

T.C.
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SOSYAL BİLİMLER ENSTİTÜSÜ
İŞLETME ANA BİLİM DALI
MUHASEBE VE FİNANSMAN (İNG) BİLİM DALI

**A STUDY ON CITY MUNICIPALITIES OF TURKEY:
RELATIONSHIP BETWEEN SOCIOECONOMIC LEVEL AND
FINANCIAL CONDITION**

Yüksek Lisan Tezi

MUSTAFA ERSÖZ

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Marmara Üniversitesi
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ABSTRACT

The first objective of this study is to examine the relationship between socioeconomic development levels of cities and financial condition of municipalities in these cities. Accountability and transparency are means of an improved democracy. In first part of the study, basic components of democracy are studied. Moreover, two of these components accountability, transparency and tools to improve accountability and transparency are studied deeply. In the second part, recent regulations to improve accountability and transparency in Turkey are studied. In last part, which is the research part of the thesis, the statistical relation between socioeconomic development indicators of cities and financial condition of municipalities are examined. 12 socioeconomic development indicators are used in research. These indicators represent health service level, industrial development, agriculture, export, literacy level, accommodation infrastructure, high education level, employment condition, population, income level and geographical situation of cities. The financial condition of municipalities is determined by using 11 different financial ratios, which represent cash solvency, budget solvency, long-term liability solvency and service solvency. Regression analysis is applied in the study on the data of 30 municipalities to find out the relation between socioeconomic development indicators and financial ratios of municipalities.

Key Words

Accountability
Transparency
Financial Analysis
Financial Tables
Public Accounting
Socio-economic Level

ÖZET

Bu çalışmanın öncelikli amacı şehirlerin gelişmişlik seviyeleri ile belediyelerin finansal durumları arasındaki ilişkiyi incelemektir. Hesap verebilirlik ve şeffaflık gelişmiş demokrasinin araçlarıdır. Çalışmanın birinci bölümünde, demokrasinin temel bileşenleri çalışıldı. Bunun yanında, bu bileşenlerden hesap verebilirlik ve şeffaflık ve bunları geliştirebilmenin araçları çalışıldı. İkinci bölümde, Türkiye’de hesap verebilirlik ve şeffaflığı geliştirmeyi amaçlayan son dönem hukuki düzenlemeleri incelendi. Tezin son bölümü de olan, araştırma bölümünde, şehirlerin sosyoekonomik gelişmişlik göstergeleri ile belediyelerin finansal durumu arasındaki istatistiksel ilişki incelendi. Araştırmada 12 gösterge kullanıldı. Bu göstergeler illerin sağlık servisi durumunu, endüstriyel gelişmişliğini, tarımını, ihracatını, okuma yazma seviyesini, konut altyapısını, yüksek öğretim seviyesini, nüfusunu, gelir seviyesini ve coğrafi konumunu temsil etmektedir. Belediyelerin finansal durumu kısa vadeli borç ödeme gücünü, bütçe durumunu, uzun vadeli borç ödeme gücünü ve hizmet sürdürme kapasitesini gösteren 11 finansal rasyonun kullanılmasıyla belirlendi. Çalışmada, sosyoekonomik gelişmişlik göstergeleri ile finansal rasyolar arasındaki ilişkiyi ortaya koyabilmek amacıyla 30 belediyenin verileri kullanılarak regresyon analizi uygulandı.

Anahtar Sözcükler

Hesap verebilirlik
Şeffaflık
Finansal Analiz
Finansal Tablolar
Kamu Muhasebesi
Sosyo-ekonomik Düzey

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ABBREVIATIONS

| | |
|------------------|---|
| CICA | Canadian Institute of Chartered Accountants |
| Code-5018 | Public Financial Management and Control Law |
| ESA-1995 | European System of Accounts |
| EU | European Union |
| GASB | Government Accounting Standards Board |
| GFS-2001 | IMF Government Financial Statistics |
| IASs | International Accounting Standards |
| ICMA | International City Management Association |
| IFAC | International Federation of Accountants |
| IFAC-PSC | International Federation of Accountants Public Sector Committee |
| IMF | International Monetary Fund |
| INTOSAI | International Organization of Supreme Audit Institutions |
| IPSAS | International Public Sector Accounting Standard |
| IT | Information Technology |
| NAO | National Audit Office |
| PSC | Public Sector Committee |
| SAI | Supreme Audit Institution |
| SAIs | Supreme Audit Institutions |
| SNA-1993 | United Nations System of National Accounts |
| SPSS | Statistics Program for Social Sciences |
| TCA | Turkish Court of Accounts |
| U.K. | United Kingdom |
| U.S.A. | United States of America |
| WB | World Bank |

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INTRODUCTION

Democracy has emerged initially in ancient Greek cities and developed in time as result of evolution of human mind and high populated characteristics of society. Today's modern democratic systems have some components to apply democracy in a safe manner for all citizens. Human rights and rule of law, free and fair elections and accountability and transparency of state administrations and politicians provide safety for all citizens regardless of their being in power. Administrations can not interfere with the rights of citizens and they can not act against predetermined laws and regulations. Citizens always have the right of not reelecting the politicians. However, to scrutinize and evaluate the acts of politicians and administrations citizens should be aware of the acts of these. Transparency and accountability provides this via tools founded by laws which emerged in time. Some of these tools are institutions as ombudsman, audits conducted by independent institutions, strategic plans and activity reports of administrations. In addition to these institutions, information systems should be proper to provide data about the real situation of administrations. Accounting system is one of these tools that provide information on financial activities of administrations. There are different accounting systems used in government accounting and various financial statements are produced via these different accounting systems. Some of these financial systems and statements are comprehensive but some are basic. Budget recording systems also give information about the usage of public resources. By examinations of these financial statements, by applications as financial statement analysis, citizens and other related parties can evaluate the activities of government agencies and this lead to more efficient, effective and economical usage of public resources.

Local governments are close to citizens in comparison with central governments. For this reason they are under more scrutiny of residents of that area and for this reason transparency and accountability is believed to be more developed in local governments and they are believed to be more efficient and effective in resource usage. Mainly for this reason the importance, power, responsibilities and resources of local governments increased in many developed countries.

Concerning Turkey, after deep economic crisis, increased debts and as result of relations with international and supranational organizations as International Monetary

Fund (IMF), World Bank (WB), and European Union (EU), many new regulations are enacted especially in last decade. The main philosophy of financial system of Turkish public management and control has changed by the enactment of Public Financial Management and Control Law (Code-5018), more concrete and analyzable accounting and budget systems have been adapted to improve accountability. Moreover, citizens got the right of information by Turkish Right to Information Law which made being informed on activities of state administrations possible. Lastly, after the enactment of Turkish Court of Accounts Law, which is in Parliament now for enactment, almost all the public sector will be audited by an independent agency in terms of financial activities. These developments are supposed to improve accountability and transparency in Turkey and more effective, efficient and economic usage of public resources.

In the study, it is aimed to find out the relation between socioeconomic development level of cities and financial condition of municipalities of these cities. Municipalities are selected as the subject of the study because it is believed that because of being closer to citizens local governments are more accountable and transparent. And citizens of socioeconomically developed cities are supposed to be more aware of their rights. For this reason, financial conditions of socioeconomically developed cities are supposed to be better in comparison with less developed cities. The results of statistical methods applied on socioeconomic development indicators of cities and financial ratios of municipalities are thought to be helpful to understand the relation.

