

TARGET COSTING IN PROCEDURES FOR PARTICIPATORY BUDGETING AT LOCAL GOVERNMENT UNITS (LGUS)

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Abstract. *The article presents the process of target costing as a tool for creating a participatory budget in local government units. As part of the project “Commune Office – efficient and friendly” the level of importance of the following qualities referring to public services was examined: legality, efficiency, accessibility, effectiveness, the pace of realization, suitability of the way of dealing with a customer, individualized attitude, equality in treating citizens’ opinions. Moreover, the relationships between the qualities of services and costs according to the type have been established by the treasurers of the communes participating in the project. Based on the findings, the authors have proposed an algorithm which will allow spending public funds according to the needs of local communities. The algorithm is treated as a model which can be used for different services offered within participatory budgets, irrespective of their range, value and tasks.*

Keywords: *target costing, participatory budgeting.*

The current concepts for management of local government units in Poland suggest that to improve the efficiency of public services delivery, local communities should be activated in decision-making on directions of resources allocation and the selection of needs to be met within the budgets of those organizations. This is consistent with the principle of subsidiarity, being the gist of decentralization of public finances geared to establish local communities. This also corresponds to the rule, identified under the management concepts, to place the decision-making as close to recipients of the products offered by the organization as possible – regardless of the sector in which they operate.

The purpose of this article is an attempt to present the process of target costing as a supporting instrument to develop a participatory budgeting at local government units, and an attempt to show how to use it

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in the decision-making processes that aim to determine the level of expenditure necessary for the implementation of the budget assumptions and potential benefits in the area of the LGU financial planning.

A survey study was conducted among residents of five municipalities of the Malopolska province. The municipalities were participating in the project, run by the State Higher Vocational School in Oswiecim, entitled “The Municipality Office Efficient and Friendly.” Some 100 people from each municipality took part in the survey that was identifying the features of the LGU’s activities that result in the highest level of satisfaction of the local community members. The assessment of impact that individual features had on the amount of costs of the services components was made using the expert method – the division was made by treasurers of the municipalities included in the survey as people having the knowledge, experience, and skills required to ensure the quality of the division.

1. Participatory budgeting as a tool for managing community finances

The financial system of Polish local government units (LGUs) is formed by regulations of a number of legal acts that are subject to constant changes of evolutionary character [See 6, pp. 82-107], that in accordance with the terms and the scope as specified in the regulations coming into force. These changes to their largest extent cover the sources of budget revenue by their scope as well as potential size of funds being obtained by LGUs. The main goal of those activities is to increase the level of decentralization of the state, strengthen the autonomy of the local government units, and repair the public finances system. [See 10, p. 79]. The structuring of systems to the finance tasks, carried out by local authorities under the European Union funds, is also of great importance in this area.

The hereto presented factors that characterize the specificity of the Polish local government sector are the result of changes related to the management concept in the subject area. A special meaning in this context should be attributed to the concept of *New Public Management* (NPM) that proposes modernization activities in the public sphere, justifying them by a need to reduce funding that fuel the LGU budgets. The *New Public Management* can then be treated as a “multi-disciplinary tool that bridges

the gap between planning, organizing, and controlling the management of human, financial, infrastructural, information resources and policy” [5, p. 278] where the following obligations have the essential meaning: [See 14, pp. 34-49; 24, p. 26]

1. the environment where they operate should be activated by local authorities,
2. recognition of the mission as the basis for determining courses of action
3. close cooperation with local communities and respecting the customer interests,
4. introduction of competition in the rendering of public services,
5. *pro-result* orientation of the activities being performed.

Complementary to *NPM* that constitutes the response to the allegations of excessive professing the principle of economic efficiency, while ignoring the need to increase public value, is so-called *Good Governance*. It is a concept that does not negate the *New Public Management* principles, but becomes their significant enhancement.

Transformations of local government systems implemented under the complementary concept take place by wider consideration of a social context and they propose standards, including professionalism, political neutrality, fairness, and the avoidance of the conflicts of interests. [See 10, pp. 64-65] The changes These changes also follow the rules binding in the concept of *GG*, including: [See 18, p. 6] openness – indicating the availability of public institutions and decision-making processes; participation – representing an increase in public confidence in the institutions and the involvement in political processes; clarity – transparency of roles and associations among institutions in the legislative and regulatory processes; effectiveness – requiring to implement goals on the basis of past experiences and forecasts of future events; compliance of policy and actions taken – representing the need for the involvement of political leaders and striving for consistency and reasonableness of work undertaken. Some authors [See 2, pp. 22-23] complement these rules by including: personal integrity, high ethical standards, and respect for the law, accountability, accessibility and solidarity with the citizens.

