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15 YEARS STANDARDS OF MANAGEMENT CONTROL IN POLAND – EVALUATION

OCENA PIĘTNASTU LAT STANDARDÓW KONTROLI ZARZĄDCZEJ W POLSCE

DOI: 10.15611/pn.2017.478.32

Summary: The article presents an overview of changes in law concerning management assessment in Poland, as it pertains to public financial institutions in accordance to the implementation of relevant European Union treaties. The subject of examination is the amendment of Public Finances Act from the year 2001. Partial evaluation will be performed on the application of a bill dated from 2009. According to the author, this is mistake, as the original American bill (Sarbanes-Oxley Act) that inspired the European legislation, only requires the management of private firms to file such declarations. Meanwhile Poland decided to have the law apply to public sector as well. The article attempts to evaluate the last 15 years of the currently functioning legal system. Studies have shown that the current supervision system of management assessment is ineffective, ineffectual and largely useless forcing the employees to needlessly rely on risk analysis and resort to costly control mechanisms and procedures.

Keywords: standards, management control, public finances, unit.

Streszczenie: Artykuł przedstawia ocenę zmian prawa w zakresie standardów kontroli zarządczej, nałożonego na jednostki sektora finansów publicznych w Polsce przez wypełnienie zobowiązań traktatowych z UE. Przedmiotem badań jest nowela ustawy o finansach publicznych z 2001 r. wprowadzająca nowy system kontroli zarządczej (do końca 2009 r. funkcjonującej pod nazwą kontroli finansowej). Częściowej ocenie podlega także zastosowanie przepisów ustawy z dnia 7 maja 2009 r. o biegłych rewidentach i ich samorządzie oraz obowiązek składania oświadczeń o stanie kontroli zarządczej, nakładający na większość kierowników sektora jednostek publicznych obowiązek składania corocznych oświadczeń o stanie kontroli zarządczej. Amerykańska ustawa Sarbanes-Oxley, na której wzorowano się w Europie, nakłada taki obowiązek na szefów wielkich przedsiębiorstw prywatnych. W Polsce natomiast nałożono taki obowiązek w sektorze publicznym. Podjęty w artykule problem przedstawia ocenę 15 lat funkcjonowania reżimu prawnego w postaci kontroli zarządczej. Badania dowiodły, że nowo ustanowiony system jest nieskuteczny, wymaga stosowania analizy ryzyka i kosztochłonnych mechanizmów kontrolnych.

Słowa kluczowe: standardy, kontrola zarządcza, finanse publiczne, jednostka.

1. Introduction

Fifteen years have passed since the introduction of modern management control (previously referred to as “financial control”)¹ yet the subject remains relevant today. Management assessment as described by the bill on public finances, was not designed to regulate the processes of public resources gathering, govern spending and disposition of property and money as opposed to powers of the old institution of financial control based on the public finances bill from 2005. The statement of reasons for the bill of public finances from 2005 implied that the institution of financial control only applied to finances of the public institution. Before the new bill of 27 August 2009 entered into force, the term management assessment was an alien term for management bodies of public financial institutions, commonly and broadly interpreted as just another term for financial control.

Financial control in public sector regulated acquiring and disposition of public resources and managing property. The exact tasks of financial assessment were as follows:

- Preliminary evaluation of appropriateness of incurred financial obligations and expenses.
- Examination and comparison of the actual disposition with the expected disposition of public resources.
- Disposition of public auctions and returns of public resources
- Conduction of affairs and application of procedures related to record keeping (art. 47 of the bill from 30th of June 2005).

2. Origin of management control standards

Deployment of the management assessment systems in public sector institutions of Polish economic state, was initiated by the United States in accordance with the concept of Pax Americana; America being the economic leader and a benchmark and trend setter for other countries.

In 2002 the USA passed legislation called “An act to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws and for other purposes: Pub. L. 107-204” commonly referred to as Sarbanes-Oxley (SOX or SarOx) that tackled a broad spectrum of issues beginning with naming the Public Company Accounting Oversight Board (PCAOB), defining responsibilities of boards of directors, ensuring the independence of auditors, defining new regulations in the process of management assessment, and performing an obligatory annual survey, ending on the issue of corporate fraud accountability.

