers of control, fulfilled their statutory duties of control in the course of contracting and payments, and that the General Assembly should take disciplinary action against the civil servants responsible for the negligence.

Arrangements for and regulation of the organisation framework of internal audit presented medium risk to the adequate and regular performance of audit assignments, and the controls introduced were operated poorly in terms of compliance. In implementing internal audit, those carrying it out were functionally not independent. Additionally, internal audit failed to plan and carry out audits at the organisational units of the Budapest Mayor's Office in several fields assessed to be of high risk, including budgeting and within that, the planning of personal allowances and the use of budget appropriations, as a result of which internal audit failed to detect the inadequacies in the operation of internal controls which are key to payments made in the course of using budget appropriations (attestation of professional performance and countersigning vouchers). In the first half of the 2009/2010 year, nearly a third of the audits specified in the audit plans were not carried out in due course.

In its review of the local government decree on the distribution of revenues among the Municipality of Budapest and the local governments of its districts in 2010, the SAO found that the amount of revenues to be distributed was set correctly by the Municipality of Budapest at HUF 216,564 million; however, the ratio of resource distribution was set incorrectly, owing to which the share of the Municipality of Budapest had to be reduced by HUF 392 million, which was added to the share due to the districts of Budapest. The deviation amounted to 0.18% of the revenues to be distributed.

Applicable legislation provided only a limited basis for an audit of the **Network Foundation for Fee Payers and Payers with Arrears in Budapest**, as the SAO's audit of the support system of the Foundation was limited to support financed by the Municipality of Budapest. In the absence of documents to prove eligibility for support, the fact of social need could not be established. The Foundation did not verify eligibility for support. The SAO's audit identified several instances of irregularity: support credited to ineligible beneficiaries in the amount of HUF 240 million, duplicate support granted in the amount of HUF 9.8 million, and excessive support in the amount of HUF 2.4 million.

As a result of its on-site audit on the utilisation of non-normative state subsidies granted between 2007 and 2009 to **non-profit organisations established to provide advocacy, care and assistance to persons with disabilities**, the SAO found that 85% of such organisations used support in a

regular manner to achieve the objectives defined in the National Disability Programme. The audit identified deficiencies in the regulation, coordination and control of budget financing, as well as in the judgement of the social benefits of support. The SAO's report pointed out the contradictions between the regulations of statutes and decrees and contractual requirements applicable in the utilisation of support. The audit identified accounts for HUF 40.1 million worth of irregular support, two thirds of which was settled by repayment into the central budget and adjusted accounts. With one organisation, the audit also established personal liability on grounds of violating the provisions of the Act on Accounting and the subsidy contract.

The SAO's **audit of state subsidies to and financial management of theatres** found that subsidies had been provided in the absence, at both the sectoral and management levels, of defined cultural, social and economic objectives to be achieved through the use of public funds, and principles and methods to help achieve such objectives. Strategies and action plans had not been developed, leading to a partial achievement of the objectives specified in the relevant government programmes and sectoral working papers. Differences remain unchanged in regional access to theatres, a prerequisite for equal cultural opportunities.

Following entry into force of the Performing Arts Act, the support system became more transparent. However, the current system of central subsidies to theatres fails to consider the financial needs of property management and development. Theatres with obsolete infrastructures or with managers suffering from a shortage of funds have been put at a disadvantage.

Through grant programmes, independent organisations received funds mostly for operations rather than to stage productions. Calls for tenders often failed to specify the objectives and terms of granting support, and administration involved long processing times. Conditions for the periodic control and accountability of the regular use of grants were not fully provided, and no comprehensive assessment was made of utilisation.

As part of the 2009 Act on the Budget, the National Assembly approved an appropriation of HUF 4,100 million for the **administration of the election of members for the European Parliament**. This was 5.8% less than expenditures on the 2004 EP elections. The decrease was the combined effect of a nearly 75% reduction in expenditures on voting at foreign missions and a cut in central expenditures by a third, and of the increase in local expenditures by over a third. Expenditures were made in the amount of HUF 3,855 million, with a residue of HUF 245 million. The specific cost of voting at foreign missions remains high. In connection with the elections, four members of the National Election Office received exceptionally high rewards.

Having conducted its audit upon the request of the Government and rated the financial situations and assets of the **National Roma Self-Government** as disorderly, the SAO initiated criminal proceedings on grounds of legal non-compliance and irregular financial management. The SAO recommended an order for the repayment of HUF 10.5 million accounted for in irregular payments.

As part of periodic **political party audits**, the SAO completed its audits on the legality of the financial management of two political parties (Christian Democratic People's Party and Hungarian Democratic Forum). The findings confirmed that in order to strengthen the enforcement of transparency in political party financing and the accountability of political parties, it was necessary to resolve the conflicts, affecting political parties' accounting records and reporting system, which have existed for a decade between the Act on Political Parties and the Act on Accounting.

In accordance with the political party audits, an audit was carried out on the legality of the financial management of **foundations in support of political parties** eligible for budgetary subsidies. Support granted by their boards and the programmes implemented within their own organisational framework were consistent with the objectives defined in the statutes of the foundations. With one of the foundations, owing to failure to implement the SAO's previous recommendations, the system of accounting was incomplete and standards were not fully observed.

2.5. Results of performance audits

The SAO's **audit on the 2009 activity of the Hungarian State Holding Company** pointed out that in 2009, legislation on the institutional system, established by means of the State Property Act, continued to be insufficient to enforce legislative intentions. The fundamental deficiencies of legislation, decision-making processes and property records continued to exist, and no disciplinary action was taken other than termination of the employment of the chief executive officer for cause. In 2009, too, there were disputes concerning powers and measures to the disadvantage of the state, which resulted in payments in the order of million HUF.

In matters of major impact, measures by decision makers, related to property management, failed to serve the purposes of the State Property Act, and were not transparent or effective enough. Decisions by the party exercising shareholder rights did not prioritise the interests of the state. Decision-making processes were characterised by the lack of concept and transparency. The regulation and practice of council powers were complicated, the control system established was partially effective, failing to expose the errors in decision-making and implementation.

The Hungarian State Holding Company managed the property entrusted to it, i.e. real property, the property of the National Land Fund and assets in business entities, without an approved strategy on property management for the medium term. Decisions to increase state holdings financed from budgetary resources continued to lack prudence in 2009 as well. Capital increase in MALÉV Hungarian Airlines Ltd. and in the Bábolna Stud Farm Ltd. financed loss-making management, which is against EU requirements.

As part of its audit of the **investment process of Metro Line 4**, the SAO assessed whether Section 1 between the Kelenföld and Keleti terminals would be completed within the budget, in accordance with contracts and in due time. Supervised by the Municipality of Budapest, the investment is administered by

the DBR Metro Project Directorate of the Budapest Transport Company. The investment is being implemented under 20 separate design-build contracts without a general designer and contractor. According to the permit document approved by the Municipality of Budapest in 2004, the deadline for the delivery of Section 1 was the end of 2009, and the cost of investment at current prices was HUF 236.5 billion. The investment was not implemented in due course: the line is expected to enter service in the second half of 2013, with costs estimated at HUF 370 billion at current prices. The Municipality of Budapest set the deadline of 2009 without taking into account the circumstances of technical preparations at the time. There was an interdependence between the construction of the tunnel, being the core technology in the investment, and the construction of stations. The former also influenced the remaining phases of construction and had an impact on the completion date of Section 1. Delays by the contractor for tunnel construction had given grounds for an obligation to pay the maximum penalty amounting to 10% of the contract price, corresponding to about EUR 20 million (HUF 5.6 billion), which had not been settled prior to the audit. At the time of the audit, it was not possible to give a precise estimate of the total investment cost, utilisation and completion date, as the construction of Section 1 of Metro Line 4 is still in progress. The greatest risk in temporal terms is presented by the uncertainty in the procurement of underground trains.

According to a comparative study commissioned by DBR, the implementation cost of Section 1 of Metro Line 4 is EUR 214 million per kilometre, ranking second in comparison with 10 underground construction projects in Europe. This is partly due to the fact that Section 1 is constructed with a high station density.

In respect of the years 2000 to 2009, the SAO conducted an audit on the operations of the **Guarantee Fund of Pension Funds**, established by private pension funds to honour claims of private pension fund members against their private pension funds. The audit found that regulatory deficiencies had existed for years in the Fund's discharge of its duties, which increased state exposure owing to the ultimate liability of the central budget for the claims of private pension fund members. The state further undertook to finance, against the central budget, the revenues of the Pension Insurance Fund lost as a result of members' contributions to their private pension funds. In connection with this, expenditures against the central budget to the end of 2009 amounted to HUF 2,043 billion due to the existence of the system of private pension funds, which progressively increased public debt. When membership in private pension funds was no longer mandatory, the exposure of the state and its commitment on payments to the Pension Insurance Fund were discontinued.

In its **audit of the processes followed in the use of EU grants for the management of irregularities, debt and claims**, the SAO found that with EU grants managed by the National Development Agency (NDA), the legal procedure applicable to contracting and withdrawal (civil-law transaction) was different from that applicable to reclaimed grants (administrative proceedings), and that the task resulting from the two different legal relationships was not resolved by regulatory means. The unresolved legal situation made both beneficiaries and courts uncertain as to the reclamation of

grants in the event of irregularities occurring on the beneficiaries' part. Within the institutional system of the NDA, beneficiaries had no means to appeal against decisions by the NDA and its organisations concerning irregularities. Legal remedy was limited to civil-law action. Legislation on tax secrecy prevented the Agricultural and Rural Development Agency, in charge of grants for agricultural and rural development, from auditing invoice issuers in the event of suspected fictitious invoicing. The above circumstances inhibited protection of the financial interests of both Hungary and the EU.

The scope of the SAO's **audit on the system of organisation and human resources in the discharge of state (public) duties** included the three major distribution systems (public education, healthcare, social and child welfare, accounting for one eighth of GDP spending), comprising a significant share of state (public) duties, and administrative services. The audit found that efforts in the period under review failed to rationalise the system of support to the discharge of public duties, and that financing continues to provide no incentives for a complex approach to the tasks to be managed/supported. Normative subsidies contribute to and differentiate within mandatory services as specified in applicable legislation. The contradictory impacts of organisational and headcount changes driven by fiscal constraints were detected in the field of healthcare, where major organisational changes had taken place. Typically, decision makers (the Government, ministries, local governments) failed to assess the impact of individual measures (such as the contribution of organisational changes and redundancies to reducing budget expenditures) on service quality and the effectiveness of such measures where they had the means to do so.

In its **audit on the role of the conditions and effectiveness of adult training in meeting the labour demand of the economy**, the SAO found that the system of adult training, supported using state funds, was only partially effective. Despite an increase in the number of people passing exams and finding employment, the long-term objectives set by the Government were not achieved in respect of the development of a set of indicators to measure effectiveness, and of the implementation of an adult training information system and career tracking system. The government action plan on training disadvantaged people was not developed either, and the reduction in the number of training programmes for the disadvantaged is owed partly to this. The system of legal regulations was complex yet incomplete, and failed to provide sufficient help for the involvement of disadvantaged people in training. The efficiency of training had also deteriorated: in 2008, subsidies used for the training of an employed trainee were two-thirds higher than in 2006. No cooperation had been established between training organisations operated using state funds. The highly diverse institutional system was funded through a system of poor transparency, comprising of multiple channels. The increase in state funds available for adult training (2.1%) was out of pace with the increase in the number of job seekers (42.8%). The use of state funds failed to reduce regional differences in terms of the level of development. Of the capacities of modernised training centres maintained by local government, only a fragment was used for adult training. The structure of supported training programmes partially met the demands of the economy.

