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Compliance Audit Issues of State-owned Business Associations

SUMMARY: State-owned business associations have a peculiar role in the system of governmental exercising of (public) functions. They have to comply with the legislative regulations, the objectives set for the business association concerned already upon the formation, the regulations set on owner or – as the case may be – government level, the policy (sector)-level regulations and standards, the expectations of the parties using the public service, the short, medium and long-term strategic objectives the organisation set for itself, the corporate values set for the managers and the employees. Our study is aimed at answering the question whether there are any guidelines for the state-owned business associations, or how the compliance of the state-owned business associations could be audited at all. As a result of our research we found that the Hungarian regulation disposes of the topic of compliance only partially, and there is uniform normative regulation hiatus in respect of the state-owned business associations. Based on the review of the regulation applicable to the state administration entities, to the insurance and credit institution sector we drew up those regulatory topics which we propose for consideration in order to establish the compliance audit foundations of state owned business associations.

KEYWORDS: state-owned business association, internal control system, compliance, integrity, compliance audit

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State-owned business associations are unique entities in the system of state functions: they are operated using public funds, they perform public function mainly, in most cases their activity is very costly and usually are not profitable directly. However, state-owned business association cannot fall out of the scope of the new type of audit policy of the state either, moreover, they are subject to even stricter rules. Our hypothesis is that in case

of state-owned business associations control functions which belong to the broader concept of compliance audit shall be established in addition to the traditional public funds and owner's audit.

Firstly, our study shows how the scope of state audit mechanisms has developed regarding state-owned business associations since 2010. Afterwards, we will examine which background compliance audit has in Hungary, and how the results thereof can be implemented in the current state-owned corporate system. Finally, regulatory recommendations will be

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presented based on our own system of criteria, highlighting that the synergic features of the control mechanisms fragmented above the state-owned business associations shall be reinterpreted.

THE CHARACTERISTIC OF STATE-OWNED BUSINESS ASSOCIATIONS - PREMISE

The system of Hungarian state-owned business associations shows a very heterogeneous picture. As opposed to the acquisitions of the private sector, the state founds business associations for business considerations, or acquires company participation for investment purposes or in order to gain profits very rarely. Such companies are founded more if a function to be performed by the stated can be realised more efficiently through a budgetary institution owned by the state than within the frameworks of the budgetary institution. In case of such company formations the measures necessary in the interest of the public good - such as various national strategy, security of supply or security of continuous public utility supply, or national economy-level security policy aspects - are relevant. Consequently, there is only an insignificant number of state-owned business associations which are of for-profit character, as well as there is a wide range of so-called dormant companies, which do not pursue any actual activity, but which fell under the scope of state-owned business associations typically through inheritance. The majority of these dormant companies are undergoing strike-off, winding-up and compulsory liquidation procedure. The rate of the companies is rather significant with regard to the scope of companies in the portfolio of Hungarian National Asset Management Inc. (hereinafter referred to as HNAM Inc.), more than forty percent (see *Table 1*).¹

As a general rule, HNAM Inc. attempts to sell the unnecessary company participations - i.e. which are no longer necessary for performing the public function - through electronic auction. According to the website of HNAM Inc., only half of the participations of nearly 80 companies put up for auction during the Summer of 2018 could be sold during the first bidding.² A sale is made more difficult by the heterogeneous character, ability for corporate operation and value of the companies,³ since these are often companies which had not been in operation for several years. It is also worth to mention that these data do not show the entire state-owned company portfolio, since the number of operational business association (company participations) is also increased by companies where HNAM Inc. is not the one exercising the proprietary rights (not even indirectly⁴). This is possible, for example, where the exercise of proprietary rights had been allocated the entity performing the specific policy supervision. With regard to such companies it is permanent dilemma whether the uniform professional and proprietary enforcement of rights or the opposite, the separation thereof is the more efficient solution. After 2010, the proprietary enforcement of rights was more typical in the Hungarian practice (namely, apart from some exceptions, the minister responsible for the supervision of state property and HNAM Inc. exercised the proprietary rights). Policy interest and expectations started to resolve this model a few years later and it became more and more frequent that in addition to the entities mentioned, other - mainly the body exercising professional supervision - became the exerciser of proprietary rights as well. After 2018, the model mentioned above was replaced by a more fragmented owner - exerciser of rights structural model. Obviously, the two extreme solutions have their advantages and disadvantages, however, with

Table 1

THE SUMMARY DATA OF THE COMPOSITION OF THE COMPANIES WHICH BELONG TO THE PORTFOLIO OF HNAM INC.

