Supporting the performance and efficiency of governance – Expediency control and performance measurement in SAI’s audit

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Abstract: The main goal of the management of public funds and public assets is to promote social well-being. In order to realize this main goal and to evaluate individual measures, it is indispensable to subcategorize the primary objective, determine the hierarchy of objectives, assign measurable criteria to the objectives, evaluate performance, and provide feedback. By performing objective, professionally-sound evaluations and providing feedback, independent audits contribute significantly to the improvement of performance. A basic requirement of all audits, however, is the auditability of the objective’s implementation and effectiveness, and the definition of performance criteria for each objective. A large part of the proven methods and tools used in the for-profit sector for performance assessment can be applied successfully at organizations of the public sector as well. The audit findings of the State Audit Office of Hungary (SAO) confirm that the management and control systems of both public entities and state-owned enterprises need to be improved significantly in order to ensure good governance and public sector management. Indicators that capture and adequately measure the effectiveness and efficiency of public spending are important prerequisites for the efficient management of public funds and for the planning process.

Keywords: state audit office; audit; performance assessment; expediency; effectiveness; efficiency; public sector management; good governance

1. Introduction
The management of the diverse and complex economic, social, and environmental problems of our time presents a serious challenge for public management and governance. Programs and public services with high financing requirements must be implemented and provided from a limited amount of public funds, while there is also a need to meet the expectations of an information-intensive, competition-oriented society.

Mainly as a result of economic and financial crises, the state appeared as a market participant in several segments, increasing its participation, among others, in the banking sector and the energy service market (see for example, Turcsányi, 2008, or Domokos, 2015). In these areas, both sectoral governance and organization management are determined by different aspects than those seen at budgetary institutions. Companies have to be managed under market
conditions, in a continuously changing environment, with revenue and profit targets in mind. As a result, the management of state-owned companies is often forced to rely on the same management techniques as those applied by other market participants.

Although public entities do not operate under market conditions and typically enjoy monopolistic positions, they are linked to the private sector in several regards (purchases, recruitment, and certain services, e.g. deliveries). The hierarchy of objectives and the operational frameworks are fundamentally defined by legislation. Consequently, the organization is far less flexible than a business association, and it is at the discretion of the manager to fill these frameworks with substance. In addition, the manager of a public sector organization needs to consider rapid shifts in the environment that pose numerous challenges, as regulatory changes tend to follow them with a lag or sometimes belatedly. Accordingly, public sector managers are increasingly expected to have innovation skills and an ability to promote risk management and organizational learning, and as such, their role goes far beyond a passive type of organizational management focusing solely on regulatory compliance.

It is clear, therefore, that governing a public entity and managing a state-owned company both require adequate managerial skills. The definition of the entire objective hierarchy, the optimization of organizational processes, performance-oriented, responsive and flexible operations, high-quality services, and the improvement of employee performance constitute the backbone of management expectations. In addition, with respect to public spending, management is required to meet the expectations of all stakeholders, i.e. households using the public services, market participants, civil society, etc. In our information society, the ability to monitor governance, the transparency of management, social dialogue, and results are basic requirements. This calls for a new approach on the part of public sector managers. The principles of 'good governance' reflect this new approach.

The basis of good governance is the thoroughly planned, effective, efficient, and responsible management of public funds. By controlling this process, state audit offices provide objective assessment and feedback on the performance of public spending. After the presentation of the theoretical background related to these qualitative aspects of good governance, this paper explores the subject based on the experiences of the State Audit Office. The paper provides a number of examples to demonstrate what happens when the objectives of
public spending are not defined adequately, or when no outcome criteria have been assigned to the pre-defined objectives. It shows the implications of a failure to collect data, which leads to a failure to monitor and measure the implementation of the objectives, and thus the use of public funds is either not expedient or it is impossible to determine whether it is expedient and effective. In the course of its performance audits, in many cases the SAO itself defined indicators in order to ensure its ability to assess the effectiveness and efficiency of public spending. This, however, raises several problems to be discussed later in the study.

2. Questions related to the effectiveness of governance

2.1 How does effectiveness relate to good governance?

Nowadays, good governance is expected to strive for reform of public administration and the enforcement of modern management and institution-organizational aspects (Pulay, 2014). Policy-makers and decision-makers often meet these expectations in consideration of the corporate governance principles and practices applied in the for-profit sector, even though the two sectors show significant differences. The hierarchy of objectives is wider and more sophisticated in the case of public spending, and social expectations necessitate tighter ethical requirements. If so, how can a management approach tailored to profit-oriented organizations gain ground in the non-profit sector? For what purpose and to what extent can the public sector adopt these management techniques?