Sarbanes-Oxley act adopted by the Congress requires the management of private public companies listed on the New York Stock Exchange (NYSE), to adhere to the

¹ In literature, terms “management control” and “internal control” are synonyms.

new strict legal discipline of producing management assessment reports. The supposed reason of these reports is mitigating the risk of being sued by the shareholders due to false or misleading information entering the stock market or outright attempts at fraud.

The European Union, following the United States, attempted to redefine the responsibility of reporting actors within accounting departments of companies and the role powers of external auditors monitoring financial reports from those departments.

International fraud and accounting scandals that took place in the United States and Europe and brought down a lot of large enterprises had initial influence on starting the effort of redefining the control measures in the financial sector. The revealing of fraudulent finances in 2001-2003 had consequently undermined the thrust of professional auditors and companies specializing in auditing. The major influence in the EU, as mentioned before, was enacting of the Sarbanes-Oxley Act and its influence on European companies trading on the American stock market.

These efforts produced the Ninth Council Directive [Dyrektywa 2006/43/WE...] on statutory audits of annual accounts and consolidated financial accounts. The directive has been in force since 29th of June 2006, and gives membership states two years to implement its regulations.

On 7th May 2009 Polish legislators passed a bill on Professional auditors and their self-governing body, entities authorized to supervise and inspect financial statements and public oversight. The aforementioned bill, in force since the 6th of June 2009, is designed to improve the standard of financial reviews and surveys, improve the quality of financial statements, as well as trust in institutions, aid competitiveness of various bodies on the domestic and international market [*Uzasadnienie do projektu ustawy*]. The bill imposed on auditors the obligation to inspect and evaluate the internal management assessment system in any investigated body.

Management assessment standards determine the basic requirements of supervising entities in public finance sector.

Management assessment standards are a set of directives for people responsible for the proper functioning of management assessment, and should be used for rating and improvement of the internal management assessment systems.

Standards are divided into five groups corresponding to specific management assessment elements:

- internal environment,
- goal and risk management,
- control mechanisms,
- communication and information,
- monitoring and evaluation.

3. Standards overview

3.1. Internal environment

Proper internal environment is fundamental to other elements of management assessment. Standards in the scope of management assessment pertain to the management body and the organization as a whole. The bulletin devotes special attention to the adequate task arbitration and proper internal structure of the organization in the context of the internal environment. The scope of tasks, responsibilities, powers and subordination degree of employees ought to be specified clearly, in concise, legible and understandable manner.

Company employees should be aware of ethical values, standards and laws that are to be observed when performing assigned tasks. Management staff are obligated by these standards to uphold and promote the ethical values by example and whenever possible by daily decision-making.

The entity is also obligated to provide for the management staff in terms of knowledge, relevant skills, training and experience in order to facilitate smooth and effective functioning and fulfillment of duties. The process of hiring in the entity ought to ensure best possible candidate fills the relevant position. The occupation should enable employees and management staff to further develop their abilities and enhance their qualifications.

The range of powers delegated (assigned powers) to management staff should be accurately defined. Assigning decision making powers, especially those concerning immediate, current and standing matters should be verified by employee signature.

Correct procedures specifying the course of economical processes ought to be observed when charging employees with the designated task. The description of necessary procedures without a proper appointment of persons responsible, is evidence of poor organization of management staff. Work regulations of the unit is an example of internal code of laws within an organization, and is one of the forms of mandating duties from the scope of financial economics. Therefore its role is a key in defining a proper internal environment.

Granting powers by the very nature of the process requires that the new duties are accepted by the employee and the fact is recorded with an appropriate document. This means that appointing duties to the employee may prove ineffective if it is not accompanied by signed document verifying its acceptance. Signing the copy of regulations is an example of accepting duties and responsibilities by the employee.

3.2. Goals and risk management

The group “Goals and risk management” relates to the issue of the purpose of the organization and assessment of risk and adapting to it.

Accordingly, following standards can be singled out:

- mission,
- declaration of tasks and objectives,

- monitoring of tasks, identifying risk,
- market analysis and risk response.

The nature of the first item from the list of goals and risk management, alludes to the opportunity of defining the purpose of the entity in the form of a short, succinct description. It is worth mentioning that properly outlining the mission statement can aid in establishing the hierarchy of goals and tasks, and may prove conducive to effective risk management. Risk management is best defined as any action that public entity can take in order to increase the odds of favorable resolution of a problem. The process should be thoroughly documented.

