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# The Methodological Renewal of the State Audit Office of Hungary in Light of the Protection of Public Funds



## *Summary*

The change in international standards unfolding from 2007, the independence and transparency criteria applying to supreme audit institutions and the enhanced enforcement of objectivity and professionalism requirements called for the methodological renewal of the State Audit Office. Auditing guidelines and standards define the fundamental principles and norms adhered to by the SAO, which provide the basis for the quality of its audit work and reports. These principles and norms provide the framework that enables the auditors of supreme audit institutions (SAIs) to preserve their independence and the probity of their work. The effects of the renewal apply to and are felt in some form in all audit phases and organisational levels. By developing its new, quality-driven operations and by completing its methodological renewal, the State Audit Office has become a supreme audit institution which, as a professionally indispensable constitutional organisation enjoying the trust of Hungarian citizens, can support the operation of a well-managed state.

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THE AUDITS OF THE STATE AUDIT OFFICE OF HUNGARY

*“The only thing that is constant is change” (Heraclitus)*

Before addressing the methodological renewal, we must look at the reasons and targets of our audits, and what the methodology actually supports. The State Audit Office of Hungary is the supreme financial and economic audit institution of the National Assembly. Acting within its functions laid down in the law, it audits the implementation of the central budget, the management of public finances, the use of funds from public finances and the management of national assets. It carries out its audits according to the criteria of legality, expediency and efficiency. The fundamental rules governing the utilisation of public funds are enshrined in Hungary’s Fundamental Law. The Fundamental Law states that every organisation managing public funds is required to publicly account for its management of public funds, and that public funds and national assets shall be managed according to the principles of transparency and the purity of public life.

In accordance with its institutional strategy, the mission of the State Audit Office of Hungary (SAO) is to promote the transparency and regularity of public finances with its value creating audits performed on a solid professional basis, thus contributing to “good governance”. The mission of SAO is to contribute through its audits to the legally compliant, successful, effective and cost-effective task performance of public entities and their employees, and other entities using public funds and thus to enforce expectations of the public sector’s operation. With its findings, recommendations and analyses based on its audit experience, the State Audit Office of Hungary assists the National Assembly, its committees and the work of the audited entities, thus contributing to well-governed state operations.

Our aim is to create added value with our audits:

- to drive change in the domain of public finances,
- to support accountability and transparency to spur public representatives to use public funds responsibly and continuously improve their performance,
- to contribute to the compliant and effective discharge of tasks and activities by audited entities, and
- to share the know-how, knowledge and evaluations acquired during audits (SAO, 2015a:7).

A fundamental expectation regarding SAO audits is that it should conduct audits in matters and areas that most need to be audited. It focuses its audits on areas where they create the most value added.

In 2011, with the adoption of the Act on the State Audit Office of Hungary<sup>1</sup>, the National Assembly reinforced the guarantees of the independence of Hungary’s supreme audit institution, the State Audit Office of Hungary. Simultaneously, the State Audit Office of Hungary commenced its organisational renewal from the aspects of accountability, transparency, quality control, ethical expectations and SAI utility. The contents generated by audits allow the enforcement of these requirements. All of this

against a continuously changing backdrop, where new areas and new requirements constantly emerge. “The only thing that is constant is change”, said Heraclitus. Both the audits and the methodologies providing the framework for audits must adapt to these changes. Consequently, the methodologies cannot themselves be set in stone. New areas and new requirements constantly emerge, and the audits need to be carried out in a new environment. At the same time, audits by SAIs within the public sector are always conducted in a setting where the government and other public sector entities use taxpayer and other public funds. They are responsible for the utilisation of these funds. As a result, public entities are accountable for their performance and the regularity of their spending.

The topic of the need for methodological renewal should first be approached from the perspective of the role of methodology itself. It should be clear that the methodology applied is primarily the guarantee for ensuring objectivity, professionalism and uniformity within the life of the audit organisation. This criterion is supplemented, in the case of the State Audit Office of Hungary, by a series of independence guarantees, one element of which is the independent creation of our methodologies. Under its statutory mandate, the State Audit Office of Hungary works out the professional rules and methods of its audits for itself, and makes these rules public. This is a key statutory provision, guaranteeing independence in terms of the documentary framework forming the basis of the execution of all the tasks and enabling the prevalence of international fundamental transparency principles to the greatest extent.