1. DEMOCRACY, ACCOUNTABILITY, TRANSPARENCY AND TOOLS TO IMPROVE ACCOUNTABILITY AND TRANSPARENCY

1.1. DEMOCRACY

1.1.1. Short History of Democracy

It is obvious that it is not possible to describe democracy in a sentence, because democracy is a very broad and comprehensive concept that includes many ideas and concepts those evolved in long history of humanity. In its most superficial way,

democracy can be thought as “the ruling of majority”. However, to be defined as a real and developed democracy the political system should have many other characteristics.

As stated by Beetham and Boyle; “The idea that ordinary people should be entitled to a say in the decisions that affect their lives is one that has emerged as an aspiration in many different historical societies. It achieved a classical institutional form in Athens in the fifth and fourth centuries BC.”¹ There was application of direct democracy in Athens. Citizens were coming together, they were discussing on regulations and issues concerning the administration of the City. It was possible to apply direct democracy in Athens because the population was low in the City. Moreover, Athenians did not give slaves, foreigners that are living in the City and women the right of participating in democratic decision making process, ruling. However, in today’s societies as result of the emergence of highly populated national states it is not possible to exercise direct democracy. It can only be applied in local government decision making process or through referendum on crucial issues in national states which are not very common. For this reason, representative democracy has emerged and evolved with its components in contemporary modern and highly populated societies.

In a highly populated society, it is not possible to get citizens together and it is not applicable to decide on administration. For this reason, communities preferred to elect their representatives to decide on political issues on behalf of themselves. However, there is a risk that representatives elected by citizens may not always act in line with the goodness of the society. For this reason, there should be some mechanisms and institutions to minimize the possibility of representatives’ selfish acts and decisions. These institutions are the components of representative democracy and they have emerged and evolved during the application of democratic political systems within long period.

These main components of democratic political systems can be enumerated as citizen rights and freedoms, free and fair elections and accountability and transparency.

¹ David Beetham and Kevin Boyle, *Introducing Democracy 80 Questions and Answers*, p. 5

1.1.2. Components of Democracy

1.1.2.1. Citizen Rights

State should respect the human rights and should function in line with the necessities of rule of law.

1.1.2.1.1 Human Rights and Freedoms

To be able to mention a real democratic system, the human rights should be protected. Some of human rights and freedoms are rights as the right of life, the right of free expression of ideas, freedom of speech, the right of free association, the right of elect and participate in political system, the rights that guarantee the equal citizenship, the property of all citizens, the rights and freedoms of minorities.

Before the emergence of the idea of respect to the human rights there was an arbitrary administration of decision makers in all over the world. King or any other execution body could easily decide to act even against the basic rights of citizens. They might decide against the life, freedoms or property of citizens. Torturing a guilty or suspected person was a common application. This kind of attacks against human and citizen rights have emerged even in 20th century democracies. For example, during the fascist, socialist and militarist administrations in the World, many citizens' lives and properties have been taken or their freedoms have been restricted by depending on the excuse of majority will, the goodness of the majority. The goodness and demand of majority thought to be more valuable, respectful than the freedoms and lives of minorities. The majority was accepted as sacred. Administrations could not be held responsible because of their unjust acts.

After tragic experiences and many struggles for them Human Rights became indispensable part of democratic societies.

According to Beetham;

“Citizen Rights are the result of struggles of the common people, often at considerable cost to themselves, to limit the power of oligarchic and oppressive regimes, and to make government more publicly accountable and responsive to whole the community”.²

² David Beetham, Democracy a Beginner's Guide, p. 13

Guaranteeing the human rights and freedoms of all citizens, even if they are minority or radicals in that country is now seen as one of the main characteristics of democratic systems in developed democratic countries. Many countries even accept the application of international scrutiny of their state's legislature and administration in terms of human rights by international jurisdiction system.

Despite developed countries' respect to human rights, there are still many countries in the world that act arbitrarily, without respecting even the most basic human rights as the right of life.

Consequently, respecting human rights is one of the main components of democracy and it is not possible to mention the existence of democracy without human rights.

1.1.2.1.2 Rule of Law

Rule of law is also one of the main components of democracy.

According to Beetham and Boyle;

“A government in a modern state has enormous powers at its disposal. Whatever its popularity, if it is not kept subject to the law like everyone else, or if it is not required to seek approval for legislation from parliament according to established procedures, or if does not respect the liberties of its citizens, however unpopular on occasion their exercise may be, then people will rapidly lose the capacity to control it.”³

Rule of law provides predetermined legislation and administration system in a country and it prevents the arbitrary applications of administration in a country.

Laws in the country are open to citizens, and society and citizens, media and civil society institutions can criticize the laws, rules and regulations in a democratic system. They can provide rearrangements of rules or they can apply for judicial control of rules and applications of administration. It is possible to apply for judicial control of laws, rules and regulations and of administrative practices. By this control mechanism, the arbitrary legislation and administration of politicians and administrators can be prevented.

However, the judiciary's independence is crucial for the realization of rule of law. The judgment process should be completely free and should be protected from any Parliament or administrative interference. This can be realized by elimination of

³ David Beetham and Kevin Boyle, p. 14

government's and Parliament's control in judge employment, appointment, promotion and election processes.

1.1.2.2 Free and Fair Elections

Free and fair elections are also indispensable components of democracy. Initially, without publicly elected legislative and government a legitimate political system can not be formed. In a political system without free and fair elections there can be only a minority's control over the society and this administration can not be accepted as a legitimate administration. In this system, minority is not obliged to act for the goodness and in line with the will of the society, because it does not need the votes of majority to maintain its power. "The ultimate sanction on a government, and the one that underpins all the others, is the power of electoral dismissal".⁴ Without this sanction administration exercise actions against human rights, freedoms of citizens and its competitors instead of acting for the goodness of the society. This is the case in many countries today, there are oligarchic ruling class administrations and they apply strict control over the society to eliminate the ideas against their administration.

For this reason, the legislative and executive bodies are obliged to be elected through free and fair elections in a democratic system. Elections must be repeated in a pre-determined period to guarantee the legislative and executive to act for the goodness of the society. In cases in which election times are under the control of the administration, it may delay or cancel elections and this harms democracy. In many democratic countries, elections are repeated in each 4 or 5 years. This period is argued to be sufficient to assess the success and performance of the parliaments and executives.

In order to realize a real democratic system, voting process must have some properties. Initially, there must be equal vote for all citizens. During the evolution of democracy, there were different applications of voting. In emerging periods, only small groups, those are wealthy, owner of land, owner of some ranks had right to vote. Workers, minorities and women did not have right to vote. In time, generally after struggle of communities equal vote for all citizens and universal suffrage evolved to apply real democracy in many countries. Secondly, there must be secret voting. Citizens must feel secure and they feel completely free during voting. This freedom can be realized by

⁴ David Beetham, p. 35

providing secret voting conditions to citizens. Thirdly, secure and fair process must be provided. Because, citizens should go voting and vote freely during elections and results of elections must be in line with the choice of the citizens. No one should interfere with or change the results of the elections. Without equal, secret, secure and fair voting process democracy can not be realized.

