



Summary
**of the Audit on the Operation of Internal Controls Established in the
Financial Management of Budapest Municipality (1046)**

Objective and scope of the audit

In the framework of the audit on the financial management system of the Municipality of Budapest scheduled for several years, in 2010 the State Audit Office of Hungary (SAO) audited the operation of internal controls established in the financial management between 2009 and the first half of 2010, as well as the utilisation of the findings and recommendations of former SAO audits and the measures taken in order to implement these recommendations.

On 1 January 2010 the number of permanent residents in the capital city of Budapest was 1,721,556. Fifteen standing committees assisted the work of the 67-member Municipal Assembly. In 2009, its 213 budgetary institutions and 42 economic enterprises of majority ownership participated in the performance of the tasks of the Municipality. According to the accounting balance, at the end of 2009 the Municipality had assets worth HUF 2,203,286 million.

The audit objective was to evaluate, whether the internal controls had been established and operated in consideration of internal and external circumstances at the Municipality, in terms of budgetary management and internal audit; furthermore, whether previous findings and recommendations concerning regularity and expediency made by SAO had been appropriately utilised.

Main findings of the audit

The deficiencies in the regulation of the tasks related to financial management and financial management control represented medium risk in the appropriate and regular implementation of the tasks at the Municipality, as the Operational and Organisational Rules did not include either the name and organisational structure of the economic enterprise or the specification of the business executive. In the audit trail of organisational units no reference was made to which internal regulations contained functions and tasks, and control elements were not specified, either. No procedural rules regarding risk management and irregularity procedures were available at the Mayor's Office. Upon the effectuation of budgetary expenditures the adequacy of internal controls playing a key role in the process of budgetary management (attestation of professional performance, counter-signature of money orders) was weak, since before effecting payments on

a contractual basis the persons appointed to attest professional performance did not perform their control tasks stipulated by law, related to the eligibility and numerical correctness of disbursements and the fulfilment of assignments specified in the contracts. Moreover, the counter-signers of money orders did not make sure that professional performance had been attested and that those attesting performance had been appointed by the County Clerk. We attributed liability to five persons attesting professional performance as in case of disbursements related to contracts of agency involving intellectual activity they attested professional performance in spite of the fact that no certificates or documents justifying the fulfilment of tasks by those entrusted were made available; or the documents enclosed did not credibly confirm that the tasks had been performed in compliance with the subject matter of the contract. Because of the deficiencies revealed, the State Audit Office of Hungary reported to the prosecuting authorities and initiated criminal proceedings.

The organisational set-up and the regulation of the **internal audit** function represented medium risk in terms of the appropriate and regular performance of internal audit tasks, as the functional independence of internal auditors was not ensured, the number of persons carrying out internal audit tasks was not specified on the basis of a capacity assessment and the strategic audit plan was not justified by risk analysis. The adequacy of the operation of the internal controls established was weak, since the functional independence of internal auditors was not ensured in the course of the performance of internal audits. Furthermore, the internal audit department did not plan and carry out audits in several fields considered as high risk – e.g. the budgeting process and, within that, the planning of personal expenses and the utilisation of budget appropriations – at the different organisational units of the Mayor's Office. Consequently, they did not reveal that in case of disbursements effected in the course of the utilisation of budget appropriations the key internal controls, the attestation of professional performance and the counter-signature of money orders were carried out inappropriately. Between 2009 and the first half of 2010 nearly one third of the audits scheduled in the audit plans were not performed in due time at the Mayor's Office.

The SAO audited the Municipality's activity to set the amount of fees chargeable for official proceedings in 2008, and their preparedness for claiming and utilising EU funds in 2009. In the course of the 2009 audit a follow-up audit was carried out in relation to the utilisation of previous recommendations made during the 2005 audit on the execution of the budget and four further audits performed between 2006-2008. Out of the recommendations of the audits carried out by SAO between 2005-2010 34% were utilised, 11% were partly utilised, while 55% were neglected. From the recommendations concerning the regulation of the

administrative prices of district heating, liquid waste treatment and funerary services, the Mayor and the County Clerk utilised those related to the completion of regulatory and accounting criteria for prime cost calculation and the modification thereof. Out of the recommendations concerning the specification of certain administrative prices, 68% of the expediency-related recommendations aiming at the substantiation of the proposed prices of public utility companies and at the promotion of their operational efficiency were not utilised, including the recommendation formulated in relation to the Hálózat Alapítvány ('Network' Foundation for Budapest Fee Payers and Defaulting Payers), proposing the modification of the subsidy scheme set up for those in utility fee arrears. The Mayor and the County Clerk took the necessary measures in order to ensure that the draft budget decree separately contains the revenues and expenditures of programmes and projects implemented by means of EU funds. In relation to EU tenders the County Clerk appointed the person responsible for the coordination of applications on the Municipality's level and for keeping record of tender applications. The County Clerk took measures in response to the recommendations of the audit report on the utilisation of financial resources spent on the parliamentary, municipal and ethnic minority elections in 2006, while the Mayor made provisions in relation to the recommendations formulated in the audit reports on the utilisation of funds appropriated for nursing by hospitals and residential social institutions of local governments and that on the utilisation of resources spent for the establishment and development of emergency medical services.

Recommendations

Apart from the findings of the on-site audit – due to the deficiencies and negligence revealed in the course of the payments of commission fees resulting from contracts of agency – we recommended the Municipal Assembly to get it reviewed, under what circumstances the entrust contracts had been concluded, whether they had been legitimate and whether the persons mandated or appointed for control tasks had performed their control duties stipulated by law regarding the conclusion of contracts and the effectuation of payments between 2006-2010. Moreover, we recommended the Municipal Assembly to initiate disciplinary proceedings against the civil servants liable for negligence, if necessary. One of the disciplinary proceedings was started upon the initiation of SAO. We recommended the County Clerk to prepare the Operational and Organisational Rules of the Mayor's Office, the internal operational rules of the organisational units and the audit trails thereof; besides, we recommended taking measures to apply internal controls in the course of attesting professional performance and counter-signing the money orders, in order to prevent, detect and correct operational errors. In addition, we recommended the Mayor and the

County Clerk to arrange for the implementation of recommendations not yet accomplished, concerning regularity and expediency, made in the course of previous SAO audits. Also, we recommended the Mayor to inform the Municipal Assembly about the audit findings and to have an action plan prepared in order to accomplish them.