STATE AUDIT
OFFICE OF HUNGARY

# S U M M A R Y

## Findings and Conclusions of the SAO Opinion on the Budget Bill of the Republic of Hungary for 2012

1121 T/4365/3 October 2011

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# OPINION ON BUDGET BILL No T/4365/3

## The budget document

The justification of the budget appropriation bill and its annexes serve the purpose of facilitating the substantiation of the decision to be made on the bill and supplying the decision-makers with credible information. Upon compiling the budget appropriation bill, special emphasis has to be laid on the presentation of the effect of the obligations determined by the decisions of earlier years and the decisions regarding the subject year on the budgets.

In spite of the provisions of the Act on Public Finances, the effects of commitments for several years (projects based on the cooperation of the public and private sectors, long-term commitments broken down by chapters and the years of expected disbursements, the impact of the expenditure items involving multi-year commitments pertaining to subsequent years and the three-year programme of central investments) do not appear in a summarised form in the budget appropriation bill(s).

The prevailing regulatory environment in which the document of the budget appropriation bill is compiled has hardly changed for years; there is no legal regulation or accepted standard that draws up a complete system of requirements regarding the contents and the structure.

A comprehensive definition of the requirements concerning the contents and the form of the budget appropriation bill would allow an overview of the pieces of information that contribute to the debate of the budget appropriation bill by the National Assembly to the necessary and adequate extent.

## Conditions of budgeting and audit

The rules of procedure of budgetary planning and the work phases of the planning process are regulated by the Act on Public Finances and the Government Decree on the Rules of Operation of Public Finances.

Pursuant to Article 50 of the Act on Public Finances, the minister responsible for public finances prepares and submits the budgetary guiding principles to the Government by 15 April. The minister responsible for public finances met this statutory obligation by the set deadline, and the Government approved the budgetary guiding principles. Pursuant to Article 26 of the Government Decree on the Rules of Operation of Public Finances, based on the budgetary guiding principles and a Government decision, the minister responsible for public finances issues the Guidelines (a planning circular) regarding the tasks and requirements related to budgetary planning as well as the documents used. The Guidelines were prepared in accordance with the relevant legal regulation, pursuant to Article 26 a)–d) of the Government Decree on the Rules of Operation of Public Finances.

Pursuant to Article 51(2) of the Act on Public Finances, the minister responsible for public finances submits the draft of the budget appropriation bill, which was prepared by the deadline laid down in the Act on Public Finances, to the Government by 31 August, but neither the structure, nor the contents of the Proposal conform to the draft of the budget appropriation bill.

The lack of a standard system of regulations determining the required content and form of the annual budgetary acts does not ensure that the National Assembly discuss a transparent bill that also guarantees a comparison between years and the reliability of the outlook for the coming years.

Rather than completing the provisions of the Act on Public Finances, it is expedient to regulate the set of criteria of the Act on the Budget within the framework of a comprehensive public finances act that also covers the rules of the financial management of the state as a whole, which was already initiated by the State Audit Office of Hungary earlier.

## Deficit, direct revenue and expenditure appropriations of the central budget

It was not possible to formulate a complete opinion on the substantiation of the bill on the 2012 budget, firstly due to the lack of documents supporting a significant portion of the revenue appropriation plans for 2012 as well as due to the lack of background calculations, and secondly because of the differences between the data recorded and the ones appearing in the budget appropriation bill, the reasons of which are only partly known or not known at all by the SAO.

The package of measures consisting of seven points included in the Széll Kálmán Plan planned a saving of HUF 550.0 billion for 2012. Due to lack of supporting documents, we cannot even give a partial opinion on savings amounting to HUF 388.0 billion.

We cannot give an opinion as to the conformity between Act LXXV of 2008 on Economical Public Financial Management and Fiscal Responsibility and the budget appropriation bill for 2012 because the necessary data and background calculations were not available by the date of closing the records on 12 September 2011. Contrary to the budget appropriation bill for 2011, the budget appropriation bill for 2012 does not contain any provisions regarding the criteria and indicators to be determined in the Act on the Budget as stipulated in Articles 3 and 4 of Act LXXV of 2008 on Economical Public Financial Management and Fiscal Responsibility. The justification of the bill does not contain any information or directions in connection with these requirements. The Government did not comply with the provisions of Act LXXV of 2008 on Economical Public Financial Management and Fiscal Responsibility.

Pursuant to Article 36(1) of the Act on Public Finances, the budget appropriation bill submitted by the Government has to be presented together with the impact assessment in support of the budgetary appropriations, containing the material conclusions and findings of the budgetary impact assessments, as required by Article 6(4) of Act LXXV of 2008 on Economical Public Financial Management and Fiscal Responsibility. For lack of documentation and information, the SAO could not give an opinion on the existence and contents of an impact assessment.

