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## **The budget efficiency of entities in public finance sector**

### **Introduction to deliberations on the budget efficiency**

Budgeting is associated with effective management. Notions of budgeting and efficiency are often very close in the literature, yet it is difficult to find the definition of budget efficiency as one concept that should be significantly emphasised, especially in the public finance sector, however, enterprises should conduct research in this area as well.

The concept of “budget efficiency” in fact is not used in the literature, it is only used in the materials on The Ministry of Finance website, but in the context of the efficiency of budget management or spending. In the literature the concepts of efficiency and budgeting are presented as completely separate ideas. Mainly in the context of defining budgeting as an efficient method and the purpose of the budget introduction, i.e. the effective allocating of available resources. Reflecting the tendency, both in science and practice especially in public finance, to improve the efficiency and effectiveness of spending public resources requires defining the concept of budget efficiency. One cannot simplify the idea by stating that budgeting is an efficient method supporting management, or reduce the evaluation of the budget efficiency to the assessment of the budget enforcement, as a much broader view on the efficiency of planning and spending the financial resources is necessary, which is to be included in the concept of budget efficiency [Czerniak, Skoczylas, 2015, p. 291–300].

This paper attempts to define the concept of budget efficiency based on the authors’ observations and literature resources related to the efficiency, as well as materials on budgeting and the efficiency of allocating the public financial resources. The efficiency of resource allocation is the closest concept in the interpretative attempt to construct the idea of budget efficiency, as the essence of budgeting by local self-governments is allocating scarce resources [Jastrzębska, 2012, p. 61].

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## 1. Rationale for a discussion on budget efficiency

When attempting to define the concept of budget efficiency, it would appear that the notion of efficiency itself should be first referred to, but it is not so easy if we analyse the observations conducted in the area as well as the ambiguity of this notion [Sands et al., 1912, p. 138–150]. It was decided that the considerations on the meaning of introducing the concept of budget efficiency into the general use would be discussed in the first place, assuming that the efficiency in conceptual context would be synonymous with taking right actions in the right way. Nevertheless, reflections on the meaning of introducing a new idea related to the budgeting sphere have to clearly explain this concept.

When analysing and observing economic practice the press often reports that the budget for a specific investment has been exceeded. Media especially fancy providing examples from the public finance sector, for example, the underestimated budget for building stadiums for Euro 2012, exceeding the budget for Berlin airport construction, etc. In this context, we refrain from specifying the frequency of miscalculated budgets, especially given that media usually remain silent when projects are executed within the budget. Yet, undoubtedly the budgets for public projects are often exceeded. Alex Klarman claims that this is a feature of every project: if something takes twice as much time as planned, it costs twice as much as approved and it was promised twice as much as was received after all – this is definitely a project, whose management is not so easy in practice and very often leads to exceeding underestimated budgets. In practice it is very difficult to complete a project while simultaneously achieving all three parameters: time, budget and scope. Of course, if one of them is abandoned it will be much easier to achieve the other two. Some call these parameters the Bermuda triangle of the project management [Nokes et al., 2003, p. 4–50]. When defining irregularities in determining the budget for a given project or even the state budget the following terms are used: bad budget, inadequate budget, mismatched budget, underestimated budget, or sometimes even ineffective budget.

Yet, exceeding the budget, its miscalculation cannot be identified with the budget efficiency, which can happen in a simplified and colloquial form. On the contrary, it can be said that the underestimated budget of a certain project or a given unit can prove to be very effective. For example, an environmental investment project was hypothetically implemented, whose budget was miscalculated and exceeded by a significant percentage not within the allowable reserve. Yet, on the other hand, it turned out that, based on benchmarking with other executed environment projects, the project was actually effective, much more economical than previous

projects, due to a fact that amount of financial resources spent for example to reduce the emission of dangerous pollutants gave results that were better by a few percent than for previous projects.

In the aforementioned reflections there are aspects that, in the authors' opinion, ought to build the importance of the concept of budget efficiency, without any special indication on the importance of any of them:

- 1) execution of planned tasks (effectiveness),
- 2) correctness of estimated expenditures (economics),
- 3) expenditure effect (efficiency).