Company participations	Amount of company participation (pcs)	Rate of company participation (%)
The companies which belong to the portfolio of HNAM Inc.	303	100.00
<i>including the companies managed directly by HNAM Inc.</i>	<i>296</i>	<i>97.69</i>
<i>including the companies assigned or submitted for asset management</i>	<i>7</i>	<i>2.31</i>
Total of those companies managed directly by HNAM Inc. in which the state has majority ownership (50% +1 vote)	154	52.03
Those companies managed directly by HNAM Inc. in which the state has minority ownership	142	47.97
Companies which are operated using the company participations managed directly by HNAM Inc.	176	59.46
From among the companies managed directly by HNAM Inc. non-operational companies	120	40,54

Source: www.mnv.hu (12 06 2019)

respect to our topic one aspect definitively has to be highlighted: if the number of entities exercising the proprietary rights is low, then it is significantly easier to develop the principles of uniform corporate governance and to have those principles controlled by the owner, while in case of a lot of exercisers of proprietary rights aligning these principles uniformly and unifying the proprietary actions is difficult due to the participation of numerous operators, and thereby differences may arise in case of the companies allocated to different exercisers of proprietary rights. This results in differences not only in operation but in terms of system or criteria, planning and strategy as well. This is relevant to our topic because one of the key issues of compliance is with which system of criteria, objectives, expectation and rules a business association owned by the state have to comply, and which governmental control mechanisms the actual control of these presume.

The primary purpose of business associations owned by the stated is supporting the performance of public functions. For this very reason all companies or company groups require different management methodologies, adjusted to the (public) function performed by them. For example, the management of a large public service provider company (group) which has been generating loss for decades and the management of a company which is the only one on the market, has monopoly, and which actually belongs to the 'more comfortable' segment of state functions cannot be compared. However, it is undoubted, that *'Only well-managed, effectively and efficiently governed state (...) government-owned enterprises serve the interest of the public. The assets managed by these companies are public assets, on the one hand their activities and the quality, effectiveness and efficiency of their financial management contribute to the responsible management of public funds, and on*

the other hand the goods and services produced by them affect the quality of life, security, health and welfare of the population.' – states the study written by *László Domokos* and his co-authors (Domokos, Várpalotai, Jakovác et al., 2016). Simultaneously, it follows from the above that the state must find the instruments with which it can facilitate that the state-owned business associations manage the public property entrusted with them actually efficiently and effectively.

Due to the nature of the task such companies are in a unique situation also in the sense that they have to ensure the fulfilment of some kind of - mostly costly - state function by using the public property entrusted with them. In their case, the profit can in fact be measured in the increase of the level of standard of the public service and the satisfaction of the citizens. Since the funding of these public assets is funded by the taxing of original income (Zéman, 2017), special attention shall be paid - even on national economy level - to the appropriate profound audit of the specific partial areas related to the performance of (public) functions of state-owned enterprises.

THE AUDIT ROLE OF THE STATE WITH REGARD TO STATE-OWNED BUSINESS ASSOCIATIONS

The state-owned business associations determine the economy and the⁵ policy regulation methodology of any given state. The relationship between the state and its own enterprises had been examined by the OECD as well, and in its recommendation⁶ it highlighted the key significance of the public policy purpose for which the given state-owned enterprise had been founded.⁷ The OECD considers this fact as the starting point, and it is of special importance that the appropriate owner's governance mechanisms are developed,

which serve the realisation of these purposes the most, without the restricting the liability of the leaders of the state-owned enterprises by interfering in the management. The increasing governmental supervision and the appreciation of the owner's instruments established by the OECD with respect to the member states examined had been noticeable in our country as well after 2010 (Boros, 2017).

Since the beginning of the 2000s, the Hungarian national economy has had deepening problems: the debts of the public finances, the low efficiency of the budget policy and the poor audit potential deepened further during the 2007-2008 crisis (Lentner, 2018; Lentner, 2019). As it had been explained by *Csaba Lentner* in his well-known study (Lentner, 2015b), substantial changes have occurred in the field of public finances since the crisis that erupted in 2007. *'These are new times that we living, which require new solutions, and this is especially true for the field of public funds. Change and establishing new rules and founding new institutions are necessary because neither the State Audit Office of Hungary, nor the other independent institutions were able to prevent the chronic governmental overspending and the drastic increase of the public debt of the previous years.'* – explains the 2011 study of the chairman of the State Audit Office of Hungary (Domokos, 2011). The change appeared in number of areas (Lentner, 2015b), therefore

- in particular on institutional level, for example in the regulation related to the central bank and state audit office regulation adopted as the first cardinal act (Domokos, 2016) Domokos, Pulay, Pető et. al, 2015),
- in supporting the strengthening of the trust vested in the functioning of the state,
- in the development of the efficient tax system (Lentner, 2015b),
- in making the debt ceiling a constitutional matter (Domokos, 2011),

- in developing the effective and useful audit system, and last but not least, in strengthening the Fiscal Council in the Fundamental Law (Kovács, 2016; Kovács, 2014; Domokos, 2011).