It is widely accepted that the legislative and executive should be elected in democratic systems, but there are some different systems in the application of elections. For example, in Presidential Systems Parliament and President, which are legislative and executive bodies respectively, are elected by the citizens directly. However, in Parliamentary systems, the legislative body, Parliament elected by the society but the executive body, government is determined according the majority of parties in the Parliament. There are some other systems except from Parliamentary and Presidential systems. These different systems evolved in time according to the historical and cultural characteristics of countries and it is not proper to accept one of these systems as more successful than the others.

Free and fair elections are compulsory for a democratic system but the representation system as result of elections is also an important issue. There are different electoral systems such as plurality system, mixed member system and the party list system. All these systems have different advantages, some are simple, and some provides majority support, and some guarantee differential representation and proportionality. However, as political systems electoral systems applied by countries evolved in line with different historical and cultural backgrounds of countries.

Consequently, despite of existence of different political systems and electoral systems in countries, free and fair elections are compulsory for a democratic system.

1.1.2.3 Accountability and Transparency

Transparency and accountability are also necessary for a democratic system. If citizens do not have fair information about the acts of the government and parliament they can not decide well during the elections. Moreover, Parliaments as representative of the citizens would need fair information about the acts of governments to scrutinize governments in an efficient way in the name of the society. Accountability and transparency are also main components of democracy, and accounting is one of the

means that are necessary to realize accountability and transparency. The relation between democracy, accountability, transparency will be reviewed in 1.3 part (Accountability and Transparency) part of the thesis after mentioning the local governments.

1.2. DEMOCRACY AND LOCAL GOVERNMENTS

Local governments developed in today's democratic societies as an administration near central governments. The local governments and central governments have different tasks despite it changes according to characteristics of countries. But generally, central governments deal with national issues and policies as national defense, monetary policy, international relations and justice. However, local governments deal with local needs and provide urban services to citizens. Local governments provide services as infrastructure investments, recreation areas, water and gas services, city waste management and transportation. These services are provided by local governments instead of central governments because it is believed that local governments are more successful in terms of resource usage and they provide services cheaper, in more efficient, economic and effective manner.

There were local governments in many countries even before modern era but importance of local administrations in many countries has increased especially in last decades because of their being more successful in resource usage. Currently, developed democratic countries prefer more autonomous local governments and they give more resources to local administrations and central government leaves some services as task of local administrations.

Actually, local governments are structured in many different versions in the world. In (United States of America) U.S.A., there are states under the federal administration; states have very autonomous administration and Parliament. City administrations are available under states and in comparison with unitary states' city administrations; city administrations have significant authority concerning education policy, police department administration. Under city administrations there are smaller administrative units. Germany also has a federal system and states and city administrations are available in the country. However, France is a unitary country and local administrations do not have significant authority, power and autonomy as in Germany and U.S.A.

However, because of increased belief in the success of local governments even countries those have strong unitary administration heritage today improved power, autonomy and activities of local governments.

Therefore, there is a trend towards more powerful local governments but it is necessary to think about the reason of this trend. Why local governments are accepted important for democracy and more successful in terms of resource usage? There are some ideas on this issue. Initially, local governments are closer to citizens than central government. Central government is away from the citizens and central government may not understand the needs of citizens via so remote administration. Moreover, citizens can easily scrutinize activities of local governments and they can more easily determine irrational usage of resources and they can criticize local administrators because of these irrational usages. It can not be so easy to criticize irrational investments if these investments to city are realized by central government. This characteristic of local government makes local government more accountable and transparent towards citizens. Secondly, local governments are more responsive to the citizen needs, because local administrators should respond demands of citizens if they want to be re-elected. Central government does not have to be so responsive to local needs because central administrations believe they are responsible to the whole society. Moreover, central government can not learn about preferences of residents from capital city. For example, mayor of a city should take the preferences of citizens into consideration when he/she makes an investment to the neighborhood but the situation is different for Ministry of Public Works. Because, Ministers are responsive to the demands of the all country and they may not be aware of needs of citizens moreover, they may not have mechanisms to ask for the preferences of the residents. Thirdly, local governments are more participant. City councils and administrations are members of the local community and the administration is very close to citizens. Non-governmental organizations, civil institutions can declare their demands to local councils and local administrations directly. This type of continuous communication between citizens and administration is inapplicable for central administrations and central government and civil institutions those demand to affect actions of central government or Parliaments have to be very powerful. Lastly, there is flexibility in local administrations. As result of participation of citizens and continuous communication between citizens and local governments, local

governments can easily and quickly change applications in a more flexible way. If the citizens do not be happy as result of an application or a service the local government can be aware of and change these applications or can cancel that service easily without many procedures that are necessary to make Ministers in central government aware of these demands.

All these characteristics of local governments make local governments advantages in terms of being more efficient, effective and economic administration. And this advantage increased the powers, resources and autonomy of local governments in last decades in many countries.

1.3. ACCOUNTABILITY AND TRANSPARENCY

1.3.1. What is Accountability?

Accountability means asking for the results of the actions of administrators to whom authority and sources are given to realize some tasks. Accountability is a concept that is composed of many elements and it is directly related to the quality of the democracy. It is believed that the more accountability of politicians and administration provides more qualified and improved democracy. Because accountability is related to holding those that are elected and appointed responsible for their actions.

In a political system in which legislation and executors are not accountable for their decisions and acts they may prefer to act for their own benefit and they may give up to act for the goodness of the society. As Downey states “that those were entrusted with the use of public resources should not only act in the public interest but should be seen to do so; and should be subject to public censure if they do not”.⁵ For this reason, in a democratic state, all elected and appointed should be accountable for their actions and decisions. Of course it is not practical for all appointed administrators to be directly accountable towards citizens, but they can be accountable towards the elected representatives of the society. Appointed administrators should be accountable towards ministers as the member of the government. Governments should be accountable towards Parliament, representatives of the citizens and Parliament should be accountable towards the society. If these accountability relations are powerful, the whole state mechanism can be kept accountable towards the society and those are

⁵ Gordon Downey, Public Accountability: fact or myth?, Public Money, June 1996, p.35

having extreme power in the name of society's usage of this power can be controlled by the society. For a strong accountability, elected people should have ability and quality to scrutinize the actions of administrators. Budget process and appropriations' control at the end of the budget year are means of legislative to scrutinize the actions of government. These means should be used for the goodness of the society. Ministers should scrutinize the regulations and their applications carefully and demands and complaints of citizens, civil associations and related parties should be taken into consideration by them to strengthen accountability. If administrators can not be successful or they act against the goodness of the society ministers should apply sanctions to administrators.

1.3.2. Transparency, the Main Component of Accountability

Accountability, as mentioned before, is a key factor to realize a qualified democracy, and transparency is the main component of and a must for accountability. Parliaments can not be kept responsible for their actions if their legislative activities, laws and regulations can not be learned by the society. Moreover, if the results of the activities of administrators are not known ministers can not keep them accountable for their activities. Information about the results of activities and actions of the administrations is necessary for accountability.