Since the 1980s, public sector management in developed countries of the world had been subject to considerable changes. This can be attributed to the economic problems arising in the aftermath of the oil crisis on the one hand, and to shifts in the operating environment of governance on the other hand (Turcsányi, 2008). Establishing a cost-efficient state to reduce the burdens of economic participants became an increasingly important objective. The outbreak of the financial crisis in 2008 and the ensuing surge in public expenditure (as a percentage of GDP) pushed this objective back into the spotlight (Felméry, 2014). In addition, the continuous improvement in the quality of market services raised the expectations set for public services, which
also motivated the public sector to improve effectiveness and efficiency (Hajnal, 2004). The information technology boom and the development of the internet also called for the application of modern technologies which, in turn, gave rise to a dramatic development in management information systems and thus improved the transparency of the operation of the public sector. All of this incited policy-makers to adopt novel approaches to the problems of governance. Essentially, they were aimed at reducing state participation and improving the effectiveness, efficiency, and economy of the public sector and enhancing the quality of public services primarily by the adaptation of the management philosophies and techniques applied in the private sector.

The guiding principles of the new public administration mainly reflected the impact of the New Public Management (NPM) movement, but the new approach to public sector management also drew from the theories of neoliberalism, Public Choice, and neo-taylorism. According to Hajnal (2004), the government and administrative reforms implemented in recent years entailed the adoption and dissemination of NPM principles and methods (both among certain multilateral organizations such as the OECD – PUMA/PGC or SIGMA, and the developed countries of the world, including Hungary). An important component of the NPM is to establish a new culture for public administration and, in a broader sense, governance. This culture, ‘is based on partnership and individual initiatives rather than (excessive) state power, effectiveness/performance rather than regularity, cooperation and flexibility rather than command and hierarchy and the values of (market) competition rather than (state) monopoly’ (Hajnal, 2004). The effect of the NPM was also perceivable – and can still be perceived – in Hungarian administrative reform processes, such as the vertical breakdown of ministries (into a strategic control center – ministry – and a number of subordinate organizations), which was a typical structure until 2011–2012. Other examples include the connection of the private sector into the public service systems (e.g. through PPP projects and outsourcing), the performance assessment of public service employees, the system of ex ante and ex post impact assessment, and the application of quality assurance (e.g. ISO).

Subsequently, the adaptation of corporate management to the public sector in general, and the application and applicability of the NPM in particular, were subject to widespread criticism for several reasons. The challenged areas included, for example, problems surrounding the output measurement of
government activities, or the complexity and uncertainty of the issue of effectiveness and efficiency. In other words, what was to be considered the result of the activity, and whether the result that was achieved could be considered a positive result. This notwithstanding, the main tenets of the movement dominate public management to this day, and they are also reflected in some of the principles of good governance.

Indeed, effectiveness, economy, efficiency, and high-quality public services are the prerequisites of good governance. This is emphasized in the 2014 report of the OECD and in several national-level recommendations and guidelines. In short, objectives and measurable effectiveness criteria should be assigned to public spending. It must be ensured that each component – from addressing a problem through planning, decisions and implementation to feedback – is carried out transparently and checked against measurable effectiveness criteria. Only this can enable state audit institutions to ascertain and control whether the management of public funds is driven by real social needs, and if public spending indeed serves the interests of the public.

Objectives and results should be determined at multiple levels; therefore, expediency and effectiveness can be interpreted at several levels. This is illustrated in Chart 1.

As a first step, governance defines the strategic objectives to be achieved (e.g. to increase the activity rate) on the basis of socio-economic needs. Strategic objectives are usually defined (as policy strategy) in legislation (e.g. employment policy strategy). Strategic objectives are broken down to sub-objectives, which comprise a hierarchical system (e.g. easing labour market entry for inactive workers, including, for example, the establishment of a counselling network; increasing the number of new enterprises, including, for example, the introduction of tax benefits). Harmony between the objectives defined at the various levels is ensured by the hierarchy of objectives. Relying on the resources available, the given process generates an output (e.g. a new tax law). The processes serving the achievement of the strategic objective end with a certain result (e.g. 10% of mothers on maternity leave return to the labour market). The impacts arising from the implementation of the programme in other areas (e.g. negative/positive externalities) must be assigned to the results (e.g. number of employees crowded out by new labour market entrants).
In order to gauge the extent to which the public funds allocated to the given programme served the implementation of the pre-defined objectives, the effectiveness of the programme should be examined. While countless questions may arise regarding the measurement of effectiveness, it is extremely important to examine effectiveness at different levels in any case, depending on the level of the objective to which it can be linked. Problems surrounding the effectiveness should be explored and analyzed. On the one hand, this is performed by management as part of its monitoring duty, while the external assessment of performance is carried out by the shareholders, the controlling
organization or the proprietor, or – as an independent organization – state audit offices by way of objective and professionally sound audits.