The methodology provides a guarantee for all users, acting as a safeguard that a specific type of audit is carried out by the State Audit Office of Hungary among all audited entities objectively, professionally and according to the same methodological criteria. A uniform methodological framework is a guarantee for impartiality. This is why INTOSAI<sup>2</sup>, the international body of supreme audit institutions makes a priority of the matter. This brings us to one of the fundamental reasons warranting methodological renewal. When renewing the fundamental professional principles of auditing, the State Audit Office of Hungary used the fundamental auditing principles developed by INTOSAI as guidance, which set public sector auditing on common professional grounds worldwide. The State Audit Office of Hungary has introduced and continues to introduce the renewed fundamental professional principles of auditing in accordance with the changes unfolding on the international scene.

#### THE SET OF INTOSAI INTERNATIONAL RULES

The Strategy of the State Audit Office of Hungary states that its set of professional rules of auditing would be renewed taking into account the ISSAI<sup>3</sup> standards and guidelines adopted by INTOSAI, also taking into account the Hungarian legal framework, while reviewing and further developing its auditing practice and methods, effective professional rules of auditing and preparing the lacking professional auditing methodological documents.

The auditing standards, which define the fundamental rules of audits (INTOSAI Auditing Standards), were adopted at the 1992 annual INTOSAI Congress. Since then, the global organisation has updated its set of professional regulatory documents several times. The 2007 annual Congress of INTOSAI adopted the current framework of professional rules of auditing (Blegvad, 2007:11), which defined the ISSAIs' four-level hierarchy and decided on the creation of INTOSAI GOVs (Guidance for Good Governance). INTOSAI classifies its professional guidelines, referred to as ISSAIs, into four levels:

1. Founding Principles, the Lima Declaration (ISSAI 1, 1977)
2. Pre-requisites for the Functioning of SAI<sup>4</sup>
3. Fundamental Auditing Principles
4. Auditing guidelines

The four-digit group of INTOSAI professional rules includes auditing guidelines linked to the application of the general Fundamental Auditing Principles and those linked to special areas (e.g.: IT audit – ISSAI 5300-5399, Corruption Prevention – ISSAI 5700-5799).

*Figure 1: Prerequisites for the Functioning of Supreme Audit Institutions*

Serial number	Address
<b>ISSAI 10</b>	Mexico Declaration on SAI Independence (2007)
<b>ISSAI 11</b>	INTOSAI Guidelines and Good Practices Related to SAI Independence (2007)
<b>ISSAI 12</b>	Value and Benefits of SAIs – making a difference to the life of citizens (2013)
<b>ISSAI 20</b>	Principles of Transparency and Accountability (2010)
<b>ISSAI 21</b>	Principles of Transparency – Good Practices (2010)
<b>ISSAI 30</b>	Code of Ethics (1998)
<b>ISSAI 40</b>	Quality Control for SAIs Implementation guidance and tools (2010)

Source: State Audit Office of Hungary.

*Figure 2: Fundamental Auditing Principles*

Address	From 1992, from 2001	From 2013*
<b>ISSAI 100</b>	Basic Principles	Fundamental Principles of Public-Sector Auditing
<b>ISSAI 200</b>	General Standards	Fundamental Principles of Financial Auditing
<b>ISSAI 300</b>	Field Standards	Fundamental Principles of Performance Auditing
<b>ISSAI 400</b>	Reporting Standards	Fundamental Principles of Compliance Auditing

\*Reviewed at the ISSAI Harmonisation Project launched by the XX INCOSAI in 2010, and new level 3 ISSAIs were adopted in October 2013 in Beijing

Source: State Audit Office of Hungary

INTOSAI GOVs are guidelines pertaining to internal control systems, accounting and governance responsibility in an effort to promote effective management, and generally aim to foster the implementation of good governance.

NEW AUDITING APPROACHES AND THE RENEWED  
PROFESSIONAL AUDITING METHODOLOGY

The most important qualitative requirements of SAI audits are substantiation and reliability, which can and must be attained using modern audit methods and the highest auditing assurance attainable under the circumstances. The main objective of professional regulation is to create a uniform and consistent, quality-centric set of requirements to create a reliable and objective basis for SAI audits, the work of auditors, the assessment of work performances and the quality-controlled execution of audits. The methodology provides a framework for answering numerous questions, including one of the most complex ones: “*How?*”.

