Miklós Nagy

What does the ferryman pay?

Quantification of a public foundation's losses

Our study examined the financial effects of Budapest Enterprise Development Public Foundation's (Budapesti Vállalkozásfejlesztési Közalapítvány, hereinafter referred to as BVK) participation in Baseline consulting programme 2.2.1. under the Economic Competitiveness Operational Programme (ECOP). Adjusting our calculations on a gradual basis, we reached a conclusion that, in total, the public foundation had accumulated a minimum of HUF 16.8–19.2 million in negative cash flow effect by the time of the financial closure of the programme at the beginning of 2008. It is an important fact that BVK, in spite of all these, was able to implement 100 per cent of its programme – at the cost of great efforts.

Approximately HUF 6.2–6.4 million can be attributed to paying for items that were not funded within the programme, as even BVK was forced to accept subsequently, in order to be able to proceed with the programme (rejections accepted). Another deficit of HUF 7.2–9.9 million resulted from the fact that the central coordinator exceeded the originally 60-day payment deadline on a regular basis, which made programme funding facilities uncertain, and required involvement of unplanned supplementary resources on BVK's part. (The fact that this value falls short of the first rough estimate specified in chapter 1.1., is mostly due to the existence of advance payments.) The fact that the transfer of nearly HUF 123 million earmarked to improve the liquidity situation was also delayed added another HUF 0.36–0.50 million to the deficit. At this point, it must be noted that not even the mere fact of providing an advance payment was free from arguments, and the amount was specified by the Manaement Authority of the ECOP as the minimum of grant amounts, which is contradictory when considering the program objective and contents.

It is to be seen that participation in the programme also yielded a number of hardly quantifiable expenses that could not be planned for in advance, as well as unfavourable effects, in addition to relatively easily quantifiable expense items. Due to liquidity problems, a six-month suspension of the programme and continuous arguments about settlements, the relationship deteriorated with the consultants who were forced to wait for their remuneration for up to a year, also with the coordination body and with the ministry. Consequently, programme efficiency fell short of the expectations, primarily due to a reduced motivation of the network of consultants. As a result, the effect of synergy expected among product systems within the integrated system of services was not sufficiently felt. In addition, the programme withdrew capital and resources from other non-profit programmes run by BVK, whereby they also fell short of their planned oper-

ating efficiency. On top of all that, BVK was forced to develop rules of procedure and software that ensured operation of the programme on a national scale, from client relationships to treasury payments.

On the whole, we may state that the overwhelming majority of the deficit stemmed from weak central programme coordination and the consequential problems of liquidity management that deviated from the plans. A lesson that must be learnt from this case is that, for similar programmes in the future, particular attention must be paid to risks arising from options of settlement frequencies, unrealistic funds transfer deadlines and costs allowed to be settled. So, risks would need to be "priced". This would facilitate specification of an amount of capital that needs to be permanently tied up for successful implementation still prior to launching the programme, as well as the replacement cost, in addition to a liquidity plan that also uses specific regulatory anomalies determined in an empirical system. At the same time, subsequently inexplicable free variations to the sets of rules accepted as constants on planning and contracting face experts in charge of implementing services with hardly resolvable difficulties.

INTRODUCTION

As a member of the Hungarian Enterprise Development Network Consortium, Budapest Enterprise Development Public Foundation concluded an agreement with the Ministry for Economy and Transport on 18 December 2002, or, more specifically, with Hungarian Enterprise Development public benefit organisation (Magyar Vállalkozásfejlesztési Kht., the intermediary body) representing the former, to participate in an enterprise development network. The programme objective is to build up a system of institutions indispensable for intermediating development and support programmes to small and medium-sized enterprises, and the EU Structural Funds in particular. In the framework of cooperation, BVK agreed to implement the related programmes, to make proper use of the resources made available to it, and to cooperate with the intermediary body on a continuous basis.

> *A baseline consulting programme (ECOP 2.2.1.) was launched in April 2004 as a central programme under the Economic Competitiveness Operational Programme (ECOP) of the National Development Plan. The objective here was to assist stability, growth and strengthening of newly founded and already running small and medium-sized enterprises. HUF 2035.3 million was available to implement the entire central programme.*
> *The programme on a national scale was implemented by a national network of county-based and Budapest-based enterprise development foundations (local centre for entrepreneurs).*
> *As a member of this network, Budapest Enterprise Development Public Foundation signed a contract in February 2005 with ECOP Management Hungarian Authority and with Hungarian Enterprise Development public benefit organisation on implementing services in the capital.*

Later, the Hungarian Enterprise Development Network Consortium, Takarékbank Zrt., Hungarian Development Bank Plc. and the Ministry for Economy and Transport signed a cooperation agreement on 21 April 2005 on establishing a new service system for micro, small and medium-sized enterprises in order to implement the contents of the programme.

The new service system (integrated enterprise development services model) was based on horizontal partner relationships where – non-profit and for-profit – organisations pursuing enterprise development cooperate in a closed system in order to dispatch available government, EU and market funds to enterprises as efficiently and effectively as possible, in order to support their development ideas. In this way, such cooperation means practical representation of the European Union's principles (partnership and subsidiarity). *(See the system flowchart)*

BVK's primary duty under the Integrated Enterprise Development Programme was to provide training, consulting, decision-preparatory and corporate communications activities in the capital in order to be able to use support funds available from various sources. These constituted a framework for launching ECOP 2.2.1. Baseline consulting central programme, which focussed on (partially) reimbursing adequately qualified and registered consultants for consultancy provided to micro, small and medium-sized enterprises, in market circumstances, i.e. contributing a kind of free knowledge transfer adapted to the companies' needs to the enterprises to be supported. A significant result of the ECOP 2.2.1. programme was for the BVK to develop an algorithm needed to operate the programme, whereby a facility opened up to manage programme coordination on an electronic system on a national scale, starting from the relationship between consultants and clients (over 80 thousand contacts) through EMIR to treasury payments.

The programme was financially settled on 31 January 2008. Professional closure took place on 7 April 2008, whereby the intermediary body confirmed utilisation of 100 percent of all available resources.