Currently, attention is drawn to the fact that the Good Governance undergoes a change, thus becoming a *Responsive Governance* [See 19,

pp. 8-9], i.e. characterized by sensitivity, tenderness, speed of response. The *RG* concept therefore refers to managing multiple stakeholders and conflicting values in such a way as to best accomplish the public interest, which is considered supremely in relation to the interest of social groups or individuals, namely the public services consumers.

The action associated with the development, or enrichment of experiences in the field of operation and management of modern public organizations, is recently also the search for such strategies of local authorities which use social activity and participation, based on cooperation and ties of a network character [See 10, p. 66]. Network Governance [See 7, p 30] is the example of this concept, i.e. the pursuit of decentralization and transfer of authority from the officials onto the citizens, as well as – appearing in various forms – their co-participation in the activities of those organizations.

One of the latest solutions to ensure compliance of changes in the local government subsector with the theories presented herein is the task-based budget, being implemented in Poland, including the market-oriented changes in the public tasks management area. Its basic task is to provide public funding for plans implemented in the future and resulting from the development strategy in close association with short-term objectives [See 10, p. 125]. However, as shown by the experiences of other countries [See 16], as well as in view of recommendations by the International Monetary Fund (IMF) in this area, it is necessary to comply with the rules of procedure for the openness and transparency of financial management, ensuring the implementation of the basic rules, including: [12]

1. The rule of public access to information,
2. The rule of transparency in preparation and implementation of the budget and the budget reporting.

The hereto presented terms and conditions are provided by the task-oriented budget, the gist of which is to manage public finances while ensuring the implementation of hierarchical and specified goals, expressed by properly quantified effects of the measures undertaken [11, p. 41].

Identification of the goals for activities to be performed by the local government unit is difficult and raises a number of controversies. In particular, it is related to problems of determining the tasks that are required to be implemented by these organizations. However, irrespective of the scope of mandatory tasks, required by law, a substantial part of the LGU activities refers to optional tasks, targeting the local communities.

Mostly in this area, civic participation should be attributed with particular importance.

An important addition to the task-based budget is therefore the participatory budget, which is an instrument that provides the efficiency of the LGU financial management system. It is recognized as one of the manifestations of innovativeness in activities of public organizations [See 23, p. 2], acting as a mechanism serving to improve public finances by promoting activation of local government units, private sector, and social communities.

Assuming that the primary goal of the LGU activity is address long-term needs of the stakeholders, it should be noted that the gist of working efficiency of these organizations is a usefulness of services rendered. Maximization of its level therefore requires understanding of those features and functions of the services offered, which are appreciated by their direct customers. The use of participatory budget is a tool for ensuring the participation of stakeholders in the decision-making process on the directions of public spending, which enables compatibility of this process effects with the needs of the given community.

2. Target Costing in the Process for Participatory Budgeting

Evaluation of the participatory budgeting performance in Porto Alegre – the city where this instrument was used for the first time – allows for determining three areas of its influence [See 17, p. 167]:

1. Activation of local communities,
2. Increasing the level of social justice,
3. Improving the system of social control.

The presented characteristics of the participatory budgeting show that its innovativeness should justify searching for new, not previously applied, methods of management at LGU. A special place can be attributed to planning in this process, especially in relation to the resources needed to provide public services, their valuation that allows for defining the level of costs of the actions performed and, consequently, for determining expenditures necessary to be borne under a given budget. Such planning is enabled by a tool called *target costing*. When using it one should bear in mind that the intention of those who created this tool was to draw attention

to the cost planning and costs projection categories (jap. *genka kikaku*) [See 4, p. 10].

Target costing is essentially not only the method used to calculate costs, but also – thanks to the efforts made at the product planning and projecting phase – the method is used for costs cutting [See 21, p. 4; 13, p. 17], which includes reaching their level as imposed by surrounding conditions [See 8, p 3] or that assumed by the organization managers. Those attributes of target costing allow for considering it as particularly important in the activities of LGU where the value of cash transfers from the state budget and those obtained from other sources is a specific standard in public service delivery.

In the context of increasing the operational efficiency of local government units, paying attention to the needs of the stakeholders of these organizations should be considered the most important feature of target costing. As provision of high usability of public services, their compliance with the needs of local communities is therefore a major factor that limits the wasting of public funds. This target costing feature is also a determinant for the use of participatory budgeting where the type of the services offered, their properties, and features should be consistent with the expectations of the community members.