The methodological renewal of the State Audit Office of Hungary is the result of a multiple step process. The first step was to identify and define the framework within which legislation, guidelines, international standards and the related strategies had to be processed. The four-level system of the professional rules of SAI auditing was created factoring in all of these elements. In terms of the contents of the hierarchical levels, we progress from fundamental principles comprehensively defining operation to the individual types of audits. This has two consequences. For one, the system is a top to bottom system, and secondly, it is a comprehensive hierarchical regulatory structure that defines the entire organisation. Emphasizing this fact is important, as we are dealing with the operation of the organisation as a whole, rather than the methodology of individual subprocesses. It is in light of this that the main steps and directions of the methodological renewal can be best understood.

The renewal of the methodological background of SAO audits began with the adoption of the new Act on the State Audit Office of Hungary, effective as of 2011, which reaffirmed the independence of the State Audit Office of Hungary in several aspects, and widened its powers, expanded its instruments, increased its transparency, and put an end to the era of audits without consequences. The constitutional status and independence of the supreme audit institution ensure that the institution delivers objective, unbiased findings and selects its audits and methods at its discretion.

The hierarchy of the governing international professional standards was set up in 2011–2012 which, at the same time, was a period of continuous preparations for the Hungarian application of the standards. Then, in 2013–2014, our organisation prepared for developing the general, as well as audit-specific fundamental auditing principles. The State Audit Office of Hungary actively participated and continues to participate in the crafting of ISSAIs and cooperates in the sharing of experience drawn from practical application and of professional know-how. These activities are performed through the working groups set up within the framework of INTOSAI<sup>5</sup> and EUROSAI<sup>6</sup>.

The State Audit Office of Hungary adopted the names and contents of the new professional rules of auditing, as well as the range of documents constituting the new system of these rules in April 2013, in accordance with the Fundamental Auditing Principles developed by INTOSAI and renewed in 2013. The State Audit Office of Hungary, after processing and interpreting the ISSAIs, drafted the methodological auditing documents taken into account the Hungarian legal environment and the factors influencing the circumstances of audits. When drafting methodological guidelines, it considered all of the professional guidelines from among the full methodological range of relevant ISSAIs that could be integrated into the Hungarian auditing environment and to the mandate of the State Audit Office of Hungary. Moreover, when processing the international standards, the State Audit Office of Hungary also drew on its own auditing experience in order to allow the use of the methodologies as “live” documents in the execution of tasks across all types and phases of audits.

INTOSAI formulated that SAIs should help their respective governments improve performance, enhance transparency, ensure accountability, maintain credibility, fight corruption, promote public trust, and foster the efficient and effective receipt and use of public resources for the benefit of their peoples. It is in alignment with this objective that the State Audit Office of Hungary drafted the Hungarian system of the professional rules of auditing. Moreover, the Hungarian model determines the fundamental principles and strategic goals that serve as a compass for us in supporting good governance and a well-governed state, whether it is about the definition of objectives, the selection of audited entities, the planning of individual tasks or the evaluation of the results (Domokos–Pulay–Pályi–Németh–Mészáros, 2016:19–20).

The principle of accountability can only be enforced if the relevant competences and responsibilities can be identified, and the processes related to public funds are regulated, transparent and easy to monitor, so our priority task is to create transparency in the utilisation of public funds. The requirement of high quality is an integral part of all activities of the State Audit Office of Hungary, which must be integrated into the strategy, culture and operational procedures of the organisation. On this point, the process is once again a process overarching the entire organisation, just like in the case of methodological renewal. The highest level of professional quality cannot be achieved without the simultaneous renewal of the quality management system and the audit methodology. The SAO, in line with the relevant international standards, has incorporated the requirement for quality in all of its activities and processes, and every auditor has an obligation to enforce the fundamental principles of quality-driven operation in the course of their task performance. The prerequisite of the methodological renewal spanning the entire organisation was to lay the foundations of quality-driven operation ensuring objective and professional implementation.

The first of professional auditing methodological documents to be drawn up, the *Fundamental Principles of SAO Audits* addresses both the general public (intended users of public funds, taxpayers) and auditors, thus supporting the transparency of the SAO's activity. These define the types of audits applied by the State Audit Office of Hungary, which may be, according to their function and subject matter, compliance

audits, performance audits or financial audits (SAO, 2015a:9–10). The renewal and the July 2015 introduction of the fundamental auditing principles marked the end of the SAO's profound methodological changeover.

