

International Seminar on  
Strengthening Public Investment and Managing  
Fiscal Risks from Public-Private Partnerships

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# **Hungarian audit experiences related to projects implemented with the co-operation of the private sector**

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## **Main subjects**

### **PPPs in Hungary**

- Legal framework
- Government's role
- Main implementing areas and data of PPPs

### **Specific questions of audit of PPPs**

- Key business-management themes
- Audit types – audit procedures

### **Some audit experiences**



## Legal framework

- **Act in the Public Finances:** declares the rules of the approval of the state long term engagements project
- **Code Civil:** regulates the state liability under a contract
- **Government Decree:** contains the obligatory elements of the projects and rules of the documentations of the engagements
- **Act on the concession:** in case of exclusive state/local government property public procurement procedure shall be apply
- **Act on Public Procurement:** 2004 amendment of the Act ensures the of administration of the complex PPP structures (common tendering of the constructing + 20-30 years service )



## **Government's role**

- **Expressing intention subsidization**
  - Gov. Decree on the usage of the new forms of the public and private sector development and service partnership**
- **PPP Inter-departmental Committee**
  - (Ministry of Economy and Transport, Ministry of Finance, Ministry of Justice, Office of the Prime Minister, Central Statistical Office )**
- **PPP Coordination Department at the Ministry of Economy and Transport**
- **Starting Pilot projects**



## **Tasks of PPP Inter-departmental Committee**

- **Coordination of the necessary amendment of the regulation**
- **Expressing opinion on PPP project before decision of Government**
- **Following and evaluating of project realization**
- **Coordinating Government communication considering PPPs**



## The main areas of implementation of PPPs in Hungary

- Road infrastructure (*M5 and M6 Motorways*)
- Stadiums, sports facilities (*Budapest Sport Hall*)
- Educational, cultural investments: *schools, dormitories, museums, theatres (National Theatre, The Palace of Arts)*
- Prisons (*in Szombathely, Tiszalök*)



## Main data of PPP-projects 2007-2010

Ministry	Project	Short description	(Expected) launch	Expected length of project (yrs)	Estimated present value of project (HUF b) Total	Budgetary expenditures (HUF m)			
						2007	2008	2009	2010
Ministry of Economy and Transport	M5 1st section	Operation and maintenance	March 2004	27	242,8	33 977	34503	34 800	35 080
	M5 2nd section M5 3rd section	Design, build, finance, operate (DBFO)	July 2004 February 2005	27 26					
	M6 1st section	Operation and maintenance	October 2004	22	111,9	15 000	15 362	15 981	16 455
	Prisons	Create 2 penal institutions in DBFO format	From November 2005 to January 2006	18	71,7	1 551	3 136	3 442	3 746
National Sports Office	"Sport 21st Facility Development Program"	Design, build, finance, operate (DBFO); learners' swimming pool, gymnasium	From 2006	15-17	30,1	486	1 700	1 756	1 809
Ministry of Education and Culture	Accommodation in residential halls or educational infra-structures	Design, build, finance, operate (DBFO)	From 2004	construction+ 20 years of operation	154,6	3 527	9 904	9 904	9 904
	Garage of The National Museum				0,5	52	91	91	92
<b>Total</b>					<b>611,6</b>	<b>54 593</b>	<b>64 696</b>	<b>65 974</b>	<b>67 086</b>
<i>as a percentage of GDP</i>					<i>2,4</i>	<i>0,2</i>	<i>0,2</i>	<i>0,2</i>	<i>0,2</i>
<i>as a percentage of the expenditure total of the 2007 annual central budget</i>					<i>7,3</i>	<i>0,7</i>	<i>0,8</i>	<i>0,8</i>	<i>0,8</i>

Source: State budget of the year 2007





## Specific questions of audit of the PPPs

### *Audit Types:*

- **Financial audit**

Regularity of accounts and records

- **Traditional performance audit ( four pillars)**

- **New Value for Money audit**

– Two dimensional matrix

– Approach based on key life cycle themes

- **Comprehensive audit:**

Audit of public procurement and the evaluation of internal control system



## **Six key performance themes\*:**

- **Suitability to business needs**
- **Appropriateness of PPP**
- **Support of the project by partners**
- **Quality of delivery of project**
- **Optional balance between cost and quality**
- **Effective risk allocation**

*\* According to the NAO's methodology*



## **Some experiences of PPP audits**

### ***M5 motorway construction***

#### **Background – I. stage of construction**

- **Great demand on M5 in early 1990s**
- **Concession contract in 1995 contained state guarantee for income from usage of motorway**
- **Too high toll – less traffic than expected – high compensation demand from private partner**
- **Negotiation about further construction and contract modification stuck between 1998-2002**

