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# *The Role of the State Audit Office of Hungary in Stabilising Public Finances*

**SUMMARY:** The State Audit Office of Hungary is the supreme financial and economic audit institution of the National Assembly. Due to its legal status and duties, the State Audit Office is the only non-governmental body that has an overview of the budget from January to December. The two main pillars of this are the auditing of the execution of the budget and providing opinions on the budget appropriation bill (to be performed with annual frequency as set out in legislation and the SAO strategy). The objective of the final accounts audit is to provide a comprehensive and objective view of the compliance of the final accounts bill, the reliability of data in the bill, and the enforcement of the provisions of the Fundamental Law pertaining to public debt. Parallel to its audit related to providing an opinion on the budget appropriation bill, the State Audit Office also prepares analyses for the Fiscal Council. In these analyses, the SAO provides opinions on the draft budget appropriation bill, the procedures related to the formulation of the public debt ratio, the calculations underlying the planned public debt figure and the substantiation thereof, and, prior to the final vote of the National Assembly on the budget appropriation bill, the enforcement of the public debt rule set out in the Fundamental Law; in other words, whether the criteria required to pass the bill have been fulfilled or not. In addition, the SAO also prepares analyses on budgetary processes for the current year and the year preceding the current year. Pursuant to the new Act on the State Audit Office effective as of 1 July 2011, with its findings, recommendations and advice the State Audit Office assists the National Assembly, its committees and the work of the audited entities. By fulfilling its statutory obligation, the State Audit Office strives to ensure that the National Assembly make the best and most substantiated decision possible in relation to the passing of both the act on the budget and the act on the final accounts. This is the purpose and objective of State Audit Office work, and this is what serves the interests of the country, the citizens of Hungary and the national economy.

**KEYWORDS:** audit, final accounts, measure, accounting, tax, Fiscal Council, budget, bill, synergy, risk

**JEL CODES:** E62, H61, H63, H68, H70

One of the fundamental duties of most supreme audit institutions is to audit the execution of the state budget. The main objective is to establish whether or not the government's report prepared for the National Assembly on the execution of the budget (final accounts), provides a true and fair view of the budget processes of the previous year. This task is of utmost importance in terms of the manage-

ment of public funds and public assets as well as the transparency and accountability of the reporting on such management. However, the audit of the processes of the previous year conducted in the current year can provide scarce information for the identification of future financial risks.

It is a unique feature of the statutory mandate of the State Audit Office (SAO or state audit office) that, in addition to the audit of the execution of the state budget, the SAO is

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also responsible for reviewing the budget bill submitted by the government. The National Assembly does not begin discussing the central budget bill until it receives the SAO's opinion as to whether or not the appropriations stated in the bill are sufficiently substantiated.

This activity of the SAO has expanded further over the past 4 years. Starting its operations on 1 January 2011, an independent Fiscal Council (Council) was established in Hungary, with the president of the SAO as an ex officio member. The Council is a new constitutional institution in Hungary, tasked with the expert assistance and supervision of responsible budgetary planning (Smuk, 2013). The Council reviews the draft bill on the state budget even before it is submitted to the National Assembly. The Council's opinion is sent to the government, and the government may consider the opinion, as it sees fit, for the finalisation of the bill. However, the Council has another, even more important statutory right. It may, directly before the approval of the budget appropriation bill, exercise a veto right. 1 January 2012 was a milestone in public finances (Domokos, 2012a). Pursuant to the Fundamental Law, if public debt exceeds half of the gross domestic product, the National Assembly may only adopt an Act on the central budget which provides for public debt reduction in proportion to the gross domestic product (debt rule). There was a need for a regulation that would contain fiscal policy within the boundaries of a framework and thereby help set public debt on a sustainable path (Balatoni – Tóth, 2012). The Council stands guard over compliance with this rule as it is the Council's responsibility to determine whether the public debt rule would be observed if a given bill was passed. If the answer is no, the Council will not grant its consent to the approval of the central budget bill, i.e., it vetoes its approval. In such cases, the government must propose amendments to

the budget appropriation bill for the reduction of expenditures or the raising of reserves. If these are accepted, the Council will assume that the debt rule will be observed. In addition, the Council also reviews budgetary processes every six months.

Pursuant to the Act on the State Audit Office, the SAO assists the activities of the Council with analyses. With this new task, the SAO regularly monitors, audits, analyses and evaluates budgetary processes, keeping an eye on the Hungarian budget. This is well illustrated by *Figure 1*.

## AUDITING OF THE EXECUTION OF THE BUDGET ACT

This SAO strategy stipulates that the auditing of the execution of the budget (final accounts) plays a priority role in consistent accounting, as this is a significant task both in terms of the foundation and history of the SAO. The auditing of the execution of the budget also plays a key role in monitoring the utilisation of public funds. In recent years, with the adoption of the new SAO Act<sup>1</sup>, the SAO's consulting and analysis activity has come to the forefront and final accounts have become one of its focus areas.

