

Piotr Oleksyk

Wrocław University of Economics
Department of Accounting Theory and Financial Analysis
e-mail: piotr.oleksyk@ue.wroc.pl
phone 71 368 05 28

The role of accounting in measurement of efficiency in local government units

Abstract. *The following article is aimed to analyze and to extract the most important factors of measuring the efficiency of the activity of local government units. Limited budgets for the activities of local government units should be spent in the most efficient way. The author proposes the implementation of a performance budgeting procedure, which is currently not mandatory in local government units. Constructing such a procedure is helpful in gaining a new look at a unit's policy. The planning process is the same at every level and should include: diagnosis of the problem, an action plan with a timetable, a plan of financial resources for their implementation, and a monitoring system for the implementation of the plan. Improper selection of indicators and targets of individual actions taken under public tasks poses significant threats in the measurement of efficiency. From among these threats, the most substantial one is unreliable indicators which hide the imperfections of unit management.*

Keywords: *performance-based budgeting, effectiveness, management control, new public management*

Introduction

The provision of public services is an essential task of local government unit. These services are almost always non-profit; however, lack of income does not mean the possibility of the resignation of measuring the effectiveness and the

valuation effects of these activities. On the contrary – the inability of achieving profits poses even greater challenge to make its activity even more effective than in the case of commercial entities. This thesis mainly refers to those who base their activity on external funds – of course, not all non-profit entities are obliged to effective spending. Business practice has developed specialized entities whose main task is to implement the statutory objectives (e.g. taking care of a positive corporate image), regardless of the cost. In the case of such entities, efficiency is measured in a different non-financial method. Such a practice is not acceptable, and even prohibited in the case of entities whose activities are based on funds provided by the general public, often with significant social opposition of its representatives.

The local government units operate in accordance with established long-term business plan based on the expenditures and revenues. This plan is closely linked to the vision of development adopted by the management unit over the medium and long term. In the case of entities operating in the public finance this plans are linked to the strategy of state governance. Under conditions of limited resources allocated to the core activities the key issue is the most effective spending of funds entrusted. In this case the problem poses the measurement of efficiency the money spent on public activity. It is not possible to use the standard indicators of financial analysis, because the revenue generated from the project are the basis for estimating efficiency. Most statutory activities of local government units is related to their mission, which is to satisfy basic social needs, and these are rarely associated with the achievement of revenue.

The obligation to measure the effectiveness of local government units based on the Public Finance Act. The 68th article of the act requires the executive of the local government units perform management control, which is expressed in the following areas of activity of these units:¹

- 1) compliance of the law and the internal procedures,
- 2) efficient and effective operation,
- 3) the reliability of financial reports,
- 4) resource protection,
- 5) respect and promote the principles of ethical conduct,
- 6) efficiency and effectiveness of the flow of information,
- 7) risk management.

The effectiveness of the public expenditure is the issue which is frequently raised in the theory of public finance especially in terms of the expected growth in demand for public goods and services, which is largely resulting from unfavorable global trends. In the face of strong pressure on spending and with the

¹ Public Finance Act, Ustawa z dnia 30 czerwca 2005 r. o finansach publicznych, Dz.U. nr 249, poz. 2104 z późn. zm.

limited amount of public funds, it is necessary to analyse efficiency and savings in spending. Such activities will allow to use public funds in a more efficient manner. Moreover, a new trend in the management of public finance, occurs and it is placing emphasis on working out a better definition of the public policy objectives detailed scheduling of public tasks, monitoring of progress in their implementation and controlling the objectives achievements.

The aim of this article is to underline the most important factors supporting the measurement of the efficiency of the local government units. The unit management is closely related to the presentation of accurate and reliable information on the efficiency of the public expenditures. The funds, however, performs in units in insufficient amount. In the face of substantial decentralization of the public duties which leads to the increase in scope of tasks and consequently in public funds which are in competence of the local government, the issue of the public spending efficiency of local government units becomes a crucial matter as well as the recognition of the factors which affect this efficiency.

1. The effectiveness of the public spending in Poland

The efficiency and the effectiveness of public expenditure are the attributes of a modern state. The use of the appropriate instruments to measure them and the resulting conclusions affect the quality of the state institutions and the local government. According to the ideology of New Public Management (NPM) it is necessary to develop and implement clearly defined standards and measures of the activities and the tasks. The control tools should also be applied, in particular with regard to the standards and measures of the activities and the tasks.