Measures taken by the state and local governments to rationalise and reduce energy use only partially contributed to the achievement of the objectives of the Hungarian energy policy, and thereby to meeting EU requirements. The regulatory framework prescribed by the National Assembly had not been developed, and the responsibilities and powers of the organisations involved in the discharge of energy-related duties had not been clearly defined. The National Energy Efficiency Action Plan for 2008–2020 did not include a viable strategy and was also incomplete in terms of the exemplary role of the public sector, while its implementation was at risk from insufficient resources. The strategy on energy saving and improved energy efficiency for the period ending in 2010, and the action programme, designed for its implementation, were not viable with the assets and resources allocated to them. The tendering system established involved both redundancies and uncovered areas. Additionally, the conditions had not been provided for the specification, measurement and monitoring of energy saving objectives. Insufficient attention had been paid at the central level to the specification of energy-related duties for the subsystem of local governments, which had an impact on the discharge of local duties. Overall, local governments had been effective in the discharge of their duties, as they had provided the services required, implemented upgrades in the field of energy and used renewable energy sources. These efforts resulted in reduced energy use but, owing to rising energy prices, expenditures increased.

The SAO's audit on **one-day surgery services** confirmed that healthcare, while facing a constant shortage of funds, fails to exploit the opportunities offered by cost-efficient care forms such as one-day surgery. In Denmark, the Netherlands and England, over 50% of surgical interventions are carried out in this form. The most frequent surgeries include cataract removal, minor gynaecological interventions, and the treatment of hernia and varicose veins. According to data from the National Health Insurance Fund, one-day surgery accounted for approximately 3% of all surgeries in 2006 and 8% in 2009, an extremely low ratio by international standards. No guidance is available on the scale, position and impact of this form of care within the institutional system, as a result of which service providers do not have a clear vision in this regard and do not take into account the impact of day case surgery on healthcare insurance. The report has been discussed at a number of conferences as well as by the National Health Protection Council.

The audit on transplantation, donation and similar alternative forms of treatment evaluated access by patients suffering from end-stage organ failure to organ transplantation as well as preceding and subsequent treatment, the level of regulation and organisation of the transplantation process, and the effectiveness and cost-efficiency of healthcare insurance and budget expenditure. In the case of kidney failure, transplantation improves the prospects and quality of life, and results in cost savings in comparison with dialysis. Benefits in kind provided to a patient, receiving dialysis, cost an annual average of HUF 5 million, whereas the treatment of a transplant patient costs HUF 7.8 million in the first year and HUF 2 million in subsequent years. Based on these figures, the approximately 2,200 persons undergoing kidney transplants generate nearly HUF 6.6 billion in savings by the Health Insurance Fund. Achievement of the transplantation average of the EU would

require an additional HUF 2.5 billion worth of health insurance funds for case financing, and increased human resources and capacities, which sectoral government aims to deliver in 2011.

In its audit on the operations of the organisations discharging state duties relating to the expressway network, the SAO found that replacement of the minister responsible for transport policy on five occasions over four years had not been in favour of predictable control and the performance of professional duties. The Ministry of Economy and Transport and its successor, the Ministry of Transport, Communications and Energy had not reviewed the financial management of operating the organisational system of the expressway network and had not assessed the expediency and efficiency of the operations of the institutional system. Professional and shareholders' control had not been fully transparent, and a part of operational control had also been delivered verbally. Organisations discharging state duties accomplished their tasks, for which, however, they had used external capacities. The processes and operations of the organisations had been regulated. Despite statutory requirements, the Coordination Centre for Transport Development and the Hungarian State Holding Company failed to enter into an agreement for property management, as a result of which the expressways completed and put in service had not been taken over from the investor National Infrastructure Developing Ltd. since 2007.

In its **audit on the operations of the National Cultural Fund**, the SAO found that in the absence of a sectoral strategy for culture by the Ministry of Education and Culture, there was no medium-term plan to cover and coordinate the activities of the National Cultural Fund for several years. The National Cultural Fund did not have short- and medium-term strategies on cultural support, which should have specified the general objectives defined by law. Professional colleges had failed to draw up separate documents to define support objectives for their respective fields; the principles and objectives of support were included partially in college minutes and annual reports on professional activities. Typically, the same tenders were announced in each year. Decisions, concerning the granting of support, were made in part by boards and in part directly by the minister in charge. Decisions on awarding the almost exclusively non-repayable grants were made by boards seating 132 to 147 delegates (partly those of social organisations), incurring annual operating costs of HUF 86–128 million. 25% of the revenues excluding operating costs was subject to the direct decision-making powers of the Minister, who approved 97.5% of support granted in 2006 to 2008 (HUF 1.8 million on average) by ad-hoc decisions and 2.5% in tenders. No standardised and measurable criteria had been developed to substantiate decisions.

In its **audit on the system of local taxes**, the SAO found that the weight of local tax revenues had increased, with taxes collected by the 3,130 local tax authorities amounting to one fifth of the budget revenues of local governments. Legislation on the system of local taxes was hasty; amendments to statutes were adopted based on a variety of ideas, since there was no medium-term concept on the revision of the system of local taxes, which led to a high level of uncertainty and a short-term approach in local tax policy

and in planning revenues. Competence and technical conditions are of a high standard at the tax authorities of Budapest, the towns with county status and major cities, collecting 93% of local taxes, but deficient at those of villages. Pursuant to budgetary statutes, local business tax capacity planning was based on estimates by local governments rather than facts, making it difficult to submit precise applications for support to reduce differences in levels of income. Improvements were seen with 29% of audited local governments in terms of the efficiency and effectiveness of tax collection, and with only 6% in terms of the efficiency of tax execution. The situation is the most favourable with local governments of high tax capacity, whereas efficiency and effectiveness remain extremely low in villages. There has been a decline in the efficiency of tax audits by local governments: half of local tax authorities had carried out no or only a few tax audits.

In the specific legal environment of the **Hungarian News Agency Corporation**, the risks attributable to regulatory deficiencies continued to exist in 2009. Such risks consisted in the absence of regulations on operations in terms of duties, powers and responsibilities, specifications for public duties at the level of activities, the amount of state subsidies required for the discharge of such duties, and regulations on the transparency of using such subsidies. In 2009, too, the National Assembly failed to adopt a decision on draft public service agreements to enable regular and transparent funding by the state, despite state funding for public duties carrying the highest risk owing to its inconsistency with EU regulations. Additional risks were presented by the fact that the Corporation carried out its 2008-2012 strategic planning without shareholders' expectations, concerning financial management, being specified, and without approval by the National Assembly.

2.6. Implementation and estimated utilisation of recommendations

The findings from and recommendations made in the SAO's audits are utilised (implemented) by taking the appropriate measures.

Owing to statutory provisions, the SAO has no direct means to enforce utilisation of its audit recommendations³. Consequently, it is paramount that audited organisations and their staff accept and are able to identify with audit findings already in the course of the audits.

Additionally, following closure of their audits, the majority of audited organisations develop action plans based on the SAO's findings and recommendations. The contents of such plans may be assessed and implementation of audit results may be monitored as part of follow-up audits.

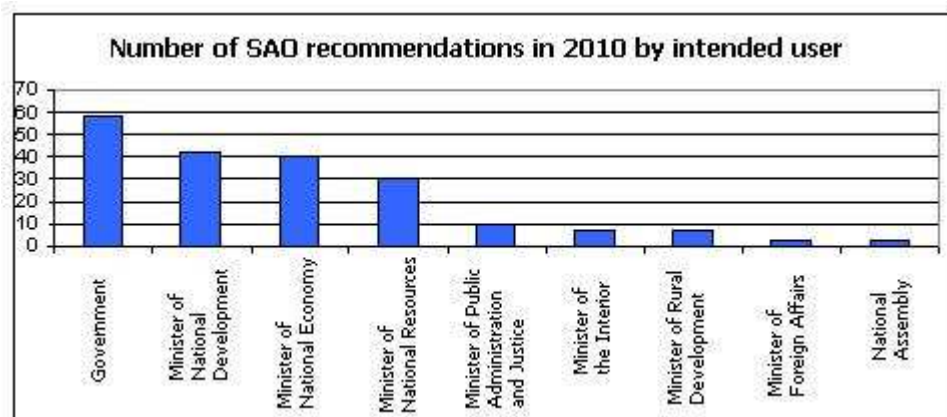
The development of a follow-up audit system is an objective defined in the SAO's strategy. In order to implement audit results in an improved manner, the SAO is making efforts to develop the system and strengthen its use of targeted follow-up audits as soon as possible.

The activity of the SAO also has an impact on the utilisation of audit results. Definition of audit objectives, selection of audit methods, report quality, adequate substantiation of findings, specific and viable recommendations are all factors that may facilitate better utilisation of audits.

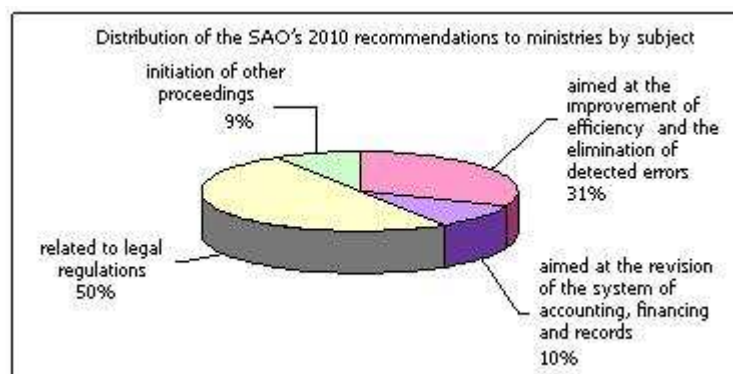
2.6.1. Statistical presentation of recommendations made in reports issued in 2010

Following the practice of previous years, the SAO requested advice from the Government and ministers with a view to monitoring utilisation of the SAO's recommendations made in the course of its audits completed in 2010. The SAO's request was granted by all of the parties concerned, in detail and scope varying by ministry. In their written responses, several ministries indicated that the findings presented and recommendations made in the SAO's audits helped their management work and financial management, and were also being considered and utilised by their internal audit.

³ Article 25(1) of Act XXXVIII of 1989 on the State Audit Office (SAO Act) requires the State Audit Office of Hungary to submit its audit findings to the chief executive of the audited organisation, allowing 8 business days for them to make comments in writing and order measures. The SAO shall be notified of such measures within 30 days. In the case of insufficient measures, notification may be given by the President of the SAO to the chief executive of the audited organisation and to the National Assembly, or the case may be presented in the annual report on the final accounts.



Advice on implementation of the SAO's recommendations, addressed to the Government, generally indicated that legal and procedural regulation and organisational structure in various fields had undergone significant changes since the SAO's reports were closed, as a result of which some of the recommendations made in such reports apply to organisational structure and regulatory environment existing prior to the changes. In respect of the fields subject to revision, the recommendations had become irrelevant.



