

Introduction

The Hungarian State Audit Office has regularly audited the handling and utilisation of the Phare assistance since 1992. The latest comprehensive audit of the programmes was completed in 1997.

We analysed the compliance with EU rules, Hungarian regulations and the implementation of programmes. The audit was based partly on the data of the 1995-1999 Phare programmes, and partly on the detailed audit of selected projects. The audit was realised in two phases both for country operation programmes and multicountry programmes. The first phase consisted of the audit on programme level. In the second phase we delivered the detailed audit of the projects selected on the basis of risk analysis. That is, the comprehensive audit did not mean the detailed audit of every programmes and projects.

Statements, result of the audit

The European Union contributed to the preparation of Hungary for EU accession by 527.6 million EURO on the frame of the 1995-1999 Phare programmes.

The direct objective of the assistance was the adaptation of EU *acquis communautaire*, preparation of agriculture for EU market, strengthening of future EU borders, development of infrastructure, environment protection and energy utilisation, development of small and medium size enterprises and assistance of education and training system. The objectives determined in the Phare programmes were based on the Hungarian “indicative programme” prepared for the 1995-1999 period. The priorities determined in the indicative programme were further improved on one side by the continuously updated “National Accession Programme for the Implementation of EU *Acquis Communautaire*”, and on the other side by the new directive for Phare assistance of European Commission.

The conditions necessary for the successful implementation of the Phare programmes were not completely available in the Hungarian institutional and regulating system. At the same time, we found insufficiencies in the approval procedure of European Commission and the EU Delegation in Budapest.

The state of the Hungarian institutional system for the preparation of 1995-1999 Phare programmes was lagging behind the EU requirements notwithstanding that the established structure of the institutional system suited to the EU rules. **The nation-wide monitoring system has been under development.** The implementation of the full monitoring system made the further development of the Hungarian institutional system possible, as it contains a management information system helping the programme managers on decision making and following the quality insurance necessary for the project implementation even if it is not regulated by the EU.

The Secretariat of Aid Co-ordination (responsible for the co-ordination of Phare programmes) **within the Prime Minister Office evaluated the status of the Phare programmes by commitments** and did not consider the effective deliveries and disbursements after signing the contracts. In consequence, **the delay in the realisation of contracts or its failure and the loss deriving from the delayed disbursement were not totally stated.**

The lack of time schedules and risk analysis, or even their continuous updating caused delay in the implementation. The delay in the commitment and disbursement phases caused strained

situation, greater than acceptable implementation risks in the Hungarian public services and the enterprises. The reason of these inadequacies is the **lack of English speaking experts** with the knowledge of Phare rules and Hungarian specific regulations.

The assistance programmes were regulated by the European Commission for the beneficiary countries from the planning phase until the implementation phase, but **the rules did not specify deadlines of the procedures for the EU institutions.**

There were continuous changes in the rules determined by the European Commission and in the Hungarian Phare implementation structure during the implementation of the 1995-1999 Phare programmes. Unfortunately, the introduction of new procedures (twinning, “grant scheme”) before finalising their rules required the rewriting of certain Phare documents several times and resulted in delay in the implementation of programme. The aim of the changes from the viewpoint of the European Commission was to speed up the implementation process and the decentralisation of the responsibilities between the EU Delegation and the European Commission. Resulting from this, the approval authority of the EU Delegation was increased. **The first change in the Hungarian implementation structure was the creation of the Secretariat of Aid Co-ordination within Prime Minister Office** in December 1997 for the co-ordination of international aid programmes. **The Central Financing and Contracting Unit (CFCU) and the National Fund** were founded within the Hungarian State Treasury in January 1999. The task of the CFCU is the administrative contact with the EU Delegation, while the most important task of the National Fund is the transfers of the allocated Phare budget to the ministries and other governmental institutes on the basis of the Financial Memorandum. The professional management of the programme remained henceforward the responsibilities of the beneficiaries after the creation of CFCU. The regulation of the contact, the sharing of responsibilities and the division of labour between the newly set-up institutions are in conformity with EU rules.