Pursuant to the provision of Article 36/B(1) of the Act on Public Finances, upon submitting the budget appropriation bill, the Government shall inform the National Assembly about the detailed limitations on commitments it intends to enforce during the subject year – in line with the medium-term plans – relating to at least three years if the proposal is accepted. The bill does not contain a statement like this, and there is no relevant reference in the general justification either. Annex 10 of the bill contains detailed framework appropriations for commitments until 2013 only with regard to the EU funds.

The budget appropriation bill contains a HUF 576.5 billion central government deficit. As in earlier years, no related financing plan was available for the audit. The central budget deficit amounts to HUF 507.3 billion, the deficit of the social security funds is HUF 34.4 billion, whereas the deficit of the separated state funds is HUF 34.8 billion in the bill. Following the approval of the budget appropriation bill, a new financing plan is prepared by the Government Debt Management Agency in each fiscal year. Thus, the financing plan available during the audit proves to be a preliminary plan.

The 2012 financing concepts available at the time of taking the records and aiming to maintain the central budget deficit and ensure the continuous liquidity of the Single Treasury Account as well as the advances are arithmetically elaborated and supported. The funds appropriated from the planned money market transactions and their scheduling are in line with the debt management strategy. The fulfilment risk of the 2012 financing plan is reduced by the interest rate risk reserve amounting to HUF 50.0 billion.

In its document entitled ‘Evaluation of the 2012 budget appropriation bill of Hungary’ the National Bank of Hungary indicates a compensation obligation of HUF 95.0 billion for its expected loss, which burdens the 2012 central budget. However, this expenditure does not appear in the budget appropriation bill, constituting a risk factor in the central budget deficit, which justifies the raising of additional funds.

In the 2012 budget appropriation bill the gross debt of the central budget is 66.4% of GDP, which is 1.9% less than the 68.3% expected for the end of 2011. At the same time, the amount of gross debt will not decline, but will increase from the HUF 19,085.1 billion expected for 2011 to HUF 19,328.3 billion.

The direct revenues of the central budget account for 73.4% of the total revenues of the central budget. When closing the records on 12 September 2011, neither the draft appropriations, nor the related documents and background calculations for 96.5% of the direct revenues, i.e. for HUF 6,440.6 billion, were available for the SAO. Based on the documents received, as to the direct revenues we can give an opinion on the substantiation of the mining rent, other budgetary revenues, interest revenues and revenues related to state property.

During our review, an appropriation was considered to be substantiated if it was supported by documents and detailed calculations.

There are differences between the tax revenue appropriations (e.g. personal income tax, corporate income tax) included in the budget appropriation bill dated 30 September 2011 and those in the text of provisions and chapter justification submitted to the Fiscal Council. The related certificates, background calculations, impact assessments and documents were not available for the SAO. Consequently, the substantiation of the tax revenues could not be judged.

In spite of the fact that the tax revenues were not supported by detailed calculations, based on available information (trends of previous years, pro-rata performance data of 2011, expected performance data, audit experience of previous years and data supplies by the National Tax and Customs Administration) the SAO prepared estimates regarding the amounts of tax revenues expected to be collected in 2012. It expressed its opinion on the feasibility of tax revenues and the risk of feasibility based on the above.

The feasibility of 27% of tax revenues, i.e. of HUF 1,764.2 billion – company car tax: HUF 46.0 billion; personal income tax: HUF 1,550.7 billion; duties paid by the population: HUF 102.5 billion and rehabilitation contribution: HUF 65.0 billion – could not be assessed. 63.3% (HUF 4,135.1 billion) of the tax revenues, including the surtax of financial organisations (HUF 187.0 billion), the surtaxes affecting certain sectors (HUF 155.0 billion), the VAT revenue (HUF 2,697.7 billion) and the excise duty (HUF 898.1 billion), were found to be feasible. (Upon reviewing the 2011 budget it was not possible to give an opinion on 33.5% of the tax revenues, and we classified 45.7% as feasible.) We indicated a high risk for 6.8%, i.e. HUF 447.1 billion (corporate income tax: HUF 356.2 billion; gambling tax: HUF 82.4 billion; environmental load charge: HUF 8.5 billion) and a medium risk for 2.9%, i.e. HUF 187.2 billion (contributions by credit institutions: HUF 8.1 billion; simplified entrepreneurial tax: HUF 179.1 billion). (Upon reviewing the 2011 budget we indicated high and medium risks for 6.2% and 14.6% of tax revenues, respectively.)

Should the development of macroeconomic indicators be less favourable than projected, there is a risk that several tax revenue appropriations (especially that of the VAT) will not be fulfilled in 2012.

