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STATE AUDIT  
OFFICE OF HUNGARY

# S U M M A R Y

of the Audit on the Implementation of the National  
Development Plan

1110

July 2011



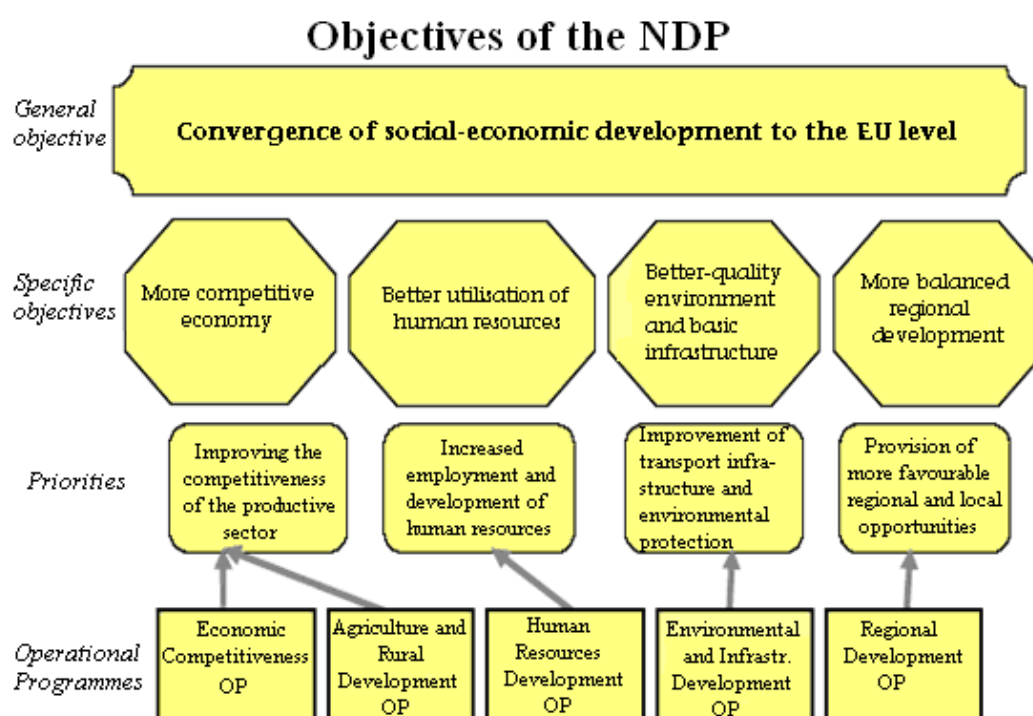
## INTRODUCTION

Becoming a full Member State of the European Union (EU) on 1 May 2004, made Hungary eligible for grants from the Structural Funds of the EU. These grants (according to the so-called Objective 1) facilitated the development and structural transformation of the economically underdeveloped regions.

The preparation of a development plan was required in order to use the grants; for the 2004–2006 period it was the National Development Plan (NDP). Another criterion was the operation of the set of tools (strategies, regulation, co-financing) and the institutional system in accordance with EU norms. The regularity and efficiency of financial management was the responsibility of the so-called managing authorities, which employed the services of intermediate bodies.

The NDP relied upon sources from the Structural Funds; therefore, the main objectives had to be in harmony with relevant EU regulations and the strategic EU goals of increasing competitiveness and employment. Convergence of social-economic development to the EU level was a general objective, and further objectives were determined to support this. The system of objectives and the programmes serving their accomplishment are shown in Chart 1.

Chart 1



Source: Community Support Framework

A total HUF 687.6 billion (EUR 2 696.3 million)<sup>1</sup> was available to accomplish NDP objectives; of which EU contribution amounted to HUF 508.9 billion (EUR 1 995.7 million) and national contribution to HUF 178.7 billion (EUR 700.6 million). Payments were in accordance with the programme lifecycles, and during the years of fund utilisation (2005–2008) amounted on average to 0.73% of GDP, 15% of general government expenditures for development.