In democratic and rule of law states, the final control of the management of public funds and public assets is performed by supreme audit institutions (SAIs), independently of the executive power. Essentially, SAIs can contribute to good governance in two different ways (OECD, 2014). First, through their existence and operation they reinforce the effectiveness of bodies responsible for government oversight and for public financial management. Professional and independent SAIs strengthen the accountability chain, which is required to ensure that public interest prevails over personal interest in decision-making. Alternatively, through performance audits SAIs assess the effectiveness, efficiency, and economy of individual programmes and hence, provide feedback on their performance. The fundamental mandate of supreme audit institutions responsible for financial and economic oversight is to strengthen public confidence in state institutions, primarily with respect to the fair, effective, and expedient management of public funds and public assets. This affects all other areas of citizens’ confidence in their government.

Objective and reliable SAI assessments contribute to demonstrating that government decisions are well-grounded, and play an important role in informing decision-makers of the government and parliamentary representatives. In this context, SAIs verify the proper use of budgetary resources, the fulfilment of public policy objectives, whether the implementation of the policies comply with legislation and the objectives, and, in general, whether the performance of the government succeeded in implementing strategic objectives.

Upon performance audits however, SAIs often encounter the problem that the legislation providing the regulatory framework of public spending fails to provide the objectives to be achieved and the criteria against which objectives can be deemed as achieved. This poses severe problems in the evaluation of individual public projects as, in the absence of objectives and criteria, the objective of the government intervention must be presumed, and indicators for its measurement must be defined subsequently. The selection of objectives and indicators is a key factor. Indeed, the definition of which indicators must be met in order to reach a certain goal may determine the outcome of the assessment as a whole – some indicators could be relevant to certain goals, while others could be irrelevant. In addition, the selection of the indicators is
limited by the quantity and quality of the data available. Policy-makers can support and limit the evaluation of the use of public funds to a clear framework if they determine the objectives of government interventions in advance, allocate measurable indicators to them, and ensure the regular collection and processing of data required for the calculation of the indicators.

2.2 Regulatory environment pertaining to the expediency and effectiveness of public spending in Hungary

Below we provide a brief overview of the regulatory environment that defines the expediency, effectiveness and efficiency requirements of public spending.

It is a reasonable expectation of public spending that it should generate social benefits (increase public good); therefore, the objective of public spending should always be measurable against a social utility target value. At the macro level, the objectives of the use of public funds are fundamentally determined by regulations and regulatory instruments under public law.

The basic principles of the strategic governance of the government are laid out in a government decree. The decree supports the government’s goal to ensure that strategic thinking becomes a fundamental element of organizational operations, and that the organization becomes capable of: concerted, high-quality strategic planning; identifying its short and medium-term objectives; defining the tasks and assigning responsibilities; as well as monitoring and assessing the implementation of the tasks and the predetermined objectives. The legislation defines the hierarchy of strategy papers, the individuals responsible for drawing up the documents, the principles of follow-up, evaluation and review, and rules pertaining to individual document types.

Sometimes, however, even the legislation fails to define the regulatory objective, which renders the interpretation of the expediency of public spending either difficult or impossible. Hungarian regulations do not include a requirement for the definition, application, and monitoring of effectiveness, efficiency, economy, or other performance indicators pertaining to the entire group of public fund users. By contrast, the legislation defines in detail the amount and the main allocations of the public funds available (prevailing Act on the Budget and the budget decree pertaining to local governments) and the
criteria for the use of public funds by budgetary institutions. They state that
the economy, efficiency and effectiveness of the use of public funds and public
assets must be ensured. However, the meaning of these concepts is unclear.

Besides legislation or in-house regulations, the performance criteria of the
given organization can be enforced by other means. For example, by the
expectations of the controlling body, the proprietor or the shareholder. This
includes the public service contract concluded by the state and the public
service provider, which is a written contract for the performance of a public
function or a part thereof on behalf of the organization. In addition to the
basic requirements of the performance of public services, the contract also
stipulates quality requirements and conditions.

Obviously, the existence of the regulation cannot ensure effective and
efficient operation in itself; it only provides a framework for it. The head of the
organization is responsible for filling these frameworks with substance.

The greatest deficiency of the regulation, therefore, is the fact that it fails to
enforce the declaration of the objectives, expected results, and performance
criteria of public spending at the systemic level. It is therefore impossible to
measure the subsequent effectiveness and efficiency of public spending. As has
been confirmed by the findings of the State Audit Office, the deficiencies
suggest that the social utility of public spending falls short of the level that
could have been achieved by a clear definition of the objective and by result-
oriented operation. Recognizing this problem, regulatory processes
commenced in relation to a segment of the economic agents managing public
funds: public administration organizations. These processes shift the system of
public spending specifically toward strategic control and result-oriented
operations. (Apart from this, there are a number of other policy programmes
and government strategies where regulations have commenced. However, they
are not targeted at ensuring the effectiveness and efficiency of public spending
or demanding follow-up and evaluation).

