



Day of the meeting	Agenda item	Speaker
26 October 2011	Introductory speech of the President of the State Audit Office of Hungary to the Budget Bill of the Republic of Hungary for 2012 as well as the relevant SAO opinion – T/4365, T/4365/3	László Domokos, President

LÁSZLÓ DOMOKOS, President of the State Audit Office of Hungary:

Thank you for the floor. Honourable Mr. Speaker, Honourable Mr. Prime Minister, Honourable Mr. Minister, Honourable Members of Parliament, Ladies and Gentlemen,

Barely more than a month ago I was standing at this same lectern. At that time I could say that in spite of the difficulties the 2010 budget was under control. Although serious interventions to the tune of hundreds of billions of forints became necessary during the year, overall, the current budget deficit did not spiral out of control. I am going to speak about the budget again, but this time looking ahead and not back. I do trust that this contribution of mine and the work of the SAO will allow me to stand in front of you as relieved on the occasion of the debate of the 2012 final accounts as I was on 20 September 2011. It means that Hungary will be able to hold its own even in a year that is bound to be difficult and that its public finances will be in order.

In compliance with its statutory obligation, the State Audit Office of Hungary prepared and forwarded its Opinion on the 2012 budget appropriation bill to the National Assembly; the Opinion was then discussed by the committees of the National Assembly. First of all, please allow me to make some comments that may seem technical in nature, but are also important in terms of their content. Then I am going to elaborate on our most important findings and, following the completion of our Opinion, on the progress achieved on the basis of our comments.

I would like to emphasise that although I handed over our Opinion to the

Deputy Speaker of the National Assembly in the middle of October, this document reflected the state of affairs as of the end of September. Planning is a process that, of course, does not stop on 30 September. However, the SAO has to draw a line somewhere and conclude the audit so that its opinion can actually be utilised in legislation. All this implies that the critiques expressed by the SAO become irrelevant from one week to the next, or even from one day to the next. Therefore, it may be easy to find conclusions in the Opinion of the SAO that were valid at the end of September, but are now outdated - fortunately.

I was glad to see that the Opinion of the State Audit Office of Hungary had become a kind of common starting point in the debate about the budget. Our comments were quoted in professional circles, in the media and on both sides of the political spectrum. This shows that the SAO presented a credible and useful document to the Members of Parliament on 14 October and that on the basis of its conclusions the quality of the draft budget has already improved considerably. This also entails serious responsibility for the State Audit Office of Hungary. Bearing in mind, I am delivering my speech to you.

The Opinion of the State Audit Office of Hungary is not a polemical essay, not even a SAO report. As an advisor to the National Assembly, the SAO gives an opinion on a draft, which, of course, may and does change until it is ultimately adopted. To a certain extent, the objective of our comments is to help improve the quality of the proposal until the final vote is held. Accordingly, our Opinion serves as a kind of guidance for the Members of Parliament going into the parliamentary debate and a call for the Government to rectify the deficiencies. The work of the SAO aims to help the National Assembly pass the best, most substantiated and well-founded budget. This is facilitated by our opinion on the budget.

One of the most immediately striking features of the SAO Opinion on the draft budget for 2012 is that it is half the length of similar documents of previous years. Although our Opinion is shorter, it also contains more gravitas. The underlying reason is that this year we set the aim of making our Opinion live up to its name. Earlier, it also included many statements taken from the budget to which no comment was made. In this Opinion, however, we only write about items and trends that we are able to classify one way or another. This serves the purpose of making the work of the SAO as simple and efficient to utilise as possible, so that the SAO may also set a good example in terms of transparency, clarity and intelligibility expected of the whole administration of justice concerning public finances. The draft budget and the SAO Opinion together constitute a whole; therefore it is worth studying and useful to study these two documents together.

It is especially important to see what exactly the SAO Opinion is about and

what issues we have not dealt with. We wanted to know whether the relevant provisions of law and planning obligations were complied with in the course of preparing the budget appropriation bill, and whether the fundamental planning documents had been prepared. Are the appropriations feasible and realistic? And are the basic requirements of transparency and accountability met? We have verified legal compliance and numerical substantiation, but we have not taken any decision on the feasibility of the draft as a whole, as this is the task of the Fiscal Council and the National Assembly, not of the SAO.