BVK incurred two types of expenses related to running the programme. For keeping continuous contact with companies and consultants, a steady administrative base had to be established and operated for settlements with the intermediary body. Both infrastructural and personnel payments were associated with it. At the same time, it was BVK's duty to monitor consultancy, check actual use of services, and pay consultants' invoices. With this activity, consultants' salaries represented the overwhelming majority of personnel expenses.

Programme implementation was far from being seamless, stemming from serious contradictions within the central programme coordination instead of service implementation. Similarly to other local enterprise development centres, BVK was also confronted with grave financial problems directly following the launch, which only kept intensifying as – in line with the initiators' intention – the basic system of consultancy was gradually completed. It was rooted in a strategy that lacked careful deliberation on wording the programme specification, as well as the financing party' behaviour that generated a gravely disadvantaged situation for the implementing organisations, including BVK.

The bodies that managed direct relationships with the consultants and the companies were faced with having to advance a total of HUF 2.2 billion as the expenses of the funding programme on a national scale, often for a period over six months, which the organisations were, and could not have been properly prepared for due to their limited financial resources. All these concluded to a situation where participation in the programme caused serious liquidity problems for the BVK, and funds earmarked for other purposes had to be released and permanently tied up in order to avoid scandal about the program.

What this study quantifies is the total losses incurred by BVK through participating in the ECOP 2.2.1. programme. On assessing losses, we primarily concentrated on items that can be measured in pecuniary terms and steadily supported in professional terms; at the same time, a section is dedicated to the sources of serious moral losses that are difficult to measure in pecuniary terms. A non-exhaustive presentation based on a financial analysis is given to illuminate how professional shortcomings of central programme coordination and regulation represented difficulties to BVK's activity to provide services, how they generated financial losses and resulted in reduced efficiency in the integrated system of services.

The primary goal of quantification is not to substantiate some pecuniary claim but rather to point out: undeliberated funding, lax observation of rules and unpredictable willingness of the central management to cooperate may cause serious losses to the organisational system set up with a view to intermediating services, ultimately disintegrating and terminating it in the long run. We intend to call the decision-makers' attention to the issue that if a hard-working ferryman is forced to pay his passengers' fares, too – instead of receiving wages for his work –, a ferry service will hardly be available on the river in the long run.

1. LOSSES MEASURABLE IN FINANCIAL TERMS

In line with the contract concluded for the ECOP 2.2.1. programme, the public foundation initially (between 2004 and October 2006) performed financial settlements with the intermediary body on a quarterly basis. In practice, what it meant was that although various expenses were incurred on a continuous basis, BVK had to make an advance payment on these until the next settlement date. According to the agreement, consultants' invoices could only be transferred for settlement once they had been paid.

1.1 The first approach

Considering that the amount due to BVK and allotted for availability (maintaining administration) throughout the entire period was almost HUF 73 million, and the limit for consultancy amounted to slightly over HUF 419 million, prefinancing alone represented a serious test to the public foundation, as the intermediary body was obliged to pay accepted invoices in 60 days following submission, in line with the relevant provision of law. A sufficient amount of programme financing advance payment received in due time ought to have been a solution to this problem, however, only minimum amounts were received and the timing was wrong, so it was unable to ensure sufficient liquidity in funding the programme.

The volume of this burden can be seen through a simple approximation: since BVK was forced to finance all expenses for a minimum of 60 days – perfectly in line with the provisions of the contract! –, the total interest loss incurred during the 3.5 years of the programme on providing advances on a limit of HUF 492 million was:

$$\frac{\textit{HUF 492 million} \times \textit{60 days}}{\textit{360 days} \times \textit{7,5\%}} = \textit{HUF 6,15 million,}$$

where the interest rate of 7.5 per cent was an approximation of the central bank base rate applicable to the relevant period[1]. However, it must also be considered that, with this amount of expenses, the public foundation is unable to receive resources, and the burden amounts to HUF 8.2 million even when using a pretty favourable interest rate of 10 per cent. Also considering that this expense was incurred distributed within a period of 3.5 years, an annual loss of HUF 1.8–2.3 million may be estimated, i.e., roughly that is the minimum amount BVK paid per annum for participating in the programme.

1.2 Deadlines unobserved

While the loss approximated in section 1.1 could be foreseen as early as on signing the contract, one could hardly have expected that payment of funds ab ovo available from EU resources did not take place by a deadline of 60 days. However, the data reveal cases when the intermediary body had BVK waiting for over 200 days, what is more, the number of days elapsed between submission of invoices for the first quarter of 2005 and funds transfer was 318 days, that is almost a year, which is five times the period promised.

Such extreme payment deadlines typically have an underlying cause where the intermediary body questioned justification of some of the invoices submitted to them, or requested additional or missing documents. Such request for missing documents was occasionally repeated two or three times within a settlement process. Considering the eighteen periodic settlements, the payment deadline of 60 days was observed on a single occasion only – in March 2007. At the same time, the intermediary body exceeded the final payment deadline following the last submission of missing documents on four occasions.

The primary problem here stems from the fact that the intermediary body only took actions towards payment after passing an explicit decision on each invoice on acceptance or rejection. However, it led to situations where items deemed immediately payable on submission were idling on the treasury's account, generating extra interest to them, while BVK was forced to tie up extra resources in the programme to finance the same for indefinite periods. Other institutions that had a difficult time obtaining capital were forced to suspend payments in such periods, i.e. the programme was halted until the approved items not yet transferred were received.

A complex calculation table was produced to quantify such losses. Our logic for measurements was as follows. First, the dates of various settlements and submission of missing documents were established, and then we determined the original respective due dates of the various amounts, according to the contract. This date was 60 days subsequent to the submission in case of items that the intermediary body did not question, while for other items, it was the date of submitting the last (consequently, accepted) missing documents. Items ultimately rejected were not considered, although, in a number of cases, even six months elapsed before it turned out for BVK that the expense was not allowed to be settled.

The next step was to calculate the interest losses at the interest rates applicable to the date when the invoice was submitted for the period between the due date (submission date + 60 days) and the payment date, as well as the financing costs. The third step quantified the increments of these interest amounts lost until the financial closure of the programme, i.e. until 31 January 2008, considering that the base rates kept changing.

