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The Contribution of the State Audit Office to Good Governance and the Renewal of Accounting

SUMMARY: The article examines the activities of the State Audit Office of Hungary from the perspective of the contribution to good governance, typically building on the method of document analysis. By presenting the parallels and differences existing between the various ideological trends, it paints a picture of the general principles of good governance, in particular of the significance of the enforcement of accountability and transparency that forms the basis of controllability. The debates surrounding the measurement of the 'goodness' of the state has been ongoing among the professional-academic audience, as a result of which numerous indicator systems have been created in recent years. Processes that promote the enforcement of the basic principles of good governance have started at both international and domestic levels. Special attention should be paid to the 2014 public accounting reform in Hungary, and on a related note, the role undertaken by the SAO in preparing the transition to accrual-based accounting and the subsequent interpretation of the impacts of the transition. After the presentation of the results of the transition, the article emphasises the reinforcement of the advisory function of the SAO, it elaborates on the anomalies surrounding the assessment of asset content, which may serve as the basis of further research aimed at the rethinking of current accounting regulations and increasing the accountability of the public sector down the line.

KEYWORDS: state audit office, good governance, accrual-based accounting, audit, expediency, effectiveness, efficiency, transparency, accountability

JEL CODES: H11, H50, H83, M41, M42, M48

THE THEORETICAL FOUNDATION OF GOOD GOVERNANCE

Good governance is by no means a newly established concept, as all governments – in line with the theoretical model adapted to their own system of values of course – wants to govern well. At the same time, the values and aspects that form the basis of these theoretical models differ from one another in terms of both space and time. Consequently, the various disciplines and

the schools representing the various directions of these disciplines define the content of good governance along different criteria. In order to uncover the links between state audit office work and good governance, it is first necessary to define good governance as well as the general principles that – today – provide its content.

Good governance versus good government

The English language distinguishes between the two ideological trends that have developed

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along good governance (*good governance* and *good government*), and as a first step it would be expedient to clarify the difference between the two.

▶ The concept of *good governance*, in other words governance as a process, is frequently linked to the economic and socio-political reforms recommended by the World Bank and launched in the 1980s¹. These reform proposals were based, amongst other things, (and similarly to the first wave of reforms of the New Public Management movement launched at the end of the 1970s in OECD countries as a result of the economic crisis) on the widespread adaptation of management techniques applied in the organisational models of business enterprises. The World Bank's approach contains the traits that reduce state influence and role, which are also characteristic of the NPM movement. As such, in particular, the stimulation of deregulation and privatisation processes desirable in state operation, based on which certain authors interpret good governance as a neo-liberal concept that limits the state to a 'night-watch' function in the narrowest sense and which allows for market mechanisms and the social coordination function of the private sector (G. Fodor – Stumpf, 2007).

▶ In contrast, the *good government* trend, which emphasises the limits of the 'marketisation' of the state and which was created in opposition of the followers of privatisation takes as its starting point the notion that the function of the state is more than just creating the system of criteria of good governance. The state must assume the tasks of good governance as well as the responsibility that goes with it in order to enforce public interest, in other words, it must perform the fair allocation of economic and social resources based on solidarity and by taking the aspects of all concerned parties into account. Consequently, the realisation of good governance requires an active, intelligent and strong state. In this

respect, the *good government* trend exhibits similar characteristics to the Neo-Weberian state. The state, assigned with a reinforced role, is attempting to ensure access to public services at the best possible quality and price to consumer citizens, with the wide-scale participation of these citizens. The essence of the Neo-Weberian notion is that result-oriented governance that embodies unbiased professionalism, must be based on constitutionality and rule of law, thereby ensuring the enforcement of accountability and political responsibility (Stumpf, 2009).

Though these ideologies exhibit significant differences in respect of their various characteristics, there are still basic principles that can be formulated which merge the requirements of bureaucratic public administration, good governance and good government.

The basic principles of good governance

In practice, the line between the above presented concepts of good governance and good government is often blurred. After the failure of the neo-liberal wave of the 1980s, in the interest of implementing good governance several responsible international organisations – such as the UN, the World Bank and the OECD – and the European Union made efforts to develop a new public administration-development concept adapted to the challenges of the modern age. The widespread cooperation resulted in an ideology-free and value-centred approach to the role of the state and its institutions and their desired mode of operation. In this respect, the basic principles of operation of the European Common Administrative Space are highly informative, which declare bureaucratic and effectiveness requirements as values by promoting the priority of value-based coordination (Pulay, 2009).

Table 1 presents the criteria of good governance (in international comparison).

Based on the parallel interpretations presented, for the purposes of this article, good governance shall mean – without any ideological distinction – efficient, effective, reliable, transparent and responsible government activity, as part of which state bodies, in cooperation with the other stakeholders of society, seek solutions to economic, social and environmental challenges by taking public interest into consideration. The general principles of good governance – as collected below –, in the forms corresponding to international, so-called best practice, are encountered increasingly frequently:

- law-abiding and compliant behaviour,
- regulation that welcomes equality and the views of others,
- activity that has the capacity to come to consensus,
- behaviour that encourages participation, cooperation,

- expedient and effective financial management,
- responsive operation,
- accountable activity,
- transparent operation.

In the theoretical model of good governance (see Figure 1), these general principles are structured according to the dimensions of legality, controllability, cooperation and effectiveness and form the interpretation framework of the regular operation and performance of the state organisation.

THE ROLE OF VALUES IN THE OPERATION OF THE STATE

Numerous international economic, financial and development policy organisations have developed, along the basic principles of good governance, indicators and indicator systems aimed at measuring the goodness of

