ÁLLAMI
SZÁMVEVŐSZÉK

Summary

of the Audit on the Financial Management of the Budapest Public Transport Company (1202)

Objectives and scope of the audit

The objective of the audit was to evaluate, whether

1. the Budapest Municipality performed the public transport tasks of the capital city of Budapest effectively;
2. whether the regulation of the operation of the Budapest Public Transport Company (hereinafter: BKV) and its organisational and operational system ensured the performance of its professional tasks;
3. whether BKV managed the available assets regularly;
4. whether BKV managed effectively the risk factors emerging in connection with the solving of its debt financing and liquidity problems; whether it ensured the maintenance of operability.

According to the provisions of the Act on Local Governments, it is an obligatory task of the Budapest Municipality to ensure the public transport of the capital city. BKV is a business association established with the aim of performing public transport tasks and founded with an equity capital of HUF 127 billion. It is entirely owned by the Budapest Municipality. Tasks are performed on the basis of the service contract concluded on 30 April 2004 for a fixed term, i.e. for eight years. In 2010, 1.374 billion passengers were transported by the vehicles of BKV. According to the 2010 accounting balance sheet, the short and long-term credits totalled nearly HUF 64 billion. In the period 2003-2009, the loss of BKV varied between HUF 5.7 and 23.5 billion, while the 2010 balance sheet presented a profit of HUF 1.018 billion.

Main findings

1) The effectiveness of the performance of public transport tasks of the Budapest Municipality

The performance of public transport tasks of the Budapest Municipality was not effective. Budapest Municipality failed to request the committees empowered by ownership rights to report, and it did not ensure the resources for the fulfilment of public service obligations of public transport to the extent necessary. The Municipality fulfilled its audit obligations and took measures to utilise the audit findings only partly. Furthermore, the quality of public transport services was only partly adequate, as no measures were taken in order to eliminate the difference between the planned and actual quality, and the survey on passengers' satisfaction was not appropriate for specifying the expected quality. Task performance is not effective despite the fact that the Budapest Municipality had a transport policy strategy, which was in line with the Single Transport Development Strategy. The Service Contract entirely contained the obligation of the Municipality to perform its public transport tasks and it regulated the exercise of proprietary rights related to BKV. The Municipality observed the Service Contract – except for the reporting of the committees empowered by ownership rights –and it also ensured the observance thereof in the course of the decision-making procedures.

The General Assembly of the Budapest Municipality did not make a decision regarding the claim for compensation due to BKV in 2004, and the chief executive officer of BKV did not submit their compensation claim for the Budapest Municipality in the following years. Despite the stipulations of the Service Contract, BKV and the Budapest Municipality did not perform the yearly accounting of the public transport compensation for the years 2004-2010. The Budapest Municipality did not ensure the reimbursement of the reasonable costs not covered by revenues and arising from the operation included in the business plans of BKV, which was approved by the committees empowered by ownership rights. Moreover, the Municipality did not provide for the financing of the loss occurring as a result thereof. The former mayor, the town-clerk and the chairmen of the committees did not notify the General Assembly of the fact that the operation of BKV was not financed in compliance with the stipulations of the Service Contract.

Between 2002-2010, the Budapest Municipality transferred HUF 27.4 billion as subsidies for operational purposes and HUF 76.2 billion for financing the expenditures of tasks related to renovation and replacement – under the title 'compensation for amortisation' – with the obligation to allocate it into the capital reserves. Besides the above and the investment of Metro Line 4, it granted further development subsidies of HUF 96.1 billion (in total HUF 199.7 billion).

Between 2002-2010, the Hungarian State provided resources for operational purposes amounting to HUF 404.2 billion for BKV (it was twice the subsidy for operational purposes granted by the Budapest Municipality). Out of this, the following amounts were paid from the central budget: HUF 38.8 billion for the assumption of BKV's debt in 2002 and for the interests of the credits assumed, HUF 178.8 billion under the legal title 'centralised normative contribution' between 2004-2010, and HUF 158.4 billion under the legal title 'consumer price subsidy' between 2002-2010. Between 2007-2010 the Hungarian State granted non-repayable subsidies for operational purposes for BKV further three times in the amount of HUF 28.1 billion under special agreements. The Hungarian State did not impose any conditions for the debt assumption and the subsidies granted under special agreements.

2) Regulation of the operation of BKV

Besides the legal provisions and the Deed of Foundation, the regulation of the operation of BKV was stipulated by the Operational and Organisational Rules of BKV, the CEO's instructions, the professional and traffic instructions issued by the deputy CEOs and directors as well as other rules. Apart from some minor deficiencies, these documents were in compliance with the legal provisions. The regulation of the operation of BKV and its organisational and operational system ensured the performance of its professional tasks.

