Audit Experiences of State-Owned Business Organisations in Service of the State Management Approach

Summary
Business associations in government ownership attend to significant public duties. Their activities, the quality, efficiency and fruitfulness of their business management have a considerable impact on the quality of life, security, health and welfare of the population using their services and contribute to the responsible management of public funds. In other words, the reasonable, compliant and effective operation of businesses operating in public interest is one of the most important social objectives. The State Audit Office’s contribution includes its audits, analyses, studies, consultancy to management systems, performed on the basis of the Hungarian National Assembly’s authorisation given in a resolution, and its support to training executives in the field of public finances. The article presents their valuegenerating utilisation.

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LÁSZLÓ DOMOKOS, PhD, President of the State Audit Office of Hungary (elnok@asz.hu), MÁRIA MAKKAI, Supervisory Manager, State Audit Office of Hungary, VIRGIL SZOMMER, Comptroller General, State Audit Office of Hungary.
Significance of the topic

The Fundamental Law, which entered into force on 1 January 2012, is the basis of Hungary’s legal system and the highest-standard precept in Hungary. The provisions of the Fundamental Law should be understood in agreement with the National Avowal included in it, and with the achievements of our historical constitution. The Fundamental Law ensures special protection for public funds and national assets, and provides guarantees for their prudent and transparent management. The Fundamental Law identifies the assets held by the Hungarian state and the local governments as national property, and establishes the purpose of its management accordingly. Thus, national assets may not be managed in private interests but must serve the benefits of the community, with special consideration for the need to protect natural resources, due to their being exhaustible, and to the fact that national assets must remain available in an amount sufficient to meet the needs of future generations.

National property also includes economic stakeholder organisations that are owned by the state and must be managed under the Fundamental Law according to requirements nearly identical to those applicable to the implementation of the central budget, although they are given greater independence than budgetary organisations. It is primordial that only well, efficiently and effectively managed state-owned business organisations serve public interest. The assets they managed constitute public property, and the standard, efficiency and performance of their activity and management contribute to responsible public funds management.

As Parliament only has limited powers to directly control the business management performed by the executive power, the Fundamental Law identifies the State Audit Office as an independent institution that attends to this task. The State Audit Office is authorised to fully supervise the use and utilisation of all public funds and national assets. Thus the State Audit Office is the supreme guard of public funds. It helps the creation of a well-governed state by its audits, by sharing its audit experiences and by analyses and evaluations of the latter. This institution holds up a mirror, presents mistakes, the international trends and the directions of moving forward.

In Hungary public duties are performed, on the one hand, by budgetary institutions founded and operated by the state. On the other hand, organisations falling outside the scope of public finances may also contribute to the – according to rules determined by law – performance of public duties and the state provides part or whole of the funds required for the performance of such duties (Lentner, 2017, pp. 75–90). In addition to institutions, business organisations operating outside the scope of public finances increasingly participate in the performance of duties. Approximately 300 business organisations in the majority ownership of the state operate in Hungary (disregarding their subsidiaries), and a significant number of them perform public duties and manage public assets. The scope of public duties concerned is extremely wide. They include water utility companies, primarily engaged in water supply, wastewater treatment and sewage disposal through utilities. This also includes forestry holdings, which manage forests in government ownership, companies attending to healthcare
and welfare duties, like spas, old-age homes, and companies in charge of social and cultural duties, among others, education and heritage protection. The government portfolio also contains state-owned companies conducting research and undertaking infrastructure development duties, such as corporations engaged in the operation of public roads and real properties and providing ancillary services. Clearly, state-owned companies and the goods produced and services provided by them affect the living standards, security, health and welfare of the population.

Audit findings

State-owned companies have a significant role in safeguarding and increasing property in state ownership, as the value of the assets they manage is high, a great deal of freedom is left for the companies in management, as they are allowed to make the daily decisions related to assets. With a view to all this, the State Audit Office regularly audits the management activities performed by business organisations in state ownership. During the audits of 221 state-owned companies conducted between 2011 and 2018, the SAO obtained a wealth of experience in relation to company management and governance, in other words, to state management. Based on audit experiences, critical areas could be identified that were inseparable from the responsibilities of the management and of those who exercise ownership and supervisory rights (SAO, 2018).