Elaborating the above-mentioned aspects from the point of view of efficiency measures should lead to determining the importance of the budget efficiency, yet the attention needs to be paid to other aspects as well, particularly to what we spend available resources on, how we use the resources that are unfortunately always limited. Therefore, it is necessary to complement the deliberations with the relevance of the incurred expenditure, the analysis of the effects resulting from spending the available funds, and to make it simple, to provide an answer whether we do right things. It seems that deliberations on the notion of budget efficiency exceed the idea of budgeting itself. However, it was recognized that the effective method supporting management, which budgeting is considered for, cannot be disregarded from the effects resulting from spending the budgeted funds. Such a significant extension of the concept of budget efficiency, which cannot be limited to the evaluation of the process itself, is justified by the specifics of the public finances, where budgeting is an obligation, yet should not be used as the tool for presenting the expenditure, but for its optimisation.

The process of resource allocation and budgeting is one of the most significant planning steps in any organisation. The resource allocation relates to dividing resources, financial in particular, from the centre to peripheral levels. Budgeting means more detailed definition of how these funds are to be used and specifying the exact purpose [Fozzard, 2001, p. 13–14]. When evaluating the budget efficiency it is not enough to confirm that assumed task has been completed, the budget has not been exceeded or the final effect is better in comparison to other similar tasks. A number of examples of the implementation of projects co-financed by EU funds can be referred to here, which are characterized by one feature in particular, i.e. the regional vanity. In many EU countries there were projects implemented that unfortunately were useful for none or only a small number of people, which can be exemplified by some airports located even in Spain or Germany, often built in so-called nearby province, i.e. less-populated areas, but in relatively close proximity to other airports with much greater potential. Assuming that the expenditures for these projects were well estimated, that they were

executed within the assumed deadline, that their cost per m<sup>2</sup> of the runway was the lowest in a given country, which is more probable due to their locations (significantly cheaper land and lower labour cost), they still cannot be claimed budget efficient. The indispensable element of this definition is a relevant, skilful and appropriate allocation of the resources to execute required tasks.

It would seem that defining what is necessary should not be a problem, yet the examples from economic reality show that each person defines their needs in a different manner, and additionally there's a desire to show off and stand out, which determines vanity to some extent and often obscures rationality that is so required in this matter [Nokes et al., 2003, p. 4–50].

The goal of any organisation that wants to stay successful is to find such resources that will enable it to achieve its goals. However the path to acquire appropriate resources, their skilful allocation and effective usage may prove to be quite complex. The decisions how to allocate them made by the organisations reflect their reactions to the changing market. Therefore, when looking for determinants of these decisions, it is necessary to identify key factors for development as well as value and competitiveness [Steinerowska-Streb, 2011, p. 61]. As W. Walczak points out, identifying these factors should be a primary process, and their erroneous diagnosis can result in far-reaching negative implications affecting the undertaken actions [Walczak, 2009, p. 355–362]. That is why the initial correct identification of the factors that will significantly influence the use of resources is so important. The factors that affect the efficiency of resources allocation can be external or internal. The external ones are related to the surroundings of creative organisations, while the internal ones concern the specifics of their activities. [Młyńska, 2015, p. 117–118].

## **2. The specifics of the public finance budgets as a determinant of the construction of the budget efficiency concept**

The budget of territorial self-government units is defined as the annual revenue and expenditure plan as well as the unit's income and expenses. It is the basis for financial management throughout the financial year [Sierak, 2016]. Similarly, the encyclopaedia of local self-government defines the municipality budget – as the annual plan of revenue and expenditure, income and expenses, which is passed by the municipality council as the budget resolution [Dylewski et al., 2010, p. 15–17]. M. Jastrzębska distinguishes three categories of the municipality budget, namely: a budgetary fund, financial plan and legal norm. A budget viewed as a budgetary fund mean concentrated capital of financial resources, while viewed as a financial plan it is establishing future expenditure and income of the community.

In case of the last category, i.e. a legal norm, the budget is passed by the legislative body, hence it is attributed to this type.

