



Summary

of the Audit on of the Analysis of the Budgetary and Financial Equilibrium of the Budapest Municipality; as well as the 2011 Audit on the Operation of Internal Controls Established in the Budget Planning and Final Accounts Preparation Processes (1113)

Objectives and scope of the audit

Whether the Municipality of Budapest

1. ensured the budgetary and financial equilibrium in its budget and the implementation thereof and whether its financial situation, rate of indebtedness and long-term solvency changed favourably;
2. operated the internal controls in the course of its budget-planning and final accounts preparation processes, as well as in the field of financial accounting and IT systems;
3. ensured the criteria for electronic public services and – by means of disclosing financial management data – the publicity thereof;
4. utilised the audit findings and recommendations of the 2010 audit performed at the Municipality by the State Audit Office of Hungary (SAO); and
5. performed the tasks related to the maintenance of public roads in an economic and effective way.

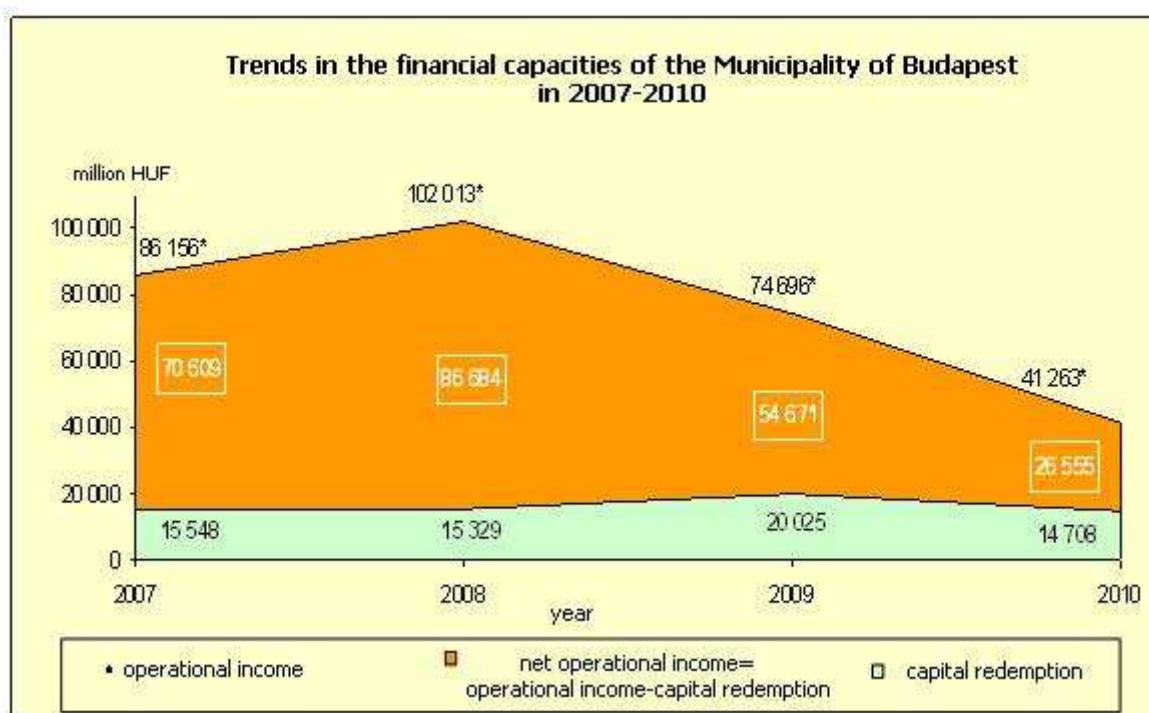
On 1 January 2010 the population of the capital town was 1,721,556. Following the municipal and mayoral elections in 2010, the number of Municipal Assembly members dropped from 67 to 33. Between October 2006 and October 2010 fifteen, following that eight standing committees assisted the work of the Municipal Assembly. In the implementation of the Municipality's financial management tasks, 214 of its budgetary institutions (on 753 premises) and 44 of its economic enterprises participated in 2010. According to the accounting balance, at the end of 2010 the Municipality of Budapest had assets worth HUF 2,227 billion. The amount of the Municipality's total debt at the end of 2010 (HUF 218 billion) equalled approximately one-fifth of the gross total debt of local governments.

