

**MODERNIZING FINANCIAL
MANAGEMENT FOR
HUNGARIAN LOCAL
GOVERNMENTS**

**SECOND YEAR SEMINAR:
MARCH 11—12, 1998**

Prepared for



Eastern European Regional Housing Project
Project 180-0034
U.S. Agency for International Development,
ENI/EEUD/UDH
Contract No. EPE-C-00-95-001100-00, RFS No. 530
formerly EPE-0034-C-00-5110-00

Prepared by

Ritu Nayar-Stone
The Urban Institute

Orsi SebÅk
Metropolitan Research
Institute
Budapest, Hungary



THE URBAN INSTITUTE

2100 M Street, NW
Washington, DC 20037
(202) 833-7200
www.urban.org

February 1999
UI Project 06610-530

TABLE OF CONTENTS

MARCH 11, 1998	1
Budget Monitoring	1
Exercise I: Monitoring	1
Panel Discussion on Accounting and Program Budgeting	1
Local Government Feedback on the Training Seminar	2
MARCH 12, 1998	3
Budget Presentations by Local Governments	3
Guest Speaker	5
Closing Ceremony—Presentation of Certificates to Participants	7
ANNEX	

OVERVIEW

This report briefly describes the March seminar on Modernizing Financial Management for Hungarian Local Governments. The program aims at training Hungarian local government finance officers to improve budgeting and financial management within their cities. The March seminar was the sixth and last seminar of the second year program, which extended from May 1997 to March 1998, following the municipal budget cycle.

The agenda, list of participants, and course material for the seminar are included in Annex A. Thirteen local governments attended the March seminar, some from large cities like Székesfehérvár and Debrecen, but the majority of the participants were from smaller towns, such as Csongrád, Püspökladány, and Szegvár. Table 1 shows the list of local governments who have attended the second-year seminars.

**MODERNIZING FINANCIAL MANAGEMENT FOR HUNGARIAN
LOCAL GOVERNMENTS
Second Year Seminars: March 11-12, 1998**

MARCH 11, 1998

Ms. Andrea TönkÅ, Metropolitan Research Institute (MRI) welcomed the participants to the seminar. She also informed the participants that some of their budgets (best examples) were displayed in the adjacent room.

Budget Monitoring

The first presentation was made by Mr. Philip Rosenberg (consultant to the Urban Institute (UI)) on budget monitoring. First, he talked about the relationship of monitoring to other management functions. Second, he discussed the monitoring process under the following categories: (1) department capacity or contractor systems, (2) reporting and reprogramming, and (3) field visitation and assistance. Mr. Rosenberg also discussed the importance of data collection and committee review. Finally, Mr. Rosenberg focused on budget reports and evaluation. He covered the following topics: accounting and financial reports; management reports; reporting hierarchy and structure; report frequency; and report evaluation and action. Mr. Rosenberg ended his presentation with two sample reports—for a pavement repairing program, and a report of expenditures.

Exercise I: Monitoring

Following Mr. Rosenberg's presentation, local governments applied the concepts of monitoring to an exercise. Role playing as a city's finance department, participants first critiqued a hypothetical sidewalk repair contract between the city and a contractor and then suggested changes that need to be made to the contract prior to acceptance by the city.

Panel Discussion on Accounting and Program Budgeting

The exercise was followed by a panel discussion on the relationship of budgeting to accounting. The panel comprised of Mr. József Kéri (local Hungarian trainer and finance officer of Szolnok), Mrs. Krajsóczki (local Hungarian trainer and finance officer from Szentes), Mrs. Kürthy (local Hungarian trainer and finance officer from Püspökladány), and a representative of TAKISZ (local administrative branch of the Ministry of Interior; responsible for collecting data and making reports). As the moderator of the panel discussion, Mr. József Hegedüs (MRI) introduced the issues concerning program budgeting and accounting. The panel addressed the following questions:

- Are there data or information requirements for a program budget that are difficult to collect or not used under the present accounting system?

- Can information requirements of the central and local government budgets be linked? And how?

Mr. Kéri started the discussion. He made a distinction between financial and the non-fiscal indexes, and stated that according to current rules the accounting system is suitable for the traditional budget and the new data requirements of a program budget, as long as the program is structured along sectoral lines.

Following Mr. Kéri's presentation the representative of TÁKISZ talked about the implementation of a computer system to serve the municipality's needs. Local governments preparing a program budget require more detailed information when compared to preparing a traditional budget according to central government specifications, and therefore try to construct the basic data to be convenient for all type of itemization. It is important to note that local governments do not apply the same accounting program, and therefore have different budgets.

Mrs. Kürthy was the next discussant. She said that without TÁKISZ there was no progress in budgeting. But the question is whether TÁKISZ knows the needs of the local governments. For example, monitoring the budget is problematic since local governments prepare the annual financial report for TÁKISZ manually.

Local Government Feedback on the Training Seminar

Ms. TönkÅ moderated the feedback from the participants on the training seminars. She asked each participant to comment on the training program in general and make specific comments on the following:

- Topics covered
- Sector focus
- Program structure
- Program organization
- Other issues

Following is a summary of the main comments made by participants:

- Because of the difficulties of program budgeting almost all the participants requested a model which could be adapted for their own city.
- Participants emphasized the usefulness of the case studies but stated that they would prefer to have more time to work on them and to discuss



- the results. Another comment was to have more Hungarian or realistic cases.
- Some of the participants asked to have a summary presentation at the end of each two day seminar to clarify where they are in the budgeting process.
 - Participants stated that the organization and presentation of seminar materials along sector issues (social, educational and communal sectors) is very useful. However, they questioned the need for the sector representative to attend all sessions, and wondered if there could be separate presentations for the two groups (finance officers and technical sector officials) by topics?
 - The participants requested a breakdown of topics and date schedules of all the training seminars at the beginning of the program.
 - It was suggested that a “school book”/manual should be prepared from the 3 year seminars in Hungary. This would be extremely useful for the local governments.
 - The Hungarian trainers could hold presentations in the cities (participating in the seminars) for the mayors or any other committee members.
 - Some of the participants stated that after the indicators seminar the use of sectors for illustration was dropped.
 - The participants would be pleased to have more exercises or small group work in which the different problems of the Hungarian local governments could be discussed.

After the second seminar the exercises were all focused for communal or technical issues rather than social or educational questions.

MARCH 12, 1998

Budget Presentations by Local Governments

The moderator for this session was Mr. Hegedüs. Mr. Hegedüs asked the local governments to make a brief speech on the impact of the training seminars on their 1998 budget. The local governments were highly appreciative of the program and their own achievements. It was announced that the next program

cycle would begin in May. All participants stated that they would continue to participate in the next training cycle.

Székesfehérvár. Mrs. Mészáros (budget expert at Székesfehérvár) stated that the city would prepare a traditional budget for 1998 and not a program budget—the reason being considerable changes in personnel at the local government. The new element in their budget would be a matrix analysis of credit utilization.

Csongrád. The local council accepted program budgeting for the 1998 budget with the condition that the city also prepare a traditional budget. This implies much extra work for the finance department and other related institutions. The city has decided to develop a program budget for the education sector and hopes to accomplish this for the 1999 budget. The current objective is to obtain more data on this sector which will enable the city to justify the necessity of local normative support, and use 70 percent of the support for operating cost and 30 percent as development cost. The city would also like to urge its schools to function more efficiently by calculating performance indicators for this sector.

Püspökladány. City leadership has supported program budgeting for the educational sector. The city has also prepared a program budget for the communal sector with the help of the finance department staff from the cities of Szolnok and Szentés. A great deal of work and effort was required to collect the data for the communal indicators manually. For 1999 the city would also like to prepare a program budget for the social sector.

Budapest, District VI. District VI's budget is very big budget (HUF8 billion), with the education sector accounting for HUF1.6 billion. There are many problems in the district—mainly concerning education, the social sector and real estate. The district does have appropriate information for the education sector, and even though they were unable to create a program budget for education for 1998, they hope to achieve this for 1999. District VI faced the following problems in developing a program budget for education:

- Calculating the impact of developed indicators on the budget
- Lack of communication between technical and financial experts
- The new council must be made aware of program budgeting

Despite this, the District staff attending the seminars learned many new techniques and applied them in creating their budget.

Nagykőrös. Three years ago the city started to work on program budgeting for the education sector which has a budget of HUF700 million. The central normative subsidy does not even cover teacher salaries. Thus it was



decided to create a separate column in the budget as “demand” for education which would depict the renewal cost. The 1998 budget was done in the traditional manner but during the planning period the city introduced many new forms (e.g., questionnaires, new charts, analysis, and graphics) which helped make their budget clearer and may facilitate a program approach next year.

Szentes. The objective of this city is that “anyone who needs information about the city can get it from the budget.” Last year (1997 budget) the city had presented the communal sector as a program budget. This year a new element was the social sector as a program budget, and a separate volume of indicators and indexes, which required the creation and specification of local subsidies/normatives. In 1999 the city plans to create a program budget for the education sector and a separate capital budget. By 2000 they would like to have a complete program budget.

Orosháza. Although the city does not have a program budget in any sector as yet, it has developed and reported new indexes in the 1998 budget (e.g., cost/person). The city board welcomed this addition. They thought that many high cost indexes would be clarified by the program budget (for example, the high cost of supporting homeless people; many homeless people around Orosháza come to the city to obtain the available social subsidy). This year they were not able to prepare a program budget, but they will persevere and ask for help from other local governments.

Nagykanizsa. Until 2002 the local government is financially constrained because of investments at Nagykanizsa in 1997 (e.g., they built a huge shopping center). For three years they have tried to economize within their institutions and dismissed several teachers. They started to use some aspects of program budgeting in estimating energy and nutrition costs, but these graphic tables have not yet been put into the final budget. However, the city is now aware of the next steps in preparing a program budget.

Szegvár. The city has a program budget for the social sector. The 1998 budget has many new elements because the sector specialists participated very actively in the budgeting process.

Hajdúszoboszló. This was the first year they participated in the budget training program. The finance officer showed the background materials to the committee, but there was no reaction. Perhaps next year they will be able to use the elements of program budgeting in their budget.

Szolnok. The city has developed indicators for different revenue sources, and finalized the structure of the budget which now consists of three volumes:

- Debt service budget
- Operation budget
- Capital budget

Within these sections they elaborated sector programs. In the education sector, programs were determined by the sector itself and not by the finance department. No one from the city board voted against the budget this year.

Guest Speaker

The guest speaker for the closing seminar was Mrs. Gubányi from the Ministry of Finance (MOF). Mrs. Gubányi first informed the participants about the Ministry's current concerns regarding the budget. According to the Ministry, the current local accounting and reporting system is too detailed. The budget report format includes 3,600 to 4,000 data requirements of which local governments "use" only one third or half. This system needs simplification both on the planning and the accounting side, which can be achieved by removing the three-way break down (sector, maintenance, welfare).

Mrs. Gubányi then focused her presentation on two topics: (1) changes in accounting regulation, and (2) issues concerning municipal assets.

Changes in the accounting system for 1998 are based on an adherence to EU standards. The EU requirements for the accounting system focuses on *national accounts* and *performance perspective*. The term "national account" is a statistical category, and according to Mrs. Gubányi similar to Hungary's earlier categorization of sector, sub-sector and special branch. Due to the similarity between the two systems, the change from the current system to national accounts can be done quickly and without serious difficulties. In Hungary the system of national accounts will be developed by the Central Statistical Office and not by the MOF.

A more serious problem, however, is the adoption of the performance perspective (when planning and accounting is based on performance). Current members of EU are exempt but new members must adopt this system. Mrs. Gubányi expressed reservations concerning this system since it has not been applied anywhere in Europe (a cashflow system is commonly used) and there are no patterns and examples to follow. In her view, identifying good performance measures in certain areas is extremely difficult and measurement techniques can be a problem (for instance, in education). Her personal opinion is that the current system is better. Despite this view, the changes will take place over a period of 8 to 10 years. Changes in the accounting system in 1998 already serve this purpose. Mrs. Gubányi listed the new data requirements in the budget report of local governments, and gave useful advice regarding completing the report. She



also offered advice concerning the accounting of assets that, in her experience, cause problems for local governments (non-material goods, computer networks, etc.).

Finally, Mrs. Gubányi emphasized the difference between municipal loans and credits, as the two entail different legal consequences. Credit refers to money taken from a credit institution by the local government. Everything else is a loan (for instance borrowing money from another local government for a specified period of time). Distinguishing between these two assets is very important because local governments with credits are required to be audited while those with loans are not.

Closing Ceremony—Presentation of Certificates to Participants

The closing ceremony was presided over by Mr. Lawrence Birch, the USAID project officer for Hungary. Mr. Birch commended the participants on their commitment and hard work in bringing about change in their budgeting process. Following his speech he handed certificates to participants from each local governments.