The original settlement deadline of expenditures was 31 December 2008, which was extended by the EU Commission by six months. This opportunity was taken advantage of by all managing authorities, with one exception (Regional Operational Programme Managing Authority). The financial settlement of programmes was still in progress between the EU Commission and Hungarian institutions when the audit was closed.

The demand for NDP funds was clearly reflected by the fact that applicants would have drawn twice the amount of the allocation. Beneficiary types and the ratios of grants provided to them are shown in Table 1.<sup>2</sup>

Table 1

Private entrepreneurs		Small and medium-sized enterprises		Corporations	
Ratio of contracts	Ratio of grants	Ratio of contracts	Ratio of grants	Ratio of contracts	Ratio of grants
2.6%	0.7%	66.1%	25.5%	2.7%	7.8%
Non-profit organisations within public finances		Non-profit organisations outside public finances		Other organisations	
Ratio of contracts	Ratio of grants	Ratio of contracts	Ratio of grants	Ratio of contracts	Ratio of grants
20.0%	58.1%	8.5%	7.2%	0.1%	0.7%

66.1% of contracts were concluded with small and medium-sized enterprises, which received a quarter of grants. The largest portion (58.1%) of grants went to state-local government, so-called non-profit organisations as beneficiaries.

During the implementation of the NDP, as a result of the fiscal consolidation (stabilisation of the budget) in 2006, the convergence programme and the restraint of domestic demand, by 2007 the growth of the Hungarian economy declined to 1% from the rate of 4–5% in earlier years. In 2008 this was exacerbated by a deterioration in external conditions and by the global financial and economic crisis, as a result of which by 2009 economic growth reached a new low (-6.3%), and dropped compared to the EU-27 average as well.

A typical data of the convergence to the EU average is the fact that the per capita GDP increased slightly, reaching 65% in 2009, up from 63% in 2004.<sup>3</sup> Of

1 Calculated with a technical exchange rate of HUF 255/EUR. The allocation includes all public expenditures (EU, national central and local contributions).

2 According to NDA (*National Development Agency*) data of 4 August 2010 (items eligible for EU funding).

3 In the same period, the per capita GDP rose by 7 percentage points in the Czech Republic, and 16 and 10 percentage points in Slovakia and Poland, respectively.

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the V4 countries, the Czech Republic was ahead of Hungary, which was overtaken by Slovakia as well by 2007.

There was a slight improvement in productivity in Hungary, although this took place in parallel with a decline in employment. In terms of employment levels, the gap between Hungary and the EU average widened. Hungarian employment rate in 2004 was 56.8%, while the EU average was 63%. By 2009, the Hungarian employment rate decreased to 55.4%. In comparison, it is an objective adopted at EU level for the employment rate of the 18-65 year old population to reach 75% by 2020.

The **objective of the audit** was to assess whether the implementation of the NDP was effective. We evaluated whether

the financial objectives have been accomplished;

the performance objectives have been accomplished, and the results achieved are sustainable;

the measures planned in the interest of the efficient operation of institutions providing the grants have been taken.

The **audit method** used was a performance audit. It was conducted partly on the basis of documents, and partly at the beneficiaries, at the site of the selected projects. Of the 18 000 projects eligible for EU funding, we selected 147 projects that had received HUF 56.7 billion in grants (8.2% of grants).

The audits of projects were conducted by taking risk aspects into account, using layering based on project features and random sampling. This ensured that the selected projects could not be considered unique examples. The principles that served as basis for the sampling were in harmony with the INTOSAI Auditing Standards<sup>4</sup> applied during the performance audit and the rules of the audit performed by the SAO that were based on these standards.

The **organisations audited** were the institutions providing grants (managing authorities, intermediate bodies) and beneficiaries. The **audited period** extended from the launch of the operational programmes on 1 January 2004 until the end of the on-site audit on 29 October 2010, and we also utilised earlier SAO reports.

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<sup>4</sup> ISSAI 3000, Standard and guidelines for performance auditing based on INTOSAI Auditing Standards and practical experience

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## SUMMARY FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

**The implementation of the NDP facilitated Hungary's integration with the EU. At the same time, however, maximum benefit for society was not achieved** due to harmonisation deficiencies of strategies aimed at the development of national economy and due to the changing of strategic objectives.