The main legal acts governing the budget of municipalities are the Constitution of The RP, the Public Finance Act of 2009 and the Local Government Legislation [Jastrzębska, 1999, p. 29]. The budgets of local self-governments are divided into public expenditures and revenue. The first level management control obliges the managers in public offices to set goals and tasks as well as monitor their implementation. This is where the following questions arise: what approach to accept to define processes and measures, which goal in a given process is ambitious and attainable, how to interpret the monitoring results. The managers in public offices face many of such questions and doubts about the management control. On the other hand, public offices have limited funding capabilities for expert services in order to develop a systematic approach for an individual unit, thus often the only way to find answers to the pressing questions is, burdened with high risk, the method of trial and error.

A group of public offices for whom the efficiency of management audit activities is important, and the above-mentioned doubts are known, have decided to jointly develop model solutions for different areas of operation of local self-government units, whose application would streamline the selected processes and lead to achieving the best budget efficiency. The indicators established to measure the efficiency of the processes within the budget have been divided into four groups. The effectiveness indicators determine the level of the goals achievement. The efficiency indicators determine the ratio of effects to the inputs and outputs spent on a given activity. The timeliness indicators illustrate the time of executing a given service and the level of consistency of achieved results with the legal regulations. These indicators are designed to assess the achievements of goals and objectives, taking into account the criteria of savings, efficiency and effectiveness, in line with the assumptions of management control. Additionally, a fourth group of customer satisfaction indicators has been introduced, based on the results of the residents survey. Unfortunately, assessing the level of the processes execution through the customer satisfaction is not commonly used, mainly for the cost reasons. The assessment of the level of the process executions is based on the results of all indicators together [Śpiewok, 2013, p. 3–5/18].

### **3. A definition of the concept of budget efficiency**

According to the Winiarska research, there are no big differences in terms of the control of the various entities. What could be the basis for defining budgetary efficiency in Poland [Winiarska, 2012, p. 11–20]. A proposal

to define the concept of budget efficiency has been based on the essence of the efficiency of resources allocation combined with budgeting. It determines the choice between possible directions of spending the budget resources [Jastrzębska, 2012, p. 61].

The allocation efficiency is the use of goods and services in such a manner that is the closest to the distribution of actual social preferences in a given community that has these resources at their disposal [Kochniarz, 2012, p. 60]. However, it needs to be clearly noted that spending directed at meeting excessive social preferences may significantly depreciate the value of the allocation efficiency in such understanding. Thus, it is necessary to evaluate, even through the expert panel, the legitimacy of the funds spending, which can be confirmed by the analysis of the investment projects presented in various cities as proposals for funding under the citizens' budgets, some of which can be even considered irrational, but still they often receive supporting votes, though not as significant to be executed.

The efficiency of the use of resources is obliged by planning, whose the most common form is budgeting. It includes a set of methods required to establish goals and allocate them among the organisational units. Budgeting is a basis for the successful implementation of goals that are expressed in financial terms. Using the method of budgeting determines the improvement of the efficiency of resources utilisation [Green, 2009]. Budgeting can be expressed as an instrument for financial planning, for it determines the amount of funds required to perform the scheduled tasks. Budgeting is divided into budgeting in business and in the public and self-government administration. This division refers to the implementation of the organisation's financial strategy and flexibility, as in the public organisations there are rigid constraints in expenditure and revenue [Szczęsny, Śliwa, 2010, p. 13; Vabo, 2009, p. 12]. It is known that saving and efficiency start when we begin to count spendings. It is assumed that budgeting is operational planning tool essential for financial managers. Because managing is about setting particular goals, planning, monitoring of approved plans, analyzing of results, finding out the reasons of variations and taking timely decisions eliminating these discrepancies [Klychova et al., 2014, p. 80].

The budgeting category has its source in the field of public finances, where budget determines the distribution of tasks over time and represents the scheme of revenue and expenditure [Komorowski, 2001, p. 198].

The literature presents the budgetary principles, whose observance affects the efficiency of the budgeting process and these are the following [Dylewski et al., 2010, p. 29; Żyżyński, 2009, p. 72]:

1. The principle of budgetary balance – the state in which expenditures are covered by incomes. The budgetary imbalance occurs when there

is a budget deficit, which is surplus of expenditure over revenue, whereas the predominance of revenue over expenditures is called the state of the budget surplus.