Main findings

1) The budgetary and financial situation, indebtedness and the risks thereof

The budgetary revenues realised at the Municipality during the implementation of the 2007-2010 budgets together with the residues utilised covered the budgetary expenditures. In the accumulation of financial surplus in the years 2007-2010, the shortfall of significant amounts (totalling HUF 426 billion) in the budgetary expenditure appropriations for accumulation purposes played an important role. That resulted in the first place from the planned major investments and reconstructions in the capital city being partially cancelled or carried over to the following years; including the construction of Metro Line 4, the investment in the central wastewater treatment plant of Budapest, the transfer of funds planned to the account of the town-rehabilitation grant, the replacement of vehicles on Metro Line 2, modernisation of bridges and roads, the extension of tram lines 1 and 3. The significant residue amounting to some HUF one hundred billion in the previous years respectively, covered the commitments carried over.

The financial situation and liquidity of the Municipality of Budapest was altogether appropriate between 2007 and 2010, the accounting assets together with dealing securities provided cover for the settlement of short-term payment obligations, except for the public health establishments of the Municipality's budgetary institutions. The long-term (20-25 years), mainly floating interest rate loans outstanding of the Municipality of Budapest for development purposes – typically (ca. 90%) due in euro – totalled HUF 172.7 billion at the end of 2010. At the same time, the total debt of the Municipality amounted to HUF 217.6 billion, which equalled 17.4% of the total debt worth HUF 1,248 billion of the local governments. On the basis of the Municipality's credit agreements, at the end of 2010 an unclaimed balance of HUF 88.4 billion was available. In addition to the Municipality's debt, the total long-term debt of economic enterprises in its majority ownership – that is not included in the financial statements of the Municipality – amounted to HUF 39.9 billion at the end of 2010, out of which the long-term debt of the Budapest Transport Company amounted to HUF 36.3 billion.



With the actual total debt of the Municipality, its financial management was still sustainable in the years 2007-2010, however the disposable income of HUF 86.7 billion in 2008 available after the current expenditures had been deducted from the current revenues and the debt service had been discharged, decreased significantly, to HUF 26.6 billion in 2010. The cover for the commitments due after 2010 (circa HUF 300 billion) related to investments and renovation works can be ensured only if the revenues – calculated in the seven-year plan as own resources for the developments – are realised and the Municipality does not enter into another significant development commitment that would charge these revenues.

In terms of the long-term solvency and the indebtedness of the Municipality of Budapest the obligations to pay the total service fee – amounting to circa HUF 33.4 billion for 25 years – related to the Warehouse project, as well as the payment liability due to the credit borrowed for the implementation of the investment (circa HUF ten billion) constitute a risk from 2010. The Municipal Assembly decided on the implementation of the Warehouse project in 2005, by means of a public procurement procedure, with a service contract, in PPP construction. The Municipality of Budapest did not observe the provisions of the Act on Public Procurement, as the attestation submitted by the winning tenderer justifying that the own resources are available did not meet the criteria set in the call for application. The conditions stipulated in the Service Contract – contrary to the provisions of the Act on Public Procurement – differed from the content of

the proposal made by the winning tenderer (in terms of the service fee, the basic commission fee regarding real property-letting and the payment liability related to project loans borrowed by the service provider). The net service fee undertaken in the service contract exceeded the amount of HUF 20.2 billion indicated in the proposal of the winning tenderer by HUF 13.2 billion. Because of the above, the State Audit Office of Hungary reported to the prosecuting authorities and initiated criminal proceedings. The multiyear consequences and funding resources of commitments related to the implementation of the Warehouse project had not been calculated with before the decision was taken or in the budget decrees of the consecutive years (until 2011). In the financial management of the Municipality, further risks are posed by the liabilities outstanding towards the economic enterprises operated, especially towards the Budapest Transport Company; and the possible amendments in the funding and scheduling of the construction works of Metro Line 4. The financial management of the Budapest Transport Company is presently being audited by SAO, the report is expected to be published at the end of 2011.