**At institutions providing grants, the fullest possible utilisation of funds was given priority over effectiveness and efficiency.** As a result, the fund utilisation (absorption) of the NDP had a favourable image. However, the criteria necessary for effectiveness (appropriate strategy; break-out points; determination of clear, measurable and accountable objectives at the levels of the national economy and the beneficiaries) required further development.

The comprehensive goal that the NDP also intended to support, namely **the convergence of Hungary to the EU average was moderate in terms of per capita income** (per capita GDP increased from 63% of the EU average in 2004 to 65% in 2009). **Of all developments, Hungary converged to the EU development level in environmental protection, health-related and certain education-related investments as well as rural development. However, in the short term they do not lead to economic growth**, and furthermore financial and economic processes both within and outside the country had a negative impact on growth.

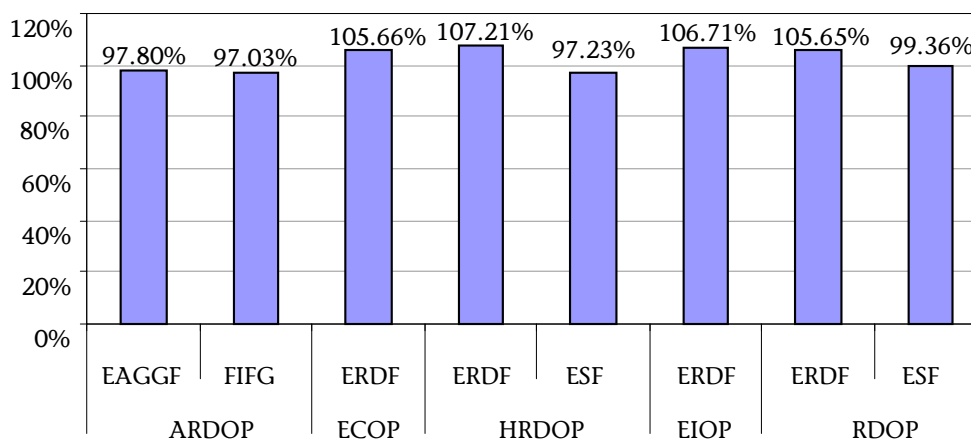
Approximately 20 000 projects were implemented using the NDP's HUF 687.6 billion available. Grants were aimed at the fields of economy, human resources, regional development, transport and environmental protection. Within these fields innumerable objectives were supported, such as: wastewater purification investments, trainings, road renovations, city rehabilitation and village fairs. **The implementation of the NDP helped the development of target areas, but due to the magnitude and fragmented nature of funds there are only partial results in the various policy areas, typically related to EU regulations.** The objectives of audited projects were accomplished in the case of three quarters of projects and in the case of every fourth project there were lags.

**99.1% of the NDP's available funds was utilised<sup>5</sup>**, and thus the loss of funds was minimised. **This, however, entailed additional domestic expenditures.** Similarly to the practices of other Member States, so-called reserve projects were supported (in an amount of approximately HUF 26.5 billion). This funding was provided from the domestic budget. The development of fund utilisation and absorption is shown in Chart 4.

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<sup>5</sup> Half of the programmes account for the unutilised funds amounting to approx. HUF 6 billion. In the case of the remaining programmes, all available funds were utilised.

Developments in the absorption of NDP operational programmes  
available funds = 100%



Source: the final cost statements of operational programmes

Additional domestic expenditures were not added up, but in addition to the aforementioned HUF 26.5 billion, further expenditures included the funding of projects taken out of the EU cost settlement, exchange rate losses and the preparation of NDP projects, which in total amounted to approximately HUF 35 billion. Another burden for the country in the coming years will be the repayment of the loan and interests thereof provided by the European Investment Bank; this loan is mandatory in the case of EU structural grants for domestic budget co-financing.<sup>6</sup>

The costs of the 37 projects taken out of EU funding during financial closing were accounted for as part of the additional expenditures by the managing authorities. In the case of the aforementioned projects, the EU funding amount was compensated for from the domestic budget in order to protect the financial interests of the community. At the same time, however, the prejudice to national financial interests and the settlement of irregular items at the expense of the budget cannot be excluded.