2. The principle of completeness (universality) – rests on presenting the completeness of financial relations in the budget so that the tasks can be covered by the whole economic calculation. Current budgets use net method in addition to gross method in financing, which in case of a surplus of a given entity contributes to the budget, and in case of a deficit it is financed from the budget, which means it is on the expenditure side.
3. The principle of material and formal unity – it rests on presenting the total cost and income, expenditure and revenue in a single collective document. The principle of material unity prevents waste of funds where the budgetary income is higher than the requirements of tasks that were to be financed from a given source of revenue. It is maintained when there is a general purpose for the revenue, which means it is not directly attributed to any specific direction of spending budget resources. The principle of formal unity occurs when a consolidated financial statement of a company is established, i.e. the aggregate budget.
4. The principle of detail (specialisation) – in line with this principle, the budgetary receipts and expenditures should be determined and executed with an accurate, detailed division rather than in a general form.
5. The principle of public disclosure – rests on presenting the financial situation in an open and public form.
6. The principle of transparency (clarity) – it rests on presenting the budget in a transparent manner to enable correct planning, quick identification and control of the process.

The above-listed budgeting principles and reflections linking budgeting to the efficiency of resources allocations are related to the efficiency of the budgeting system, yet this aspect should be taken into account to a small extent when determining the budget efficiency. The main budget, sub budgets, budgeting instructions, company's chart of accounts (those included in the budget) and the IT system are the elements of the budgeting system that needs to be linked closely, otherwise the budgeting system will not be efficient. The efficiency of the budgeting system, which is extremely important, will not guarantee the budget efficiency, which needs to be understood in a much broader manner.

If the concept of social utility or welfare is to be used as a guide to resource allocation across the government two key elements must be

in place: firstly, criteria and mechanisms for the reconciliation of differences in individuals' relative utilities for different combinations of goods so that a comprehensive social utility function can be described; and secondly, a common denominator of utility as a basis for comparison of alternative uses of public funds. Measures of cost effectiveness cannot provide the first of these elements, and offer only a partial – sector or programme specific – solution to the second. Comprehensive solutions have been found in the concept of allocative efficiency and the monetary valuation of costs and benefits, both of which are applied in cost-benefit analysis techniques [Miaskowska-Daszkiwicz, Szmulik, 2010, p. 150].

In the budgeting process it is necessary to clearly define rules for the use of the funds at the organisation's disposal as well as determine plans for its operation. It is also important to balance the goals with the possibilities of their execution, which results from the amount of available resources [Green, 2009; Bartnik, 2015, p. 30]. Increasing the use of performance information in budget processes is an important initiative that is widespread across OECD countries. It is part of an ongoing process that seeks to move the focus of decision making in budgeting away from inputs (how much money can I get?) towards measurable results (what can I achieve with this money?) [Curristine et al., 2007, p. 2].

By combining these considerations one can speak of the budget efficiency only if the funds are spent in a rational manner in line with their earlier planning, in order to achieve the best results out of the incurred expenditure. The features identifying the budget efficiency will be as follows:

- correctness of the estimates,
- feasibility of the budget,
- meeting deadlines,
- as well as rationality, the verification of which causes the biggest problems. Rationality should be identified with the implementation of actual, meaningful tasks, justified by the economic efficiency, etc.

In conclusion, it can be stated that the budget efficiency is a rational definition of goals and indicators of the budget leading to spending funds in line with their earlier planning and utilising according to the principle of transparency (the clarity of spending public funds) in order to achieve the best results from the expenditures incurred by the public finance units.

#### **4. Dilemmas of the need to introduce the deadline for the budget efficiency**

Budgeting is a management-enhancing method, so the assessment of budgeting cannot be simplified to the evaluation of the procedure and its correctness, it is necessary to evaluate the results the budgeting



leads to, or even take a step further and evaluate the effects of budgeted tasks. Budgeting needs to be looked at more widely. If the primary goal of budgeting is to discipline expenditure and execution timeframe to create a performance-oriented activity, then when evaluating the budget efficiency one needs to take into account the correctness of the choice of action, tasks and projects that are included in the budget.