3. Findings of SAO audits

The audits of the State Audit Office measure different aspects of performance
to ensure that public funds are managed in an orderly, growth-stimulating
fashion. The methodology of the SAO’s performance audits are based on the
INTOSAI standards (ISSAI 100 and ISSAI 300). Performance auditing
promotes the transparent operation of organizations by providing, based on
the audit evidence, an independent and authentic perspective, by issuing conclusions for the targeted users of the audit results, and by offering an insight into the implementation and outcomes of audited activities related to the management of public funds and public assets. Accordingly, it provides useful information while serving as a basis for the acquisition of knowledge and performance improvement. Performance audits support the responsible parties in the improvement of accountability by offering new evaluation criteria. (SAO, 2015)

In addition, the SAO’s compliance audits and results of the Integrity Survey also identified effectivity problems. These experiences can be used in the planning process of performance audits, too.

3.1 Audit findings of SAO’s performance audits

The performance audits of the SAO shed light on a number of problems that derived from inadequate indicators, backtesting, or the inadequate definition of objectives. Németh and Kolozsi (2015) processed the audit findings, and the possible problems arising during the audits were found to be the following (the number in brackets correspond to the relevant audit report):

a) Objectives have not been set or proved to be deficient (e.g. the reorganization of psychiatric health care) [No. 1286].

b) Objectives have been set but the system of indicators and criteria designed to measure the successful implementation of the objectives is either missing or inadequate [subsidy scheme of public employment, No. 13097].

c) Objectives have been set, an indicator system has been designed, and a set of criteria have been developed and applied. However, there is no follow-up and the reasons for deviations are not analyzed [implementation of rural development objectives, No. 1293].

d) There are simultaneous deficiencies at multiple levels with respect to the definition of objectives, the performance criteria, as well as backtesting [financial management of business associations in majority state/local government ownership].

The following will examine each of these examples.
3.1.1 Reorganization of psychiatric care: consequences of the lack of efficiency objectives

In 2012, the State Audit Office conducted a performance audit with regards to the reorganization of psychiatric care. The purpose of SAO’s first-time audit of psychiatric care was to evaluate whether the resources being spent on reorganizing psychiatric care were appropriately utilized and whether the reorganization was more cost-effective, and provided higher-quality, more easily accessible service. The audit covered the period between 1 January 2006 and 30 September 2011.

The audit found that goals had not been set at the macro level, neither in terms of effectiveness nor in terms of efficiency of psychiatric care (neither in the professional or public health, nor in the financial areas); the relevant indicators had not been designed, and therefore, it was not possible to monitor and evaluate the effects of the reorganization.

Due to such major deficiencies in planning, severe problems emerged in the already distressed health care system. For example, closing down the National Institute of Psychiatry and Neurology eliminated the national institution for psychiatric care that was meant to provide a comprehensive framework for individual types of psychiatric care, and the institutions designated to take over the tasks were unprepared. As a result, a substantial amount of financial liabilities accumulated.

The audit found that even though several government initiatives had been announced for the reorganization of healthcare in the period of 2006–2011, they did not specifically determine the tasks and size of psychiatric care. Hospital restructuring in 2007 terminated inpatient psychiatric care in 11 hospitals, curbed the number of total active beds in psychiatry by 20% nationwide, and closed down the National Institute of Psychiatry and Neurology – which was considered to be the apex of the mental health profession – without any surveys with respect to the regional distribution of psychiatric diseases, or to the expected impact of the decisions. In addition, there was no consultation with professional organizations or patient advocacy groups, and the health care system was unprepared for the dramatic change entailed by the reorganization. Although the goal of the reorganization – including the termination of the national institution – was to streamline the
The lack of adequate professional planning deteriorated the conditions of psychiatric care. Bed cuts in inpatient psychiatric care as part of hospital restructuring did not address earlier capacity imbalances, nor were there any legal provisions on adjusting capacities in specialist outpatient care. The elimination of the National Institute of Psychiatry and Neurology – a top quality professional institution – was an unreasonable decision. Decision-makers failed to survey the financial implications of the institution’s elimination in advance, and the institutions designated to take over the tasks were unprepared. The target date for the institution’s liquidation, therefore, was delayed by a year.

Starting from 2008, the Ministry of Health, in conjunction with various Hungarian psychiatric professional organizations commenced the development of a criteria system suitable for measuring performance. However, the evaluation of cost efficiency and effectiveness did not have an established and applied methodology at the time, which resulted in the State Audit Office developing its own indicators suitable for performance assessment during the audit. Through the analysis of these indicators, the SAO found that the cost-efficiency and effectiveness of public spending on psychiatric care deteriorated in comparison to 2006. The primary reasons behind this deterioration were capacity imbalances in psychiatric care, and in the absence of disease registers, health care and social care capacities were not based on morbidity data. There was no organized care regulating services for patients, and regional access was unevenly distributed. Moreover, in the absence of accurate disease registers, no information was available on the actual prevalence of psychiatric disorders by region.

Reorganization has failed to lead to a more even distribution of hospital capacities or create a more sustainable care system better geared to treatment needs.

