

**CONSTRUCTION AND THE PROCESS
OF IMPLEMENTING THE MANAGEMENT CONTROL
SYSTEM IN A LOCAL SELF-GOVERNMENT UNIT –
A PRACTICAL APPROACH**

Anna Bartoszewicz

Department of Accountancy
University of Warmia and Mazury in Olsztyn
e-mail: anna.bartoszewicz@uwm.edu.pl

K e y w o r d s: control, management control, audit, public finance sector, local self-government unit.

A b s t r a c t

Since 1 January 2010, management control has been functioning in the units of the public finance sector as it has replaced the previously applied financial control. The assumption of management control was to support the achievement of the objectives and performance of tasks carried out by public entities in Poland and consequently to facilitate the process of managing them. As practice shows, some entities have failed to develop an adequate system of action that would allow making a good use of this tool.

Thus, the purpose of this article is to present a practical approach to the deployment and implementation of a management control system in a local government unit and indicate substantive gaps that remain. The article presents an exemplary solution of the deployment and implementation of a management control system operating in one of the district offices in Poland. The article also presents implications resulting from the functioning of this system and gives a critical approach to the subject matter, pointing out shortcomings in the functioning of management control in a public entity.

**BUDOWA I PROCES WDROŻENIA SYSTEMU KONTROLI ZARZĄDCZEJ W JEDNOSTCE
SAMORZĄDU TERYTORIALNEGO – UJĘCIE PRAKTYCZNE**

Anna Bartoszewicz

Katedra Rachunkowości
Uniwersytet Warmińsko-Mazurski w Olsztynie

S ł o w a k l u c z o w e: kontrola, kontrola zarządcza, audyt, sektor finansów publicznych, jednostka samorządu terytorialnego.

Abstrakt

Od 1 stycznia 2010 roku w jednostkach sektora finansów publicznych w Polsce funkcjonuje kontrola zarządcza, która zastąpiła funkcjonującą dotychczas kontrolę finansową. W założeniu kontrola zarządcza miała wspomóc realizację celów i zadań wykonywanych przez podmioty publiczne oraz ułatwić proces zarządzania nimi. Jak się jednak okazało, w niektórych jednostkach w dalszym ciągu nie udało się wypracować odpowiedniego systemu działania, który pozwoliłby na pełne wykorzystanie tego narzędzia.

Celem artykułu jest zaprezentowanie praktycznego podejścia do procesu budowy i wdrożenia systemu kontroli zarządczej w jednostce samorządu terytorialnego oraz wskazanie luk, które należy uzupełnić w tym zakresie. W publikacji przedstawiono przykładowe rozwiązanie w zakresie budowy i implementacji systemu kontroli zarządczej, który funkcjonuje w jednym ze starostw powiatowych w Polsce. Zaprezentowano także implikacje związane z funkcjonowaniem tego systemu oraz krytycznie przeanalizowano, wskazując na pewne niedociągnięcia w funkcjonowaniu kontroli zarządczej w badanym podmiocie.

Introduction

Recently, the evolution of control systems in the units of the public finance sector has become a noticeable and common phenomenon in Poland. Until January 1, 2010 only financial or internal controls were applied in public entities as control measures. In the traditional sense, their main purpose was to verify the tasks completed by the entity's employees thereby ensuring compliance with legal regulations and set procedures.

However, with the enactment of the Act of 27 August 2009 on Public Finance¹ the term „management control” was implemented with state administration bodies². This term has replaced the hitherto existing financial control (see also: *Ustawa o finansach...* 2014, s. 490), while transforming pre-existing control activities of an inspection and revision nature more toward the level of attainment of objectives by the unit.

Since that moment, the term „control” was to mean first of all „to identify risks and implement the process of risk management”. As a consequence, it caused a significant increase in the efficiency of public sector entities with minimum involvement of additional financial resources or means.

It should be emphasized that the implementation of the solutions mentioned above is particularly important in the local government sector, which in Poland is formed by three types of entities: municipalities, districts and provinces. Their specific associations and organizational units have been established to carry out public tasks, thus their main task is to satisfy the most

¹ The Act came into force on 1 January 2010.

² The term „management control” was introduced with art. 68 of the Act of z 27 August 2009 on Public Finance.

urgent needs of the local community. Therefore, in such units scheduled tasks require effective implementation and monitoring. And that is possible, among other things, due to the efficiently working system of management control.