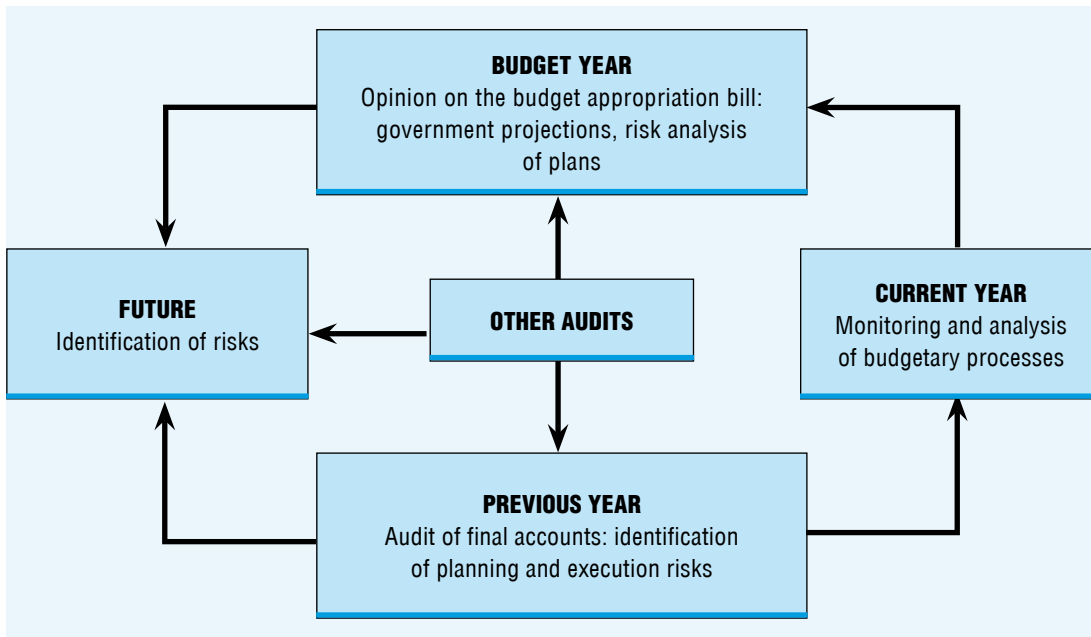
It is the SAO's statutory obligation to audit the bill on the execution of the budget of Hungary, during which the State Audit Office assesses the reliability of the bill.

In recent years, the audit of final accounts has developed continuously. The SAO has renewed the methodology of budget execution audits, and has established an audit model that employs a different approach, different content and different procedures than before.

The reports on the final accounts – in relation to the renewed methodology – are made public in a concise and easy-to-understand format. With regard to the execution of the

Figure 1

**ACTIVITIES OF THE STATE AUDIT OFFICE RELATING TO BUDGETARY PROCESSES**



Source: Pulay, 2015

2012 budget, the SAO has already issued a statement on the reliability of the final accounts as a whole.

Within the European Union, the existence of a monitoring and analyst institution that is independent of government is a key element in reinforcing European economic governance. As a consulting body to the National Assembly, the SAO partly fulfils this function as well, and it also prepares analyses for the Council. Auditing, monitoring and analysis tasks complement one another well, as the experiences gained during audits can be utilised during analytical work. Ever since the auditing of the 2012 final accounts, reports on the audit have been supplemented with analyses on the macro-economic correlations of the budgetary processes of the given year.

The report on the 2012 final accounts was the first report to have been fully prepared within the framework of the new SAO Act.

Adopted in 2011, the SAO Act put an end to the era of audits without consequences; accordingly, findings had to be followed by specific action plans and measures, the implementation of which can be audited by the SAO in the context of follow-up audits.

**Legal regulation**

The rules of the execution of the budget are set forth in the relevant provisions of Act CXCV of 2011 on Public Finances (Act on Public Finances) and Government Decree No. 368/2011 (XII. 31.) on the Implementation of the Act on Public Finances.

The auditing of the execution of the central budget is set out as a designated task for the National Assembly’s supreme financial and economic audit institution by the legislator in the Fundamental Law. The audit assignments

of the SAO are determined by the Act on the State Audit Office (SAO Act) and other laws. Pursuant to the SAO Act<sup>2</sup>, the State Audit Office shall audit the final accounts prepared in relation to the execution of the central budget. Pursuant to statutory provisions, it is obliged to audit the execution of the central budget on an annual basis.

Based on the authorisation granted by law, as part of its independence, the SAO establishes the professional rules of its audits itself.

### Objective, type and scope of the audit

The objective of the audit of the final accounts is for the SAO to provide an independent and professionally sound opinion on the bill on the final accounts and on the reliability of the underlying data. Through this, it supports the National Assembly in making a well-founded decision concerning the acceptability of the bill.

During the auditing of final accounts, the SAO inspects the compliance of the bill on the final accounts and the reliability of the underlying data. The objective of the audit of final accounts is to determine

- whether the fulfilment of the revenue and expenditure appropriations of the central budget complied with statutory requirements without material errors,
- whether the revenues of public finances were utilised in accordance with the provisions of the Budget Act and in line with the legal requirements of the management of public funds, and whether the bill presents a true and fair view of the financial data and information pertaining to the execution of the budget,
- whether those vested with power and competence in the execution of the budget managed public funds in a regular and lawful manner and in accordance with budget appropriations,

- whether the content and structure of the bill on the execution of the budget is in line with legal regulations, and whether the provisions of the Fundamental Law and the Stability Act concerning public debt have been enforced.