SAO’s audits are aimed primarily at the creation of the conditions for performing public duties and at the assessment of financial and asset management. SAO primarily audited and assessed the financial situation, asset management, the configuration of internal control systems, and compliance with the relevant regulations in areas constituting integral parts of the former. The audits also included the assessment of certain areas in leadership performance.

In the case of state-owned business organisations, the exercise of ownership rights means the exercise of rights and obligations of the owner. The ownership rights of state-owned companies – and the state’s share – are fundamentally exercised by Magyar Nemzeti Vagyonkezelő Zrt. (Hungarian National Asset Management Inc) or, in certain cases, other legal entities appointed by law.

Exercise of ownership rights

The relevant statutory regulations require the organisations exercising ownership right on behalf of the state to enforce the corporate management’s responsibility and asset management that guarantees the enforcement of public interest. The audits have revealed that the party exercising ownership rights, the supervisory board and the management primarily endeavour to accomplish the obligations required by law, and they make less effort at adding proactive means of governance to their activity to supplement the mandatory requirements set out in statutes. According to the audit findings, ownership rights were exercised basically in compliance with the law. The
Parties exercising ownership rights determined the system of corporate decisions and the duties of the company management in the deed of foundation. The established supervisory boards reinforced the owners’ supervision of these companies. Experience shows that the exercise of ownership rights was focused on the approval of company reports and paid less attention to strategic planning and development.

Based on SAO’s audit experiences, in the case of companies, the management’s responsibility has remained largely unenforced or merely formal. The party exercising ownership rights approved the business plans, reports and accounts, but failed to evaluate and review them.

The current regulatory environment does not specify criteria for performance in asset management, fails to provide considerations for the efficient use of state property in accordance with its intended purpose and for accountability. The parties exercising ownership rights are not obliged by law to set performance objectives and measurable criteria for these companies in order to gauge operation and management, or to set up a monitoring system. For this reason, they do not define any performance objectives or criteria for these companies, and thus performance gauging is not ensured for these companies, in other words, it is unmeasurable whether public funds and public assets have been used efficiently and economically, and the managers’ performance cannot be assessed. In the absence of defined efficiency criteria, the stakeholder can only be held accountable for the lawfulness of spending public funds. As the statutes merely set frameworks, the company manager is fundamentally at liberty to fill the framework with content and to decide whether to enforce efficiency and economic viability criteria in the management of assets. All these justify the need to set requirements.

As a significant number of these companies attend to public duties or public benefit duties, lawful and efficient business management on a going concern basis is important. The audit experiences show that these companies have contracts for the performance of public duties, and the contracts have generally been drafted in agreement with the relevant statutory requirements, but in most cases they had not been updated to reflect recent statutory changes.

The party exercising ownership rights is required by law to regularly review such contracts, but the type of review is not specified and the term “regularly” is not defined either. When the ownership right of the assets is exercised, the party exercising ownership rights is required to verify the presence of the assets, their lawful handling, replacement and use for the intended purpose. When the ownership title to shares is exercised, the owner reviews the company’s operation and business management, the achievement of the objectives and the lawful performance of duties. The beneficiaries exercised ownership rights by reviewing the information retrieved and the data reported. They rarely exercised their right to check asset management, the retention, increase and use of assets on the site.

Change in the owner’s person took place in several audited companies, some within a year, and in some companies several organisations exercised the ownership rights simultaneously in respect of the individual assets of the company. In such cases the
risk may be run that the expectations of multiple parties exercising ownership rights might be divergent or that the principle of responsible asset management is difficult to enforce if at all. The audit experiences show that the duties of the parties exercising ownership rights of assets and shares are not clear for either the party exercising such rights or for the companies, and they are frequently blurred or confused.

It may also be a problem that the party obliged to perform public duties is frequently the same person as the party exercising ownership rights. In such cases the principles set out in the relevant statutes to govern the duties related to the exercise of ownership rights and competences cannot prevail. The management procedure of exercising ownership rights should reasonably be separated from technical management. It is also important to precisely define, through the application of modern process management principles and methods (internal control system), the owner’s duties and competences, and in relation to this, also the functions supporting the individual areas in technical management. In the case of parties exercising ownership rights of several business organisations at a time, the elaboration of portfolio management may be a reasonable solution.