It is worth mentioning that management control is a critical function in organizations. Management control failures can lead to large financial losses, reputation damage, and possibly even to organization failure (MERCHANT, VAN DER STEDE 2007, p. 3).

Despite the seemingly clear guidelines for the development and implementation of management control, included in the Public Finance Act, some solutions adopted by local governments unfortunately seem to be unsuccessful. Thus, the purpose of this article is to present a practical approach to the deployment and implementation of a management control system in a local government unit and indicate remaining substantive gaps. In order to achieve this objective, the analysis of both legal instruments and subject literature have been applied.

Based on the case study method, an exemplary solution of the deployment and implementation of a management control system operating in one of the district offices in Poland has been illustrated in this study. The article also presents implications resulting from the functioning of this system and gives a critical approach to the subject matter, pointing out shortcomings in the functioning of management control in entity.

The essence of management control and its coordination in local government in the light of the legislation and scientific theories

Management control was already defined by Anthony in 1965 as „the process by which managers ensure that resources are obtained and used effectively and efficiently in the accomplishment of the organization’s objectives” (ANTHONY 1965).

In Poland the management control was introduced to the public finance sector entities with the provisions of the Act of 27 August 2009 on Public Finance, where it was described as „all activities undertaken to ensure that objectives and tasks are realized in compliance with legal regulations, efficiently, economically and punctually” (art. 68 of the Act on Public Finance). The mandatory obligation to observe the rules of management control applies to all public sector entities. This range involves the entities listed in Article 9 of the Act on Public Finance, including local government units. According to the regulations, the purpose of management control is to ensure in particular (art. 68 paragraph 2 of the Public Finance Act):

- 1) Compliance of activity with law regulations and internal procedures;
- 2) Effectiveness of taken actions;
- 3) Reliability of reports;
- 4) Protection of resources;
- 5) Respecting and promoting the principles of ethical conduct;
- 6) Effectiveness of communication and information flow; and
- 7) Risk management.

The main framework for the functioning of the system of management control in public finance sector units is determined by generally applicable standards of management control. These are defined on the basis of globally-accepted concepts and common standards of internal control (SZCZEPAN-KIEWICZ et al. 2015, p. 21) and they were divided into the following five groups (Bulletin No. 23 of the Minister of Finance of 16 December 2009):

- Internal environment,
- Objectives and risk management,
- Control measures,
- Information and communication, and
- Monitoring and assessment³.

Ensuring the efficient, adequate and effective management control at local governments should be the responsibility of their heads:

- a) the mayor (vogt, president) in the case of municipalities;
- b) chairman of the board in case of the local government units, namely:
 - starost for the district office,
 - marshal of the province for the marshal's office; and
- c) head of another organizational unit of local government.

In addition, the local government manager is obligated to make a statement about the status of management control for the preceding year with respect to the unit led by him. Data sources in this area should include:

- self-assessment of the state of management control, made by the heads of organizational units based on self-assessment questionnaire prepared in cooperation with the Internal Auditor;
- anonymous assessment of management system and control, made by employees of these cells, based on a questionnaire; and
- current monitoring of the level of risk and types of risks.

It should be emphasized that an important aspect of management control is to systematically identify risks that may threaten the objectives and tasks of the unit. In the case of local government units and government administration, this process should also include the objectives and tasks that are carried out by

³ Due to the volume of this article, its content has been limited to reporting exclusively the major names of specific groups of standards.

the supervised or subordinated units. Each unit should adapt its methodology for risk management to their specific needs and characteristics. There are varieties of techniques to identify risks: checklists, brainstorming, analysis of reports, audit results, risk registers, review of the organization, graphical process analysis, and SWOT analysis.

The surest solution in this regard appears to be the creation of an appropriate position responsible for management control. A person in this position could have a task to chair a team composed of the heads of various departments of the unit/entity who annually would identify risks which threaten achievement of objectives and tasks of the unit. In addition to unit leadership, this process should include the remaining employees of the unit, among which a survey is carried out on risk identification. These survey results are analyzed and used as the basis to implement controls and take steps to minimize risks in future. It should be stressed that the introduction of management control not only transformed the character or nature of control in public sector, but it also changed the approach to internal audit. Figure 1 presents the model of the realization of the process of management control in the public finance sector unit.