The final accounts audit is a compliance audit. Compliance audits are intended to determine whether the activities or operations constituting the subject of the audit are in compliance with the relevant regulations and requirements in all material respects.

As a general rule, the audit covers the bill on the final accounts and its annexes, as well as the balance sheets and financial statements required to be included upon the presentation of the final accounts. As part of the audit, the SAO inspects compliance with the provisions of the Fundamental Law and the Stability Act pertaining to public debt. The audit covers the data of a given fiscal year.

It is important in respect of the auditing of the final accounts that the SAO identifies the planning and implementation risks detected during the execution of the budget of the preceding year (e.g. certain tax revenues were planned too high, measures intended to reduce certain expenditures were not implemented). The SAO considers these risks during subsequent audits.

### Execution of the audit

A major change occurred in the accounting of public finances in 2014, which necessitated the mapping out, during the 2013 audit of the final accounts, of whether the transition to accrual-based accounting has been completed in the subsystems of public finances.

The audit concerns five key areas (centrally managed appropriations, budgetary institutions, chapter-managed appropriations, extra-budgetary funds and social security funds).

As part of the final accounts audit, the SAO inspects in all audited areas the compliance (regularity) of financial management and the utilisation of the appropriations, as well as harmony with the rules on fiscal management.

Non-compliance related errors detected during the audit are classified by the SAO into two main groups:

- compliance (regularity) errors,
- and errors that impact the reliability of the data of the final accounts bill (reliability errors).

The State Audit Office assesses the errors detected in terms of whether they are material individually or together, and determines the impact they have on the results of the final accounts audit. In addition, the SAO also assesses the nature and sum of the errors and the circumstances of their occurrence in respect of the final accounts bill as a whole.

In order to contribute to improving the reliability of data in the final accounts bill, during the audit the SAO may inform the management of the audited entity of the material errors detected. If the given conditions are in place, the SAO may request the audited entities to correct the errors. If the management of the audited entity is unwilling to correct the errors indicated by the SAO in spite of the possibility to do so, the SAO may inform the management of the controlling body of the audited entity of the uncorrected errors as well as their impact on the State Audit Office opinion. In the report on the final accounts bill, the SAO compares the sum of all errors affecting the reliability of the bill to the materiality threshold value.

### Identification of risks

Through the compilation of studies and analyses, the SAO's possibilities to identify and signal risks have expanded even further.

This system of analyses helps identify future risks, as it points out the recurring problems of budget planning and execution (such as budget reserves and carry-over accumulation). The deficit target cannot be achieved safely without sufficient reserves. Excessive reserve accumulation, however, draws resources away from growth. Audit experiences show that there is a hasty utilisation of unused reserves at the end of the year, which may lead to wastage.

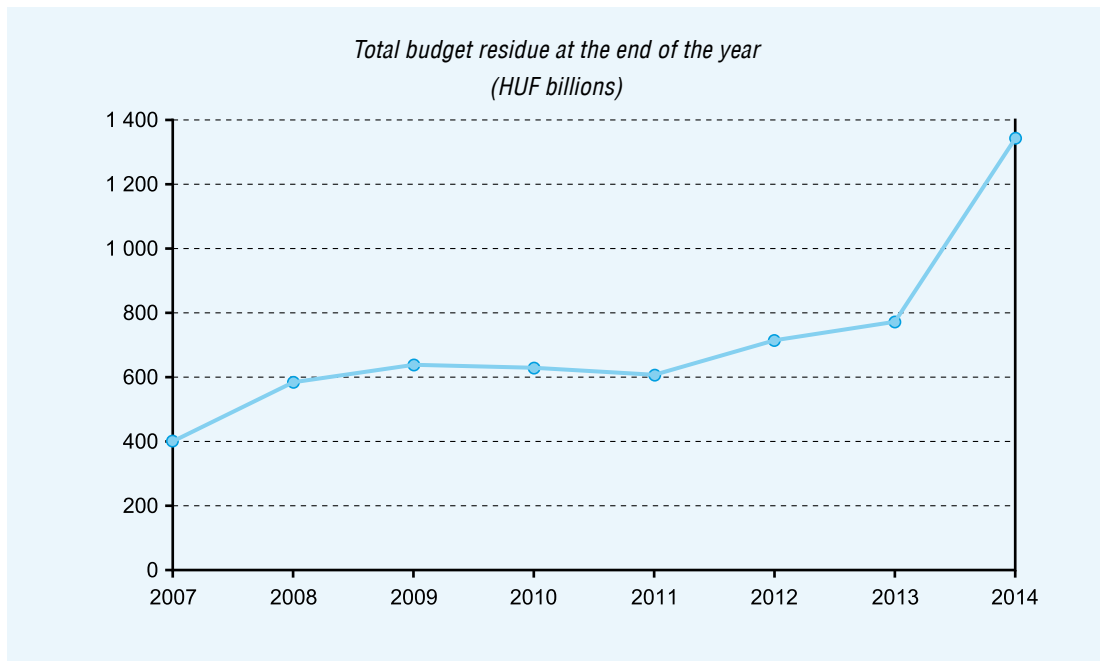
The accumulation of budget residues has been identified as another future risk. According to Hungarian regulations, a part of the budgetary appropriation not used in the current year (residue) may be carried over to the subsequent year under certain terms and conditions. This implies savings in the current year but overspending in the subsequent year. Consequently, total residue continues to grow as a result of measures promoting savings in the current year. The extent of the risk is well illustrated by the fact that the residue accumulated by the end of 2014 was considerably higher than that recorded at the end of 2013 (*see Figure 2*).