For calculating the interest burdens for the period between the payment date and the due date, linear interest calculation was used in the following formula.

$$\frac{\textit{Amount} \times \textit{average interest} \times \textit{days in delay}}{365} = \textit{interest, loss within the year}$$

where the average interest calculated for period t:

$$\textit{average interest}_t = \left[\prod_{j=t}^{x}(1+k_j)\right]^{\frac{12}{x-t}} - 1 \quad ,$$

where

k is an interest rate valid for a given month
t is the month of the due date
x is the month of the payment date

As the period elapsed between payments and the financial closure was typically over a year, compound interest calculation was used for such periods.

$$\textit{Interest loss within the year} \times \textit{average interest}^{(\textit{days to closure}/365)} = \textit{full financial loss}$$

Average interest calculated for period i:

$$average\ interest_i = \left[\prod_{j=i}^{n}(1+k_j)\right]^{\frac{12}{n-j}} - 1,$$

where

k is an interest rate valid in the given month
i is the month of the payment date
n is the month of the financial closure

Again, the calculations were made considering two different interest rates. First, we used the currently effective central bank base rate, as it yields a strict estimate of the minimum losses, as BVK would in no way not have been able to finance its activities at a lower cost. On the second calculation, we added a 2.5-percentage point extra charge to the interest rate, which represents a considerably more realistic but still minimum estimate of the public foundation's cost of funds. The reason we still stick to this approach is that it reflects in part that BVK used its other fixed reserves invested in government securities for funding, and the resulting loss was actually more moderate than the current interest rate of BVK. At the same time, it is important to recognise that this solution terminated the possibility of running or launching other projects through withdrawal of capital and cross-financing.

To illustrate detailed calculations, a table of central bank base rates related to availability (administrative) costs is presented in Appendix No. 3. For a summary of our results, *see Table 1.*

Although the calculated interest loss to closure is less than 1.25–1.74 of the total amount of funds, it is to be seen that BVK incurred a loss of HUF 4.6–6.5 million in addition to the expenses imposed by the contractual financing deadline of 60 days. Therefore, if we intend to establish the total loss resulting from participation in the programme from BVK's point of view, we also need to consider the financing costs of the 60 days permitted by the contract.

1.3 The second approach

If the expenses resulting from the financing obligation specified in the contract are added to the loss resulting from delayed payments described in section 1.2, the amount of which can be approximated through a rough estimate seen in section 1.1, the result adds up to total losses of HUF 10.76 million and HUF 14.62 million respectively, which, considering the programme period of 3.5 years means an annual average deficit of HUF 3.0–4.2 million.

In order to receive a more accurate estimate, we have calculated the total loss by using the actual figures for each item, instead of a fixed

Table 1

LOSSES RESULTING FROM DELAYED TRANSFER OF FUNDS

(HUF)

Central bank base rate	Amount	Interest loss to payment	Interest loss to closure
Availability	72,948,400	1,145,351.61	1,263,347.80
Consulting	419,151,223	3,030,936.19	3,348,757.80
Total	492,151,224	4,176,287.79	4,612,105.59
+ an extra cost of 2.5 percentage points	**Amount**	**Interest loss to payment**	**Interest loss to closure**
Availability	72,948,400	1,558,236.91	1,775,023.86
Consulting	419,151,223	4,075,023.06	4,641,852.29
Total	492,151,224	5,633,259.97	6,416,876.15

average interest rate of 7.5 per cent. The totals received in the latter case are presented in *Table 2.*

These more accurate calculations reveal that the total profit/loss of the public foundation decreased by approximately HUF 7.2–9.9 million, as a result of its participation in the programme. (A difference from the rough estimate results from the fact that the current central bank base rate should have been weighted with the existing demand for financing, and an increase in the latter coincided with a decrease in the base rate.)

Although this approach yields a much more accurate result compared to the first one, further adjustments are needed for two reasons. The first reason is that it was ignored that the various operating costs were typically incurred evenly distributed throughout the operating period, and not on preparing the accounts. On the other hand, it was also ignored that the coordinating organisation has recognised and accepted the existence of extra burdens, and received a HUF 123 million advance payment on 31 August 2005, subsequent to an amendment to the law, under an obligation of settlement when 80 per cent of the programme was completed, at the latest. In order to be able to consider all these, a statement of BVK's cash flow in the ECOP 2.2.1. programme has been produced.

1.4 Cash flow based measurement

In the cash flow model, different operating expenses were always recorded at the end of the month when they were incurred. Given that consultants' invoices were accepted by BVK only directly prior to settlement dates with the intermediary body – irrespective of the completion date – in order to reduce its own financing burdens (shifting the same to the consultants), the majority of expenses resulting from consulting were always incurred around the settlement dates.

Figures 1 and *2* show the level of cash under the programme, i.e. cumulative cash flow calculated at the central bank base rate, as well as at the central bank base rate plus a 2.5-percentage point extra charge of financing. On making our calculations, we settled interest burdens payable on the need for financing on a monthly basis, i.e. in case of a need for financing, the figure will indicate a decreasing cash level also in the absence of a different type of expense. In the figures, the cash level calculated without the accepted rejections is represented by a different line.

The two figures are an excellent illustration of problems concerning the financial management of BVK, which implemented the programme: until the advance was received in

Table 2

TOTAL LOSSES AND FINANCING COSTS RESULTING FROM DELAYED TRANSFER OF FUNDS

(HUF)

Central bank base rate	Amount	Interest loss to payment	Interest loss to closure
Availability	72,948,400	1,974,397.22	2,161,496.97
Consulting	419,151,223	4,554,505.54	5,016,945.07
Total	492,151,224	6,528,902.76	7,178,442.03
+ an extra cost of 2.5 percentage points	**Amount**	**Interest loss to payment**	**Interest loss to closure**
Availability	72,948,400	2,672,735.60	3,014,446.78
Consulting	419,151,223	6,098,884.09	6,928,827.65
Total	492,151,224	8,771,619.69	9,943,274.43

August 2005, the project had an increasing need for financing, continuously consuming the liquid assets available to BVK, like a greedy monster in a Hungarian folk-tale. With the expenses approaching HUF 30 million, other resources had had to be invested in the project by the time the advance was received, which was able to keep the system "above water" for only seven months, and then BVK was again forced to use its own funds. It was no use receiving major funds transfers later to offset invoices settled earlier, such funds were insufficient to turn the cash balance into positive.