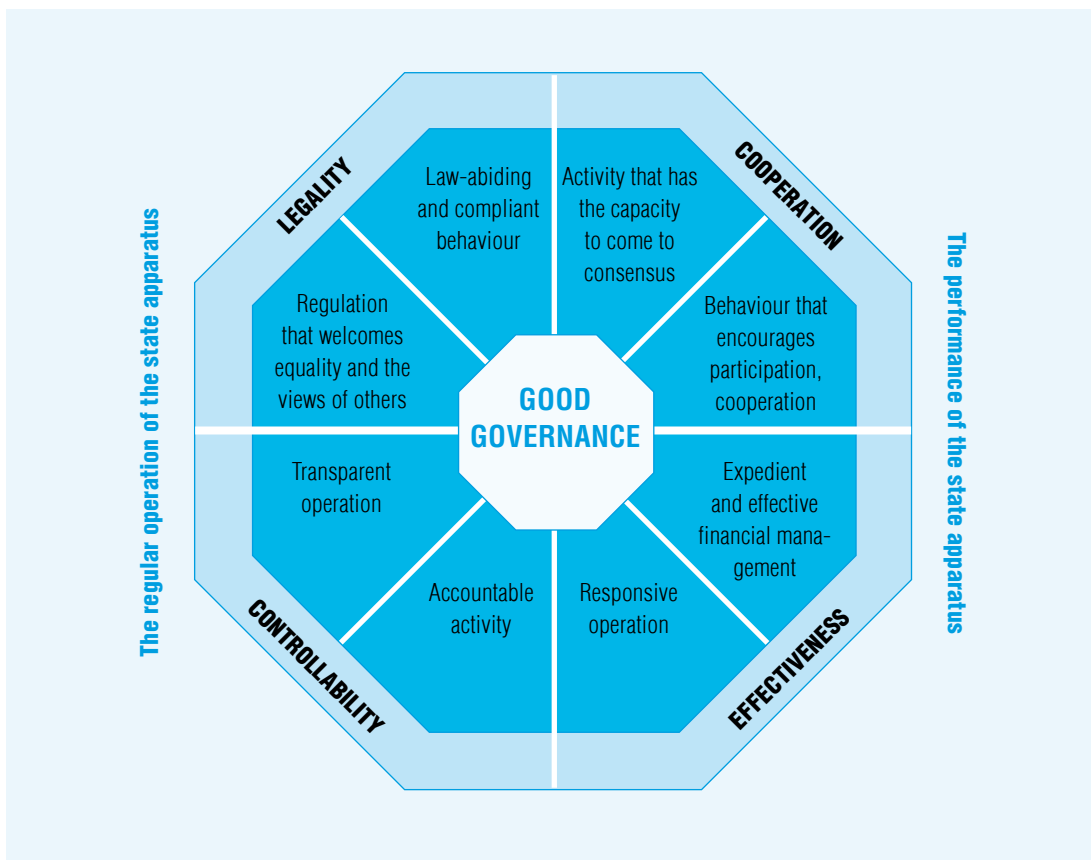
Table 1

THE CRITERIA OF GOOD GOVERNANCE		
World Bank ²	OECD ³ according to the	European Union ⁴
• voice and accountability	• openness, transparency and accountability towards democratic institutions	• openness • accountability
• rule of law	• respect of the rule of law	
• political stability and absence of violence	• correct and equal treatment of citizens, including the system of intervention and participation	• participation
• effectiveness	• government effectiveness	• effectiveness
• regulatory quality	• clear, transparent and applicable laws and regulators • coherence and consistency in policy-making	• coherence
• control of corruption	• high norms of ethical conduct	

Source: own editing

Figure 1

THE THEORETICAL MODEL OF GOOD GOVERNANCE



Source: Báger (2012), p. 150

the state and the performance of the government. Among the assessment and evaluation methods used in Hungary, the JÁX⁵ and the Good State Mosaic developed by the Good State and Governance Research Institute, operating within the Institute of the Science of the State and Governance of the National University of Public Service, merits mention. The approximately four hundred governance indicators registered worldwide (as a function of the objectives to be accomplished by and the requirements set against them) set out to measure the enforcement of public good and the implementation of good governance along varying impact areas and dimensions. Accordingly, the various indicator systems focus on

different aspects of governance during measurement and assessment.

The differentiation of evaluation methods can in part be traced back to the fact that the issue of the enforcement and measurability of the content of value abstractions embodying public good have generated heated value debates. The value concepts linked to the enforcement of public good as the ultimate objective of state operation generate relatively pure categories. Such as compliance with laws and statutes, equality, impartiality, proportionality, rule of law, proceedings within a reasonable time, participation, respect of privacy, transparency,⁶ or in the approach of *Bovaird* and *Löffler* (2003), social participation,

transparency, accountability, equality, ethics, fairness (fair proceedings), competitiveness, efficiency, sustainability, rule of law. However, the evaluation of content values, such as the input and output side is not so obvious, as from the perspective of the enforcement of the effects of public good (*output*), a number of government instruments (*input*) may be classified as “good” (Kis, 2014).

IN NUMBERS

According to aggregate 2013 WGI indicators, Hungary's rating has deteriorated compared to 2000 values both in terms of government efficiency and the prevention of corruption.

Hungary's performance in 2013 helped the country achieve 48th place in the IMD competitiveness rankings (which compares the performances of 61 states), which means that Hungary's rating dropped one position compared to 2011.

In 2015, overall the IMD still ranked Hungary in 48th place, however, based on government efficiency indicators, the country is only in 54th place.

The most frequently used indicators and indicator systems, which serve to ‘describe’ the enforcement of value abstractions, do not directly assess the goodness and quality of governance, but rather through the measurement of social, economic and environmental impacts generated by governance. Well-known international examples include, but are not limited to the following:

- WGI indicators (World Bank)⁷
- Society at a Glance and Government at a Glance indicators (OECD)⁸
- indicator systems of the European Commission⁹
- World Competitiveness ranking¹⁰

Hungarian examples, such as the JÁX or the Good State Mosaic, focus primarily on the strengths and weaknesses of governance capacities determining state operation and

similarly to international practice assessment is conducted through the impacts achieved. The JÁX and the Good State Mosaic are based on the impact areas detailed in *Table 2* as well as the system of value-based indicators characterising these areas along varying dimensions.

THE CONTRIBUTION OF THE STATE AUDIT OFFICE TO GOOD GOVERNANCE

Establishing an efficient state operation and improving the quality of governance are in the fundamental interest of all nations. Accordingly, Hungarian government objectives assign high priority to accomplishing good governance, which is facilitated by targeted government programmes. These include the local government reform, as well as the reform programmes of the justice system and public administration.

As interpreted by the various reforms, “*the state can be considered to be good if it serves the needs of individuals, communities and enterprises in the interest and framework of public welfare, in the most appropriate way.*”¹¹ The foundation of the contribution of the State Audit Office of Hungary (SAO) to good state operation is provided by Act LXVI of 2011. By passing this act the National Assembly has set out, amongst others, the following tasks for the SAO.¹²

“With its findings, recommendations and advice based on its audit experience, the State Audit Office of Hungary assists the National Assembly, its committees and the work of the audited entities, thus facilitating well-governed state operations.”