The primary limitation in the internal auditor's work is that the auditor cannot take responsibility for the management of the entity, as it's a role and task of the unit's manager. In practice this means that the decision on whether to implement the auditor's recommendations should be made by the manager – of the organisation's department or the whole unit. Furthermore, the internal auditor should be guaranteed independence, i.e. their work should not be limited, for example by refusing access to documents, people, or even a ban on examining a specific area of the unit's operation. From the point of view of some unit managers this puts the auditor in a privileged position, as they cannot be instructed to perform multiple activities, and simultaneously the auditor does not take the responsibility for implementing the recommendations. However, it is the impossibility to take responsibility for management along with independence that are the basis of the internal auditor's objectivity. Moreover, the internal auditor is not freed from responsibility for the efficiency and quality of their work [Popławski, 2013, p. 3–5/18].

The effective functioning of the local self-governments and rational utilisation of public funds are conditioned by the specific actions taken by the authorities of the budgetary units. These actions must take into account the social (e.g. increasing public demand for services by the state institutions) and economic factors (e.g. economic crisis, globalisation) [Dylewski et al., 2010, p. 29]. Examining the budget efficiency in the local self-government unit is not an easy task but worth presenting. The task is difficult due to specifics and rigidity of these units' functioning. However, the literature presents many aspects of perceiving and examining the efficiency, thus the legitimacy of this paper's topic is maintained.

It may be too that such a new generation of econocrats and accountocrats would be much more prone to "bureau-shaping", as analysed by P. Dunleavy (1985, 1991); that is, the propensity of top public managers to aim for high-status analytic work in collegial elite units and to distance themselves from front-line supervisory roles in favour of a "super-control" position which offers more job satisfaction and less tedious routine. Once bureaucrats adopt such preferences, there is nothing against their interests in enthusiastically cutting service delivery budgets down the line, or in breaking up and deprivileging the world of public service delivery, so

long as the power and status of central agencies is retained or augmented [Hood, 1995, p. 102].

The budget efficiency could also be an excellent measure for assessing the governance and management of public resources by the local self-government units.

Thus, the questions arise: Should the concept of the budget efficiency be introduced? Is it a voluntary choice or an economic necessity?

In the authors' opinion the answer to these questions should be found in the current market situation that forces many public finance entities to seek optimal solutions in the decision-making process. Examining the efficiency will never come to the final, desirable result as there is broad comprehension of this concept. Information included in this paper can be a basis for further research in the field of the budget efficiency. The research could be conducted on a broader scale, for example by comparing several different units of local self-government. The budget efficiency could be also an excellent measure of governance and management of public funds by local self-government units. There are many possibilities and approaches to the essence of the efficiency, but it is not surprising given the large scale of defining and interpreting this concept.

This article should be considered as a basis and a contribution to a further discussion on this subject.

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### **The budget efficiency of entities in public finance sector (Summary)**

The main purpose of this research paper is to define issues related to budget efficiency. Deliberations related to budgeting are limited to stating that budgeting is an effective method of supporting management, and the evaluation of budgeting efficiency is reduced to the assessment of the budget enforcement. The market factual data of the public finance sector require a much broader view of the efficiency of public financial resources planning and spending. The assessment of the budget efficiency is not an easy task, yet it is necessary especially in the aforementioned public entities, which results from the specific nature and rigidity of these entities' functioning. The paper opens a discussions on the issue of the budget efficiency in an organisation, aiming at defining the concept and emphasizing the importance of this topic while discussing dilemmas of the necessity to introduce the idea to the literature of the subject. The construction of the notion of the budget efficiency has been built taking into account the specifics of the public finance entities, which required their brief estimation. The paper content presents issues related to the essence, assessment and evaluation of the efficiency in the unit of local self-government. This paper attempts to define the concept of budget efficiency based on literature resources related to efficiency, budgeting and the efficiency of resource allocation.

### **Keywords**

budget, budgeting, efficiency