In summary: the centrally executed reorganization of the institutional system did not have a pre-determined hierarchy of objectives and the expected results were not defined; therefore, it was not possible to assess the objectives of the public funds spent on the project or identify the social utility of the reorganization. In such situations, there is a concern that objectives are hastily determined, reflecting immediate needs and interests rather than as a result of a thorough and concerted planning process with maximum consideration to social utility. In the absence of a hierarchy of objectives, it is impossible to
measure the expediency, effectiveness, and efficiency of the programme as a whole, which ultimately calls into question the expediency, effectiveness, and efficiency of public spending.

3.1.2 Public employment, and consequences from the lack of an appropriate indicator system and criteria

As it has become apparent, the establishment of a hierarchy of objectives is indispensable for expedient, effective, and efficient operations. The example presented below illustrates the possible implications of deficiencies in the indicators designed to measure the achievement of goals, the relevant criteria, and the information system supporting their measurement.

In September 2013, the State Audit Office published Report No. 13097 on the performance audit on the efficiency and effectiveness of the subsidy scheme of public employment and the related training programs. The objective of the audit was to assess the effectiveness and efficiency of the public employment system which had been in place between 2009 and 2012 Q1 (including the related subsidy scheme and training system and the changes introduced). This audit specifically sought to evaluate the cooperation between local governments and labour organizations efficiency and effectiveness in facilitating the return to work, and improvement of labour market positions, of individuals experiencing long-term unemployment with low-level academic qualifications capable of working through public employment or training schemes.

The audit found that the strategic objectives regarding public employment in the review period had been set (in several, interdependent documents), and from 2011, specific goals and tasks were defined in relation to the strategies. However, they either did not or insufficiently set the effectiveness and efficiency indicators and criteria suitable for confirming the implementation of the objectives, and allowing for continuous monitoring and ex-post evaluations. The entire infrastructure of the measurement was also either deficient or missing. Due to the lack of a comparable indicator system measuring the effectiveness and efficiency of the public employment system in place, there was no central evaluation.
Due to these limitations, wherever the quality and quantity of the data available allowed, the State Audit Office derived its own indicators from the pre-determined objectives, and drew its conclusions on the basis of the analysis of these indicators. As a result, the SAO found that the number of persons involved in public employment doubled from 2009 to 2011, which means that the public employment system was effective in supporting unemployed individuals in obtaining public employment, and in accomplishing the strategic objectives regarding subsidised employment. Public employment had a positive effect on both the employment rate and the unemployment rate (improving the employment rate by 0.8–1.1% and the unemployment rate by 1.4–2.0%). In addition, the subsidy scheme efficiently contributed to involving those of productive age and receiving social benefits in employment. Goals which were also employment policy objectives.

Based on the audit findings, the SAO issued a recommendation for developing a criteria and indicator system suitable for measuring the performance of public employment, and for setting up a monitoring system for the implementation of the pre-determined objectives.

Another problem explored by the audit was the fact that, owing to deficiencies in the continuity, timeliness, and reliability of registries and disclosures, the information system of public employment did not support regular reporting and feedback to policy-makers in the review period. In some areas, the quantity or quality of the data available was insufficient for the monitoring process. For example, they did not collect data systematically with respect to the exits of public workers from the open labour market. This would have been required for comprehensive government analyses, but no comparable data was available with respect to the entry of public workers into the open labour market (neither at the central nor at the local levels). Consequently, it was impossible to assess the effectiveness and efficiency of the efforts to facilitate the return of public workers to the open labour market. With that in mind, the SAO recommended the development of a data reporting system that provides reliable data for the evaluation of the implementation of public employment objectives.

In this case, it is not possible to decide whether the objectives were implemented effectively and efficiently, because in the absence of pre-determined indicators and criteria it remains unclear which outcome would have been considered effective and efficient by those who set the objectives. In
any event, the SAO found that the use of public funds contributed to the reduction of the unemployment rate and a significant increase in the number of public workers. Additionally, the efficiency of the public employment subsidy system improved by 2011 from the aspect of the central budget (i.e. the per capita subsidy amount declined with a simultaneous increase in the number of public workers). Ultimately, the results achieved by the use of public funds contributed to the implementation of the pre-determined objectives.

3.1.3 Implementation of rural development objectives; consequences of deviation from the objectives

Sometimes, even though strategic objectives are defined, the related, multi-level sub-objectives are set, and the adequate indicators and criteria are put in place, during implementation the program is modified (e.g. in terms of funding, the criteria system or target groups) on the basis of priorities that are not in line with the original objectives. Consequently, its effectiveness and efficiency fail to achieve the pre-determined level.

In August 2012, the SAO published its report on the performance audit on effectiveness and efficiency of the utilization of funds for the implementation of rural development objectives, and the strengthening of the role of local communities in the improvement of the quality of life in rural areas. The main purpose of the audit was to assess whether the utilization of funds allocated to the implementation of rural development objectives to improve the quality of life in rural areas, to encourage diversification of the rural economy, and to strengthen the role of local communities, was effective and efficient in the period of 2007–2011.