Losses caused by the project are clearly represented by the volume of the cash balance remaining after the – theoretically complete – financial settlement. *(See Table 3)* Although rejections also accepted by BVK represent a considerable difference, it is to be seen that the majority of these expenses were incurred because the expenses permitted in the original contract to be settled were not specified accurately enough, and the intermediary body continuously set new rules, in addition to reinterpreting its earlier guidelines. On the one hand, it can be stated in no way that the items rejected with BVK's approval are clearly expenses incurred through a fault of the implementing party, with burdens to be borne by BVK alone. On the other hand, it is an important lesson to be learnt that rejected items did not considerably change the course of cash flow for the project, i.e. the loss incurred by the implementing party by the time of the closure can be traced back to wrong planning instead of problems with settlement.

According to our adjusted calculation that considers all well-documented items, by the closure date on 31 January 2008, BVK incurred a loss of at least a HUF 10.6–12.8 million, but HUF 16.8–19.2 million seems more realistic, through participation in the entire ECOP 2.2.1. project, even at a conservative estimate. Considering that this expense was associated with a total utilised amount of HUF 492 million, the system causes a loss of 2.2–3.9 per cent of the grant amount to the implementing organisations.

On the whole, the outcome may be that the implementing organisations will be interested in decelerating, or even discontinuing the programmes, or, that the people working more are imposed higher penalties in the system. Provided that organisations still participate in similar programmes in the wake of decisions made on other than economic grounds, it would result in their other earlier programmes or resources becoming scarce, giving rise to a kind of cross-financing system. In this way, the intermediary body actually drains funds of others provided for other purposes, while continuously disintegrating the underlying distribution network, which must not be a goal.

1.5 Losses related to advances

The approach seen in section 1.4. does integrate all factors; at the same time, there is an opportunity to quantify another factor, losses related to the transfer date of advance payments. According to BVK's interpretation, the HUF 123 million advance payment transferred

Table 3

CLOSING CASH FLOW POSITION OF THE ECOP 2.2.1. PROGRAMME FOR BVK

(HUF)

	Total expenses	Excluding accepted rejection items
At central bank base rate	–16,842,417	–10,644,218
+ an extra charge of 2.5 percentage points	–19,185,165	–12,781,660

Figure 1

MONTHLY CLOSING CASH IN BKV'S ECOP 2.2.1. PROGRAMME
(central bank rate)

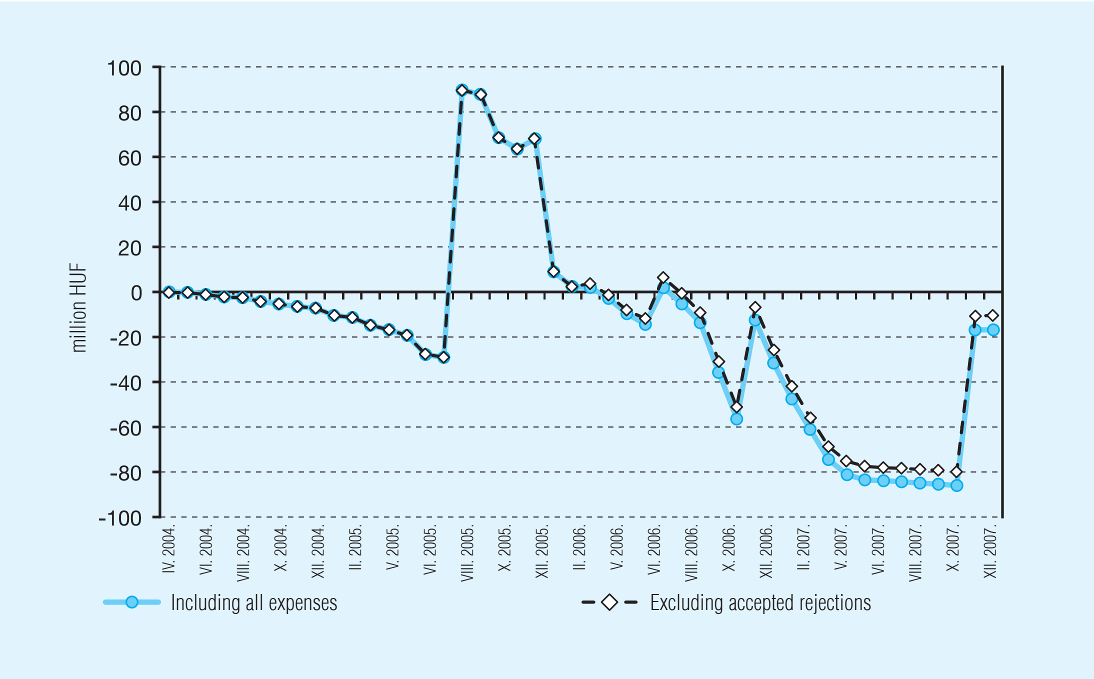
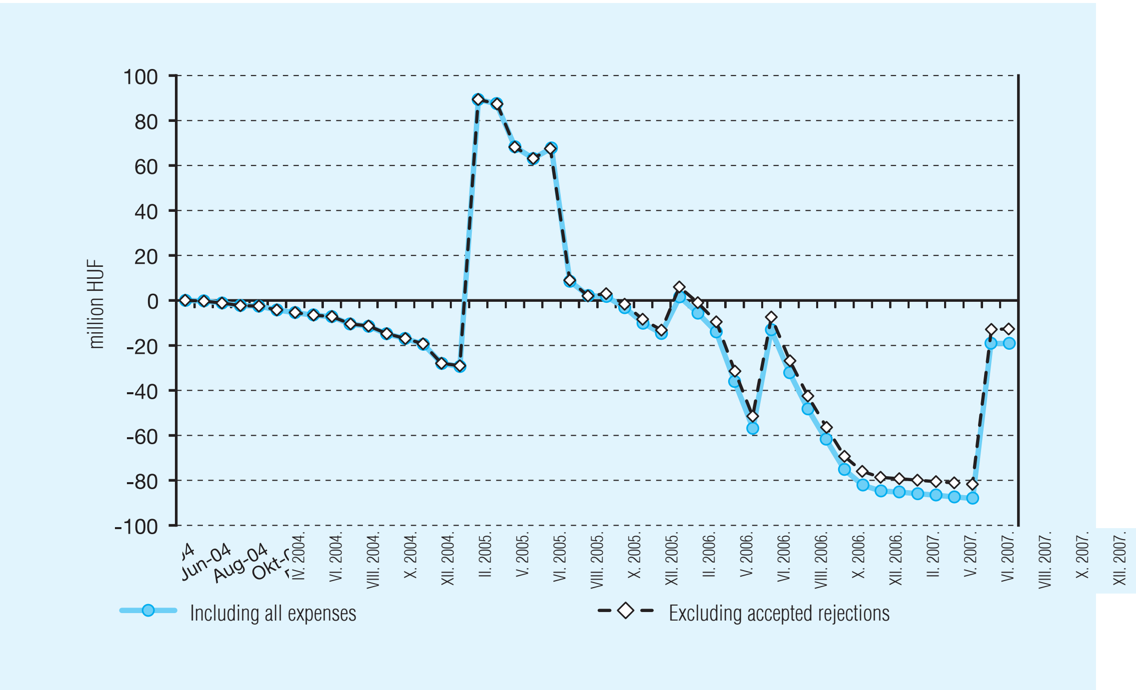


