

Benchmarking – an instrument for evaluation of financial management on local level

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Annotation: The purpose of this paper is to make a review of the possibilities to use benchmarking as an instrument for evaluation of the financial management in Bulgarian municipal administrations. A system of indicators is proposed that will enable the monitoring of the dynamics of the evaluated processes and the making of international comparisons.

Key words: benchmarking, financial management, financial resources, good practices, measurement and evaluation indicators, local authority, public services.

The integration of the Republic of Bulgaria into the European Union requires utilization and application of good European policies, practices and standards to continue the reform towards financial decentralization and further development of local self-government. The modified legal paradigm of financial self-government of municipalities places them in an environment of limited financial resources while, on the other hand, necessitates services and activities adequate to the needs of their citizens. The necessity to apply and put into practice this approach to financial management triggered public discussions about the application of modern instruments of financial government at municipal level. Some more important instruments are:

- systems for multiannual financial planning providing security and transparency in the managerial decision-making concerning the financial conditions of the municipalities in the short term, the middle term and in the long term;
- program budgeting where the scarce budget resources are planned, raised and allocated not on the basis of presumption of financial provision for a specific activity but on the basis of its efficiency and efficacy;
- non-traditional techniques for funding of municipal budgets such as lease funding, extended use of grant schemes and funds and emission of municipal bonds.
- *benchmarking* that supports the step-by-step introduction of the changes needed for the provision of funding for modern public services and for increasing their quality by proliferating good practices.

The above directions in the modernization of municipal financial management in the Republic of Bulgaria form the core of a new concept of municipal financial management that uses all means of the modern financial theory and practice in order to satisfy efficiently the municipal population's needs for various services. That is the *subject* of this paper which is limited to the application of *benchmarking* as an instrument for evaluation of financial management at local level.

It is well known that benchmarking is a concept related to the studying, the exchange of information and the acquisition of good practices that will gradually improve the work [1, 12, 14]. The closest Bulgarian term is comparative analysis. The

Japanese use the word “dantotsu” which means striving “to be the best among the best”.

Many European countries have already started applying actively benchmarking to compare and to distribute the best practices in their administrations. For example in England the study of experience of the best is an essential element of the process of “making” policy in a particular field before developing specific normative acts or before undertaking actions to improve the administrative activity. In that respect the role of the European Commission should be pointed out as it takes into account the efficiency and the importance of the transfer of good practices from one administration to another [14].

The main purpose of benchmarking activities including in the sphere of financial management of municipalities is to find better methods of performance in order to improve their overall development [12]. This process should include: regular comparison of different aspects of the functions or the processes with the best functions or processes in that field; finding the weaknesses of these functions and processes; seeking new approaches to improve the performance; implementation of improvements; monitoring of progress and review of benefits.

The potential of benchmarking with regard to the competitive advantages of Bulgarian municipalities is still relatively limited to the presentation of good practices related to individual elements of financial management, e.g.: involvement of citizens in the stages of budgeting process; improvement of the budgeting process (developing a budget oriented towards services/end results); management of municipal assets; use of alternative sources of funding; management of municipal services, etc. [5].

There exist various practices to attract the citizens to the budgeting process. However their variety includes mainly informing citizens of municipal budgets by discussing publicly the draft budget in a manner that does not allow the participants in the discussion to make direct changes. It is believed that the citizens' interests will be defended during the debates within the standing committees of the municipal councils and their final meetings. However this is not achieved in most cases. In this respect it is interesting to consider the experience of the Municipality of Ruse aimed to promote citizens' involvement in the budgeting process using an Internet inquiry for selection of priorities in the budget [5].: The Internet inquiry presents several priorities in different spheres of public life. The citizens may support by their votes a particular priority or write a comment with a new proposal. Every week the topic that occurs most frequently in the “comments” is put to a vote as a new priority. The proposal that got the highest number of votes is included for funding in the municipal budget. The achieved results refer to: support of municipal priorities; added new proposal; comments of problematic fields; support of proposals made by the citizens in the municipal council; feedback and awareness of the implementation of commitments.

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Attention should also be drawn to the efforts of the local authorities in the municipality of Varna aimed at the collection of local taxes and charges and the control over expenses consisting in:

- Cooperation with the Registry Services: notification of the municipal authorities of all sales and registered property rights over real estate property. Letters are sent out on the basis of the received information to the persons who participated in transactions but did not submit a declaration for payment of taxes.