The goals of every public financial sector entity ought to be declared clearly at least a year in advance. Performance should be evaluated with designated metrics. Supervising or overriding entities should have a monitoring system provided, for the purpose of supervision of designated goals and completion of tasks in subordinate or monitored entities. Simultaneous evaluation of realization of established goals with such criteria as effectiveness and frugality is thus highly recommended. Appointing a responsible person or entity is essential to the seamless realization of the mission plan.

Public financial sector entities should evaluate the associated risk not less often than once a year. In case of administrative units or municipal entities special attention should be paid to the fact that goals and tasks are pursued by designated subordinate organizations. In the event of major change in conditions affecting an entity, risks should promptly be evaluated anew. The process of identifying risks should be subject to a strict analysis, designed to estimate the odds and potential consequences of the associated risk. Above everything else it is crucial to have an acceptable risk threshold and a defined course of action in response to (tolerate, mitigate, act or withdraw) the critical level of risk. Actions, designed to effectively decrease the risk involved, should be predefined for such an event.

Management assessment and risk management require a proper risk analysis, most likely learned from scratch by the employees without understanding of the underlying problem due to sheer difficulty of the subject of risk evaluation. The time and money allotted for training of the staff contributes to disorganization (especially in small entities) and waste of public funds.

3.3. Control mechanisms

Standards in the field of control mechanisms are, most of all, a set of basic mechanisms, capable to function in the frameworks of management assessment. However, they do not form a closed catalog, since the system of management assessment is supposed to remain flexible and adaptable for the particular needs of an entity of the public sector. It is essential to remember that the deployment costs of control mechanism have to remain lower than savings made possible with them, in order to remain viable.

Internal procedures, instructions and guidelines, documents defining the breadth of duties, powers and responsibilities of employees, along with other internal documents, constitute the whole of internal paperwork of management assessment system. This documentation should primarily be consistent, not contradictory, and freely and easily available for anyone. Constant supervision of tasks should be performed in order to maintain the performance, effectiveness and frugality. Mechanisms designed to preserve the continuity of operation of the entity should be developed from, among other things, the results of risk analysis and other useful documents. All the resources of the entity should be secured from the access for unprivileged personnel. Management staff and employees should provide care, security and proper use of the resources of the entity.

Every public finances entity should have basic control mechanisms, pertaining to economic and financial operations. Among the basic control mechanisms are the following:

- thorough and reliable records and documentation of transactions,
- authorizing of all financial operations by the head of the entity (eligible person),
- distribution of duties and responsibilities,
- verification of financial operations before and after their realization.

It is also of utmost importance to have some data and privacy protection and information systems security.

It is worth observing that most likely these aspects of management assessment incur unnecessary expenses that do not correspond to and are not a response to the risk identified. Some entities employ external, outside costly control mechanisms. This practice has two negative consequences. First issue is that control mechanisms are implemented that are of little use for the entity, simply because the risk does not occur for that entity and so the risk mitigation strategy of some control mechanisms is simply wasted. The second issue is the fact that every taken measure has to be paid for and accounted for and this, in the author's opinion, is a waste of public resources.

3.4. Information and communication

Standards within the area of information and communication contain the provision of ensuring that entity employees are granted access to necessary information for the execution of assigned tasks, especially those pertaining to management assessment. The standard states that: "management staff and employees ought to have access to information needed in order to perform their duties. The system of communication should enable information flow within the entity, both in vertical and horizontal direction. The efficient system of communication will not only enable information exchange, but also facilitate understanding of that information with the recipient". [Komunikat Nr 3 Ministra Finansów z 16 lutego 2011].

Relevant and accurate information ought to be procured and provided in appropriate manner for the management staff and employees for the purpose of task

completion. One of the elements of this standard is an effective communication system within the organizational unit, allowing each staff member to better understand the purpose of the management assessment system, rules governing its function, and individual role and accountability in it. Communication should also be successful in the outside sphere of influence, with external entities and organizational units, that may positively impact the ability of reaching designated goals as well as positively influence other activities of the whole entity such as gathering and spending public resources.