By introducing “*compliance audits*”, the SAO has established a broader audit-specific background compared to regularity audits in the area of the audit of the regularity of public spending. While regularity audit includes the auditing of adherence to current rules (e.g. legislation, regulations, agreements), propriety audits are a type of compliance audits that are performed where legal provisions cannot be applied as a criterion, or where there are clear deficiencies in legislation to be able to judge certain issues. In the course of propriety audits, the audit is conducted along the general fundamental principles governing proper financial management within the public sector (SAO, 2015c:5).

*Performance audits* are a type of SAO audits intended to establish whether the management of public funds and public assets complies with the principles of effectiveness, efficiency and economy, and whether there is room for improvement. Their aim is to support cost-efficient, effective and successful utilisation of public funds and the financial management of and task performance using national assets. These audits identify any factors potentially hindering the attainment of the criteria of cost efficiency, effectiveness and success shaping financial management and task performance (SAO, 2015b:4–5).

*Financial audits* aim to assess whether the information published in the financial statements of an organisation comply with the applicable financial reporting and regulatory framework, contributing to the reinforcement of trust in such financial statements among their intended users.

To directly support the work of auditors, we have elaborated a set of rules and guidelines to be adhered to when executing audits. These guidelines are a supplement to the Fundamental Auditing Principles.

## SPECIAL METHODOLOGICAL GUIDELINES

The State Audit Office of Hungary has general powers in auditing the responsible financial management of public funds. The audits increasingly facilitate transparency, accountability and accounting for public funds in the financial management of public property. In terms of consistent accounting, the audit of the execution of the central budget and of final accounts plays a prominent role. The State Audit Office of Hungary carried out its – statutory – audit assignments in accordance with statutory requirements. In line with the provisions of the Act on SAO, the State Audit Office of Hungary is required to audit final accounts on an annual basis.

It was defined among the strategic goals of the State Audit Office of Hungary that, for more efficient and effective final accounts audits, it should develop an audit model that is different in approach, contents and procedures from the one used before and that it should continue to support the National Assembly in its work and in making substantiated decisions. The SAO's implementation of this strategic goal resulted in the renewal of the methodology for final accounts audits, which was published on the

SAO's website in January 2015.<sup>7</sup> The changed accounting system – since the adoption of the earlier methodologies – of public finances was one of the reasons that called for a framework for the drafting of the document. (As of 1 January 2014, new financial and budget accounting rules came into force, under which budget accounting consists of cash-based budget accounting and accrual-based accounting). Moreover, the renewal of the international standards on auditing also played a part. The State Audit Office of Hungary formulated the methodology of final accounts audits with a view to being able to obtain a substantiated opinion during the audit procedures on the execution of the budget as a whole. The audit provides a comprehensive and objective view on the reliability of data included in the annual final accounts bill. The audit covers five main areas: centrally-managed appropriations, social security funds, extra-budgetary funds, chapter-managed appropriations and appropriations related to EU grants, and central budgetary institutions.

The ISSAI standards and guidelines and the State Audit Office of Hungary' professional rules of auditing are public and accessible for all on the State Audit Office of Hungary's website, through Figure 3.

Figure 3: *The system of professional regulations of SAO auditing*

System of documents that represent the theoretical basis of audit-specific regulations				Governing ISSAI
<b>Level 1</b>	<b>Lima Declaration</b>			<b>ISSAI 1</b>
<b>Level 2</b>	The principles of SAO operation	Items guaranteeing independence		ISSAI 10
		SAI's principles of transparency and accountability		ISSAI 20
		Principles of ethics		ISSAI 30
		Principles of quality-driven operation		ISSAI 40
		Principles of the utilisation of SAI work		ISSAI 12
<b>Level 3</b>	Fundamental principles of SAO audits (SAI auditing standards)	Fundamental principles of SAO audits	General auditing principles	ISSAI 100
			Financial auditing principles	ISSAI 200
			Fundamental principles of performance auditing	ISSAI 300
			Fundamental principles of compliance auditing	ISSAI 400
		Implementation guidelines	Implementation guidelines for financial auditing	ISSAI 1000
			Implementation guidelines for performance auditing	ISSAI 3000, 3100, 3200
			Implementation guidelines for compliance auditing	ISSAI 4000, 4100
			Other guidelines	Other INTOSAI guidelines