- Cooperation with the Traffic Police: receipt of information about newly registered motor vehicles in order to control their declaration. The checks have established that nearly 20% of motor vehicle owners have not submitted a declaration for payment of taxes.

- Cooperation with the State Motor Vehicle Inspection (DAI): there is an agreement in place not to perform technical check-ups if a copy of a receipt of paid motor vehicle tax is not presented;

- Indirect control of motor vehicle taxes through the revenues from taxes on the acquisition of movable property. Warning letters are sent to the persons who transferred the tax on "acquisition of a motor vehicle" by a bank transfer but did not declare it within the legal time limit.

- Sending messages and invitations to incorrect taxpayers: public municipal receivables for past years are collected. The tax liabilities are paid in order of their arising. When payments of liabilities for the current year are made and there exist liabilities from previous years the persons are sent notifications with a warning that the next payment will be used to cover the liabilities in the order of their arising.

- Checks of the database of declared data concerning the structure of real estate properties. It is established that there exists a considerable number of declarations with incorrect information where the structures of the buildings are lowered.

- Checks in the information system regarding waste taxes and official correction of established mistakes in the processing of declarations.

- Checks of companies that have declared low reporting values of their properties: it is checked whether the expenses for a major overhaul and improvements were accounted for correctly and whether the value of the fixed asset was increased with the amount of the expenses.

- Sending out letters to the insurance companies to remind them that they must comply with the provisions of the Local Taxes and Charges Act (LTCA) when issuing certificates of the insurance value of motor vehicles where the insurance value of the motor vehicles represents its market price.

- Reminding letters are sent to persons who have not paid their liabilities in order to improve the collectability of the patent tax. Such letters are sent immediately after the expiry of

the deadline for payment of the relevant installment. The declared patent activities of tourist complexes are checked to establish discrepancies between the declared and the actual data.

- Checks of inhabited properties that were not declared because of absence of Act 16. A procedure to find and inspect such properties is under construction.

The application of benchmarking as an instrument for evaluation of the financial management of municipalities requires provision of information that may be compared between municipalities and that reflects the level of local authorities' independence when taking decisions regarding the budget, e.g.:

- what share of the actual costs and expenses falls within the direct control of local authorities and what is the share of higher levels of governance?

- how stable are the municipalities' revenue and expenditure powers?

- what is the local authorities' ability to maintain a positive balance in the current operational budget at the end of the year?

- what is the "viability" of the sources of revenue, i.e. whether the municipal revenues grow at least with the rate of inflation?

- to what extent can municipalities retain the grown of their expenditure at a level lower than the rate of inflation?

- what are the capital investment possibilities for local authorities and to what extent do municipalities increase the total value of their capital assets?

- what are the possibilities for local authorities to use mechanisms of debt financing?

The specified measuring components can be adapted to specific areas by forming a system of indicators allowing for quantitative comparisons between the municipalities (both at EU level and within the boundaries of individual countries). The value of the indicators will make possible the evaluation of the achievement of the targets and the achieved specific results in the implementation of the financial policy of the municipality. The evaluation indicators may be aimed at the type and the level of the performed activities, the direct results (provided products and services) and/or the achievements and the public impact. Due to its continuous nature the evaluation of the indicators may serve as an early warning system and as a tool for improvement of the transparency of municipal financial management and for better accountability to the public. It will allow to monitor the dynamics of the evaluated processes and to make international comparisons.

Various research publications, analytical reports and comments [2, 3, 4, 6] suggest different indicators for measurement and evaluation of municipal financial management in Bulgaria that could be systematized as follows (see fig. 1):