Table 1
List of Cities Participating in the Second Year (1997-1998) Seminars on Modernizing Financial Management for Hungarian Local Governments

No.	Cities	Population	May 14-15, 1997	June 18-19, 1997	September 24-25, 1997	November 14-15, 1997	December 10-11, 1997	March 11-12, 1998
1.	Budapest District VI	23,246	T		T	T	T	T
2.	Csongrád	19,112	T	T	T	T	T	T
3.	Debrecen	210,143	T	T	T	T		
4.	Eger	61,400	T		T			T
5.	Gödöllő	29,761	T	T	T			
6.	Hajdúszoboszló	23,387	T	T	T	T		T
7.	Hódmezővásárhely	49,901	T		T		T	
8.	Karcag	22,637	T					
9.	Kazincbarcika	34,759	T	T	T			T
10.	Kecskemét	105,058	T	T	T			
11.	Nagykanizsa	53,353		T	T	T	T	T
12.	Nagykőrös	26,646		T	T	T	T	T
13.	Orosháza	34,600	T	T	T	T	T	T
14.	Püspökladány	17,000	T	T	T	T		T
15.	Szegvár	5,285	T	T	T	T	T	T
16.	Székesfehérvár	107,181	T	T	T	T	T	T
17.	Szentes	33,000	T	T	T	T	T	T
18.	Szolnok	81,500	T	T	T	T	T	T

ANNEX A

United States Agency for International Development

Modernizing Financial Management for Hungarian Local Governments

Hotel Rubin, 1118 Budapest, Dayka Gabor u. 3

March 11-12, 1998

TABLE OF CONTENTS

Agenda

List of Participants

A. Transparencies

A.1 Budget Monitoring

B. Exercise

B.1 Case study - Monitoring

C. Background Reading

C.1 “Accounting Support for Results Oriented Budgeting” by Edward A. Lehan

C.2 “Auditing Municipal Budget Reports” by Dr. Lajos Ötött and Mrs. Rác

C.3 “New Regulations in the Budgeting of the Government Agencies” by Lászlóné Gubányi

C.4 “The Organization and Functions of Internal Auditing in Local Governments”
by József Nagy

E:\PROJECT\budget\handouts\mar97\English\tocmar-e.doc

Agenda
MODERNIZING FINANCIAL MANAGEMENT
FOR HUNGARIAN LOCAL GOVERNMENTS
March 11-12, 1998, Budapest
Hotel Rubin, 1118 Budapest, Dayka Gábor u. 3

9.30 - 10.00 a.m.	Registration
10.00 - 11.30 p.m.	Budget Monitoring <i>Philip Rosenberg, The Urban Institute</i>
11.30 - 12.00 p.m.	Exercise – Monitoring Group Presentation and Critique <i>Philip Rosenberg, The Urban Institute</i>
11.30 p.m.	Coffee served during Exercise
12.00 - 1.00 a.m.	Panel discussion – Accounting <i>József Kéri, Szolnok</i> <i>Erzsébet Krajovszki, Szentes</i> <i>Mária Kürthy, Püspökladány</i> <i>Representatives of TÁKISZ</i> <i>Moderator: József Hegediüs</i>
1.00 - 2.00 p.m.	Hosted Lunch
2.00 - 3.00 p.m.	Local Government Feedback Session <i>Moderator: Katalin Pallai, City Government of Budapest</i>
3.00 - 4.00 p.m.	Presentations by Local Governments of Budgets I. <i>Moderator: József Hegediüs, Városkutatás</i>
4.00 p.m.	Reception

March 12, 1998

- 9:00 - 10:00 a.m. Presentations by Local Governments of Budgets II.
Moderator: József Hegedüs, Városkutatás
- 10:00 - 11:00 a.m. Guest Speaker
Lászlóné Gubányi, Ministry of Finance
- 11:00 - 11:30 a.m. Coffee break
- 11:30 - 12:30 p.m. Presentation of Certificates to Participants
Thomas Cornell, USAID
- 12:30 - 1:00 p.m. Hosted Lunch

LIST OF PARTICIPANTS

Municipalities

1. Mrs Kotsis
finance staff
Mayor`s Office VI. district
2. Lajos Germán
office manager
Mayor`s Office VI. district
3. Tamás J. Kiss
educational staff
Mayor`s Office VI. district
4. Dr. Marián Miklós
council member, alderman
Mayor`s Office VI. district
5. Ferenc Lázi
council member, head of the finance comittee
Mayor`s Office VI. district
6. Éva Horinka
Mayor`s Office, VI. district
7. Mrs. Szepesi
group leader
Mayor`s Office, Csongrád
8. Bardy Beatrix
Mayor`s Office, Csongrád
9. Mrs. Heltati Dr
office manager
Mayor`s Office, Gödöllő
10. István Tengelits
office manager
Mayor`s Office, Gödöllő
11. László Lőrincz
finance office manager
Mayor`s Office, Hajdúszoboszló
12. Imre Varga
educational office manager
Mayor`s Office, Hajdúszoboszló
13. Edina Kérdo
Mayor`s Office, Hódmezovásárhely
14. Mrs. Tóth, dr. Gabriella Dávid
educational staff
Mayor`s Office, Hódmezövásárhely
15. Literáti Nagy Gabriella
Mayor`s Office, Kazincbarcika
16. Mrs. Gátszegi, Gertrúd Gorontay
finance officer
Mayor`s Office, Nagykanizsa
17. Mrs. Szányi, Mária Kovács
finance officer
Mayor`s Office, Nagykanizsa
18. Ferencné Holló
finance staff
Mayor`s Office, Nagykőrös
19. Mrs. Tóth Éva Péczeli
finance staff
Mayor`s Office, Nagykőrös
20. Mrs. Laluska
Mayor`s Office, Orosháza
21. Mrs. Haklik
Head of Financial Department
Mayor`s Office, Orosháza
22. Mrs Gyömbér
administraion group leader
Mayor`s Office, Szegvár
23. Ibolya Végh
notary
Mayor`s Office, Szegvár
24. Mrs. Mészáros, Regina Jasztrapszky
budget expert
Mayor`s Office, Székesfehérvár
25. Gál Antal
manager, Family Help Center
Mayor`s Office, Szentes
26. Varga Sándor
manager, city management
Mayor`s Office, Szentes
27. Lipták János
manager, technical department
Mayor`s Office, Szentes
28. Mrs. Lencse, Mária Szalontai
manager, social policy department
Mayor`s Office, Szentes
29. Imre Balogh
municipal officer
Mayors Office, Szentes

Advisors

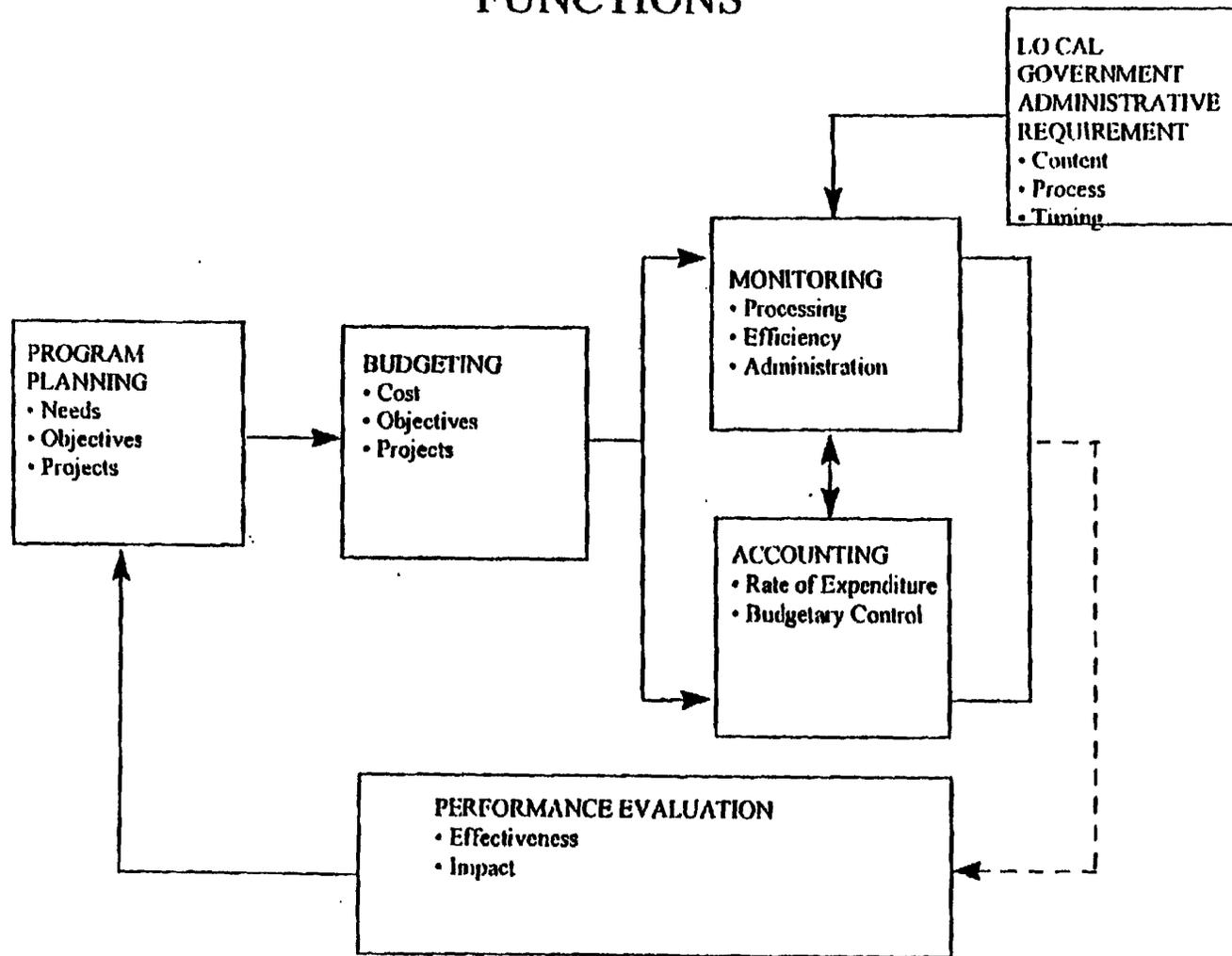
30. Thomas Cornell
head of USAID in Hungary,
Budapest
31. Katharine Mark
advisor, municipal finance
The Urban Institute, Budapest
32. Philip Rosenberg
advisor, municipal finance
The Urban Institute, USA
33. Mrs. Krajsóczki
group leader
Mayor's Office, Szentes
34. József Kéri
head of financial department
Mayor's Office, Szolnok
35. Péter László

Mayor's Office, Szolnok
36. Menyhárt István

Mayor's Office, Szolnok
37. Mrs. Kürthy
municipal finance office manager
Mayor's Office, Püspökladány
38. Mrs. Gubányi
head of accounting department
Ministry of Finance, Budapest
39. Mihály Lados
senior research fellow
MTA RKK, Regional Research Institute, Győr
40. Katalin Pallai

Local Government
41. Zoltán Györgyi
advisor, education
Oktatáskutató Intézet, Budapest
42. József Hegedus
advisor, municipalities
Metropolitan Research Institute
43. Róbert Kovács
fellow
Metropolitan Research Institute
44. Orsolya Sebok
fellow
Metropolitan Research Institute
45. Andrea Tönkő
fellow
Metropolitan Research Institute

RELATIONSHIP OF MONITORING TO OTHER MANAGEMENT FUNCTIONS



15

BUDGET MONITORING

- FORMAL PERFORMANCE REVIEW
- ORAL, WRITTEN AND VISUAL PRESENTATIONS
- COMMITTEE REVIEW
- REVIEW COVERS: PAST, CURRENT, FUTURE
- ALLOW TIME FOR CORRECTIVE ACTION

ADMINISTRATION AND EXECUTION

- CONSTANT REVIEW
 - DEPARTMENT/INSTITUTION
 - EXECUTIVE
 - LEGISLATIVE
- BUDGET CONTROL AND ACCOUNTING
 - FUNDS AND ACCOUNTS
 - BUDGETARY APPROPRIATIONS
 - ALLOTMENTS

THE MONITORING PROCESS

DEPARTMENT/ CONTRACTOR CAPACITY/SYSTEMS	REPORTING & REPROGRAMMING	FIELD VISITATION & ASSISTANCE
REVIEW ADMINISTRATIVE CAPACITY <ul style="list-style-type: none"> • PERSONNEL/SKILLS • EQUIPMENT • PAST PERFORMANCE • ACCOUNTING SYSTEMS • PURCHASING • ASSET MANAGEMENT INCORPORATE REQUIREMENTS WITHIN CONTRACT OR PERFORMANCE AGREEMENT	REVIEW REPORTS FOR ACCOMPLISHMENTS OF: <ul style="list-style-type: none"> • TARGETS • MILESTONES • RATES OF EXPENDITURE • CONTRACT COMPLIANCE • CONFORMANCE TO LAW PROVIDE INPUT TO MANAGEMENT DECISION TO ADJUST BUDGET/ OUTCOMES/ STRATEGY	PROVIDE TECHNICAL ASSISTANCE BY FIELD VISITATION TO: <ul style="list-style-type: none"> • CORRECT DEFICIENCIES • OBSERVE ACTIONS • REVIEW PROGRESS CONDUCT UNITED REVIEWS TO TEST COMPLIANCE WITH MANAGEMENT AND PERFORMANCE ISSUES

REPORTS AND EVALUATION

- ACCOUNTING AND FINANCIAL REPORTS
 - CLASSIFICATION OF FUNDS
 - REPORTS BY FUND OR ACCOUNT
 - APPROPRIATION
 - EXPENDITURES
 - UNENCUMBERED BALANCE
 - OTHERS REQUIRED BY LAW

REPORTS AND EVALUATION

- MANAGEMENT REPORTS
 - FINANCIAL AND STATISTICAL DATA
 - ACTUAL VS. ESTIMATE
 - PERCENTAGES
 - COMPARATIVE AND HISTORICAL DATA
 - RATIOS
 - RELATIONAL TO DEMOGRAPHIC DATA
 - TRENDS

REPORTS AND EVALUATION

- MANAGEMENT REPORTS
 - PERFORMANCE MEASUREMENT
 - PROGRAM ACHIEVEMENT AND STATUS
 - EXCEPTION REPORTING
 - MANAGEMENT ANALYSIS
 - SPECIAL REPORTS
 - PUBLIC VS. INTERNAL REPORTS

REPORTS AND EVALUATION

- REPORTING HIERARCHY AND STRUCTURE
 - OPERATING AND WORKING REPORTS
 - DETAIL
 - MANAGEMENT REPORTS
 - SUMMARY
 - DISTRIBUTION
 - WHO GETS WHAT WHEN?