The commitment towards promoting the implementation of good governance is also reflected in the strategic documents of the SAO,

Table 2

STRUCTURE OF THE GOOD STATE MOSAIC

Impact areas	Dimensions	Examples of indicators used
1. SECURITY AND TRUST IN GOVERNMENT	External security Public safety and disaster management Legal security Public confidence in government and transparency Secure livelihood	<ul style="list-style-type: none"> • Annual defence spending per 1000 persons at current price • The population's perception of safety in public areas and in their home environment
2. COMMUNITY WELFARE	Income position Social exclusion Healthcare and social safety net Employment and education The individual in society	<ul style="list-style-type: none"> • household sector total adjusted disposable income • poverty or the risk of social exclusion
3. FINANCIAL STABILITY AND ECONOMIC COMPETITIVENESS	Financial stability Economic diversification Investment and human capital Innovation	<ul style="list-style-type: none"> • Net financing capacity relative to national economy GDP • share of gross added value of technology and knowledge-intensive industries
4. SUSTAINABILITY	Climate change Management of natural resources Environmental burdens Economic sustainability Social sustainability	<ul style="list-style-type: none"> • greenhouse gas emissions • produced biomass
5. DEMOCRACY	Political competition Political participation Social dialogue Democratic exercise of rights Freedom of the press, freedom of speech	<ul style="list-style-type: none"> • number of registered parties • proportionality or disproportionality of the electoral system
6. EFFICIENT PUBLIC ADMINISTRATION	Accessibility Administrative burden Resource efficiency Preparedness	<ul style="list-style-type: none"> • users of developed e-government services as a proportion of internet users • number of services supporting the administration process

Source: Good State and Governance Report, 2015.

and accordingly the mission of the SAO is formulated as follows:

“The mission of the State Audit Office of Hungary (SAO) is to promote the transparency and regularity of public finances with

its value creating audits performed on a solid professional basis, thus contributing to ‘good governance’.”

Before going into details concerning the role of the SAO in promoting good govern-

ance, we should first present to some extent the institutions exercising audit powers over the institutions of the public sector as well as their respective tasks, in the interest of identifying the key audit borderlines and mapping out the audit hierarchy.

The system of public finance controls

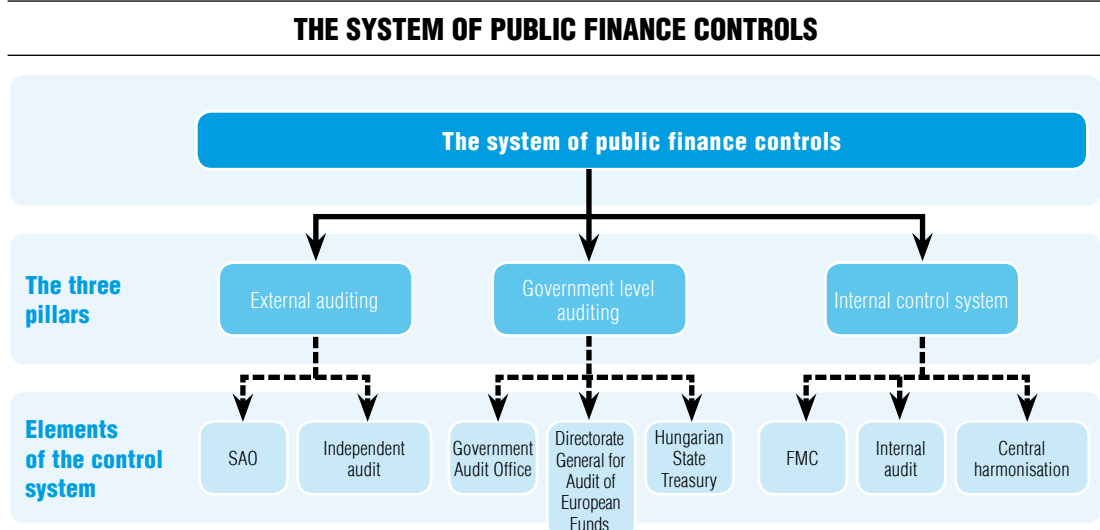
The fundamental objective of public finance controls is to promote the regular, regulated, economic, effective and efficient management of the funds and assets of public finances. The control of public finances – which extends to all subsystems of public finances – is supported by three pillars. These pillars comprise external auditing, government level auditing and the internal control system (see Figure 2).

There is no hierarchical relationship between the three pillars that form the control system of public finances, and these pillars make up the whole system together. Yet there is still a sort of hierarchy to speak of, where the various audit levels clearly differ in respect of their set of objectives, scope of tasks and powers and the related tools. The state audit

office, as the supreme financial and economic audit institution conducting the external auditing of public finances, performs its tasks in subordination to the National Assembly. It has general powers in auditing the responsible financial management of public funds as well as of state and local government assets, and during its audit activity is independent of all other organisations. Through its findings and recommendations based on audit experiences, it supports the work of the National Assembly and its committees, and furthermore, it shares the good practices with the institutions of the public sector. Based on all this, through its task performance, the SAO's activity contributes to implementing a well-controlled state operation.

In contrast, the government level auditing of public finances falls under the scope of activities of the Government Audit Office, the Directorate General for Audit of European Funds and the Hungarian State Treasury. These supervisory bodies, similarly to the SAO but with a more limited range of powers, audit the utilisation of public funds, the management and protection of national assets, and the efficient, economic and effective performance of public

Figure 2



Source: own editing¹³

tasks. In other words, they perform – similarly to the SAO – objective, fact-finding auditing and advisory activities that draw conclusions and formulate recommendations, but their work primarily supports government decision-making. As a result, the guarantees of independence from current government are in their case enforced in a different fashion. There is also a significant difference between the SAO and governmental audit bodies in respect of what mandates they have. The SAO is not an authority, and in the absence of appropriate mandates it may not deliver judgement and may not penalise, it may only make independent recommendations or communicate findings. In contrast, the Government Audit Office may impose fines and the Treasury can issue binding resolutions, while the State Audit Office has no such powers.