The SAO manages information concerning implementation of its recommendations in a database, which is used during follow-up audits.

Overall, 73% of SAO's recommendations entered various stages of implementation. 5% of the recommendations were clearly rejected, and no appreciable information was available on 22% at the time of compiling this audit.

2.6.2. Utilisation of audit findings and recommendations

Implementation of the recommendations made in the course of its **audit of the 2009 final accounts** will be made by the SAO as part of the 2010 final accounts. Following the practice of previous years, a part of the audited organisations developed action plans for the implementation of the SAO's

recommendations, made in its audits of the final accounts, which they submitted to the SAO. In the SAO's judgement, the measures planned may generally be suitable to eliminate detected errors and deficiencies; however, the SAO is planning to implement a system for closer monitoring, which will provide reasonable assurance on the implementation of the measures, as well as potential guidance for the coming period. Concerning the field of EU developments, the SAO's recommendations made to the Minister of National Economy in respect of legislation and legislative amendments have been implemented.

In providing an **opinion on the 2011 budget**, the SAO recommended that reserves for extraordinary government measures as specified in the bill be regulated at the level of the Act on Public Finances. The amendment to the Act on Public Finances became effective following closure of the audit, under which this type of reserve will supersede the general reserve.

As a result of the findings and recommendations of the SAO's audits **in the field of healthcare**, minor steps have been taken in the appropriate direction in certain distinct sub-fields. One such step was the designation of the Office of Health Authorisation and Administrative Procedures under Government Decree 315/2008. (XII. 22.) as the authority for the operation of the uniform HR monitoring system of the sector.

As part of a grant awarded to the National Health Insurance Fund, with a view to making the system of prescription exemptions more efficient and targeted, the Department of Cash Benefits and Pension Insurance of the Ministry of National Economy has been cooperating with the health sector in implementing IT development to streamline administrative processes involved in the system of prescription exemptions, and the procedures of the service. Using IT solutions, the project is aimed at improving the efficiency of procedural action relating to applications for prescription exemption certificates, application assessment and the issue of certificates, thereby providing the conditions for e-administration.

In the field of social services, the programme 'modernisation of social services' (Social Renewal Operational Programme 5.4.1) is being implemented, as part of which needs-based activities are defined and a regulatory system is developed. The programme may provide a response to the indicators called for in the report. The programme runs until 30 November 2011.

In connection with the recommendations of the report on the **audit of state subsidies to and financial management of theatres**, the Minister of National Resources has advised that a cultural strategy is being developed for the Ministry and is scheduled to be adopted by 31 August 2011. Following announcement of the strategy, an action plan will be drawn up. The Ministry will be able to draft the bill on national cultural/arts institutions, their duties and the principles of their support in the context of the adoption of the cultural strategy and of amendments to the Performing Arts Act, given that current draft amendments being negotiated contain provisions in this regard as well. Tenders are announced in accordance with the objectives of the cultural sector and the principles to be defined in the cultural strategy, while interim calls for

tender are drafted subject to the objectives and requirements specified in the cultural strategy. The Ministry intends to assess accomplishment of the objectives defined in the Performing Arts Act by 30 November 2011.

Based on the SAO's report on the **audit of the processes followed in the use of EU grants for the management of irregularities, debt and claims**, the Minister of National Development has initiated unambiguous regulation of the legal relationship established between the National Development Agency and the beneficiary upon providing the subsidy and during the irregularity and claims management, at an appropriate level, in line with the area of law it belongs to, and the clarification of beneficiaries' opportunities for legal remedy. Government Decree 4/2011. (I. 28.) defines the legal relationship between the sponsor and the beneficiaries, and provides legal remedies to beneficiaries within the institutional system.

Progress is being made with the promulgation of the Government Decree on development policy, laying the foundations for irregularity procedures, to provide uniform criteria for the judgement of irregularities and to improve the effectiveness of irregularity management. The audit has thus achieved its objective: it has contributed to the development of the regulation and practice of irregularity management in order to protect the financial interests of both Hungary and the EU.

At the SAO's recommendation that the Minister of Rural Development should add a criterion for grant applications requiring applicants to consent to access by the Agricultural and Rural Development Agency to data within the scope as tax secrecy for the review of invoice issuers, amendments have been adopted to Act XVII of 2007 on certain aspects of the procedure relevant to agricultural, agrorural development and fishing subsidies and other measures.

Some of the recommendations addressed to the Minister of Finance in the SAO's **report on the audit of the activity of the Hungarian State Holding Company in 2008** have been utilised by the Minister by amending specific legal provisions. None of the SAO's recommendations concerning liability has been utilised.

In its 2010 report on the **audit of the activity of the Hungarian State Holding Company in 2009**, the SAO put forward a recommendation to the Minister of National Development concerning the review of regulation, ensuring the coherence of legal regulations, and investigation of personal liability. In June 2010, amendments made to the Act on State Property brought substantial changes to the mechanism and organisation of exercising shareholder rights. In the new structure, action plans were developed for the utilisation of the SAO's recommendations, the results of which will be presented in the SAO's report on its audit commenced in mid-March 2011.

The SAO's recommendations made, as in previous years, to the National Assembly and the Government in connection with legislation and other regulation based on the findings from the **audit of the Hungarian News Agency Corporation** have not been utilised on the whole. In 2010, changes were made to the operating environment of the Corporation. Legal regulations

adopted in 2010 revised the ownership structure, organisation and control system of the Corporation, improving the transparency of the duties and powers of the new owner.

Taking into account the recommendations in the report on the **2008 audit of the financial management system of local governments**, the National Assembly defined, with relevance to local governments, the method of current budget deficit calculation, and the method to recognise in the budget decree external and internal financing to cover current budget deficit as well as the revenues and expenditures of financial operations for financing purposes; additionally, it improved the consistency of disclosure dates for financial management data of public interest as specified in the Act on Public Finances and the Act on the Freedom of Electronic Information. The Government appended Government Decree 193/2003. (IX. 26.) on the internal audit of budgetary institutions with provisions on the obligations of associations conducting internal audits concerning consultation, advice and reporting. As of 15 September 2010, Act CXXIX of 2003 on Public Procurement allows the SAO to initiate proceedings ex officio in the event of failure to conduct a public procurement procedure, within a limitation period of three years of becoming aware of such failure.

The SAO's audit findings and recommendations presented over several years, including opinion on the budget, have contributed to the fact that revision of the system of local governments and rethinking the duties of local governments are now on the agenda.

The SAO has recommended that the Government adopt a medium-term concept on tax policy that also enables **local tax revenues** to be planned safely; introduce to the budget appropriation bill the method of calculating tax capacity relating to reduced income differences based on the previous year's factual data on local business tax revenues; and encourage a more efficient discharge of local tax administration duties. The SAO put forward recommendations for the minister in charge of tax policy concerning replacement of the obsolete ÖNKADÓ software and modification of the rules for transactions on tax collection accounts. As a result of the SAO's audit, local business tax capacity is calculated as of 2011 from factual data using the tax base reported in the tax returns two years earlier. Consequently, the amount of support or withdrawal to reduce income differences will be fixed in advance, allowing each local government to take it into account throughout the year.

The Ministry of National Economy of Hungary has advised that the entire system of **adult training** would be upgraded, and recommendations by the SAO would be considered in drafting the relevant bill. One of the key directions of the new Act on Adult Training will be streamlining and improved transparency.

Utilising findings from audits of **non-profit organisations involved in supporting persons with disabilities**, the Government is about to order, in accordance with the relevant provision of the Act on Public Benefit Organizations, amendments to the government decree on the specific rules of reporting and public accounting for other organisations as specified in the Act

on Accounting. The Minister of National Resources is about to issue a decree to provide for beneficiaries' obligations concerning management and operation of real property and valuable tangibles procured using support, as well as the rules of alienation; and is about to issue an instruction requiring support agreements to include effectiveness indicators and the minimum targets to be achieved by the use of support.

Based on findings from audits of **energy management**, the SAO has put forward recommendations to the Government concerning development of the missing strategies and programmes on energy, and climate and environmental protection; enhancement of existing strategies and programmes; specification of requirements for responsibilities and powers; regulation of the operations and duties of the underlying organisation in a uniform framework; enhancement of the statistical information system; amendments to legal regulation concerning the discharge of duties by local governments; and incentives for the establishment of a network of energy experts. Recommendations have been made to the minister in charge of energy, concerning ensuring consistency of the duties and structure of organisational units in charge of energy issues; and carrying out the required data collection and processing. Pursuant to government decisions and relying on the SAO's recommendation, the fields of climate policy and energy, previously managed by two separate ministries, were integrated under the supervision of the Ministry of National Development, whereby an independent Office of the Minister of State was established for climate and energy affairs. On 22 December 2010, the Government discussed and approved Hungary's Action Plan on the Use of Renewable Energy; additionally, development of the long-term Energy Strategy 2030 is underway.

Political parties are required to disclose officially their statements on their financial management of the previous year. Statutory requirements regulating statements by the political parties are not consistent with the provisions of the Act on Accounting, while statements fail to comply with the requirements for both the balance sheet and profit and loss accounts, as a result of which the contents of the statements may vary depending on the accounting policies adopted. The SAO has been warning of such contradictions for a decade. At its repeated initiatives to eliminate such contradictions, the Minister of Public Administration and Justice proposed that amendments to the Act be drafted by the Ministry of Public Administration and Justice and the Ministry of National Economy of Hungary in cooperation with the SAO.

The audit of the **Network Foundation** has highlighted the limitations of the SAO's powers of auditing organisations outside public finances. This called for an amendment to Article 2(5) of the SAO Act, under which the scope the SAO's audits now cover the whole of the audited organisation's financial management. The wider scope of auditing allows making a more effective judgement as to the standards of discharging duties of public interest, and to the regularity and efficiency of using public money.

3. BACKGROUND ACTIVITIES IN SUPPORT OF AUDITS

3.1. Legal measures, cooperation with authorities

The State Audit Office of Hungary is the audit institution of the National Assembly, carrying out its audits subordinated to the Constitution and statutes. With its findings, recommendations and advice based on its audit experience, the SAO intends to offer continued assistance with the work of the National Assembly, its committees and the audited organisations, as well as to facilitate well-governed state operations.

