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Development Directorate of the  
Ministry of Environment and Water,  
Hungary

Report of Factual Findings in Connection with  
the Green Investment Sub-Programs  
undertaken within the framework of the Green  
Investment System, Hungary, for the period  
ending December 31, 2009

May, 2010

Környezetvédelmi és Vízügyi Minisztérium  
Fejlesztési Igazgatóság

Budapest, 2010. május 13.

Huba Bence, Igazgató részére

1134. Budapest  
Váci út 45.

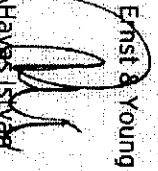
Tisztelt Huba Bence Úr!

Elvégztük a Környezetvédelmi és Vízügyi Minisztérium Fejlesztési Igazgatósággal (továbbiakban „KVVV-FI”) 2010. március 30-án kötött szerződésben a Zöld Beruházási Rendszer Klímabarát Otthon Panel Alprogram (Alprogram I.) és Energiahatékonysági Alprogram (Alprogram II.) vizsgálatával kapcsolatban meghatározott feladatokat.

Az elvégzett munkáival kapcsolatban esetleges kérdéseivel kérem keressenek engem, vagy Bindics Judit kollegánomé. Reméljük a továbbiakban is sikeresen tudunk együttműködni.

Tisztelettel,

Ernst & Young

  
Havas István  
Vezérigazgató

ERNST & YOUNG  
Tanácsadó Kft.  
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**Report of Factual Findings in Connection with the Climate Friendly Home Sub-Programs undertaken within the framework of the Green Investment Scheme, Hungary, for the period ending December 31, 2009**

To the Development Directorate of the Ministry of Environment and Water (MoEW), Hungary:

We have performed the procedures agreed with you in our contract dated March 30, 2010 with respect to two Green Investment Scheme Climate Friendly Home Sub-Programs (GIS programs) operated by the Directorate within the framework of the Green Investment Scheme (GIS):

1. The Green Investment Scheme Climate-friendly Home Panel Sub-program (Sub-program 1), operated by ÉMI Non-Profit Company for Quality and Innovation in Building (ÉMI NKft) (Phase 1) and the "Energy Centre" Energy Efficiency Environment and Energy Information Agency Non-Profit Company (EK NKft) (Phase 2);
2. The Green Investment Scheme Climate-friendly Home Energy Efficiency Sub-program (Sub-program 2), operated by the "Energy Centre" Energy Efficiency Environment and Energy Information Agency Non-Profit Company (EK NKft).

As a result our information about the contractual background (and any terms, conditions or obligation therein) of the two GIS Programs is limited. We emphasise that our findings may have been different had we been given full access to the three CO<sub>2</sub> quota sales contracts. Our engagement was undertaken in accordance with the International Standard on Related Services applicable to agreed-upon procedures engagements. The procedures were performed solely to assist you in assessing the procedures operated by the Development Directorate relating to the GIS and the two bodies involved in operating the GIS Programs and are summarized as follows:

1. For both GIS Programs we reviewed the process applied for making calls for application, the related program documentation, program manuals, evaluation criteria and grant contracts to verify that they are in compliance with current Hungarian legislation.
2. For both GIS Programs we compared the CO<sub>2</sub> reduction calculations to relevant Hungarian legislation and confirmed that this methodology was applied by the two operating bodies and the Development Directorate of MoEW in evaluating the grant applications.
3. For both GIS Programs we reviewed the process used for carrying out on-the-spot checks at Beneficiaries.
4. For both GIS Programs we reviewed the system used to record and monitor the flow of funds received from the Buyers of the CO<sub>2</sub> quotas through to the payments made to the Beneficiaries.
5. We reviewed the monitoring reports for 2009 of both operating bodies to verify that expenditures regarding the GIS Programs are described in a transparent and comprehensive manner.

We report our findings below:

The Terms of References regarding our assignment did not include the review of the three CO<sub>2</sub> quota sales contracts, therefore we were not given access to the contract documents in full.

Re procedure 1:

This table summarizes the total number of grant applications of the two GIS Programs by December 31, 2009:

Name of Sub-program	No. of applications by December 31, 2009
1. Sub-program 1	1 709
Phase 1	948 (approved)
Phase 2	761 (registered arrived in the system)
2. Sub-program 2	2
TOTAL	1 711

Current Hungarian legislation:

- Government Decree 323/2007. (XII. 11.) on implementation rules of Act LX of 1995 on Kyoto Protocol to United Nations Framework Convention on Climate Change
- Government Decree 121/2009. (VI. 11.) on modification of Government Decree 323/2007. (XII. 11.)
- Government Decree 280/2009. (XII. 11.) on modification of Government Decree 323/2007. (XII. 11.)
- Directive of Ministry of Local Governments 4/2009. (II. 27.) on the utilization of chapter-managed appropriation allocation fund account
- Directive of Ministry of Environment and Water 10/2009. (VII. 17.) on the operation, utilization, recording and controlling of Green Investment Scheme

For both GIS Programs we reviewed the process applied for making calls for application, the related program documentation, program manuals, evaluation criteria and grant contracts. We verify that they were in compliance with current Hungarian legislation.