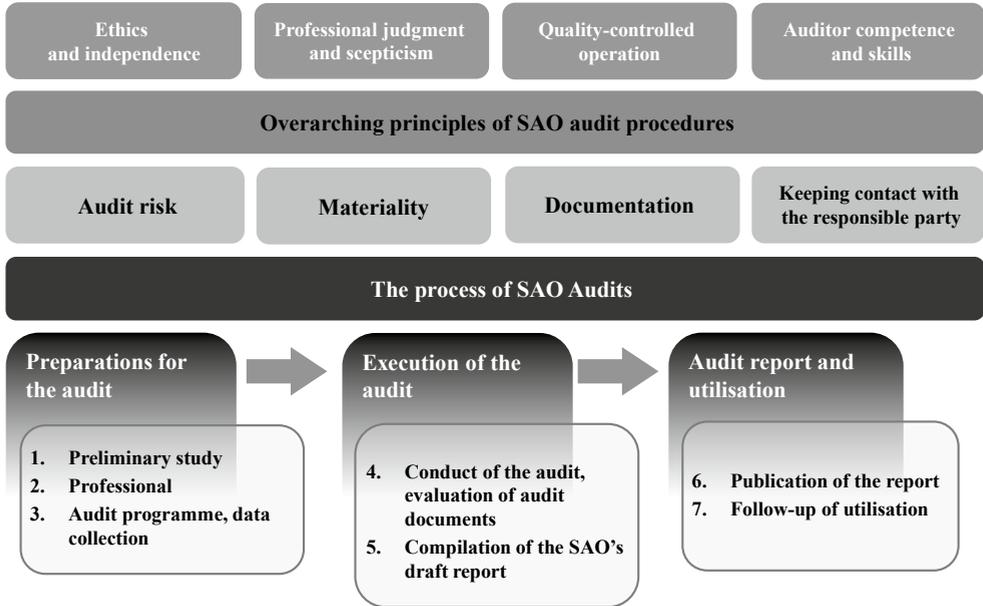
Source: State Audit Office of Hungary

Some of the audits launched from the second half of 2015 were conducted by the State Audit Office of Hungary according to the renewed Fundamental Auditing Principles, striving to gradually build individual audit types upon each other. The regu-

lated, orderly, responsible and compliant operation of audited entities is the starting point for applying performance audits.

Figure 4 presents the link between the fundamental principles of SAO audits and the seven-phase audit process.

*Figure 4: Fundamental Principles of SAO Audits*



*Source: State Audit Office of Hungary*

The execution of all seven phases of the audit process, from audit planning through the implementation thereof, to the formulation of findings and recommendations and the utilisation thereof, is aimed at supporting the regular, effective, efficient, accountable and transparent utilisation of public funds and the development of the public finance system, and at ensuring that national assets are as safe as possible.

#### AUDIT CRITERIA

State Audit Office of Hungary audits are programme-based. This means that the audits are conducted on predefined subjects on the basis of predefined criteria adapted to the type of audit. The audit criteria allowing the evaluation of the subject matter of the audit assignment are the benchmarks serving as the basis of the evaluations. This is why it is a fundamental requirement when defining criteria to factor in their importance, completeness, reliability, comparability, acceptability, availability, understandability and objectivity, as well as the type of audit. The criteria are predominantly de-

defined on the basis of legislation, public law organisational regulatory tools, standards, fundamental principles and best practices, but the State Audit Office of Hungary also defines some of the criteria. Clearly defined criteria ensure objective evaluation performed on the basis of the audit.

## RISK ANALYSIS

The shortcomings, discrepancies or misstatements in the subject matter, the probability thereof and the risk of their impact should be factored into audits and evaluated (SAO, 2015a:15). Every audit therefore begins with a risk analysis. Risk analysis relies both on internal and external data sources. (External data sources include: official, publicly accessible databases, financial reports and data, National Assembly committee minutes, National Assembly notices, information from the press, reports; internal data sources include experience drawn from earlier and pending audits, public and internal surveys, integrity surveys). The identified risks and their potential impacts must be kept in mind continuously during the conduct of the audit. For example, the risk analysis of the controls and measures of the audited entity is intended to identify the organisational processes presenting a significant risk to the achievement of the organisation's objectives in spite of the controls in place. Risk analysis contributes to outlining the questions and scope of the audit, devising the audit procedures and designing sampling and control tests.

It is of public interest that the State Audit Office of Hungary audits the areas most in need of auditing, while using an optimal level of audit resources. Thus the definition of audit topics, as well as the selection of the specific audit sites linked to the audit topics is preceded by thorough preparatory work, supported by the continuous processing of the information necessary for topic selection and risk analysis. To select audit priorities and areas, the riskiest areas, topics and processes are mapped out in the course of risk analysis, and risks are identified and evaluated. Where analysis involves a population with a great number of elements, the key goal of risk analysis is to sort the elements according to the specified risk criteria, i.e. to establish a risk "ranking" in the interest of selecting the riskiest elements (Domokos–Nyéki–Jakovác–Németh–Hatvani, 2015:11).