The audit found that the objectives of the New Hungary Rural Development Program (NHRDP) were in line both with the objectives of the National Development Policy Concept and with EU requirements. Output, result, and impact indicators were defined to measure the implementation of the targets and impacts (e.g. number of villages and micro-enterprises supported, number of new jobs, total amount invested, and net number of new jobs created as a result of development).
However, problems arose during the implementation of the program as a result of the low number of completed projects, the commitments undertaken in relation to the funding, and the limited rate of payments. The programme was modified several times, but the substance of rural development objectives remained the same. Thus, for example, there was a shift in the allocations between the measures aimed at improving the quality of life in rural areas and encouraging the diversification of the rural economy: more than a half of the funds allocated to the measure aimed at the creation and development of micro-enterprises was reallocated to the measure targeting the improvement of the image and attractiveness of rural life and the quality of services. This modification was contrary to the objective set out in the NHRDP’s economic development programme, which was intended to strengthen micro-enterprises operating in rural settlements and to improve local employment. Increasing the resources for improving the image and attractiveness of rural settlements and the quality of services rendered did not contribute to managing the social tensions generated by the restrained economic activity of the population living in rural areas, by the low employment rates and hence, by the limited amount of income.

The reorganization of resources was not accompanied by an overall review of indicators intended to measure the implementation of the objectives (e.g. number of micro-enterprises supported, total amount invested, number of multifunctional service centres, etc.). The indicators were modified only in part, and without underlying calculations and impact assessments.

The monitoring committee was tasked with monitoring and evaluating the program results on a continuous basis. However, the efficiency of this, which was designed to supervise the quality of the execution – partly as independent of the executive organizations – was low.

In summary, although the objectives and the related effectiveness indicators were defined at the start of the project, during subsequent modifications of the program – justified by reasons irrespective of the project – the indicators intended to measure the results and the resources ensuring that such indicators were achieved were not significantly changed, and the results, performance, and impacts expected from the support system received less attention. Consequently, the originally defined regional development and convergence objectives were implemented only partially and therefore, the expediency,
effectiveness, and efficiency of public spending fell short of the originally desired levels.

3.2 Audit findings pertaining to state-owned enterprises

The SAO reports prepared on the macro-economic correlations of fiscal processes (the latest one of which was issued in September 2015) pointed out that the ratio of public spending on economic functions to GDP had increased continuously since 2011. The increase in expenditures allocated to economic functions primarily reflects the high absorption of EU grants and state acquisitions. This trend also reflects the increasing economic participation of the state, which, according to Domokos (2015) opens up new opportunities (e.g. increasing national wealth, development of depleted but not replaced assets, increasing economic strength of the state), but also carries a certain degree of risk. For instance, the need to ensure the funding required for a more active participation in economic functions entails the reallocation or withdrawal of resources, which may pose funding risks over time in other areas (e.g. among those receiving reduced budgetary subsidies or subject to special taxes, as well as in areas receiving a smaller proportion of EU transfers). In addition, a competition for the acquisition of public funds materializes between traditional state functions and the economic functions of the state.

The fact that the state is at the same time a legislator, shareholder, and supervisor in an increasing number of economic areas may also be a risk factor. Being responsible for all three functions simultaneously gives rise to a conflict of interest between, for example, the legislator and the shareholder (the creation of a regulatory environment encouraging competition vs. the crowding-out of competitors and monopolistic endeavours). The change in ownership implies that, through its business associations, the state now operates in markets where its presence was previously limited to a regulatory role. Accordingly, there is a risk that the level of expertise required for the management of a state-owned company competing under market conditions is insufficient, and thus the operation of the organization is ineffective or inefficient. This increases the risk of losses and wasteful operation. These risks may be mitigated by an adequate regulatory environment and by the exercising
of ownership rights (e.g. shareholder's control), and by facilitating transparent and performance-oriented operations.

In consideration of the risks involved, the auditing of the financial management of state-owned enterprises (SOEs) has become a relatively new but increasingly important area of SAO audits (e.g. transportation companies, district heating providers, waste management companies, water and public utility companies, theatres). The audit findings contribute to improving the relevant regulations, as well as SOE's management and processes for exercising ownership rights and ultimately, to improving the state's performance.

The SAO performs the assessment of the companies in the context of compliance audits. Propriety audits are performed where certain issues cannot be judged on the basis of legal provisions or where there are clear deficiencies in legislation. Performance audits are intended to establish whether the stewardship of public funds and public assets complies with the principles of effectiveness, efficiency, and economy, and whether there is room for improvement. Typically, however, there are no effectiveness requirements in place (set by the exercisers of ownership rights, the bodies of the company, or its management) to determine the objective to be achieved and the desired impact. Therefore, in most cases the accountability of public spending is limited to its regularity and propriety. SAO audits are primarily intended to verify and evaluate financial standing, asset management, the existence of internal control systems and the regularity of the areas constituting an integral part of these items. At the same time, audit findings allow us to identify critical areas that may not be separated from the scope of responsibility of management and the exercisers of ownership or oversight rights.

