



**NATIONAL UNIVERSITY OF PUBLIC SERVICE
Doctoral School of Public Administration Sciences**

SUMMARY

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Supporting Good Governance through the Renewal of the Operations and Activities of the Supreme Audit Institution

PhD Theses

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THE SETTING OF THE SCIENTIFIC PROBLEM

Nowadays, good governance is considered throughout the world to be an activity which promotes national prosperity, economic development and social participation. Consequently, the state sector is able to serve the needs of society, as well as the public good. The *modernisation of public finance systems, including the system of public auditing* is also part of this.

The recent global financial crisis once again brought to the foreground the necessity of having a higher quality of regulation and more effective public auditing. An interesting development of these changes is that the supreme institutions of external auditing have reinterpreted their roles; they no longer consider their mission to be limited to the regularity audits of public spending, but rather to influence the use of public funds and thereby the more effective operation of the economy, meaning that their activities should generate added value for society. *Leading audit offices consider their contribution to good governance to be their mission*, of which audits are just one tool.

In accordance with its strategy, the mission of the State Audit Office of Hungary (SAO) is to promote the transparency and regularity of public finances with its value creating audits performed on a solid professional basis, thus contributing to “good governance”. By now, good governance has become a concept that can be described with a complex set of criteria against which the performance of individual economic policies and state organisations can be measured.

It follows from the Fundamental Law, the legal status and tasks of public institutions and the values of public service, that each individual public institution and budgetary institution needs to clarify the core issues that justified its establishment and determine its relationship to the state, to the government and to the citizens.

This is the environment which inspired my choice of topic. On the one hand, by reviewing the relevant literature, I seek to answer the question of how to fill the catchy slogan of good governance with actual content. On the other hand, by studying the documents of the umbrella organisations of supreme audit institutions (INTOSAI, EUROSAT) and the modernisation efforts of top supreme audit institutions, I am collecting and evaluating those principles, approaches and best practices, with which these institutions attempt to contribute to good governance in an effective manner. Finally, by tying in organisational and management

science, I wish to introduce a few institutional organisational solutions that can help to truly transform supreme audit institutions into exemplary public sector organisations.

THE GOAL OF THE RESEARCH IS TO ANSWER THE FOLLOWING QUESTIONS

What approaches exist regarding the concept of good governance; what are their common features and how do they differ from one another? What are the elements of good governance to which supreme audit institutions can effectively contribute? To what degree do the activities of the State Audit Office of Hungary comply with the international standards of good governance? In which directions should supreme audit institutions change in order to be able to effectively contribute to good governance? How (with which tools and methods) can this change be accomplished? How does the new Act on the State Audit Office ensure the guarantees of independence? Did the State Audit Office receive the necessary legal mandate for supporting good governance through effective and productive audits, and its advisory activities? Which goals and key principles enable the state audits to contribute to the implementation of good governance with substantial and premium added value? Which factors necessitated the organisational and operational renewal of the State Audit Office? How did the State Audit Office contribute to introducing and propagating integrity culture? How did the reorganisation take place and what are its tangible results? What are the challenges that necessitate the modernisation of state management and the related SAO audits? How can the audit experiences of the State Audit Office contribute to the modernisation of state management? What are the basic conditions, goals, tools, scope and results of the support of good governance by the supreme audit institutions?

HYPOTHESES

H1: Supreme audit institutions are one of the key institutions in supporting good governance.

In performing its work the State Audit Office is guided by international audit office standards, its operation and activities are almost fully consistent with INTOSAI requirements and INTOSAI's criteria regarding model institutions.

H2: The State Audit Office received a legal mandate to support good governance. The independence of supreme audit institutions is a fundamental pillar of their contribution to good governance. Legal regulations guaranteeing the State Audit Office's independence fully comply with relevant international principles and standards. The

new Act on the SAO strengthened the SAO's audit mandates, thereby ending the era of audits without consequences.

H3: The State Audit Office employs objective and transparent audit standards, processes and methods, and also continuously develops its quality-controlled operation, effectively applying modern organisational and management methods, and flexibly reacting to changes in the environment and to arising risks.

H4: A key element in implementing good governance is to significantly curb corruption and disseminate effective institutionalisation in the world of public finances and public property. The State Audit Office played an outstanding role in introducing in Hungary the integrity model, which supplements the generally applied repression-based approach.

H5: By auditing, analysing and evaluating budgetary processes, the State Audit Office significantly contributes to the stability, transparency and reliability of the budget, and to the compliance with the Central Budget Act. The State Audit Office supports the modernisation of state management and the operation of a well governed state by sharing audit experiences and providing detailed recommendations.