Sub-program 1

Phase 1

Starting in 2008 the Ministry of Local Governments (MoLG) published the Panel Program ("Support for the energy-saving refurbishment of apartment buildings constructed with pre-fabrication technology", code: LFP-2008-LA-2). This program was closed at end of 2008, therefore the received applications were not evaluated by the MoLG. Following the Government Decree 121/2009. (VI. 11.) on modification of Government Decree 323/2007. (XII. 11.) and a Co-operation Agreement (dated July 2009) between the Ministry of Environment and Water (MoEW) and the Ministry of Local Governments (MoLG) the two Ministries agreed to submit 948 applications received by the MoLG to the MoEW, to be financed by the GIS, Sub-program 1. (Phase 1) - subject to fully meeting GIS requirements. Compliance of the application with GIS conditions was examined by ÉMI NKft (see detailed below). Approval decision regarding grants was made by the Minister of Environment and Water.

One of the criteria for submission of application to the GIS subprogram by the MoLG was that the project implementation did not start before June 12, 2009.

The Operating Body for Phase 1 was ÉMI NKft.

Since the original applications by the MoLG did not contain a CO<sub>2</sub> savings calculation Budapest

University of Technology and Economics developed a conversion formula enabling the calculation of the CO<sub>2</sub> saving for each application. According to interviews EMI Nkft applied this formula consistently for all 948 applications.

Since not all costs eligible under the MoLG Program were eligible in the GIS, on average 5% of the grant is paid by MoLG and 95% by the MoEW GIS program. (per Section 21 of the Government Decree No. 121/2009 (VI.11))

We performed walk-through tests for 5 grant applications from receipt of the grant application through to payment to the Beneficiary. The criteria for selecting the 5 applications were the status of the application (paid to the Beneficiary, Grant Contract signed, grant approved by the MoEW) and the amount of the grant. We found no exceptions to the procedures in the Operating Manual and the Manual for on-the-spot checks.

#### Phase 2

The MoEW published a Call for Application for Sub-program 1 on July 2009 (ZBR-LH-09). The initial deadline for applications was extended in October 2009 to December 2009. 761 applications were registered arrived in the system until the final deadline (31 December 2009).

The Operating Body for Phase 2 is EK Nkft.

The evaluation of these applications is in progress, no grant approval decisions were made by December 31, 2009. Due to the early status of the projects we could not review the documentation of the projects, or perform any walk-through tests.

On February 17, 2010 the MoEW and EK Nkft signed a Grant Contract for the operation of the Sub-program 1 Phase 2.

As of December 31, 2009 EK Nkft has neither an Operational Manual nor a Manual for on-the-spot checks. We understand from interviews that the preparation of the Manuals is in progress and will be approved by the MoEW.

No operational cost was declared in 2009 by EK Nkft.

#### Sub-program 2

The MoEW published a call for application for Sub-program 2 on December 2009. (ZBR-EH-09)  
Two applications were submitted until December 31, 2009.

The Operating Body for Sub-program 2 is EK Nkft.

Applications can be submitted until the final deadline, October 30, 2010. Neither evaluations, nor grant approval decisions were made by December 31, 2009. Due to the early status of the projects we could not review the documentation of the projects, or perform any walk-through tests.

On December 23, 2009 the MoEW and EK Nkft signed a Grant Contract for the operation of Sub-program 2, the appendix of which contains tasks for EK Nkft regarding application management, finance and accounting.

As of December 31, 2009 EK Nkft has neither an Operational Manual nor a Manual for on-the-spot checks. We understand from interviews that the preparation of the Manuals is in progress and will be approved by the MoEW.

No operational cost was declared in 2009 by EK Nkft.

Re procedure 2:

#### Legal background

Directive 2002/91/EC of the European Parliament and of the Council of December 16, 2002 on the energy performance of buildings determines relevant EU level guidelines.

Decree of Minister without portfolio No. 7/2006. (V.24.) on the energy performance of buildings - which determines relevant national regulations - is based on the Directive 2002/91/EC. The national regulation determines the calculation methods for assessing the energy categories of buildings. The national regulation does not determine a calculation method for CO<sub>2</sub> reduction.

Therefore the MoEW engaged an external expert (assistant professor of Budapest University of Technology and Economics) to develop a uniform calculation method for CO<sub>2</sub> reduction which - by using a set of assumptions - determines CO<sub>2</sub> reduction based on the energy categories of buildings.

This method is based on Decree of Minister without portfolio No. 7/2006. (V.24.) and the National Climate Change Strategy 2008-2025.