**Increasing the number of new and retained jobs was an NDP-level objective**, and according to the final reports constituting the basis of the audit this figure was around **34,500**. However, the **job retaining effect of these programmes was stronger**.<sup>7</sup> In the case of ECOP projects, the institution

<sup>6</sup> This was a loan of EUR 445 million, equalling around HUF 113.5 billion, at a technical exchange rate of HUF 255/EUR.

<sup>7</sup> The results are made doubtful by the fact that according to a different assessment method, the NDP has created 20,200 new jobs. This was the direct employment impact of the ECOP and HRDOP programmes and estimated data according to the assessment report (November 2010) entitled 'The Impact of Cohesion Policy on the Level and Quality of Employment in V4 Countries' and prepared by the TÁRKI Ltd., KOPINT-TÁRKI Ltd. and PPH Evaluation Ltd. consortium, commissioned by the NDA. According to the method applied during the assessment, the 20,200 new jobs were created using approximately HUF 250 billion of grants, which means that the creation of a single job cost HUF 12.4 million on average.

providing the grant – due to the crisis – also accepted retained jobs instead of newly created jobs.<sup>8</sup> Furthermore, small-scale agricultural enterprises and farmers reported the number of all employees working in the enterprise, regardless of the commitment, as in their opinion the grant contributed to the maintenance of the whole company. This was also accepted by the institution providing the grant. The number of jobs was in part provided by data calculated by the institution providing the grant (in the case of the ECOP) and in part from data disclosure by beneficiaries (in the case of ARDOP and RDOP). There were no exact data on the costs of job creation, because in the case of several projects objectives and activities other than job creation were also funded or job creation was a consequence of a given development.

Gross added value increased as a result of the ARDOP and ECOP grants, but at the time of our audit these data could not be aggregated for the NDP as a whole. Detailed job data are shown in Table 3 below.

Table 3

Performances in the field of improving the competitiveness of the productive sector (CSF Priority 1)	Performance 2004–2008
The number of new and retained jobs ECOP: 11 263; RDOP: 2 972; ARDOP: 20 237	34,472

Another NDP-level objective was the **quality development of human resources**, within the framework of which **approximately 330 thousand persons received training**. There is no data regarding the number of persons with vocational qualifications as in some programmes the nature of education has changed and they did not necessarily provide such qualifications. Some of the programmes, in harmony with the fight against social exclusion, focused on the training of persons working in integrated education and social fields and the improvement of the employability of disadvantaged people. Furthermore, in accordance with EU objectives, they supported life-long learning and the development of entrepreneurial skills. There were trainings that were adapted to company needs and essentially stood for internal trainings (the goal was to facilitate a more efficient performance in given positions). Other training programmes facilitated employment, with varied results. In the case of certain programmes, around 50% of those completing the programme found jobs, while only 10% of disadvantaged persons became employed. In these cases, trainings and job opportunities were not in harmony. The number of persons receiving training is shown in Table 4.

Table 4

Performances in the field of increasing employment and development of human resources (CSF Priority 2)	Performance 2004–2008
Number of persons participating in human resources development and training programmes	335,017 persons

<sup>8</sup> This evaluation was a domestic competency, and did not infringe EU regulations regarding state subsidies, transparency and equal opportunities or any domestic statutes.



HRDOP 234 421 persons; ARDOP 14 861 persons; RDOP 85 735 persons <sup>9</sup>	
Ratio of persons between the ages of 25–64 participating in adult training - HRDOP	3.1%

In the field of environmental protection, **113 000 residents joined the sewer system as a result of the grants.** In the field of transport development, **the length of new, modernised and renovated roads reached 723 km.** The construction and renovation of roads is reflected by a joint indicator, but, **in line with domestic needs, it shows that primarily renovations and modernisations were implemented.**<sup>10</sup> Detailed data are shown in Table 5 below.