In the SAO's experience, recurring inadequacies in budget planning and execution entail a major future financial risk. This has a detrimental effect on the protection system of public finances, thereby reducing immunity against financial crises. By identifying the risks, the SAO – as a supreme audit institution – could contribute significantly to strengthening the protection system against financial crises.

### Audit experiences

The audit experiences gained by the SAO during the audit of the final accounts greatly contribute to deciding which topics or areas are to be put into focus and audited and analysed subsequently as priorities. One of the

**TOTAL BUDGET RESIDUE IN THE 2007–2014 PERIOD**



Source: Internal compilation based on the data of final accounts

results of the experiences gained in relation to the final accounts is that during its audits and analyses, the SAO pays particular attention to issues of taxation, including the specific issues of tax administration. The foundation for the more intense auditing of tax revenues and taxation issues was laid down by the risk analysis of factors uncovered by the SAO during the audit of the final accounts at the National Tax and Customs Administration and at its predecessor, the Hungarian Tax and Financial Control Administration.

The auditing of the 2012 final accounts uncovered the risk related to the rapid increase in arrears. Having regard to the above, during the 2013 audit of the final accounts, the SAO paid special attention to this issue. With its findings and recommendations, the SAO contributed to reducing the tax arrears of active taxpayers in 2013 compared to 2012 (see Table 1).

It should be stressed that in recent years, the SAO has also supported the more reliable operation of the audited entities by focusing on issues of integrity. The adoption of the new SAO Act opened up an opportunity for the SAO to promote the culture of integrity by including advisory activities and the support of good governance in its tasks. Integrity development is not just a tool in the fight against corruption, but also a pillar of good governance. During the 2013 audit of the final accounts – recognising the significance of integrity development –, the SAO extended its audit activity to assessing the integrity of organisations involved in the audit. In the public sector, the appraisal of integrity is essential for assessing reliability. In the context of its final accounts audit, using a questionnaire survey, the SAO surveyed integrity at a total of 167 organisations and evaluated the questionnaires. During the audit, by focusing on the topic of

Table 1

**TAX AND CUSTOMS ARREARS IN THE 2011–2013 PERIOD**

Year	Total arrears (HUF billions)	Tax arrears of active taxpayers	
		As a % of total arrears	HUF billions
2011	2,051.0	30.0	613.5
2012	2,142.7	32.6	698.5
2013	2,260.9	30.2	682.8

Source: SAO final accounts reports based on data supplied by the National Tax and Customs Administration

integrity, the State Audit Office enforced its advisory role, which contributed to the more reliable operation of audited entities.

The implementation of recommendations, proposals and notices made by the SAO during its audits can be monitored and tracked continuously during final accounts audits. In the course of the audit of the 2012 final accounts, as part of a follow-up audit, the SAO found that three of the six comprehensive recommendations made in the 2011 final accounts report had been implemented in full, while three had been implemented in part or had been in progress upon the conclusion of the audit already. This represents significant progress compared to previous years when most of the recommendations were not accompanied by successful measures.

A positive change has been observed since the 2012 final accounts audit – which was different compared to previous years, representing a real step forward – in that the final accounts audit also provided an opinion on the reliability of the final accounts as a whole. For the first time, the SAO evaluated the compilation process of the final accounts and verified the validity and substantiation of the data contained in the final accounts bill. The State Audit Office deemed the 2012 bill on the final accounts to be substantiated, the data to be reliable and the execution of the budget to be in line with the statutes (Pongrácz, 2015).

For 2012, the SAO audited a total of 105 statements and accounts, and issued qualified opinions in three of these cases. Likewise, the SAO audit for 2011 involved 105 statements and accounts, but five qualified opinions and one adverse opinion were issued. The SAO viewed the difference as a sign of development. The reliability of statements is the foundation of the responsible management of public funds. Overall, the execution of the 2012 budget represents a step in the direction of responsible financial management.

During the audit of the 2012 final accounts, the SAO qualified the scope and functioning of the internal control system at all budgetary institutions and chapter-managed appropriations designated for auditing. 85 per cent of the audited institutions received qualifications of partially compliant or compliant. Typically, it was institutions freshly included in the audit that fell into the non-compliant category.

During the audit of the 2013 final accounts, the SAO deemed the final accounts bill to be substantiated and the data to be reliable.

For 2013, the SAO audited a total of 131 statements and accounts (26 more than for 2012) and issued adverse opinions in two of these cases. There were no qualified opinions issued. Of the statements audited, the SAO assessed one as unreliable and gave an adverse opinion.



The SAO assessed the scope and operation of internal control systems in the case of 63 institutions and 17 chapter-managed appropriations. 75 per cent of the systems rated received compliant qualifications, while 22.5 per cent and 2.5 per cent were partially compliant and non-compliant, respectively. In the preceding year, 15 per cent of the internal control systems audited were found to be non-compliant. The reason for the improvement is that audited entities paid increased attention to monitoring activity, to continuous and ad hoc follow-ups implemented as part of operative activities as well as internal auditing.