In the Hungarian model based on the active role of the state, the purpose of the audit system prevailing in national economy level has changed in a direction which facilitated the actual intervention of the entity authorised thereto in the financial processes. As it is explained by Csaba Lentner: *'it is a fundamental national interest that the management of Hungarian public funds and national assets is transparent, efficient and accountable. The rise of Hungary and overcoming the current economic and social issues are inconceivable without professional and regular audit.'* (Lentner, 2015b) These changes lead to that the state has to set new types of audit requirements for its business association which belong to its own assets. These requirements appear with ever increasing strength - on the one hand - on the regulatory level (external factors), and - on the other hand - on the level of corporate governance and internal control mechanisms (internal factors).

In respect of the external factors, having examined the regulatory side briefly, it can be established that the proper management of public funds is an obligation deducible from the Fundamental Law (Domokos, Várpalotai, Javovác et al., 2016). The constitutional rules are complemented by the acts related to assets. On the one hand, Act CXCVI of 2011 on National Assets (hereinafter referred to as National Assets Act), Act CVI of 2007 on State-owned Assets (State-owned Assets Act) and the implementation decree thereof. In addition to the general regulations governing assets, the civil law provisions stipulating the general rules of corporate functioning also have a key role, as well as the rules of Act CXXII of 2009 on the Economical Operation

of Public Business Organisations pertaining especially to state-owned enterprises.

Another important scope of sources of law are those sources of law which set the normative rules pertaining to public finances, in particular the acts on public finances, accounting, rules of taxation, the specific types of tax and duties, as well as the implementation decrees thereof, the public procurement and competition regulations, and also the various sector-specific regulations as well, which stipulate additional requirements in respect of the business associations which provide the specific public services (Lentner, 2015a).

Naturally, in addition to the above, numerous other normative regulations and regulations not deemed as normative - which often arise from international implementation obligations - determined the frameworks of the functioning of state-owned enterprises (especially in the public service sectors).

However, the unique, special purpose of the business associations does not lie in the regulations mentioned above. Namely, in the Hungarian practice, in case of the formation of the new state-owned business association, usually a government decision specifies the purposes of establishing the business association, in addition to determining the main features necessary for the formation. The provisions of the government decisions are then formulated by the exerciser of proprietary rights to the state-owned enterprises, in form of an act which is suitable to result in legal effects in terms of company law, i.e. in owner's decision.⁸ Consequently, the owner's resolutions are relevant as well. Such owner's resolutions are mirrored by each and every company through the acts of their own decision-making forums as well. However, these can be deemed as legal statements made within the company, which legal statements we classify in the category of internal factors. One should not forget about the multi-layered

– sometimes casuistic – internal policy system of state-owned business associations either, which could also affect the flexible, or – as the case may be – rigid operational methodology of this type of business association. Finally, this category also includes the acts of the executive officer or the corporate bodies of various legal status, which again may contribute significantly to the establishment of the modern state-owned corporate operational criteria.

In fact, the enforcement of all regulations and requirements determining the system of objectives of the operation of state-owned enterprises constitutes separate topics, the hiatuses of which may give rise to questioning the justification of the existence of the company concerned. In contrast to the manager-like state functioning which took root in the neoliberal economic system (Polanyai, 2001) and which relies on the passivity of the state, the economic system which has gained ground recently, relies on active state participation and which may be understood as the renaissance of the Keynesian philosophy *'means the foundation of good state functioning'* (Lentner, 2019). Thus, the activity of the state on the appropriate level is essential (Lentner, 2019). The question is how the state can audit the compliance and appropriateness of the operation of state-owned enterprises?