The CO<sub>2</sub> calculation uses the following set of assumptions:

1. Assumptions based on Decree of Minister without portfolio No. 7/2006. (V.24.):
  - net hot water demand is calculated using statistical average figures
  - internal heat load is calculated using statistical average figures
  - In case of insulated windows air circulation is calculated using statistical average figures
  - In case of residential housing energy consumption of lighting is disregarded
  - for the following areas it is possible to use a simplified and a detailed method of calculation:
    - heat bridges
    - solar gains
    - heated temperature bridge, length of heating period
    - loss elements in building engineering systems
    - indirect radiation gains (this, too, may be disregarded)
    - temperature of unheated areas
    - heat flows directed to the ground
2. Further assumptions used by the expert:
  - In determining the CO<sub>2</sub> factor of electrical energy it is assumed that the savings made will not replace atomic energy capacities.
  - In case of district heating the existence of related energy production is not considered, only average figures are used.

We confirmed during the interviews that this methodology was used by both Operating Bodies. The method was applied as follows:

- Sub-program 1 Phase 1: Since the original applications by the MoLG did not contain a CO<sub>2</sub> savings calculation ÉMI NKft developed together with the Budapest University of Technology and Economics a conversion formula enabling the calculation of the CO<sub>2</sub> saving for each application. According to interviews ÉMI NKft applied this formula consistently for all 948 applications. Our 5 walk-through tests confirmed that this calculation formula was applied.

- Sub-program 1 Phase 2: The Grant Application Form contained a uniform table to determine the energy category of the buildings and CO<sub>2</sub> reduction before and after the project. This table must be certified by an independent energy expert who is a certified member of the Chamber of Engineering or the Chamber of Architects. Due to the early status of the projects we could not verify that the table was reviewed during the evaluation process by EK NKft.

- Sub-program 2: The Grant Application Form contained a uniform table to determine the energy category of the buildings and CO<sub>2</sub> reduction before and after the project. This table must be certified by an independent energy expert who is a certified member of the Chamber of Engineering or the Chamber of Architects. Due to the early status of the projects we could not verify that the table was reviewed during the evaluation process by EK NKft.

Re procedure 3:

Sub-program 1 Phase 1:

EMI has a Manual for on-the-spot checks. According to this at least once - before payment of the grant - each project must be checked on-site. In addition the project can be checked on-site during implementation.

We performed walk-through tests for 5 grant applications from receipt of the grant application until payment to the Beneficiary. Of the 5 applications one had reached completion in 2009 and we verified that an on-the-spot check was carried out in line with the Manual for on-the-spot checks.

Sub-program 1 Phase 2:

On February 17, 2010 the MoEW and EK NKft signed a Grant Contract for the operation of the Sub-program 1 Phase 2.

As of December 31, 2009 EK NKft has neither an Operational Manual nor a Manual for on-the-spot checks. We understand from interviews that the preparation of the Manuals is in progress and will be approved by the MoEW.

Sub-program 2:

On December 23, 2009 the MoEW and EK NKft signed a Grant Contract for the operation of Sub-program 2, the appendix of which contains tasks for EK NKft regarding application management, finance and accounting.

As of December 31, 2009 EK NKft has neither an Operational Manual nor a Manual for on-the-spot checks. We understand from interviews that the preparation of the Manuals is in progress and will be approved by the MoEW.

Re procedure 4:

We understand from interviews that there were three Buyers of the CO<sub>2</sub> quotas and three CO<sub>2</sub> quota sales contracts were signed.

The total sales price received by the MoEW is 134 750 000 EUR.

The Ministry of Environment and Water opened a EUR bank account at the Hungarian State Treasury on July 29, 2008 (HU36-10004885-10008016-05011139) to receive the amounts from the Buyers.

The amounts received were transferred and kept on a HUF bank account (HU38-100032000-01220263-50000005) at the Hungarian State Treasury. The bank account is in the name of MoEW and also contains funds from other 12 funding programs. The GIS funds can be identified through an individual state budget identification number (283067).

In 2009 no payments from GIS were made either to the Operating Bodies or to the Beneficiaries and operating costs for the two GIS Programs were not calculated or recorded in 2009.

We confirmed that the balance identified via the state budget identification number on the HUF bank account was 36 077 252 723 HUF on December 31, 2009. This amount includes the converted amount of EUR 134 750 000 plus interest (EUR 177 291.36) received for the amounts from Buyer 1 and Buyer 2. Interest for the amount from Buyer 3 is held on the EUR bank account. Only amounts held in EUR earn interest. We understand from interviews that all interest earned on the income from the quota sales will be transferred out of the GIS accounts in 2010 since all interest earned is the property of the MoEW.

Re procedure 5:

In 2009 neither EK NKft nor EMI NKft prepared a monitoring report.

Budapest, May 13, 2010



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