The internal audit was established as a tool for monitoring and evaluating management control systems and indicating desired improvements in this area. It has thus become a necessary instrument to implement the appropriate solutions in the control system, in particular to determine the relationship between management control, audit and internal control (KIZIUKIEWICZ 2013, p. 59).

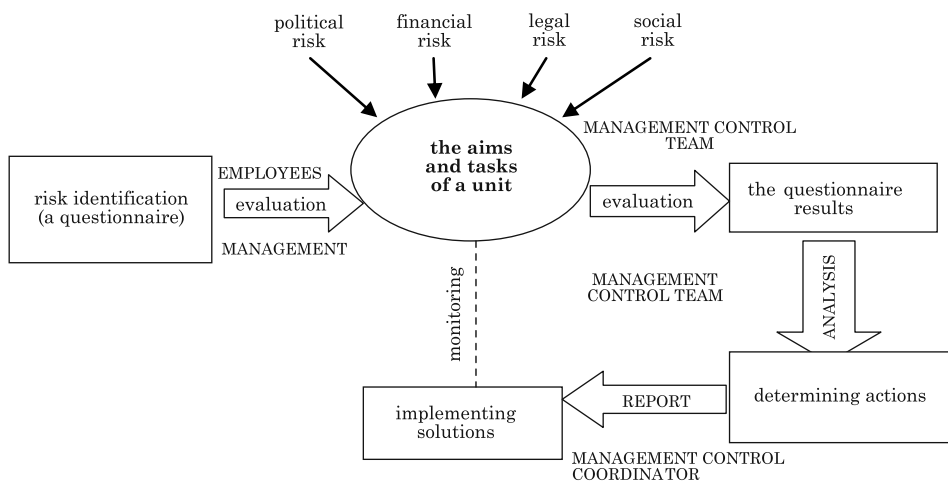


Fig. 1. Model of the realization of management control in the public finance sector unit
Source: own study.

Construction and tasks of management control system at a district office – a case study

In order to demonstrate how management control system was constructed and implemented in a local government unit, an exemplary solution was used, which has been operating since 2011 in one of the county authorities in Poland. For counties, the new concept was to be implemented in the district offices, whose tasks are, among other things, provide assistance to county authorities in carrying out their tasks and bearing responsibilities. For this reason, management control systems in respect of the counties have been implemented and are functioning in these units.

The main internal act governing the operation of management control of the entity is Starost Ordinance on Defining the Rules for the Operation of Management Control in the District Office and its Organizational Units. The rules set out in particular the aims and objectives of management control, as well as the system of management control and organization of management control in the District Office. According to the Ordinance mentioned above, the objectives set for management control are primarily ensuring compliance with applicable laws and procedures, maintaining success rate and efficiency, ensuring credibility of the reports, protecting resources, respecting and promoting the principles of ethical conduct, and ensuring efficient flow of information and risk management.

The organizational structure of the audited entity included an independent position for management control, which reported directly to the Starost of the District. This position was covered by a designated employee of the District Office charged with the coordination of the management control system in the audited entity.

In addition, the heads of County departments as well as employees involved in independent positions were responsible for verifying the correctness of tasks by subordinate employees in the organizational structure. The task of management control in the entity is comparing the actual status quo to the planned one, explaining possible causes of deviations from the implied values, as well as taking actions to eliminate the occurrence of deviations in the future.

The basis for the implementation of management control are rules, instructions, procedures and principles approved by Starost. They consist of the following issues:

- protocols of internal audits conducted by the chief specialist in management control on the first and second level;
- protocols of internal audits conducted by heads of departments;
- cards of internal audits;
- post-audit recommendations; and
- reports on the implementation of audit recommendations.

The system of management control functions in an entity on two levels: Level I, which includes control of district organizational units, and Level II which provides supervision exercised on the county level. Managers of individual units are in charge of the functioning of management control at Level I, whereas management control at Level II is provided by the Starost (or other person authorized by him/her) and the Audit Commission of the District Council. The following activities constitute the management control system:

- systematizing the organization and activities of the district units achieved through the establishment of the statutes and regulations of these units;
- identifying objectives and tasks in accordance with applicable laws;
- setting and enforcing law within local law regulations by the resolutions of the District Council and District Board;
- supervising the operations of units through the organization of internal controls and analysis of the results of external institutional audits;
- organizing information flow and communication with units; and
- financial and task planning, as well as reporting on the implementation of the plans in half-yearly and annual prospect.