REPORTS AND EVALUATION

- REPORT FREQUENCY
 - DAILY
 - WEEKLY
 - MONTHLY
 - PERIOD
 - QUARTERLY
 - SEMIANNUALLY
 - ANNUALLY
 - AS NEEDED

REPORTS AND EVALUATION

- REPORTING EVALUATION AND ACTION
 - WHAT DOES THE REPORT TELL ME?
 - SHOULD ANY ACTION BE TAKEN?
 - WHO HAS THE RESPONSIBILITY?
 - MAKE BUDGETARY ADJUSTMENTS, PROGRAM DECISIONS, ETC.

SAMPLE REPORT

SERVICE: TRANSPORTATION

PROGRAM: PAVEMENT REPAIR

OBJECTIVE: Improve quality by repairing and paving 15% of the City's streets.
Increase citizen satisfaction by 20%.

INDICATORS OF PERFORMANCE (ft in 000)

INPUT	96 ACTUAL	PLAN QTR	ACTUAL QTR
DEMAND			
Lane Km of Paved Streets	638	638	638
Citizen Requests	180	46	40 +
Km of Sidewalk	313	313	313
Km of Curb	211	211	211
WORK LOAD			
Hours Repairing Streets	23,799	4,633	5,100 -
Tons of Asphalt Used	7,380	1,907	2,100 -
Km of Cracks Sealed	16	0	0
PRODUCTIVITY			
Cost Per Ton of Asphalt Applied	32 ft	52 ft	62 ft
Cost Per Km of Cracks Sealed	200 ft	0	0
EFFECTIVENESS			
% Change in Citizen Complaints	-	-10%	- 15% +

EXPENDITURES (ft in 000)

	96 ACTUAL	PLAN QTR	ACTUAL QTR
PERSONNEL	62,500	14,375	15,800 -
OPERATING COSTS	26,000	7,000	13,780 -
CAPITAL OUTLAY	<u>98,000</u>	<u>9,800</u>	<u>12,300 -</u>
TOTAL	186,500	31,175	41,880

**Report of Expenditures
Against Quarterly Plan
(000)**

	1	2	3	4	5	6	7
DEPARTMENT: Police	ANNUAL BUDGET	PLANNED THROUGH 1ST QTR.	ACTUAL	Over (UNDER) PLAN	% OVER (UNDER)	UNEXPENDED BALANCE OF TOTAL BUDGET	% BUDGET EXPENDED
Services:							
Patrol	600	137	124	(13)	(9)	476	21.7
Community Service	200	100	105	5	5	95	52.5
Total	<u>800</u>	<u>237</u>	<u>229</u>	<u>(8)</u>	<u>(4)</u>	<u>571</u>	<u>28.6</u>
DEPARTMENT: Public Works				Column 3 minus Column 2			
Services:							
_____	9-9	9-9	9-9	9-9	9-9	9-9	9-9
_____	9-9	9-9	9-9	9-9	9-9	9-9	9-9
_____	9-9	9-9	9-9	9-9	9-9	9-9	9-9
Total	<u>9-9</u>	<u>9-9</u>	<u>9-9</u>	<u>9-9</u>	<u>9-9</u>	<u>9-9</u>	<u>9-9</u>

22

CONSTRUCTION OVERVIEW

The Center City section of the city of Evermore has a small commercial strip which is scheduled for some sidewalk repair and street tree planting. On the next pages you will find a copy of the construction contract which is set to be signed between the City and the contractor selected to do the project. This project was estimated to cost Ft 2,200,000 when the City put the job out to bid; the award was given to the low bidder who bid the work at Ft 2,100,000.

The City's Communal Services department is generally responsible for overseeing the bidding process and has prepared the contract which you will be reviewing.

The group is to function as the Finance Department in reviewing the proposed contract for deficiencies. The Mayor has publicly announced that work will commence immediately. The contract was hand delivered to you at 11:00 a.m. Any changes you suggest will have to be negotiated with the Communal Services department today, since the signing of the contract is scheduled for 9:00 a.m. tomorrow. As you work through your analysis of the contract, try to keep in mind the time constraints and scale of the project. Identify the most serious deficiencies. Also keep in mind that what you are reviewing is the bid specifications — assume all standard language, blueprints, etc., are satisfactory.

CENTER CITY COMMERCIAL AREA PUBLIC IMPROVEMENTS

1. GENERAL DESCRIPTION OF THE PROJECT: The sidewalk area on the westerly side of Evermore Boulevard is to receive certain improvements that will include sidewalk repair and/or replacement, installation of new curbing, realignment of existing curbing and the construction of tree wells. Handicap sidewalk ramps are to be built.
2. BID SPECIFICATIONS:
 - a. General: Remove existing defective, damaged or cracked concrete or asphalt sidewalks and driveways. Repair and/or replace with like and equal materials. All grades must meet and match existing adjacent grades. All handicap ramps will be constructed of concrete at locations shown on the construction plans. Tree wells will be saw cut in existing satisfactory pavement areas and pre-formed into areas where new materials are to be installed.
 - b. Starting and Completion Dates: The project must commence not later than two working days after the award of the contract and must be completed within five weeks (25 working days) from the date of said commencement.
 - c. Concrete Sidewalks, Driveways and Ramps: The City of Evermore, Engineering Department Standards are required for all concrete sidewalks, driveways and handicap ramps. The finish will be determined in the field at the time of construction by the Communal Services. Sample finishes may be required, if necessary.
 - d. Asphalt Sidewalks: The repair and/or replacement of all asphalt sidewalks must meet standards. The perimeter of all repair and replacement areas will be saw cut to a square, neat and uniform edge. A one ton roller will be used for final compaction. Grades must meet existing adjacent grades.
 - e. Removal and Replacement of Sidewalks and Driveways: All material that is excavated at any time and at any location on this project must be completely removed from the site at the end of each work day. The dumping and/or storage of this material may be stored within the City of Evermore in an area to be approved and designated by Communal Services, otherwise such dumping and/or storage is not allowed within the limits of the City of Evermore. The replacement of the pavement in the areas where required, must be completed within 72 hours from the time of excavation.

- f. Safety and Security: All walkways will be kept in a passable condition at all times other than when physical removal or replacement are in process. The safety of the pedestrian is the full responsibility of the contractor. Proper security and protection of the newly installed asphalt or concrete materials on the project must be maintained at all times, and safe access to all establishments must be maintained. All locations of facilities existing or installed concurrently with this project must be verified and protected by the contractor. This includes facilities or appurtenance above, at grade, below, or adjacent to the work areas as delineated on the plans.
- g. Tree Planting: The tree planting will be accomplished and completed prior to the installation of the new sidewalk pavement in the planting areas. Trees are to be 3" caliber, a Mountain Ash. The guarantee required is one growing season. Planting must meet standard specifications for planting and maintenance of deciduous trees.
- h. Coordination and Cooperation: The contractor is required to coordinate all work activities thru Communal Services for all phases of the project. A minimum of 24 hours is required for any revision in a previously planned activity and approval must be rendered in writing to the contractor by Communal Services.

The coordination of activities with utility companies, subcontractors or contractors with separate contracts in the same area must be done in the presence of a Communal Services representative for his information and background of proposed or planned activities by other than the prime contractor.

- i. Clean Up: Clean up of the entire project area is the responsibility of the contractor. In addition to the standard item of clean up operations as specified in the City of Evermore Contract Standards, the contractor is required to clean and test all catch basins within the project area and those basins that collect surface drainage from the project area.
- j. Final Approval: Final approval will be in the form of a formal written statement by the awarding authority. The following elements must be satisfactorily completed and submitted before the Final Approval Request is submitted.
 - a. Submission of Final Payment Request Form.

- b. Written results of the Final Inspection by the Contractor, Communal Services, Design Engineer, and the City of Evermore's officially designated representative.
- c. Submission of the Original set and one copy of the As-Built-Drawings of the Project Improvements indicating date of completion and acceptance by the city.
- d. Payments: Payments are to be made on a monthly basis upon the submission by the contractor of the PROGRESS AND PAYMENT SCHEDULE that is certified and approved by the appropriate parties. The contractor will be paid for the work completed as of and to the date of the payment schedule.
- e. Final Payment: The final payment will be made after all the proper inspections, submissions of AS-BUILT-DRAWINGS, and the concurrence of the design and inspecting engineers. The final payment will be made not later than 30 days after submission for payment, or 30 days after the final payment request procedure is satisfactorily submitted and accepted.

CONSTRUCTION OVERVIEW

PART ONE REPORTING FORM

General project description

Deficiencies (if any)

Bid Specifications

a. general

b. starting and completion dates

c. concrete sidewalks, driveways
and ramps

d. asphalt sidewalks

e. removal and replacement of
sidewalks and driveways

f. safety and security

g. tree planting

h. coordination and cooperation

i. clean up

j. final approval

CONSTRUCTION OVERVIEW

PART II

— Center City Commercial Area Improvements

Instructions

— The second half of this game involves each group making administrative decisions as various problems arise during the construction phase of the sidewalk repair and tree planting contract. The problems are to be handled in sequence. Do not go on to the next problem until your group has decided how to handle the previous one. Report at the bottom of each page your decision and the probable contract consequences thereof.

IMPORTANT NOTE

— The contract under which this construction occurs is the unrevised version you worked on in Part I.

PROBLEM NUMBER ONE:

Day 6 of the construction time period

The Communal Services representative reports to the project supervisor that no on-site construction activity has commenced. The contractor, when notified of this apparent violation of the contract, says that his men are constructing the forms for the tree wells at another job site, but the fact that these forms are for use in the Center City job meets the contract requirement for commencement of work within two days after the effective date of the contract.

TASK ONE:

Is this a contract violation? _____ Specify:

Is this problem caused by a contract deficiency? ____

Specify: _____

TASK TWO:

Alternative Administrative Actions (select the best one)

- (1) Insist that the contractor is in violation of the contract and demand that on-site construction activities commence immediately.
- (2) Advise the contractor that regardless of the definition of "official commencement" that since he has acknowledged commencement, he must complete all work within 25 working days as the contract calls for.

Does your choice have a probable negative impact on any of the following? (if so, describe):

(a) project budget _____

(b) completion time _____

(c) construction standards _____

PROBLEM NUMBER TWO:

The contractor begins sidewalk repair and replacement work at one end of the site. All three of the merchants in the first three stores affected complain that construction equipment is blocking access to their stores. The following day the same merchants complain that the removed sidewalk material is left in piles next to the excavation holes throughout the day, thus creating an unsightly and hazardous access to the stores for their patrons. The merchants demand instantaneous removal of all debris and the construction of temporary walkways to their stores during the construction period.

TASK ONE:

Is this a contract violation? ____ Specify:

Is this problem caused by a contract deficiency? ____

Specify: _____

TASK TWO:

Alternative Administrative Actions (select one)

- (1) Insist that the contractor immediately remove the debris at the end of each working day and install temporary walkways to each store prior to the commencement of any work in front of a store. Agree to a change order to

accommodate the requirement for installation of temporary walkways.

- (2) Insist that everything the merchants demand was "implied" in the contract and must be done without a contract modification. Have the city remove any existing debris and install temporary walkways to the three stores. Suspend further work on the site until the contractor agrees to the city's interpretation of the contract.
- (3) Negotiate with the contractor to stage his work so that each store will be affected only for 48 hours or less by construction activity. Explain to the merchants that this construction disruption is necessitated by the nature of the patch repair work being done.

PROBLEM NUMBER TWO
(Continued)

- (4) Arrange for a Communal Services truck to be stationed each day at the project site from 8 a.m. until 4 p.m. so that debris can be loaded as the sidewalks are torn up instead of letting it accumulate for removal at the end of the day. Negotiate with the contractor to pay the city that portion of the bid price which was allocated for debris removal as partial compensation for the city's providing daily on-site facilities for debris removal.

Does your choice have a probable negative impact on any of the following? (if so, describe):

(a) project budget _____

(b) completion time _____

(c) construction standards _____

PROBLEM NUMBER THREE:

The Communal Services representative and the city councilman from the community both bring to the attention of the project director that the cuts made for the tree plantings are not of uniform spacing. Also, one tree cut, in addition to being out of spacing along the curb length dimension, is also 18 inches out of alignment (i.e., closer to the building fronts than the others). The contractor says that he spaced them according to where there was good sidewalk material which wouldn't crack when cut, and in the center of any new pour of concrete or asphalt to insure proper drying of the patch.

TASK ONE:

Is this a contract violation? ____ Specify:

Is this problem caused by a contract deficiency? ____

Specify: _____

TASK TWO:

Alternative Administrative Actions (select one)

- (1) Let the tree cuts stay where they are and explain to the city councilman that the "economy" nature of the repair work necessitated the spacing of the tree wells as they are. Ask the contractor to re-cut the one tree well which is 18 inches too close to the building in order to placate the city councilman. Accept a cost overrun for the extra work.