H6: As a result of the dissertation, a comprehensive model is created, outlining the role of supreme audit institutions in support of good governance, which in turn shall enable the State Audit Office to support the operation of a well governed state in a sustainable and continuous manner.

RESEARCH METHODS

a. Literature review and analysis

- The review and classification of the relevant literature; the exploration of good governance related theories, models and practices.
- The review of declarations adopted at INTOSAI congresses, INTOSAI standards, and associated UN general assembly resolutions.
- The study of the effects of switching to accrual-based accounting on the basis of a document drafted by Federation of European Accountants and Auditors.
- The review of EUROSAC's congressional decisions and survey experiences. The review of documents describing the strategies and activities of Spanish, French and Dutch audit offices.

- The review of materials of INTOSAI's congress on capacity building, as well as the materials of its Committees on Capacity Building and Knowledge Sharing.
- The analytical evaluation of documents regarding the requirements and opportunities of the modernisation of SAIs (academic papers, publications and standards of international organisations, etc.).
- Document analysis (the review of the strategic and theoretical-methodology documents of international organisations and national supreme audit organisations, according to the established perspectives of the doctoral dissertation).
- The review and presentation of international and domestic best practices in a case study format.
- International comparative analysis, longitudinal comparative legal analysis.

b. Empirical Research

- International questionnaire survey of 34 European countries, examining the independence of supreme audit institutions.
- Longitudinal study “Integrity survey – A map of corruption risks”

c. Audit and Institutional Experiences

- The review of the SAO's audit and other experiences with regard to switching to accrual-based accounting and in connection with supporting sustainable development.
- The review of international literature regarding the management and governance of publicly owned companies, the comparative analysis of domestic laws, regulations and international standards. The review of the experiences of 113 SAO audits.
- The analysis of the audit planning strategy, processes and results of the State Audit Office. The review of the State Audit Office's reports and the documents on utilisation.
- The analysis of the State Audit Office's audit-methodological modernisation and its training framework.
- The review of the relevant key literature on organisational development. The analysis of the SAO's partial strategy on organisational development. The impact analysis of the organisation's transformation.
- The review and evaluation of data concerning supreme audit institutions, primarily the State Audit Office of Hungary, using statistical methods.
- The creation of the “Contribution of supreme audit institutions to good governance” dynamic model.

A CONCISE DESCRIPTION OF THE RESPECTIVE AREA OF STUDY, BY CHAPTER

Chapter 1: Introduction

Chapter 2: The substantive requirements and typical characteristics of good governance

The chapter seeks explore the approaches regarding the concept of good governance, as well as their common features and differences. In light of the broad spectrum and complex duties of those who participate in governance, how can the various concepts be used in certain areas of governance?

Nowadays, good governance is considered throughout the world to be an activity that promotes national prosperity, economic development and social participation, through which the state is able to serve the needs of society, as well as the public good more efficiently. There are debates, however, as to how the level of quality of governance systems can be better improved through various activities, processes and institutions.

By exploring the more favourable impacts related to the elements of good governance, using research and analysis, the scope of substantive elements of good governance has gradually expanded. The chapter reviews the objectives and general fundamental principles of good governance that emerged as a result of this expansion - synthesizing the fundamental principles used by various nations - based on the experiences of *international organisations and integrations*. The key international organisations mostly agree on the fundamental principles of good governance, however the differences are also noteworthy; these play a significant role in the evaluation of good governance (performance management; political and administrative structures, the operation of risk management and anti-corruption measures taken). The chapter presents the content of the core principles as international best practices based on the methodology and practice employed by APEC and the methodology guideline of the European Union.

We can identify two main interpretations of good governance; the first focuses on the intensified use of the substantive elements of governance, while the second trend distinguishes the activity and the process within good governance. There are seven fundamental principles and goals of good governance where the key roles of good governance and state audits are close related: legality, transparency, accountability, performance management, the operation of risk management, ethics and anti-corruption.