Assets may only be managed after the asset management right has been granted. The right to asset management may be conferred by contract or, exceptionally, by statutory appointment. With a few exceptions, including the ban on alienation, encumbrance and provision as collateral, the asset manager is entitled to the owner’s rights and subject to the owner’s obligations. The asset management contracts were frequently found to fail to meet the statutory requirements, as they did not specify the volume and/or value of the managed assets or these had not been up-to-date, and this jeopardised the retention and the maintenance of accurate records of the assets. Due to the absence of tracking changes in statutory regulations, these contracts failed to ensure the conditions of lawful asset management. This suggests the party exercising ownership rights is not on the top of things and thus these companies enjoy extremely generous autonomy.

Management

The company audits revealed that the rules of accounting were established deficiently, on the one hand, and the regulations were not updated simultaneously with statutory changes, on the other. Moreover, we even came across a company that had no accounting regulation at all. A regulatory environment and the development of controls are fundamental prerequisites of lawful and efficient management.

In order to preserve the value of national assets, the audited companies implemented capital investment projects and conducted maintenance to increase asset life. These were financed partly from the sum of costs included in service charges and depreciation. The companies raised the remaining financing requirement from external resources (e.g. aids and loans). In general, the companies made efforts at maintaining the value and condition of the assets, however, the inspections of capital investment projects and renovations revealed deficiencies in public procurement
procedures. In several cases, for the public procurement procedure the companies required the conclusion of contracts exceeding the statutory limit or conducted these procedures in conflict with the relevant regulations.

During the audit of business organisations in (full or partial) state ownership, the absence of correct inventories and failure to use inventories as supporting evidence for balance-sheet items were common. For this reason, neither the principle of giving a true and fair view, nor the protection and safeguarding of property were enforced. In the accounting records, separation was frequently not performed in financial flows (e.g. the absence of reconciliation with aids per financial envelope, the separate financial clearing and monitoring of the individual activities), and as a result, accountability and transparency were not guaranteed.

In order to eliminate the irregularities and deficiencies revealed during its audits and to promote transparent and efficient operation, SAO makes recommendations and in response, the executives of the audited organisations are required to compile action plans. The obligation to act and its supervision by SAO are powerful guarantees for the inclusion of SAO’s recommendations into the practice of the audited organisation, thus eliminating the irregularities, deficiencies and inappropriate practices revealed. SAO also verifies the implementation of the recommended actions and of the action plan in the framework of follow-up audits (Domokos, 2014). On average, SAO made 4 or 5 recommendations for a business organisation, to the No. 1 executive of the organisation. The recommendations typically addressed gaps in the internal control, the absence of supporting evidences to the accounting records, or to failure to meet the obligation to publish, and the audited organisations complied with their obligation to make action plans. Thus with its recommendations made to the stakeholders on the basis of its audit experiences, SAO is directing the managers of state-owned companies towards compliant and appropriate operation, which is also the basis of efficient and successful business management.

Consultancy and support by the State Audit Office

In addition to its primary control activity, the law also authorises the State Audit Office to perform a kind of consultancy and deliver its opinion. In addition to audits, the aim is partly to improve transparency and efficiency in the systemic use of public funds with the help of SAO’s analyses and studies, and to contribute to the more efficient running of the institutions and systems that provide public services. Another aim is to trigger favourable changes by its audits and analyses in order to improve the citizens’ standard of living through the improvement of the public services they use.

Giving an evaluation of its experiences gained from the audit of state-owned business organisations from this perspective, in the framework of its analysis disclosed in July 2018, SAO overviewed the provision of conditions for the performance of duties by state-owned business organisations and the characteristic features of the exercise of ownership rights; and evaluated the operating and management risks run by the companies in terms of the sustainability of operation (profitability, indebtedness and
liquidity). The analysis also evaluated the requirements and considerations of integrity (which means value-driven conduct/operation, see below), capitalising on the findings of surveys and analyses performed by the audit office in this field.