However, today's state mechanism is a very complicated and great one. For this reason it is very hard to control all the activities of state organizations. To prevent this, the regulations should not be complex, continuous information should be published and convenient reporting should be realized about the activities of state organizations. There should be communication with citizens and all necessary information for just decision making have to be shared with citizens, Parliament, and the ministers. Sometimes, even ministers may prefer to act against the goodness of the society, for this reason all information and data related to the activities of state should be achievable by citizens, civil institutions and all related parties. If there is some classified information or data without persuasive explanation it can not be possible to mention a real accountability for that organization.

Of course secrecy of security matters should be taken into consideration, as stated by Lodge on the case of EU

“if the reasons why access to information are unclear, or are not seen to be legitimate, justifiable or well-founded, then public skepticism over EU policymakers’ and policy enforcers’ intentions can not be easily boasted by measures purporting to make the EU policy-making process more transparent, accessible, accountable and democratic”.⁶

There are five attributes to realize transparency. The first one is physical access to the organization to scrutinize the activities. For example, during the construction of a road, some experts may want to examine the building process. If they can not get physical access it is not possible to mention strong transparency. Moreover, citizens may demand to visit the Parliament members to get some information concerning issues. Without having physical access to deputies, transparency can not be realized. Second attribute to transparency is access to documents. All documents should be achievable by citizens and related parties. Third attribute to transparency is transparency of debates. It may be possible to make Parliament debates open to society, but in practice there may be some problems in making the debates of the board members of any state organization or cabinet. However, even these debates should be accessible by citizens and related parties as much as possible. Forth attribute of transparency is intelligibility of voting. The votes of deputies on an issue should be learned by citizens. By this way, they can be kept accountable by citizens during elections or even before elections through criticisms. The last attribute to transparency is clarity of interests which means the citizens have all information about the results of the choices done by administrators of deputies.⁷

It is believed also in European Union that transparency is related to the quality of democracy and must for accountability and for this reason the importance attributed to transparency and accountability increases in EU institutions. In EU the transparency concept has first emerged about competition policy in 1960’s. In 1980’s general right access in all documents in EU institutions has been given to citizens and through Maastricht Treaty transparency officially became part of EU law and politics.⁸

One of the main policies in EU today is to make EU institutions as transparent as possible. Moreover, transparency is accepted as something more than access to

⁶ Juliet Lodge, Transparency and EU Governance, Journal of Contemporary European Studies, Vol.11, No.1, 2003, p.114

⁷ From; Pierpaolo Settembri, Transparency and The EU Legislator, JCSM 2005, Volume 43, Number 3. pp. 642-643

⁸ From; Pierpaolo Settembri, pp. 639-640

documents. Transparency is thought to get access to all information necessary to hold the involved institutions accountable.

However, despite EU believes transparency and accountability there still have some problems related to the EU institutions in terms of realization of these. Initially, it is believed that there is a disconnection between citizens and EU, this is mainly because of EU's being away from citizens and citizens are not interested in EU policies. EU institutions and citizens should be bridged and this can be realized through increasing the popularity of EU among citizens.

Another problem in EU is related to EU Council. EU Council of Ministers has significant autonomy and there is a lack of transparency for the Council towards EU Parliament. Moreover, Council is not accountable for any institution in EU; Council members are accountable to their domestic legislator. However, executive's accountability towards Parliament is a crucial aspect of democratic legitimacy and this situation jeopardizes the quality of democracy in EU. This is probably the result of EU Parliament's not being popular among citizens. If the importance and effect of EU Parliament increases in lives of EU citizens its popularity will probably increase. As result of this, citizens can accept EU Parliament as their own legislator and they can demand more Parliament scrutiny over EU Council and more accountable Council towards their representatives. This can probably be realized through increased believe in EU citizenship.⁹

Consequently, it is a fact that for an effective accountability there should be a real transparency. And both transparency and accountability are compulsory for a qualified democracy. For this reason, there is increased significance attributed to transparency and accountability in developed democratic countries and societies as in EU. "A generation ago the bureaucracy was largely seen as uncommunicative, a virtual 'black box'.... With changes in society there were calls for new accountability requirements with the expectations of the public seeking a more transparent and open government".¹⁰ And this trend caused emergence of means to hold state organizations accountable and make them more transparent.

⁹ From; Pierpaolo Settembri, p. 644

¹⁰ Pat Barrett, Auditor-General for Australia, Financial Management in the Public Sector-How Accrual Accounting and Budgeting Enhances Governance and Accountability, August 2004, p. 3, www.anao.gov.au

Some of these means can be numerated as regulations about Ombudsman, More Effective Audit, Strategic Plans and Performance Measurement applications.

1.3.3. Means to Improve Accountability and Transparency

1.3.3.1 Ombudsman Institution

Ombudsman is an institution that first emerged in 18th century in Sweden. Ombudsman institution has began to be applied in Scandinavian countries after Sweden and “Currently, it is being applied more than 40 countries that includes France, England, Italy, Spain, Israel, India, Nigeria and Portugal in national, regional, city and municipality level”.¹¹ Moreover, Ombudsman institution has also started to be applied in EU through the Maastricht Agreement.

Ombudsman institution aims to audit the civil servants. During this audit, ombudsman checks the actions of civil servants if they are in line with laws and regulations and if they are realized in a rational way. Moreover, ombudsman institution accepts and investigates the complaints of citizens about the actions of civil servants.

Ombudsman institutions are accepted as compulsory and beneficial in today’s complex and complicated state organizations. There are lots of regulations and different applications of these organizations. An ordinary citizen may not have sufficient knowledge to understand this complex mechanism and Ombudsman institutions help citizens to stop unjust applications of state organizations to secure themselves against these applications.

Another reason that caused the Ombudsman institutions to be applied in many countries is the insufficiency of classical audit mechanisms. Parliamentary control mechanism over governments and administration is generally on common issues and can not be applied on specific issues. Moreover, this mechanism works very slowly and unfortunately most of the times it does not work as result of party disciplinary. Administrative audit can also be insufficient; there may be some problems about independence. The audit boards are generally a part of the administration on the Ministry. This may prevent independent and effective audit. Lastly, judicial audit may also be insufficient in some respects, because it works slowly and it is about regularity

¹¹ Mahir IŞIKAY, Ombudsmanlık Kurumunun AB ve Türkiye’deki Konumu, p.1, <http://archiv.jura.uni-saarland.de/turkish/MIsikay.html>

audit only. Ombudsman institutions are independent, easily reachable, elastic and quickly working institutions. They have sophisticated knowledge and they audit state organizations not only in terms of regularity but also in terms of effectiveness, efficiency and economy of their actions.¹² Moreover as Reid states,

“Ombudsman is free to decide whether or not a complaint warrants an investigation, he is bound to cover all points raised by a complainant; he may extend his investigation to cover other aspects of the matter; and he may at any time discontinue an investigation”¹³,

which makes this institution very effective.