On the basis of the data contained in the records, we deemed the revenues planned for 2012 in connection with state property (HUF 37,080.2 million) and the National Land Fund (HUF 11,950.0 million) well-founded and feasible. (Upon reviewing the 2011 budget, we considered 14.1% of the revenues related to state property as high-risk ones and 21.9% of them as not substantiated; it was not possible to assess the substantiation of the revenues related to the National Land Fund.) An amount of HUF 50,423.8 million is indicated as revenue (Property Chapter and National Land Fund) in the budget appropriation bill, reflecting a HUF 1,393.6 million difference compared to the sum indicated in the records on 12 September. This deviation is a result of a decrease of HUF 6.4 million in the revenues related to state property and of an increase of HUF 1,400.0 million in the revenues of the National Land Fund. The increase in the revenues of the National Land Fund is attributable to the trebling of arable land sales. The SAO does not have any information on the reasons for the modification.

The SAO gave an opinion on the substantiation of the appropriations of direct expenditures planned for 2012 on the basis of the drafts included in the records that were closed on 12 September 2011. When the records were taken, for lack of documents we could not give an opinion on a total 13% of the direct expenditures, including 99.3% of the planned appropriation of Current support of enterprises in Chapter XVII, Ministry of National Development; 94.2% of the planned appropriation of Special reserves in Chapter X, Ministry of Public Administration and Justice; the title Resolving the ownership issues of former church properties and the subtitle Compensation of employers due to the restructuring of the tax system under the title Special reserves in Chapter X, Ministry of Public Administration and Justice; the titles Extraordinary government measures and Country Protection Fund in Chapter XI, Prime Minister's Office; the titles Guarantee and contribution to social security services, Consumer price subsidy and Current support of enterprises in Chapter XLII, Direct revenues and expenditures of the budget. The sum of the appropriations shown under these titles in the budget appropriation bill is HUF 1,067.7 billion.

43.3% of the expenditures related to state property (HUF 87,513.0 million) was not substantiated or could not be assessed upon closing the records. (When the 2011 budget was reviewed, 47.3% of the expenditures related to state property was not substantiated.) Expenditures related to state property amount to HUF 93,060.5 million in the budget appropriation bill. There was increase in Accumulation-type expenditures (HUF 2,800.0 million), Utilisation-related current expenditures (HUF 1,050.0 million), Expenditures burdening the Hungarian State in connection with earlier sales (HUF 1,247.5 million) and in the Chapter reserve (HUF 450.0 million). Documents that support the increase in expenditure items were not available for the SAO.

The 2012 expenditure appropriation of HUF 17,275.0 million related to the National Land Fund is substantiated.

Accumulation of reserves amounted to HUF 403.6 billion, of which the reserve for Extraordinary government measures amounting to HUF 100.0 billion and the amount of HUF 150.0 billion of the Country Protection Fund may reduce the risks arising in the expenditures that can be exceeded without obligatory amendment and other possible risks (e.g. shortfall in tax revenues), if they are not used partly or at all. The Country Protection Fund is a new type of reserve in the central budget. Its regulation, the method of creating the appropriation and its extent as well as the way and conditions of its utilisation are not included either in the 2012 draft budget or in the planned amendment to the Act on Public Finances. The SAO deems the regulation necessary. When closing the records, of the reserves only the amount of HUF 69.0 billion of the special reserves was known; we could not judge the substantiation of 94.2% of them due to the lack of background calculations. In the budget appropriation bill the special reserve appropriation amounts to HUF 153.6 billion, which shows an increase of HUF 84.6 billion compared to the records; the difference is caused by the HUF 84.6 billion planned under the subtitle Compensation of employers due to the restructuring of the tax system.

In order to avoid blockings and corrections during the year, the SAO considers it necessary to ensure adequate funds for managing the risks identified.

## Budgetary institutions and chapter-managed appropriations

On reviewing the figures in the bill submitted to the National Assembly and in the records taken during the on-site audit we found that they differ from each other. The SAO does not have information on the documentation and substantiation of the deviation in the figures that changed in the bill; therefore it was not possible to assess the related effects.

The budget chapters started to compile their respective 2012 budgets on the basis of the Guidelines issued by the Ministry of National Economy.

The planning work for 2012, similarly to previous years, was characterised by the fact that in the course of developing the appropriations, not all the legal regulations that affect the budgetary appropriations were yet effective.

Instead of determining the funds necessary for the performance of tasks, the total amounts of available support earmarked in chapters, issued by the Ministry of National Economy, were determined on the basis of the 2011 original funding appropriations, with adjustments to structural changes and the changes in levelling (e.g. the reduction of the base due to the removal of the blockings carried out in 2011 and the removal of one-off tasks) and also to the surpluses. In the case of chapters/organisations that are not managed or supervised by the Government, according to the Guidelines, the Ministry of National Economy also included structural changes (withdrawal of reserves) in the base, for which changes no decision had been taken.