COMPLIANCE AUDIT IN CASE OF STATE-OWNED ENTERPRISES

In the private sector, compliance can be considered as an already widespread field which had been developed in practice as well. At larger privately-owned companies, a separate compliance department manages the issue of corporate compliance. However, the issue of compliance is not characteristic only to the corporate sector, since numerous

scientific disciplines study how the regulations applicable to the given sector can be enforced (Cramer, Roy, Burrell et al., 2008; Simon, Clinton, 2009). Compliance is a rather complex concept, since it includes – among others – financial, economic, tax, business, legal, ethical, sustainability and proprietary compliance as well.

In course of compliance audits, the State Audit of Hungary examined whether the *'activity or operation subject to the audit complies with the regulations and requirements applicable to the audited entity in all significant respects'* (The Principles of Compliance Audit, 2015). It is worth mentioning here that State Audit Office of Hungary distinguishes between two sub-types of compliance audit: regulatory audit and appropriateness audit. In course of the audit procedures, the two methods may be combined as well. The regulatory audit is aimed primarily at the examination of compliance with legal regulations, while the appropriateness audit pertains to areas where some kind of normative regulatory hiatus is experienced, and the principles constitute that sub-type of compliance audits which shall be applied in cases where the legislative regulations cannot be applied, or where obvious legislative deficiencies are noticeable with regard to the consideration of specific issues, and the issue concerned cannot be deliberated upon based on the principles of the recognised practices.

In course of the assessment of the compliance of an organisation the question we are actually aiming to answer is whether the operating mechanisms of the organisation can be subordinated to all regulations applicable to the organisation, and the objectives and requirements set for it. In the narrower sense compliance means the observance and enforcement of the legal regulations – including the decisions of the owner – applicable to the business association. However, in the broader

sense, it means so much more: it also means compliance with the objectives set for the business association concerned already upon the formation, the regulations set on owner or - as the case may be - government level, the policy (sector)-level regulations and standards, the expectations of the parties using the public service, the short, medium and long-term strategic objectives the organisation set for itself, the corporate values set for the managers and the employees.

Currently there is no concrete regulations which would give guidelines on the internal regulation of compliance for publicly-owned business associations, although the examination of this topic is becoming more and more widespread on international level as well.

In Hungary, the topic of compliance and the elaboration of the control function related thereto has appeared in recent years mainly in the field of the law of credit institutions and insurance law (Kovács, Szóka, 2016). In these sectors, the rules of legal compliance have been developed on a very high level, in acts. Naturally, there are aides for state-owned business associations as well, however, due to the differences in terminology, companies do not even realise that they are facing a compliance topic.

According to Act CXCV of 2011 on Public Finances (hereinafter referred to as Public Finances Act), the purpose of public finances controls is to ensure proper, economical, efficient and effective management of the funds of public finances and the national assets, as well as the proper fulfilment of the reporting and data provision obligations.⁹

According to Article 10 (2) of the National Assets Act, the exerciser of owner's rights shall regularly audit the management of the national assets by the user of the national assets, and it shall notify the user of the national assets of its findings, furthermore, if the findings

of the exerciser of owner's rights concern the competence of the State Audit Office of Hungary, then it shall notify the State Audit Office of Hungary as well. The activity related to the exercising of proprietary rights attached to state-owned assets is audited by the State Audit Office of Hungary annually.¹⁰ In addition to the above, HNAM Inc. regularly audits the management of the state-owned assets by persons, entities or other users which are contracted partners of HNAM Inc., and it notifies the supervisory board of HNAM Inc., the entity audited, and if necessary, the minister and the State Audit Office of Hungary of its findings.¹¹

The Public Finances Act specifies different levels of public finances controls, thus it pertains to

- external – the State Audit Office of Hungary, and in cases specified by the Public Finances Act, the treasury - ,
- the governmental – governmental control entity, the entity auditing the European subsidies, and the treasury - ,
- and internal audit functions, with regard to the entities within its scope (Domokos, Várpalotai, Javovác et.al., 2016).

Based on the INTOSAI internal control standards applicable to the public sector it can be established that *'internal control is a dynamic and complex process, which adjusts to the changes occurring in the organisation constantly. The management and levels of the employees shall participate in the process in order to determine risks and to provide reasonable securities for the fulfilment of the mission of the organisation and for the achievement of its goals set.'*¹² In the COSO Framework, internal control is a process which is influenced by the board of directors, the management and the employees of the company, and which had been established to provide reasonable assurances in respect of organisational objectives such as efficient and effective operation, the reliability

of internal and external financial reporting, as well as compliance with the relevant laws, regulations and internal policies.