- (2) Require all tree wells to be cut at consistent intervals. Extend the term of the project and process a change order to correct the contract and provide for the additional cost of redoing the work. Accept the argument of the contractor that additional sidewalk must be replaced in six locations to provide a proper setting in which to pour new concrete over previously cut tree wells "slightly out of spacing alignment with the new specifications."

PROBLEM NUMBER THREE
(Continued)

- (3) Modify the planting design to evenly space the 3" trees at distances twice the original plan and revise specifications to install low shrubbery in the other tree wells in order to obscure the irregular nature of the well spacing. The contractor says he can supply shrubbery for the same price as the original tree order; however, the change in the nursery order will require a three week extension without penalty in the project completion date.

Does your choice have a probable negative impact on any of the following? (if so, describe):

(a) project budget _____

(b) completion time _____

(c) construction standards _____

PROBLEM NUMBER FOUR:

The contractor, in doing street excavation to install a handicap curb ramp, punctures a city water line. All

Day 21 of the construction period

work is suspended on installation of handicap curb ramps until water line is repaired and the city water company checks the location of their lines near the other curb ramp installation sites. This portion of the project is delayed six days. The city water company says that its cost (Ft 31,200) should be added to the project cost, either as a bill to the contractor or paid by the Communal Services.

TASK ONE:

Is this a contract violation? _____ Specify:

Is this problem caused by a contract deficiency? ____

Specify: _____

TASK TWO:

Alternative Administrative Actions (select one)

- (1) Accept the six day delay on the contractor's part and tell the city water department that they were at fault for not checking the location of their lines against the plans when the plans were submitted for general review by all city agencies four months ago.
- (2) Admit a coordination failure by the Communal Services to the water company and pay their Ft 31,200 claim out of City funds.
- (3) Sue the contractor after the job is completed for not checking with the water department on the location of their lines before drilling the street.

PROBLEM NUMBER FOUR

(Continued)

Does your choice have a probable negative impact on any of the following? (if so, describe):

(a) project budget _____

(b) completion time _____

(c) construction standards _____

ACCOUNTING SUPPORT FOR RESULTS-ORIENTED BUDGETING

By
Edward Anthony Lehan
February, 1997

This paper outlines key accounting issues affecting government budget processes, with special reference to the practice of results-oriented budgeting.

The struggle to enhance the utility of governmental accounting for public officials, the investment community and the general public, including the provision of appropriate accounting support for budgets and budgeting, began early in this century - and the struggle continues to this day.

Attempts to replace the traditional line-item approach with results-oriented budgeting began in earnest around 1950 with the introduction of performance and program budgets in a spectrum of jurisdictions across the United States. At that time, ~~accounting professionals clearly perceived the impact on traditional accounting~~

(MFOA), may serve as a representative sample of opinion:

“The adoption of the performance budget by a municipality requires a major change in accounting procedures in order to develop the possibilities of the new method to the fullest advantage.” *Accounting Publication Series, 11-2, MFOA, May 1, 1954.*

Over the years since that time, the literature concerned with public budgeting has included frequent references to the critical role of accounting, often citing inadequate accounting support as a key factor limiting the advance of alternatives to the traditional “line-item” approach to budgeting.

Acknowledging the lessons of experience since 1950, therefore, appropriate accounting support must be considered a “condition precedent” for successful implementation of results-oriented budgeting. Unquestionably, results-oriented budgeting presents public officials with complex problems of accounting organization and procedure, which, in the opinion of the author, can only be satisfactorily solved by

adopting a broad institutional solution based on the policy and management requirements of the budgeting concept, rather than the reverse.

THE REGISTRATION OF BUDGETS WITHIN ACCOUNTING SYSTEMS

In a seminal move in 1934, the Governmental Finance Officers Association of the United States and Canada (GFOA) issued the first of its influential series of manuals (known universally as the blue books) embracing the recommendations of the then newly established National Committee on Governmental Accounting (NCGA) for the improvement of government accounting. Several of these recommendations directly and indirectly affected the accounting-budgeting relationship. NCGA suggestions included 1) establishment of a set of separate, but inter-related, "funds" as the basic accounting organization of governmental jurisdictions, effectively tying budgets to funds, 2) adoption of the "double entry" accounting methodology, 3) incorporating budgetary accounts as an integral component of governmental accounting systems, and 4) recognition of expenditures and revenues on a "modified accrual" basis, except for governmental enterprises which should use the accrual approach.

According to NCGA recommendations, jurisdictions adopting procedures reflecting generally accepted accounting principles (GAAP) should register their budgets in the general ledgers of appropriate funds, as follows:

- Total estimated revenues posted as a debit to an asset control account.
- Total appropriations posted as a credit to a liability control account.

(Note: if a difference between the two totals is positive (credit) or negative (debit), the amount is accordingly posted to fund balance.)

A subsidiary ledger supports each of these general ledger control accounts:

- A Revenue Ledger for recording the details of revenue estimates and revenues as received.
- An Expenditure Ledger for recording details of appropriation allocations and allotments, if used, and disbursements and encumbrances, as incurred.

Because coded classification schemes and the associated figures are embedded within it, expenditure ledgers are of the greatest significance to program managers and budget officers, especially if they are working with results-oriented budgets. With reference to the use of this ledger, the location of pre-audit controls on the incurrence of encumbrances and disbursements proved to be an important, and contentious, issue. In each jurisdiction, the resolution of this issue determines the fundamental design of its expenditure ledger. If the control points are associated with results-oriented "lump-sum" summaries (program, project, activity or task), rather than to expenditure summaries or objects of expenditure, these latter entries will be identified as *analytical* rather than *control* identifiers and codes, providing information only. In those governments where the leading accounting officials are unwilling to establish controls at a programmatic level (lump-sum), the managerial assumptions of results-oriented budgeting are seriously compromised.

In 1984, the NCGA was succeeded by the Government Accounting Standards Board (GASB), which has continued the effort to enhance the utility of governmental accounting, including accounting support for results-oriented budgets and budgeting. Summing up at this point, after almost fifty years of effort, adherence to the standards adopted by the NCGA-GASB has increased significantly within the United States. However, it is generally acknowledged that an unknown, but, substantial number of governments in the United States do not, at the present time, conduct their accounting and financial reporting in compliance with the recommended standards. For example, many jurisdictions do not maintain proper fixed asset records, basic information which enters into cost calculations through depreciation allocations.

With specific reference to budgetary accounting, knowledgeable public officials, especially experienced budget officers, identify the rigidity of accounting arrangements, and the uncooperative attitude of government accountants, with the failure to effectively practice results-oriented budgeting in many United States jurisdictions. In this connection, in 1994 GASB published a concept statement related to government reporting of service efforts and accomplishments (SEA), indicating that it is considering the issuance of standards for the inclusion of performance information in year-end financial reports of state and local governments in the United States. Significantly, this proposal has met with significant resistance by various interests, including organizations representing government accountants. *In general, it is safe to say that accounting professionals do not want to be held accountable for the collection, validation and dissemination of performance data.*

As a practical matter, it has proved very difficult to introduce and maintain results-oriented budgeting, with its heavy demands on the accounting system, without the leadership and enthusiastic support of governmental accountants. As pointed up by the following list, the shift from line-item budgets to budgets featuring "lumpsum" activity allotments, work plans and periodic formal performance reviews requires a great deal of cooperation from governmental accountants. The accounting ramifications of results-oriented budgeting include the following:

- Accounts and classifications proliferate, including identification of fixed and variable costs.
- Transactions and entries increase in number and complexity.
- Reconciliation problems increase.
- Accounting systems reflect fewer continuities as accounts and classifications change from period to period to meet changing issues. (This situation may also result in demands for restatement of accounting data to illuminate new issues.)
- Accountants and auditors are assigned increased responsibility for the entry and integrity of "non-monetary" data (work load, performance indicators and program benefit information) and the calculation of relationships of this data to expenditure and revenue information.

With reference to budgetary accounting in other regions of the world, the reported situation seems to be even less favorable. An unknown, but substantial, number of governmental jurisdictions across the world still use "line-item" budgets, that is, budgets which relate departmental appropriations directly to expenditure summaries (e.g., personal services, contractual services, etc.) or objects of expenditure (e.g., salaries, electrical charges, etc.). An unknown, but substantial number of these jurisdictions, Indonesia, for example, rely on "single entry" cash accounting procedures. To prepare their interim and year-end budget reports, these jurisdictions compare actual cash disbursements to budget allocations and to actual receipts. They also refer to records of budget allocations and available cash to control the flow of disbursements. Additionally, these governments may attempt to control the flow of obligations (contracts and purchase orders) by reference to budget allocations and

projections of cash availability, but the frequency of reports concerning deficit spending point to serious lapses in basic budget control procedures.

REQUIREMENTS FOR FORMAT ELABORATION AND FLEXIBILITY

The introduction of "performance" and "program" budgeting focused attention on the expenditure classification scheme. Both these forms of results-oriented budgeting require that expenditures be aggregated, or summarized, by expressive titles. Grouped by five classification "families," the following exhibit displays the diversity of classification concepts found in various budget documents:

Organization	Accounting	Configuration	Performance	Policy
Ministry	Fund	Class	Function	Goal
Agency	Account	Category	Cost Center	Objective
Department	Cost Center	Component	Responsibility Center	Service
Division	Object	Element	Activity	Program
Bureau	Item		Task	Project
Section			Job	
Unit			Time	
			Space (area)	
	Use of the prefix sub-, as in Sub-Object, etc.	Use of the prefix sub-, as in Sub-Component, etc.	Use of the prefix sub-, as in Sub-Function, etc.	Use of the prefix sub-, as in Sub-Program, etc.

Typically, jurisdictions mix their identifiers, drawing terms from more than one classification family. For example, organizational terms are often associated with accounting and performance concepts, as shown in the following exhibit based on the format used in the 1983-84 budget of the City of Chelsea, Massachusetts:

Classification Concept	Classification Family	Title
Fund	Accounting	General
Function	Performance	Public Safety
Department	Organization	Police
Activity	Performance	Patrols
Object	Accounting	Compensation

With reference to performance budgets, to knit these aggregations together, an elaborate hierarchy of summaries is frequently needed, as shown in the following illustration:

AN EXAMPLE OF A COST CENTER CLASSIFICATION SCHEME

EXPENDITURES	
<u>CODE AND TITLE</u>	<u>CLASSIFICATION</u>
01 General	Fund
04 Security	Function
10 Fire Protection	Department
02 Fire Prevention	Division
02 Licenses and Permit Issuance	Section
03 Inspection	Cost Center
03 Sprinkler Testing	Activity/Task
1 Variable	Cost Concept
1 Personal Services	Expenditure Summary
1 Salaries	Expenditure Object
REVENUES	
<u>CODE AND TITLE</u>	<u>CLASSIFICATION</u>
01 General	Fund
04 Security	Function
10 Fire Protection	Department
02 Fire Prevention	Division
02 Licenses and Permit Issuance	Section
03 Inspection	Cost Center
03 Sprinkler Testing	Activity/Task
03 Fees	Revenue Summary
09 Sprinkler Permits	Revenue Source

Because programs frequently involve more than one organizational unit within a government, the classification schemes employed in program budgets are more complicated than those needed by performance formats. As a case in point, in FY85, the family planning program of the Government of Jamaica (GOJ) involved a Family Planning Board (FPB), the coordinating agency, and four ministries, including the key delivery system provided by the Ministry of Health through its extensive Maternal and Child Health Clinic System. For management purposes,

within the FPB and the ministries, family planning was identified and coded as an integrated array of cost centers, similar to the fire protection example shown immediately above. Additionally, using the "cross-classification," or "cross-walk" technique, the FPB budget officer prepared a program perspective summarizing the entire family planning budget, including all participating units of government. As shown below, this Program Perspective cross-classified the allocations to the participating institutions to indicate their relative impact on the three key operating thrusts of the program.

FY85 Program Perspective: Jamaica's Family Planning Program (000's JS)

IMPACTS >	Maintaining Current Practitioners	Recruiting Lapsed Practitioners	Recruiting New Practitioners	Total
Family Planning Board	3,423.2	615.6	3575.2	7,614.0
Ministry of Health	3,000.0	75.4	835.5	3910.9
Ministry of Education			392.3	392.3
Youth & Community Development			1,107.6	1,107.6
Ministry of Agriculture	82.3		400.0	482.3
Total	6,505.5	691.0	6,310.6	13,507.1
Number of Acceptors	114,000	20,000	43,000	177,000
Cost per Acceptor	57.06	34.55	146.76	76.31
Estimated Births				61,000
Estimated Births Averted				17,700
Cost per Averted Birth				763.31

At that time, it should be noted, the GOJ was using a decentralized, non-computerized single entry cash accounting system, therefore, the program perspective was prepared manually. With the availability of computer technology, the cross-classifications required to support program budgeting can be produced by reference to codes assigned for that purpose, prepared, as needed for analysis and/or decisions, by using spread-sheet programs. Computer technology makes it possible to formulate and implement budgets with multiple formats. In contrast to mono-value formats, cross-classified formats permit policy officials to explore more than one dimensions of an expenditure proposal, facilitating insight and understanding.