The system of management control in the audited entity is composed of four subsystems covering the following elements:

- internal control (IC);
- financial control in the subordinate units (FC);
- ISO quality management (ISO); and
- internal audit (IA).

The management control system in the analyzed unit is illustrated in Figure 2.

Internal control is coordinated by the District Starost. The control is performed by the heads of particular departments of the District Office which verify the work performed by subordinate employees. All organizational units of the District Office are covered by internal control, which is carried out to verify their operations for compliance with applicable law, while financial control is carried out by the main specialist for management control, basing on semi-annual plans approved by the District Starost. The scope of the audit includes verification of the correctness of accounting in organizational units of the County, collection and spending of public funds, public procurement, protection of resources, and the reliability of reports. Another element of management control is the ISO quality management system, headed by a dedicated representative for quality assessment whose role is monitoring the implementation of the objectives that are pre-determined each year by the heads of individual departments and district office staff. On 31 December each

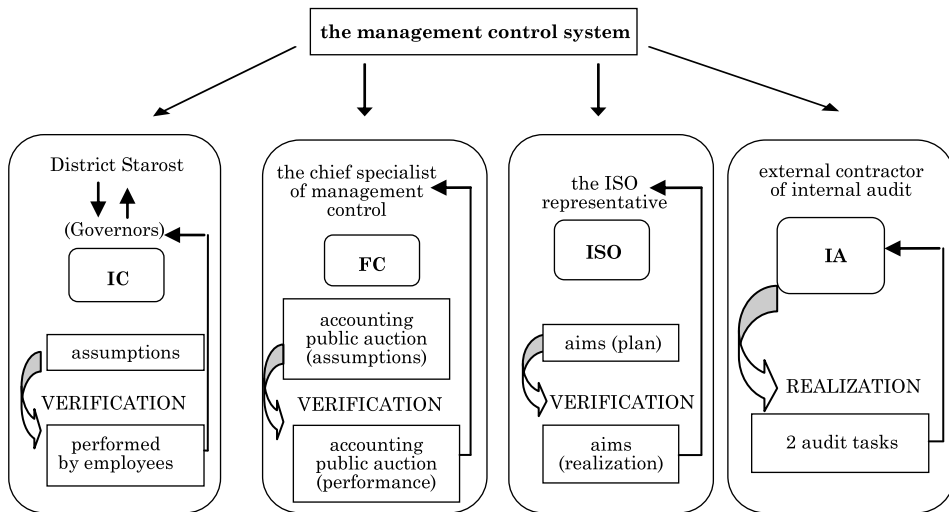


Fig. 2. The management control system in the analyzed unit

Source: own study.

year, they draw up a report on the implementation of these objectives for that year, and then forward them to ISO representative for the analysis. In the entity being the subject of this research, the internal audit is also a part of the management control system. The internal audit is run by an external service provider. Annually, two audits are performed, usually one in the Starost's Office, and the other one in the selected organization unit of the District. Tasks are selected basing on the results of risk analysis performed for the purposes of the audit, the ISO audit results and conclusions resulting from financial audits.

Steps in implementing the management control system in the entity and items to supplement information gaps

The process of implementing management control in the entity was conducted in four phases: I. Preparatory Phase; II. Diagnostic Phase; III. Main Phase; IV. Accounting Phase. The first phase consisted primarily of the appointment of a coordinator to implement the management control in the audited District Office. His role was to organize the process of implementing this tool and then coordinating the work on the functioning of the whole system. The heads of individual departments and the people employed on independent positions were also involved in the process. For the second stage,

the team mentioned above verified the existing status of the entity: the legal, legislative, personnel and financial state of the District Office. In addition, a review of controls, internal environment, information flow and communication was conducted in the entity. The role of the auditor in the process of management control activities was also defined. At the Main Phase the course and rules of management control were developed. The responsibilities of individuals involved in the process were defined. The Starost Ordinance on the operation of management control in the entity and other organizational units of the county came into force. The last Phase (Accounting) summarized the work carried out thus far. Its purpose was, among other things, identification of irregularities and weaknesses of the implemented system. This Phase allowed choice of the right methods to improve the entire system going forward. While analyzing the process of constructing and implementing management control system in the audited entity, it was evident that there were certain information gaps that made the system incomplete. I argue that the most important gap is the missing risk identification and risk analysis for the unit. It is not possible to fully use the management control tool if this information is not available. Risk identification reveals all the areas or weak points that the entity should be protected against. The risk analysis makes it possible to specify potential impact and risk likelihood in the future. If this step is omitted, it is difficult to determine the appropriate response to possible risks, such as tolerating, transferring, withdrawing, or mitigating such risk. It is worth pointing out that this stage requires involvement of not only department management, but also remaining workers who would be able to identify a risk.