The third pillar of public finance controls is made up of the control system of the given budgetary institution. Independence in this case can only be interpreted within organisational frameworks. The objective of the establishment of the internal control system is to ensure that activities are performed in a regular, economic, efficient and effective manner, that accounting obligations are met, and that losses and damages arising from wasteful management and improper use are uncovered and prevented. The creation, operation and development of the internal control system, and the operation of independent internal audit as an element of the internal control system are the responsibility of the head of the budgetary institution. Internal auditing is an advisory activity under the direct supervision of the head of the budgetary institution, which audits financial management and the performance of public functions from the perspective of compliance with statutes and internal regulators and which provides objective assurance; the objective of which activity is to develop the operation of the given budgetary institu-

tion and to improve its effectiveness. As far as scope is concerned, though internal audit is at the lowest level of the audit hierarchy, its significance is by no means negligible as through its impact on the development and operation of internal controls, it provides one of the key factors of establishing accountability.

INTEGRITY SURVEY

In the spirit of the fight against corruption, ever since 2011 the SAO conducts an annual integrity survey based on voluntary responses, which maps out the level of protection of the public sector against corruption risks.

In 2014 a record number of respondents, 1584 in total, representing 55% of the Hungarian public sector (taking employee headcount into account) took part in the survey.

After this brief detour concerning the system of controls of public finances, let us return to the utility of the state audit office work, and present how the SAO, given its auditing, research and advisory role and by setting up its own organisational operation to be used as an example, serves the enforcement of the basic principles of good governance.

Presentation of the activity of the SAO in respect of enforcing the basic principles of good governance

Law-abiding and compliant behaviour

It is the legal and moral obligation of all players in the public sector – be it an organisation or an office employee for that matter – to reinforce the rule of law. In this respect, the function of the SAO is at least threefold. Through its audits, it provides control over the players of the public sector in the interest of developing and maintaining compliance, and the realisation of the regular, economic, efficient

and effective management of public funds. The guarantee of long-term sustainability, however, lies in the fact that compliance and regular utilisation of public funds is not simply a form of behaviour enforced by audit activity, but is primarily based on voluntary compliance with laws arising from the commitment of players to regularity. As a result, the SAO's advisory function is assigned a priority role, within which studies and analyses on present and future processes help to uncover and understand external and internal correlations in the various areas of the public sector, as well as the changes occurring and their impacts. At the same time, they also highlight potential regulatory deficiencies, such as factors potentially threatening the responsible and sustainable management of public assets and environmental and social sustainability. Beyond the above, advisory activity establishes a framework for the wide-scale dissemination of good examples to follow, which also have an impact on promoting the development of public finances. Finally, another tool of reinforcing compliant behaviour is for the SAO to lead by example for public sector institutions through the establishment of its own organisational operation, through the transparency and traceability of its organisational processes and through effective, efficient and economic resource utilisation.

Regulation that welcomes equality and the views of others

Relevant international literature distinguishes between *equality* and *equity*. While the former term in essence stands for equal treatment, the meaning of the latter goes beyond this, and assumes that the conditions of equal access are supported by specific, practical tools. The SAO can best facilitate the enforcement of this basic principle as part of the review of the internal control systems of audited entities, by assessing established controls and by pointing out potential deficiencies, and in ad-

dition can use its own organisational solutions as an example to promote the enforcement of equal opportunities. An example of this, for instance, is the trainee programme supporting recent graduates in gaining work experience, that was launched by the SAO in 2011 in the spirit of corporate social responsibility; or the auditor career model established at the organisation. The openness of the SAO and its receptiveness to the views of others is also reflected by the fact that the development of the organisation continues to progress on the basis of international methodological guidelines.

Activity reinforcing the ability to reach consensus

The ability to reach consensus, in other words the willingness to become familiar with and to consider the opinions of the parties concerned, is the work method applied by organisations that strive to achieve long-term effectiveness, and is an essential component of state audit office work, and therefore state audit office reports as well.

In the case of state players, we may encounter detailed regulators and regulations concerning the levels and players of decision-making. By this we refer, for instance, to the mandates of the representative body or those of the committees, notaries and the mayor authorised by this representative body in local government decision making; or the regulation of powers assignable or non-assignable by the representative body; but for that matter also the regulation of the varying powers of the controlling body, the fund manager or the decision making body in the case of public funds. The role of the SAO in promoting the ability to reach consensus throughout the entire public sector can only be enforced indirectly. The SAO formulates opinions on the law-abiding conduct of public sector players subsequently, through its audit activity and on the basis of its audit findings, however, as

a result of this subsequent control, its opinion helps promote law-abiding behaviour in line with the intentions of legislators. Situations may also occur where, on the basis of its audit findings, the SAO uncovers unlawful situations that may in essence be traced back to a lack of consensus between the players of the public sector. In such cases, warning letters may serve as an appropriate tool to resolve the issue and to force consensus.

Of course the SAO, as an organisation that leads by example, also strives to achieve consensus in a regulated framework by projecting this to its own organisational operation, in a manner that does not threaten its independence; this consensus is obviously interpreted differently in respect of organisational processes and in respect of external communication. Examples of organisational processes include the numerous quality assurance tools supporting the process that begins with the preparation of the auditor working paper and ends with the issue of the state audit office report. In the case of external communication, consensus can only be interpreted within a framework set out by statutes – as a guarantee of the right to submit observations by the audited entity –, to which observations the SAO responds within 30 days of receipt.¹⁴ The fact that the SAO is obligated to indicate unaccepted observations in the SAO reports along with the corresponding justifications acts as a guarantee of the in-depth review of these observations.

Behaviour that encourages participation, cooperation

One of the aspects of the enforcement of the basic principle during state audit office work is contact with the audited entity, and the active involvement of the audited entity in the data request phase (concerning data set out by the audit programme) and the on-the-spot check phase. Manipulation-free cooperation realised

with the participation of the audited entity is of fundamental importance in respect of audit findings and the collection of records and basic documents supporting these findings. It is no coincidence, therefore, that the audited entity’s manager is bound by a legal obligation to cooperate¹⁵, non-compliance may be penalised by the SAO pursuant to its legal mandate. At the same time, on account of the voluntary participation of respondents, the example of the integrity survey presented earlier also fits this bill as it generates benefits for the organisations participating in the survey as well. They are given a status report on the exposure of the organisation to corruption risks, on the level of development of their control tools that serve to decrease risk, and the development of the organisation’s internal control system not only increases protection against corruption risks, but also has a tangible impact from the perspective of findings formulated during a potential audit.

PUBLIC INTEREST DISCLOSURE

According to the relevant act, a public interest disclosure, received by the SAO, calls attention to a circumstance the remedying or discontinuation of which is in the interest of the community or the whole society. A public interest disclosure may also contain a proposal.