“The duties of ombudsman institution can be enumerated as;

To secure citizens’ right and freedom,

To secure citizens against the administration,

To work for betterment of administration to prevent injustice that resulted from bad administration”.¹⁴

Ombudsman institutions have very broad investigation right; they can investigate about the actions of almost all state organizations. For example, in Sweden, Ombudsman can even check the judicial applications in terms of time of judgments. However, ombudsman institutions do not have power to demand the administration that is being investigated or audited to change its applications. Ombudsman can not give a decision about the applications of administration that is obliged to be applied and ombudsman can not apply any sanctions towards administrations if they do not change their applications according to the demands of Ombudsman. However, ombudsman can report the irrational and unjust applications of administrations towards citizens to Parliament and public. Ombudsman only exhibits and reports the maladministration and unjust administration and media, public and Parliament applies pressure on administration to review maladministration and injustice.

Ombudsman has the support of Parliaments and this provides important power to ombudsman. However, they are supposed to be politically neutral. Ombudsmen should be independent in their reports and decisions, by this way they can be more effective. Other public organizations should be in cooperation with ombudsmen. Those are

¹² Mahir IŞIKAY, p. 3,4

¹³ William K. Reid, Changing Notions of Public Accountability, Public Administration, Vol.70 Spring 1992, p. 83

¹⁴ Mahir IŞIKAY, p. 4

appointed as ombudsman should be reliable, talented and experienced people. Citizens should reach at and convey their complaints to ombudsman easily without any payment. With these properties, ombudsman is an institution that increases the transparency and accountability of state organizations. It provides deep and reliable scrutiny about the complex applications of administrations. Citizens and Parliament can hold administrations responsible for their unjust and mal-administrations.

1.3.3.2. Audit

1.3.3.2.1. Importance of Audit

As mentioned before state is a complex mechanism and information about activities, applications and results of the activities of state organizations are submitted to decision makers. Decision makers depend on the information submitted to them in decision making process. Truth, reliability of this information should be checked. Independent audit should be exercised; decision makers can not deal with controlling all the applications themselves. In a state of law, in government institutions, applications have to be in compliance with laws and other regulations. Regularity and performance of state organizations' activities, decisions and applications should also be audited. This is a necessity for state of law, accountability and democracy. Audit organization should also be independent and neutral to be effective and to exhibit the real condition of the auditee.

As stated by Kenger,

“Verbally audit can be defined as the examination, check and control whether the work is done reasonable, right and in compliance with pre-determined rules and the demand of the management. In modern understanding, the meaning of audit covers evaluation of the results of activities of an organization in terms of efficiency, effectiveness and economy via standards set according to probability and relativity methods”.¹⁵

As mentioned before audit is a process in which the activities of the auditee are checked and controlled by the independent auditor. In state audit, as result of the necessities of the democracy, audit is exercised on behalf of the Parliament by Supreme Audit Institutions (SAIs). Despite there are many auditing departments within institutions

¹⁵ Başdenetçi Erdal KENGER, Denetim, Denetçi Yardımcıları Eğitim Notu, T.C. Başbakanlık Yüksek Denetleme Kurulu, p. 4

those apply internal audit, SAI audit is accepted as the most effective because of being an external audit and applied by an independent organization. Parliaments are representatives of citizens, Parliament members are accountable towards citizens, voters, and they are responsible for the results of mal-administration, waste of resources and appropriations. SAIs are tools of Parliaments and SAIs audit for Parliaments and provide reports and information to them.

Parliaments give authority and permission to governments; governments realize some actions, apply policies and use resources to realize the predetermined objectives. Parliaments learn the results of the activities of government by SAI audit. For this reason, SAIs should be independent. SAIs help Parliaments to scrutinize the results of activities by preparing reports for Parliaments. There are four steps in the audit process. Initially, SAIs prepare report and submits these reports to Parliament, Parliaments evaluate these reports. In many developed democratic countries reports that are submitted to Parliaments are evaluated and investigated by a Commission established in the Parliament for this purpose. After the evaluation of the reports Parliament advices government agencies and government agencies should respond the Parliament about the issues in the reports and advices of Parliament. Ministers or managers of government agencies can respond to Parliament about the reports and recommendations of Parliament. This process should be transparent and open to public. Reports, advices of Parliament and responses of government agencies should be open to society. This process is one of the necessities to hold administrators accountable towards society and Parliament.

In first applications, SAIs used to prepare reports to Parliaments which were prepared for the assurance of the veracity and completeness of the government's financial accounts and their compliance with parliamentary appropriations of public resources. However, now comprehensive reporting is available, SAIs prepare for and submits to Parliament reports related to financial audit, regularity audit and performance audit. Parliaments evaluate all these reports and demands for better administration which reinforces the accountability.

SAIs audit is crucial for democracy. For this reason, SAIs should be independent from government effects. Moreover, the quality of SAI audit and reports should be guaranteed. Internationally accepted Auditing and Reporting Standards should be

followed by SAIs. In order to realize the utmost accountability SAIs should audit all the state agencies. The audit coverage of SAIs should include all the government activities. If there are some state agencies that are not open to SAI audit it can not be possible to claim that the non-audited state agency is accountable towards Parliament. INTOSAI (International Organization of Supreme Audit Institutions) demands and recommends the audit of all state activities by SAIs. This statement is also declared in “Lima Declaration” which is one of the most important papers of INTOSAI because of determining the main characteristics of SAIs.

Actually this is the case in many developed democracies. For example, NAO (National Audit Office), which is SAI of U.K., audits the Consolidated Fund that includes all revenues of state, National Loans Fund, Ministries, autonomous organizations, public institutions other than government, international organizations.¹⁶ However, in some developing and underdeveloped countries activities of some government agencies as military or mass habitation organizations can not be audited, or SAIs may not be independent, government or Ministers can affect the audit process and reports of SAIs. Therefore, a qualified and independent SAI audit is crucial for accountability, transparency and the quality of democracy.

1.3.3.2.2. Types of Audit

There are three types of audit. These are financial audit, regularity audit and performance audit.

1.3.3.2.2.1. Financial Audit

Financial audit is the control of the financial statements of an organization, entity in terms of their being in line with pre-determined rules. These pre-determined rules for entities are accounting rules, recording rules and tax laws and regulations. Financial statements and records that form the financial statements are controlled by the auditors. However, because of including thousands of transactions for huge organizations sampling methods are applied by the auditors instead of controlling each record, transaction and documents to which these records depend. Auditor presents results of

¹⁶ From: About Us: The Role of the National Audit Office: Financial Audit, <http://www.nao.org.uk/about/accounts.htm>, p. 1

the audit by his/her report, and the auditor states his/her opinion concerning the reliability of financial statements for decision makers in this report.

1.3.3.2.2. Regularity Audit

Regularity audit is control of financial activities of an organization in terms of their being in line with pre-determined legal framework as laws, regulations, rules, procedures and agreements. Each financial activity has different characteristic and they should be realized in line with their pre-determined regulations. If activities are realized by ignoring these regulations, that financial activity becomes invalid. Moreover, if there emerges some illegal payments as result of the illegal applications this amount should be paid back by the responsible managers. Results of regularity audit are not publicized generally, but legal actions are followed to realize the compensation of the illegal payments, loss of the entity, organization.