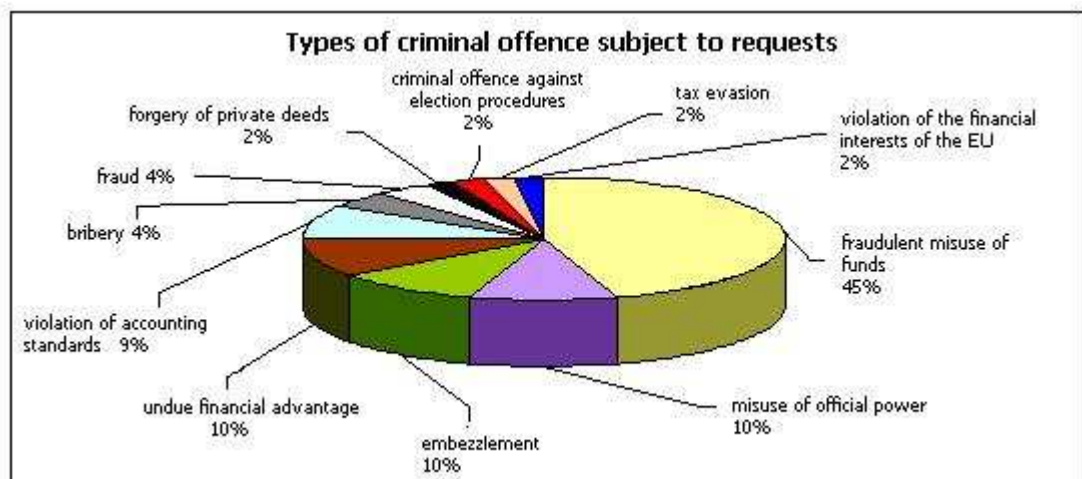
The State Audit Office is not an authority; it is not mandated to sanction the auditees. The utilisation of its findings and recommendations is facilitated not only by their convincing power, but by publicity as well (its reports are available to anyone on its website). Additionally, on grounds of its audit findings, the SAO may initiate proceedings (such as criminal proceedings) with the competent authorities against the audited organisations and the persons responsible in cases of infringement of law.

In cases where infringement of law is suspected, the SAO is required to communicate its audit findings to the competent investigating authorities. In order to facilitate criminal prosecution relating to irregular use of public money, the SAO, mostly on grounds of criminal offences against property (such as fraudulent misuse of funds), **brought criminal complaints in a total of 9 cases** in 2010 (3 in the first half of the year and 6 in the second)⁴. Based on the information available, investigations were launched on grounds of the complaints brought by the SAO, and in the case of the National Roma Self-Government, investigation had already been in progress. In the case of the Local Government of the village of Biri, criminal proceedings were validly terminated, in line with investigation data.

The SAO supports the activity of the authorities involved in criminal proceedings and efficient use of the required data by providing public access to its reports on its website and by fulfilling an increasing number of requests from authorities. The SAO has found that investigating authorities (police departments, public prosecutors, etc.) greatly rely on its reports in the discharge of their duties.

Out of the **60 requests received in 2010**, 58 concerned investigations in progress, previously initiated by either the SAO or other complainants. To the extent possible, the SAO met its obligation of data supply by submitting documents, primarily auditor's reports, containing facts brought to its knowledge in the course of the audits conducted.

⁴ Complaints were brought in connection with the following: Local Government of Fertőd, Local Government of Budapest District VIII (Józsefváros), Local Government of Biri, Hungarian State Holding Company, National Roma Self-Government, Metro Line 4 project, Korona Publishing House, Local Government of Budapest District XI (Újbuda), Municipality of Budapest.



Pursuant to the authority conferred by Article 327(1)(b) of the Public Procurement Act, the SAO is authorised to initiate proceedings for legal remedy on grounds of infringements of law coming to its knowledge in connection with public procurement.

The amendment to the Public Procurement Act effective as of 1 April 2009 curbed the increase seen from 2006 to 2008 in the number of **proceedings initiated for legal remedy**, allowing, in the event of failure to conduct a public procurement procedure, proceedings for legal remedy to be initiated within a limitation period of one year of the date of the contract executed without a public procurement procedure.

On the initiative of the SAO, the Public Procurement Arbitration Board established infringement of law on grounds of unlawful neglect of a public procurement procedure in one case in 2010, imposing a fine of HUF 1 million on the local government concerned⁵.

The amendment to the Public Procurement Act effective as of 15 September 2010 specifies the limitation period available to initiate proceedings for legal remedy in accordance with the rule applied prior to 1 April 2009 (i.e. one year following the infringement of law, and three years in the event of unlawful neglect of a public procurement procedure), as a result of which a substantive increase is expected in the number of proceedings for legal remedy initiated by the SAO.

3.2. Methodological work

Continuous and quality-driven development activities in the fields of methodology and auditing, which are aligned with international trends and support the practical work of auditing, are essential for the SAO to discharge its duties to a high standard, efficiently and effectively. The SAO's strategic goals

⁵ Local Government of Ajka

include upgrading the methods of its audits in accordance with international standards and other authorities, and adopting international best practices.

At the XX. INTOSAI Congress of 2010, as a result of several years of preparations, standards and practical guidelines were finalised and introduced, which will provide guidance in the future to the supreme audit institutions of member states.

With the 40 new ISSAIs (International Standards of Supreme Audit Institutions) adopted by the Congress, and INTOSAI GOV (Guidance for Good Governance), contents have been supplied for the previously approved framework of INTOSAI professional standards. Following the decision of the Congress, the documents prepared by the professional working groups concerning the profession of auditing will be recommended to supreme audit institutions as guidance to be followed in the future.

Since 2008, INTOSAI has seen an acceleration in the international standardisation of professional requirements as well as in work aimed at the development of professional rules, standards and guidelines, required for audits that meet the current demands. The SAO has been an active contributor to that work.

In a breakdown by key types of audit, the SAO in 2010 continued to upgrade, due primarily to major legislative changes, its methodologies and methodology guidelines developed in previous years, and to review related field manuals based on audit experience. In addition to updating professional rules, new documents (methodologies, field manuals) were also drafted concerning the profession of auditing, such as the methodology for financial regularity audits on national economy accounts.

At the end of 2010, a comprehensive internal assessment was made of INTOSAI's system of documents, concerning the profession of auditing, which put forward recommendations on the possible directions of adapting international requirements. The recommendations covered the SAO's system of documents, concerning the profession of auditing, and the directions of further development in activities of audit methodology.

An expert working group is in charge of the scheduled translation of INTOSAI's key documents concerning the profession of auditing. As part of its regular activity, the responsibilities of the working group include the translation of key documents, concerning the profession of auditing, proofreading existing Hungarian translations against professional criteria, and updating the contents of the existing glossary of auditing terms.

3.3. Studies and research

The key function of the Research Institute of the State Audit Office of Hungary (RI) is to carry out research to support the SAO's advisory services provided for the National Assembly and the government. As part of its research, the Institute relies on the SAO's audit experience to compile summary and

assessment studies, and background studies to explain the mechanism and improvement opportunities of the public finance system.

In 2010, the Institute released the following studies and compilations as separate publications:

Opportunities to Create a Competency-Based Structure in Public Administration – Method and Case Study

Released as one of the papers exploring the relationships of public finance reform and state reform, this study describes opportunities to create a competency-based structure (competent organisation). It uses the concept of competency to refer collectively to the abilities, skills and attitudes needed by individuals or the organisation concerned to function effectively. The research was carried out primarily to explore and understand competency structure at the organisational level. In addition to theoretical foundations, the study relies on empirical research carried out among the civil servants at the local governments of two towns with county status (Eger and Szombathely) to classify and rank key individual (creativity, flexibility), social (team work, conflict management) work and methodology (professional knowledge, problem solving) competencies which may best facilitate effective operations in public administration. The study recommends following a competency-based approach in public administration reform.

Competitiveness in the Public Sector and the Economy – Empirical Findings and Implications

Based on empirical research carried out in stage 2 of the joint research effort started in late 2005 by RI and the Competitiveness Research Centre of Corvinus University of Budapest⁶, the study provides a summary of the interfaces, connections and interactions identified between the competitiveness of Hungary's public sector and economy. These include the role of analysing international competitiveness rankings, assessment of corporate competitiveness based on questionnaire surveys, performance characteristics of corporations of various sizes identified through statistical analysis, competencies of local government staff, the role of the organisations of the civil sector, and an overview of the key implications of the foregoing for public sector institutions and organisations. The study is therefore a contribution to a better understanding of the relationship between competitiveness in the public sector and the economy.

A Review of the Efficiency of State Subsidies for Tourism Development at the Levels of Regions and the National Economy

In order to obtain a more detailed understanding of the relationships identified in the SAO's report on the audit of priority investment for tourism at local governments, the RI reviewed the efficiency of state subsidies for tourism

⁶ In stage 1 (2006–2007), researchers carried out a survey of literature and developed concepts. Their findings were published in a study in 2007.

development at the levels of regions and the national economy. The research relied on empirical data collection on ten development projects implemented using state subsidies in the field of tourism, and investigated how each project influenced the economy of the communities and regions concerned. This research was complemented by a so-called follow-up study to review changes in the impact factors of 11 investment projects in tourism, which had been studied in previous research. The research found development projects in tourism to have significant multiplier effects at the levels of both communities and the national economy. Such effects are felt in income generated by businesses, employment, revenues of the central budget, and local tax revenues as well. HUF 100 granted to the facilities in subsidies generated HUF 664 in investment value. The spas and wellness hotels, opened as a result of the development projects, represent 21st-century technology in Hungarian provincial towns, encouraging the development of their communities.

Reformation of National Economy Planning – National Needs, EU Requirements

The study offers critical analysis and recommendations for improvement to facilitate national economy planning. On a first note, the study provides a summary of international best practices and examples, and explains EU requirements for planning and development policy. It outlines a concept in which planning takes into account both domestic and EU funds, national plans and the programmes urged by the EU form an integrated system, and national and sectoral plans are complemented by medium-term regional plans with realistic perspectives on financial resources. The concept underlines the need for the substantive (not merely formal) involvement of professional organisations and NGOs in planning.

Other research by the RI, such as that on mapping corruption risks, on the financial risks to the financial management of local governments, and on the financing of culture, was utilised in preparations for the SAO's audits and in the scientific conference, co-hosted with the Hungarian Economic Association in May 2010.

3.4. Other duties of the SAO

3.4.1. Recommendations and opinion

Recommendations on the appointment of auditors

Pursuant to the SAO Act, from 1 January 2010 until the new President was elected in 5 July 2010, within the scope specified in applicable legislation, the Secretary General exercised the power of recommendation on the appointment of auditors. In that period, upon request, the Secretary General made recommendations on auditors for the Hungarian Development Bank, the Wesselényi Miklós Compensation Fund for Flood and Inland Waters Protection, the Central Nuclear Financial Fund, and for the Innovation Fund for Research and Technology.

In the second half of 2010, exercising their right to nominate auditors under the Act on Public Finances, the President of the State Audit Office of Hungary made recommendations on auditor nomination in two cases: for the Homeland Fund and the National Cultural Fund.

Recommendations on the appointment of chairpersons of supervisory boards

Until released⁷ from that duty on 29 May 2010, the Secretary General of the SAO exercised the right to make recommendations on the nomination of persons to chair the supervisory boards of certain publicly owned businesses as specified in Article 4(3) of Act CXXII of 2009, upon the request of the management of such businesses.

Following the February 2010 evaluation of the applications submitted in response to the new call, announced on the SAO's website in order to update the register developed in 2003 on which the system is based, the number of the files on record rose to 771 with the addition of 52 successful applications.

From the launch of the application system in 2003 until 29 May 2010, the SAO evaluated applications received from a total of 426 economic entities, allowing the SAO to make recommendations concerning the nomination of 391 individuals in the register.

At the time of releasing the SAO from the duty, 141 individuals were holding positions as chairpersons in supervisory boards based on the recommendation of the SAO.

The SAO took the necessary steps in connection with its discontinued duty of nomination. The SAO initiated termination of its relevant data processing, submitted in 2003, which the Commissioner for Data Protection confirmed.