In addition to permitting an elaborate and flexible format, expenditure ledgers should be designed to assist program managers with the implementation of their budgets. This includes the following facilities:

- Coding and timely reporting of the variable costs of activities/tasks listed in those Work Plans which are subordinate to controlling cost center allocations.
- Coding and timely reporting of work hours charged to activities/tasks listed in Work Plans. (Because Work Plans are fundamentally based on work time calculations, this facility is of even greater value to program managers than variable cost reporting.)
- Permitting program managers to enter budget reservations into the accounting system as contingent liabilities, especially requisitions for goods and services which have not yet reached the status encumbrances, that is, contracts and purchase orders. (Because it tracks the status of obligations from source to settlement, this arrangement is especially useful in jurisdictions with centralized purchasing units with their inevitable service queues. The ability to reserve portions of available budget balances also facilitates the planning of operations.)

PERFORMANCE DATA PROBLEMS

Thus far, this paper has centered on problems related to the accounting foundations of results-oriented budgeting, which are serious, but are thought to be amenable to technical accounting solutions. However, problems with the collection, validation and the use of performance data are equally serious, perhaps even more so, given the fact that results-oriented budgets claim to be justified on the consequences of budget allocations.

Accounting concerns figures representing money. In contrast, performance data is almost always non-monetary data. It is almost always unique to the program in question, and is almost always developed and recorded by the concerned program personnel. This latter characteristic tends to render performance data suspect (especially to accountants) because it is collected and presented by program personnel who have a compelling interest in "looking good." In most governments, performance data is captured "catch-as-catch-can," stored in ad-hoc filing systems and occasionally related to expenditure and revenue reports by program leaders. Typically, performance data is originally formulated at work sites by program personnel who count, register and report events judged useful in evaluating performance. Typically, performance data is entered into records which make up a fairly elaborate set of files, including original source documents, reporting forms and

ledger-like records. Typically, reporting and tabulation errors are rife in such "uncontrolled" recording systems, where money is not involved.

Of course, many of the problems associated with performance data can be mitigated if governments are willing to take steps to guarantee data validity, such as, strictly enforced internal controls on the collection of data, independent surveys, sampling studies and field audits. But, because performance data is so difficult and expensive to validate, all too many governments do not even try. Certainly, it is fair to state that the expense of validating performance is deemed a sufficient deterrent by most governments to inhibit the development and maintenance of credible performance data arrays.

PRACTICAL ALTERNATIVES

Cost Finding. With regard to input side of results-oriented budgets, it is generally agreed that cost accounting systems would provide the best accounting support. However, in contrast to profit-oriented enterprises, governments lack compelling incentives to invest in this expensive elaboration of their accounting systems, especially for the service programs assigned to its general fund. Earlier, in the discussion of the Jamaica Family Planning Program, it was suggested that the "cross-classification" technique could be used on an as-needed basis. Similarly, when cost estimates, especially statements of total, or "full" cost are required to make important decisions, cost finding procedures can yield acceptable results. As research and analysis, rather than accounting, cost finding requires the assembly, evaluation and adjustment of relevant information drawn from various sources, including data provided by the formal accounting system, to derive the desired costs.

Monetizing Performance Indicators. Associating fees and/or service charges with performance indicators is the best way to ensure the validity of performance data, because where money is involved, reporting procedures will fall under the scrutiny of accountants and auditors. With the fee schedule known, revenue reports can be organized to provide evidence of the volume of use, service or activity. Additionally, if performance data can be made subject to internal accounting controls, responsible program managers will be much more likely to foster the use mechanical and electronic counting devices, and establish and enforce administrative controls, such as, double entry or cross-footed data recording and tabulations and calculations to reduce the possibility of error.

Use Work Hours As The Basis of Work Plans. Governments using results-oriented budgets tend to conduct formal periodic performance reviews, which require the formulation of Work Plans. According to best practice, these reviews are conducted two-thirds of the way through each review period, which are usually quarters of the fiscal year. This practice allows time for corrective action to ensure target attainment, if needed. Obviously, if Work Plans are based on unit costs or cost per unit of output, the process will be dependent on timely reporting of expenditure and revenue information. Regrettably, tardy reporting is an outstanding weakness of governmental accounting systems. Fortunately, these indispensable instruments of results-oriented budgets are better based on performance ratios, such as, output per work hour, or the reverse, releasing the monitoring process from undue dependence on interim reports drawn from the accounting system.

As-Needed Use of "Cross-Classifications." As noted earlier, public programs frequently involve the efforts of more than one organizational unit. Program budgeting provides a way of bringing organizationally segregated program components together in one summary. Most budget officers agree that this approach is very effective for policy-making, but requires extraordinary organizational arrangements, crossing normal responsibility lines during implementation. Even if jurisdictions can not support program budgets with appropriate organizational arrangements, including accounting support, it is possible to formulate and monitor program budgets by using the "cross-classification," or "cross-walk," technique selectively, on an as-needed basis. As previously illustrated by the Jamaica Family Planning Program Perspective, these matrices can be developed manually, if the computerized spread-sheet technology is not available.

A CONCLUDING NOTE

As outlined by this paper, appropriate accounting support has been, and remains, a critical issue for public officials seeking to formulate and implement results-oriented budgets. In this regard, the recent initiative of the Governmental Accounting Standards Board concerning the inclusion of data related to "service efforts and accomplishments" in year-end financial reports assumes, rather than addresses the underlying accounting capability issue discussed by this paper. Most assuredly, however, if GASB adopts the proposed reporting standards, or some variation thereof, the imperative to comply will stimulate the most searching review of appropriate accounting support for budgeting ever undertaken.

Auditing Municipal Budget Reports

by Dr Lajos ÖTÖTT, Advisor, State Audit Office, Budapest
Mrs Rácz, Registered Auditor, Dr Printz and Co. Ltd.

Published in issue 1995/7-8 of the periodical *Accounting and Auditing*

When the draft versions of Law 1991/XVIII on Accounting was under discussion, it was raised whether the annual budget reports of budgetary organizations could/should be made subject to mandatory auditing. The authors of this article, being experts of the State Audit Office (SAO), opted for the *should* version at that time, but their idea was dropped at technical discussions within SAO. Later accounting experts external to SAO also supported the idea that the scope of mandatory auditing should be extended to also budgetary organizations as of 1998.

Background: Single-entry and Double-entry Book-keeping.

In the 70's, single-entry book-keeping was an accepted practice with budgetary organizations, especially the soviet councils, since they were forced to expend budgetary appropriations. It was very easy to maintain revenue and expenditure sheets; however, end-of-year reports on assets always caused problems to prepare. Control over assets was almost impossible to effect due to lack of discipline in accounting and documentation practices. The reform actions of the 80's, especially the famous/infamous MoF Decree 19 introduced business-like processes in budgetary financial management. The new accounting regulations of somewhat industrial-type were disliked by many, but allowed a certain degree of cost monitoring. Cost monitoring was especially important for institutions (large health and educational ones) which could separate expenditures from costs. Whether monitoring results reflected the real costs or not is another issue, since even today cost monitoring is a fundamental problem in public finance: we do not know what costs how much and why.

This is one of the major problems in budget planning, since it is well-known that the basic tasks of societal public consumption and those of the system of service provider institutions have been separated from one another as a result of budgetary liberalization processes. Some of the services provided by specifically large institutions observe no rules, they represent artificial tasks accomplished by artificial organizations using up tremendous funds.

The new business-like financial management had as many supporters as many opponents to it. Small institutions undoubtedly suffered, since they did not have enough staff with experience to meet the requirement of double-entry book-keeping. Books are more reliable now due to more discipline in accounting and documentation practices; though expenditures and costs are equal in some of the institutions.

The fact should be recognized now that even budgetary financial management incurs costs, moreover immense ones. Freedom in financial management and business-like activities have made budgetary financial management increasingly complicated and difficult to understand.

Institutions have been granted flexibility, which means that even institutions providing the same type of services are difficult to compare. Data maintained in the general ledger can be validated by using complicated detailed sub-ledger records only, and the fact that account movements during the year are posted under single-entry book-keeping leads to many errors, hinders end-of-month and quarterly reconciliation, and validation of end-of-year data.

The Situation with State Auditing

The increasingly complicated rules in budgetary financial management is only one of the facts that justify the need for external auditing in budgetary institutions.

Another approach is the problem with the state auditing system, that collapsed in 1989-1990. After Law II/1979 had been passed, a system and institutions to state auditing was created. By the mid 80's, the auditing system for budgetary financial management was relatively well developed, but also had some shortcomings in terms of imperfect regulations, overdeveloped hierarchy, and tasks allocated to the wrong decision-making levels.

Frequent auditing and effective internal auditing themselves worked against malpractice. Budgetary institutions new that “another auditing will come in 2 years’ time” and that they could turn to the auditor with their problems even to prevent mistakes from occurring.

In 1990, the new democratic constitutional state created altered interests leading to changes in state auditing. The State Audit Office was set up as the highest auditing government agency. Auditors welcomed the new institution that meant new challenges, new practices, and also the security of freedom to them.

The system of state auditing that had been developed before 1990 collapsed and deregulation efforts resulted in abolishing even some regulations that had never violated the principle of democracy. After the soviet councils of counties had been eliminated (transformed), the auditing systems in county councils ceased to exist. Local governments dissolved the cadre of auditors by dismissing the experts or allocating other tasks to them. Internal auditing at that time did not work at all, and it took years to develop. Laws and regulations had provisions overlapping each other and also left gaps uncovered.

Some organizations that had supervisory roles did not know whether they had any obligation to audit institutions under their supervision, and if yes at what frequency. However, escaping deregulation processes, MoF Decree 96/1987 is still in effect and specifies a two-year frequency for external auditing and sets out the principles of and requirements for internal auditing. Lawyers should decide whether the doubts about the applicability of the Decree due to the fact that the law of a higher level that called the Decree to life has been abolished are valid or not. We are convinced that regulations in force should be observed and enforced.

The Law on Public Finance adopted in 1992 regulates the system of state auditing. However, associated government decrees fail to provide any guidelines as to implementation. There is a law in force with an earlier implementation decree, which is in no harmony with the law in effect. So what agencies are responsible for auditing and what are their responsibilities?

Auditing of Municipalities

Municipalities, formed in 1990, had similarly chaotic systems for auditing. The law on the State Audit Office specifies that intergovernmental relations and the use of state subsidies are areas for auditing by the SAO.

Law LXV/1990 on Municipalities sets out that “municipal financial management should be audited” by the SAO, which is a controversial issue to this day. The situation is as follows: more than 200 auditors used to audit the less than 1500 soviet councils. After the change of regime, hardly more than 50 experts could be involved in auditing the 3200 local governments that evolved, and areas for auditing included normative and targeted subsidies, as well as subsidies provided to municipalities in hardship out of their own control. That means that the number of auditors has dropped to one tenth for twice as many municipalities. The number of municipal internal auditors have been increased, but that could not provide any solution to the problem. The present staff of auditors can review the financial management of 160 municipalities per year, in principle therefore a municipality would be audited every 20 years. It is our expert opinion that some audits performed over individual subsidies or some municipal tasks cannot replace an overall review of financial management in terms of compliance with rules, efficiency and effectiveness.

Reasons to Problems in Auditing

What has led to the situation? The democratic state has created the system of local government, the local agencies of state power, without a direct state supervision over their financial management. The SAO has been authorized to audit them. What is the problem in meeting the obligation to audit?

In previous paragraphs it has been mentioned that in the financial management of soviet councils the system of biannual auditing represented a threat against malpractice and also senior (but not top-level) management in councils had someone to turn to with their problems in financial management and accounting. They needed such assistance even when councils' financial management was liberalized in the 80's. After the change of regime, this process has stopped, the middle-level senior management ceased to exist, and also experts in financial management left/had to leave their jobs. New staff of experts needed time to get familiar with the operations of the municipal system, and also to understand the procedures in financial management and to develop an accounting system. New staff was also challenged by the introduction of a number of new regulations. No wonder that audits and reviews by the State Audit Office have contained reports on malpractice and many faults in relation to using state subsidies.

The State Audit Office carries out reviews against legality, practicality, and effectiveness. The law does not specify any frequency for audits of municipal financial management. It has been discussed in the past few years whether the staff of SAO should be increased so that they can review each local government every 3-4 years. The SAO has no responsibility in general for reviewing the financial management and auditing the annual reports of local authorities. The SAO is an organization responsible for checking the finances and financial management of the legislative power. Therefore it represents a waste of highly qualified expertise when SAO experts need to audit annual reports or spend time searching for basic

documents instead of checking the overall operations and financial management practices of municipalities and making recommendations as to refining or improving the system.

It has become clear that municipal financial management should be checked for compliance with rules, e.g. by auditing municipal annual reports. This is a practical solution, because compulsory auditing of annual reports was introduced in another subsystem of public finance this year. On request by SAO, Law 1995/XXI makes it mandatory to audit the 1994 annual reports of funds.

Mandatory Auditing of Municipalities

Article 120 of Law 1995/XLVIII on certain amendments of law with the aim of economic stabilization makes it mandatory for local governments to use (employ) auditors and to audit annual reports.

What does the law say? Art. 120 specifies the municipalities that are mandate to undergo auditing. Paragraphs of the article only imply rather than explicitly say that the specified municipalities should employ permanent auditors who perform auditing as a continuous effort all through the year. (Unfortunately most Hungarian laws need interpretation instead of being clear and applicable in practice as they are.)