The specificity of the participatory budgeting also allows for stating that the proper implementation of the process assumptions requires proceeding in accordance with the phases identified [See 15, pp. 53-54] in the target costing. In particular, this applies to the assumptions implementation phase (establishment phase), which involves determining the target cost for a projected service and features, functions, and components that constitute the quality of the services offered. A special role in this phase is attributed to research aimed at understanding of the needs and preferences of customers, as well as, definition of a target demand for the products offered. Assessment of the LGU activities indicates that the research in this area can be carried out under participatory procedures on key matters of concern to local government communities. In this area, also tools known from activities of commercial entities can be used, including, e.g. *crowdsourcing*, being the form of obtaining information from social groups interested in the problem. The main idea behind crowdsourcing is that the required information is obtained electronically, so the solution to the problem is delivered very quickly. A major drawback of this method is

that it uses as an information source only those individuals who are active Internet users. In terms of rural communities in Poland, it is estimated that close to 50% of the population actively use Internet, therefore, the results obtained via this method will not include an opinion of individuals not using the Internet.

The target costing phase two stands for the *attainment phase* that aims at determining whether the adopted level of target costs is realistic and is attainable. [1, pp. 23-24; 15, p. 53] At LGU it is related to a need to design the processes for delivery of those services so that the established values are not exceeded. At companies, this phase also results in making a decision to launch the production. At LGU, decision-makers can focus their attention only on the maximum cost cutting, while ensuring the usability of the services rendered. Often, therefore, the implementation of specific actions will be initiated, and higher costs than those determined in the first phase the budget will be taken into account.

The currently observed trend to limit the impact of the LGU specificity on the quality of management is the reason why they increasingly move away from a narrow – known from the works of management accounting theorists – identification of budgeting with planning [See 22, pp. 44-45], recognizing that in view of those supplementary tools, it is the method of determining and implementing plans that have been established previously [3, p. 11]. Such a definition of the budgeting processes at LGU thus clearly indicates that the target costing cannot be considered as an alternative method for other costing systems. It should be supplemented – also in the local government units – by the use of costing accounts that ensure proper records evidence and control of resources allocation as well as minimization of costs in the budget execution process. The philosophy, adopted in this paper, to adapt and implement solutions that have been used in the commercial sector entities allows for proposing such tools such as: standard costing account, continuous improvement account (*kaizen costing*), product life-cycle costing account (*life cycle costing*) etc. A. Szycha [See 20, p. 77] describes this dependence by highlighting the calculation aspect and the control one in costs-oriented actions. The first one recognizes the costing account as the method for calculating the target cost of products, their features, and components. The second one, however, means the system that uses a variety of methods and activities serving to achieve a desired target cost.

3. The Costs of Public Services Rendering as Expression of Local Communities Needs

The purpose of the conducted survey studies was to determine the level of importance of the selected features of services satisfying the needs of communities of the municipalities surveyed and to define the parameters of the equation allowing to determine the cost structure, by the type of components used in production, which is suitable for budgets that meet the requirements of stakeholders in the communities surveyed.

A closed number of features of the services provided by LGU (Table 1) was used in the study, addressed to the inhabitants of the municipalities surveyed, indicating such features as: legality, legality, efficiency, accessibility, effectiveness, rate of delivery, adequacy of interior setting, individualized approach, equal treatment, and understanding of procedures.

The notion of legality in the survey was used to define compliance with the binding law, which stands for assurance that some issue shall be resolved once and will not require appeal procedures, making complaints, etc. The efficiency was understood as a feature that ensures a large number of effects at relatively low level of implementation costs (it is to ensure that the living in the operational area of a given LGU will not entail excessive fiscal burden, etc.). Accessibility in the right place and the right time is to ensure that all citizens have access to the services offered by a given LGU without a need for excessive effort aimed at seeking offers in this area. The effectiveness is expressed by means of compliance with the expectations of citizens, ensuring adequate image of the entire LGU (it is a surety that the community in which citizens live is properly managed and meets the needs of other stakeholders. The rate of the services delivery is to ensure that the needs of residents are implemented without undue delay. “Adequacy of Interior Setting” is an indicator of the LGU office equipment and appearance standard. Individualized approach means delivery of services with understanding for any individual situation of the citizen, with a willingness to help resolve cases. Equal treatment ensures the provision of services regardless of sex, age, financial status, and education of a stakeholder. Understanding of procedures refers to the clarity, accessibility, understanding of procedures/practices applied, sharing information in “non-professional” language etc.

A task of the residents participating in the survey was to assess the subjectively perceived level of importance of the features proposed, using a scale from 1 to 5. Medians of the results obtained (Table 1) were used to determine a structure of costs by their type to gain certainty that the identified structure shall satisfy the needs of at least half of the residents.

Table 1.
Median results for assessment of the level of importance of the proposed features of public services

Specification	Legality	Efficiency	Accessibility	Effectiveness	Rate of Delivery	Adequacy of Interior Setting	Individualized Approach	Equal Treatment	Understanding of procedures
Brzeszcze	5	4	5	5	5	3	5	4	5
Chelmek	4	3	4	4	5	4	5	3	4
Mucharz	4	3	4	4	4	3	5	5	5
Oświęcim	5	4	4	4	5	4	5	5	5
Wieprz	4	3	4	4	5	2	4	3	4

Source: Own calculations.