Considering that the Guidelines did not contain clear guidance for the planning of (institutional and central) appropriations for the number of staff, personal allowances and accumulation, the organs that manage the chapters were also unable to assist the planning work of chapters/institutions by elaborating the detailed regulations in line with Article 27 of the Government Decree on the Rules of Operation of Public Finances. As a result, the elaboration of budget proposals for the chapters was not uniform, which, eventually, allowed the Ministry of National Economy to make non-normative decisions upon discussing said proposals and upon finalising the bill.

In accordance with the provisions of the Guidelines, the managing bodies revised the data supplies of the institutions under their direction, compiled the budget proposals for the administrative titles and the chapter-managed appropriations, and forwarded them to the Ministry of National Economy after consolidation.

During the compilation of the plan proposal, some of the chapters, in parallel with the reverse planning of the issued total amount of available support, submitted additional demand for funding, whereas other chapters submitted their budget proposals including appropriation amounts increased with additional demands not yet approved by the Ministry of National Economy.

In the course of planning, within non-personnel expenses – with the exception of the appropriation for the employment of people who invoice their services – the chapters complied with the regulations and requirements included in the Guidelines.

Upon planning the number of staff, the chapters did not state the changes in the deduction of appropriations in a uniform manner, as the restructuring of tasks within and among chapters and the conclusion of the relevant agreements had not taken place completely until 12 September 2011.

Upon planning the personal allowances and the contributions imposed on employers, the ministries compiled the appropriations applying unchanged remuneration basis/basic salary. The ministries took account of the ban on increasing non-regular personal allowances and the requirement to reduce external personal allowances to the minimum level. The increase in non-regular and external personal allowances taking place in certain chapters (National Assembly, Prosecution Service of the Republic of Hungary) were justified by changes in legislation [Article 5(1) of Act LVI of 1990 on the Remuneration of Members of Parliament, Article 50(3) of the Act LXXX of 1994 on the Prosecutorial Service Relations and Prosecutorial Data Management] as well as by the amended regulations concerning the planning of chapter-managed appropriations, which require expenditures to be planned where they occur.

Compared to the previous year, the appropriations of institutional non-personnel expenses were increased by the change in the planning of chapter-managed appropriations and the reallocation of certain appropriations. The ministries revised their respective appropriations regarding the performance of intellectual activity. However, with the exception of three organisations (Fiscal Council, Prosecution Service of the Republic of Hungary and Hungarian Atomic Energy Authority) they continued to plan disbursements, in spite of the fact that – pursuant to the provisions of the Guidelines – it is permitted only in particularly justified cases. For 2012 as well, almost all chapters indicated additional demands in the field of non-personnel expenses compared to the funds available.

The chapters planned the institutional accumulation expenditures on the basis of the resources available. The appropriations serve preservation purposes, the creation of safe operating conditions, as well as the development of the IT and telecommunications networks.

Chapter-managed appropriations serve the implementation of priority programmes of the given sector, primarily in the form of disbursements outside public finances. In accordance with changes in planning rules, expenditures within public finances have to be planned where they occur. Accordingly, from 2012 on, no appropriation amendment can be implemented to the debit of chapter-managed appropriations during the year. The significant decrease in the number of chapter-managed appropriations was a result of the joint impact of several factors (development of homogeneous tasks, planning as institutional expenditure).

In the case of the appropriations where, without amendment, the fulfilment may be different from the original appropriation, amounts equalling the 2011 original appropriations were planned by the ministries concerned. In the case of the National Development Agency, the scope of appropriations whose fulfilment without amendment may deviate from the appropriation was expanded by the following appropriations: 2012 EEA and Norway Grants 2009–2014 and the subsidy for the construction of Metro Line 4 in Budapest.

Annex 9 of the budget bill lists (under 92 titles/subtitles in total) the appropriations whose fulfilment may deviate from the appropriation without amendment. These appropriations – representing a total expenditure appropriation of HUF 8,177.6 billion – already carry some risk, regarding the fact that their fulfilment exceeding the original expenditure appropriation may jeopardise the compliance with the deficit target set by the bill.

The chapters concerned planned central investment in line with the aspects determined in the Guidelines.

The Ministry of National Economy did not determine a total figure for the revenues, but the Guidelines stipulate that whenever the planned revenues were lower than the expected performance for 2011, the permission of the minister responsible for public finances was required and any discrepancy (increase/decrease) had to be justified. In the course of formulating the Opinion we found that – with the exception of the Ministry of Rural Development – the ministries observed this regulation. However, until the closing of the on-site audit (12 September 2011) – with the exception of the Hungarian Central Statistical Office and the Hungarian Financial Supervisory Authority – they did not receive a written reply from the Ministry of National Economy.

In compliance with planning regulations, revenues from fines were planned by the ministries as a completely centralised revenue for 2012. The additional funding that replaces revenues is not included in the total figure issued by the Ministry of National Economy, only in the bill.