Under Paragraph (2) of Art. 120, Articles 92/A - 92/C are added to Article 92 of Law 1990/LXV on Municipalities. Under Paragraph (1) of the amendment, the general assemblies (councils) of counties, cities with county rights, the capital city as well as districts in the capital shall retain auditors. Cities that are centers of counties are all cities with county rights, therefore mandatory auditing is applicable to them as well. In addition, general assemblies are required by law to publish the annual reports of municipalities and municipal institutions, with simplified content and in a format defined by the Ministers of Finance and Interior, in the Gazette of Home Affairs, and the Company Gazette. A simplified annual budget report consists of a balance sheet, cash flow statement and statement of remaining funds as well as profit and loss statement. The additional appendix, that is also part of an annual report, shall not be published.

The same paragraph requires the general assembly to announce tenders for positions of auditors, evaluate bids and the mayor should award the job to an auditor within 60 days of the effective date of the law. Since the effective date is October 15, 1995, the municipalities specified above should entrust auditors before December 15, 1995. The law fails to give an indication whether mandatory auditing is applicable to 1995 annual reports already, or the 1996 annual reports only when a continuous auditing effort is carried out. 1995 reports cannot be audited in accordance with specifications by law, since audited reports cannot be submitted before February 28, the required submission date due to the well-known fact that correction entries of the 13th month can be posted in books only late January, or early February. The situation will need clarification by legislators under e.g. an implementation decree.

A group of municipalities with an obligation to use auditors has been defined above. Some others are the municipalities whose total expenditures in the previous year exceeded Ft 100 million and also had some borrowings. These municipalities are required to have their annual reports audited and published from the year they took out a loan till the last year of the loan repayment period. At present there are more than 600 such municipalities.

There is some problems with regulations in relation to the second group of municipalities (that represent the larger group as far as their number is concerned), since regulations do not mandate (though do not prohibit either) municipalities to use permanent auditors, regulations require an audit of annual reports only. That provision might prove to be weak, since auditors will not have the opportunity and time (especially when submission date is unchanged) to perform a thorough review of the annual financial management of municipalities. As a solution, municipalities could entrust large auditing firms with a number of experts, but this would be too costly for them. Therefore the law should be interpreted in a way that municipalities in the second group should also use permanent auditors for the period of their loan payment obligations.

Rights and obligations of auditors are specified by the newly amended Article 92/C of the Municipal Act. The Article specifies also the obligations of the body of representatives and the mayor in relation to helping auditors to carry out their work, namely allowing auditors to inspect documents, participate in general assembly meetings, and to give recommendations if necessary. When a mayor fails to convene the general assembly on request by the auditor, the auditor will initiate the involvement of a supervisory body, i.e. public administration offices of the capital or counties.

Who Can be Auditors to Municipalities and What are Their Responsibilities?

Under the provisions of the law, an auditor (being either an individual or a firm) need to be registered in the list maintained by the Chamber of Hungarian Auditors in order to be allowed to audit budgetary annual reports, and also need to have a “budgetary” qualification. This budgetary qualification is not clear, since the individuals who are trained as auditors will receive a qualification “certified auditor”, without any further specification, which is right since they all have to pass the same exams regardless of earlier education or experience. Regulations will need to be amended to give clear definition of preconditions for registration as “certified auditor with budgetary qualification”; also the Chamber of Auditors will need to announce their position..

The authors of this article think that this kind of “labeling”, i.e. making distinction between auditors is necessary, because different kinds of tasks are involved. Due to special features in budgetary financial management, the complex municipal services, the financing system, and regulations on municipal and financial management practices are not easy to understand. In budgetary financial management, appropriations and associated accomplishments are the prime areas for auditing. It should be determined whether the use of appropriations is effective, justified, and in compliance with laws. Only as a next step after that, the auditor can start checking whether the accomplishments stated are real ones and are supported with basic documents, whether the general ledger, the sub-ledger and the inventory are in compliance with one another. The auditors task is different also because municipalities all prepare consolidated statements. There are some municipalities that have more than one hundred institutions belonging to them. Therefore the statements of institutions will need to be checked for reliability. Normative subsidies, targeted and addressed subsidies that are used by municipalities are very special items, as money movements within the public finance system and

outside the public finance system are. An auditor should not only know the specific accounting rules, but also be experienced in operations of the institutions and their service provision. While appraisal and review of assets and ability to generate revenue are the prime areas for auditing in the case of companies, auditors are supposed to focus on an optimum usage of assets owned in the case of municipalities. Effectiveness on municipal financial management is not something that can be expressed merely in financial terms, outcome is manifested in the quality of implementation. Therefore auditors are supposed to give an answer to whether the annual financial management in a municipality was in compliance with statutory requirements and other regulations as well as internal municipal procedures, whether the municipality did provide the basic, mandated services to citizens. In summary, auditing of budgetary organizations is different in quality, even if the methods or techniques used are similar or identical to traditional auditing methods.

Facilitating Auditors' Work

Auditors face new challenges when reviewing budgetary organizations. The State Audit Office has had an experience of more than half decade in auditing municipalities in relation to usage of budgetary resources, reviewing their situation in terms of internal auditing and managing assets owned. SAO, as the highest auditing agency, endeavors to provide technical assistance to municipalities in relation to carrying out auditing activities. The Methodological Committee of SAO is coordinating the preparation of a publication entitled "*Guidelines to Auditing Municipal Annual Reports*". The publication will cover specific tasks in auditing, and also give an overview of municipalities' roles in the system of public finance, as well as the checks municipalities are required to effect, experiences gathered through audits by SAO so far, as well as trends in developments in municipal auditing. The publication is expected to be completed in August, and will provide useful information to auditors and municipalities alike.

Will the Content of Municipal Auditing Change?

One of the reasons that has led to mandatory auditing of municipalities was that the authorization provided by laws is not sufficient to accomplish tasks involved. Another reason was that the situation has ripen for mandatory auditing in public finance due to liberalization in financial management, restrictive economic policy, necessary austerity measures, as well as complicated and many times imperfect accounting regulations.

Revenues and expenditures of the municipalities listed in the law on stabilization account for about two-thirds of the public finance revenues and expenditures of municipalities in total. Therefore a good proportion of municipalities are covered as far as auditing is concerned. The statement is especially true for municipalities that employ permanent auditors. Therefore audits by SAO will need to be reengineered. SAO will continuously be entitled to effect audits to their discretion at any municipalities, moreover can review even audited reports. However, even the appearances of supervision will need to be avoided, emphasis should be shifted on other areas. More time can be devoted to ensuring appropriate use of assets, efficient internal auditing procedures, or reviewing the financing system as a whole and reveal any problems to it. Performance monitoring is an equally important activity that should be introduced, since it is well-known that many areas in public services can be measured for performance. There are

performance measures that can be used in education, health and social allowances, maintenance and renewal of local roads and bridges and many other areas.

Therefore, mandatory auditing of municipal budgetary reports also means that auditing by SAO can be filled in with more content and requirements.

Purity in municipal auditing is ensured by several factors: on one hand, auditors are obligated to provide good quality services by law, and their own professional liability and self-esteem, and on the other, the State Audit Office will be entitled to inspect audited books at any time, which will mean that SAO will be able to carry out technical audits in other areas with clear conscience.

NEW REGULATIONS IN THE BUDGETING OF THE GOVERNMENT AGENCIES

The Hungarian government announced its Decree No. 54/1996 “On the regulation of reporting and accounting requirements of government agencies”. The decree was published in the “Magyar Kozlony”, No. 28.

The approval of the new regulation was necessary for two reasons: the modification of the Law on the Budget and the establishment of the Hungarian State Treasury. The law stipulates that government agencies will have to operate in a more efficient way and use public resources more rationally. They will have to put a larger emphasis on planning their estimates (statement of costs) and spending their resources according to these plans.

In the frame of the Budget reform, the Hungarian State Treasury was established in November 1995, after several months of preparation. With the establishment of the State Treasury, the conditions for retrospective financing of government agencies and separate state funds were assured.

These two major changes underlay the modifications of the accounting regulations in 1996. By introducing the retrospective financing method, the bank accounts of government agencies and funds were closed, and they were replaced by new accounts for the use of estimates. This created a new type of relationship between the treasury and its client institutions.

The changes of the new decree can be summarized as follows:

- budget estimates became part of the closed system of double-entry bookkeeping,
- both the estimates and the use of the estimates have to be recorded according to the functional and the economic classification of the double entry bookkeeping system,
- as a result of the previous changes, a new development is that account group no. 7 includes total expenditures and not only the current expenditures according to functional classification.

Reporting requirements

The government decree did not introduce major changes in reporting requirements. Regulations concerning the annual budget report and its deadline remained the same. The regulations concerning the forwarding and processing of reports were not modified either. Supervisory agencies will have 15 days to review the reports instead of the previous 12 days.

The annual budget report will consist of 4 parts in the future as well. These are:

- balance sheet

- cash flow statement
- cash balance statement, retained earnings from budget estimates statement, income statement,
- supplements.

The new name of the “Balance Sheet” is “Accounting Balance Sheet”. The modification is justified by the fact that agencies prepare more kinds of financial statements such as asset statements, statement of earnings etc. From these statements the government had to select the one to be included as part of the annual report. In municipal circles the term “asset statement” is not used in a correct way and it is misleading. In the “accounting balance sheet” - according to the Law on Accounting - the items are entered at their historical value while the items of the asset statement are entered at their current market value. If we compare the two statements the importance of differences are clear.

The structure of the “accounting balance sheet” remained the same. The asset side does not include any changes compared to the 1995 effective balance sheet. However, some new items are included under liabilities such as retained earnings from primary activities and business activities. The new items can only be used by government agencies and funds. These institutions will show the retained earnings from budget estimates instead of business activities or cash. Municipalities and government agencies that belong to the authority of municipalities will use the same entries as before.

The cash flow statement of the budget report has the same structure as the budget itself. As the 1996 budget hardly differs from the previous budgets, the cash flow statement did not change either. When preparing the cash flow statement, government agencies have to take into consideration that the VAT of development expenditures is included under development expenditures and not under material expenditures any more.

The Financial Part of the Supplement consists of 16 tables with required contents and format. These tables are included in the Appendix of the decree as well. Appendix no. 17, the general ledger, contains new rules. Every government agency has to prepare such a general ledger to underlie the annual report and has to keep them. The general ledger is part of the annual budget report, however, it does not need to be forwarded for processing.

The traditional General Ledger includes the number and the name of the accounts and four columns. The first two columns show turnover data and the third and the fourth show balances.

The general ledger presented in Appendix 17 contains 12 columns, in addition to the names and numbers of accounts. The 12 columns are separated into 3 blocks. The first block includes the turnover and balance data of Statement of Operations accounts, the second block includes the turnover and balance data of the Budget Estimates Accounts and the third the Cash Flow accounts.

The balance data of each block underlie the entries of the annual accounting balance sheet. The debit amount of the balance accounts correspond to the “total of the asset entries” on the accounting balance sheet. The same way, the credit amounts correspond to the liabilities on the accounting balance sheet. (When you compare the values you have to take into consideration other balances such as depreciation.)

The balance data of the Cash Flow and the Estimates Blocks correspond to the estimates and cash flow balance of the Cash Flow Statement.

The preparation of the new General Ledger does not require more work, because the most widely used softwares were developed by taking into consideration the new government decree. The programs select the accounts according to the requirements of the new general ledger.

Report no. 1 of the Supplement includes the balance of the estimates. The aim of this statement is to present the modifications in the estimates categorized by authority. From 1996, if they do not receive resources from the E-fund, municipalities and government agencies can not modify estimates in their own authority any more. In case of government agencies the modifications can only be entered by the supervisory agencies. If the supervisory agency does not receive information on the modification automatically, the government agency is required to inform the authority.

If we interpret the Law on Local Government and the Law on the Budget, municipal agencies can not modify their estimates in their own authority either. According to the Law on the Budget, the total estimates of the local governments are comprised of the estimates of their own and their institutions. The Law on Local Governments stipulates that estimates of the municipalities can only be modified by the approval of the council.

Therefore the leaders of the different institutions can only propose changes in revenues or in the transfer of funds. The council will have to approve any increase in the estimates.

As a result of these changes, the structure of the statement changed. The columns that included the modifications is now separated into two columns. One of them can be used for modifications proposed by the head of the municipal institution, while the other includes changes initiated by a supervisory agency.

There are not any more changes in the structure or the contents of the original Supplement.

Accounting requirements

Accounting of estimates

Government agencies showed their estimates in account group no.0 until the approval of the new government decree. For the sake of more exact accounting, however, estimates are

included in the account groups no. 1-9.

Where and how do you have to show the estimates? To put it simply, you have to show an estimate in the group of accounts where the balance is included.

As we have mentioned earlier, estimates need to be recorded completely by economic categorizes, that is, according to the legal title and also by functional categories, that is by tasks. Therefore estimates need to be recorded in account groups no. 1,3,4,5,9. For bookkeeping purposes technical accounts are used too, which are not balance accounts. These technical accounts include account 351. "Estimates accounts" and no. 496 "Estimates closing accounts". Accounting for estimates should comply with the following procedure:

By economic categorization:

Estimates expenditures: D351 -C 1.,3., 4., 5.
Estimates revenues: D4., 9 -C 351

Estimates of development expenditures (investments, renewal and the related VAT) are recorded on the credit side of account group no. 1, estimates accounts.

The estimates of money received should be shown on the credit side of account group no. 3., estimates accounts.

"Loan installment" and "Bonds payable" estimates should be recorded on the credit side of account group no. 4, estimates accounts.