Making the measurement and the valuation of the results provide the basis for evaluating the effects, which can be linked to the effectiveness and evaluation of the efficiency of the activities undertaken [Filipiak 2011: 225]. The new public management promotes the idea of the so-called 3E, which is an assessment of economy, efficiency and effectiveness. The new public management approach calls for the assessment of the following factors [Lubińska (ed.) 2007: 27]:

- what tasks the units perform,
- what expenses are allocated on individual tasks in a given financial year,
- what goals they want to achieve,
- the effects (results) of the intended targets,
- whether the intended targets have been achieved.

The efficiency in relation to the execution of public and local government tasks is understood as “a set of economic relationships in the form of cash flows between the participants engaged in the tasks assigned by law and depends largely

on the accuracy and correctness of the selection and the construction of the monetary instruments through which the division processes and the exchange of produced goods and services are carried out” [Sochacka-Krysiak 2009: 192]. Postuła and Perczyński indicate that the public spending are the primary factor in the increase in efficiency [Postuła, Perczyński (eds.) 2010: 20]. Thus, the efficiency can be understood as the formation of the public expenditure, including local governments, which allows for the greatest social utility of the allocated public funds. An important factor in increasing efficiency is also the decentralization. Patrzalek states that “the processes of collecting and distributing the public funds are more effective, if the trustees of the public funds and the institutions responsible for the provision of the public and social goods are closer to the local and regional communities” [Patrzalek 2012: 60].

The precise determination of the expenditure and the effects is a prerequisite for measuring the effectiveness, which is not always possible in the sector of public finances. This is due to the fact that the tasks of the public sector, including local government units, may be qualitative in their nature and difficult to quantify, as not only the effect is analyzed, but also the scope of the impact on the environment and the external benefits of the public expenditure are measured [Stiglitz 2004: 330]. Furthermore, the effects of the certain public expenditures occur after many years, which results in the lack of precise timing of the expenditure and the effects.

The effectiveness of the public expenditure should be measured at two levels – macro-and microeconomic. The macroeconomic analysis of the public expenditure is looking for the dependencies that exist between the amount and the structure of expenditure and fundamental macroeconomic values. There are various indicators such as the economic growth (local, regional or nationwide), the inflation rate and the unemployment rate that provide the information about the effects of the public expenditure. At the local government level the analysis can be performed only to a limited extent and for the general aggregates. The analysis can also be applied to those tasks that are implemented in the region or in the cooperation with other local governments [Tomkiewicz 2003: 38].

The microeconomic analysis of the efficiency of public expenditure is the study of how the public funds are spent by individual administrators (the subject analysis). The object analysis examines the amount of the public expenditure and its structure. Combining the results of the object and the subject analysis allows us to determine whether the transferred funds were effectively used by a particular officer or agency of the public sector, including local government units. In measuring the efficiency at the micro-and macro-economic level both the quantitative and the qualitative approach should be applied. This follows from the fact that the state and local governments units in particular are focused on the citizen and the society, its needs, development, social relations, and therefore the use of the quantitative measure only would be insufficient.

2. Efficiency measurement

In the amendment to the Public Finance Act the legislature upheld the principle of the effectiveness of the public spending of the money resources. It shows that the public expenditure should be made in a purposeful and economical way, with the principles of the best results of the data inputs, and the optimal selection of the methods and the means of achieving these goals, and also in the amount and under the terms of previously contracted commitments (Art. 44 The Public Finance Act). The legislature, seeing the need for measuring the effectiveness, indicate in the Public Finance Act the following instruments conducive to its growth and the measurement:

- performance-based budgeting,
- long-term financial planning (especially multi-state financial plan, long-term financial forecast for local government units),
- management control.

The indicated instruments are based on the measure and the assessment of the degree of realization of the set goals and the implementation of the programs, tasks, sub-tasks and activities. The implementation of a performance-based budget is mandatory in the government sector, but optional in the local government sector.

The amendment to the Public Finance Act and the regulations imposed on the local government units the preparation of the long-term financial forecast, according to art. 226 of this Act. The long-term financial forecast should be realistic and for each year covered by the forecast the elements listed below should be determined [Oleksyk 2012: 379-380]:

- the current revenues and the current expenditure of the budget of local government units, including the debt service, the guarantees and the sureties,
- property income, including the income from the sale of assets, and the capital expenditure of the budget of a local government unit,
- the result of the budget of a local government unit,
- investing the surplus or financing the deficit,
- revenues and expenditures of the budget of a local government unit, including the debt incurred and planned,
- the amount of the debt of a local government unit.