Chapter 3: State Audit Institutions and the UN in the service of good governance

The chapter examines how state audit institutions and their international organisations support the implementation of good governance. Dedication to good governance appears among the objectives of state audit institutions, the foundations of which are laid by the declarations adopted by the state audit institutions (Lima, Johannesburg, Beijing). Pursuant to the Lima Declaration, the effective utilisation of public finances necessitates the establishment of a state audit institution in every country, the independence of which is guaranteed by law. One of the traditional duties of a state audit institution is the regularity and compliance audit of processes related to public funds; the another is the performance-based audit of these processes, extending not only to specific public finance transactions, but also to the organisational and administrative systems of governance. The Johannesburg declaration further encouraged national audit institutions to take on greater roles in the interest of supporting good governance. The Beijing Declaration further expanded the horizon of commitment by supporting good governance on a global scale. INTOSAI and the UN are cooperating in the review and management of issues of particular importance. Among these the first is to improve the accountability of governments and administrative authorities to their Parliament. Another important area is to enhance the transparency of government activities, and thereby assist the Parliament to take on a more active role. The third area is to develop public administration and public services, improve their effectiveness and strengthen their integrity. Finally, the fight against fraud and corruption in public administration and the prevention of corruption also necessitate the close cooperation of anti-corruption institutions. The fact that there are significant similarities in the current approaches to good governance provides a solid foundation for cooperation. One of the most important focus areas is the introduction of accrual-based accounting and programme-based budgeting into the public sector. The chapter introduces its reasons and impacts.

The chapter reviews the documents introducing the activities of the Spanish, French and Dutch audit offices.

Chapter 4: The realisation of good governance and INTOSAI requirements in the operation and activities of the State Audit Office of Hungary

This section describes in two steps, how and to what extent the operation and activities of the State Audit Office meet the international requirements. First the analysis - principles, goals and general standards - focuses on the question, if the SAO's characteristic features concerning the operation and activities are in line with the INTOSAI's principles on

independent model organisations and if the SAO can be considered as a model organisation – that satisfies most of the good government principles as well. In the second step those good-governance-principles are examined in the SAO's activity, which are not included directly in the criteria of the model institution.

The state audit office is only able to support good governance if its *constitutional status and independence* ensure that the institution delivers objective, unbiased findings and selects its audits and methods at its discretion. All this is critical to ensure the effective contribution of supreme audit institutions to good governance; therefore the legal standing, powers and independence of supreme audit institutions form the foundation upon which their good governance promoting activity is based. After the adoption of the Fundamental Law, the first cardinal act passed by the National Assembly was the Act on the State Audit Office. The new Act on the SAO, effective as of 1 July 2011, reaffirmed the independence of the State Audit Office in several aspects, and widened its powers, expanded its instruments, increased its transparency, and put an end to the era of audits without consequences.

Chapter 5: Directions of the SAO's modernisation programme

This chapter looks at the global challenges that necessitate the growing role of SAOs in global good governance; the ways the State Audit Office can contribute to supporting global good governance; and results has achieved in the recent period.

Governments regularly face newly emerging challenges that also influence audit activities. Therefore, shifts in international trends are typically observed in audits performed by SAOs, e.g. future orientation, longer-term outlook, capacity building and extensive knowledge transfer. One of the explicit goals of SAO's medium-term strategy is for it to become an organisation that is able to rise to the challenges of the time, adapt to change and thereby serve the benefit of society as a whole. Results achieved so far serve as a good point of departure for future development which has now become indispensable.

This chapter attempts to outline the major directions of a SAO modernisation programme. One of the main directions and purposes of the SAO modernisation programme is to become better prepared - primarily in a manner meeting INTOSAI requirements - to contribute to the establishment and functioning of global good governance.

One of the most important requirements of government planning and decision-making is the concept of sustainable development. Consequently, it is also an indispensable task for SAOs to integrate into their activities the monitoring and evaluation of national sustainability

strategies and programmes. This chapter presents the relevant summary conclusions and recommendations of INTOSAI, in consideration of which SAO has determined the directions of its activity serving sustainable development. Furthermore, an introduction is given to those pillars which underpin SAO's activity of this type.

The third direction of the modernisation process, which is also presented here, is the set-up of an innovative self-learning organisational system whose importance is also emphasised in SAO's strategy.

Chapter 6: The methodology of and experience from the fight against corruption based on a culture of integrity

This chapter seeks an answer to the question of to what extent legal thinking, emphasising repression, has been superseded and supplemented by what is known as the integrity model focussing on prevention, and what role SAO plays in this.

SAO's Integrity Project contains a number of initiatives. This chapter takes a detailed look at SAO's activities related to disseminating a culture of integrity and its quantifiable results. The research assesses what methodologies SAO has worked out within the scope of the Integrity Project in order to enhance public sector integrity; share “good practices”; and operate anti-corruption protective systems and, furthermore, in what manner it contributes to implementing the Government's anti-corruption programmes and training integrity consultants.