The SAO audited the measures taken in response to the recommendations made in the SAO report on the execution of the 2012 central budget. All five recommendations made in the SAO report on the 2012 final accounts were utilised, and the organisations concerned took the required measures in harmony with the action plans.

### THE SAO IS THE PRIMARY CRITIC OF THE INTRODUCTION OF (SYSTEMIC) CHANGES AFFECTING PUBLIC FINANCES AS A WHOLE, AND SPEARHEADS THE ACCOUNTABILITY PROCESS

For the sake of the transparency of the complex processes of public finances, the SAO – in line with its Strategy – conducts interdependent audits that are based on a systemic/holistic approach, take advantage of the synergy effect and allow summary evaluations. During the various audits, the SAO monitors systemic changes affecting public finances as a whole. Last year, the most significant change of this nature was the transition to accrual-based accounting.

In the context of the legal harmonisation related to Council Directive 2011/85/EU on the requirements for budgetary frameworks

of the Member States, as of 1 January 2014, cash-based budgetary accounting and accrual-based financial accounting must be applied parallel to one another in public finance accounting.

As part of the renewal of the public finance and budgetary system, at the beginning of 2013 the government formulated a new government decree on accounting, pursuant to which accrual-based accounting was introduced as of 1 January 2014 at all levels of public finances. The objective of introducing the new accounting system is to improve the clarity of financial statements, to ensure accountability, and to ensure more efficient tools for the planning of the budget, the measurement of interim processes and the supporting of decisions.

### The role of the SAO

In the spring of 2012, the State Audit Office conducted an international survey (EU Member States, English-speaking countries outside of the EU, Switzerland and Russia) among state audit offices on the types of the reporting systems of public finances, the transition to accrual-based accounting, and the role of national state audit offices in this transition.

The survey revealed considerable differences between the various countries. Certain countries have already introduced it to great success, with all subsystems of public finances and all reporting accrual-based; however, not all of these countries applied accrual-based budgetary planning. In other countries, including Hungary, the cash-based or modified cash-based approach was still in place, and there were no transition reforms in progress with specific schedules. In the remaining countries participating in the survey the transition had commenced, while certain countries employed a mixed solution.



Based on the survey, the possible roles of state audit offices during the transition to accrual-based accounting were as follows:

- providing opinions on draft legislation and professional regulations;
- participating in professional bodies supporting the transition;
- discussing the topic of transition in the state audit office audits;
- auditing and issuing opinions on accrual-based reports of an experimental nature.

The SAO has supported the transition to accrual-based accounting from the start. In the exposé of the 2012 final accounts, the President of the State Audit Office of Hungary called the attention of the National Assembly to the significance of the transition to accrual-based accounting, which

*“could further improve transparency and accountability in respect of public funds and public assets which, by way of increased public confidence, could continue to facilitate the better management of public funds.”* (Domokos, 2013b)

Typically, temporary difficulties arise during the introduction of new systems. In the case of the transition to accrual-based accounting, however, these difficulties are far outweighed by the benefits that follow the transition.

Being an institution calling for accountability in relation to the changes affecting public finances as a whole, one of the SAO’s objectives in conducting the 2013 final accounts audit was to assess whether chapters and institutions had made preparations to establish an accrual-based accounting system in public finances that would promote the transparency and organisation of public finances, and whether the tasks related to the 2014 transition of public finance accounting had been completed.

## Experiences

Based on audit findings or in independent form, the SAO prepared studies, analyses and a series of articles in the field of accrual-based accounting, which were published on the SAO’s website and in its publication the *Public Finance Quarterly*. It informed the general public of industry events, as well as the publication of studies and articles on the SAO News Portal.

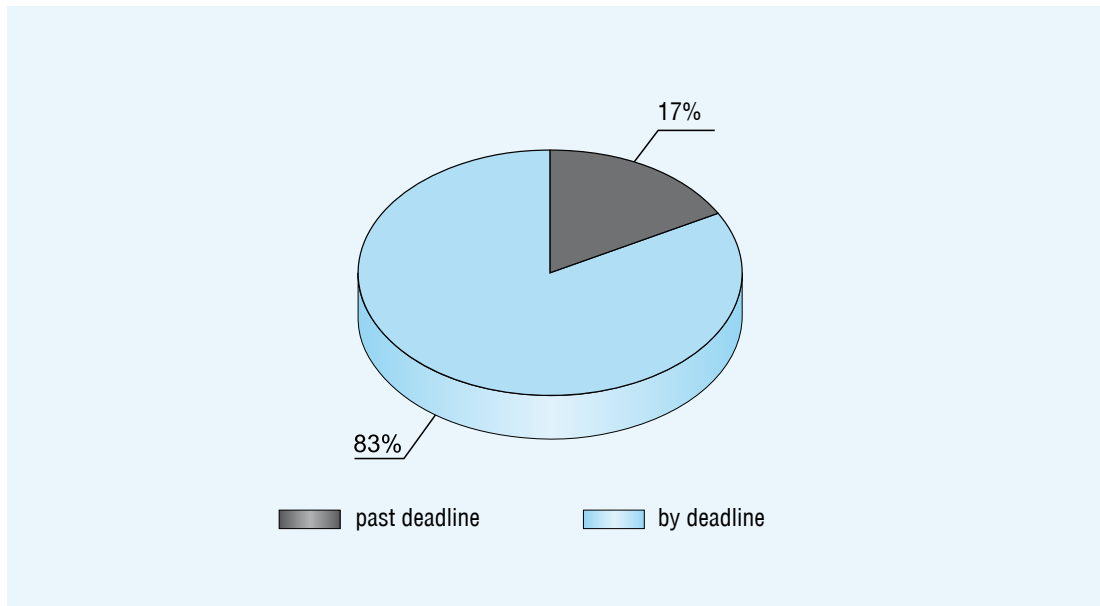
Experiences obtained during the final accounts audit demonstrate that the deficiencies of the IT system posed the greatest difficulty during the transition. During the transition to accrual-based accounting, most organisations fulfilled the requirements related to the setting up of the public finance information system; however, there were delays compared to the pre-defined deadlines in the case of a few organisations. 17 per cent of audited organisations – primarily on account of the deficiencies of the IT system – were unable to adhere to the specified deadline. The progress of the preparation of the balance sheet to be prepared by audited entities by 31 March 2014 is shown in *Figure 3*.