SAO audits pointed out that deficiencies in the management of state-owned companies generate losses in numerous areas, including financial and non-financial losses (e.g. loss of confidence, moral hazards). These losses stem from various sources and could reflect deficiencies in the exercising of ownership rights and management-related problems. The materialization of deficiencies at multiple control levels may amplify one another, leading to significant economic, effectiveness, or efficiency losses.

3.2.1 Deficiencies arising in the exercising of ownership rights
Appropriate exercise of ownership rights, tight ownership control, and the
definition of the direction of public asset management are indispensable factors
in responsible public spending and asset management. Audit findings point to
a lack or ambiguity of directives regarding the use of public funds and public
assets (e.g. the National Asset Management Directives defining the strategic
and annual frameworks for the responsible management of state property, or
the Annual National Asset Management Programme have not been
completed). Moreover, the exercise of ownership or oversight does not fulfil its
intended role in several areas (definition of performance criteria, reporting
system, ownership control, and evaluation). Audits and analyses on areas
playing a key role in terms of competitiveness (acquisition and utilization of
knowledge, investment projects, inexpensive energy, employment, market
organisation, and sustainable development) found evidence for the absence of
targeted indicators (indices) suitable for measuring results, direct and indirect
benefits, and pointed out – in the case of the use of domestic funds – the lack
(or deficiencies) of monitoring systems ensuring reliable and up-to-date data
reporting and feedback. The SAO has drawn attention to these problems on
several occasions, and identified the risks entailed.

Ownership control is a particularly important item of ownership rights
which, in the case of local governments, is typically manifested in the activity
of the Supervisory Board. The primary asset manager (Hungarian State
Holding Company) monitored the activity of the companies primarily on the
basis of controls relying on requested data disclosures. However, it failed to
perform on-site inspections regarding the financial management, preservation,
accumulation, and use of public assets. The company's disclosures were
insufficient, and problems were detected with respect to the owner's reporting
systems as well (non-compliance with regulations, failure to provide the
required information, failure to demand reports), which impaired the
enforcement of transparency.

The Supervisory Boards discussed and approved the annual business plans
and the annual reports. However, they usually did not inspect – for the
protection of the owner's assets and public interest – changes in wealth, the
financial management of company assets, and stewardship of the state property
entrusted to the company.

In order to ensure the accomplishment of the objectives, clear effectiveness
requirements must be defined for management, and the fulfilment of these
performance criteria must be monitored and evaluated on a continuous basis. In case of deviations, the owner must take the necessary measures. Evidence shows that the performance assessment system of corporate managers is not consistent, and it lacks a related, efficient-incentive system.

With regards to ownership control, in addition to its recommendations based on the audit findings, the SAO also issued letters of warning, advising the exercisers of ownership rights to (among other things) review the financial management of the business association, and – in this context – define expectations regarding the content of business plans and reports, and to review and manage the accounts receivable of the business association. The SAO also advised the owner to define – in the context of exercising its ownership rights – a set of criteria to measure, for example, the efficiency of public service functions or professional standards for evaluating service levels for the company.

3.2.2 Management of state-owned companies

The audits found that, in many cases, the financial management of the companies did not comply with statutory requirements (e.g. important accounting policies were missing, prime cost calculations were unfounded or missing, the requirements of accounting separation were violated). Severe regularity and financial management problems went undetected in many cases; neither management, nor the exerciser of ownership rights, took measures to reduce the risks arising from these problems, and the Supervisory Boards failed to raise attention to the risks jeopardizing the implementation of the objectives.

For the most part, business plans did not include criteria pertaining to the effectiveness, economy, and efficiency of financial management and professional performance. In the absence of pre-determined criteria, the performance of the company’s management cannot be measured, and the loss-producing or profit-generating areas cannot be identified. In numerous cases, the plans did not include detailed information about the scheduled projects. Therefore, it is impossible to make informed decisions regarding the allocation of public funds or investment projects.
The SAO found that, in many cases, the internal regulations pertaining to prime cost calculation did not adhere to legal regulations in the case of companies providing public services. This issue is not only important from the perspective of compliance with the Act on Accounting. Indeed, another important function of prime cost calculation – in the economic sense – is to support the decision-making process. In the case of business associations performing public functions and providing public services, there are numerous areas where it is impossible to make well-founded and forward-looking decisions in the absence of adequate prime cost calculations. These areas typically include the execution of planning tasks, price formation, cost analysis, and calculations providing the foundation for economic decisions – indicators designed to measure internal performance. These areas are also within the management’s scope of responsibility and, through the approval of the business plans, they are of decisive importance from the perspective of the supervisory exerciser of ownership rights.