Table 5

Performances in the field of improving transport infrastructure and developing environmental protection (CSF Priority 3)	Performance 2004–2008
Length of new and modernised roads – EIOP	179 km
Length of new or renovated four- and five-digit state or local government roads – RDOP	544 km
Number of residents provided with new or renewed water purification and sewage treatment capacities – EIOP	113,055 persons

Despite the fact that the RDOP financial indicator was accomplished, the implementation of the NDP as a whole did not improve the situation of regional disparities (CSF Priority 4). Therefore, **the more balanced development of the country's regions remained a priority even after the NDP's implementation period** and shall probably pose a great challenge in the future as well.

In accordance with the RDOP plan, at least 75%, but actually 78% of grants went to the four less developed regions, but due to the modest amounts of grants<sup>11</sup> and the numerous objectives, this impact was observable in only a few limited geographical areas.

Examining a longer period (between 2000–2008), the Central Hungary region produced a strong growth (of 21 percentage points), while the situation of the other six regions did not essentially change. According to 2008 EUROSTAT data (based on per capita GDP compared to the EU27 average), the Northern Hungary, Northern and Southern Great Plain as well as the South Transdanubia regions were put on the '20 poorest regions' list.

<sup>9</sup> In the case of nearly 70% of persons participating in RDOP funded training (component 3.1.1.), one person participated in more than one trainings, which typically lasted for 3-5 days.

<sup>10</sup> Larger environmental protection and transport projects were not funded from the funds providing grants to the NDP, but from the Cohesion Fund which we have not audited this time.

<sup>11</sup> A significant part of the NDP (82.3%) was made up of sector programmes; the RDOP accounted for 17.7% of available funds which were allocated to 7 regions.

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The effectiveness, efficiency and assessability of fund utilisation were weakened by planning deficiencies, the lack of initial technical data and the determination of diverse objectives during planning. Although the indicators assigned to the programmes did fulfil the minimum EU Commission requirements at the planning stage, their suitability to measure goals and objectives was limited.<sup>12</sup> The comparison of planned and actual results was made more difficult by the fact that during the financial reallocations implemented in accordance with relevant regulations, the performance targets were not adjusted to the increased or reduced funds.

The EU Commission and the Member States, including Hungary, measure the impact and results of grants using not only the analysis of indicators assigned to programmes, but using a number of other methods (such as comparing funded and non-funded enterprises) as well, and publish these impacts and results on websites. However, **regarding the results of domestic programmes** there is **no clear and easily understandable summary for decision makers** (those determining development objectives and those providing grants) and **the society**.<sup>13</sup>

The 143 projects<sup>14</sup> we have audited with **performance audits** have been completed. Of these projects, 110 were in the maintenance stage, and for **three quarters of these projects the objectives have been accomplished, and for each fourth project there was a lag in the accomplishment of objectives compared to the deadlines** (one of the indicators assessed during the audit was accomplished under 80%).

Assessment was made more difficult due to the fact that while there was detailed regulation available to evaluate the regularity of projects, there were no such regulations in grant and procedural rules to assess the performance of the objectives undertaken by the beneficiaries and to call them to account. Furthermore, in the case of certain projects, the beneficiaries often indicated 10–15 objectives in the application or contract which they considered indicators, but not all of them formed the basis of the assessment or accountability. The managing authorities evaluated the accomplishment of objectives individually for each project.

**Among the projects examined we found good practices.** According to the answers provided on the audit questionnaire, **even amidst strong competition and at a time of crisis, there were successful developments, where beneficiaries primarily underlined their own preparedness** and that they strived to have good cooperation with the

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<sup>12</sup> For example, there was a single indicator for the length of new and modernised roads or the number of persons who became employed through training and those who gained other sorts of advantages. The EU Commission also faced this problem that appeared at an EU level as well, and in 2009 it prepared a guide on the most important indicators. Rural development programmes already had a system of indicators determined at an EU level prior to 2009, which means that there was no uniform practice at EU level either.

<sup>13</sup> The amount of grants can be monitored using the NDA's 'grant map'. <http://www.nfu.hu/terkepter>

<sup>14</sup> Of the 147 selected projects, 4 were irregular, and they were not reviewed using performance audits. In one case (for one project), the SAO filed charges for suspicion of misappropriation.

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institutional system (such as a company ‘producing medical herbs’ or a company ‘operating a wellness hotel’).