In the bill, fine revenues, environmental product taxes and other centralised revenues out of the centralised revenues are shown among the revenues of Chapter XLII and not below the line in the chapters concerned. This presentation method increased the transparency of the bill.

Contrary to the rule stipulated in the Guidelines, the bill contains general reserves for four chapters (Ministry of Public Administration and Justice, Ministry of Rural Development, Ministry of National Economy and Ministry of National Development), in a total amount of HUF 930.4 million, and there were changes in the order of titles in the National Assembly, Parliamentary Commissioners' Office of Hungary, Ministry of Public Administration and Justice, Ministry of Rural Development, Ministry of Defence, Ministry of the Interior, EU Developments and Hungarian Academy of Sciences chapters.

## Accounting in relation to the European Union

According to the provisions of the budget appropriation bill for 2012, the central budget resource part of the EU funds appearing in the budget amounts to HUF 249,138.2 million[1], which is completed with EU funds amounting to HUF 1,567,500.9 million. The amount of the planned contribution to the EU budget for 2012 is HUF 264,336.6 million.

Among the revenues of the central budget arising from EU membership, revenues amounting to HUF 173.6 million are planned under the subtitle of reimbursement of the collection costs of the sugar sector contribution, and revenues of HUF 8,644.0 million are planned under the subtitle of reimbursement of the costs of customs duty collection for 2012. The total amount planned under legal title groups 3 Structural Funds and 4 Cohesion Fund of subtitle 'Subsequent return on EU subsidies' of title 7 of Chapter XLII is HUF 39,813.2 million.

Out of the budget subsidy total amounting to HUF 193,121.9 million specified for the EU Developments chapter by the Ministry of National Economy for 2012 the institutional budget is entitled to HUF 1,614.2 million, whereas the remaining HUF 191,507.7 million is distributed among the chapter-managed appropriations. At chapter level, at the outset of the planning process the amount included in the bill shows a deviation of HUF 5,723.9 million compared to the amount of the subsidy appropriation (HUF 198,845.8 million) proposed by the Ministry of National Economy. The reason for the change is that contrary to the stipulations of the Guidelines, the appropriation *'Support to supplements to own funds for EU development tenders of local governments and their partnerships'*planned at the EU Developments chapter was transferred in the bill to the centralised appropriations that can be utilised by local governments.

In our opinion, the total amount available for the chapter-managed appropriations of the EU Developments chapter for 2012 ensures the performance of the tasks only if the possibility set forth in the bill is utilised, i.e. the fulfilment of the appropriations may deviate from the appropriation without amendment, or if the passage between appropriations is ensured. Risks are posed by the possible loss of funds of the Electronic Administration Operational Programme (EAOP) priority 3; the problems related to attending to the ETC/IPA/ENPI national control activity on the appropriation *'Support to Intermediate Bodies'* and existing in the case of the appropriation *'Social Renewal Operational Programme – Labour Market Fund'* and the scheme SROP–4.2.1./B/TMS as well as the support to the construction of Metro Line 4 in Budapest. A further risk is carried by the fact that the Guidelines and the budget appropriation bill did not take into account the disbursements expected for the Cohesion Fund projects in the case of which the extension application that was submitted earlier by Hungary to the EU Commission and that is being evaluated may be approved by the EU Commission in 2012. Upon planning the EU appropriations, in order to avoid loss of funds, the National Development Agency took account of the n+2, n+3 rule. However, approaching

1 It also contains the funds taken over from the separated state funds.

the end of the 2007–2013 programming period, the support framework appropriated by the Ministry of National Economy and its further reduction pose an increasing risk upon the drawing of EU funds from the EU Commission.

In the chapter-level planning of revenues, the calculation table of the internal planning guidelines of the National Development Agency automatically calculated with a revenue-to-support ratio of 85–15%, and did not take into account the amount of own resources of central budgetary institutions that can be accounted for, in the case of the EDOP[1]/CHOP[2] JEREMIE[3] type financial assets the funds flowing back due to the irregularity, or the expenditures that cannot be accounted for because of elimination from the Action Plan, which burden the EU Developments chapter on the basis of the Government's decision, adding to the share of revenue and reducing the share of support. The above listed risks may be reduced by the fact that in the case of the ETC programmes the budget figure contains reserve funds, as for the EU fund the budget appropriation bill includes a 100% advance payment, which will decrease to 15% in 2012 pursuant to the decision by the Ministry of National Economy and the Ministry of National Development.

In the case of the Ministry of Rural Development chapter there is a difference between the budget figures in the budget appropriation bill and the ones planned by the chapter in terms of the top-up related to the direct agricultural subsidies and subsidies to producers provided to the account of the European Agricultural Guarantee Fund (EAGF) in the amount of HUF 1,281.7 million, which was added to the appropriations of the New Hungary Rural Development Programme (NHRDP).