Honourable National Assembly,

In the light of the critiques made it has to be emphasised that upon forming its opinion the State Audit Office of Hungary did not deal with macroeconomic issues, as it was not the task of the SAO. Based on the decision of the Fiscal Council, we assumed that the forecast of the Government was realistic and that the macroeconomic path was sustainable.

Nevertheless, please let me briefly outline the macroeconomic conditions under which the draft budget for 2012 was prepared. This is important because the rapidly changing economic environment had an impact on our Opinion and its often critical comments.

For years, the SAO has been dissatisfied with the planning of the budget, its numerical substantiation and the accessibility of the related calculations, as this is the case also this year. However, this year's planning work was rendered very difficult by the fact that the macroeconomic circumstances of the 2012 budget had fundamentally changed by the middle of the summer. It became obvious that the external conditions for economic growth of approximately 3% were not in place. Suffice it to say that Hungarian exports had increased by nearly 20% at the beginning of the year, but by the middle of the year the growth rate fell to 3.1%. In this situation it would have been a mistake if the Government had insisted on its original conceptions and compiled an unfounded budget. Making the right decision, however, it insisted only on one goal: to meet the deficit target. To this end, it had to introduce new measures, and rather quickly to boot. Due to the time pressure, when our Opinion was being provided on the budget appropriation bill, i.e. in September, these measures were not yet elaborated in adequate detail. This is what the State Audit Office of Hungary primarily objected to in its Opinion, i.e. the lack of detailed elaboration; this was the target of most of our critiques.

Ladies and Gentlemen,

A chronic problem that has existed for years is that every now and again the budget spirals out of control but needs to be corrected almost every year. All this is very closely linked to the crisis situation the country is in; therefore, this situation must be changed.

The adjustment of the budget becomes – at least partially – necessary every year because the planning process is inadequate. There is a lack of basic planning documents, and bills necessary for the substantiation of appropriations as well as the impacts of expenditures on subsequent years, while detailed background calculations are missing. The annual amount of funds spent on individual tasks often cannot be established, and – due to the lack of performance indicators – it cannot be ascertained either, in what way and how effectively expenditures are utilised.

The State Audit Office of Hungary has already called attention to these anomalies on several occasions, but we are once again compelled to warn that this cannot go on like this. Planning of adequate quality is a national interest; without it there is no traceable, transparent and predictable state operation, which, in turn, is the fundamental condition of public confidence in the state.

It is a sign of planning problems that the ministries did not comply with the provisions of the ministry responsible for planning. Namely, the Guidelines of the Ministry of National Economy prescribed the specification of resources necessary to perform state tasks; however, the ministries continued with baseline planning. Meanwhile, the Guidelines did not provide clear guidance concerning the planning of staff headcount, personal allowances and the appropriations for accumulation purposes; consequently, the elaboration of the budget proposals of chapters was not standardised.

Providing an opinion on the 2012 draft budget was characterised by a peculiar duality. It was a positive change compared to the 2011 budget that the portion of the central budget of which we could form an opinion has increased. This was down to the fact that we had prepared estimates using previous years' trends, audit experience as well as available information and other data sources, on the basis of which a more accurate opinion could be given on the feasibility of appropriations.

At the same time, the circumstance that – compared to previous years – the appropriations had not been better substantiated, documented or supported by calculations negatively impacted our effectiveness. The main underlying reason was that certain government decisions had not been taken until 30 September, although it is a fact that the situation has steadily been improving since then. It can be considered a step back compared to 2011 that the bill does not contain any provisions regarding the requirements and

indicators to be specified. The justification of the bill does not contain any information or directions in connection with these requirements. Thus the Government has not complied with the provisions of the Act on Cost-efficient State Management and Fiscal Responsibility. It says a lot that at the end of September in the case of the overwhelming majority (98.6%) of tax revenues no background calculations by the government were available; consequently, we were able to evaluate these items only on the basis of our own estimates.

It represents an acknowledgement and utilisation of the SAO's work that some of the deficiencies indicated in our Opinion have already been remedied by the Government or that the Government has taken steps in order to prevent them. For example, the fact that the volumes presenting the chapters in detail contain additional information compared to the bill submitted on 30 September. They contain, inter alia, expected performance data for 2011 and target figures valid until 2015, which are indispensable for judging the figures of the draft.