The State Audit Office shares the trends and recognised good practices revealed during its audits with the interested stakeholders and with the wider public. In order to promote knowledge sharing, it publishes analyses and organises conferences. Sharing “good practices” promotes improvement in the regulation of the operation of the audited companies and development in public finances. In addition, to companies potentially subject to audit, it provides support in compliant operation despite being unaffected by recent SAO audits. Capitalising on its audit experiences, SAO supports the lawful operation of organisations using public funds by the elaboration, publication and annual updating of self-tests. In relation to its support and consulting functions, SAO launched its self-tests in November 2014. The completion of these self-tests is voluntary. With the help of these self-tests, in addition to the audited organisations, unaudited ones also have the opportunity to size up their current situation, adopt “good practices” and improve the regulation and lawfulness of operation.

SAO’s experts share their experiences and the “good practices” they have collected at expert and executive conferences, professional lectures and forums in order to provide communication opportunities for companies potentially subject to audit in the interest of more compliant operation.

Pursuant to the act on the State Audit Office, SAO uses its findings, recommendations and advice based on its audit experiences to help the work of Parliament, its committees and the audited organisations in order to promote the operation of a well-governed state. SAO also assists legislation at the three topmost levels of the legislative hierarchy, namely, in the adoption of acts by Parliament, decrees by the government and orders by local governments. The State Audit Office endeavours to transfer its audit experiences to legislators for incorporating them into new statutory regulations. Naturally, SAO does not wish to take over the duties and responsibilities of legislators, however, it is supposed to call the attention to risky and poorly regulated or unregulated areas it considers reasonable to address by legislation. Coherent regulation of an appropriate standard and free of legal loopholes is especially important for SAO because in the absence of an applicable rule or in the case of deficient regulation, the organisations cannot be held accountable during compliance audits, even if irresponsible public fund management provides ground for calling them to account.

SAO also supports legislative procedures indirectly. For example, it dispatches its reports and analyses to Members of Parliament, government members and the parties exercising ownership rights over the audited companies. Moreover, by sharing its audit experiences in a way that raises public awareness, it also urges legislators to remedy the deficiencies revealed and any incorrect practices by statutes, if required.

In a resolution, the Hungarian National Assembly authorised the State Audit Office to expand its consultancy on management systems and to support training in ethical public finance management. In order to accomplish this task, the State Audit Office has established a joint department with the University of Miskolc for doing research.
in and for teaching performance measurement in the public sector. In the framework of this cooperation, educational programmes and modules were elaborated for training the current and the next generation of heads of business organisations managing public funds and public assets, with focus on performance assessment, measurement of the value of public services, monitoring, controlling and human resources management, the integrity approach and the dissemination of methods and instruments supporting the reinforcement of integrity controls used in the course of management.

Promoting competitiveness

The intersection between the state’s exercise of its ownership right and SAO’s efforts is assessing and making public service companies’ performance measurable based on unbiased indicators. SAO’s baseline is that the avoidance of loss making is a basic requirement in the public sector; however, as profitability is an inaccurate standard for efficiency, it can only be assessed in the light of the set objectives. However, if there are no quantified targets, efficiency is unmeasurable. Experiences show that the use of measurable performance indicators is extremely rare in the public sector, and what is more, numerous organisations do not set performance target either. SAO has taken steps to improve the measurability of public service performances. In cooperation with the Faculty of Economics of the University of Miskolc, it has been working on the elaboration of a model and a measuring system based on the model that enables the setting of 5 to 10 indicators to properly express public service organisations’ performance.

The baseline of the model is the competitiveness of public service organisations. The purpose of the model is to identify interventions that improve competitiveness. In this model, performance measurement is not an end in itself, rather, it is a means for assessing competitiveness, and a feedback required for successful intervention, which helps identifying the required intervention, the extent of intervention and then the effects of an intervention. A model has been elaborated for the competitiveness of public service provider organisations on the basis of principles laid down during previous research conducted on performance management by the Faculty of Economics of the University of Miskolc. The elaborated model is depicted in Chart 1.