The relation between the public finances controls and the state-owned business associations is essentially established by – in addition to the rules of assets mentioned above – Article 69/A of the Public Finances Act, according to which the rules applicable to the internal control system of the budgetary institutions shall be applicable to the internal control system of other entities classified as parts of the public sector.¹³ The other entities classified as parts of the public sector are currently specified by a Minister of Finance Announcement (Official Gazette No. 2018/36). Point 12 of Article 1 of the Public Finances Act specifies the definition of other entities classified as parts of the public sector. This scope includes those organisations which are not part of the public finances under the Public Finances Act, which however belong to the government sector under Council Regulation (EC) No 479/2009 of 25 May 2009 on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community. Other organisations classified as parts of the government sector are bound by more obligations since they are obliged to provide data to the minister responsible for public finances for the purpose of preparation of the act on the central budget, shall fulfil data provision for the preparation of the compilations to be presented mandatorily in the act on the implementation of the central budget, they shall fulfil the regular data provisions specified in Government Decree No. 368/2011 (XII.31.) on the Implementation of the Public Finances (hereinafter referred to as Implementation Decree for the Public Finances Act), and these organisations may conclude any debt-generating transaction under Article 9 of Act CXCIV of 2011 on

the Economic Stability of Hungary validly only upon the prior approval of the minister responsible for public finances, in accordance with the provisions of Gov. Decree No. 353/2011 (XII:30.) on the Detailed Rules of Approval of Debt-generating Transactions.

Part I of the announcement¹⁴ includes the other organisations classified as parts of the government sector which are in operation at the time of the issuance of the announcement, and which therefore are obliged to enforce the regulations presented according to the act. Point A) of the announcement specifies the organisations classified in the Central government sub-sector.¹⁵ The majority of the one hundred and forty-seven organisations is a business association subject to some kind of state ownership.¹⁶

The rules applicable to internal audit are specified by Sub-heading 47 of the Public Finances Act, while the detailed rules of the internal control system are specified by Gov. Decree No. 370/2011. (XII. 31.) on the Internal Control System and Internal Audit of Budgetary Institutions (hereinafter referred to as Internal Control Decree), the scope of which extends to the other organisations classified as parts of the government sector as well.¹⁷

At the same time, the Internal Control Decree does not pertain to the topic of compliance but specifies the specific rules applicable to the elements of the internal control system.

Actually, it can be established that there is no unique legal regulation for the compliance, integrity and internal control of state-owned business associations which had been developed specifically for this scope but through various referring provisions, the specific rules of the public finances legislation related to budgetary institutions shall be applicable. Another point to think about is whether it would be practical to determine the rules applicable to the lines of defence of the external audit and the internal

control mechanisms of state-owned business associations in a separate law, taking into consideration the particularities we outlined. Our answer is evidently that the development of such a flagship law would fill a gap, since the audit of state-owned business associations is a very complex process. The functioning thereof is determined partially by property law and (public) finance law, and partially by civil law, as well as partially by administrative law, especially the specific administration, i.e. special part thereof. It follows from the above that control mechanisms are concentrated to such control focus areas, and therefore the controlling synergy often fails to prevail between them. For example, owner's control should extend to each and every partial areas, however – in addition to the assessment of the financial or legal compliance – it should definitively extend to whether the organisation concerned complies with the expectation and needs of the owner – i.e. the state – and the users of its services – the citizens and organisations – as well as with the objectives set at the time of the formation. The difficulty of the audits which cover the entire range of the operation of state-owned business associations is that division of control and the exercising of owner's rights of such companies among multiple entities. Therefore, it may be possible that the exerciser of owner's rights and the entity exercising professional supervision are completely separate from one another, which causes numerous difficulties in the operation, in funding, and not least in controlling as well. In addition, the creation of synergy among the exercisers of owner's rights of often cumbersome, too: the acts of exercising owner's rights established along the lines of different legal grounds cause the content particularities thereof to differ significantly from each other as well. Just one example. we emphasised how important business planning and the owner's guidance related thereto are. In this regard,

in connection with the structure, content and main element of the business plans some exerciser's of owner's rights develop planning guidelines, while other do not participate in the operation thereof at all, apart from supporting the company concerned.

Undoubtedly, the scope of laws with which a state-owned business association must comply is versatile. Naturally, the control functions specified in the laws have a wide range of measures, however, the countless supervisory, controlling and proprietary authorisations also causes the fragmentation of the controlling authorisations simultaneously, and several segments remain which have to be controlled internally by the business association concerned. This requires the development of an efficient internal control system. The internal control system is a system of processes which includes all those principles, procedures and internal policies which the budgetary institution must develop and operate in order to ensure that its activity is proper and is compliant with the requirement of cost-efficiency, efficiency and efficacy (Kovács, 2007; cited by: Gyüre, 2012; Kis, 2015). In our opinion, the framework of this shall be determined on statutory level.