Honourable National Assembly,

Now please allow me to elaborate on our most important findings. The objective of our work is to improve the draft budget. Accordingly, in connection with our comments I will also indicate what progress has taken place since the submittal of the SAO Opinion on 14 October, i.e. in barely 7 working days.

It is a clearly favourable development that the draft contains several elements that improve transparency. For example, expenditures are planned where spending actually takes place. Although this may seem to be an elementary expectation, in a complex fiscal system it is apparently and regrettably still not evident.

It improves transparency and is a first step in the right direction that the profile of the Pension Insurance Fund is being significantly streamlined. The goal is to pay only old-age pensions from the Fund in the future, without using funds originating from anywhere else. The year 2012 will be a significant step forward in this respect. Namely, the provisions for those who have not yet reached the age-limit of the old-age pension will be financed by the Health Insurance Fund and the National Social Policy Fund, which is to be newly established, and not by the Pension Insurance Fund. As a result of the changes, the budgetary funding needs of the Pension Insurance Fund will radically decline. In 2010 it required budgetary subsidy in the amount of HUF 310.3 billion; in 2012 it will need a mere HUF 48 billion.

We also considered the steps taken in order to restore the balance of the Health Insurance Fund as steps forward. The contribution increase that adds

to the revenues of the Fund and the introduction of two new tax types (accident tax and public health product tax) allow a reduction of subsidies to the Fund from the central budget. At the end of September it was still a serious source of uncertainty that most of the statutory proposals substantiating the revenues of the Fund were not yet known. Consequently, it is especially favourable that the proposed legislation on the public health product tax and the accident tax has already been submitted to the National Assembly, i.e. the Government in the meantime has made up for this deficiency.

It is a forward-thinking innovation that revenues from fines will also be centralised. This is important because institutions cannot finance their operation from fines, thus no implication can be made that fines are imposed in order to be able to pay wages. The separation of operation from fining may strengthen citizens' confidence in the state. The new system will not make authorities interested in collecting as high revenues from fines as possible, thus fines will be able to fulfil their original function: to serve as guarantees of legal compliance and ensure that those who do not comply with the rules will shoulder the resulting burden. It is also an important aspect that, due to their ad hoc character, revenues from fines cannot be planned precisely, whereas approved funding is a more certain source for institutions. Accordingly, the operation of the state will be more stable and more balanced.

A favourable change compared to recent years is that as soon as 30 September the proportion of tax revenues of which we could give an opinion increased to 73%. This ratio was 66.5% in 2011, and only 4% in 2010. It is gratifying that the situation has improved further in the short period of time that has elapsed since our Opinion was completed, as the Government has prepared and submitted several provisions of law that the SAO previously called for. As parts of the tax package, the Government submitted the draft of the new provisions of law concerning the vehicle tax and the company car tax. In the case of the latter, the Government expects revenues of HUF 46 billion, which would exceed the revenues expected for 2011 by 76.9%; without knowing the act, the SAO was not able to judge how realistic this figure was. In the meantime, details of the amendments to the acts on the VAT, duties and the personal income tax have also become known, which is also a significant step forward in terms of transparency and statutory substantiation.

The SAO deemed 63.6% of the 2012 tax revenues feasible; this ratio in the 2011 budget was 45.7%, which means that in this respect there has been a noticeable improvement in planning. We considered 6.8% of the tax revenues as high-risk, which means a slight increase compared to the Opinion one year ago, whereas the proportion of medium-risk tax revenues declined. If

domestic macroeconomic developments are worse than expected due to the external economic environment, it poses a risk from the aspect of the feasibility of several tax revenue appropriations, especially that of the VAT. It is justified to emphasise the VAT because this is the largest tax item, representing nearly HUF 2,700 billion; therefore, even a relatively small underperformance may strike a blow to the budget.

The daily life and quality of life of the local population is especially affected by the financial management of local governments; therefore, these budget items are of key importance. Earlier, several local governments did not meet their social obligations related to catering for children and the supply of schoolbooks, so it is a step forward that these items have been classified among the subsidies with a specific purpose, instead of the subsidies without a specific purpose. According to the proposal, the support of public education IT tasks will also be included among the subsidies with a specific purpose, thus creating a guarantee for the performance of the obligations related to this important field.