1.3.3.2.3. Performance Audit

Performance audit, according to INTOSAI “is an audit of economy, efficiency and effectiveness with which the audited body uses its resources in carrying out its responsibilities”.¹⁷ Origins of performance audit depend on program budget in which program objectives were determined and results of each program are examined. Performance audit has developed over time. Currently, performance audit mainly aims to improve the performance of audited body through recommendations about its activities. Moreover, performance audit controls the activities of state agencies via comparing the objectives of the entities determined in strategic plans and the results of applications of these agencies. This part of the performance audit is examined in, 1.3.3.3 Strategic Plans, Yearly Activity Plans and Performance Measurement Applications, part of the Thesis. Decision makers or managers of organizations can realize insufficient, uneconomic and ineffective applications via the reports prepared as result of performance audit conducted. Performance audit of the agency provides information about the activities of state organizations and by this way it helps public insight over activities.

¹⁷ INTOSAI Audit Standards-1992, Handbook in Performance Audit theory and Practice, The Swedish National Audit Office, p.17

In performance audit, auditor can study the organization as a whole or he/she can prefer to study on specific issues. For example, performance audit can be related to specific subject, as success of pre-school education for Ministry of National Education.

Each audit type has different characteristics but consequently all financial, regularity and performance audit helps more qualified accountability, transparency and they helps the improvement of democracy in a country.

1.3.3.3 Strategic Plans, Yearly Activity Reports and Performance Measurement Applications

Performance audit is a method used to improve the efficiency, economy and effectiveness of activities of state organizations. As mentioned before (Supreme Audit Institutions) SAIs examine the activities of state agencies and gives recommendations to improve activities of those agencies. Performance audit is generally applied on a specific issue instead of on whole of the auditee. Audit team determines one specific activity of the state agency and examines whether the audited organization operates in an efficient, economic and effective way on that issue. For example, for a hospital, audit team examines the performance of one department or one type of activity of the hospital, as maintenance of fixtures. However, performance measurement has a comprehensive point of view. In performance measurement, performance indicators that are supposed to exhibit the performance of the agency are determined initially and these indicators are examined at the end of the period. Moreover, performance audit is applied rarely but performance measurement can be applied continuously. After the performance indicators are determined it gives opportunity to prepare these indicators for each period. By this way, it can be possible to see the performance of the agency at the end of each period.

For this reason, performance measurement is a very important tool for accountability and transparency. Citizens or managers can examine the performance indicators and can have information about the activities of the agency. Moreover, if the performance indicators are publicized via reports as “Yearly Activity Reports” this improves the transparency.

For a successful measurement application, initially the goals and objectives of the state agency should be determined by plans as “Strategic Plan” as in Turkey. By this way citizens or managers can compare the results of the activities, the performance

indicators with the pre-determined goals and objectives. If the objectives and goals can not be realized by the resources that are supposed to be sufficient to realize these objectives and goals, therefore the management or one specific department of the agency can be accepted as unsuccessful. By this way, performance measurement improves the accountability of the state agencies. Moreover, specific activities of departments that are unsuccessful can be determined easily by performance indicators and it can be possible to spend more attention to these activities of department. This process helps the improvement of the service quality and provides a continuous improvement for the state agencies.

Activity reports those include performance indicators should be prepared and publicized at the end of each period for successful performance measurement application. Because, if the results of the activities, performance indicators are not publicized regularly the comparison of indicators with pre-determined objectives those are in plans can not be possible. Therefore, plan that includes pre-determined objectives and goals of the agency, reasonable performance indicators and regularly prepared activity report that includes the performance results for the period are necessary. If all these parts are prepared in a realistic and just manner, a successful performance measurement and continuous performance, service quality improvement can be realized.

Determination of performance indicators is important for performance measurement. Because the performance indicators that are not well-selected may not provide realistic information concerning the success and performance of the agency. In first applications performance indicators were established to exhibit the amount of workforce or money spent for an activity, or the cost of one unit of service or production. However, these are not sufficient to show the success of the agency. Outcomes are more important for an agency than inputs and outputs. An agency can spend lots of money for an activity but if we only take the amount spend for that activity into consideration we can not see the performance of the agency in a healthy way. Moreover, an agency can provide a service or produce a good by spending a very tiny cost, but this also can not provide sufficient information about the success of the agency. Because, those services or goods provided by little spending may be totally unnecessary for the society. There may be no need for those services. For example, an airport, constructed to a very poor city in which a very low demand for airport is available, is a failure despite it costs very low. In recent

applications performance indicators that aim to measure the effectiveness of state agencies are also used. Effectiveness of an agency is related to its goals. If an agency realizes its goals it is effective. Via performance indicators that help to measure effectiveness the performance and success of the state agency can be measured in a more realistic manner.

Performance indicators should also be comparable for better performance measurement. It should be possible to compare the indicators with past years' indicators, or with indicators of other state agencies that have similar objectives or with pre-determined standards that are accepted as successful. For example, for a municipality of a small city in which economy mainly depends on agriculture, performance indicators should be comparable with past periods' indicators, with the performance indicators of neighbor small city municipalities those also depends on agriculture and with the standard indicators that are accepted as successful for small city municipalities in which agriculture is the main economic activity. By this way, society and managers can compare the results of the activities of the mayor and departments of municipality with other cities, previous years (previous administrations) and can evaluate the administration. State agencies can cooperate with Supreme Audit Institutions or any other special agencies to determine best performance indicators.

Performance indicators are widely used in many developed countries for almost two decades. As result of these applications, there emerged some impacts of performance measurement. Goals are aimed by employees, performance improved, accountability improved and cost of operations decreased.¹⁸

Consequently, via application of performance indicators and performance measurement, continuous improvement of the quality of services and continuous accountability for the administrations can be realized.

1.3.3.4. Accounting Applications

Accountability and transparency necessitate publication of real condition about the activities of government agencies. Accounting is a very important instrument to realize

¹⁸ From: H. Poister Theodore, Streib Gregory, Performance measurement in municipal government: Assessing the state of the practice, *Public Administration Review*, Vol. 59, No. 4 (Jul. - Aug., 1999), pp. 325-335

accountability and transparency in terms of economic activities of state agencies by its properties.

Governments make decisions on economic issues and these policies are applied. Thousands of unique transactions occur during the application of economic policies. All these transactions are recorded in accounting system and results are reported via financial statements at the end of each period. Decision makers can evaluate the results of economic policies by using accounting data. Citizens and other civil society organizations can see and evaluate these data. By this way accountability and transparency can be improved. Moreover, information achieved by accounting system can help decision makers to do sound planning on economic issues.

However, in order to provide a healthy accountability and transparency and to be a good instrument for decision makers accounting system should be reliable, comprehensive and should include timely data. If recording of economic events is not reliable financial statements does not show true information about the economic policies and citizens and decision makers can not see the real results of these policies. Accounting system should include all the transactions and economic events, if some economic events are not recorded in accounting system it can not be possible to see all results of economic policies and decision makers and citizens can not evaluate the economic policies in a healthy way. Government can misinform citizens and society and it can jeopardize accountability, it eliminates transparency and diminishes the quality of democracy. Government can apply bad policies because of insufficient information. Moreover, timely information is important to apply timely policies. For this reason accounting system should provide timely information. Financial statements should be available at the end of periods and even some financial statements should be prepared and publicized in each half or quarter periods. If financial statements are not prepared timely a sound decision making and real evaluation of results of economic policies can not be realized.