In this model, the outcome, i.e. the socially relevant impact, is considered as a result, and the partial results required to achieve the output (in terms of both the quantity and the quality of service output) and the conditions that need to be created in operation and in the quantity and quality of input to achieve the desired level of output are analysed. In order to determine the competitiveness of public service organisations, the input, operating, output and outcome indicators need to be assigned depending on the organisation/sector. It is important that the indicators should be relevant, quantifiable and measurable. The four pillars are quantifiable based on the public service organisations’ data (micro-monitor). The data are, on the one hand, accessible from the data provided by the organisations for statistical purposes, and on the other, quantifiable through surveys by questionnaires. The
required questionnaire, including all four pillar modules, have been elaborated by the researchers of the University of Miskolc, the small-group tests have been conducted, and the preparation of testing in a wider circle – with the involvement of the State Audit Office – is in progress. The outcome of the measurement enables positioning, temporal and sectoral comparisons and ranking. The retention of or improvement in the position achieved in the given ranking poses a challenge for the organisation’s management, and provides a tool for the party exercising ownership rights to assess executive performance on the basis of objective performance indicators. In addition, the indicator is also suitable for predicting the time when the owner needs to intervene.

The purpose of cooperation between SAO and the University of Miskolc is to support a “well-governed state”, to train public and civil servants who manage public funds efficiently and transparently, and thus to contribute to the development of state management. In order to spread “good practices”, SAO regularly organises series of events to share knowledge, and promotes training ethical public finance managers. Through improving knowledge in public finances and management, the purpose of training top managers is to contribute to the implementation of common objectives and to promote the operation of the well-governed state. SAO and the University of Miskolc also closely cooperate in this topic. The joint endeavour of the two institutions is to lay the scientific foundations of a management training that combines ethical executive behaviour and the measurement and evaluation of managerial performances in both theory and practice. As in addition to professional expertise, the heads of public sector institutions should also be well-versed in management, they need to continuously improve in order to be able to meet the increasingly complex
expectations towards them. SAO’s management training programme offers help in this. Within this framework, the course on good practices is complemented by a 1.5-day training module and by a 5-week remote learning programme.

SAO’s contribution to reinforcing the state management approach

In order to improve the efficiency and effectiveness of state-owned business organisations, and ultimately their public recognition, a coordinated cooperation is needed between the owners, owners’ representatives and public service organisations attending to the management of state-owned companies. Thus the functions of the individual roles, such as setting and achieving strategic objectives and the verification of their implementation, should constitute a system of incentives to ensure the retention of an increase in public assets and the responsible and frugal use of public funds, in addition to the provision of (public) services and the manufacture of products, both high-standard and sustainably affordable, to the satisfaction of all.

Based on the fundamental and recurrent problems identified during the audit of state-owned business organisations, the State Audit Office has recognised the need for a systemic renewal of state management. SAO has compiled a 4-point recommendation package to renew state management, which required that

– The work done by the managers of state-owned companies should be regularly evaluated for lawfulness, efficiency, efficacy and economy;
– The efficacy, evaluation capacity and activity of the party exercising ownership rights should be improved;
– The managers of state-owned companies should meet strict ethical and integrity requirements;
– The system of remuneration for company managers must be transformed.

The decision adopted by the Government of Hungary in September 2015 about the transformation of the procedure of appointing managers at the head of companies in majority state ownership is of special significance in the application of SAO’s recommendations regarding the renewal of state management. It established that the executives’ remuneration and requirements need to converge to the market leading salaries and requirements, and a considerable part of the current bonuses should be included in the basic salary. No additional benefit was recommended for the managers of loss-making state-owned companies. The decision underlines that the Government is committed to the creation of the conditions of a transparent, efficient and economical operation of companies in majority state ownership, and – at the proposal of the President of the State Audit Office – it is also committed to the regular evaluation of the activities performed by the managers of business organisations in majority state ownership for lawfulness, efficiency and economy. The decision points out that the managers of state-owned companies must meet strict ethical and integrity requirements.