As the result of the experiences and the changes in the EU and Hungarian regulations, the implementation of the Phare programmes **became more efficient and more scheduled** between 1995 and 1999 from the side of the Hungarian institutions. **The time necessary for approval and implementation of programmes decreased in its tendency.** The quality of the documents prepared according to the Phare rules improved significantly.

The effect of the above mentioned institutional and regulation changes could be measured against the fact that **the rate of the uncommitted and undisbursed budget continuously decreased.** Hungary received 527.6 million EURO assistance in the frame of the 1995-1999 Phare programmes, from which **the value of the programmes selected for audit amounted to 430 million EURO.** It means, that **we audited the 81.5 % of the assistance** approved for Hungary on the programme or project level.

The commitment was 303 million EURO from the audited 430 million EURO assistance until 30 September 2000. The uncommitted and undisbursed value was 38 million EURO which was a loss for Hungary. An additional 89 million EURO can be used in the 1999 Phare programme, the implementation of which started only at the beginning of 2000. So, there is still the possibility to commit all the available budget.

More than the half of the contractual value consisted of investment and infrastructure developments in the case of the 1995 and 1997 programmes, and service contracts meant more than the half of the budget available in the 1996 programme. The investment projects were realised by the participation of Hungarian enterprises, while the rate of the Hungarian partners was only 40 % in the case of service contracts.

As a general rule, the Hungarian beneficiaries have complied with the Phare and Hungarian regulations but we discovered certain procedural shortcomings and financial irregularities, which beyond the partial utilisation of the PHARE assistance **might involve the risk of repayment to the EU**. These inadequacies **could be eliminated** partially by making use of the findings of the internal and external controls, and partially by self-monitoring, thus avoiding the repayment obligations of any eventual EU audit.

The supplies and investments financed from Phare budget as the property of Hungarian State show up in the State assets with several years' delay if at all. The property titles of Phare supplies used by enterprises are unsettled, specifically, the asset separation between the Treasury and the enterprises has not been completed. The supplies and investments procured and financed by Phare assistance and registered in the Hungarian State assets has been **in compliance with neither Phare nor Hungarian legal requirements**. Its practice differed by institutions and economic organisations. The procured supplies and realised investments were not registered (the Ministry of Agriculture and Rural Development and the Ministry of Environmental Protection) or were activated with delay (the Ministry of Economy, the Ministry of Foreign Affairs and the Hungarian Customs and Finance Guard).

The MÁV Rt (Hungarian State Railways Holding Company) has carried out the registration and the activation of the supplies and investments financed by Phare assistance in its balance sheet, and separated the Treasury and enterprise assets. These supplies are to be found on the asset side of the balance sheet, however **the liability side is unsettled**. Based on the Accounting Law, the Treasury assets are not part of the company's own capital, they must be shown vis-à-vis long-term liabilities. Although legal discretion compensate for the lack of a property management contract between the State and MÁV Rt concerning the exclusive state and Treasury assets in the care of MÁV Rt, the activation is considerably influenced by the lack of the full separation of the enterprise and Treasury assets. MÁV Rt **depreciates the activated investments** realised by Phare assistance in its balance sheet, **which decreases income before taxation** and increases its losses. The currently used method of accounting considerably influences its credit worthiness and the reliable and real image held of the company's management. All of the above necessitate the separation of assets, preceded by an appropriate inter-ministerial agreement, and the signing of an asset management contract, required by the Hungarian law, furthermore the settlement of property titles accordingly.

The practice of paying and reclaiming of VAT complied with the relevant Hungarian laws for VAT and the provisions of Phare. Financial support provided by Phare has not been used to pay VAT, not even temporarily. Due to the subsequent reimbursement practice of the VAT by the Hungarian Tax Office, the Hungarian organisation responsible for the implementation of Phare programs had to find a solution for settling the VAT part of the suppliers' invoices. This problem was especially significant in the case of investments because of the substantial VAT part of the invoice. Two different practices emerged as a solution, the key to unifying them might lie in the modification of the VAT law enacted on the 1, January 2001, which classifies the supplies from Phare assistance into the 0% category.