A very strong correlation of management control to the internal control and financial control tools seems also to be a shortcoming in the functioning of the system; i.e., in the audited entity the process of control is mainly focused on verifying the correctness of employees' work and its compliance with applicable laws and procedures. The management aspect is missing, which would have improved the level of achievement of the objectives in the audited entity, and thus would have improved the efficiency of all its operations. The realization of aims is evaluated only by the ISO Representative paying special attention to the quality norms. Including the ISO audit in the management control system is not a good solution. The incorporation of internal audit process into the management control system also raises some reservations. According to the provisions of the Act on Public Finance, an audit should lead to an assessment of the functioning of management control in terms of its adequacy, effectiveness and its performance in the unit. Thus, it is definitely contradictory to combine control and audit functions in one system. In the analyzed example the internal audit is built into the system of management control as one of the four elements, which, in this case, appears to be unjustified.

To sum up, it should be stated that dividing the management control system into four separate blocks, without a system coordinator and a management control team, is a bad solution. Consequently, there will be no transfer of information in the system and there will be no feedback between the diagnosed improprieties and the evaluation of the realization of the aims, and the decision-making process. In the analyzed example, the information gets only to the coordinator of given blocks, however, there is no picture of the unit functioning as a whole entity. The management control team should identify and analyze the risk in the unit and then transfer the results to the manager, in this case to the Starost who, on the basis of the information, could estimate the realization of the aims and make decisions about further actions.

Conclusion

The assumption of management control is to support the achievement of objectives and performance of tasks carried out by public entities in Poland and thus to facilitate the process of managing them. However, in order for the system to function, it becomes necessary to appropriately construct and implement it. As practice shows, some entities have failed to develop an adequate system of action that would allow good use of this tool. Perhaps the reason is a too general approach to the functioning of management control (see also: KOWALCZYK 2012, s. 74, 75) in relation to public sector entities. Another reason can be the mistaken understanding of its concepts. And although the introduction of management control to the finance public sector was an important step towards changing the mentality of public administration, many areas in this matter still need some refinement.

Translated by ALEKSANDRA BORZOL
Proofreading by DONALD SCHEPERS

Accepted for print 31.03.2016

References

- ANTHONY R.N. 1965. *Planning and Control Systems: Framework for Analysis*, Boston Graduate School of Business Administration, Harvard University.
- Audyt wewnętrzny w strukturze kontroli zarządczej*. 2013. Red. T. Kiziukiewicz. Difin, Warszawa. Komunikat nr 23 z 16 grudnia 2009 roku w sprawie standardów kontroli zarządczej dla sektora finansów publicznych (Dz.Urz. MF nr 15, poz. 84).
- KOWALCZYK E. 2012. *Odpowiedzialność kierownika i głównego księgowego jednostki finansów publicznych*. ODDK, Gdańsk.
- MERCHANT K.A., VAN DER STEDE W.A. 2007. *Management Control Systems. Performance Measurement, Evaluation and Incentives*. Second Edition, FT Prentice Hall Financial Times, England.

-
- SZEPANKIEWICZ E., KAMELA-SOWIŃSKA A., ŻÓŁTOWSKI R., KŁAK J., SZYBA A., MŁYNARCZYK K., WITKOWSKA M., LUMA A. 2015. *Kontrola zarządcza i audyt wewnętrzny w jednostkach samorządu terytorialnego*. Oficyna a Wolters Kluwer bussiness, Warszawa.
- Ustawa o finansach publicznych. Komentarz*. 2014. 2 wydanie. Ed. P. Smoleń. CH Beck, Warszawa.
- Ustawa z 27 sierpnia 2009 roku o finansach publicznych, DzU z 2013 r., poz. 885.