As factors hindering success, they mentioned the sluggishness of administration and payments, the overdue issue of payment receipts, frequent organisational and personnel changes, the changing legal and economic environment, excessive bureaucracy and the multi-player institutional system.

Beneficiaries explained that partial accomplishment of objectives was in 30% due to the financial-economic crisis. In addition, they referred to the weak crop and the creation of excess crop silo capacity in agriculture, as well as reorganisations, the decline in normative grants and the amendments to the public education act in the case of primary schools.

There were **deficiencies in the utilisation of three projects** (2% of audited projects, 15.8% of total value). The development of the Győr-Gönyű Harbour aimed at environmentally friendly transportation was a complex project, which was only partially completed and, as a result, the completed part of the project did not function as planned. A schedule was prepared at the time of our audit with respect to tasks required for utilisation. The use of an information provision IT module developed by the local government for enterprises has become impossible due to statutory amendments. Based on noise maps, the Municipality of Budapest and 21 other local governments developed action plans. However, the representative councils of 10 local governments only approved these plans, but failed to appoint persons responsible for the tasks or set a deadline.

The maintenance of health-related and human resources projects is risky in a period of shortage of funds in cases when the policy does not take into account the impact of developments during operation and financing. Due to the capacity limiting effect of the act on the development of health care systems<sup>15</sup>, sustainability required the reallocation of further capacities, in addition to the capacities set out by the act, among hospitals to operate EU investments. Training organisations (from kindergartens to universities) can receive the curriculum and models developed within the framework of the human resources development programme free of charge, but a further criterion of sustainability and utilisation is that the new, changing strategies should build upon these foundations.

During the audited period, the institutions providing grants conformed to EU regulations, although they were still changing and forming during implementation and they were not efficient. The grant system was characterised by protracted processes, excessive bureaucracy and complicated tenders. There were accelerating and simplifying measures taken as a result of assessments and audits, but – due to the short programming period of the NDP (3 years instead of 7) – they primarily appeared in the NHDP period.<sup>16</sup>

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15 Act CXXXII of 2006

16 For example: internet-based process support, the extension of the normative tendering procedure facilitating faster management, support documents instead of support agreements that have longer processing times, submission of fewer invoice copies etc. Other measures (increasing the provision of advance payments,

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The methods applied during the utilisation of structural fund grants, the many years of planning, monitoring and the experiences gained in the field of assessment all developed domestic practices. Another positive development was that the monitoring information system established to keep records of financial, accounting and monitoring activities as well as administration processes was available to all Hungarian EU institutions. The system was continuously under development and compared to the starting stages the quality of record-keeping has greatly improved.

At the closing of the audit, the Ministry of National Development introduced a number of measures and planned to introduce others in 2011 to improve effectiveness and efficiency, but these measures or this period were not covered by our current review.

The effectiveness of fund utilisation, the overshadowing of efficiency, objectives that are too diverse, making objectives measurable and the necessary accountability with respect to results are phenomena that are present not only in Hungary. Therefore, these issues are also dealt with by the reform of the cohesion policy that is aimed at the period starting from 2014. Taking into account that Hungary already has a detailed implementation plan for the whole 2007–2013 programming period, we recommend that the resolution of the weaknesses of the grant system be performed in the period after 2013, in light of EU development objectives.

In addition to utilising the findings of the on-site audit, **we recommended:**

**that the Minister of National Development and the Minister of Rural Development**

1. Continue the development of the future grant system – in light of the EU objectives for the period after 2013 – in a way that in parallel with the avoidance of the loss of funds and with regularity, the accomplishment of strategic goals and the sustainability of projects also become priorities.
2. In the interest of the protection of domestic financial interests, take measures to review NDP projects that have been taken out of the EU cost settlement and have been settled in full at the expense of the domestic budget and to integrate the experiences of the review into the next programming period.
3. Take steps to present a clear and easily understandable summary of results accomplished by NDP programmes to decision makers (those determining development objectives and those providing grants) and the society.
4. Have the substantiation of the action plans of projects dealing with utilisation problems reviewed, and if necessary have new action plans prepared.

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decreasing of collateral charges) increased financial risk, particularly in the changed economic environment of recent years (SAO report No. 1010).