Figure 2

MONTHLY CLOSING CASH IN BKV'S ECOP 2.2.1. PROGRAMME
(central bank rate + 2.5% points)



on 31 August 2005 was actually due on 8 April 2005 (from that date on, a legal opportunity was available to perform the funds transfer, and BVK even requested so), i.e. the authority waited 145 days to carry out the funds transfer instead of the agreed 60 days. This loss of HUF 3.2–4.3 million, however, would only be legally enforceable in part, as it previously raised the project cash flow position to the positive range (although temporarily only), so a portion of the loss presented in *Table 4* actually represents lost profit from investing a positive balance.

Accuracy of this calculation could be considerably improved if, instead of interest lost, we examined how an advance payment transferred in due time, i.e. within the period 8 April 2005 + 60 days (up to 7 June) would have improved the cash flow position of the whole project on closure. *(See Figure 3 and 4)* For our calculations, we considered full utilisation of the 60 days, i.e. the theoretically possible worst situation for BVK, thus approaching the loss incurred from the lower limit. *(See Table 5)*

Our results indicate that the closing funds could have been HUF 357–505 thousand higher through an earlier transfer, assuming that no return is yielded to BVK on a positive balance. Therefore, this is the loss actually incurred by the implementing organisation, and approximately HUF 2.9–3.8 million of the losses seen in Table 4 represents lost returns on investments.

2. INDIRECT LOSSES THAT ARE HARD TO QUANTIFY

On implementing the ECOP 2.2.1. programme, BVK incurred a number of costs, expenses and losses that were extremely difficult and unpredictable to measure in pecuniary

Table 4

TOTAL LOSSES AND LOST REVENUE DUE TO DELAYED TRANSFER OF FUNDS

(HUF)

Central bank base rate	Amount	Interest loss to payment	Interest loss to closure
Advance	123,037,806	2,751,656.47	3,247,067.06
+ an extra charge of 2.5 percentage points	**Amount**	**Interest loss to payment**	**Interest loss to closure**
Advance	123,037,806	3,467,972.47	4,327,323.12

Table 5

CLOSING CASH FLOW POSITION OF BVK UNDER ECOP 2.2.1. PROGRAMME, WITH AN ADVANCE TRANSFERRED IN JUNE

(HUF)

Closing position	Total costs	Excluding accepted rejection items
At central bank base rate	–16,485,332	–10,287,133
with an extra charge of +2.5 percentage points	–18,680,556	–12,277,051
Changes caused by delayed transfers *		
At central bank base rate	–357,085.00	–357,084.65
with an extra charge of +2.5 percentage points	–504,609.00	–504,609.00

*Difference between balances calculated with a funds transfer in June and one in August (Table 3)

Figure 3

MONTHLY CLOSING CASH IN BKV'S ECOP 2.2.1. PROGRAMME

(central bank rate, advance payment in June 2005)