SAO annually surveys the corruption risks of public sector organisations and suitable controls established by these organisations to prevent or mitigate such risks. Based on these experiences, in 2017 SAO launched a survey of the integrity of business or-
rganisations in majority state ownership. The findings of the integrity survey have confirmed that corruption risks basically depend on objective factors. They are affected by company size, the provision of public services and the amount of public funds used. In contrast, the firmness of the integrity controls put in place to prevent these risks primarily depends on subjective factors, namely, on the owner and management of the business organisation. Based on the survey findings, the party exercising ownership rights can best improve organisational integrity through the effective operation of a supervisory committee. The most the management can do for the improvement of integrity is the creation of a high-standard internal control. The business organisations of the highest integrity, which were found to endeavour to “improve”, analysed and managed risks, including corruption risks, at a system level (Pulay and Lucza, 2018).

In the course of SAO’s audits, in addition to the financial situation, asset management and the internal control system, in the framework of a separate module, the performance of the leaders of state-owned business organisations was also checked and evaluated. In addition to the criteria of compliance with the statutory and internal regulations, the evaluation is based on questions supporting the State Audit Office’s advisory activity, excluding the evaluation of the performance of basic professional and public duties. SAO’s evaluation of management performance was aimed at facilitating improvement in management activity, organisational integrity and the achievement of organisational objectives, and through this, at promoting responsible public fund and public asset management.

Based on the experiences of audits performed in four years, SAO published a series of studies related to the strategic objective of the well-governed state, and including a study about the State Audit Office’s contribution to the renewal of state management, published in 2016 (Domokos et al., 2016). Relying on the assumptions of the study, below is a discussion of the areas considered most important on the basis of SAO’s audit experiences.

– Companies can be efficiently and successfully managed if its activity is focused on the achievement of the objectives and the mission set for the organisations. This is why it is reasonable for the party exercising ownership rights to set strategic objectives for each of its companies. Once the objectives have been set and the mission of the organisation is clear, an action like cost-cutting coupled with quality-related goals will have an effect towards the provision of high-quality services or the sustainability of product manufacturing.

– The fundamental objective is the same for state-owned and private property: to retain and increase assets. The theoretical difference lies in the fact that the beneficial owners of publicly owned companies are citizens, and consequently, the party exercising ownership rights should represent public interest. Consequently, the party exercising ownership rights should set clear performance requirements for the management operating the company and for the supervisory committee. SAO’s management performance assessments provide some guidance on this, as they mark the areas critical in public finances, where management activity can be improved. The management performance assessment system contributes to the renewal of public administration.
and to the achievement of the strategic objective of creating an efficient national public administration, as set out in Article XXVI of the Fundamental Law.

– Goal-setting only makes sense if it is backed up by accountability. Calling someone to account requires a thorough understanding of its performance. To this end, the party exercising ownership rights should be well-informed and should make a proactive contribution. The performance of the management and of the supervisory committee, beyond the expected lawful operation, should be evaluated time and again, comparing the set performance objectives with the results achieved. This is the way to successfully, economically and efficiently achieve the objectives set. The owner should set the evaluation criteria in advance and should perform assessment on this basis. The evaluation should feed back to the operation, remuneration and mandate of the management and of the supervisory committee.

– The managers of state-owned business organisations must perform their activity in service of the public, enforcing the principles of integrity and transparency in public life. This is why competence, objectivity, impartiality, moral integrity and giving precedence to public interest are important. In order to enable its enforcement, the party exercising ownership rights should select the members of the management and of the supervisory committee on the basis of their previous performance, abilities and commitment to the service of the public.

– Due to the high number of state-owned companies, obtaining appropriate information and proactive contribution pose intrinsic challenges for the state, as the owner. The state should develop an efficient method for exercising its ownership right. Based on their strategic significance and other criteria, state-owned business organisations can be classified into several groups, and the various forms of strategic governance can be elaborated for these groups. The fate of the individual constituents can be decided on the basis of the financial and professional evaluation of the corporate portfolio. This can be merger wherever the conditions of the economies of scale can be met, or the sale of minority participations in the case of business enterprises with unjustified state involvement. The benefit of portfolio management is the higher level of coordination. In addition to the harmonisation of the contents of capital investments, this provides an opportunity for planning projects for a period when they can be most economically implemented.

– The feasibility of the objectives set by or for state-owned companies is fundamentally influenced by the owner’s decisions. As a basic condition for a good proprietary decision, the owner must recognise the need of a proprietary decision or intervention in time. This requires regular report by the supervisory committee to the owner about the findings of its audits and inspections, taking full responsibility for their content.