## STATISTICAL METHODS

The State Audit Office of Hungary endeavours to achieve a high degree of certainty in each of its audits, so the fundamental principle of planning audit procedures is to ensure that the audits provide reasonable assurance in the identification of irregularities, unlawful measures or compliance shortcomings. At the same time, reasonable assurance also means that the information forming the subject matter of the audit complies with the pertaining audit criteria in all material respects.

In the course of audits, we often have to interpret a large set of information (or population in statistical terms) to achieve the audit objectives or to conduct the detailed direct audit procedures defined in the audit programme from some perspec-

tive, to form an opinion on it. In such cases, we must always assess the proportion of applying the audit to the entire population (e.g. financial records consisting of several hundreds of thousands of items, or a set of paper-based accounting records) relative to the available resources and the value added created by the audit. In an effort to achieve a high level of assurance while effectively utilising the available resources, the State Audit Office of Hungary – within the available methodological framework – applies procedures used in statistic analyses, that is, statistical methods, and proceeds according to their rules. Statistical methods are used for the preparation of analyses and risk analyses, for determining the sample to be audited and at the final stage of work processes, during evaluation. When applying these methods, it is important to keep in mind the reliability of the population, selection of the appropriate procedures and distinction of characteristic and value-based matters.

Sampling procedures and evaluations on the basis of the samples, and the resulting findings and conclusions thus constitute a key element in the execution of SAO audits. The underlying concept of audit sampling is to restrict the audit to a prudently selected subset of the entire population rather than auditing each item of the population, and to obtain audit evidence suitable for making conclusions about the entire population by examining specific characteristics of the selected items. Just like every phase of the audit, every activity, procedure and sampling is governed by a set of requirements. Sampling is considered successful from the perspective of the audit if the findings based on the items of the sample are the closest to the ones that would be made if examining the entire population, and is considered effective if these findings are achieved with the least amount of effort (that is, the smallest sample size still acceptable). This fosters the effectiveness and success of audit work. The ISSAI standards defining the fundamental principles of the various audit types also prescribe the careful selection of data collection and sampling methods.

According to the requirements of general Fundamental Auditing Principles, auditors must substantiate their findings and conclusions with sufficient appropriate evidence (SAO, 2015a:17). The data, documents and information provided by the audited parties and serving as the basis of evidence must originate from a “reliable source” and be documented, complete, authentic, usable and transparent to both the audited and the auditing party.

## IT APPLICATIONS

Another fundamental criterion of SAO audits alongside transparency is the reliability of data in order to establish correct findings. The management of public funds, the financial management of public assets, the discharge of statutory (public) tasks and reporting on these activities are increasingly supported by IT tools and applications. The quantity of electronic data, information and documents is growing nearly exponentially. The rapidly changing information and communication culture impacts the performance of state tasks and the organisation of public administration. The development of infocommunications channels, tools, services and competencies con-

tributes to the effectiveness of state operations. Simultaneously, however, electronic information systems and processes represent an increasing risk in processes related to public funds. Therefore the reliability, closed nature and regulated and compliant operation of IT systems have become key factors.

The reliability and protection of such data, information and records and the generation and handling environment of electronic information are therefore increasingly incorporated into our audits. Not every area and element of this is governed by legal provisions; therefore, there is a need for the application of propriety and effectiveness criteria. Our audit methodologies also support the auditing of this domain.

Today, IT audits are two-directional: they may either be control audits or process audits. For one, organisational controls must adequately support IT task performance. Secondly, IT applications and their controls must adequately support the compliant and reliable execution of tasks. As a result, ensuring the safety, confidentiality and integrity of IT applications is currently inevitable, alongside the existence and verification of input, processing and output controls to guarantee reliable output data.

During our audits we also strive to take advantage of the latest information technology and technical facilities. One way of doing this is designating a greater role to electronic channels in data supply and in communication. This has multiple benefits, as communication with the audited entity is controlled, traceable and searchable. The electronic data supply requested in the context of audits reinforced transparency both for the audited and the auditing party. The use of IT applications and audits also allows the quicker evaluation and processing of data, rendering the auditor's work more efficient.