In addition, the chapter presents a longitudinal survey. SAO's “*Integrity Survey – A Map of Corruption Risks*”, a series of surveys conducted annually since 2011, is an internationally recognised scientific research programme constituting an important body of knowledge generated by SAO. The survey is designed to assess those risks which may have an adverse influence on the given organisations in the public sector. In addition to identifying risks, the survey also maps the level of availability of controls serving to handle such risks.

In Hungary, combating corruption was for a long time characterised by a fight between corrupt individuals and law enforcements agencies. A new approach was necessary to make anti-corruption efforts more effective and to identify and manage, i.e. prevent, corruption risks. A paradigm shift taking place in the fight against corruption meant the establishment of integrity-based thinking in Hungary, in which SAO had a decisive role to play.

Chapter 7: Contribution to the renewal of public management

Based on specialised literature, legislation and experience drawn from audits, this chapter identifies challenges necessitating the renewal of public management and related SAO audits; international recommendations concerning public enterprise governance and the extent to which the domestic regulatory environment and practice is consistent therewith; and audit experiences from public enterprise governance together with the system level problems such experience can reveal.

An important hallmark of the well governed State is how the State establishes and operates its institutional system necessary for it to fulfil its social role and deliver its services, the ultimate goal of which is to perform public functions in an effective, efficient and accountable manner by means of using available resources economically. One of the critical areas of public management is the governance of public and municipal (publicly owned) business associations. The chapter identifies the reasons for the renewal of state governance and the key factors of well managed public companies. From a legal analysis of effective legal regulations applicable to public enterprise governance it concludes that the framework ensured by legislation is consistent with international recommendations. At the same time, by means of a comparative analysis of SAO reports introducing experience from the audits of public and municipal business associations and published in the period 2011-2015, basic and recurring management problems with public finance implications can be identified, such as the absence or deficiencies of performance requirements, planning, cost price calculation and owner's control.

Chapter 8: The framework of capacity building

This chapter interprets the needs, processes and dimensions of capacity building. Capacity building means a set of actions, structures, abilities and knowledge that make an organisation efficient. Through presenting critical factors, processes and a framework laying the foundation for capacity building, the chapter examines opportunities to improve the functioning of SAO in the light of the role and implementation of sustainable strategic development objectives. As a first step, it presents the directions, areas of focus and utilisation of SAO audits. Then it introduces the concept and role of capacity building based on INTOSAI's interpretation. The system of capacity building is examined via two approaches, the first being the process and key issues, the second the dimensions of capacity building.

The chapter divides the dimensions of capacity building into three areas. The key issues of strengthening professional and audit capacity lies in renewing audit methodologies; establishing a related training framework; and a quality-driven operation. SAO supports

organisational capacity building primarily by operating a performance evaluation framework. In respect of capacity to cooperate with the external environment, the chapter discusses the subject of participation.

Chapter 9: Establishing an innovative self-learning organisational system

The chapter introduces the factors that made it necessary for SAO to renew its organisation and functioning; how organisational restructuring has taken place; and what results have been achieved.

After 2010, SAO carried out an action plan of improvements and interventions covering almost all aspects of organisational life. These organisational development interventions relied on different organisational development models and tools on the basis of several fundamental principles. It was important to ensure that interventions were based on well-founded and actual needs for change. The organisational development action plan focussed on the formulated objectives – based on a strategic cascade model – and, using a top-down approach, identified a range of essential elements in need of change.

The chapter gives an overview of the most important approaches to organisational development and then analyses those factors which called for renewal. It gives a detailed introduction to the different stages of reorganisation between 2010 and 2011; the shift to a matrix-type organisation and a project-based operation and the outcomes achieved. It devotes special attention to the operation of the risk analysis function and the importance of change management.

Chapter 10: The active SAO's contribution to good governance: the dynamic SAO model of good governance

SAOs are the principal guarantee of good governance. A SAO only fulfils its mission if it remains independent of the government but not independent of good governance. The chapter introduces a comprehensive dynamic model related to the supreme audit institutions' role in supporting good governance, which provides an overview and systemise the SAIs' contribution to good governance. The chapter introduces the fundamental conditions, principles, tools and scope of supporting good governance. The model can provide guidance to working out a standardised international set of requirements.