With regard to the terminological distinction of compliance and integrity, it is worth to refer to the following: according to the Methodological Guidelines developed by the State Audit Office of Hungary for surveying the anti-corruption situation of state administration bodies, the establishment of the anti-corruption controls thereof and for the audit of the enforcement of such controls¹⁸, the word 'integrity' derived from Latin means intactness, incorruption and immaculacy. Accordingly, in terms of organisation integrity means the operation of a given entity in compliance with the social expectations and to be subordinated to strict values. The purpose of the Integrity Survey launched by

the State Audit Office of Hungary in 2011 is *'to identify the risk which adversely affect ethical, transparent operation, as well as exploring the controls designated to manage such risks'* (Németh, Bartus, Szabó, 2016). In short, this means that *'it does what it had been established for, in a way it is expected from it and fulfils its mission'* (Pulay, Jenei, 2016). This shows that organisational integrity and compliance are close concepts, and an opportunity for distinction may be if the compliance definition we explained is compared to the what we wrote about integrity. Undoubtedly, the objectives appearing in both concepts are on the same vertical. The higher the level of the integrity of an entity is, the more efficient the compliance controls are (see Table 2).

THE OPPORTUNITIES FOR SUPPORTING ORGANISATIONAL INTEGRITY AND COMPLIANCE IN CASE OF STATE-OWNED BUSINESS ASSOCIATIONS – CONCLUSION AND RECOMMENDATIONS

As we have already mentioned, the operation of state-owned business associations and the social trust factor concerning them are crucial

in respect of the functioning of the state, its international or even social reputation, as well as its competitiveness and efficiency. For this reason we think it is very important to examine which criteria, objectives, expectations and rules state-owned business associations have to comply with, and which state control mechanisms are worth establishing for these. It is certain that the operation of these companies shall be subjected to enhanced and actual control: from the aspects of lawfulness, asset management, ownership and public finances. The control mechanisms shall also cover numerous issues which relate only partially to specific areas of control, therefore in particular to the system of objectives giving rise to the formation of the company, for in the event a company is no longer able to fulfil its purpose, it is unable to comply with the fundamental system of objectives set for it by the state, then the justification of the existence of the company concerned may be called into question. We also emphasised that in course of the assessment of the compliance of an organisation the question we are actually aiming to answer is whether the operating mechanisms of the organisation can be subordinated to all regulations applicable to the organisation, and the objectives and

Table 2

THE EVT, FIV AND FRC INDEXES REFLECTING THE INTEGRITY VULNERABILITY AND THE ESTABLISHMENT OF THE CONTROLS OF THE PARTICIPANTS OF THE 2016-2018 INTEGRITY SURVEY

Index	The value of the index in 2016 (%)	The value of the index in 2017 (%)	The value of the index in 2018 (%)
Inherent Vulnerability Index (EVT)	48.4	41.4	41.6
Factors Increasing Vulnerability (FIV)	35.2	25.0	27.8
Factors Reinforcing Controls (FRC)	60.0	49.8	46.6

Source: own compilation based on the 2016-2018 integrity surveys of the State Audit Office of Hungary

requirements set for it. We formulated the narrower and broader definition of the compliance to be enforced in respect of state-owned enterprises: in the narrower sense, compliance means the observance and enforcement of the legal regulations – including the decisions of the owner – applicable to the business association. However, in the broader sense, it means so much more: it also means compliance with the objectives set for the business association concerned already upon the formation, the regulations set on owner or - as the case may be - government level, the policy (sector)-level regulations and standards, the expectations of the parties using the public service, the short, medium and long-term strategic objectives the organisation set for itself, the corporate values set for the managers and the employees. We could also see that a process for the regulation of legal compliance has already started in the legal system, with respect to the credit institution and insurance industries.

We also pointed out that the controlling of the numerous regulations to be enforced with regard to state-owned enterprises is based on the cooperation of the organisations which have different controlling competences. However, the roles of the executive officers of the companies in ensuring compliance should not be disregarded. The Public Finances Act, the Internal Control Decree and the Integrity Management System¹⁹ already provide normative bases for this. This scope is complemented by the gap-filling research²⁰ and surveys of the State Audit Office of Hungary, which – year by year – serve as guidelines for ensuring the organisational integrity and compliance of state-owned companies (Németh, Martus, Vargha et al., 2019), (*see Table 3*).