Operating expenses estimates (such as labor costs, social security, and material costs) are shown on the credit side of account group no. 5, estimates accounts.

Estimates of financial transfers received are recorded on the debit side of account group no. 4, estimates accounts.

Revenues from operations, special municipal revenues, accumulated and other capital income should be recorded on the debit side of account group no. 9, estimates accounts.

By functional categories

Estimates expenditures: D351 -C 7
Estimates revenues: D9981 -C 351

The estimates expenditures are shown by tasks on the credit side of account group no. 7.

The estimates revenues are recorded on the debit side of general ledger account no. 9981.

General ledger account no. 9981 has to be opened including categories by tasks.

Estimates accounts are not balance accounts, therefore they have to be closed at the end of the year. For closing account no. 496 “ Estimates closing accounts” should be applied.

At the closing of General Ledger accounts you have to observe the following procedure:

By economic categories:

Estimates expenditures:	D 1.,3., 4., 5.	-C 496
Estimates revenues:	D496	-C 4., 9

By functional categories

The closing items are not the same for the institutions that belong to Treasury’s system and for those which do not. Government agencies and separate state funds have to use the following accounts to close their estimates:

- 425. Estimates expenditures from primary operation
- 426. Estimates revenues from primary operations
- 427. Estimates expenditures from business activities
- 428. Estimates revenues from business activities

Accounting entries

Estimates expenditures:	D7	-C 425 or 427
Estimates revenues:	D426 or 428	-C9981

Closing items for those institutions that do not belong to the Treasury’s system (such as municipal institutions, social security agency etc.):

Estimates expenditures:	D7	-C 496
Estimates revenues:	D496	-C 9981

Modifications in estimates have to be recorded continuously during the year.

Accounting of investments

When accounting for investments, the respective regulations of the Law on Accounting, the principles presented in the Law of the Budget and the regulations on investments and operations stipulated in different government decrees have to be followed. To satisfy all these requirements, the structure of the account group no.1 had to be modified. We can fulfill all legal requirements by dissecting the general ledger accounts of account group no. 1 in 5 digits. The

first position is always 1. This integer shows that the particular asset serves the operation of the government agency for longer than one year. The second digit shows the type of the asset. The second digit includes the following categories:

1. immaterial items
2. real estate
3. machinery, equipment, facilities
4. vehicles
5. government reserves, and the so called large investments
6. assets transferred for operation and administration
7. invested financial assets
8. VAT of development expenditures

If we compare the original numbering system and the new one, we can notice the following differences.

Account groups no. 15 and 16 which included investments and estimates were eliminated. Account groups no. 18 and 19 were consolidated with account groups 16 and 17.

The contents of account group 18 was modified. As we have mentioned earlier, the introduction of this account group was necessary due to changes in the planning mechanism. The application of account group 19 is forbidden for every government agency, the government decree refers to it as a “designated” account group in the appendix.

The third digit of the general ledger account shows the type of transaction. These are:

1. activated invested assets
2. depreciation
3. purchase of invested assets
4. renewal
5. budget estimates of purchase
6. budget estimates of renewal
7. investments in process
8. prepaid expenses for investments
9. technical carry over accounts.

The appropriate structure of the general ledger assures the necessary data for the Cash Flow Statement.

The fourth digit shows the use of the asset.

1. for operations
2. for professional activities
3. for welfare, cultural and sport activities.

The fifth digit also refers to the use of the asset.

1. for primary operations
2. for primary operations and business activities together
3. for business activities.

If the value of the fifth digit is zero, it means that the asset is fully depreciated.

The entries for purchases and renewal changed too. The expenditures for professional activities include all expenditures to underlie the Cash Flow Statement in the annual report and other requirements. Completing the previous system, we have to account for expenditures by activities (categorized by functions) together with the investment expenditures by title (purchase, renewal).

An equipment for example need to be recorded as follows (on a 3 digit general ledger):

1. D 133 - C341 or C3521
2. D7 - C412
3. D131 - C139

In every account group, as we have said, the third digit is 9 if the account is only a technical account, which is not a balance account. If you look at the previous recording procedure, you will notice that you have to credit the account at activation. You only debit the account at the closing, when the balance of the so called transaction accounts (purchase, renewal general ledger accounts) are entered.

Accounting of supplies, receivable and securities

These items belong to current assets. Current assets are recorded in account group no. 2. As a change, account group no. 31 and 32 which included receivable and securities were transferred to group 2. This change was necessary because in group no. 3 new items were introduced due to the establishment of the Treasury. There is no change in the method of accounting and record keeping in account group no. 2. A structural change is that some of the account groups were designated for additional types of entries so that group 28 and 29 could serve the accounting of the receivable and securities. However, during the year, you do not need to keep records either on the supply accounts or on the receivable accounts. You only have to record value differences, so that at the end of the year these records show the same supplies and receivable amounts as the analytic bookkeeping system.

You need to keep records by functional categories in case of the sales and the purchase of securities. At the purchase of securities for example you have to keep the following procedure:

By economic classification

D2933 - C341 or 3521

By functional classification

D7 - C299

(Account no. 299 is a carry over account for securities.)

Accounting of financial transactions

The third group of accounts serves the accounting of financial transactions of government agencies.

Account groups 31 and 32 can only be used by the Treasury.

Account groups 33 and 34 show the financial assets.

Government agencies that belong to the treasury's system can not use account group no. 34 (bank account transactions) because they do not have bank accounts.

Account group no. 35 includes the "use of estimates" accounts for those institutions which belong to the Treasury's system and can not use group 34.

Account group no. 36 is designated for an additional purpose, to account for foreign currency transactions.

Account group 37 and 38 include estimates of money received and the use of the estimates. To be able to fulfill the requirement of accounting by functional categories, the account no. 389 is used for carrying over balance. For example the accounting for money transfer for investment out of the government requires the following procedure:

By economic classification

D3752 - C341 or 3521

By functional classification

D7 - C389

Account group no. 39 includes active financial transactions. The institutions that do not belong

to the Treasury's system can use this account the same way as before. In the case of agencies that belong to the Treasury's system, the aim is to include these items in the circle of total expenditures. As a first step these agencies have to account for prepaid expenses in account group no. 5 from 1996 and not in "settlement accounts"

Accounting of costs

Government agencies show their expenditures in account group no. 5 categorized by economic classification. The structure of account group no. 5 follows the basic structure of the budget used by these agencies. Since there were no major changes in the structure of the budget, there were no important changes in the accounting of costs either. There is only one modification which is worth mentioning. From 1996 the VAT of development expenses are not shown in account group no. 57.

A main feature of account group no. 5 is that estimates and the expenses charged on these estimates can be connected. For example:

5111. Estimates for salaries

5112. Use of estimates for salaries

The balance on the General Ledger shows how much over-expenditure or saving occurred. According to the government decree the government agencies record their expenses and revenues related to estimates in account group no. 5. Therefore new accounts were introduced in this group, including:

518. Prepaid fees

5491. Prepaid fuel

5492. Prepaid per diem

5493. Prepaid heating

5494. Other prepaid purchase

The estimates expenditures are recorded on the debit side of the appropriate general ledger account, and the prepaid costs are entered on the credit side balanced by the respective expenditure account on the debit side. For example, the entries in connection with advanced travel costs are as follows:

D5492 - C 331 HUF 2,000 Entries of advances for travel from petty cash.

(The actual cost was HUF 2,400.)

D 51623 - C 5492 HUF 2,000 To account for the advance

and

D 51323 - C 331

HUF 400

Account group no. 59 includes the technical accounts. For example the depreciation, and the accounting for expenditures without money in connection with the primary or business activities.

In account group no. 6 - which contains the indirect costs - the only change was account no. 69. Account no. 69 has not been used by government agencies yet. According to the new regulations account group no. 69 includes the advance VAT payments.

The accounting of advance VAT payment by functional categories should comply with the following principles:

- if it is clear which activities can be charged with the VAT, the best is to include the item under the expenditures of the respective activity
- if the activity is not clear, only the place of the expenses incurred, the expenditure can be charged to one of the accounts between 61-68
- the use of account 69 is necessary only in exceptional cases. For example, if we do not know the activity on which we can charge the expenditure and we want to distribute the costs differently from the structure of the accounts 61 - 68, we can use account 69.

In account group 7 we show expenses completely, classified by functional categories. There was no change in the method of accounting. Agencies can develop the contents of the accounts in their own authority. However, there is an important requirement: every activity should include an estimates account and a use of estimates account.

Account group no. 8 can not be used by government agencies.

Accounting of revenues

The accounting of revenues in account group no. 9 is closely connected to the basic structure of the budget. As you know, there were no changes in the structure of the budget, therefore account group no. 9 was completed with the estimates only.

Similarly to the structure of account group no. 5, the aim is that a government agency would be able to connect the estimates revenues categorized by economic classes to the use of estimates. For example:

9111. Revenues estimates connected to the primary activity

9112. Use of revenues from estimates connected to the primary activity.

The balance of the two accounts show either over expenditure of revenues or saved revenues.

Accounting of revenues by functional categories on account 998 “ Accounting revenues by functional categories” comply with the following rules:

D 999 - C 9982

(Account no. 999 is the carry over account of account group no.9.)

Annual closing of the use of estimates accounts

At the end of the year, the estimates expenditures accounts have a debit balance, while the estimates revenue accounts have a credit balance categorized according to both economic or functional categories.

The closing of the estimates accounts are done according to the following example:

By economic categories:

D 119	- C 113
	C 114
D 129	- C 123
	C 124
D 139	- C 133
	C 134
D 149	- C 143
	C 144
D 189	- C 1812
	C 1822
D 389	- C 37-38
	use of estimates accounts
D 46-47	- C 479
	use of estimates accounts
D 59	- C51-58
d 91-98	- C 999

By examining the listed items you can see that the at the closing of the use of estimates accounts you have to account inside the group of accounts.

By functional categories

The closing items are not the same for the agencies that belong to the Treasury’s system and for those which do not. Government agencies and separate funds close according to the following

rules:

Net expenditures	D 425	-C7
	D 427	
Net revenues	D 9982	-C426
		-C428

Agencies which do not belong to the Treasury's system have to use the following procedure:

Net expenditures	D 492	-C7
	D 495	
Net revenues	D 9982	-C494

In case of government agencies that belong to the Treasury's system, the savings from estimates expenditures are shown on accounts 425 and 427. The over-expenditure of revenues are shown on accounts 426 and 428. For those agencies which do not belong to the Treasury's system, these accounts are no. 494 and 495.

Transitory accounting

Government agencies had to open their books according to government decree no. 179/1991 (December 30) until 1996. In practice this meant that they had to open their general ledgers and books by applying the 1995 account mirror and programs.

The closing regulations of government decree 54/1996 require the use of new accounts from June 1996. The change can take place automatically because every old account corresponds to a new one.

However, we have to emphasize that accounting by functional categories was not complete in 1995. Therefore the items used in 1995 need to be completed. These additional items include expenditures accounted in account group no. 1 and 3 by functional categories. We also call your attention to the requirement that expenses without VAT accounted in account group no. 9 need to be completed with the assets as well.

THE ORGANIZATION AND FUNCTIONS OF INTERNAL AUDITING IN LOCAL GOVERNMENTS

by József Nagy

Section 2 of Par 48 of Act LXIII (1994) modifying the Act on Local Governments (1990) requires that the auditing of the financial management of local governments be performed by an internal auditor with certifications as required by law. The modification emphasizes the independent auditing activities rather than the development of an internal auditing system. The responsibility of internal auditing raises several questions.

Auditing is present everywhere in the chain of management and is an element of leadership. If operations become of a broader scope and more diverse and leadership and executive function become separated, control by leaders becomes insufficient. A unified system of internal auditing has to be established and operated in order to put financial management under on-going control.

The Internal Auditor in the Organization

Due to the special principle of division of functions, in local governments the council is responsible for much of the financial management (For instance, the council is responsible for the security of financial management.) This has led to the idea that the internal auditor should be directly subordinated to the council. Although the general leadership function of the council cannot be questioned, *it seems more proper to put the internal auditor under the direct control of the mayor*. Operational financial management is the responsibility of the mayor's office and the head of this office is the mayor him/herself. Therefore it appears adequate that the internal auditor follow the instructions of the mayor. Nevertheless, it would be a mistake to require that the auditor be controlled exclusively by the mayor. The scope of competence and responsibilities of the city notary has become better defined in the area of financial management. *Therefore it is reasonable that the mayor cooperate with the city notary in defining the auditor's activity*. This is also reasonable because employer's rights over the employees of the mayor's office are exercised by the notary. The rules of internal auditing should include the internal auditing activities, leadership (mayor and notary) authority and requirements of cooperation. These rules should mention the responsibilities of the Financial Committee - as defined by the Act of Modification referred to above.

Elements and Techniques of Internal Auditing

There are several categories within internal auditing:

- leadership control
- control integrated in operation
- independent internal audit

The various elements of control are present in practical operation in a differentiated way and to different degrees. In about two thirds of 3200 local governments the main control is exercised by the leadership.

The development of the auditing/control system depends on the type and size of the individual budget institution. The bigger the local government or the institution is, the more complex its responsibilities are, the more differentiated its functions will be. And this entails a decentralized type of management and leadership control.

In order to provide an efficient leadership control, local government leaders must have information about basic financial management and operational processes.