With the exception of three institutions, the organisations fulfilled the requirements set forth in the provisions of the Decree<sup>3</sup> of the Ministry for National Economy. One of the deficiencies that affected three institutions was that the inventory did not comprehensively contain the commitments. (Pongrácz – Kuszinger, 2014)

*“In spite of the transition-related difficulties and problems experienced during the audit, it is our firm belief that accrual-based accounting contributes to more accurate accounting, and creates the opportunity for economically minded accounting among budgetary institutions.”* (Domokos, 2014a).

In addition, it also improves transparency and accountability related to public assets and

**PREPARATION OF THE BALANCE SHEET BY THE 31 MARCH 2014 DEADLINE  
AT AUDITED ENTITIES**



Source: Pongrácz – Kuszinger, 2014

public funds which, through increasing public confidence, further facilitates better public financial management.

**PROVIDING AN OPINION ON THE BUDGET APPROPRIATION BILL**

It is the statutory obligation of the SAO to provide an opinion for the National Assembly on the substantiation of the bill on the central budget and the feasibility of revenue appropriations. Pursuant to the Act on Public Finances, the general objective of the audit was to examine whether planned revenues are economically sound, and whether planned expenditures are approved exclusively to the extent required for the adequate performance of public tasks. In the interest of fulfilling its obligation, the State Audit Office conducts its audit at the organisations responsible for the

planning of central budgetary appropriations, primarily at the Ministry for National Economy and the controlling bodies of budgetary chapters. The State Audit Office has an experience of 25 years in this field, as this is how long auditors have been working to ensure that Hungary has the most reliable and substantiated budget act possible year after year.

“The power to provide opinions is not an SAO task in the classic sense. The SAO is not an auditor in the classic sense in this process, rather it has taken on the role of advisor to the National Assembly. We point out deficiencies, call attention to the risks, and we also indicate which pieces of legislation should be adopted as quickly as possible, and which parts need fine-tuning. Our opinion, therefore, serves as a kind of guide for the Members of Parliament and a call to the Government” (Domokos, 2012b).

### Identification of risks in the process of budget planning

As part of the development of audit activity, the SAO strategy set out as an objective that the provision of an opinion on the budget would receive new emphasis, taking into account the changes in the environment and the rules of the European Union to be introduced with regard to the preliminary reconciliation of the budgets of Member States. Accordingly, in the interest of providing a well-founded, substantiated opinion on the budget, the State Audit Office has renewed its methodological guidelines.

The audit that lays the foundation for the opinion on the budget focuses on the appropriations that play a key role in terms of achieving the budget balance target (key appropriations), as well as the detection of the related risks. Key appropriations are appropriations that have considerable impact on the achievement of the budget balance target or which reach or exceed 0.5 per cent of the total revenue and total expenditure of the central subsystem, or the range of appropriations established on the basis of other filtering criteria, where an appropriation may be included in that range based on the fulfilment of a single criteria. Based on previous years' experience

with respect to the provision of opinion, low-risk appropriations are excluded, allowing attention to be focused on areas associated with actual risks. The range of key appropriations is expanded to include the new appropriations contained in the budget appropriation bill of the given year. The SAO conducts priority audits regarding the new appropriations that are yet to be supported by empirical data, as their realisation carries considerable uncertainty in the lack of thorough background calculations and impact studies. The amount of key appropriations and new revenue and expenditure appropriations must reach at least 80 per cent of the total revenue and expenditure of the budget appropriation bill.

Based on the data in *Table 2*, we can state that during the review of budget appropriation bills, the SAO has ensured coverage above the 80 per cent set out in the methodological guidelines, and as such this was – based on summarised opinions following the qualification of appropriations – suitable to assess the budget appropriation bill as a whole.