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It was with a similar objective that the SAO developed a system of self-testing for local and minority governments and church institutions that serves as a guideline, with which the heads of the organisations and institutions concerned can, by taking responsibility for the development or restoration of regular operation, start correcting the errors and deficiencies on their own.

During its activities, the SAO, as the primary watchman of the responsible management

of public funds and public assets, also relies on citizens. Even though the SAO is not an investigative authority and as such cannot directly act on the basis of reports made in person or in writing, public interest disclosures still carry weight. It is through these that important information is integrated during risk analysis supporting audit planning processes.

THE 2014 ACTIVITY OF THE SAO IN NUMBERS

- 233 SAO reports issued
- 966 organisations affected during the audits related to the reports issued
- 2642 recommendations issued in total based on findings with obligations to take action
- 574 intended users

Expedient and effective financial management

Players of the public sector – in light of globalisation processes and economic tendencies – are increasingly obligated to comply with social requirements concerning the efficiency of the public sector. They must ensure efficiency and effectiveness in respect of both the operation of the public sector and the provision of public services. Though the limits of this study do not allow for the detailed presentation of international research and publications in this area, it is certainly true that the issue of increasing the effectiveness of the public sector is on the agenda in both developed and developing economies.¹⁶ The effectiveness of financial management is best interpretable through the ratio of resources utilised and the results thereby accomplished. The value of this ratio only carries actual information if we can clearly state which objective or task were the utilised resources used for and to which extent were they utilised. This train of thought unavoidably leads to the topic of the establishment of public finance ac-

counting that is able to serve this new type of information need. We will elaborate in detail on the role undertaken by the SAO in the renewal of Hungarian accounting regulations later on, but the present chapter only wishes to illustrate that the SAO – in addition to the intention to adapt the methodology of performance audits and to extend the application thereof – pays special attention to the evaluation of the effectiveness and efficiency of the financial management of public sector players during its audits. It assigns priority to the determination of requirements for the various institutions, as well as to the establishment of the criteria system of accountability and the implementation thereof. These represent a fundamental prerequisite of the efficient management of resources and the efficient utilisation of public funds, in a manner set out in statutes.

The SAO strives to achieve effectiveness, efficiency, economy and sustainability in respect of its own operation as well. It continuously monitors and optimises its organisational processes, it assigns measurable indicators to the organisational objectives set, and supports the increase of working days available for audits and the increase of auditors participating in audits through efficient resource planning.

Responsive operation

This is closely related to the concept of efficiency as discussed above. The appropriate allocation of resources and state interventions serving the realisation of public good is possible only if information based on past experiences and on future processes and their expected impact are available in time. Efficiency is, therefore, accompanied by timeliness. Another prerequisite of responsive and effective state operation is the proportionality of the objectives set and the consequences of decisions aimed at accomplishing these objectives, as well as decision-making based

on subsidiarity. The SAO's activity, therefore, cannot be just made up of the auditing of past processes. As part of its advisory function, it, amongst other things, also prepares analyses and studies on future tendencies and trends. And with its opinion providing role undertaken in the legislative process, it supports the work of the National Assembly and its committees as well as that of the Fiscal Council.

IN 2014, THERE WERE

- 50 indications made to the Prosecutors' Office
- 21 public procurement legal remedy proceedings opened
- 29 cases where the SAO notified the capital and county government offices – responsible for the legal compliance supervision of the audited local government

In the spirit of the realisation of good governance, the SAO also introduced reforms that serve to improve its own responsiveness. By changing its organisational structure and flattening the organisational pyramid, it has transitioned to a matrix-type organisational operation. The switch to project-centred work provides adequate flexibility in the face of challenges arising in relation to social expectations and environmental changes.

Accountable activity

All players of the public sector must be aware that through their actions they embody the state and, depending on their activities, they (could) decide the fate of others. As such, public service is a profession that carries great responsibility, where the guarantees of responsibility and accountability related to the given activity must be ensured. In the interest of the above, the SAO has the following legal tools at its disposal:

- initiation of criminal proceedings and

other disciplinary actions in the case of suspicion of offence;

- initiation of measures taken by authorities when uncovering wasteful management of public funds or public assets;
- obligation of the audited entity to act;
- and the follow-up audit of the implementation of the action plan.

It is an important change that as of 2011, the new SAO Act stipulates an obligation to act for audited entities. This means that the institutions are obligated to prepare action plans stipulating specific measures concerning each State Audit Office finding, which obligation promotes the improvement of accountability.

Though belonging to the area of accountability within the organisation, irresponsible behaviour and its consequences that are manifested by disregarding the ethical aspects (which is more difficult to define than disciplinary offences arising from non-compliance with legal norms) is today gaining increasing emphasis. In respect of this particular issue, the SAO (as part of compliance audits) examines the existence of internal controls serving the integrity of public sector institutions, and with its recommendations based on the assessment of the entire internal control system, serves the reinforcement of the integrity of public finance organisations.

In connection with the latter for instance, accountability, in respect of SAO's own activities, is enforced through the declaration of auditor responsibility, on the basis of the SAO Act and the relevant provisions of the SAO's Operational and Organisational Rules.^{17,18} The auditor is responsible for the independent performance of tasks that fall under his/her competence, by the deadline set and in compliance with ethical requirements, and the auditor is also liable for the professional opinion. The auditor's responsibility is enforced throughout the entire process of the

SAO audit organised on a project basis. In line with the seven phases¹⁹ of the audit process, the Operational and Organisational Rules set out the extension of the responsibility of the auditor performing the audit to other areas. The Operational and Organisational Rules regulate in detail the scope of responsibility of employees who fall under the scope of the Act on Public Officials²⁰ and the Labour Code, and furthermore also state that the provisions concerning auditors prevail in respect of the liability, rights and obligations of external experts involved in the audit.