Undoubtedly, the improvement of the compliance and structural integrity, as well as increasing the efficiency of state-owned

business associations may be achieved through numerous measures (Németh E., Martus B., Vargha B., 2018). Such measures include which presume the intra-organisational commitment of the manager and employees of the state-owned enterprise, and their need for establishing a compliance culture. There is a group of measures which may be formulated from outside, by the exerciser of the owner's rights and/or the entity exercising policy control or supervision. Naturally, the organisational integrity of these is the responsibility of the manager of the company. Finally, these issues may be influenced by legislative measures as well, just to mention the most important ones (Pulay, Kovács, 2019). In order to improve the efficiency of the audit, these control mechanisms shall be used in a harmonised manner, and the cooperation among the entities conducting the audit shall be ensured.

As we have mentioned, the adoption of a separate law for the internal control system of state-owned companies would be progressive. The already mentioned Article 69/A of the Public Finances Act already provides opportunity to adopt such law (government decree).

Taking into consideration the rules of the Internal Control Decree and the Integrity Management System in addition to the rules of the credit institution and insurance legislation, it would be advisable to regulate the following.

- the executive officer of the state-owned business association is responsible for the establishment, operation and improvement of the internal control system,
- in course of the establishment of the internal control system, the unique characteristics of the organisation shall be taken into consideration,
- it is advisable to integrate those rules of the Internal Control Decree which are well-established in respect of the budgetary institutions,

Table 3

THE AREAS OF ESTABLISHMENT OF INTEGRITY (2016-2018)

The areas of establishment of the integrity controls in 2016	The areas of establishment of the integrity controls in 2017	The areas of establishment of the integrity controls in 2018
<ul style="list-style-type: none"> • Property management, management of public funds, • Corporate governance, supervision, • Activity, provision of public services, • Organisational structure, • Procurements, public procurements, • Legal environment, • Internal regularity, • Human resources management, • Internal controls, risk management, • Special anti-corruption systems and procedures. 	<ul style="list-style-type: none"> • Responsible management (provision of the owner’s property, legal environment, role of the supervisory board, reporting to the owner, discretion of the owner, company management, development of the company structure, management information system); • Performance of public functions, external relations (performance of public function, provision of public service, specification of fees, support provided to external organisations, acceptance of support from such organisations, risks of contractual partner, outsourcing, disclosure, publicity); • Financial management (property management, European Union funding, partnership contracts, company group, financial management efficiency); • Compliance, audit (internal regularity, public procurement, bidding, accounting audit, external and internal audits); • Organisational culture, ethical conduct (integrity culture in the internal policies, allowances for private purposes, selection of employees, conflict of interest, performance evaluation, ethics proceedings, media presence). 	<p>In addition to the areas specified in the 2017 analysis:</p> <ul style="list-style-type: none"> • External relations: receiving external support, or providing support, accounting of the support, surveying the satisfaction of clients, disclosure of data of public interest. • External and internal audits: accounting audit, audits conducted by external bodies, level of standard and utilisation of the internal audits, risk analysis and risk management. • Organisational culture: human resources management, regulation and assessment of conflicts of interest during the selection of the employees, remuneration system, performance evaluation, ethics proceedings.

Source: own compilation based on the 2016-2018 integrity surveys of the State Audit Office of Hungary

• similar to the provisions regulated on statutory level in the law of credit institutions and insurance law, it is advisable to specify the requirement of legislative compliance on legislative level as well, however, in addition to the above and relying on the definition

of compliance in the broader sense, the compliance expectations of the values and objectives of state-owned business associations and the realisation of the related public functions, as well as the necessity of specifying the measures necessary to ensure ethical operation,

- the operation of compliance reporting/complaint management system is a well-established practice among the business associations of the private sector. In some places, these kinds of reports are examined by a completely independent person or body. Institutionalising this is recommended in case of state-owned business associations as well,
- it is advisable to develop the issues concerning compliance and organisational integrity according to the uniform guidelines of the exerciser of owner's rights, taking into consideration the unique corporate particularities and on the level of organisational regulations,
- specifying the provisions applicable to internal control for state-owned companies on the level of the regulation mentioned above shall also be taken into

consideration. In connection with this it is advisable to strengthen the relationship and the cooperation of the internal controller and the bodies, organisations fulfilling other control functions (for example, with the supervisory board, the auditor or compliance organisation),

- the integration of the contents of the integrity reports of the State Audit Office of Hungary and the international compliance standards into the corporate regulation shall be handled as an issues which belongs to the controlling competence of the exerciser of owner's rights.

