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SUMMARY

of the Audit on the Support to Business Associations in Which Public Higher Education Institutions Have an Interest and on the Utilisation of Their Profits (1290)

Objective and scope of the audit

The State Audit Office of Hungary completed the audit on the support provided to business associations in which public higher education institutions have an interest and on the utilisation of their profits regarding the years 2006-2010.

The objective of the audit was to assess how the support and profits related to shares held by public higher education institutions ('institutions') were utilised. We analysed the changes in the Act CXXXIX of 2005 on higher education regarding the acquisition of shares, including the objectives and substantiation of the acquisition of shares, the realisation of objectives, the functioning of shareholder controls as well as the contribution of shares to a more effective performance of institutional tasks, and in the case of companies in which institutions hold a majority share, the utilisation of supports received and profits earned. The audit covered the years 2006-2010.

Main findings

On 31 December 2010, out of 29 public higher education institutions, 23 held a total of 137 shares in business associations ('companies') of which 57 were 100% shares, 64 were minority interests and 16 were qualified majority shares. Indirect ownership through own companies occurred in 35 cases, of which 25 were minority interests. Companies in which institutions held a share in 2010 were all (except one) small and medium-sized enterprises, and 125 of them can be regarded as small and micro-enterprises. Seventy-three per cent of shares (one hundred) were acquired by institutions following the entry into force of the Act CXXXIX of 2005 on higher education (1 March 2006). The main reasons were the conditions of access to funds through applications as well as the liberalisation of rules related to the acquisition of shares.

In 2010, the share of institutions in the equity capital of companies amounting to a total of HUF 2,263.7 million was HUF 1,254.7 million. Equity capital of companies increased from HUF 3,572.0 million in 2006 to HUF 4,119.3 million in

2010, and so the shares of institutions also increased from HUF 1,938.8 million to HUF 3,007.9 million.

Companies in which institutions held a majority share acquired the right to use a total of HUF 8,909.2 million of grants in 2006-2010, of which the amount used was HUF 5,499.9 million. The majority, i.e. 94% of approved grants were obtained through applications for grants. In the audited period, the institutions provided non-repayable grants to their companies for a total of HUF 749.9 million.

With a view to facilitating convergence objectives for economic development through the cooperation of enterprises and knowledge centres, the Government supported the establishment of joint organisations with the participation of economic, education and local government bodies of regions. For implementation, it provided EU and national public funding. The opportunity was available for companies implementing projects, founded for that specific purpose to apply for grants. By directly using innovation contributions, these companies had access to resources ensuring their own funds, but from 2012 on, this was no longer possible.

The legal framework for the acquisition of shares by institutions was not stable; the main rules were modified seven times. Legislation granted more and more rights to institutions, which decreased the transparency and accountability of the utilisation of public funds without providing for appropriate further regulation and control over the expediency of decisions.

Among the institutions audited on-site, five had prepared internal regulations on the acquisition of shares. Out of 11 institutions, nine had no rules on the reporting, evaluation and monitoring of companies and two regulated them partially.

Sixty-eight per cent of proposals aimed at acquiring shares were supported by financial calculations and sound professional arguments. Sixty-six per cent of majority-owned companies had a business plan adopted by a shareholder's decision, which was the basis of the control exercised by and of the accounts rendered to the shareholder. Mid-term and yearly objectives allowing for measurement and assessment were lacking regarding professional results of 84.2% of companies, and financial results of 54.9% of companies; that is why the activities of such companies could not be evaluated in a quantified manner.

Since 1 January 2009, state-owned higher education institutions have been permitted to found a company on condition that they establish a compulsory reserve or risk fund to cover the company's potential losses against their own revenues, and to take part in any institution-owned company after making the required payment to the common risk coverage fund. Institutions (with six exceptions) did not establish any common risk coverage fund, or any own reserve or risk fund.

Out of 23 institutions holding shares, 13 did not control the companies and the way shareholders' rights were exercised at all, and the others did so once in every three years. The rule concerning the conflicts of interest of companies' executive officers was not observed in 29 cases at 14 institutions out of 23.

In the institutions, it was not precisely measured how the professional and economic activity of companies contributed to the task performance of institutions; necessary professional and other indicators and their target values were not determined. In the absence of these, it was not possible for the audit to quantify the contribution of companies to the performance of institutional tasks.

In the case of shares below 50%, institutions were provided limited opportunities to assert their rights as shareholders.

Shares did not generate any substantial direct profit to institutions; they only had a slight effect on improving the effectiveness of the financial management of the institutions in proportion to the shares acquired. The yield rate of funds invested by institutions in companies barely exceeded half of the central bank base rate in the audited period.

Apart from the dividend received of HUF 25.6 million, the institutions left the profit earned of HUF 2,586.2 million for the companies, which increased their fixed assets and also improved their liquidity position. In the years 2006-2010, companies in which institutions held a majority share acquired the right to use a total of HUF 8.9 billion of state aid, of which the amount utilised was HUF 5.5 billion. The on-site audit revealed that the grants obtained had been utilised in accordance with the contract.

The establishment of companies resulted in making use of additional R&D resources, in the development of direct relations with enterprises, in research and development cooperation as well as in acquiring special training markets, but no concrete objectives and expectations were defined for these purposes. Apart from lifting legislative constraints in fiscal management and the Government's intentions appearing in providing resources by way of grants, the institutions' acquisition of shares in companies did not make any substantiated contribution also demonstrable by financial calculations to the more effective performance of tasks than if such tasks had been performed within the institutions' own organisation. However, they offered an opportunity to supplement and make the remuneration of instructors, researchers, employees, doctoral candidates and students more competitive, and to provide appropriate practical training to students to carry out professional tasks and thus increase their chances to find a job. At the same time, the liberalised and frequently changing regulations as well as the deficiencies observed resulted in a higher risk as regards the use and transparency of public funds.

We recommended the Minister of Human Resources to take measures to ensure, in his proprietary and supervisory capacity, that the state-owned higher education institutions review their shares by making financial calculations, then review such shares himself based on the said calculations, and, whenever appropriate, to liquidate such shares, in particular those below 50%. For the remaining companies, we recommended him to take measures to ensure that indicators to measure the performance of professional tasks and economic effectiveness are developed. Furthermore, we recommended that a supervisory and proprietary audit be conducted to check whether irregularities have been eliminated.