Consequently, accounting system is one of the instruments that improve the quality of democracy by providing accountable and transparent governments. For this reason, many developed countries applies more comprehensive accounting systems and reporting methods today in the world to improve democracy and to apply more successful economic policies.

1.4. ACCOUNTING SYSTEMS APPLIED IN GOVERNMENT ACCOUNTING

There are four accounting systems applied in the world as government accounting. Cash basis accounting system is the traditional and most widely used system. Modified cash basis and modified accrual basis systems are also applied to eliminate insufficiency of cash based system. Accrual based accounting system is a system that has been used by private sector for more than a century and there is a trend recently towards application of accrual basis system also in government accounting especially in developed countries to improve accountability and efficiency.

1.4.1. Cash Basis Accounting System

Cash basis accounting system recognizes only the transactions that are resulted from cash receipt and cash payment. It is the recognition of financial events and transactions when cash is received or paid. Cash basis accounting system does not deal with the time in which goods are taken and services are provided. In this accounting system, financial reports mainly give information about budget income and expenditure expectations, cash receipt, cash payment, opening and closing cash balances.

Cash and near cash balances (cash equivalents) are accepted as cash and transactions those make changes in cash and cash near balances are recognized. Cash includes cash in hand, cash in transit and cash in deposit. Near cash balances include temporary investments in marketable securities, and bullion. Unless there is a cash effect during acquisition and disposal of them, other assets are not recorded. “Tangible assets, accrued income and expenditures, expenditures to assets those will be used for long period, debts and other liabilities, commitments and other guarantees, price and value changes in assets and liabilities are not recognized or they are recognized according to the cash transaction not in line with the period in which they are benefited.”¹⁹ Assets other than cash are controlled by other additional statements but they are not seen in main financial statements prepared according to cash based accounting system.

For a state organization cash receipts may be composed of receipts from reciprocal (exchange) transactions as sale of goods and services, receipt from non-reciprocal

¹⁹ Fikret Çöker, Tahakkuk Esaslı Devlet Muhasebesi, Sayıştay Denetçi Yardımcılarına Verilen Kurs Notu, Nisan 2005, p. 50

transactions as taxation receipts, issue of currency, financing inflows as borrowing, interest receipt, capital contributions by the controlling entity or owner, and custodial receipts.

Cash payments, outflows may be composed of payments related to reciprocal transactions as purchase of goods and services, payments related to non-reciprocal transactions as government transfers, grants and contributions, financing outflows as repayment of cash, and custodial payments.

In cash basis accounting system, cash payments may be classified as payments for current issues and for capital acquisition. Payments done to acquire assets that is expected to have more than one year life period may be categorized as capital payments and payments done for other expenditures, that does not have benefit more than one year, as staff payments may be categorized as current payments.

Actually, cash basis accounting system is widely used as state accounting systems in the world. This is mainly because of historical developments. Accounting applications and recording of state payments and incomes developed in line with development of budget applications. Budgets and appropriations via which authority to expend is given to governments are cash based and for this reason accounting system that is used to record collection of cash and spend of public money developed as cash based.

There are some benefits and limitations of cash basis accounting system. Initially cash basis accounting system is easy to manage. It prepares one main financial statement that exhibits cash balance and cash payments and cash receipts. For this reason, it is easy to prepare the financial statements and record the transactions. Little qualified staff and training expenditure is necessary to apply cash basis accounting system. Secondly, because of budget and appropriations are cash based, financial statements can easily be compared with the anticipated expenditures and income. Legislative bodies, ministers and citizens can easily scrutinize the government and public entity managers in this respect. Thirdly, cash payments and receipts can easily be determined correctly and recognition of transactions can be done in an objective manner without application of any valuation method. Forth, it is relatively easy to prepare cash based accounting results in comparison with other accounting methods. For this reason, cash basis accounting system provides information earlier than other methods which gives decision makers the opportunity of having timely information.

However, there are some limitations of cash basis accounting system. Initially, decision makers and citizens demand for more detailed and comprehensive information about the results of government activities. Cash basis accounting system can not provide this information. Secondly, cash basis accounting only records cash paid and received but there can be other resources that may affect the service capacity and quality of the entity. Cash basis accounting does not give information about these resources. For example, it is not possible to see information about the capital accumulation of a government entity in this system. Because of these reasons cash basis accounting system is believed to be insufficient to provide healthy information for decision makers and it can't be a good tool for transparency and to keep governments and state agencies accountable. For these limitations and as result of increased importance of accountability and transparency, many developed democratic countries given up to use cash basis accounting system.

1.4.2. Modified Cash Basis Accounting System

Modified cash basis accounting system is another accounting system that is used in state accounting. In this accounting system, the events and transactions that are recorded are same with cash basis accounting system. It means financial events are recorded by ignoring their period of realization and only cash payments and receipts are recorded. In this system, as in cash basis system, tangible assets, liabilities, commitments and guarantees and issues related to debt management are not recorded. The main difference between cash basis system and modified cash basis system is that in modified cash basis cash payments and receipts of the period are continued to be recorded at the end of the period for a short time, which is generally one month. In this short period, results of economic events of previous term, which are generally related to expenditures of the term, are acknowledged and recorded. The main objective of this accounting system is the recognition of economic events in their period. Despite this characteristic, modified cash basis system has all the other characteristics, so benefits and limitations of cash basis accounting system.

1.4.3. Modified Accrual Basis Accounting System

Modified accrual accounting system has mainly the system and logic of accrual based accounting system. In this system, as in accrual based accounting system, financial events are recognized when they realize without taking the cash receipt and payments into consideration. When an economic value is created, changed, exchanged, transferred to another entity or disappeared it is recorded.

Despite both modified accrual basis and accrual basis have same systematic; the main difference between two methods is scope. In modified accrual basis system land, buildings, vehicles, fixtures, woods, monuments, infrastructures and other assets similar to these are not recorded in accounting system and they are not reported in financial statements. Because of not including recognition, revaluation, depreciation of tangible assets modified accrual basis is easier than accrual based accounting system. But it does not provide comprehensive information as accrual basis system at the same time. In comparison with cash basis and modified cash basis systems it provides more comprehensive information. Modified accrual basis system is not a budget oriented system, different from cash basis systems. Despite not including the recognition of assets it recognizes and provides information about accrued receivables and debts, commitments and guarantees those can increase liabilities in the future.

1.4.4. Accrual Basis Accounting System

Accrual basis accounting system is a system that provides much more comprehensive information about activities of state entities and for this reason it is a more complex accounting system. In accrual basis accounting system financial transactions and events are recorded when they occur without taking the time cash payment and receipt into account. All assets, liabilities, revenues and expenditures are recorded. For this reason accrual basis is so comprehensive that it includes all economic events.

According to IFAC-PSC,

“The accrual basis provides users with information about such matters as the resources controlled by the entity, the cost of its operations (or the cost of providing services) and other information useful in assessing financial position and changes in it and in assessing whether the reporting entity is operating economically and efficiently”.²⁰

²⁰IFAC-PSC Study 1 Financial Reporting by National Governments, paragraph.089

In addition to recording all economic transactions and events when they occur, accrual basis accounting can also provide information about cash flows. Because, accrual basis provides opportunity to prepare Cash Flow Statement in which cash flows those occur during the period of the economic entity can be seen.