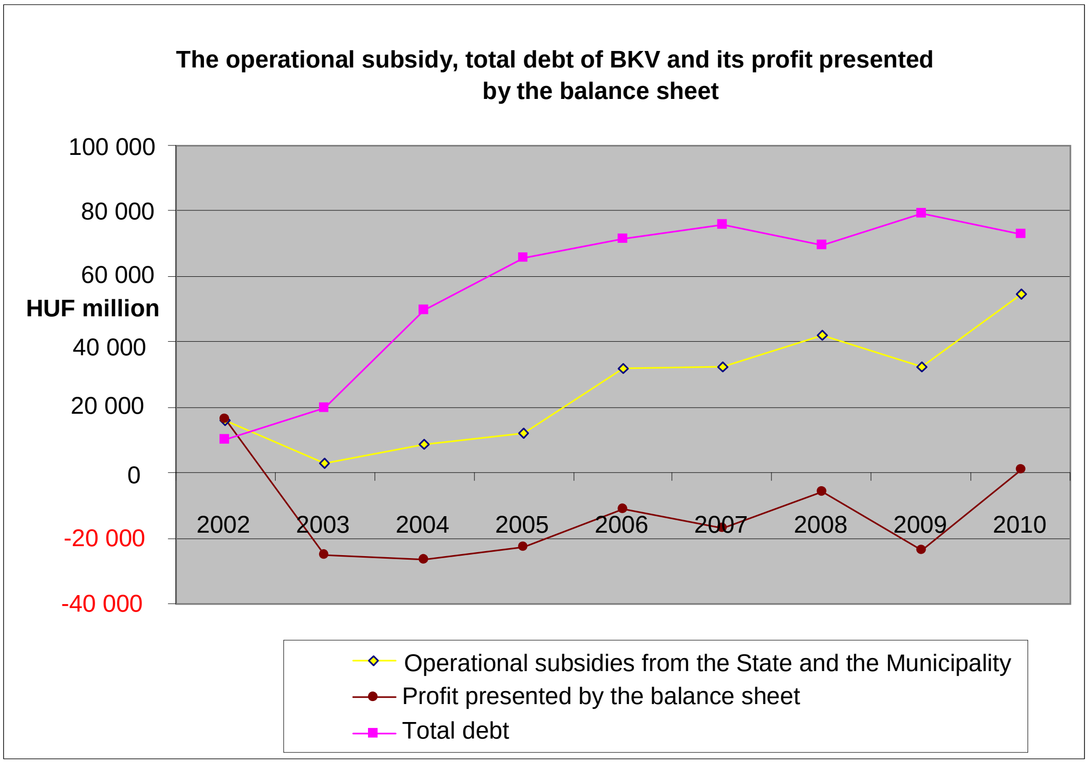
3) Regularity of the management of assets available for BKV

In 2003-2009, BKV continuously suffered losses, its revenues arising from the performance of public transport tasks of the capital city did not cover the expenditures. The reasonable costs not covered by revenues were not reimbursed by the Budapest Municipality in 2004-2010. In the business plans of BKV, the deficit of the financial management was presented every year, and the company planned to borrow credits in order to finance the expenditures not covered by revenues. The business plans were approved in all cases by the committees empowered with ownership rights by the Budapest Municipality. Following the debt assumption made by the Hungarian State in 2002, the total debt of BKV amounted to HUF 72.8 billion by the end of 2010. In 2002-2010, the interests paid by BKV amounted to HUF 41.4 billion, which could have been avoided by accounting for and paying the compensation specified in the Service Contract.

The average gross annual earnings of full-time employees of BKV exceeded the average gross earnings in the land passenger transport sector published by the

Hungarian Central Statistical Office by 16.9-22.2% in 2005-2010. The yearly payment of the additional earnings in the amount of HUF 4.3-6.7 billion – having regard to the loss-making financial management – imposed disproportionate burden, which was also increased by the wage and benefit system disadvantageous for BKV, undertaken in contracts concluded between 2005-2009 with employees in management positions. Between 2007-2010, BKV paid more than HUF 1.8 billion due to termination of employment for severance pay.

At BKV, personnel and material expenses increased by more than 73% and 60% from 2002 to 2010, respectively. The change in the subsidies provided to BKV by the State and the Municipality influenced the profit presented by the balance sheet significantly and the change in the total debt to a lesser degree.



The service of BKV, which is typically equipment-demanding, involves increasing maintenance and operational costs besides the deterioration of the technical condition. The maintenance of the equipments necessary to the operation was not ensured, from 2007 the value of the replacement of assets and renovations did not even reach the total amount of the accounted depreciation and the subsidies received.

The technical condition of the vehicle fleet is indicated by the fact that it exceeded in all vehicle categories the planned lifetime, and all the subsystems of the infrastructure reached the limit, after which any type of errors may occur any time. The consequences in the traffic are demonstrated the best by the number of cancellations of scheduled vehicles, which was two and a half times more in 2010 than in 2007, and it represents a traffic safety risk.

4) The effectiveness of solving the debt financing and liquidity problems of BKV and of managing the emerging risk factors

BKV did not manage effectively the risk factors emerging upon solving its debt financing and liquidity problems, as in the course of the preparation of its decisions on commitments generating debt, it presented only the risks of not taking up any credit, while it did not carry out a risk analysis regarding the consequences of the borrowing, and it did not reveal the external and internal risks jeopardizing the preservation of financial balance. Until the conclusion of the on-site audit (by the end of May 2011), BKV ensured the maintenance of operability. The company ensured financial balance and the stability of the financial management with its revenues from subsidies not planned, while it maintained solvency by renewing its credits and borrowing further credits. The return of development credits was not ensured. The commitments generating debt decreased only as a result of unplanned subsidies. The due repayment of debt burdens jeopardized the maintenance of solvency and operability, as financial balance was not ensured in the 2011 business plan, either. An essential requirement for the maintenance of financial balance is that the expenditures of BKV pay off in terms of revenues and the repayment of credits can be also ensured by means of revenues.

Main recommendations

We recommended the Mayor – among others – to modify the bonus tasks of the CEO and the fulfilment of the stipulations of the Service Contract. We recommended the town-clerk that the risk analysis substantiating the internal audit plans cover also BKV and that he take measures in order to examine the reason for the failure to carry out audits. We formulated recommendations for the CEO of BKV to take measures in order to submit to the Budapest Municipality the total of the calculated claim for compensation and the additional need for funding due on grounds of the bonus system, to review comprehensively and modify the incentive system of the intellectual staff, to prepare the regulation on the evaluation and management of financial risks, and to complete the business plans with debt repayment and interest payment data.