Key and new appropriations included in the audit are qualified on the basis of the methodological guidelines. A revenue appropriation will be considered risky if, based on the documents submitted, shortfall is expected in the given year; while an expenditure ap-

*Table 2*

#### **COVERAGE DURING THE PROVISION OF OPINIONS ON BUDGET APPROPRIATIONS BILLS BETWEEN 2013 AND 2016**

	Budget appropriation bill			
	2013	2014	2015	2016
Audited revenue appropriations as a percentage of total revenue	88%	93,6%	88,9%	89,7%
Audited expenditure appropriations as a percentage of total expenditure	82%	88,6%	82,7%	83,6%

Source: SAO opinions on the budget appropriation bills for 2013, 2014, 2015 and 2016

appropriation will be deemed risky if utilisation is expected to exceed the budgeted amount. The qualification system of budgetary appropriations is summarised in *Table 3*.

During qualification by the SAO, in respect of revenues support and feasibility must be assessed, while in the case of expenditures, the assessment is focused on substantiation and on establishing whether the planned appropriation ensures the performance of the public task. A revenue appropriation may be feasible despite a lack of substantiation, and the planned amount of expenditure appropriation could ensure the performance of the public task.

The question arises: what are the major risks in respect of the fulfilment of the central budget? In his Parliamentary exposé, *Domokos* (2014b) emphasised that developments in the macro-economic situation and the international environment pose the greatest risk. He also added that the opinion of the SAO is not a macro-economic analysis; it does not qualify the macro-economic path presented by the

government or any other indicators concerning economic growth, inflation and economic development – it assumes that they are approved and accepted. Furthermore, it does not formulate opinions on economic and socio-political priorities, as this is not its task. The SAO does not have to compete with macro-economic modellers in projecting the risks of future financial crises, but it should identify the weak points of the system of public finances to identify the risks that may exacerbate financial crises or weaken the resilience of the system of public finances against financial crises.

From the perspective of the execution of the budget, uncapped budgetary appropriations in general and appropriations that can be exceeded without separate authorisation in particular, represent a unique risk. Uncapped appropriations – as listed in the Annex to the Act on the Budget – are appropriations of the central subsystem whose fulfilment may deviate from the appropriation without amendment. In the 2016 budget appropriation bill,

*Table 3*

**THE QUALIFICATION SYSTEM OF BUDGETARY APPROPRIATIONS**

		QUALIFICATION OF APPROPRIATIONS			Feasibility of revenues	Compliance of expenditure appropriation
		Substantiated	Partly	Unsubstantiated		
SUPPORT	Supported	X			Feasible	The amount is sufficient to perform the task
	Partially supported		X			
	Unsupported			X	Feasible	The amount is insufficient to perform the task
					X	

Source: SAO Methodological guidelines

Table 4

**THE SAO QUALIFICATION OF THE REVENUE AND EXPENDITURE APPROPRIATIONS OF THE 2015 AND 2016 BUDGETARY APPROPRIATION BILLS AS A PERCENTAGE OF THE AMOUNT OF AUDITED REVENUE AND EXPENDITURE APPROPRIATIONS**

	BUDGET APPROPRIATION BILL			
	2015		2016	
	revenue appropriations	expenditure appropriations	revenue appropriations	expenditure appropriations
Substantiated	71.9%	93.38%	89.55%	96.60%
Partly substantiated	26.9%	6.58%	10.27%	2.92%
Unsubstantiated	1.2%	0.04%	0.18%	0.48%

Source: SAO opinions on the budget appropriation bills for 2015 and 2016

the amount of expenditure appropriations that can be exceeded during the year reaches 53.3 per cent of the total expenditure, HUF 8,822.9 billion. (The corresponding figures in the 2015 and 2014 budget appropriation bills were 57.6 per cent/HUF 9,946.3 billion and 56.4 per cent/HUF 9,528.2 billion, respectively). Within this, the amount of appropriations that can be exceeded without separate regulation is HUF 6,301.9 billion, representing 38.1 per cent of the total expenditure. (The corresponding figures in the 2015 and 2014 budget appropriation bills were 37.4 per cent/HUF 6,453.8 billion and 39.6 per cent/HUF 6,681.9 billion, respectively). This means that in respect of appropriations that account for more than 50 per cent of the total expenditure of the central budget, it is impossible to know in advance the extent to which they will be utilised by the end of the year. In recent years, these appropriations were planned with sufficient allowance; therefore, the risk arising from their uncapped nature did not result in the actual overshooting of the budget. In fact, in 2013, the amount utilised was HUF 56.9 billion less overall than the amount appropriated. From an economic perspective, we can

state that there was a HUF 56.9 billion “hidden reserve” in the central budget. This, however, was not available in a transparent manner and to be utilised flexibly; therefore, the reserve is real.

A new element in the budget act is the so-called implicit reserve, which offsets potential macro-economic changes further. The improvement in the public debt ratio by more than 0.1 percentage points and the favourable change in GDP-proportionate deficit compared to the 3 per cent threshold represent, at the same time, an implicit reserve for the management of macro-economic and budgetary risks. The amount of implicit reserves of the 2015 and 2016 budget appropriation bills is shown in *Table 5*.

Regarding the reserves, it is a positive development that, for the first time in the act on the central budget for 2016, chapter stability reserves were created in a total amount of HUF 35.0 billion, which improves the security of the feasibility of the budget further.