The practices of VAT invoicing pertaining to performance guarantees varied - even within one project - (ex: MÁV Rt's Hungarian-Slovenian Railway program). The proposals arising from the standpoints taken by the Ministry of Finance and the Hungarian Tax Office regarding this issue were at times contradictory.

The extent of Phare financing, and of the Hungarian co-financing towards the beneficiaries is only partially indicated. Concise and comprehensive reports or economic analyses, concerning the whole country - including contributions of the budget, local governments, en

terprises and foundations - have not been made. As a consequence, **it is not possible to present comprehensively the actual distribution by sources of the financial means made available by Phare and Hungarian budget. There is no database or information system** indicating the Phare and domestic contributions and their usage, even **the regulation to make such a system is inadequate**, furthermore the setting up of a monitoring system compensating for the above mentioned inadequacies is currently under development. The comprehensive and reliable recording of domestic contributions was not facilitated by the inclusion of Phare assistance into the program-financing system in the ministries chapters of the Hungarian budget as of 1 January 1998. As a result, neither the data concerning Phare and domestic contributions in the Budget, nor consequently the financial data concerning the co-financing are comprehensive.

The internal control system - including the built-in process control mechanisms - **did not function adequately**. Arising from this, there were payments of invoices of irregular nature, without a competent signature (that of a program authorising officer, invoice controller, counter signer) or which required the subsequent modification of the contract. The misalignment of the contract, the performance of the supplier and the financial payments at the Ministry of Environment lasting several months amounted to irregularities. Consequently, the mandatory record keeping in line with Phare provisions did not reflect the actual state of affairs. It is also objectionable that disbursement by the Hungarian Enterprise Foundation was conducted based on incomplete and unchecked invoices. In this last case, further significant inadequacies resulted from the registration and archiving of the Phare documents, which did not comply with Phare provisions, making the audit more difficult.

Generally, those involved in the implementation of **projects selected on risk assessment basis**, proceeded with due diligence from the viewpoint of procedural regulation. An exception from this was the preparation of the 1995-97 programs. The beneficiaries did not prepare a schedule including risk analysis in a more detailed fashion than expected by the European Commission. The preparation of schedules was impeded by the fact that the time limit for approval by the EU Delegation and the European Commission is not regulated, and thus cannot be estimated. The ruling on certain documents by the EU Delegation in Budapest or the European Commission regularly required several months. One reason for this is that the growing tasks of the EU Delegation were not accompanied by the development of capacities; furthermore, the beneficiaries submitted documents not in compliance with Phare regulations.

The preparation of the 1998 and 1999 programmes improved, thanks to the experiences accumulated during the implementation of previous programmes. A compelling factor was that the European Commission reduced the time available for implementation from 3 to 2 years, starting in 1997.

The European Commission objected on several occasions to the documents' construction shape- and form-wise, and requested supplements and the completion of the documents from the beneficiaries. As a consequence, the time required for the implementation of the projects increased, the process of approving a project took longer than planned originally.

The beneficiaries did not estimate the necessary capacity requirements of human resources and of professional backgrounding order to complete the programs successfully and on time. Consequently, the documents were not prepared on time nor were they of the quality and form required by regulations. The lack of practical knowledge in Phare procedures appeared most sharply where not the ministries were the final beneficiaries. In the majority of

these cases, the expertise gradually decreased from the ministry's experts towards the final beneficiaries.

The fact that the background institutions of the beneficiaries could not submit an application, due to the EU regulations of insuring equal opportunity, **proved to be a disadvantage to the beneficiaries upon application**. This regulation resulted in the exclusion of those institutions from the possibility of applying, which possessed the professional and local knowledge necessary for the implementation. Such was the case with the Phare programs of MÁV Rt and the Ministry of Education.