The challenge in the long-term financial forecasting is the appropriate estimation of the amount of the income of the unit. It is a very difficult part of the financial planning, since in this case one needs to make a complicated econometric statistical analysis that will allow for a reliable estimation of the future cash flows increasing the potential of the unit. The most important elements of such a model are:

- the growth affected by the revenues from grants and subsidies,
- the increase in the economic potential,
- the growth of wealth of the inhabitants of the area as a result of ongoing investments
- socio-demographic factors (population growth in the area due to e.g. internal migration).

These factors are specific to the local government units and should be extended to the standard elements of financial modeling. This forecast should cover the period of the financial year and the next three years following this period. The primary objective of the long-term financial forecast is to prepare reliable information on the basics of financing individual business segments in the future. The data contained in the long-term financial forecast may be the key information on the prospects of the development of the unit. It is important to analyze the debt of the unit, as exceeding the permissible thresholds may be the key problem with the current management of the unit, which often results in the failure of some actions. The information contained in the forecast is therefore the basis for making investment activities on the basis of a long-term investment plan. Currently, there are only some general guidelines for the preparation of this plan, despite the fact that the preparation of a long-term investment plan is a very difficult and multi-faceted task.

3. Problems of implementation

The most important problems related to the performance-based budget in local governments units include [Korolewska, Marchewka-Bartkowiak 2013: 170-171]:

- difficulties in formulating measurable objectives of the budgetary tasks,
- difficulties in defining performance measures and indicators of objectives of the budgetary tasks and specifying the expected value,
- the lack of adequate and reliable information systems for planning and monitoring the implementation of a performance-based budget (the need to integrate large amounts of data),
- the existing accounting model in local government units and too general provisions in the Act on accounting are not conducive to the records and the settlement of costs/expenditure in the system of tasks and other possible cost objects (services, products, programs and strategic objectives),
- low understanding and use of management functions of a performance-based budget,

- the problem of recognizing particular areas for funding the tasks and projects (especially in the cases where the department/unit has a very diverse range of activities),
- the conviction of administrators to the necessity of implementing a performance-based budget,
- the resistance from the workers,
- the need to make changes by all employees of the City and in all its subordinate units,
- changes in the organizational structure require the changes in the scope of tasks, which hampers comparing them over a period of time,
- the lack of organizational regulations allowing the assignment of particular tasks related creating a performance-based budget to qualified employees.

Generally, the leader of the measure is the person responsible for monitoring the individual/particular measures and the identification of opportunities and risks in achieving the planned path values for each measure assigned to them. In contrast, the owner of the measure is the person responsible for the activities that affect the value of the meter. In the city council the leaders of the measures should be directors of organizational units or persons responsible for the selected functional areas of the city council. In contrast, the owner of the measures should be a person appointed by the mayor as the coordinator of controlling tasks, mostly an employee of a public finance department. The basic tasks of the leaders of measures, taking into account the functioning of the city council, should be

- monthly monitoring of the measure,
- informing the owner of the measure if the meter reaches critical values and preparing a corrective action plan,
- preparing the information on the evolution of the measure,
- participating in quarterly and annual reviews,
- preparing proposals for changes in indicators, targets and specific objectives,
- initiating the actions that affect the value of the measure.

Monthly inspections should be carried out by the leaders of the measures. The leaders should evaluate the achieved value of the measure in relation to the plan. In the event of a critical assessment of the level of the measure the leader should develop a corrective action plan and initiate a corrective action. The information about the action taken in relation to the measure should also be forwarded to the owner of the measure. The owner of the measure should be an independent person, reporting only to the President of the city. Any dependence on the leader of the measure (the director of the organizational office of the city council) may cause disturbances of the process associated with setting the measures, preparing the calculation formulas of the measure, providing the data needed for the calculation or with setting a target value of the measure.

Another important issue relates to the resistance of the office workers. This matter always comes up when implementing new concepts in different types of entities, whether private or public, and it is very natural. It seems that the appropriate involvement of employees from different departments and units of the city council, proper communication and reporting on the implementation of the new solution should significantly reduce the resistance of the workers. The pilot implementation of a performance-based budget, e.g. only in terms of several disciplines is also used to help the employees become familiar with the development of such a budget. Positive effects can be quickly noticed by the workers and change their attitude to this new model of budgeting. It is highly recommended because the involvement of city office workers in the development of a performance-based budget and their understanding of the assigned responsibility for the execution of individual tasks contribute to the achievement of the desired effects.