Transparent operation

In respect of the operation of public sector institutions, the principle of transparency demands that organisational operation is implemented along external and internal regulators, in a manner that can be monitored by external stakeholders (auditing bodies, citizens) as well. Based on this, it assumes that the applied procedures, rights and obligations are known to all parties or at the very least these parties have the opportunity to become familiar with these. This provides an opportunity for external auditing bodies to review the legality of the decisions made by organs of the public sector. In this respect, the SAO has a dual role. As the supreme financial and economic audit institution of the National Assembly, it promotes the transparency of public finances through value creating audits, performed on a solid professional basis. At the same time, by making reports public and by operating indirect channels of communication, it provides information to citizens on processes of the utilisation of public funds that otherwise would not be visible. During its audits, the SAO confirms the enforcement of the principle of authenticity in the respect of both the financial accounts of public finance organisations

and the financial statements concerning their financial management. Meanwhile, the findings regarding potential errors and decisions uncovered during the audit ultimately serve the improvement of the reliability of the information content of financial statements. Utilisation is equally important, in other words, ensuring that information concerning the regularity of the utilisation of public funds, as well as information on the efficiency and effectiveness of financial management is received by all concerned parties. In the interest of utilisation – as the accomplishment of a strategic objective – the SAO performs a proactive communication activity through a number of channels.

On the other hand, beyond the disclosure of reports, the SAO also wishes to provide an example by making its own operation and organisational processes more transparent for public sector institutions, and for this reason it complies with and discloses the external and internal regulators relevant to its operation, and enforces their contents during its communications.

THE ROLE OF THE SAO IN RENEWING THE ACCOUNTING SYSTEM OF PUBLIC FINANCES

The theoretical foundations of accrual-based accounting

The accrual-based approach which emphasises the priority of non-financial quantitative data – which is a general practice in the field of industrial economics – is not a new phenomenon, in order to understand it however, it is expedient to review a few of the developmental milestones of the history of accounting. In essence, accounting has developed continuously, adapting to changing information needs of the financial mana-

gement of the various eras. Obviously, accounting served to register different types of information in medieval trade and other types after industrialisation, when focus shifted to production costs determining the foundations of industrial economics.

It was with the publication of the chart of accounts published by *Schmalenbach* in 1927 that modern accounting reached the level of development where, in addition to asset and liability accounts, the accounting system based on four-line accounting theories also containing expense and profit accounts made it possible to compile a profit statement that was able to present the sum and structure of profits realised in the given period (Baricz – Róth, 2004). This was especially important because Schmalenbach, taking the basic accounting principle of the continuity of business as a starting point, stated that the most important information (instead of the assessment of stocks) is provided by pure yield derived on the basis of non-financial movements in the given period, in other words realised profit recognised, and as such he considered the income statement (which serves to recognise profit realised through output in the given period) to be the most significant document of accounting (Baricz, 1997).

Accounting reform processes

As detailed before, the NPM reforms characteristic of the 1980s were primarily based on the adoption of management techniques applied in the business sector, and ultimately aimed at creating a smaller, more efficient, more effective and consumer-oriented public sector that is typically operated by market type mechanisms. The establishment of the accrual-based accounting of the public sector fits into this theoretical framework well. In fact, according to *Likierman* (2003), NPM

reforms cannot actually accomplish their true goal without accrual-based accounting providing a true and fair overview of the economic performance of public sector players and the financial situation of the public sector, which is essential on the one hand for the substantiation of economic or economic policy decisions, and on the other for establishing the conditions of accountability. The basis of trends supporting the viability of the introduction of accrual-based accounting in the public sector is that accounting information based on non-financial quantitative data – by recording economic events linked to the time of their occurrence – provides a more reliable picture on the economic performance of public sector players. Having acquired adequate information, decision-makers are in a clearer decision-making position which ultimately results in better decisions, for instance in respect of achieving the correct ratio of operating and accumulation expenditures.

The most frequently quoted arguments for accrual-based accounting from the side of the auditing and accountability of public sector players are that, compared to traditional cash-based approach, it allows a narrower space for maneuvering to manipulate financial information related to financial management, and thereby, to distort the results of financial management. The accrual-based approach provides a greater overview of the prime cost side of public services, which typically leads to the simplification of decision-making situations related to the planning of public services and „*make or buy*” issues. Furthermore, depreciation is displayed in financial statements as a profit reducing item, which must be taken into account by public sector players when shaping their financial management. Though the adoption of the accrual-based approach in the public sector has drawn and is still drawing criticism, these primarily concern

the very narrowly interpreted profit category (Guthrie, 1998), and profit as a performance measurement tool that is difficult to interpret in the public sector (Hepworth, 2002). Yet, in recent decades we have regularly witnessed the implementation of reform processes that modernise the accounting of public sectors in various developed and developing countries. By processing the study presenting the internal control system of the public finances of EU member states²¹, issued by the European commission, *Bathó* (2012) provides a detailed overview of the accounting practices of most European countries as well as Anglo-Saxon areas. *Table 3* selects and presents a few of these examples.

Presentation of Hungarian trends

In Hungary, pursuant to Government Decree No. 4/2013. (I. 11.) on the accounting of public finances, as of 1 January 2014, cash-based accounting (amended earlier) regarding organisations falling under the scope of the Act on Public Finances²² was replaced by accrual-based accounting. As a result of the public accounting reform, budgetary and financial accounting systems were separated, reporting obligation related to budget and financial statements was amended, and the set of criteria of accounting settlement changed as did reporting and closing deadlines.

Let us now take a look at the antecedents of the introduction of the accounting reform, with particular attention to the role undertaken by the SAO.

Prior to the transition of the public sector to accrual-based accounting, the SAO attended several roundtable discussions and conferences representing this particular topic, participated in bilateral meetings, the summary of which events – in many cases along with the lectures delivered – is also available in the

archives of the SAO News Portal. Selecting from the events of the past five years:

- In May 2011, as part of the international seminar organised with the cooperation of the Hessen audit office, the representatives of European regional audit organisations discussed topical issues of public accounting and budgetary planning, including the experiences of the gradual transition to International Public Sector Accounting Standards (IPSAS).²³
- On 24 March 2012, *László Domokos*, President of the State Audit Office and *Lajos Kósa*, President of the Association of Cities with County Rights (MJVSZ) held a professional consultation on the advantages of an accrual-based public finance information system and on the auditing of the asset management of local governments. According to the position shared by the parties, the greatest problem of the accounting system in force at the time was that it failed to provide adequate information on public finances and local government finances, and was unable to accurately present the changes in assets. Due to the above, the introduction of the accrual-based approach in the Hungarian public sector is of priority importance, and is promoted by both the SAO and the MJVSZ.²⁴
- On 2 April 2012, as part of a professional consultation by the State Audit Office and the National Association of Local Governments (TÖOSZ), the TÖOSZ presented its position concerning the necessity of the transformation of the accounting system of public finances. The association confirmed that it wishes to join the initiative launched by the SAO and the MJVSZ, which is aimed at the introduction of an accrual-based public finance information system.²⁵
- The SAO attended the international seminar held in Paris on 25 March 2013, also