Within the appropriation *'Current expenditures and income subsidies'* the Ministry of Rural Development planned HUF 38,000.0 million for the top-up, which is the maximum amount pursuant to Government Decision 1084/2011. (IV. 12.); the budget appropriation bill contains HUF 26,700.0 million for the appropriation. Pursuant to EU regulations, the planned amount allowed for top-up support shall be decreased year by year; the Ministry of National Economy met this requirement in the 2012 budget appropriation bill.

As a consequence of the sanctions applied by EU audits until the end of 2010, the amount to be repaid in 2012 and the subsequent years is expected to reach HUF 15.0–20.0 billion. Most of it is related to the SAPARD pre-accession assistance and the 2004–2006 EU programming period. Contrary to the HUF 10,910.1 million planned by the Ministry of Rural Development, the budget appropriation bill appropriated an expenditure and support amount of HUF 1,300.0 million for the settlement of the portion of the payables to the EU due in 2012 from the appropriation '*Exchange rate risk and other expenditures not reimbursed by the EU'*. Pursuant to the provisions of Article 13/C of the Act on Public Finances, the Ministry of Rural Development has to cover its payment obligations stemming from the irregularities revealed during the audits from its

[1] Economic Development Operational Programme

[2] Central Hungary Operational Programme

[3] Joint European Resources for Micro to Medium Enterprises

own budget. In the event that in 2012 the sum total of the payables that become due because of the sanctions related to the audits and the arising exchange rate loss exceed the sum total of the HUF 1,300.0 million subsidy appropriation and the realised exchange rate gain (if any), the difference burdens the central budget.

## Separated state funds and social security funds (the funds)

We gave an opinion on the appropriations of the funds on the basis of the budget appropriation bill and the documents received from the fund managers during the on-site audit. There are several differences between the appropriations in the bill and the budget figures indicated in the records at the fund managers; therefore, we compared the appropriations included in the bill and the ones recorded on site, and we quantified the differences.

The bill does not contain information on the expenditure items of the funds involving multi-year commitments; therefore, it does not comply with the provisions of Article 36(1)b) of the Act on Public Finances. It does not contain the detailed limitations on commitments required by Article 36/B(1) either, with the exception of the limitation regarding the subject year, stipulated in the case of the Research and Technology Innovation Fund in Article 15 of the provisions.

Pursuant to Article 86(8) of the Act on Public Finances, upon submitting the bill, the five-year forecast of the revenues and expenditures of the Pension Insurance Fund and the fifty-year forecast of the demographic processes and their effects have to be presented to the National Assembly for their information. This is not included in the bill.

Pursuant to Article 115 of the Act on Public Finances, upon the submittal of the budget, the balance sheets of the public finances have to contain the expected data for the planned year and the previous year as well as the actual figures for the year preceding the latter. The Guidelines did not specify any obligation regarding the above, and they are not contained in the budget appropriation bill either. The lack thereof hinders comparability between years.

### *Separated state funds*

Within the funds, as far as we know, six separated state funds will continue to operate in 2012 as well. These are: the Labour Market Fund, the Bethlen Gábor Fund, the Central Nuclear Financial Fund, the National Cultural Fund, the Wesselényi Miklós Compensation Fund for Flood and Inland Waters Protection, as well as the Research and Technology Innovation Fund.

Summarising the appropriations, total revenues of the separated state funds in 2012 will be HUF 416,152.4 million, of which subsidies will amount to HUF 79,559.2 million. The total expenditures thereof will reach HUF 416,152.4 million, with *'change in the sum total of deposits'* amounting to HUF 44,761.1 million. Excluding the budgetary subsidies to the separated state funds (HUF

79,559.2 million), the total closing balance of the separated state funds is HUF -34,798.1 million.

Compared to what was recorded during the on-site audit, the total expenditures and total revenues of two separated state funds (the Central Nuclear Financial Fund and the Wesselényi Miklós Compensation Fund for Flood and Inland Waters Protection) remained unchanged, the gross sum of two separated state funds increased (that of the Labour Market Fund by HUF 50,000.0 million and that of the National Cultural Fund by HUF 951.8 million), whereas the total expenditures and revenues of two separated state funds decreased (those of the Bethlen Gábor Fund by HUF 1,457.2 million and those of the Research and Technology Innovation Fund by HUF 15,908.4 million) according to the budget appropriation bill.

Compared to the state recorded on site, there was a change in the order of titles among the appropriations in the case of the Labour Market Fund. Pursuant to Article 14(3) of the budget appropriation bill, a new appropriation (*'Start Work Programme'*) was created. The Labour Market Fund provides financing for public employment programmes in a total amount of HUF 132,182.5 million, of which budgetary subsidy is HUF 50,000.0 million and own resources from the Fund are HUF 82,182.5 million. The objective, tools and regulatory background of the Start Work Programme are unknown; therefore, it is not possible to assess the feasibility of the appropriation.