4. Conclusions
In several cases, the audits conducted by the State Audit Office of Hungary shed light on general problems that may give rise to risks that could potentially jeopardize the achievement of policy or social objectives. The audit findings of the SAO confirm that the control systems of both public entities and state-owned enterprises need to be improved significantly in order to ensure good governance and public sector management. This calls for a paradigm shift, and new horizons should be opened up in the public sector management approach. It is indispensable to ensure the transparency, publicity, and measurability of the public sector management’s performance, because this is the only way to ensure effective, efficient, cost-effective, and sustainable public management, and to also increase social well-being.

First, the regulatory environment should be improved to identify objectives, to specify the expected performance and to develop the indicator system related to public spending. The owner must define the criteria for the implementation of objectives and sub-objectives in a manner that ensures the objective execution of performance assessment and control. At the same time, objectivity requires reliable databases, which are currently not available in the whole sector.
Parallel to this, it is also essential to improve the regulations pertaining to management along the lines of new aspects. The ethical requirements set for public managers should be tightened to properly reflect the fact that they act on behalf of the community, bearing responsibility for public property and for safeguarding the future of the community. Public confidence in management must be earned and retained. Good managers act as an example for all and do everything in their power to ensure that the organization entrusts them to fulfil the public purpose for which it was established.

The State Audit Office, as a supreme audit institution, plays a prominent role in the renewal of public management. Its performance audits are designed to evaluate the use of public funds focusing on expediency and effectiveness, enforcing its transparency and the measurability of performance. The execution of performance audits, however, is often impaired due to the lack of the required indicator system. Therefore, in recent years the SAO has supported – and will continue to support – the enforcement of the expediency/effectiveness/efficiency requirement in the planning, implementation, and evaluation of government objectives through the publication of a series of performance-oriented studies.

In its advisory role, the SAO has often called the legislator’s attention to problems surrounding the effectiveness- and efficiency-based assessment of public spending, and issued a number of recommendations. Some of the proposals pertained to the selection, performance assessment and remuneration of management. The proposal package included the following recommendations:

– the performance of the management of state-owned companies should be evaluated from the perspective of compliance, effectiveness, efficiency, and economy on a continuous basis;

– the ability and activity of the exerciser of ownership rights to evaluate effectiveness should be strengthened;

– managers of state-owned companies should comply with strict ethical and integrity principles; and

– the remuneration system of company managers should be reformed.

The SAO wishes to continue to play a leading role in the creation of a knowledge base in order to enable economic actors responsible for the management of public funds, as well as those controlling and supervising the
process, to safeguard public funds and public assets in an ethical and highly professional manner.

References

1. Certainly, the frameworks imply different things at different management levels; moreover, even subordinate public sector employees have a degree of independence, and hence, responsibility.

2. According to the neoliberal movement, since competition strengthens the economy, the state should be downsized, public services should be steered to the market and in general, the economic role of the for-profit sector should be increased.

3. In the bureaucracy theory of Public Choice, policy-makers and executive officials seek to maximize their personal utility, and the movement explores the implications of this choice.

4. Taylorism studies the topics of process management and performance improvement.

5. OECD PUMA (Public Management Committee) and subsequently, PGC (Public Governance Committee) were established to provide support to participating Member States in the planning, implementation and evaluation of public policies and public services.

6. Partners for good governance: mapping the role of supreme audit institutions (OECD, 2014)

7. E.g. the 2004 publication entitled The Good Governance Standard for Public Services by the Independent Commission for Good Governance in Public Services, or the publication entitled Principles for Good Governance and Ethical Practice by the Independent Sector in the USA; Good Governance in Practice, Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung (BMZ), 2012; International Framework: Good Governance in the Public Sector, Chartered Institute of Public Finance and Accountancy (CIPFA) and the International Federation of Accountants® (IFAC®), 2013; Good governance guide for public sector agencies, Government of Western Australia, 2013.
8. Social utility means the benefits reaped by society as a whole. It consists of direct and indirect components, and considers environmental impacts and, for example, the effects on job creation. It is a broader category than financial utility. It is primarily used for cost-benefit analyses prepared for development projects financed from EU funds.

9. Government Decree No. 38/2012 (III. 12.) on Strategic Governance

10. Strategic planning documents: country forecast, national medium-term strategy, ministerial programme, institutional work plan (i.e. mandatory documents), as well as the long-term concept, the white book, policy strategy, policy programme, institutional strategy and green book (optional)


13. The goal of the series of surveys performed annually by the SAO since 2011 has been to identify the risks which may adversely influence the integrity of the given organisations within public sector institutions. In addition to identifying the risks, the survey also maps out the coverage levels of controls serving to manage these risks. In addition to the fight against corruption, expanding the circle of institutions that accept and endorse the integrity-based mentality is another high priority of the integrity surveys. The ultimate goal is to promote cultural change and to create integrity-based institutional operation and to spread thinking in terms of risks in the Hungarian public sector.

14. State Owned Enterprises (SOEs) are enterprises where the state has significant control through full, majority, or significant minority ownership (owned by the central or local governments).