2) The operation of internal controls

In the Mayor's Office the adequacy of the operation of the internal controls was weak in the course of the budget-planning for 2010 and the preparation of the final accounts in 2009. The shortcomings in the regulation of IT tasks related to financial accounting activities posed high risk in terms of the appropriate implementation of IT tasks, the adequacy of the operation of the internal controls was weak.

3) Electronic public services, disclosure obligation

In the IT system providing e-public services at the Municipality, administrative functions of 2nd level electronic services were provided for the citizens and the enterprises. The Municipality of Budapest did not fully comply with its disclosure obligation in relation to the data concerning subsidies provided for special purpose and contracts exceeding the net amount of HUF five million.

4) The utilisation of previous recommendations

In the course of its 2010 audit on the Municipality's financial management system, SAO made 18 recommendations concerning regularity, and 2 recommendations concerning expediency. Upon SAO's recommendation, the Municipal Assembly ordered that the payments of expenditures effected between 2006-2010 in relation to the fee of those not being permanent staff members be verified, setting a deadline of June 2011. The internal audit department verified the conclusion of contracts and the payments and – due to the deficiencies

revealed – recommended further measures and calling to account. In the on-site phase of the present audit – within the deadline set in the action plan issued by the Mayor and the County Clerk in March 2011 – further five regularity and two expediency recommendations were implemented. During this process the County Clerk provided for the stipulation of criteria for the conclusion of contracts on employment involving intellectual activity to the account of the external personal allowances appropriation. For being liable for negligence in attesting the professional performance of external contractors, one of the heads of department was subject to disciplinary punishment. One of the contractors was requested to pay back the unjustified commission fee paid, then – once the repayment was refused – a civil case was initiated. Measures were taken to establish the single organisation of internal audit and to plan the audit of areas considered high-risk, in order to set up and operate the appropriate framework for internal audit. In the action plan the deadline of late October 2011 was set for the implementation of the remaining recommendations.

5) Tasks related to the maintenance of public roads

Within the property of the Municipality, the network of public roads represents a significant property element (worth HUF 656 billion), equalling nearly 30% of the total assets according to the accounting balance sheet. In the years 2009 and 2010 the provision of the Municipality's tasks related to the maintenance of public roads was not profitable, as the service fee concluded in the public service contract was not specified on the basis of preliminary calculation. The Municipality of Budapest did not verify the implementation of tasks related to the maintenance of public roads, the quality standard of the work performed caused unwarranted extra workload. In the years 2006-2010, the performance of public road maintenance tasks was not effective, as the Budapest Public Area Maintenance Company missed the deadline set and did not comply with technical professional standards when performing its task. The quantity-based data included in the field books substantiating the accounts submitted to the Municipality were reckoned by estimation. The Municipality of Budapest did not ensure the amount necessary for the long-term sustenance of the use value of public roads.

Recommendations

Apart from the findings of the on-site audit we recommended the Mayor, among others, to permanently inform the Municipal Assembly on the current financial situation, the changes thereof, the settlement criteria for the commitments generating debt; moreover, to have a proposal prepared for the Municipal Assembly containing a full summary and presentation of the voluntary tasks undertaken by the Municipality. The SAO recommended the Mayor to propose

that the Municipal Assembly amend the order of financial accounting for the remuneration due for services aiming at the performance of public road maintenance tasks. The County Clerk was recommended to stipulate for the audit assignments in case of IT systems used in the course of the budgeting process and for financial accounting task; as well as to operate the internal controls and to provide for the audit and economic and effective provision of public road maintenance tasks.