## WHAT WE AUDIT

Pursuant to the Act on Public Finances<sup>8</sup>, controls in public finances guarantee the compliant, cost-effective and sound financial management of public funds and national assets. For this very reason, public entities are accountable for their performance and not only the compliant, but also the expedient, effective, efficient and cost-effective utilisation of their funds.

The State Audit Office of Hungary's auditing mandate is broad, allowing it to audit other users of public funds besides the public sector, including any organisation that handles public funds or receives support from public funds, or utilises national assets for purposes linked to public interest and community needs. The compliant use of public funds is checked through broadly conducted, primarily thematic audits focusing on regularity. One area of regularity audits is the auditing of internal control systems. Any shortcomings in such systems necessarily represent a risk to the compliant use of public funds and compliant operation. Our audits therefore almost always focus on the presence of the control environment and its reliable operation as a priority. These matters constitute the fundamental element of essentially all of our audit programmes. Over the past years, the State Audit Office of Hungary has expanded its systematic audits to municipal and minority self-governments, as well as state and

local government owned business organisations, public service providers and central budgetary institutions, educational and healthcare institutions using public funds in the course of their financial management.

The budgetary institution's highest-ranking executive is responsible for enforcing efficiency, effectiveness and economy in the organisation's operations and to ensure that executives at every level of the organisation are aware of the objectives and tools for achieving them, and are capable of evaluating the results achieved. To make transparency and accountability an integral part of organisational culture, first and foremost, the commitment of the executives of entities utilising public funds/discharging public tasks is needed. The head of the budgetary institution is responsible for performing public functions in accordance with the provisions of legal regulations, the deed of foundation and the provisions of the internal policy as well as for fulfilling the obligations stipulated by law for the institution. The prerequisite for transparency and accountability's the fulfilment of the requirements defined in legislation, the clear definition, communication and traceability of and accountability for responsibility relations.

The fundamental objective of controls established and operated within public finances is to operate control systems that ensure the regularity, economy, transparency, efficiency and effectivity of the financial management of public funds and national assets. This objective cannot be achieved without reinforcing the internal control system within the public sector or without the compliant, reliable and effective operation of individual control activities and internal audits.

Our audit experience (Domokos–Németh–Jakovác, 2016:17–24) confirms that the prerequisite for the efficient management of public funds and for the underlying planning process is that indicators (substantiated by data available over time and reflecting reality) are put in place for capturing and measuring the effectiveness (approaching targets) and efficiency (resource utilisation) of public spending adequately. The main condition for conducting performance audits is:

- the availability of clearly defined performance indicators for performing evaluations;
  - the definition of a target for the appropriate indicators to evaluate effectiveness;
- and
- the availability of data for monitoring developments and performance measures.

Performance audits should be conducted on the basis of performance indicators that are broadly accepted both on a societal and professional level including by the audited entity. To evaluate effectiveness, no other indicator can reasonably be used than the one defined by the organisation defining the objectives themselves.

#### LAUNCHING CHANGE

In line with its strategy, parallel to the organisational renewal and the rethinking of its quality control processes, the State Audit Office of Hungary enhanced its methodologies continuously, and in the second half of 2015 it commenced the migration to its new report format.

As a result of the methodological renewal and the enhancement of the quality assurance system, the SAO issued its first report in the new format in the second half of 2015. The new report format was primarily intended to render the reports more user-friendly and to improve their clarity and understandability. The overhaul of the format was based on the analysis of user requirements and international examples. The substantive elements of SAO reports are presented in a new order, equipped with informative titles and contents. Individual thematic units are clear and distinct. Thanks to the new editing format, users can reach the audit findings and conclusions faster, while the logical presentation of audit objectives, questions, answers, findings and conclusions, and their substantiation ensures easy tracking. The clearly focused, easy-to-overview and structured appearance, the use of visual elements and the improved electronic applicability are intended to ensure that the SAO's reports are easy to read, user-friendly, impressive, easier to utilise and more effective. At the same time, the gradual transition to the new format also serves the creation and reinforcement of a new type of audit approach; its new appearance is the culmination of the methodological development.

The adoption of the new Act on the SAO meant the end of the era of audits without any consequences. The three most important elements of this are highlighted in the following section. The first is the cooperation obligation on the basis of which the audited entity and its employees are required to cooperate.