Table 3

INTERNATIONAL OVERVIEW OF THE ACCOUNTING PRACTICES OF VARIOUS COUNTRIES

Country	What system is employed in public accounting (at central and local government-level)?	Informational time and time demand of accounting reforms
United Kingdom	The whole of the public sector applies accrual-based accounting. The IFRS (International Financial Reporting Standards) were adapted and interpreted for the public sector. The transition of the local government sector was performed in the 1990s.	The transition to accrual-based public accounting and budgetary planning began in 1995 and was completed by the 2001–2002 fiscal year.
Netherlands	The country has a mixed system.	Local governments and provinces have followed the accrual-based approach since the 1980s. There are, however, mixed solutions at the central level. Ministries employ a special cash-based approach. All subordinated institutions use the accrual-based approach. The planned transition of the central level to accrual-based accounting only has been postponed.
Ireland	The central level employs cash-based accounting.	There is a pilot project for the introduction of accrual-based accounting as well as proclaimed government intention, but no specific schedule.
Germany	Federal ('central') level reporting has stuck with cash-based accounting. However, certain provinces have made (or are in the progress of making) the transition to accrual-based accounting.	The federal level has not made the transition. The Ministry of Finance argues that the majority of federal expenditures are grants, welfare allowance or interest payments, therefore, the transition would not be beneficial. At the federal level, an intention was formulated to introduce the essential elements of accrual-based accounting midway through the federal asset report that is part of the final accounts.
Australia	Public sector accounting uses an accrual-based approach.	Full accrual-based reporting at the national (federal) level was achieved by the year 1999/2000. Full-scale introduction took three years.
New Zealand	The whole of the public sector employs accrual-based accounting.	The relevant act was passed in 1989. The transition was first realised in the statement regarding the fiscal year ending on 30 June 1993. New Zealand was one of the first countries to make the transition to accrual-based public accounting.

Source: Based on Bathó (2012)

attended by experts of state audit offices, the European Court of Auditors, the European Commission and Eurostat, where they discussed the role of European Budgetary Accounting Standards²⁶ and the possibility of creating common European standards. The topicality of the subject was provided by the fact that on account of the debt crisis, the comprehensiveness, reliability and the ensuring of the comparability of budgetary data among Member States have become particularly important, along with the application of budgetary accrual-based accounting standards harmonised at the European level in the interest of the predictability of budgetary situations.²⁷

- At a bilateral discussion in the autumn of 2013 in Bern at the Federal Audit Office, the joint delegation of the SAO, the Ministry of Human Resources and the Ministry for National Economy learnt about the Swiss experiences regarding the introduction and operation of accrual-based

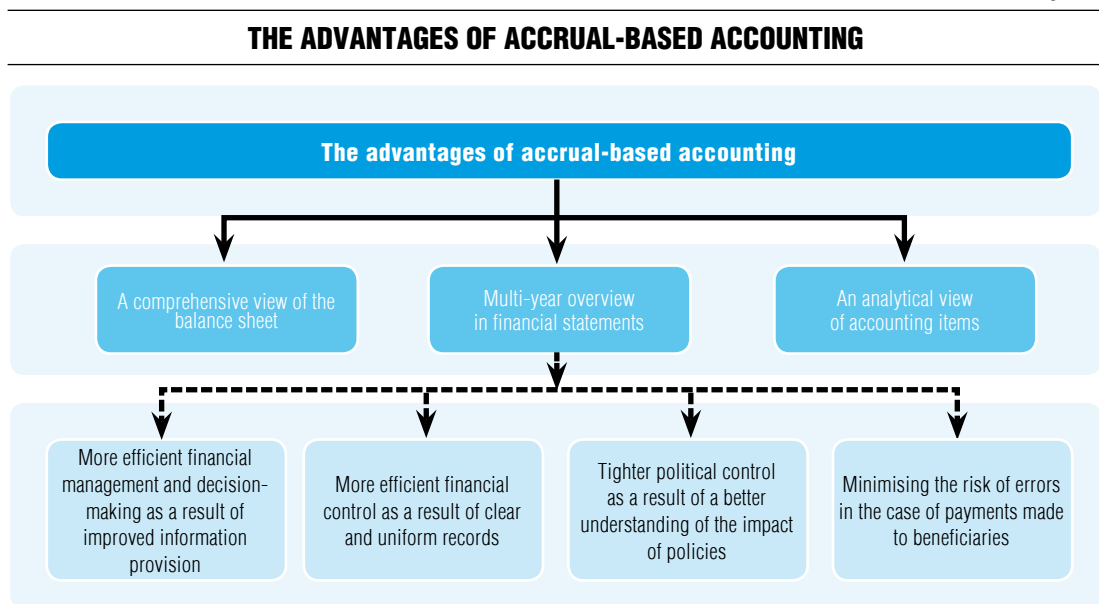
public accounting, as well as the practice of the auditing of the Swiss federal final accounts.²⁸

In addition to participating at professional events, the SAO also undertook the task of issuing its own publications, with the online platform of the *Public Finance Quarterly* dedicating a separate series to articles on the subject. Ten publications were published in 2014 as part of the series, among them articles mapping out the possibilities and risks of the new accounting system of public finances, articles on the experiences of the introduction of accrual-based accounting or works on the common European Budgetary Accounting Standards.

The results achieved and the presentation of the current situation

There has been and still is widespread consensus in that the previous amended cash-based approach – in spite of all the benefits arising from its simplicity – failed to meet the requirements

Figure 3



Source: European Commission (2008)

set against modern information systems that are essential for efficient financial management. The advantages of the introduction of accrual-based accounting are summarised in *Figure 3* on the basis of the summary prepared by the European Commission.

Though we still have limited practical experience as far as accrual-based accounting is concerned. The first reports by public sector players were only completed this year, and the SAO is continuously publishing studies on the results to date. On a related note, articles and studies have also been published on the difficulties of the transition in Hungary, which publications primarily drew attention to the deficiencies of the information technology system established (Pongrácz – Kuszinger, 2014), as well as the delayed completion of the balance sheets and first-quarter budgetary statements needed for the transition (Benedek – Szenténé – Farkas, 2014). The stakeholders, therefore, were not prepared for the transition. The difficulties experienced during the introduction of the accounting reform were in line with the joint position of the SAO and the MJVSZ (that we have referred to earlier), according to which, the key to the adoption of the accrual-based approach is the level of development and receptive capacity of the information system of public finances. It is no coincidence, therefore, that the SAO, on the basis of its widespread research based on international comparisons²⁹ and on the basis of international experiences, emphasised a gradual, scheduled transition that allows for a longer preparation period.