As part of the handover process carried out in connection with the termination of data processing, 128 applications, out of the 829 managed by the SAO, were closed by being returned personally in response to the SAO's announcement. The 701 applications not collected had been destroyed before a notary public by 4 September 2010.

Opinion on the qualification of auditors for budget auditing

Within the scope defined by specific legislation, auditing requires adequate knowledge and experience in respect of the specificities of the organisation concerned.

Article 89(e) of Act XLIII of 2010 on the Central Administrative Bodies, and the Legal Status of the Members of the Government and of the Secretaries of State repealed the duty of the State Audit Office of Hungary to nominate the chairpersons of supervisory boards.

Since 2008, there has been a requirement to consult the SAO when assessing requests concerning the qualification of auditors for budget auditing, or withdrawing such qualifications. The SAO is authorised to express opinions concerning establishment of conflict of interest, and concerning indication of reasonable grounds for suspecting that a disciplinary offence has been committed.

In 2010, the SAO's opinions were based on the written documents submitted by the Chamber, as well as data and information gained from audits by directorates of auditing.

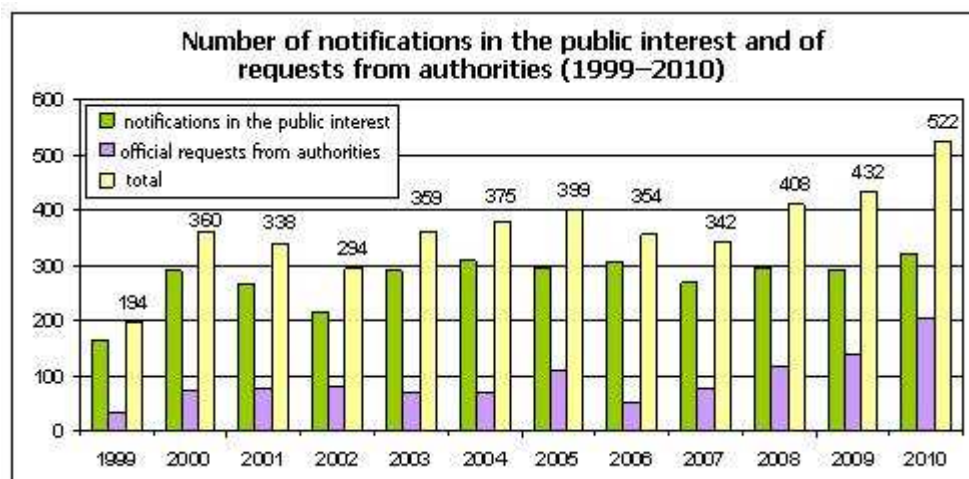
In 2010, the SAO expressed opinions concerning the qualification for budget audits of Chamber members including 16 audit firms and 5 individual auditors. A 'passed' rating was given in each of those cases.

Between 2008, when the SAO was charged with this responsibility, and late 2010, the SAO expressed opinions concerning the qualification of a total of 243 applicants (231 firms and 12 individuals).

In 2010, no qualifications for budget auditing were withdrawn, and no specific indication was given of suspected conflict of interest or commission of disciplinary offences.

3.4.2. Notifications in the public interest

The SAO's experience from previous years is that in election years, there is a strong "notification sentiment", which is supported by a record number of reports received in 2010.



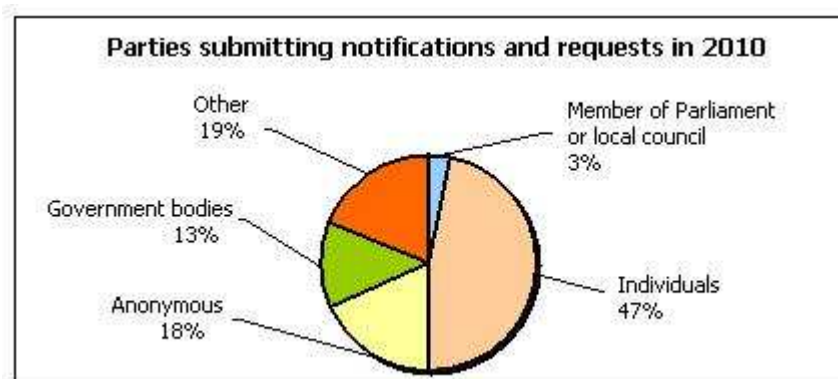
An outstanding number of letters were received expressing complaints and objections concerning the operations, financial management and property management of local governments. The tendency may have been reinforced by the absence of legality audits on the operations of local governments by public administration offices. The establishment of government offices in Budapest

and the counties in late 2010 is expected to have a beneficial impact on that situation.

Following the local elections, there was a significant increase in the number of requests for audits urged by new representative councils and mayors concerning the previous election cycle.

There continued to be a high number of notifications requesting audits by the SAO or reporting irregularities which fall within the scope of the SAO's audit mandate. The SAO is not under an obligation to conduct audits based on notifications; however, where the subject of notification was related to a specific scheduled audit, it was taken into account in the course of the audit, also having regard to auditing resources. There was also an increase in the number of requests for positions and advice, as well as questions.

In the second half of the year, following guidance from its new management, the SAO reviewed the practice of dealing with notifications, and the relevant internal policy. Consequently, substantive response and action is taken only when the SAO is qualified as an "authorised body to take relevant action". Otherwise, the SAO will take recourse to removal of action.



3.4.3. Integrity Project

On 1 December 2009, the SAO launched its priority EU project 'Mapping Corruption Risks – Promotion of an Integrity-Based Culture of Public Administration' (referred to as the 'Project'), designed to assess the operations of budgetary institutions against corruption criteria, identify critical phenomena (causes and symptoms), and improve Hungary's auditing practice and public administration culture with integrity in mind. [-] Highly valuable in terms of professional innovation and implemented using HUF 286.54 million worth of EU funds, the methodology development enables drawing a map of Hungary's public sector from the perspective of corruption vulnerability and risks.

The project organisation was set up as of 1 December 2009. External contributors were contracted on the basis of competitive tendering. Project activities and their implementation to appropriate standard are monitored by quality assurance officers.

In deviation from the schedule, public procurement procedures scheduled for 2010 could only be conducted after July, with an approximately four-month delay. Eight public procurement procedures were conducted, including two central procedures for public procurement. As a result of public procurement, contracts were awarded in the total amount of HUF 43.9 million.

The first version of the questionnaire used for the survey of corruption risks in annual data collection carried out as part of the Project, and of the related data collection plan, had been developed by late July 2010. This was followed by a pilot test in late October 2010 using a representative sample of organisations, comprised of 203 institutions. The data collection tool was finalised and converted into an electronic format by the end of 2010, based on experience from the pilot test.

For seven years starting in February 2011, the SAO will use a downloadable questionnaire to collect data nationwide involving 4,131 budgetary institutions. A notable element in combating corruption is the so-called integrity approach, which assumes commitment to values at the institutional level, consistent and irreproachable organisational operations, measured by those values – an ethical work environment, as well as clear and transparent internal processes.

Pursuant to a successful public procurement procedure, a services contract was concluded on 2 August 2010 for the development of an electronic data collection, processing and mapping system to support annual data collection. Delivery of the Project website (integritas.asz.hu) and the data collection and visualisation modules marked the completion of the first two stages of development work by 31 December 2010.

In the second half of 2010, service providers for events and communication were selected in competition. With a view to promoting the integrity approach to a wide audience, they contributed to hosting seven regional and an international professional conference, involving 600 institutions, until early 2011. The events were part of the communication campaign related to the first nationwide data collection.

Out of the HUF 286.54 million worth of EU funds available for the Project, cumulated payments were made in the amount of HUF 65.5 million until 31 December 2010, amounting to 22.8% of the funds available. Owing to the national conference held in December 2010, the Project was featured in the media (electronic media, printed press, television and radio interviews) on 100 occasions following implementation.

3.5. Cooperation with professional organisations

The SAO is a party to cooperation agreements with eight institutions of higher education, including five universities and three colleges, which were motivated by the need for a more efficient and effective discharge of duties. The contents of such agreements are shaped by the contracting parties with a view to the development of financial auditing.

As part of the cooperation, the SAO undertook, among other commitments, to share its experience in the field of auditing and its knowledge of methodology, to participate in students' training, and to provide internship opportunities subject to limitations (on an annual average, the SAO had the capacity to take 12 interns for varying periods).

Procedures for communication are specified in the SAO's Rules of Organisation and Operation, and an instruction from each of the President and the Secretary General.

Relying on experience to date while seeking new areas of cooperation, a framework of cooperation needs to be developed to ensure implementation of a medium-term institutional strategy which focuses on quality and added value.

3.6. International relations

The annual tasks of cooperation with international audit organisations and partner supreme audit institutions are specified in the annual communication plan, which draws on the SAO's medium-term strategy on international relations. Entering into office in mid-2010, the SAO's new management focused on the adaptation of international audit standards, and on acquisition of experience that is directly applicable in audit activities.

The SAO contributes to the work of **INTOSAI** (International Organization of Supreme Audit Institutions) at both expert and institutional level. In 2010, too, the SAO was represented in INTOSAI's subcommittees on peer review, financial audit guidelines and internal control, as well as in the Financial Crisis Working Group. The SAO's representative contributed to the report of the National Performance Indicators Working Group by drafting working papers.

The SAO's delegation attended the INTOSAI Congress held in November 2010 in South Africa. The SAO contributed to coverage of the two key themes of the Congress ('The Value and Benefits of Supreme Audit Institutions' and 'Environmental Auditing and Sustainable Development') by compiling country reports. During the year, the SAO also fulfilled its obligations arising from its Governing Board membership.

The SAO successfully completed compilation of its guide on best practices to improve quality management, for which mandate was given at the 2008 Congress of the **EUROSAI** (the INTOSAI regional working group for Europe) to the working group on the same Congress theme. In its November 2010 session, the Governing Board of EUROSAI approved the document compiled under the coordination of the SAO, with contributions from the Supreme Audit Institutions of Denmark, Malta, Poland and Russia, as well as the European Court of Auditors (ECA).

During the year, as a member of the Governing Board, the SAO contributed constructive opinion to the development of the first EUROSAI strategy. The SAO delegated a representative to the EUROSAI Training Committee.

The SAO participated in the work of the EUROSAI working groups on IT and the environment, and used the opportunity to acquire new knowledge, such as in the field of climate change. As part of the working group set up for the audit of funds allocated for the prevention of natural disasters and the elimination of their consequences, the SAO joined the coordinated audit on the same subject.

Attended by the SAO, the leading themes of the 7th Congress of **EURORAI** (European Organisation of Regional External Public Finance Audit Institutions) in 2010 were the challenges presented by a changing economic environment, and audits performed by supreme audit institutions. At the seminar of the organisation, through examples from several countries, SAO staff gained an insight into audits on local tax revenues and the varying focal points in auditing budget revenues in each country.

As in previous years, in 2010 the SAO attended the annual meeting of the **Contact Committee**, the network for cooperation between the heads of supreme audit institutions of EU Member States and the ECA. In the meeting, the SAO gave an account of the progress of the coordinated performance audit of the railway development project TEN-T Corridor V (Lyon-Triest-Koper-Ljubljana-Budapest), and of arrangements for the workshop to be held on the subject. In 2008, the Contact Committee adopted a decision on conducting a coordinated audit on TEN-T investment projects under the supervision and with the participation of the SAO. The draft of the joint audit report has been compiled, and a professional seminar was held in March 2011 to present results.