In the case of the National Cultural Fund, as a result of the increase in the revenue stemming from 90% of the gambling tax on the 5/90 lottery, total revenues were higher by HUF 951.8 million (changing to HUF 10,116.0 million), whereas total expenditures grew by HUF 151.8 million (to HUF 7,714.5 million). Consequently, the amount of the change in the sum total of deposits also changed by HUF 800.0 million, growing to HUF 2,401.5 million from the previous HUF 1,601.5 million.

At the Bethlen Gábor Fund, compared to the HUF 13,030.0 million recorded during the on-site audit, the amount of other subsidies decreased by HUF 1,457.2 million to HUF 11,572.8 million. Accordingly, there will be changes on the expenditure side in the distribution of funds for individual tasks.

Compared to the planned HUF 23,146.5 million, budgetary subsidy to the Research and Technology Innovation Fund decreased by HUF 16,108.4 million (69.6%). Consequently, the fund manager is unable to provide funds for new applications, and is also unable to ensure complete coverage for its 2012 obligations (determinations). With the considerable decrease in the budgetary subsidy to the Research and Technology Innovation Fund, the 'guarantee rule' set forth in the Act on the Research and Technology Innovation Fund, according to which the state contributes to the resources of the Research and Technology Innovation Fund with an amount corresponding to the innovation contribution paid in, and then returns it to economic agents through applications, was not implemented.

## *Social security funds*

The budget appropriation bill continues to name two social security funds (Pension Insurance Fund and Health Insurance Fund), and contains significant changes in the case of both social security funds. The 2012 budget of the Pension Insurance Fund is considerably different in terms of its content as well, compared to both what was recorded during the on-site audit and to earlier years.

Total revenues of the social security funds in 2012 amount to HUF 4,518,147.5 million, of which HUF 18,024.2 million is subsidy; total expenditures amount to HUF 4,552.567.7 million, with a planned deficit of HUF 34,420.2 million. According to the budget appropriation bill, deficit was still not planned for the Pension Insurance Fund, but the planned deficit of the Health Insurance Fund is HUF 34,420.2 million.

The 2012 total expenditure and revenue of the Pension Insurance Fund (HUF 2,796,907.6 million) is 11.5% (HUF 363,507.4 million) below the amount indicated in the records.

In the budget of the Pension Insurance Fund, the appropriation of the retirement pension (HUF 2,125,800.0 million) also includes the retirement and disability pensions of the beneficiaries above the age limit.

Starting from 1 January 2012, the Pension Insurance Fund will not finance own-right pensions – early retirement pensions, service pensions and age exemption pensions – paid to those below the age limit of the retirement pension; these pensions appear among the expenditures of the newly created National Social Policy Fund under title 21 of the Ministry of National Resources chapter. The expenditure appropriation of the new Fund (which includes the legal titles of subsidies to families, provisions under the age limit, supplementary and additional income allowances and various compensations) is HUF 863,399.7 million. Its revenue appropriation amounts to HUF 17,714.0 million, which exclusively originates from the planned transfer of funds from the revenues of the Pension Insurance Fund. Details of government decisions regarding the new Fund are yet unknown.

The disability and accident disability pensions as well as the rehabilitation allowance appropriation also ceased to exist in the budget proposal of the Pension Insurance Fund. In the future, the disability and accident disability pensions under the age limit as well as the rehabilitation allowance will be financed from the Health Insurance Fund. The appropriate amount (HUF 206,045.5 million) will be transferred to the Health Insurance Fund by the Pension Insurance Fund from its contribution revenues.

A new appropriation in the budget of the Pension Insurance Fund is the 'service dependent pension' (HUF 60,698.4 million), which appropriation – according to the information from the fund manager – covers the source of preferential retirement of women after 40 years of service of specified content.

The most important change in the budget proposal of the Health Insurance Fund is that while in the earlier phase of planning a surplus of HUF 17,704.4

million was planned, the bill already indicates a deficit of HUF 34,420.2 million. The deterioration in the balance is attributable to the fact that other revenues only partially make up for the missing portion of the central budget subsidy, which was reduced in the meantime. A recurring problem concerning the Health Insurance Fund is that the revenues do not cover the expenditures. The sectoral (professional) statutes that substantiate the revenues and the reduction of expenditures are submitted to the National Assembly at a time when their budgetary effects cannot be assessed in the period of giving the opinion, and there are measures where there is no (adequate) data provision for the quantification of their effects.