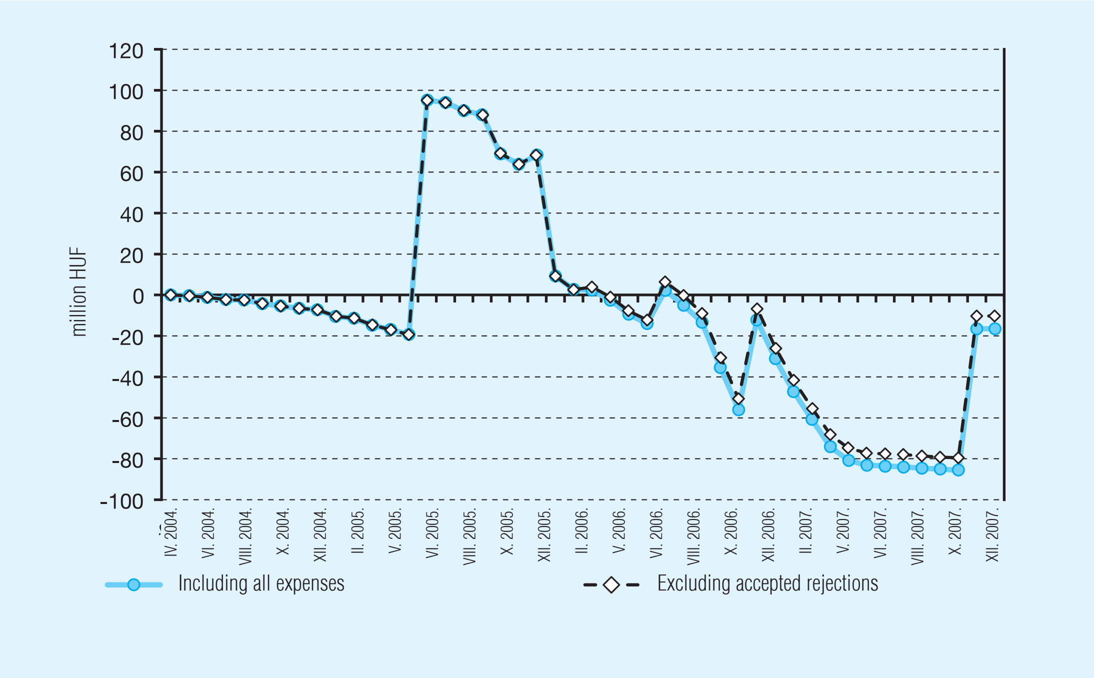
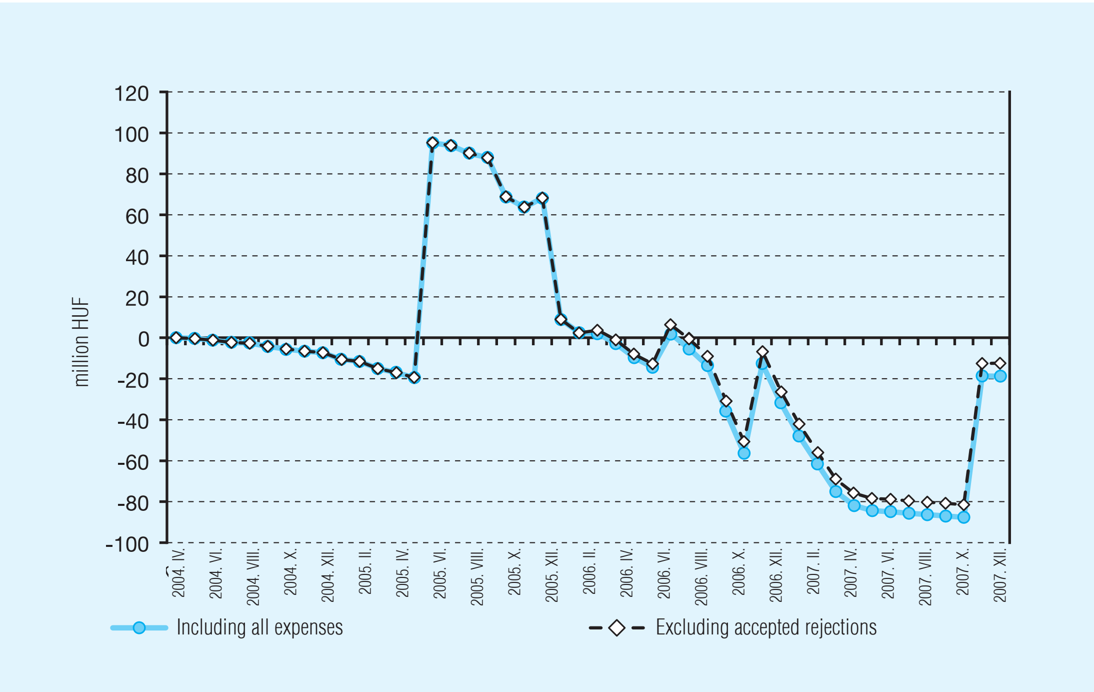


Figure 4

MONTHLY CLOSING CASH IN BKV'S ECOP 2.2.1. PROGRAMME

(central bank rate + 2.5% points, advance payment in June 2005)



terms, still, they could not be ignored on reviewing, due to their significance. In the continuation, we are going to review the most significant ones of these.

❶ BVK used its reserves tied up for other purposes to finance the programme. Accordingly, the amounts tied up in the ECOP 2.2.1. programme did not serve their original purpose, however, we have always ignored financial and social yields lost in other areas so far. Please note that the central bank base rate charged on the tied up capital hardly represents the total loss incurred due to a lack of opportunity to use the funds elsewhere, as we have reason to believe that the social yields of projects implemented with the participation of BVK, which also reflect external effects, are higher than the base rate.

❷ On settlements, a number of items arose, which BVK deemed as justified, and paid for them; however, the consideration value of such invoices was never received. Such disagreements result from an inaccurate definition of expenses eligible to be represented, and serious problems resulted from the fact that often more than six months elapsed until a certain type of expense turned out to be ineligible for settlement in the programme. For this reason, however, BVK carried on operating for months, until a final decision was made, considering such invoices to be eligible for representation, and did not seek to eliminate or replace them.

❸ There are multiple controversial items that were, in BVK's opinion, undoubtedly justified and necessary for the project, but still were not accepted by the intermediary body. During the period of 3.5 years, a total invoice amount of HUF 9.67 million was rejected by the intermediary body, HUF 4.26 million of which BVK accepted. (These losses are attributable to insufficiently clarified conditions of eligibility for settlement on contracting.) There is an additional unrefunded amount of HUF 5.4 million that cannot be explained by any interpretation of settlement, according to BVK's position. Given, however, that rejection had been made clear already during the programme, BVK wrote off rejected invoices as its own loss, and replaced them by additional ones on programme settlement, in order to utilise the full grant limit (i.e. to implement the project objectives). Consequently, in order to utilise the full limit, BVK actually had to reach a cost ratio of 102 per cent.

❹ Due to delays in the programme, extra wages and overhead costs were incurred by BVK for approximately 6–8 months, which were allowed to be represented in the original limit (invariable in amount), but if the project had been successfully completed in due time, this amount could have been contributed to meeting the objective, i.e. programme efficiency was significantly impaired. According to BVK's estimate, costs arisen in favour of the programme but not settled because the limit ran short amounted to a minimum of HUF 2,709,352.

❺ As the programme schedule for paying advances was rather unfortunate, the enormous delays caused constant cash flow problems to BVK. It resulted in delayed payments, whereby BVK incurred considerable loss of trust through no fault of its own, while those waiting to be paid incurred other accessory costs.