We hope that through our study we contributed to highlighting the topic of compliance from the state, enterprise aspect and to the cornerstones of the establishment of the regulatory environment.

NOTES

¹ Source: www.mnv.hu (12.06.2019)

² Online: http://www.mnvzrt.hu/felso_menu/tarsasagi_portfolio/elektronikus_aukcios_rendszerek_portfolio/ear_portfolio.html (03.06.2019)

³ See the auction surface of HNAM Inc. Online: https://e-arveres.mnv.hu/index-meghirdetesek-uzletresz.html?.actionId=action.common.SelectAuctionTypeAction&item=partnerMainPage&FRAME_SKIP_DEJAVU=1&auctionType=3 (03.06.2019)

⁴ Understood as company participations assigned or submitted for asset management.

⁵ See Preamble Article (9) of Regulation (EC) No 77/2008 on establishing a common framework

for business registers for statistical purposes and repealing Council Regulation (EEC) No 2186/93

⁶ OECD Guidelines on Corporate Governance of State-Owned Enterprises. Online: <http://www.oecd.org/corporate/guidelines-corporate-governance-SOEs.htm> 3. (25.05.2019)

⁷ In 2013, in its exploratory opinion on 'The unexplored economic potential of EU competitiveness — reform of state-owned enterprises', the European Economic and Social Committee argued that the state should, ensure that there is proper public scrutiny and regulation, which requires putting in place a system of governance for its public undertakings, underpinned by the participation of all

stakeholders, as well as representatives of the staff of those undertakings.

⁸ According to Article 29(3) of the State-owned Assets Act, unless any ministerial decree under Article 3(2a) of the State-owned Assets Act stipulated otherwise, the entity authorised to found economic organisations, to acquire participation in such organisations, as well as to exercise the proprietary (member's, shareholder's, founder's) rights on behalf of the state is HNAM Inc. In addition, HNAM Inc. may grant authorisation to other persons and organisations to proceed in course of the formation of the economic organisation, and the acquire company participation on behalf of the state.

⁹ See Section 61 of the Public Finances Act.

¹⁰ See Section 2 (4) of the State-owned Assets Act.

¹¹ See Section 17 (1) d) of the State-owned Assets Act.

¹² <https://allamhaztartas.kormany.hu/belso-ellenorzesi-szakmai-anyagok> (21.05.2019).

¹³ In compliance with Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States.

¹⁴ Part II of the Announcement includes those government-sector other organisations terminated or phased out in 2017 in respect of which the legal successors thereof – or in the absence of legal successor the party obliged to prepare its annual account in accordance with the accounting rules – is subject to subsequent data provision obligation for 2017.

¹⁵ Meanwhile, Point B) of the Announcement is about the organisations classified in the Local government sub-sector.

¹⁶ In addition, foundations, foundations for public benefit, credit institution organisations, funds and authorities may also be found in this part.

¹⁷ See Article 1 of the Internal Control Decree.

¹⁸ Methodological guidelines for surveying the anti-corruption situation of state administration bodies, the establishment of the anti-corruption controls thereof and for the audit of the enforcement of such controls. <https://korrupciomegelozes.kormany.hu/download/3/70/41000/M%C3%B3dszertani%20%C3%BAtmutat%C3%B3.pdf> (13 07 2019)

¹⁹ Government Decree No. 50/2013 (II.25.) on the Integrity Management System of State Administration Bodies and on the Procedures Applicable to the Acceptance of Lobbyists.

²⁰ State Audit Office of Hungary: Analysis of the results of the integrity survey conducted among the business associations in majority state ownership 2016 Available at: https://www.asz.hu/storage/files/files/Publikaciok/Elemzesek_tanulmanyok/2016/gt_integritas_tanulmany.pdf?ctid=976 (25.04.2019); State Audit Office of Hungary: Study on the 2017 integrity situation of publicly owned business associations. Available at: https://www.asz.hu/storage/files/files/Publikaciok/Elemzesek_tanulmanyok/2018/integritas_elemzes_20180425.pdf?ctid=1237 (25.04.2019); State Audit Office of Hungary: Study on the 2018 integrity situation of publicly owned business associations. Available at: https://asz.hu/storage/files/files/elemzesek/2019/20190320_kgt_int.pdf (25 04 2019)

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