Meanwhile, considering the uncertainties of the external economic environment, it is very forward-thinking that by way of prudence the Government included a higher amount of reserve (HUF 403 billion) in next year's budget than in previous years. A new type of reserve in the central budget is the Country Protection Fund with its appropriation of HUF 150 billion; the provisions of law serving as a basis for its regulation were not yet known in the period the opinion on the budget was being prepared. The possibility of planning general reserves for chapters was not contained in the Guidelines of the Ministry of National Economy. Nevertheless, in the Ministry of Public Administration and Justice, Ministry of Rural Development, Ministry of National Economy and Ministry of National Development chapters the bill contains general reserves for chapters in a total amount of HUF 940.4 million.

It is also a favourable change that upon the debate on the SAO Opinion the Committee on Audit Office and Budget approved the submittal of an amending proposal that is a considerable step forward in meeting the deficit target. According to the proposal of the Committee, it would not be allowed to use the funds of the interest reserve and the Country Protection Fund in the first nine months of the year, and even after that only if it does not jeopardise the deficit target of 2.5%. This clearly reduces the chance of the budget deficit spiralling out of control, and is a good demonstration of the commitment to meet the deficit target.

It is regrettable, however, that from several aspects the regulation of reserve utilisation is not in line with the principle of strict and efficient use of public funds. The experience of past years also shows that the spending of reserves did not ultimately serve their original purpose. Instead, they funded tasks that could be planned in advance. The freezings during the year resulting

from the ill-advised planning of reserves dramatically jeopardised the operation of budgetary institutions and the meeting of their payment obligations. At the same time, the late lifting of the freezes resulted in a massive increase in next year's obligations. Considering the adverse effects, this practice must be put to an end, and the spending of reserves needs to be regulated once and for all.

Honourable Members of Parliament,

Upon the evaluation of the draft budget for 2012, i.e. on 23 September, following the indication by Central Bank Governor András Simor, the Fiscal Council highlighted the fact that the expected loss of the National Bank of Hungary (NBH) was not included in the proposal as a serious risk. At the time, i.e. one month ago, referring to the NBH's budgetary evaluation, the Governor of the Central Bank still indicated a reimbursement obligation of HUF 95 billion. Apparently, however, the financial situation and prospects of the NBH have improved considerably during the recent weeks. At the meeting of the Committee on Audit Office and Budget of the National Assembly on 18 October, the Governor of the Central Bank said that according to the latest calculation of the Central Bank this amount is much smaller than originally calculated: a mere HUF 12 billion.

The State Audit Office of Hungary was glad to learn that the preliminary calculations of the Central Bank proved to be exaggerated and that the amount indicated in the first estimate of the NBH shrank to one-eighth. Although in terms of credibility it is not optimal, the practice of the NBH is still to be commended. Namely, it is appropriate if an institution that uses budgetary funds for its financial management carries out corrective actions when it realises that it failed to take account of important aspects during planning. Accordingly, the expected loss declined, but the position of the SAO has remained unchanged, i.e. funds, of course, need to be provided in the budget for the reimbursement obligation.

Honourable Mr. Speaker, Honourable Members of Parliament,

The package of measures consisting of seven points included in the Széll Kálmán Plan planned on a saving of HUF 550 billion for 2012. Due to lack of documentation, the State Audit Office of Hungary was unable to judge the substantiation of this amount. We were able to give partial opinions regarding the reorganisation of higher education, the restructuring of public health, the development of the public service career model, the transformation of public transport as well as regarding government and local government financing and revenues. Of the HUF 550 billion, these items cover a mere HUF 162 billion of planned savings. It means that for the time being savings amounting to HUF 388 billion are not yet underpinned by law;

therefore, the State Audit Office of Hungary was not able to give an opinion on them.

In the case of the so-called uncapped appropriations, which can be exceeded without an amendment, the ministries planned HUF 8,177.6 billion, which equals the amount for the previous year. Due to its magnitude, it poses a certain risk in terms of meeting the deficit target anyway. The lack of statutory control does not mean that the expenditure appropriations cannot be met or will necessarily be exceeded. In this case we called attention that the Government has to monitor these items on an ongoing basis and develop a monitoring system that immediately indicates when there is a chance of exceeding expenditures.