❻ Helpfulness of the management authority was not unanimous throughout the programme, which may result in a considerable setback for the participating organisations' future willingness to cooperate. For example, the ratio of advance payments was defined as 25 per cent, while section (4) of article 91 of government decree 217/1998. (XII. 30.) provides a facility for the management authority in case of central programmes (and ECOP 2.2.1. was a central programme) to ignore the 25 per cent rule, and to provide a portion in line with the financing ratio that suits the given measure.

So, it is the management authority's competence to decide on the ratio of advance payments. BVK requested a higher ratio of advance payments on multiple occasions in order to eliminate liquidity problems, but these were rejected by the ECOP management authority on every occasion.

The provision of law also provides a facility for easier terms for non-profit organisations on settling advance payments. The settlement deadline may be delayed until the date the programme is 95-per cent completed, instead of the normal 80 per cent, for non-profit organisations, if permitted by the management authority. However, such requests made by BVK were also rejected by the authority. All these reveal that although provisions of law provide facilities to reduce liquidity problems (that is, legislation or amendments are not inevitable), such intent of the management bodies seemed to be absent for this programme.

❼In order to reduce its financing burdens, BVK – similarly to other regional implementing organisations – developed a practice of accepting external consultant's invoices only when the settlement period approached, in order to make payments directly before the required deadlines, and thus minimising the need for financing. What it meant was that consultants often waited months to be paid after performing their duties. In many cases, it led to consultants leaving the programme, and not intending to cooperate with BVK in other ways, either. Another nuisance was that consultants waiting for their money were not interested in popularising the services of the ECOP 2.2.1. programme and other grant programmes, as they had to finance the costs themselves, which made them feel the drawbacks of the grant system through their own adversity. This is why the full subsidy amount reached the targeted entrepreneurs considerably more slowly, which caused a competitive disadvantage to the economy.

It is a strange contradiction that it was precisely the consultants, whose duty was to propagate grants, motivate and help entrepreneurs to enter the grant system, that were forced into an increasingly grave financial situation, and it resulted in considerably decreased motivation of consultants. Another contradiction awaiting resolution in the future is that state organisations supervising the available funds may be interested in stretching the programme as much as possible, as it may yield extra interest revenues to them.

❽As a result of uncertain payments, the auditor recommended representing loss in value in the balance sheet for the year 2005 – as no material payments were made until the spring of 2006 –, which caused lower profits, and resulting moral damage.

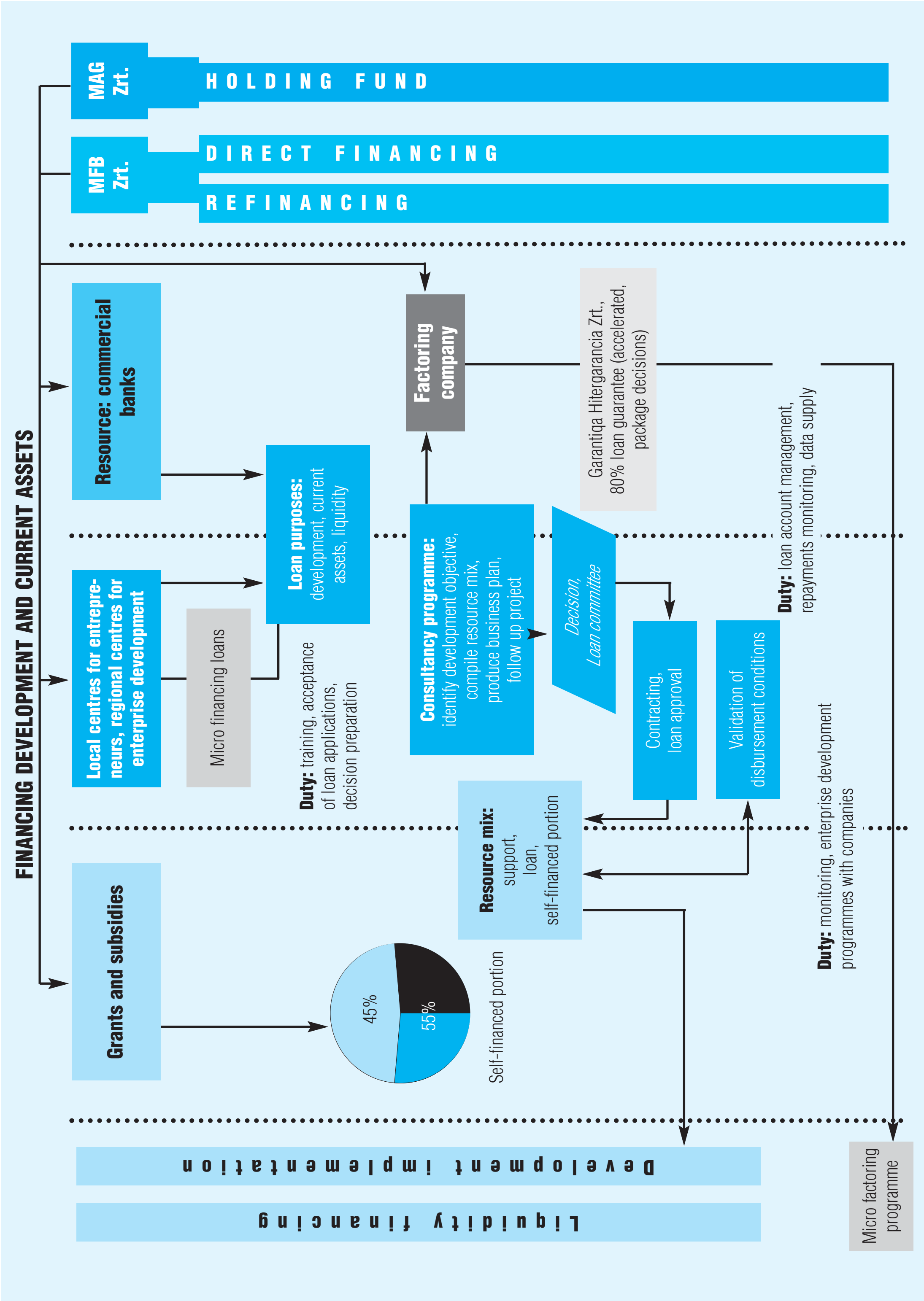
❾The strenuous professional work needed to operate the programme despite the financial and professional problems considerably decreased the capacity otherwise intended to be used to maintain contact with the consultants, or to train and educate them. This necessarily impaired program efficiency.