Therefore, the staff of public sector of financial institutions need access to the constantly updated database of information, with the intent of sound and thorough completion of allotted tasks. Also, the ability of the management of the entity to make key decisions is determined by the quality of information provided. For the agile operation of an entity, information flow and the importance of information assessment are key issues in accomplishing the entity's goals [Małecka-Łyszczek, Ćwiklicki 2015].

3.5. Monitoring and evaluation

Standards of monitoring and evaluation introduce a principle of constant evaluation of the management assessment operational system within any entity. Performing such evaluation, should be based on findings from the prior efficiency of a particular element of management assessment that made it possible to solve currently identified problems. The manager of the entity is liable for the evaluation, however, other personnel with executive powers can be made responsible. Self-evaluation is recommended at least once a year in accordance with monitoring standards.

An important element when preparing a self-evaluation of the management assessment system is the fact the employee training personnel taking part in the process should have at least some basic knowledge of management assessment. Already trained employees are expected to understand the purpose of self-assessment and have the knowledge necessary to perform self-assessment [Komunikat Nr 3 Ministra Finansów z 16 lutego 2011].

The review of the management assessment system can be performed by means of multiple separate evaluations performed by the employees process that should be documented. A statement mentioning grading and documenting self-assessment appearing in the monitoring and evaluation standards, does not include subject matter, that ought to be reiterated in internal procedures.

Obtaining a guarantee of the state of management assessment by the head of the entity should be based on:

- monitoring,
- self-assessment,
- conducted audits.

Standards in the discipline of monitoring and evaluation, also recommend annually obtaining the above mentioned guarantee, in the form of a declaration on the condition of management assessment for the preceding year. The document is allegedly a specification of the desired state of management assessment, rather than a set or obligatory procedures [Komunikat Nr 23 Ministra Finansów z dnia 16 grudnia 2009].

Standards of management assessment detailed above and described in guidelines of the Minister of Finances, constitute a reference point for solutions adopted in any given entity. Simply implementing the general standards directly, without customization for the need of a specific entity, might prove unsatisfactory influence on the quality of management assessment process. It is the complementary knowledge of goals facing the entity, that enables correct identification of needs in the field of management assessment, effectively improving functioning of the entity.

It is necessary to emphasize that in practice² management assessment in the sector of public finances forces a submission of management assessment declaration (self-evaluation) from the heads of department, that in the author's opinion, contributes nothing to the recipients understanding of validity of expenses incurred from public resources. It is an example of the flawed process of implementing American patterns into Polish legislation. The solution has merit in the USA, since the declarations filed by the chairmen of enormous private companies might be subject to civilian lawsuits and claims made by shareholders, looking for recompense in the event of financial misstatement or even outright fraud. Meanwhile, Polish legislation required the implementing of management assessment in most public sector entities, not excluding even elementary schools. In other words – the solution that is appropriate in the private sector of the United States, was turned into a caricature in Polish private sector.

4. Conclusions

It is highly probable that the standards of management assessment as well as the functioning of internal control mechanisms, did not live up to its expectations nor has it fulfilled its role, and presumably, even caused some damage by increasing spending in the public sector. The established standards of management assessment system, impose additional expenses on public sector entities, including:

- organization of training for the workforce including the management staff,
- providing proper protection for the data and information systems,
- providing replacement staff for employees attending training,
- incurring the costs of man-hours spent on broadening information by employees and management.

² Only the ministers in charge of the government administration are formally obliged to submit declarations, but ministers can commit unit managers in the department that also filed such a statement. According to the author's knowledge, the ministers often use this power.

It is the author's belief that in its current form the presently functioning system of management assessment is not a useful tool for supervising public spending and does nothing to contribute to the economic development. It is author's opinion, that the main reason for this state of affairs is the global application of management assessment to both public and private sector, with the original intent of the act that inspired the creation of the system, only targeted at private enterprises of considerable size. Therefore management assessment in public sector is most likely ineffective and inefficient because it makes no distinction between size or type of entity. The internal management assessment system does not help in managing small units whose management already has a solid grasp of every single process in their company. However, the functioning of this system could fulfill its purpose in sufficiently large institutions such as ministries, marshal offices and various major governing bodies. It has absolutely no application in tiny village schools or kindergartens.

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