The SAO continued to participate in the work of the liaison network, which traditionally prepares meetings of the Contact Committee in addition to coordinating working group activities and facilitating the efficiency of cooperation. The SAO continuously and actively contributed to the work of working groups within the Contact Committee dealing with various issues concerning the use of EU funds (Structural Funds, Value Added Tax, common audit standards), as well as to the work of knowledge networks established to cover audits related to fiscal policy and the Lisbon Strategy.

With a view to enhancing their professional knowledge, SAO staff attended seminars to share experience from audits in the fields of public procurement and the Common Agricultural Policy. Additionally, recognising the need of the Hungarian institutional system for more detailed advice on the practice of Member State audits to prepare for ECA audits more successfully, the SAO, with contributions from ECA experts, held a seminar in Budapest on the ECA's audit methodology and audits on cohesion policy and agricultural subsidies.

In 2010, heads of the supreme audit institutions of the **Visegrad Group** as well as Austria and Slovenia held their annual meeting in Slia -Sielnica, Slovakia. They discussed how supreme audit institutions could address the impacts of the financial and economic crisis more efficiently. The SAO's delegates gave an account of experience with crisis management in Hungary, and of the results of the questionnaire survey carried out by the SAO concerning potential fields of cooperation (on the subjects of PPP schemes and anti-corruption efforts). The supreme audit institutions of the Group were

invited to the conference on integrity held on 9 December 2010 as part of the project *'Mapping Corruption Risks – Promotion of an Integrity-Based Culture of Public Administration'*.

In 2010, cooperation continued between the SAO and the State Audit Office of Vietnam as part of the international development cooperation coordinated by the Ministry of Foreign Affairs.

The 2010 plan on international relations appropriated HUF 36 million for visits outside Hungary. Total expenditure amounted to HUF 22 million. In 2010, SAO staff participated in 42 foreign visits, with 67 delegates spending a total of 412 days on their visits. The SAO's expenditure on hospitality amounted to HUF 0.2 million in 2010.

4. PUBLICATION OF REPORTS

Being the supreme organ of state auditing, the SAO's activities and audit reports are addressed primarily to the National Assembly and Members of Parliament.

Aiming at more efficient professional communication in order to improve communications with the National Assembly, the SAO has been distributing summaries of its reports to all MPs as of November 2010, and direct access is provided to its latest reports from the e-alerts of the National Assembly website.

4.1. Cooperation with the National Assembly

In terms of the use made of the SAO's reports by the National Assembly and its committees, active periods in 2010 were the parliamentary elections and the months following election of the SAO's new President. In these periods, standing committees included eight of the SAO's reports in their agendas.

In 2010, the SAO published 46 reports, with only 10 in the first half of the year.

Its opinion on the budget as well as its reports on the final accounts, the audits of the Hungarian News Agency Corporation and the Hungarian State Holding Company were submitted by the SAO to the National Assembly in compliance with statutory requirements. Except for the audit on the Hungarian State Holding Company, the reports were also discussed by the committees.

The committees devoted separate agenda items to discussing the SAO's reports on the 2009 audit of the financial management system of local governments, the audit on the system of organisation and human resources in the discharge of state (public) duties, and the audit of the utilisation of non-normative state subsidies granted and state assets provided free of charge to non-profit organisations involved in providing assistance to persons with disabilities.

Requests for presentations on the SAO's audit findings were made by the panel set up to review the financial standing of Hungarian Railways, and the subcommittees on the headquarters project of Hungarian Television and on support programmes financed from the Labour Market Fund.

In the new parliamentary cycle, senior officers and staff of the SAO provided personal assistance with the work of the standing committees on nearly a hundred occasions, and also attended the sessions of several subcommittees, review panels and ad-hoc committees.

On seven occasions each, the President and Vice-President of the State Audit Office of Hungary attended committee sessions submitting proposals. In plenary sessions, the President gave speeches in discussions of three SAO reports (final accounts, opinion on the budget, SAO annual report).

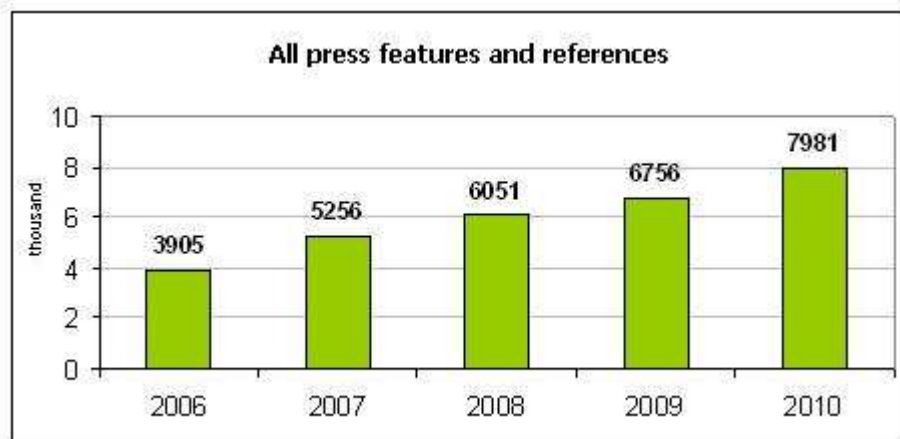
In 2010, the President of the SAO received three written questions from Members of Parliament, which were answered according to the Rules of Procedure of the National Assembly.

4.2. Information to the public

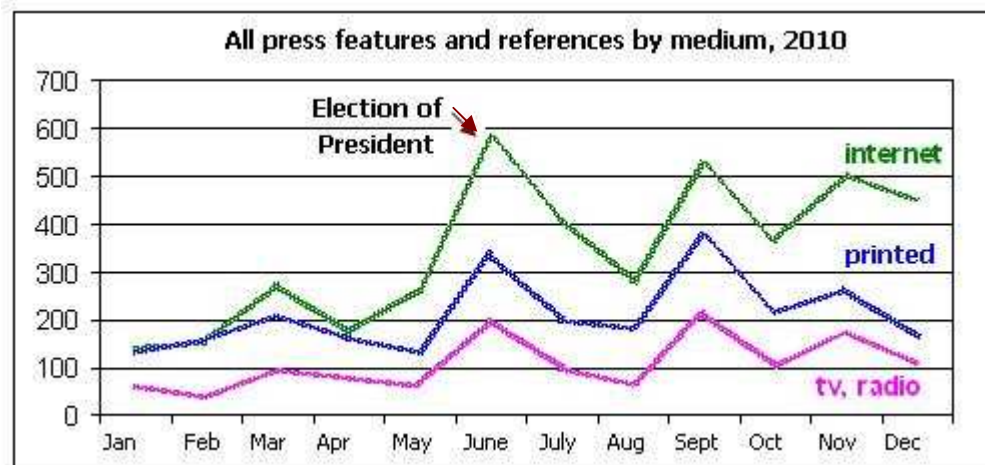
The publicity of the SAO's work, professional activities, achievements and reports is of strategic significance. Revising its means of communication, the SAO made its press relations dynamic in every field, improved its materials, and, mindful of the importance of efficiency, used its best endeavours to make the best possible use of available opportunities and resources.

A guide was compiled to collect the key criteria for the preparation of press summaries on reports, and a template was designed to enable the consistency of reports in terms of layout and identity. The clarity of the SAO's documents was also improved. As opposed to the previous practice, as of September 2010, the SAO's has been holding joint press conferences not only with the local governments of counties and towns with county status, but also with those of Budapest districts⁸. Several training courses were prepared on communication. The system of press releases was revised: a significantly higher number of press releases are issued on a new set of topics.

⁸ Press conferences were held in Salgótarján and Győr in August and in Békéscsaba and Veszprém in September, and accounts were also given of the financial management of the local governments of Districts III and VIII of Budapest. Press conferences were held in Kaposvár in November, Zalaegerszeg, Pécs, Szombathely and Szeged in December, three with the Vice-President in attendance.



2010 was a year of dual character: 1,274 news items were published in the first quarter and 2,355 in the fourth; the SAO held no press conferences in the first half of the year, and a total of 18 in the second.



The SAO staged seven media events of its own, some at its headquarters and some in the House of Parliament. Nine press conferences were held outside Budapest.

The President's first press conference held in mid-August focused on state and local government action concerning energy management, in particular audits on the impact of support for energy rationalisation. In September, the SAO provided information to the press on audits of the implementation of the 2009 budget of the Republic of Hungary, and of the 2009 activities of the Hungarian State Holding Company. At another press conference in the same month, questions were taken from journalists about the audit on organ transplantation, donation and alternative forms of treatment. The President held a press conference in October to give an account of the seminar 'Follow the Good Example – Best Practices in the Use of Public Monies'. Also in October,

the RI presented its studies on development projects in tourism and the effectiveness of national economy planning. A media event was staged in December in connection with the international professional conference 'INTEGRITÁS(Z)'. The SAO also released its report in December on the audit of the Guarantee Fund of Pension Funds at a press conference.

Unlimited access to and the option to download the SAO's reports and technical publications from the SAO's website are an essential contribution to ensuring publicity. In 2010, there were close to 140,000 visitors to the main page of the SAO's website, and reports were downloaded from external IP addresses on approximately 56,000 occasions. In 2010, report summaries in English were downloaded 1,157 times in total.

In 2010, major developments were completed or launched: an advanced search was added to the website, efforts were started to optimise the website for external search engines, arrangements started for the new SAO news portal, and the official website of the SAO was remodelled.

5. STANDARDS OF AUDITORS' WORK – GUARANTEES FOR QUALITY

5.1. Quality assurance for auditing

As in previous years, the SAO continued to pay special attention to ensuring a balanced quality of its reports by exercising continuous control over the quality of auditing, as well as by continuously reviewing the substantiation and adequacy of audit findings.

Adopted six years ago, the quality management system relies on supervision and review procedures to apply adequate controls to ensure that the SAO's audits are conducted to a high standard.

From preparation to report approval, each stage of a SAO audit is closed by the review and certification of compliance with professional standards. At the end of the quality control process, an independent review is carried out to verify that the audit findings included in the SAO's reports are legally and professionally substantiated and are supported by facts. As a result, in addition to internal quality control by directorates of auditing, drafts of the SAO's reports and of auditors' reports raising the possibility of personal liability are reviewed twice for the professional and legal substance of findings, conclusions and recommendations, and of raising the possibility of personal liability.