**INDICATORS FOR MEASUREMENT AND
EVALUATION OF MUNICIPAL FINANCIAL
MANAGEMENT**

INDICATOR	METHOD OF MEASUREMENT
Share of municipal revenue in the country's GDP	Sum of municipalities' own revenues divided by the GDP
Share of municipal expenditure in consolidated public expenditures	Summed municipal budget expenditure divided by the consolidated public expenditure
Coefficient of decentralization	Sum of municipalities' own revenues divided by the overall revenues of municipalities
Coefficient of centralization	Sum of municipalities' overall income divided by the municipalities' own revenues
Local control over the determination of tax rates and charges	Percentage of overall municipal revenues for which the municipalities sets the rates
Local control over state transfers	Percentage of the overall transfers by the central authorities that are not targeted
Local control over the factors impacting expenditures	Percentage of the municipal expenditures determined entirely by a decision of the Municipal Council
Viability of revenues	Annual growth of current revenues adjusted by the inflation rate
Control over the rate of expenditure	Annual growth of current expenditure adjusted by the inflation rate
Stability of municipal revenues and expenditures	The change in revenues and expenditures (in %) compared to the previous year is adjusted by the inflation ration
Financial balance	Annual current expenditures minus the annual expenditures including all unpaid expenditures
Total amount of capital investments at local level	Change in the level of capital investments in municipalities compared to the previous year
Amount of capital investments that may be effected by municipalities	Percentage of municipal capital investments based on own revenues
Maintenance of the value of municipal assets	Annual evaluation (after depreciation) of the physical assets of the municipality
Possibility for municipalities to use debt instruments for capital investments	Percentage of capital investments funded by debts
Control over debt levels	Debt payments as a percentage of the overall current expenditure (there is usually a limit of 15 %)

Fig.1

The above indicators are interrelated and cover the main aspects of municipal financial management. For example, if the revenues do not grow as fast as the expenditure that will disturb the financial balance. If debts accrue fast then the financial balance will be disturbed in the foreseeable future as debts have to be paid with interest. The value of municipal assets drops if there are insufficient capital investments.

The quantitative comparisons of the local finances of individual countries are made on the basis of the first four indicators:

- Share of municipal revenues in the Gross Domestic Product в brutния вътрешен продукт (БВП) на страната: отразява тежестта на местния публичен сектор в националното стопанство.
- Share of municipal expenditure in the total expenditure of the public sector: it reflects the ratio in the distribution of responsibilities between the state and the municipalities.
- Coefficient of decentralization (CoD): reflects the share of local revenues in the overall revenues of municipalities. For Bulgaria that share is about 30%, while for most European countries the CoD is between 50 and 60%. [15, 16].
- Coefficient of centralization (CoC): represents the distribution ratio of the resources between the central government and the municipalities. For Bulgaria the CoC is more than 70% of the budget resources of the public sector. For most European countries the CoC is between 50 and 40%.

The unweighted average values in Europe for the period 2000 – 2009 show 8.9% share of local finances in GDP and 21.1% share in the expenditure of the public sector [2, 7, 15, 16]. The European countries are divided into three groups on the basis of these values:

Group one comprises 6 countries where the budgets of local authorities form a share of less than 5% in GDP, while their share in the overall budget expenditure is considerably below the average level for Europe. These are Greece, Romania, Portugal, Slovenia, Slovakia and Spain.

Group two, comprising the largest number of countries, whose local budgets are close to the average level. The share of municipalities in GDP varies between 7 and 13.3%, and in the OBE - between 10 and 35%. There are 5 states whose municipalities are very close to the average values of both indicators. Bulgaria is among them (9% of GDP and 20% of OBE).

Group three, consisting of 5 states – Norway, Sweden, Denmark, Finland and Hungary, where the share in GDP is above 17%, and of OBE above 30%.

The application of benchmarking in a comparative European context [2,9] allows us to derive the following characteristics of a “good model” of financial management of municipalities where:

- The amount of the local authorities’ own resources is greater compared to the provided resources. The scope and sources of own revenues is controlled by the local authorities and include: property taxes that ensure stability; some corporate taxes that ensure viability (e.g. taxes on the economic activity, taxes for hotel management and entertainment, percentage of the value added tax, etc.); some motor vehicle taxes; consumer charges related to the direct return on expenses for provision of particular services plus income from municipal property and licence charges.

- Local authorities rely relatively less on state transfers and take independent decisions regarding the manner of utilization of such resources. State transfers should include both the shared national taxes and the subsidies that cover the following expenses: for activities related to the government; for specific needs when the powers regarding the income do not correspond to the allocated compulsory expenditures related to municipal activities; for compensation of the absence of local potential for income generation in poorer municipalities.

- The municipal capacity for capital expenditure is increased.

The system of financial relationships between the central and the local authorities must be simplified, comprehensive, transparent, streamlined and sufficiently stable and predictable. It should be based on generally applicable rules that are not subject to negotiation and that are applied on equal basis by government and self-government bodies at all levels.

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