Note

1 For the central bank base rates of the National Bank of Hungary for the various periods, see Appendix No. 2

Appendix No. 1

APPENDIX NO. 1 THE INTEGRATED ENTERPRISE DEVELOPMENT SERVICES MODEL



Appendix. No. 2

CHANGES IN THE CENTRAL BANK (MNB) BASE RATE

As of 28 November 2003	12.50%
As of 23 March 2004	12.25%
As of 6 April 2004	12.00%
As of 4 May 2004	11.50%
As of 17 August 2004	11.00%
As of 19 October 2004	10.50%
As of 23 November 2004	10.00%
As of 21 December 2004	9.50%
As of 25 January 2005	9.00%
As of 22 február 2005	8.25%
As of 30 March 2005	7.75%
As of 26 April 2005	7.50%
As of 24 May 2005	7.25%
As of 21 June 2005	7.00%
As of 19 July 2005	6.75%
As of 23 August 2005	6.25%
As of 20 September 2005	6.00%
As of 20 June 2006	6.25%
As of 25 July 2006	6.75%
As of 29 August 2006	7.25%
As of 26 September 2006	7.75%
As of 25 October 2006	8.00%
As of 26 June 2007	7.75%
As of 25 September 2007	7.50%
As of 1 April 2008	8.00%

Appendix 3

QUANTIFICATION OF LOSSES INCURRED DUE TO DELAYED FUND TRANSFERS

Settlement period	Submission date of document/missing documents	Payment date	Amount (HUF)	No. of days payment	Excess	Interest rate to payment	Linear interest (HUG)	No. of days to closure	Interest rate to	Compound interest (HUF)
Year 2004	2005-02-28	2005-12-22	4 870 575	297	237	7.11%	224 808.96	770	7.20%	260 316.18
	2005-11-09	2005-12-22	1 115 002	43	0	6.00%	0.00	770	7.20%	0.00
Q1 2005	2005-04-30	2006-03-14	746 056	318	258	6.43%	33 910.53	688	7.36%	38 765.07
	2005-11-09	2006-03-14	2 342 052	125	65	6.00%	25 024.67	688	7.36%	28 607.12
	2006-03-02	2006-03-14	39 645	12	0	6.00%	0.00	688	7.36%	0.00
Q2 2005	2005-07-31	2006-03-14	1 511 792	226	166	6.12%	42 110.71	688	7.36%	48 139.16
	2005-11-09	2006-03-14	667 007	125	65	6.09%	7 234.64	688	7.36%	8 270.33
	2006-03-02	2006-03-14	16 620	12	0	6.00%	0.00	688	7.36%	0.00
Q3 2005	2005-10-30	2006-07-05	3 949 086	248	188	6.00%	122 042.99	575	7.64%	137 058.55
Q4 2005	2006-01-31	2006-07-05	3 608 730	155	95	6.00%	56 355.51	575	7.68%	63 320.26
	2006-03-16	2006-07-05	1 188 510	111	51	6.00%	9 963.95	575	7.68%	11 195.35
Q1 2006	2006-04-30	2006-11-21	7 655 170	205	145	6.85%	208 448.83	436	7.82%	228 056.48
Q2 2006	2006-07-28	2006-12-06	9 820 255	131	71	7.33%	140 045.98	436	7.80%	153 197.11
	2006-10-25	2006-12-06	951 096	42	0	8.00%	0.00	436	7.80%	0.00
Q3 2006	2006-10-31	2007-01-31	8 193 751	92	32	8.00%	57 468.50	365	7.79%	61 944.29
	2007-01-04	2007-01-31	373 944	27	0	8.00%	0.00	365	7.79%	0.00
Q4 2006	2007-01-15	2007-05-04	4 135 010	109	49	8.00%	44 408.88	272	7.69%	46 931.01
	2007-04-06	2007-05-04	229 604	28	0	8.00%	0.00	272	7.69%	0.00
Nov 2006	2007-01-29	2007-05-04	3 096 971	95	35	8.00%	23 757.59	272	7.69%	25 106.86
Dec 2006	2007-02-06	2007-05-04	3 481 438	87	27	8.00%	20 602.48	272	7.69%	21 772.57
Jan 2007	2007-03-20	2007-07-06	166 532	108	48	8.00%	1 752.01	209	7.61%	1 827.12
	2007-06-08	2007-07-06	1 874 305	28	0	8.00%	0.00	209	6.00%	0.00
Feb 2007	2007-04-20	2007-07-06	2 617 720	77	17	8.00%	9 753.70	209	7.61%	10 171.88
Mar 2007	2007-05-10	2007-07-06	2 466 164	57	0	8.00%	0.00	209	7.61%	0.00
Apr 2007	2007-05-31	2007-12-19	2 302 471	202	142	7.68%	68 779.98	43	7.50%	69 368.49
	2007-11-22	2007-12-19	93 600	27	0	7.50%	0.00	43	7.50%	0.00
May 2007	2007-07-12	2007-12-19	1 790 347	160	100	7.62%	37 400.73	43	7.50%	37 720.74
	2007-11-22	2007-12-19	202 555	27	0	7.50%	0.00	43	7.50%	0.00
Jun – Jul 2007	2007-09-04	2007-12-19	1 114 821	106	46	7.50%	10 537.35	43	7.50%	10 627.51
	2007-11-22	2007-12-19	2 327 571	27	0	7.50%	0.00	43	6.00%	0.00
Closure	2007-09-04	2008-01-31	51 600	149	89	7.50%	943.64	43	7.50%	951.72
Total			**72 948 400**				**1 145 352.00**			**1 263 347.80**