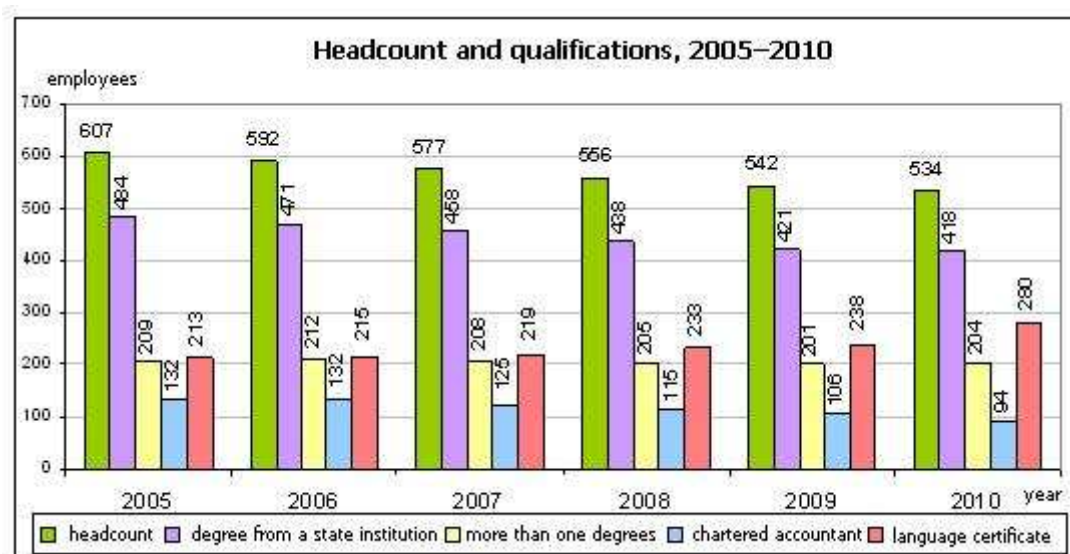
In addition to the discharge of the above duties, subsequent professional and methodology reviews of previously closed audits were also carried out in 2010 by the Quality Assurance Department, which is part of the President's Directorate and is separated from the directorates carrying out the audits, and performs its reviews independently. Overall, internal quality assurance reviews found that the SAO's audits conducted in 2010 satisfied quality requirements on the whole. The results of assessment on that subject are also used by the SAO's management for the purposes of quality improvement.

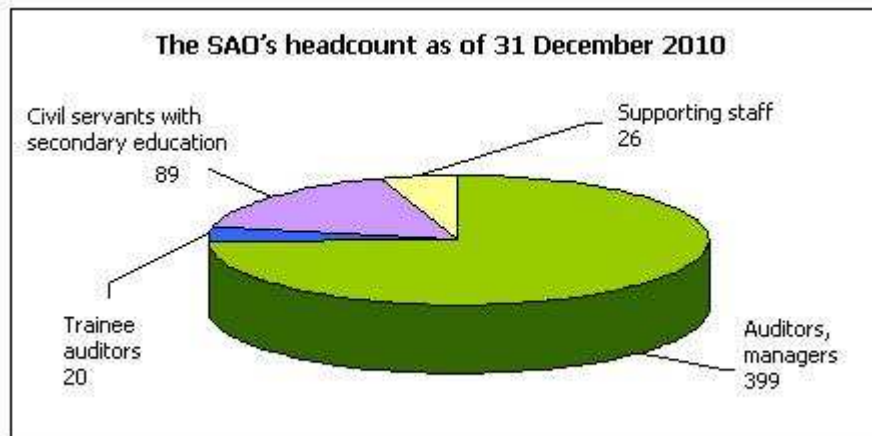
In order to ensure and continuously improve the quality of auditing, the SAO also played an active role in international relations. Having regard to the provisions of the EUROSAI guide as well, the SAO's new management has set an objective to upgrade the quality management system. Based on a review of operational experience with the IT system deployed in the previous year to support audit documentation, and of the whole range of quality control and quality assurance procedures, management intends to enhance the internal quality management system with independent review procedures introduced to guarantee the reliability and appropriate quality of auditors' reports.

5.2. Human resource management

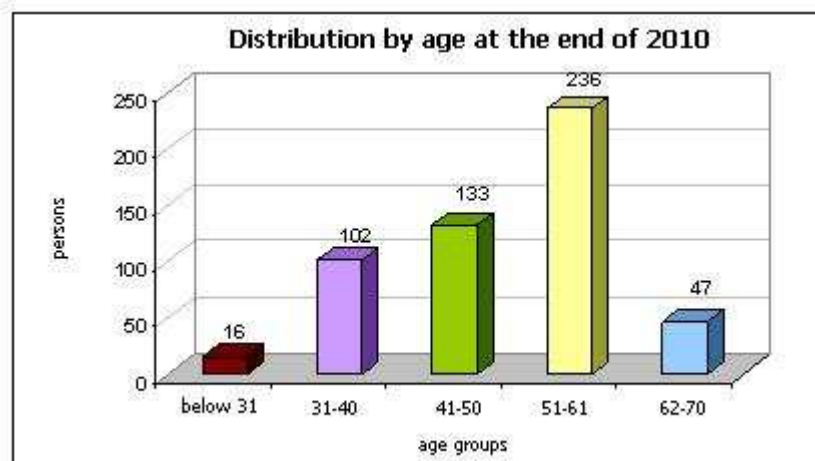
As a result of recent years' declining trend, the SAO's headcount was 534 as at 31 December 2010, with an additional 9 employees at the Research Institute for the Hungarian State Audit Office. During the year, several employees, eligible for retirement or early retirement, chose to retire under terms which they considered advantageous. The reduction in headcount is largely owed to the general hiring freeze imposed on public administration in 2009, as a result of which openings were filled only in the case of jobs which were critical to organisational operability.

The SAO's new elected executive managers, i.e. the President and the Vice-President entered into office on 5 July 2010. That date marks the beginning of continuous headcount increase, as part of which 33 employees joined the organisation, including 25 auditors and two executive auditors.





Most commonly, a career in state auditing starts in positions other than that of an auditor. Financial analysts, planners, investors, and in particular those engaged in budgeting and accounting, generally enter the field of auditing with considerable professional experience, which often they have gained as middle managers. In addition to obtaining qualifications in accounting and auditing, auditors gain significant professional confidence and negotiating skills from having more than one degree. Other than professional routine, it is also essential for auditors to have up-to-date knowledge and skills in their own field, IT and communication.



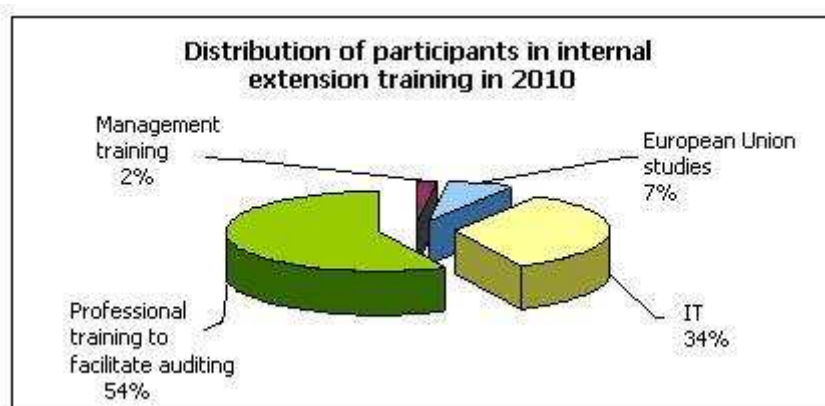
Owing to minor staff movements, internal training focused on extension training in the strict sense, rather than preparation. Training on specific subjects was arranged with the audit plan in mind. In 2010, training was delivered on 61 occasions, 33 subjects, and 90 training days.

Training events were aligned with professional duties. Audit kick-off meetings serve the enhancement of professional knowledge as well as purposes of organisation. In order to support financial regularity audits, high priority is

given each year to the explanation of and consultation concerning changes in financial controls (taxation, accounting, etc.).

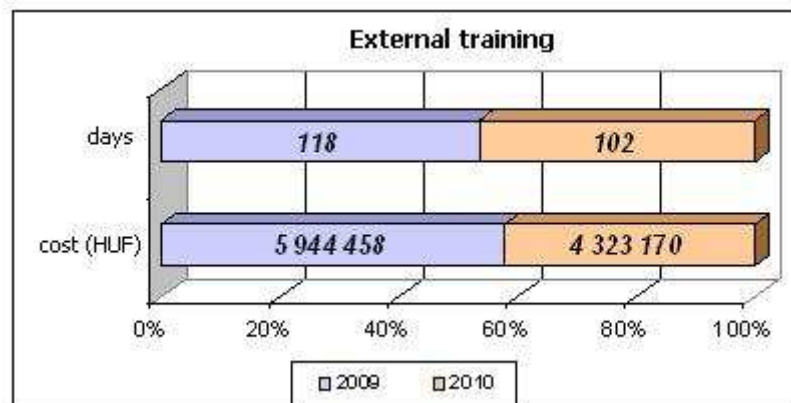
Within the scope of updating professional knowledge, with relevance to legislative changes, issues concerning data protection and secrecy and the SAO's related duties were included in the agenda as consultation. The syllabus of EU training was updated, supplying employees with the latest information.

IT training focused on preparation required for the deployment of VIDOR, the documentation system for local audits. Courses launched in the previous year continued in the first half of 2010, involving 123 participants on 10 occasions. In the second half of the year, follow-up and enhancement courses were run on a total of 13 days with 184 participants, following which employees took an exam and received certificates proving completion of the course. The role of covering IT methods to facilitate reporting also remained important. Some of those methods were specialised on the basis of requirements for specific employment groups.



Some SAO employees are qualified auditors with suspended membership in the Chamber of Hungarian Auditors. Several SAO auditors undertake duties of training and organisation as part of mandatory extension training at the Chamber, which allowed 73 SAO employees to earn important credits at 19 internal professional SAO events.

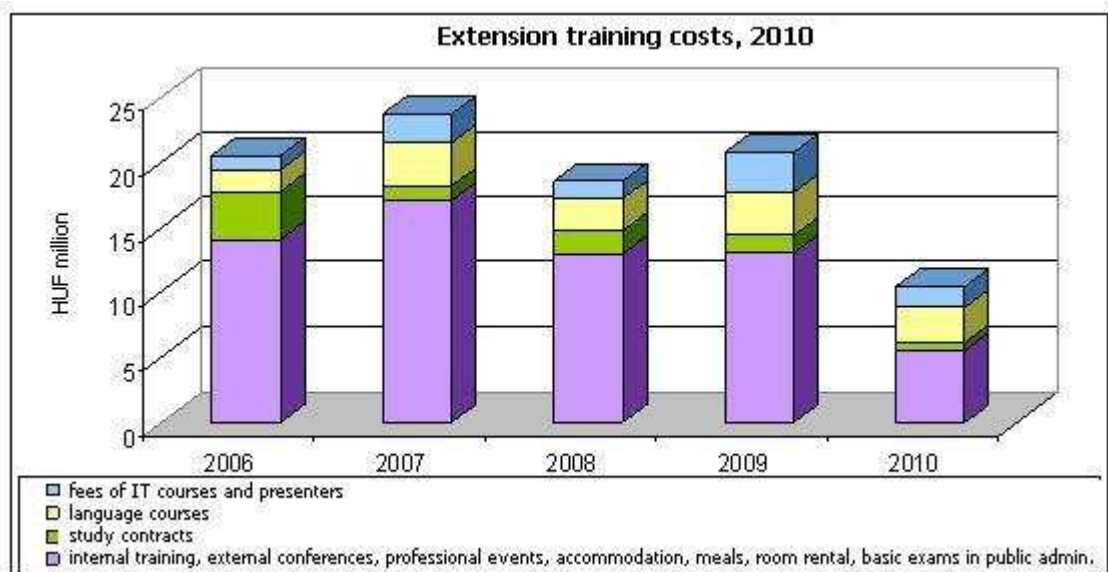
In comparison with previous years – in connection with headcount reductions, an increased load of audit assignments and the reinforced protection of audit resources – the participation of SAO employees in external forms of training and extension training was limited. The SAO also took deliberate austerity measures: arrangements for the disclosure of professional information enabled the SAO to limit the number of employees attending national professional events, conferences and meetings. Staff members were delegated to a total of 77 conferences and professional presentations on over 50 subjects.