The costs of the transition, as in other countries, are not fully known in Hungary either, given that the some of the costs related to the introduction and application of the accrual-based method are difficult to quantify. These costs include the required training, IT transitions, as well as extra costs due to inexperience

in relation to this new approach, the mapping out of which could be the topic of separate research in the future.

The further active participation of the SAO is perhaps more important in the respect that through its audit findings and analyses, it should seek to answer the question whether the new public accounting regulation has accomplished its goal, and to point out potential regulatory anomalies. We cannot disregard the fact that even though new public accounting is attempting to broaden its relationship with the accounting act³⁰ in respect of the application of accounting principles, some of these are only enforced to limited extent, while others not at all. One such problem area, for instance, could be the assessment of assets³¹ which is aimed at the identification and determination of the value of asset elements, where in order to enforce the strategic approach that provides the foundation of responsible public asset management, the value relationships providing cost value should be generated as projected for the entire life-cycle. In the absence of information concerning the life-cycle of phenomenon occurrences that make up asset content and due to the lack of information related to the economic content of the various life-cycle phases, the adequate allocation of resources is doubtful and highly relative. Unfortunately, the new regulation has not resulted in significant progress in respect of the information need of the dynamic asset formula³² that serves to establish the determination of asset content by taking the time factor into account. In the interest of establishing the criteria system of responsible financial management and increasing accountability, in its advisory role the SAO can facilitate the development of current accounting regulations through research on the possibilities of the assessment of asset content.

NOTES

- ¹ World Bank Development Report, 1983
- ² Kaufman, D. – Kraay, A. – Mastruzzi, M., 2010
- ³ Directorate on Public Administration and Management. OECD, 2010
- ⁴ Commission of the European Communities: European Governance. A White Paper, 2001
For the analysis, see: Zoltán Horváth – László Sinka: White Paper of the European Commission on the Reform of European Governance, 2001
- ⁵ Good State and Governance index
- ⁶ Council of Europe, 2007
- ⁷ www.govindicators.org or <http://info.worldbank.org/governance/wgi/index.asp>
- ⁸ the database and the indicators are available at the <http://www.oecd.org/gov/government-at-a-glance-2015-database.htm> and http://www.oecd-ilibrary.org/social-issues-migration-health/society-at-a-glance-2014_soc_glance-2014-en websites
- ⁹ For more details, see the http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database website
- ¹⁰ The full database of the Competitiveness Yearbook published annually by the Swiss-based research centre is only available subject to subscription. <http://www.imd.org/wcc/>
- ¹¹ Zoltán Magyary: Közigazgatás-fejlesztési Program (Public Administration Development Programme), p. 12
- ¹² Article 1(4) of the SAO Act
- ¹³ On the basis of Lentner, Cs. – Lantos, O. Lecture on general public finances (source and time of download <http://vtki.uni-nke.hu/kozigazgatasi-vizsgak/kozigazgatasi-szakvizsga/tananyag-es-kovetelmeny-rendszer>, 15.10.2015), and the lecture delivered by László Domokos at the event organised by the Public Association of the Hungarian Financial and Economic Auditors on 23.02.2012 (source and time of download <http://www.domokoslaszlo.com/hirek-domokos-laszlo/a-kozponti-koltsegvetesi-szervek-ellenorzesenek-aktualis-feladatairol>, 15.10.2015)
- ¹⁴ Article 29 of the SAO Act
- ¹⁵ Article 28 of the SAO Act
- ¹⁶ See for example the analysis entitled “Reflections from our audits: Service delivery” on public services, published in June 2015 by the New Zealand state audit office.
- ¹⁷ SAO Instruction 4/2014 (XII. 31.) of the President of the State Audit Office of Hungary on the Rules of Organisation and Operation of the State Audit Office of Hungary (effective as of 1 January 2015)
- ¹⁸ On the auditor’s responsibility, see Article 25 of the SAO Act and Sections 15 and 21 of the Operational and Organisational Rules
- ¹⁹ The milestones of the seven phases of State audit office audits are: the preparation of preliminary studies, audit planning, the finalisation of the audit programme and the conducting of the request for data, the preparation for the audit and the drawing up and handing over of auditor working papers, the preparation of the SAO draft report on the basis of auditor working papers, the finalisation of the draft report and the subsequent issue of the report, and finally the utilisation of the SAO report.

- ²⁰ Act CXCIX of 2011 on Public Officials
- ²¹ “Compendium of the public internal control systems in the EU Member States 2012”, Luxembourg: Publications Office of the European Union, 2011
- ²² Act CXCV of 2011 on Public Finances
- ²³ Source: SAO News Portal (<http://www.aszhirportal.hu/hu/Hirek/Uj-kozigazgas-Europaban---allapotfelmeres>)
- ²⁴ Source: SAO News Portal (<http://www.aszhirportal.hu/hu/Hirek/Az-eredmenyszemleletre-valo-atte-rest-javasolja-az-ASZ-es-az-MJVSZ>)
- ²⁵ Source: SAO News Portal (<http://www.aszhirportal.hu/hu/Hirek/Az-eredmenyszemleletre-valo-atte-rest-javasolja-az-ASZ-es-az-MJVSZ>)
- ²⁶ International Public Sector Accounting Standards (IPSAS)
- ²⁷ Source: SAO News Portal (<http://www.aszhirportal.hu/hu/Hirek/Szeminarium-a-Nemzetkozi-Koltsegetesi-Szamviteli-Standardokrol>)
- ²⁸ Source: SAO News Portal: (<http://www.aszhirportal.hu/hu/hirek/tapasztalatcsere-az-eredmenyszemleletu-allamszamvitellel-kapcsolatban>)
- ²⁹ SAO RESEARCH INSTITUTE (RIHSAO), 2011
- ³⁰ Act C of 2000 on Accounting
- ³¹ For the detailed possibilities of determining asset content, see Malasics (2002).
- ³² For more details, see Malasics (2002), pp. 66–69

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