Although the total revenues of the Health Insurance Fund increased significantly (by HUF 287,286.4 million) to HUF 1,721,239.9 million, this increase is attributable to the fact that the coverage of provisions related to disability (HUF 342,342.2 million) appeared in the budget proposal. In parallel with that, total expenditures also increased, which is entirely the result of the disbursement of disability provisions (HUF 284,352.2 million) and health damage allowances (HUF 57,990.0 million) from the Health Insurance Fund. The fulfilment of the planned expenditure side of HUF 1,755,660.1 million in the bill depends on the effectiveness of the medicine policy measures to be implemented within the framework of the Széll Kálmán Plan.

## The local government subsystem

In 2012, local governments – including minority local governments and multi-purpose micro-regional associations – will have GFS revenues of HUF 3,202.6 billion at their disposal.

Out of this amount, the fund provided by the central budget in Chapter IX 'Subsidies to local governments and locally utilised part of the personal income tax' amounts to HUF 1,140.6 billion, which is 100.7% of the 2011 adjusted base target figure (HUF 1,132.7 billion).

In terms of its content, the HUF 7.9 billion increase in central funds – compared to the adjusted base – is the balance of the following items of opposite signs.

Fund reducing items in a total amount of HUF 45.3 billion: the expenditure reduction of HUF 15.0 billion planned under the title '*reorganisation of mandatory local government tasks in line with economies of scale*' in the Convergence Programme of Hungary for 2011–2015 prepared on the basis of the Széll Kálmán Plan and HUF 30.3 billion related to the restructuring of social allowances paid out by local governments.

Fund increasing items in a total amount of HUF 53.2 billion: an increase of HUF 22.0 billion in duty revenues of county local governments calculated in line with the rules valid until now (own current revenues of local governments until now) as well as an increase of HUF 2.1 billion in the support to supplements to own funds for EU development tenders of local governments and their associations and an increase of HUF 29.1 billion in the support related to the restructuring of social allowances paid out by local governments.

Excluding the distorting effect of the personal income tax, subsidy and duty revenues of county local governments, Chapter IX shows a HUF 14.1 billion (1.3%) decline in funds.

The termination of subsidies due to the expenditure reduction set forth under the title *'reorganisation of mandatory local government tasks in line with economies of scale'* as well as the reduction of the subsidy and of the reserve are supported with a justification. The amendments to appropriations related to the change in the social supply system, especially in terms of social allowances in money, are supported by calculations as well.

In parallel with the basic elements of the regulation of local government funds remaining unchanged, the bill for 2012 contains changes concerning the regulation of funds of county local governments. From 1 January 2012, county local government institutions will be probably maintained by the state. Therefore, the county local governments were cancelled from the texts of the annexes that determine the conditions of use of budgetary subsidy; at the same time, the appropriations related to individual legal titles decreased, due to the expected reorganisation of county tasks. In compliance with these changes, in Chapter IX of Annex 1 that summarises the subsidies to local governments, the portion due to the counties appeared in a separate appropriation, collected from normative and other appropriations. The related duty revenue was also added to the appropriation.

In the fund regulation, for the sake of simplification, the normative personal income tax will be replaced by state subsidy next year, as it is already functioning in practice. Accordingly, from 2012 on, on the 'personal income tax branch' only the personal income tax remaining at local level – 8% of the personal income tax declared for the settlements in 2010 – will be due to the local governments. As a result of the change in the tax law and the crisis that was still felt in 2010, this fund shows a decrease of HUF 13.3 billion compared to the previous year, which is offset by the bill by increasing the normative state contribution to the operating, management, sports and cultural tasks of local governments with the same amount.

The sectoral distribution of the funds provided from Chapter IX 'Subsidies to local governments and locally utilised part of the personal income tax' was mainly modified as a result of the reallocation of appropriations due to county tasks; the extent of other internal reallocations is not significant.

According to the experience of previous years, many local governments did not meet their statutory obligations related to social benefits in connection with catering for children and the supply of schoolbooks. The budget appropriation bill already facilitates the observance of these obligations with the means of financial regulation as well by including the normative subsidies related to catering and schoolbook supply – subsidies without a specific purpose until now (Annex 3) – in the subsidies with a specified purpose (Annex 8) from next year on. According to the proposal, the support of public education IT tasks will also be included among normative subsidies with a specific purpose, thus creating a guarantee for the fulfilment of the obligations related to this important field.

When the SAO Opinion was compiled, the new pivotal bills fundamentally affecting Chapter IX 'Subsidies to local governments and locally utilised part of the personal income tax' of the 2012 budget appropriation bill and regulating the performance of public tasks as well as the amendments to the professional (sectoral) laws were unknown. Therefore, it was not possible to assess their harmony and the harmony of the appropriations. As in the previous years, the chapter justification of the budget appropriation bill has not been prepared yet; therefore, its content could not be utilised in the course of compiling the SAO Opinion.