It is a risk factor if during the fiscal year changes that did not appear during the planning and substantiation of the budgetary appropriations are made with regard to the large distribution and provision systems. In the case of the 2012 budget a change like that is the transformation of the scope of duties of the county local government system, which has been already “foreshadowed” but is not yet known in detail. The SAO established that as neither the draft of the new cardinal laws that also concern local governments and regulate the discharge of public duties, nor the amendments to sectoral laws have been prepared, the harmony between these provisions of law and the appropriations could not be judged.

Compared to last year, the scope and magnitude of direct expenditure appropriations on which we could not give an opinion due to lack of supporting documents have increased. Until the closure of the on-site audit, the ratio of these draft appropriations to the total expenditures of the central budget increased from the previous year’s 0.1% to 13%. This is a very remarkable increase, which indicates an alarming process. For example, more than 40% of the expenditures related to state assets was not substantiated or could not be assessed, which is an extremely high value.

Honourable National Assembly,

It is risky in itself that the appropriation of the EU developments chapter provides the necessary funds for the discharge of tasks only if the opportunities provided by statutory regulations are utilised to the fullest. It means that the allocation available can be exceeded without amendment, and the funds can be reallocated among appropriations. A further risk is posed by possible delays in project implementation and the subsidies for the own resources to be provided for central budgetary institutions.

The Government and the country have to brace themselves for the repayment of EU funds to the tune of HUF 10 billion in the form of sanctions. It concerns

mainly inflows of funds to agriculture that were received by the Hungarian agricultural sector prior to 2006. The draft budget does not take account of this partly foreseeable item, which clearly poses a risk in terms of meeting the deficit target.

In the period between 2007 and 2013 the precondition of drawing EU funds is that until 2015 the Hungarian budget should provide the necessary co-financing to utilise the total amount. The National Development Agency set out from the utilisation of the total allocation until 2015, but the amount of the subsidy appropriated by the Ministry of National Economy and its further reduction carry an increasing risk as the end of the period approaches. It is a problem that the transparency of the payments of the national top-up subsidy related to the Single Area Payment Scheme is not ensured by the bill, as they do not appear in a separate line in the act.

Of the separated funds, the revenue and expenditure appropriations of the Research and Technology Innovation Fund ended up more than 30% lower than the originally planned amount. Due to the substantial decline in the fiscal subsidy, the opinion of the SAO is that the Fund will be unable to fully cover its obligations in 2012, which questions the feasibility of the statutory objectives.

An overview of the risk factors related to the financing of public debt also constitutes a part of the Opinion. It is risky that the draft does not contain a financing plan, while investor sentiment, which changes almost on a daily basis, the market yield level of government securities, also prone to considerable fluctuations, and the volatile forint exchange rate, which often changes due to events outside of Hungary, represent serious risk factors. The unfavourable effects may be mitigated by the HUF 50 billion interest risk reserve, and it is also considered positive that in the case the draft budget is implemented the reduction of the gross debt of the central budget is ensured.

Honourable Mr. Speaker, Honourable Members of Parliament,

The objective of the State Audit Office of Hungary is to facilitate the sustainability of the budget as well as the effective, regular and efficient spending of public funds. The starting point of the SAO opinion on the budget appropriation bill is that the planning and adoption of the budget is not merely an annually recurring, mandatory technical task. The quality of the document adopted is a constitutional issue to which adequate guarantees have to be attached in terms of safety, responsibility and obligations. This serves stability and matches the interests of the country and the constituents.

A budget adopted on the basis of a clear definition of tasks, transparent planning, as well as requirements concerning goals and performance makes

performance easier to measure. Thus the possibilities of accountability, analysis and evaluation, correction and, last but not least, of auditing may improve.

Honourable Mr. Speaker, Mr. Minister, Honourable Members of Parliament,

Finally, please let me wish you useful work from the aspect of Hungary and Hungarian society. Be strict, put Hungarian public finances in order, as there is more need for it in this chaotic, crisis-ridden world than ever.

Order creates value – this was my thought upon starting my work as the President of the State Audit Office of Hungary, and I still consider order as the most important value. I close my thoughts with István Széchenyi's words of warning: *'If we are not strict with ourselves in trifling matters, we cannot be strict in important matters, even if we want to'*.

Thank you for your attention.