– The primary expectation from the managers of state-owned companies is compliance with the rules. Lawful activity in itself is no guarantee for the efficient service of the common good. Adjustment is needed to the quickly changing environment and to challenges. This is why innovative skills and the ability to manage risks have appreciated in the public sector. Public sector managers have roles that go far beyond static management merely required to ensure lawful operation. The managers of state-owned
companies must act with due care, committed to the public, abiding by the rules and respecting budgetary limits, enforcing claims and performing obligations by the deadline.

– The management should compile detailed business plans. They should plan the performance criteria and indicators. In the business plan, criteria should be set for the efficiency, economy and effectiveness of management and for the performance of duties to lay the basis for grounded decisions.

– A management can pass the right decisions if it has up-to-date information about the company’s operation and the characteristics and quality of its activity and procedures. For this reason the managers of state-owned companies should build management information systems to support their decisions. In addition to the external audit of state-owned companies, internal control can also have such a role. This is the most direct method of tracking and monitoring the lawfulness of a company’s operation by the management.

– In addition to their reporting obligation, the managers of state-owned companies are also required to ensure that operation is transparent for both the owners and the public. The party exercising ownership rights can assess management performance and adopt grounded decisions on the basis of the reports and data related to operation, management, the achievement of the objectives set and to the publicly disclosed data. Citizens can assess the extent of contribution to the service of the public and to the improvement of citizens’ welfare on the basis of the data and information disclosed.

– State-owned companies manage public assets, and use public funds for their business management. This is why it is important to only allow the managers of state-owned companies to perform other activities unrelated to the company’s core activity.

– Due to the state’s increasing economic involvement, the interface between the public and private sectors is growing, and unless integrity improves, this increases corruption risks. In order to reduce corruption risks, focus should be placed on knowledge and meeting the ethical requirements. The corporate management should set up a management environment to ensure integrity in accordance with the expectations of the legal entity/minister acting on behalf of the owner.

The characteristic features of ethical governance based on integrity

State-owned business organisations have a significant role in the national economy. The value of their assets and the number of their employees are substantial, and the significance of their social role is shown, among others, by the fact that the ten million Hungarian citizens use their (public) services on a daily basis, and directly or indirectly pay significant amounts – in the form or charges, fees, rates and/or taxes – for them. This alone illustrates the fact that the successful and efficient management of these companies is in elementary public interest and has a substantial impact on the efficiency of the national assets. Safeguarding and increasing their assets and efficient and successful operation bring an enormous responsibility and poses a huge challenge. Each decision made by state-owned business organisations can make
a difference of billions of forints to the central budget and thus on Hungarian households. For this very reason, thoroughly grounded and prudent companies managing resources on a frugal budget can fundamentally contribute to social welfare and improve the efficiency of and raise the added value in the national economy.

The essence of management with focus on integrity is that the organisation endeavours to implement the common good and formulates its mission and the values to be adopted by each of its employees accordingly. With the establishment of integrity controls, the risk of incorrect employee behaviour jeopardising the service of the common good is reduced to the minimum.

The meaning and essence of integrity can be summed up in a sentence: I am what I am supposed to be and I do what I am supposed to do. For a person this means that he performs his obligations and fulfils his mission in agreement with the values he advocates. At the level of an organisation, this may be put as follows: it does what it has been established for and in a way it is expected to fulfil its mission (Pulay, 2017).

One of the essential preconditions of achieving the objectives set for a “well-governed state” is the manner of establishing and running the institutional system required for the fulfilment of its social role and for providing its services, with the ultimate goal of performing public duties in an efficient, successful and accountable manner, frugally using the available resources. Ultimately, state management fulfils its mission if it serves the common good. State management includes all the planning, organisational, management and control activities required for the establishment and operation of the system of institutions that enable the performance of state functions.