The higher leadership has to monitor:

- whether budgeted items are adequate for sectoral responsibilities;
- where the budget can be cut and where resources have to be channeled to;
- how revenues are collected and whether the local government will meet revenue estimates by year end;
- whether expenditure estimates cover the costs of carrying out services;
- what additional resources should and could be involved to carry out major services.

Leadership control can be performed periodically or in an on-going manner, as an integral part of management activities. Leadership control is more effective if exercised on an on-going basis. An organizational precondition to this is that information necessary for decision making is obtained in time by the given level of leadership. Therefore local governments should operate *an information system that ensures access to up-to-date information.* Local government leaders may obtain financial information from planning documents, annual budgets, monthly balances, accounting and annual and bi-annual financial reports.

One way to exercise leadership control is to evaluate information and analyses, including the evaluation of data from public administration, various sectors as well as financial - accounting and other data. This element of leadership control is based on the internal information system. In creating such a system it is extremely important that leaders at various levels have access to data relevant to their level in management. These data have to make the analysis of implementation and financial management possible, however, at the same time must not be overly abundant and detailed which would overwhelm leaders.

Exercising signing, issuing orders of payment and countersigning rights is differentiated depending on the various scopes of competence. The right of signing and issuing orders of payment becomes a tool of leadership control only if it works as a conscious “screening system”. For example, by filtering out resolutions, contracts or obligations drafted not in compliance with rules series of mistakes can be prevented. In implementing the budget, the activities of undertaking an obligation, countersigning it, validation, issuing the order of payment and countersigning follow one another. The undertaking of an obligation is valid only with the issue of order of payment and countersigning.

Countersigning should be operated as a tool to check on:

- whether the obligation serves meeting the responsibility of the local government or institution;
- whether the budget estimate can finance the costs of the obligation;

- whether there was a tender and the best offer was contracted;
- whether the contract includes all guarantees necessary to ensure safe financial management and serve the interests of the local government;

Countersigning the order of payment checks:

- whether the product was taken, the service provided, whether its quality and quantity has met what is required by regulations or by the contract;
- whether the billed per unit price is the same as in the contract;
- whether the product was approved in terms of quality and quantity, whether the bill includes those appendices that are required by voucher regulations.

High level leaders can ask subordinated managers and staff to report on the accomplishment of tasks and on the state of implementation. Holding meetings regularly concerning major services makes leadership activities more efficient. Requiring reporting in a consequent manner is an important leadership tool.

In local governments (cities) and institutions with complex responsibilities there are the following levels of internal leadership control:

A) Higher level leadership control

- mayor, head of institution
- deputy mayor, deputy head of institution
- notary

B) Medium level leadership control

- department heads
- office heads
- section heads etc.

C) Lower level leadership control

- group heads
- staff

The mayor, notary, district notary and head of institution have also to control how their co-leaders use their authorities. In auditing activities exercised at the medium level, specialized knowledge is of great importance as such persons have to perform detailed auditing.

Reporting can happen regularly, occasionally or in important periods of time, and can be performed at meetings, verbally or in writing.

It is suggested that memos should be written to summarize meetings. Purposefulness and effectiveness of meetings can be enhanced by drafting activity plans and documenting the

making and implementation of decisions. Writing reports is useful not only because they are documents but also because it disciplines staff.

Site auditing helps understand local problems and evaluate performance. The power of this technique resides in the direct personal contact. Site auditing is best if performed with a pre-established frequency.

Auditing as an Integral Part of the Operation Process

A precondition to develop an integrated auditing is that *the financial management processes of the various fields should be well organized*. Check points have to be built in the processes. The individual management tasks have to be performed in an order that makes all operations controllable. For instance, validation and checking bills happen at different stages but can be performed only after the previous operation and its checking has been done.

Having the issuance of the order of payment and its countersigning before payment integrated in the operational process means that it has to be checked whether the supply has arrived, whether it has been entered in the books, whether attached documents meet the requirements of the voucher system and whether the documents bear the necessary signatures. (These responsibilities are included in the operation rules of the finance department and the senior staff member's job description.)

After payment comes the analytical recording. Analytical records have to be reconciled with stock records at least quarterly. This stage of the operation is included in the rules of the accounts system and job description of the supplies book keeper.

The integrated audit system is effective only if scopes of competence and responsibilities concerning the various financial management and management tasks are defined in internal regulations. It has to be regulated who does what and when. Further responsibilities have to be included in the job description of employees. For instance: responsibility for the assets of the stock manager in a unit is defined as follows:

- takes care of keeping, storing supplies taken in and keeps the records as required;
- writes vouchers in relation with stock audit;
- writes the inventory quarterly on the basis of which reconciles the unit's assets with the district records and the analytical records;
- investigates potential differences and reports them to the finance department head;
- makes proposals regarding scrapping.

Within the framework of integrated audit, book keeping vouchers have to be checked before booking:

- whether they are complete;
- whether they are correct in terms of format and content;
- whether are entered in the right account

Vouchers have to be categorized by type of journal before booking.

To find out whether they are correct, the figures in cash and bank books can be checked against bank account abstracts and by reconciling cash book reports and total turnover in journals. In other areas of ledger booking there are no such check point figures available. In order to better ensure the correctness of figures in books, such figures can be developed. The closed system of double entry book keeping is also an audit tool in the accounting system. By preparing the balance of the accounts in the ledger and by providing periodical abstracts of the ledger entered figures can be checked.

Concerning audit integrated in the operation process the following should be examined

- whether check points are identified;
- whether the scope of competence of auditing is defined
- whether points of reference (what considerations the auditing should be based on), frequency of audits system of feed back (who should be notified about faults, what has to be done in remedy) are defined
- whether there is incompatibility between responsibilities.

In this kind of auditing there are three categories: *self-auditing, additional auditing of staff and independent special auditing.*

Self-auditing - work accomplished by the individual is checked against requirements - is a basic form of auditing integrated in the process and is an organic part of the system. This form of auditing requires autonomous activities and a sense of personal responsibility to be consciously encouraged. Self auditing is most typical in drafting cash balances and in internal reconciliation by the book keeper. However, in case of incompatibility, it is essential that auditing is done by another person too (e.g. cash handling and cash audit). Self-auditing can be applied in any process, nevertheless integrated audit has to be performed by some other person too.

The system of auditing integrated in the operation process builds first of all on the additional auditing of staff. This kind of auditing encompasses the whole of the operations in a way that the implementation of any operation is checked by a person doing another operation. For instance:

- in spending what is budgeted, invoices are validated and accounted (of course with due leadership control by issuing orders of payment and countersigning);
- monitoring the use of personal benefits;
- surveying the state of outstandings (local taxes, service fees in institutions);
- checking whether vouchers are completely booked;
- checking the reconciliation of analytical records and ledger;
- checking the reconciliation of ledger and budget reports etc.

In this kind of auditing, especially in procedures such as book keeping, automated forms of auditing are highly useful. A most important task of auditing is to guarantee the reliability of processed data.

In independent specialized auditing, it is recommended to carry out regular or periodical audits requiring specialized knowledge. In local governments independent specialized audits are extremely important.

Cash book audit. The cash book auditor checks cash vouchers, completeness of entries, legality of orders of payments before paying and correctness of amounts. Cash is audited daily, along with other assets handled in the cash office and are reconciled with the cash account. Cash audit can be performed on commission by one person (notary, district notary).

Bills audit. Its purpose is to check bills before paying them. (Especially important is to check whether what is in the contract has been accomplished, quality and quantity approved, correctness of prices and of calculations)

Inventory audit. Encompasses all operations concerning inventory and appraisal of assets (resources) and finding discrepancies. Inventory audit has to check the process of inventory. The inventory auditor should be independent from all staff working on the inventory. The auditor should sign vouchers and summaries in confirmation of what he/she has accomplished.

Auditing the use or scrapping of unnecessary assets. Scrapping is done with the cooperation and under the surveillance of the scrapping committee. Employees with experience in supplies and assets management as well as with technical background should sit in this committee. The committee should establish whether the given piece can be used, or the reasons for scrapping it and recommend scrapping and use of waste materials.

Independent Internal Audit

Independent internal audit is based upon a control program and is commissioned by the leadership in order to serve special leadership and control purposes. Its elements do not contradict, do not overlap but reinforce and complement each other and encompass the whole of financial management.

Independent internal audit can be performed by:

- a) full or part time employees of the organization (independent auditor, group or department)
- b) an employee doing several jobs (incompatibility has to be excluded; some one working in the area of cash and values management, accounting personal benefits must not audit.)
- c) by audit association. Local governments in an audit association sign an agreement that clearly states which of the associated local governments exercises employer's rights over the internal auditor working in the form of association. Employer's rights cover only basic issues such as salary and holiday arrangements. The annual number of working days of the internal auditor is divided between the local governments in proportion with their contribution to the auditor's salary. The subject of audit in the individual local government is determined locally. The audit

has to be carried out on the basis of the control program approved by local leadership. To use the outcomes of the audit is the responsibility of the local leadership.

d) Contracting an outside auditor is a form of independent internal audit, too. Local governments can contract anyone with the necessary professional qualifications to audit a specific subject or subjects. The contract has to be drafted carefully in terms of format and content, especially concerning the subject of the audit, deadline and payment.

When defining the task of the internal auditor, the organization has to consider its own

- size
- regulations of operations and financial management.

A) If the organization is small, leadership and executive functions may not be divided and thus the three elements of the internal control system do not exist. Generally, leadership control and periodical independent internal audit is sufficient.

B) Legislation and government decrees concerning financial management provide a framework of rules. Local regulations govern the definition of responsibilities of specific institutions, scopes of competence, deadlines and jobs to meet those responsibilities. Such regulations are the organizational and operational rules, procedures rules, accounting system, inventory rules etc. If these rules are missing or incomplete, do not meet their functions and do not provide the necessary internal organization that is the basis for the internal audit system.

In relation to internal auditing in local governments, often emerges the question what and how the internal auditor should audit. As for 'what', a more general answer can be offered, while for the 'how' a detailed and specific, professional one.

The internal auditor cannot be detached from the community in which he/she works. *It is proper that internal auditing tries to answer urgent financial questions that are central to the local government in the given period of time.* It is not sufficient that the auditor checks only the daily issues of compliance with regulations, but also should examine financial management in a comprehensive way.

Planning the audit

The best way to start planning the audit is to assess human and material resources and the number of audit days. Then it can be established what subjects can be examined in so many days and what should be delayed or performed by involving outside resources. A basic consideration is to coordinate task to be done and necessary resources (number of audit days), so that the audit plan's becoming a wish list can be avoided. To identify subjects for auditing, the opinion of the finance committee and the body of representatives should be asked.

Phases of the audit procedure

Phases of the audit are separate processes that are closely interrelated. The results of one process are a precondition to the success of the next one. However, the order of phases represent a logical order, and can be regarded as the technological order of the whole process.

When preparing for the audit, its subject has to be studied. All information that help identify the objective of the audit as well as activities and methods to achieve the objective has to be collected. The end product of the preparation phase is the audit program, consisting of three parts: Part I includes the objective(s) of the audit, Part II the subjects to be audited and Part III organizational issues of the audit such as the period to be audited, starting and closing date of the audit, the name of the auditor etc. as well as audit methods.

These are the formal elements in the program. The content element is how the program is organized and whether it is realistic. The program is realistic if the subjects to be audited can be examined by using methods of financial-economic auditing. It is desirable that audit programs are signed by the mayor and the notary.

In the preparation phase information necessary for the site audit has to be collected.

- Study technical literature concerning the objectives and activities of the audit and the organization in question;
- Consult experts;
- Exchange of experience with organizations and individuals conducting similar audit;
- Study provisions of law and leadership instructions concerning the organization to be audited;
- Study bylaws of the organization to be audited;
- Study plans, reports, correspondence, previous audit materials concerning the organization to be audited;
- Study the results of measures taken as a consequence of previous audits.

In the site audit the auditor has to carefully observe the rights and obligations of the local government. He/she may request only those data, information, vouchers, processed data that are necessary to accomplish the program. The audit has to be performed in such depth, may be beyond the program, that is necessary to establish a well-grounded, clear and full opinion.

The auditor uses both documents and logical thinking as tools of examination and uses a wide range of methods and techniques to establish his/her opinion and conclusions. The purpose of conflicting opinions is to clarify misunderstandings, wrong conclusions before putting them in writing.

Established facts, conclusions and proposals of the auditor are drafted in an internal audit report. *As for the format of such reports, there are two extremities:*

a) too wordy

b) too laconic

Both are to be avoided.

It is often a problem with the content that the reports are too much of a narrative with few conclusions by the auditor. A conclusion includes a brief description of facts, compares requirements to the actual situation and outlines negative processes and their effects. It is not

always clear for internal auditors in what cases and how they should raise the issue of personal accountability.

As the specific cases tend to be very different, only a general idea can be offered. Normally, making some accountable is proper if damages or transgressing the law can be proved. Accountability has to be specific and personal. The fact of guilt of negligence, the person committing it and its effects have to be put in writing and measures have to be taken accordingly.

A recognition and, if necessary an accountability, clause has to be attached to the report. The recognition clause is to be signed by a staff of the audited area and the accountability clause by the employee made accountable.

To reports revealing serious negligence, documents in evidence have to be attached.

The efficiency of the audit is enhanced if the council discusses the internal audit report and identifies measures to remedy mistakes. The best is if the mayor instructs the heads of units or the notary responsible for implementation to take the measures. It is the internal auditor's responsibility to follow up the implementation of these measures and carry out a follow-up audit.