A questionnaire, addressed to the treasurers of surveyed municipalities, was complementary to the conducted research. The treasurers had a task to present relations occurring between the various components of costs by type of production factors used and the features of public services (Table 2). Costs components The costs components by type were considered as components, indicating: Salaries including derivatives, Equipment in fixed assets components (with specified low-value assets), Materials, energy and fuel, Outsourced services, Taxes and fees, and Other cost categories determining the value of the resources wearing at the organization. The relationships reflect how the components affect the features of the services offered by LGU.

Treasurers of municipalities were considered experts; therefore, survey results contained in Table 2 stand for the average results included under the survey feedback.

Table 2.

Relations between the features of services and the costs by type and according to the opinion of treasurers of the surveyed municipalities (in %).

Specification	Salaries including derivatives	Equipment in fixed assets components	Low-value assets	Materials, energy, fuel	Outsourced services	Taxes and fees	Other
Legality	44.0	8.0	9.0	6.0	19.0	8.0	6.0
Efficiency	30.0	17.0	15.0	11.0	6.0	13.0	8.0
Accessibility	25.0	24.0	14.0	15.0	10.0	6.0	6.0
Effectiveness	30.0	17.0	16.0	14.0	13.0	8.0	2.0
Rate of Delivery	40.0	17.0	12.0	11.0	12.0	4.0	4.0
Adequacy of Interior Setting	20.0	26.0	24.0	15.0	9.0	4.0	2.0
Individualized Approach	32.0	12.0	17.0	16.0	11.0	2.0	10.0
Equal Treatment	28.0	8.0	20.0	12.0	12.0	4.0	16.0
Understanding of Procedures	40.0	14.0	16.0	10.0	14.0	2.0	4.0

Source: own elaboration.

In accordance with the procedure applicable in the target costing to determine the cost structure by type, which shall provide for the needs reported by more than half of the residents of the municipality, requires the calculation of a quotient of the share that median assigned to a selected feature has in total medians for a given feature and the percentage value of the relation between the feature and the cost component in the adopted costs structure. The so calculated cost structure by type is illustrated in Table 3.

The basic assumption in this study is recognition of the independence of municipalities and a diversity of their needs and features in the various communities. For this reason, the cost structure by type was identified separately for each of the surveyed local government units.

Table 3.*Costs structure by type in the surveyed municipalities (%).*

Specification	Salaries including derivatives	Equipment in fixed assets components	Low-value assets	Materials, energy, fuel	Outsourced services	Taxes and fees	Other
Brzeszcze	33.0	15.4	15.4	12.1	12.1	5.7	6.4
Chelmek	32.7	15.9	15.6	12.3	12.0	5.4	6.1
Mucharz	32.6	15.2	15.8	12.2	12.1	5.3	6.8
Oświęcim	32.6	15.5	15.8	12.1	12.0	5.5	6.6
Wieprz	33.1	15.6	15.3	12.1	12.1	5.5	6.3
On average in the surveyed municipalities	32.8	15.5	15.6	12.2	12.0	5.5	6.4

Source: own elaboration.

Assessment of the costs structure by type of worn production factors indicates that individual components of public services in the surveyed communities remain at a relatively constant dependence, determining that the activities performed by municipalities should take place under conditions of relatively high human capital accumulated in staff (as described in payroll costs, including derivatives at the level of one third of total overheads) and equipment in fixed assets components, which is implemented through acceptance of the amortization costs at the level of ca. 30.0% of total overheads.

4. Conclusion

The considerations conducted lead to the conclusion that target costing is one of the solutions that can improve the process of development and subsequent implementation of the LGU budgets. Its main advantages include well-recognized operating procedures in both the commercial sector and – most importantly in the local government subsector – the use of the stakeholders needs in the process of planning the costs of the services rendered. These costs in further assessment allow for identifying expenses necessary to be incurred in each budgetary period, and indicate

which resources of the unit can be used in its operations, without the need to spend cash.

The implementation of target costing activates municipalities in improving their management systems, e.g. through pressure on the implementation of tools allowing to understand the needs of local communities, including public consultations, or *crowdsourcing*. At the same time, also the evaluation of the conducted studies results indicates that the proposed mechanisms can be successfully used to solve problems related to individual tasks or services provided by local government units. From the perspective of economic practice, such a solution seems particularly appropriate because targeting the allocation of the LGU resources onto identified social needs stands for the quality of policy pursued by local government heads, mayors, governors etc.

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