The second is the obligation of the audited entity to take action. According to the Act on the SAO, the head of the audited body must develop an action plan in response to the findings in the report and send that plan to the State Audit Office of Hungary within thirty days from the receipt of the report. Thanks to the new Act on the SAO, the recommendations stated in our reports are now utilised to a far greater degree, thus the State Audit Office of Hungary was able to impact the operation of audited entities and the level of regulation of their internal processes considerably more effectively.

The third is the system of follow-up audits which consists of evaluating whether the audited entity has implemented the tasks it undertook in its action plan. The result of this work is indicative of the regularity of the audited entity's operation. Follow-up audits provide feedback to decision-makers and the audited entities, and simultaneously support the compliant and effective utilisation of public funds. Follow-up audits help ensure that the State Audit Office of Hungary achieves veritable change through its audits in connection with the sound management of public finances.

#### SHARING GOOD PRACTICES

The State Audit Office of Hungary continuously strives to disseminate good practices, through which unaudited local governments will also adopt the positive examples. To lay the groundwork for this effort, the State Audit Office of Hungary has decided to assume an active role in the promotion of the *good practices* identified in the context of its audits. We regularly host good practice conferences. At these conferences, besides showcasing SAO's audit experience, the heads of audited entities share their methods,

procedures and thought practices that may be useful for other organisations. Non-audited organisations also adopt good practices by voluntarily complying with rules.

The conferences primarily cover topics in which the State Audit Office of Hungary has extensive audit experience. The dissemination of good practices is particularly justified among local governments, as the tried and tested solutions of one local government can be adopted by hundreds or thousands of other local governments. For this reason, the State Audit Office of Hungary and the Ministry of Public Administration and Justice launched a joint further training programme in 2013, the aim of which was to strengthen the integrity of local governments, and the appropriate and efficient auditing of regulations and financial processes based on SAO's experience and the legal compliance supervision of government offices.

### SELF-TEST SYSTEM

Pursuant to the Act on the SAO, the State Audit Office of Hungary has general powers in auditing the responsible financial management of public funds as well as of state and local government assets. This represents more than 10,000 potential audited entities. This volume cannot realistically be audited on an annual basis.

With a view to promoting the compliant use of public funds, the State Audit Office of Hungary, in the context of its public financial support and advisory function, also supports the regulation and regularity of the operation of entities and institutions using public funds through a system of self-tests created by the State Audit Office of Hungary. This is another way of ensuring the transparent and accountable use of public funds. We have compiled five self-tests based on the audit experience of past years. The self-tests provide support for the following areas: the regularity of the use of public funds by church institutions, the development of local governments' internal control systems, the regularity of the operation of local minority self-governments, the regular operation of central budgetary institutions, and the regular utilisation of European Union funding by budgetary institutions and business organisations.

Based on the self-tests, institutions can evaluate their activities and consequently improve the regularity of their use of public funds and public function performance, their governance, financial management and audit duties, their fulfilment of the related expectations, and the transparent and accountable use of public funds. The majority of self-tests are based on the elements of internal control systems, formulating questions on the control environment, risk management, control activity, information and communication and monitoring. Our thematic audits identify the type-errors and recurring deficiencies that can be effectively corrected by completing the self-tests created by the State Audit Office and feeding back the results, thus spreading good practices. The self-tests support the heads and financial managers, as well as the internal auditors of the organisations in discharging their tasks in accordance with the statutory requirements, thereby contributing to the regularity of public spending. This allows substantial progress in the improvement of the compliant operation of non-audited organisations and institutions.

## NOTES

- <sup>1</sup> Act LXVI of 2011 on the State Audit Office of Hungary.
- <sup>2</sup> International Organisation of Supreme Audit Institutions, composed of the supreme audit institutions of the member states of the United Nations.
- <sup>3</sup> ISSAI – International Standards of Supreme Audit Institutions.
- <sup>4</sup> Supreme Audit Institutions.
- <sup>5</sup> European Organisation of Supreme Audit Institutions.
- <sup>6</sup> On the sharing of our experience of the introduction of ISSAI on performance audits, see for example: [www.aszhirportal.hu/en/news/implementation-of-performance-audit-guidelines-sharing-european-experiences](http://www.aszhirportal.hu/en/news/implementation-of-performance-audit-guidelines-sharing-european-experiences).
- <sup>7</sup> [www.asz.hu/hu/az-allami-szamvevoszek-ellenorzeseinek-szakmai-szabalyai](http://www.asz.hu/hu/az-allami-szamvevoszek-ellenorzeseinek-szakmai-szabalyai).
- <sup>8</sup> Act CXCV of 2011 on Public Finances.

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