The State Audit Office opinion on the budget appropriation bill stands out among the utilisation of the SAO’s work by the National Assembly. The opinion on the budget indicates

**IMPLICIT RESERVES OF THE 2015 AND 2016 BUDGET APPROPRIATION BILLS  
(HUF BILLIONS)**

	BUDGET APPROPRIATION BILL	
	2015	2016
Implicit reserve of the public debt ratio	260.0	305.6
Implicit reserve of GDP-proportionate deficit	200.0	351.9

Source: SAO opinions on the budget appropriation bills for 2015 and 2016

which areas of the bill require improvement until the final vote. Experiences show that the government improves several sections of the budget appropriation bill every year.

**THE ROLE AND TASKS OF THE SAO  
IN THE FISCAL COUNCIL**

The Fiscal Council is a 3-member body that supports the legislative activity of the National Assembly, the main task of which is to ensure that the act on the budget complies with financial regulations. Its chairman, who has outstanding professional expertise and experience, is appointed by the President of Hungary for a term of six years. The other two members of the council are the Governor of the National Bank of Hungary (MNB) and the President of the SAO in office. The legal status and task of the Council is defined by the Fundamental Law of Hungary, and is set out in detail by Act CXCIV of 2011 on the Economic Stability of Hungary (Act on Stability). The operation of the Fiscal Council is supported by the supreme audit institution and the analyst apparatus of the central bank, and since the establishment of the Secretariat of the Council in 2013, external academic and analyst capacities contribute to an increasing extent to its organisation (Kovács, 2014). SAO analyses are primarily based on the expertise

that the state audit office has amassed during the audits related to the budget.

**Synergies in the activities  
of the Fiscal Council and the SAO**

In terms of synergy, it is extremely important that through its audits, the SAO is able to continuously (practically throughout the entire year) monitor budgetary processes, as the final accounts audit that begins at the start of the year does not even end when the audit that lays the foundation for the opinion on the budget appropriation bill already begins, emphasised László Domokos in his presentation at the Fiscal Council conference (2013a). The SAO regularly audits institutions that play a crucial role in preparing the budget. This allows the SAO to gain first-hand information concerning the budget by also auditing local governments and central budgetary institutions (such as universities and hospitals).

The priority task of the Council is to ensure that the objective of reducing public debt is met, in compliance with the Fundamental Law, during the approval of the central budget. The National Assembly cannot adopt a budget as a result of which public debt would exceed half of the gross domestic product; moreover, if government debt exceeds this value, the Na-

tional Assembly may only adopt budgets that provide for the reduction of public debt. The debt rule serves as a compass of sorts in the everyday work of the SAO (Domokos, 2014c). The State Audit Office defines its audit plan in consideration of the debt rule; indeed, this is one of the focal points of numerous audits and analyses, and the SAO makes recommendations and performs advisory tasks in the interest of accomplishing this goal. Another audit assignment of the SAO arising from the debt rule is to audit the management of public debt. In the past, this area was the subject of targeted audits by the State Audit Office every five years, the last being conducted in 2012.

With a view to providing even more efficient support to the Fiscal Council, the primary ambition of the SAO is to systematically integrate the results and experiences of its budget-related audits into the Council's decision-making process (Domokos, 2012a). To this end, the SAO has taken measures in relation to given core functions of the Council. The first measure was to set up the monitoring system that allowed the systematic tracking and analysis of the budgetary processes of the given year. In addition, it developed new methodological guidelines to provide opinions on the budget appropriation bill, as well as a manual for inspecting the fulfilment of the debt rule.

The state audit office work ensuring the more efficient performance of activities supporting the Council can be divided into two parts: the tasks arising from statutory obligations and other tasks supporting the performance of mandatory tasks. Pursuant to the provisions of the Act on Stability, mandatory

tasks to be repeated on an annual basis include the analysis of budgetary processes every six months and the assessment of the expected changes of public debt; the provision of an opinion on the draft budget appropriation bill; and the assessment of the enforcement of the public debt rule before the final vote during the audit that lays the foundation for the opinion on the bill on the central budget of Hungary. Beyond mandatory tasks, the Council may also have other responsibilities. It may also provide opinions on bills containing statutory amendments required to substantiate the bill on the central budget, or to provide opinions on any issues related to the planning and execution of the central budget or the utilisation of public funds in any other manner.

In the case of both mandatory and other supporting tasks, the supporting activity provided by the SAO is concluded with the preparation of a written document. In the case of each task, this comprises an analysis that contains the SAO's assessment, opinion, indications and potential recommendations. The SAO's work performed for the Council – similarly to the review of the budget – is intended to support 'good governance'. The analyses contribute to substantiating the Council's decisions and to improving the substantiation of annual budgets. Domokos (2014c) stressed that the reports of the renewed Council cover the processes of the Hungarian economy successfully, assess risks correctly, and prognosticate the developments in public finances reliably. As a result, year after year, the Council sends messages that legislators accept and act on, thereby improving the quality of the budget.

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#### NOTES

<sup>1</sup> Act LXVI of 2011 on the State Audit Office of Hungary

<sup>2</sup> SAO Act, Article 5 (7)

<sup>3</sup> Decree No. 36/2013 (IX. 13.) of the Ministry for National Economy on the tasks related to the 2014 transition of the accounting of public finances (NGM Decree)



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