***Bad contract, all risks belonged to the state and no step-out right***



## **Solution – II. stage of M5 motorway construction**

- **Government decided to buy 40% of the company and give the right for further construction**
- **This contract shares the risks between the public and the private partner**
- **Real partnership between the contracting parties**

⇒ **Real PPP but higher cost by I. stage heritage**



## **M6 motorway construction**

- **Off Budget Sheet PPP project**
- **Balanced risk allocation**
- **Technical and financial panels for conflicts**
- **State interest guaranteed by many sided control system**
- **But: comparison between PPP option and public sector comparator (PSC) was only after the contract**
- **Recommendations of SAO to Government:**
  - **conceptions of projects be based on financial plans**
  - **comparisons of costs are to be made earlier**



## **Test of key audit themes in cases of motorway construction**

	<b>M5 I. phase</b>	<b>M5 II. phase</b>	<b>M6</b>
<b>• Requirements</b>	<b>Yes</b>	<b>Yes</b>	<b>Yes</b>
<b>• Appropriateness of PPP</b>	<b>No</b>	<b>Yes</b>	<b>Yes</b>
<b>• Support of the project</b>	<b>No</b>	<b>No</b>	<b>Yes</b>
<b>• Management</b>	<b>No</b>	<b>Yes</b>	<b>Yes</b>
<b>• Optimal balance</b>	<b>No</b>	<b>No</b>	<b>Yes</b>
<b>• Risk allocation</b>	<b>No</b>	<b>Yes</b>	<b>Yes</b>



## **Main findings of the audit of construction of Budapest Sports Hall**

- **State interest was not protected sufficiently**
- ***Contracting*: fix contractual prices without detailed budget did not incite cost-efficient use of private capital**
- ***Financing (risk diversification)*: low private capital application, bank credit with full scope state guarantee**
- ***Following technical details and deadlines*: investor, main contractor and operator is the entrepreneur in one person; this hindered the enforcement of the state demand**



## **Recommendations of State Audit Office**

**Government shall ensure the economical usage of public money with preparation of regulation and the determination of decision making rights considering state burdens especially with**

- Specification of contractual prices and technical details of investments**
- Identification of directives for Ministries concerning the preparation of internal rules dealing with the above-mentioned factors**





## **Main statements of the audit of new National Theatre project**

- **No detailed study plan was prepared about the investment**
- **The design competition was properly conducted and evaluated but not the winner work was carried out**
- **In the course of obtaining the building permit the authorities did not require compliance with certain legal provisions**
- **According to the financial structure of the project the required resources were ensured by the main contractor from bank loan. State guarantee was a pre-condition of loan disbursement**
- **The part programs of investment was made under constant improvisation**



## **Main statements of the audit of new National Theatre project (Cont.-ed)**

### **Operation:**

- **Established by the state itself and is directly controlled by the Ministry of National Cultural Heritage**
- **The deed of foundation of the Company was incomplete**
- **The Company's organisational and operational regulations are out-of-date**
- **In the opinion of the management of the National Theatre Co. Ltd., the financing of the operation is ensured on the long term with 80% budgetary subsidy**



## **The recommendations of the SAO audit**

- **To the Government: to revise the legal provisions concerning the preparation and implementation of state projects or projects implemented with state subsidy, in order to clearly create uniform notions, as well as transparency and responsibility**
- **To the Minister of National Cultural Heritage, exercising shareholders' rights**
  - **Have the expediency of the form of management of the National Theatre reviewed**
  - **Have the set of terms of state subsidy to be provided for the operation of the National Theatre reviewed**



## The Palace of Arts

- **Suitability to business needs: yes, except the cost**
- **Appropriateness of PPP: partly**
- **Support of the project by partners: yes, but with an initiative role of private partner**
- **Quality of delivery of project: yes**
- **Optimal balance between cost and quality: lack of feasibility study and comparison of cost**
- **Effective risk allocation: lack of risk allocation in the first contract**



## Conclusions

- **to harmonise short-term opportunities to save state funds with the consideration of long-term return in both construction and operation**
- **to have alternatively prepared concepts**
- **to regularly monitor, analyse and assess the changes in the PPP projects**
- **to establish relationships of strategic partnership**
- **to provide high level trainings**



## Conclusions (Cont.-ed)

- **to use standardised contracts**
- **to create long-term financial planning**
- **to prepare comparative analyses**
- **to establish a comprehensive database**
- **to inform public all the relating information**
- **would be useful to draw on lessons learnt from failed PPPs**



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**Thank you for your attention**