SAO employees are regular participants in language courses offered each year by Goethe-Institut and Institut Français at preferential rates to Hungarian civil servants.

As in previous years, the SAO also used opportunities in 2010 for foreign study trips. The SAO continued to delegate staff to the International Auditor Fellowship Program of the GAO. On the international course of the Supreme Audit Institution of India, one SAO employee was enrolled in each of the subjects of performance auditing and environmental auditing. Two SAO employees had their international expert status (European Commission, ECA) renewed for a year.

As a result of efforts to reduce the costs of instruction and training, total costs in 2010 were lowered to about 50% of the HUF 20 million in 2009. Modern and cost-efficient methods of training organisation were applied, including the electronic distribution of training materials to participants. The greatest savings were achieved in ad-hoc costs (external professional events, conferences, accommodation, fees of outside presenters). In the case of training sessions spanning several days, employees from the counties were accommodated at preferential rates.



5.3. Organisational development

In the spirit of the new medium-term strategy, the management of the SAO initiated efforts to modernise the organisation and operations in the second half of 2010. The variety of challenges calls for a greater level of organisation and operating efficiency in the SAO's audits.

Most importantly, conditions needed to be provided for quality-driven operations and for an organisation, which is prepared for continuous renewal. Such work was started with the decisions and measures by HR executives concerning organisation. The establishment of a stable organisational structure which is of uniform strength, but enables flexible development is a longer process. Some of the directions for transition were set in the Rules of Organisation and Operation updated as of 30 December 2010.

The ROO provided for the establishment of the President's Directorate, the heads of which directly assist the work of the SAO's President in the manner of a cabinet. The Department of Organisational Coordination at the Directorate recruited young and dynamic employees who had adopted the approaches of both the corporate and non-profit sectors. A prominent role is given to the Department of Communication and Parliament Relations, which has been partly reinforced with employees experienced in electronic and printed media. The fundamental concept has been outlined for the establishment of a Department of Human Resources and Organisational Development with comprehensive duties and powers, to become operational in 2011.

With the establishment of the President's Directorate, controlled directly by the President, the number of the SAO's directorates rose to four. The ROO also introduced major changes to the three previously functioning directorates. Some of the activities of the Organisational Management and Operational Directorate were transferred to the President's Directorate. Of the two remaining large units, one comprises departments supporting audits more

directly (Law, Administration, Strategy, IT Development, Anti-Corruption Project), and the other comprises departments in charge of the budget and financial management.

The two Audit Directorates (Directorate for Audits on the Central Level of General Government; Directorate of Municipal and Regional Audits) are undergoing major restructuring. In the SAO's auditing work, setting up and operating investigation teams independently of the departmental structure was a known and frequently used solution. This system should be improved and introduced in general practice through the mapping and conscious application of professional competencies. Arrangements for audits are made and work tasks are allocated on the principle of appropriate competency, knowledge and experience. Although the ROO makes reference to audit departments organised and named on a traditional sectoral, functional, thematic, etc. basis, arrangements are being made for a more uniformed 'audit office', which integrates the high-level professional competencies required for audits, while enabling project-style work by facilitating creative cooperation among employees.

Audit assignments require an efficient organisation with an optimum headcount. For that reason, new staff is being recruited to approximate a headcount of 600 from the significantly reduced levels of recent years. The primary areas where new resources are needed have been mapped, and a programme was developed in 2010 for the selection of an adequate number and quality of new staff.

Selected as part of a public application scheme, 30 fresh graduates are offered the opportunity to act as contributing assistants in audits for three years, under the supervision of professional mentors. The project was launched in late 2010 with the publication of the invitation and the selection of candidates. Already mindful of the competencies aligned with auditing needs, procedures have also been developed partially for the application and selection of experienced professionals (future auditors).

Ensuring continuity and transparency in labour supply, and retention of the best audit professionals are key to staff and organisational development. As part of preparatory discussions for a modernised Act on the State Audit Office, a career model is being developed in respect of medium-term strategic goals to provide stable employment and high earnings to employees who are dedicated, deliver continued high performance and are prepared for professional improvement. Organisational operations rely on the full range of its employees' professional competence, knowledge, skills and experience; additionally, the SAO is planning to improve the level of preparedness on a continuous basis through an internal system for extension training that is efficient and provides practical assistance with audit work.

6. AN OVERVIEW OF SAO'S FINANCIAL MANAGEMENT

In the Act on the Budget, the National Assembly allocated HUF 6631.2 million for the discharge of the SAO's duties in 2010, of which HUF 6611.2 million was covered from subsidies and HUF 20 million from the SAO's own revenues.

During the year, key budget appropriations and their performance were as follows:

	HUF million			
	Original appropriation	Adjusted appropriation	Performance	Performance as a % of adjusted appropriation
Personal allowances	4,459.1	4,490.9	4,099.6	91.3
Contributions payable by employers	1,144.3	1,163.8	1,081.6	92.9
Non-personnel and current expenses	941.5	1,029.1	911.5	88.6
Institutional investment	72.6	208.2	139.8	67.1
Renovation	13.7	37.6	37.6	100.0
Lending		1.6	1.6	100.0
Total expenditures	6,631.2	6,931.2	6,271.7	90.5
Operating income	18.0	18.0	7.6	42.2
Non-operating income	2.0	2.0		
Loan repayment		1.6	1.6	100.0
Subsidies	6,611.2	6,631.5	6,631.5	100.0
Residue from the previous year		278.1	278.1	100.0
Total income	6,631.2	6,931.2	6,918.8	99.8

Pursuant to adjustments during the year, the original appropriation was increased by HUF 300 million, comprising

- HUF 278.1 million for the use of the appropriations residue from 2009;
- HUF 14.7 million in salary supplements paid under Government Decree 316/2009. (XII.28.);
- HUF 5.6 million in expenditures on the employment of national experts; and
- HUF 1.6 million in housing loans disbursed against repayment instalments collected.

The combined amount of personal allowances and contributions payable by employers accounted for 83% of expenditures, with 14% spent on non-personnel expenses and 3% on non-operating expenditures.

Owing to the SAO's operating environment, the seven months without elected executives, the hiring freeze imposed in 2009, and the absence of the powers of restructuring and appointment, fiscal management – as a result of the pressure for austerity – was limited to expenditures that were absolutely necessary. In the first half of the year, this prevented new projects, exceptional audit assignments and public procurement of reasonable assets, while headcount was gradually reduced. As a result, particularly in the field of personal allowances, appropriation residues were accumulated the extent of which was significant in comparison with previous years.

The budgetary impacts of organisational restructuring, started in the second half of the year, as well as the renewed strategy and the recruitment of qualified and dedicated employees, required to carry out new audit assignments, will mostly be felt in 2011 and 2012.

In 2010, HUF 647.1 million was accumulated in residues, of which HUF 201.3 million is to cover commitments arising from rescheduled and delayed tasks to be performed in 2011. The combined amount of personal allowances and contributions payable by employers account for 98.6% of the residues available.

The circumstances of financial management indicated above, as well as additional tasks arising in the interim period, including increased employment of experts in connection with the membership of the Fiscal Council and audits on the undertakings of the state and local governments, require that HUF 445.8 million worth of uncommitted appropriation residues from 2010 should be reclaimed and used in 2011 and 2012.

As in previous years, the SAO's financial management in 2010 prioritised austerity in the use of resources. Public procurement procedures allowed the SAO to use services for operation below former contract prices. The deployment of new solutions enabled reductions in the costs incurred from the use of paper and printing house capacities in the field of auditing and institutional operations, and from the procurement of new hardware, licenses and upgrades in the field of IT.

Under the new service agreement concluded in December 2009, voice service between SAO's locations (employees work in 24 locations) is free of charge as of January 2010, as a result of which expenditures on fixed-line telephone services were reduced by approximately 7.3% in 2010.

IT activities at the SAO are aimed primarily at using the means of IT and telecommunications to provide versatile and efficient support for the SAO's strategic mission and the effective discharge of its duties. In 2010, too, development in IT and telecommunications was implemented on the basis of the results of previous years. The SAO has a continuously maintained, developed and monitored infrastructure, a uniform system for network telecommunications, application systems which can flexibly adapt to needs and comply with security standards, and training and conference facilities with up-to-date equipment.

The IT budget approved for 2010 allowed implementation of the projects and development tasks provided for in the strategy and the annual plan.

Using EU funds, development was completed in May 2009 of VIDOR, the electronic system used to support documentation of auditors' work as well as to record, store and share the documents produced and collected in the course of audits. The approximately 400 users of the system were trained on a continuous basis in 2010 at the SAO's training facility. Training in the use of the system is also aided by video material explaining its functions. Since the

system was deployed, experience with operations and the needs for improvement have been collected on a continuous basis.

In the second half of 2010, the SAO launched an overview of the existing functions and possibilities of the system and started development of a uniform system for documentation and document management in order to allow upgrades to integrate functions and software components to support both in-process and subsequent controls, and to provide the conditions for interoperability with the electronic document management system.

The SAO's custom-built audit planning, registering and monitoring system was deployed in 2002 to support audit planning and statements on the use of audit resources. Aligned with the needs of organisational restructuring, the system is about to be reviewed.

For auditing purposes, the SAO has been relying regularly on various electronic databases containing transactional data of the audited budgetary institutions. In order to improve the efficiency of auditors' work, as a result of cooperation between the Hungarian State Treasury, GIRO and the SAO, as of 2010 central budgetary institutions have been supplying the data required for financial audits in a uniform structure, taking into account auditors' needs.

In 2010, the SAO joined the central electronic service (CS) under the Act on Electronic Public Services. Simultaneously, a new module (Office Portal) was developed for the SAO's case monitoring system, which provides an interface with the CS.

The services of the SAO's website are enhanced on a continuous basis and are kept up-to-date.

Continuous development and operation of the SAO's intranet system enables employees to access the full range of up-to-date information and documents of public interest.

In order to improve the efficiency of audit work, auditors using office notebooks are provided remote access from outside the SAO network to certain central services through an appropriate hardware security tool. As of the second half of 2010, remote access was extended to cover all databases using Lotus Notes.

Other key components of the IT infrastructure include the deployment and continuous enhancement of SAO's hardware equipment, and the supply of hardware, primarily PCs and notebooks, which are required by employees to perform their tasks efficiently and access information technology services. In line with the SAO's strategic goals, the use of notebooks has been increasing in recent years among employees involved in on-site audits.

In 2010, the procurement of security software and renewal of licences for such software (firewall, intrusion prevention, spam filter, web security and content filter, Symantec virus protection, etc.) enabled ensuring the integrity and confidentiality of data generated and stored at the SAO.

Overall, the appropriations available provided the operational conditions required by the SAO for the uninterrupted discharge of its duties.