NEW SCIENTIFIC RESULTS

- I. This dissertation examines against a number of criteria how the activities of the State Audit Office meet the international standards of good governance. The thesis explores historical and international approaches to the concept of good governance, including their commonalities and differences and highlights those elements of good governance to which supreme audit institutions (state audit offices) can make an effective contribution. It has been demonstrated that in performing its work the State Audit Office is guided by international audit office standards and its entire functioning and activities are almost fully consistent with INTOSAI requirements.
- II. The paper points out that the independence of supreme audit institutions is not only a prerequisite of the objectivity of their audit activities but also the basis of those innovations which enable their more effective contribution to good governance. It analyses, by way of international comparison, the question of whether the Hungarian State Audit Office has received the necessary statutory mandate enabling it to support good governance through its effective and efficient audits and advisory activities. It provides evidence that the State Audit Office has received an enforceable statutory mandate to support good governance; that domestic legal regulations guaranteeing the State Audit Office's independence comply with relevant international principles and standards to an extent exceeding international guidelines; and that the new SAO Act has reinforced SAO's audit powers and guarantees.
- III. The SAO organises and performs its tasks as a model institution, which has significantly strengthened its capability to support, and even act as a guarantor of, the well-governed State. SAO as an independent model institution is basically suitable regarding the enforcement of the requirements of good governance and INTOSAI.
- IV. The thesis gives an account of how the State Audit Office has contributed to raising awareness of and disseminating the culture of integrity and proves that the State Audit Office has played an outstanding role in the domestic introduction of the integrity model that supplements the generally applied repression-based approach. Through its surveys, evaluative analyses and recommendations, the State Audit Office facilitates the application of the integrity model in the sphere of public administration and public services.

- V. Since a well-governed public sector is inconceivable without the effective and efficient governance of state- and local government-owned business associations, the paper identifies challenges that necessitate the renewal of state management and the related SAO audits. By reviewing the relevant international literature, it presents the rationale for the renewal of state management and the key factors of well-managed state-owned companies. A legal analysis of effective Hungarian laws concerning the management of state-owned companies showed that legislation provides management frameworks that are in line with international recommendations. By synthetising audit experiences, the paper analyses how to ensure that those involved in the governance of state- and local government-owned business associations perform effective and efficient financial management in the manner best serving the public good with respect to community assets entrusted to them for the purposes of public service, and which are ultimately owned by the citizens of a country.
- VI. The role of supreme audit institutions in supporting good governance has not been explained before by means of a comprehensive model. One of the main results of the academic paper is that - in consideration of the mandate and duties of the State Audit Office enshrined in the new legislation - it has constructed a model to provide an overview of and systemise the contribution of supreme audit institutions to good governance. What is known as the Hungarian model presents the basic conditions, principles, tools and scope of promoting good governance.

PRACTICAL USABILITY OF RESEARCH FINDINGS AND RECOMMENDATIONS

The dissertation contains a number of renewal and development proposals from the aspect of both international knowledge transfer and domestic institutional development, with a special focus on modernising public management.

Among the activities of SAO, the promotion of good governance has gained an increasingly important role, which also determines the themes evolving in the context of international knowledge transfer. The SAO strategy has created a completely new framework enabling the institution to fulfil the requirements of the well-governed state at a higher level and continue to do so in a sustainable manner in the future.

In respect of SAO's opportunities to improve its functioning, the factors, processes and framework analysed and interpreted in the paper are of critical importance. As a model

organisation, SAO can serve as a basis for sharing “good practices” both in Hungary and abroad and thereby, besides supporting good governance, for shaping attitudes to the state and public life and developing public thinking.

In auditing public/municipal business associations, SAO has acquired wide-ranging experience in respect of their governance and management, i.e. of public management. The ideas raised by the institution concerning the renewal of public management have also drawn a response from the Government. The paper presents SAO’s detailed recommendations for the exercisers of ownership rights in public companies, their supervisory and management boards, formulated on the basis of its audits, in order to address systemic problems. Capacity building and organisational development have enabled SAO to perform a holistic assessment and make recommendations for the overhaul of Hungarian public management in its entirety on the basis of a new type of targeted, thematic and concentrated audits carried out at business associations in majority state ownership.

The thesis presents how SAO has built a system in a creative and sustainable manner to fight corruption in Hungary and thus contributed to enforcing integrity criteria in individual institutions.

The SAO model created as a result of the dissertation and presenting the basic conditions, principles, tools and scope of promoting good governance can serve as a guidance for developing a standardised international system of requirements. Moreover, a model has crystallised that enables the State Audit Office to support the operation of the well-governed state in a sustainable and continuous manner. The model’s novel feature, also by international standard, lies in its high complexity. This complexity is reflected not only in how the model is built from the fundamentals, core principles, values and strategic objectives to the outcomes of good governance, but also in how it is manifested in the development of the supreme audit body’s capacities and innovative self-learning organisational system as well as in the application of risk and change management.