Conclusions

A performance-based budget in local government units may be constructed on a voluntary basis, parallel to the existing budget in the traditional system. According to the provisions of the Public Finance Act, the powers to adopt a resolution on the drafting of the budget resolution has been granted to a constitutive organ of a local government unit. A constitutive organ may establish the budgetary scope of performance-based budget items (e.g. tasks, subtasks, the number and structure of the specific measures and targets). The records of the performance-based budget structure are either in the content of the adopted city budget or take the form of an accompanying document of the local governments unit budget.

In most cases, the implementation of a performance-based budget is the desire to increase the efficiency of the financial management of local government units. Moreover, the amendment to the Public Finance Act in 2009, introducing new instruments such as long-term financial forecast and management control, may induce local government units to implement a performance-based budget.

Appreciating the voluntary effort of the local government units implementing a performance-based budget, one may note the lack of uniform regulations, which leads to a lack of consistency between the different tasks and measures and makes the comparisons between similar cities quite impossible. The information presented in the system of task by each local government should have a significantly greater similarity, so that one can make comparative analyses, e.g. in terms of efficiency of expenditure for the same tasks by individual units.

The measurement of economic factors through different types of indicators is nowadays the standard in the management of many areas of modern economic life.

The most common purpose of manipulating on indicators is the desire to achieve higher profit, or payment for goods or services. In the case of local government units there is a possibility of manipulation of another type. The most common reason for these manipulation are financial security requirements contained in the legal regulations (mainly regarding the requirements for the maximum level of debt etc.).

Setting objectives and measures in the performance – based budgeting procedure is extremely difficult. It is a process in which excessive flexibility for lower-level units in the selection of indicators may be associated with the risk of manipulating of the indicators. As a consequence it may also lead to pathological practices that could be called “creative performance – based budgeting.” Creativity in this case should be seen as negative practice, connected with the selection of measures which are “convenient” for the unit management. The solution, which will significantly reduce the possibility of manipulation is to introduce regulation, which clearly define the selection of indicators for each task. The choice of measures should be defined in the Public Finance Act so that any attempted manipulation was significantly difficult to hide due to the obligation to obey mandatory regulations.

Measures designated in the performance – based budgeting process are very useful in measuring the effectiveness of local government units. These units are obliged to identify business development plans for at least one year. Such plan should include minimum and maximum values of predefined indicators. In case of product indicators it may be desirable to exceed the minimum ratio(e.g. the more miles of roads built is the better). However, a positive trend with cost indicators is the greatest lower deflection from the maximum unit cost index.

The implementation of a performance – based budgeting is a different approach to planning and determining the objectives of local government units. The planning principles so far were based mainly on the execution of expenditure in previous periods without the possibility of assessing the relevance of these expenditures. The experience of developed countries proves that accounting records and reporting on their own are not able to change or improve anything. One should not forget that the essence of accounting and reporting is to provide reliable information necessary for current decisions making – operational as well as long-term – strategic. Thus, the correct use of relevant information is the most important in making changes in public expenditures. New kind of reports in performance – based budgeting a (especially information concerning the indicators) are helpful in obtaining information about effectiveness of elementary operations. These results are the basis of taking preventive corrective measures. Unfortunately, these measures when used in improper management environment may also become means for hiding the actual unit’s performance which is based on funds from stakeholders waiting for reliable information.

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Rola rachunkowości w pomiarze efektywności jednostek samorządu terytorialnego

Streszczenie. Artykuł ma na celu wskazanie kluczowych czynników niezbędnych do oceny efektywności w podsektorze samorządowym sektora finansów publicznych. Nie tylko zaprezentowano, ale przede wszystkim przeanalizowano i wyodrębniono najistotniejsze czynniki pomiaru efektywności w JST. Ograniczone środki budżetowe przeznaczane na ciągłą działalność powinny być wydatkowane w sposób jak najbardziej efektywny. Autor proponuje wdrożenie procedury budżetowania zadaniowego, która nie jest obowiązkowa w działalności jednostek samorządowych. Procedura ta jest bardzo pomocna w kompleksowej ocenie działalności jednostki. Nie jest jednak idealna, ponieważ stwarza poważne zagrożenia związane z przygotowaniem nierzetelnej oceny na podstawie doboru niewłaściwych mierników efektywności. Zagrożenia te wynikają najczęściej z chęci ukrycia przez zarządzających własnych błędów, które są zwykle skutkiem błędnych, przeszłych decyzji.

Słowa kluczowe: budżetowanie, efektywność, kontrola zarządcza, nowe zarządzanie publiczne