The efficient and successful management of state-owned business organisations is conceivable basically uniformly. The reason is that their duties, the challenges related to their management, and their operating environments are basically identical, and all of them are required to work for the common good, similar types of conflicts of interest arise and challenges are posed to the party exercising ownership rights, the supervisory committee and the managements, and all of them are run in the same social and economic environment. The concept of managing business organisations includes the exercise of all the rights and performance of all the obligations directly by the party exercising ownership rights or indirectly by the body authorised by it (typically the supervisory body), on the one hand, and the management, managing director or managing body (board of directors) in charge of the state-owned company, on the other.

In terms of content, the management of state-owned business organisations includes the determination of characteristic features for the objectives of the goods and services these companies intend to provide (strategic objectives), the specification of operating conditions and performance requirements, the selection of the members of the management and of the supervisory committee, organisational and workflow management, the evaluation and control of achievements and operation, and the decisions adopted as a result or affecting the managers in person. According to the nature of management, the owner may exercise ownership rights over the companies in its ownership directly or may transfer them. In both solutions a super-
visory committee may be set up for auditing the company’s operation on behalf of
the owner.

A company’s efficiency, social use and performance of public duties primarily de-
pend on its managers, in other words, on the combination of their knowledge, expe-
tise, responsibility and willingness to go that extra mile. The primary expectation from
the managers of state-owned companies is compliance with the rules. In addition, a
manager should prepare for quick changes in the environment, including numerous
challenges, and for the fact that legislation can only be adjusted subsequently, with a
delay. Consequently, innovative capacity, risk management, change management and
the ability to facilitate organisational learning are increasing expectations from state-
owned business organisations. This means that today, managers have roles far beyond
static management merely required to ensure lawful operation.

The innovative capacity of public-sector companies means the extent to which
they are capable of establishing and applying new or significantly renewed services,
communication methods, procedures or organisational methods. The management
has an important role in shaping the innovation capacity through the configuration
of work organisation solutions (Makó and Illésy, 2017).

Risk management is a system that consists of the means and methods of govern-
ance, including the elements of risk identification, analysis, classification, tracking
and, if required, the mitigation of exposure to risk (Domokos et al., 2017). The es-
tablishment and operation of the risk management procedure in adjustment to the
characteristics and objectives of the organisation is the responsibility of the manag-
er of the organisation. Change management is a series of carefully considered and
previously planned activities to facilitate the achievement of both individual and or-
ganisational changes, and in the expected results (Farkas, 2017). Responsibility for
managing changes and for planning lies with the top management. Organisational
learning is the efficient transformation of the knowledge and competence obtained
by the members of the organisation into an organisational capability, their becoming
shared knowledge and integration into the memory of the organisation (Makó and Il-
lésy, 2017). Knowledge management, which implements organisational learning, has
an outstanding significance for the competitiveness of organisations, as based on an
analysis of its activity, procedures and risks; this includes improvement in the opera-
tion of its organisation and in its results in the framework of change management.

The State Audit Office bases its audits on the Fundamental Law, and judges the
performance of the manager of the organisation that uses public funds and public as-
sets primarily based on his enforcement of lawfulness, efficiency and expediency. In
order to determine the requirements that may be set for public sector management,
the baseline was the elaboration of proposals for the quality of management on the
basis of the experiences obtained during the audit of state-owned business organisa-
tions. Since October 2016 it has been decreed that the managers of public service
institutions are in charge of the creation of an internal control system suitable for en-
forcing ethical values and integrity. The integrity approach focuses on the prevention
of corruption, and thus the organisation’s executives have increased responsibility, as
it is presumed that with the help of corruption risk analyses, the executive reveals and raises awareness of the corruption risks jeopardising the organisation in its management. The other characteristic feature of the integrity approach is its emphasis on the significance of manifesting and following positive values. This can be done, among others, through a strategy, a mission statement and/or a code of conduct setting values, and through the management’s example.

Based on the audit experiences obtained by the State Audit Office, in sum it can be assumed that irrespective of whether they perform public duties or not, in order to adopt a state management approach, state-owned business organisations need to serve the common good. Its implementation is conceivable in an ethical management system elaborated in a state management approach based on a strategic principle, focussed on values and capable of preserving, and moreover, reinforcing the organisation’s advocated values during adjustment to changes. Setting up an organisational framework that ensures lawful and efficient operation without profligacy is first and foremost the responsibility of the top management of state-owned business organisations.

References