Committee also states that,

“In its comprehensive system, accrual basis includes records of revenues, expenditures (including depreciation), all tangible, intangible, current and capital assets, liabilities and other economic flows and by this way it provides information about those via financial statements. It can be possible to determine and measure costs of operations, goods and services produced. All assets those meet the generally accepted definition of an asset and recognition criteria”.²¹

All liabilities related to goods and services bought during the period, including accrued expenditures, all borrowing and debts, all accounts payable, accrued liabilities, transfer payments payable are recorded as liabilities in this system. All revenues, as tax revenues, which is specific for state entities, revenues from goods and services sold are recorded. Expenditures related to the purchase of goods and services, depreciation of assets, loss on sale of assets, non-reciprocal government transfers, non-payable government grants and contributions are recorded. Moreover, at the end of the period it can be possible to see the financial results of operations and policies applied during the period. Via examining the changes in net assets/equity part of “Statement of Financial Position” which shows the difference between assets and liabilities, it is possible to understand the results of operations of the period. If the value of the entity increased or decreased as result of the operations it can be possible to see this change.

For a government entity to provide a service is generally the main objective. For this reason, an accounting system that gives opportunity of determining the service cost is a vital tool for decision makers. In addition, governments generally spend money for long term huge infrastructure constructions and these have important economic value for the government entities. In accrual basis it is possible to record, revalue and depreciate these assets and by this information decision makers can easily see the value of assets and can make healthier infrastructure planning.

²¹ IFAC-PSC Government Financial Reporting Accounting Issues and Practices May 2000-Study 11, p. 56

Accrual basis is not widely used in government accounting but it is being used by private sector entities for a very long time. However, nowadays there is a trend towards application of accrual basis system also in state accounting. Governments generally preferred to take accrual basis accounting applications of private sector by making some arrangement for applications specific to state agencies. For this reason, International Accounting Standards (IASs) are used as the core for government accounting applications. Public Sector Committee (PSC) under IFAC (International Federation of Accountants) prepares accounting standards for government accounting. Moreover, Government Accounting Standards Board (GASB) in United States is another body that prepares and publishes accounting standards for state entities, for state accounting.

In comparison with other accounting systems accrual basis has many benefits for users of financial statements. Because of providing information about overall financial position of government entities it helps decision makers to make healthy decisions on feasibility of services they intend to provide. It provides accountability to the public by demonstrating detailed information about assets and liabilities. Managers can predict funding requirements to sustain services and to maintain assets necessary to sustain services. Managers can make healthier planning on repayment of long term debts, liabilities. Moreover, it can be possible to successfully manage cash balance by this system.

Detailed information about assets provides efficient use of assets, and saving of money. Managements can make payments on time and this diminishes payment for financial instruments and provides saving of money. Net Asset/Equity part of the “Statement of Financial Position” gives concrete information about the performance of the managers, governments and it can be possible to evaluate their performance.

All revenues and expenditures occurred during the period can be presented in financial statements and decision makers and society can evaluate the financial condition and performance of the entity. Type of revenues can be examined and this helps the managers to make better planning. Type of expenditures can be seen in financial statements and citizens can easily evaluate the preferences of management. For example, an increase in staff payments before an election can be understood as a populist expenditure or the percentage of education expenditures for state and any change for different periods in this percentage can give citizens information about the

preferences of the government and can be helpful to evaluate the importance of education for the government. Therefore, because of showing all revenues and expenses in a detailed way accrual basis improves accountability.

Cash flows can be controlled in accrual basis. It provides detailed information about the cash inflows, sources of cash inflows, and cash outflows, for what kind of activities cash outflows occurred. This information is helpful for managers for cash planning and citizens can also examine the activities for which money spend.

Consequently, it is possible to argue that the main property of accrual basis is that it provides detailed information about the financial condition of the government entity and it records all financial issues occurred related to that entity. This detailed and comprehensive information improves the accountability and provides sound and reliable information for decision making. By application of accrual basis state entities can improve efficiency and economy in their operations and by this way they can be more effective, they can realize goals and objectives with less resource.

However, accrual basis accounting also have some limitations. Initially, it is very detailed and complex system. For this reason, it is costly to apply it. Asset valuation, determination of depreciation costs, and other activities necessitate well trained staff and this also increases the cost of recording.

Moreover, during the valuation of tangible and intangible assets some subjective methods are used and this may jeopardize the reliability and objectiveness of financial statements. For this reason, valuation methods should be examined carefully and standards should be set to guarantee reliability of financial statements.

1.5. REPORTING IN GOVERNMENT SECTOR

A reliable reporting is important to improve accountability and transparency because results of activities of government entities are presented via reports. There are four main reporting applications for government reporting. These systems have different scopes, characteristics and frameworks but all of them are used to understand, evaluate and analyze the financial condition of governments. These four government reporting systems are United Nations System of National Accounts (SNA-1993), Government Financial Statistics (GFS-2001), European System of Accounts (ESA-1995) and financial reporting acquired from application of cash basis and accrual basis accounting

systems. Many governments prepare reports in line with the accounting system that they apply and in line with the other reporting systems at the same time. Scopes of government reporting systems are as in Table-1 below.

Table- 1
SCOPES OF GOVERNMENT REPORTING SYSTEMS

| REPORTING SYSTEM | SCOPE |
|------------------------------|--|
| SNA-1993 | Public Sector and Private Sector Financial Information |
| GFS-2001 | Public Sector Financial Information |
| ESA-1995 | Public Sector and Private Sector Financial Information |
| FINANCIAL REPORTING FOR GOV. | Public Sector Financial Information |

In these systems Public Sector refers to General Government and does not include Government Business Enterprises.

1.5.1. United Nation System of National Accounts (SNA-1993)

“SNA-1993 is the international standard for national accounts”²², and it is derived from many areas of macroeconomic analysis. Initial studies on reporting commenced with the production and output concepts. There was an aim to record output level; this objective caused the development of Input-Output Tables by Leontief (Wassily Leontief, Input-Output Economics”, 1951, *Scientific American*) by which Gross Domestic Product became the main concept in macroeconomics. After this,

“Keynes work in developing an analytical framework to explain the dynamics of the macroeconomics following the Great Depression of 1930’s introduced many of the key macro economic variables like consumption, investment savings and wealth that are now focal variables in today’s system of accounts”²³.

Moreover, Keynes classified actors, decision makers of economy which are households, business, governments and foreign economics.

Studies to prepare the record of economy are first realized by a group lead by Richard Stone from Cambridge University and “The System of Accounts” was published in 1968. The aim of the system was to provide economic statistics of the country and use these data to analyze the economy and make decisions about it. In its first version, SNA was providing information about production of goods and services, the sources and distribution of income and capital accumulation, however, the improvement of the

²² IFAC-PSC Study 11, p. 189

²³ Karen Wilson, The Architecture of the System of National Accounts: A three way country comparison, Canada, Australia, and United Kingdom, National Bureau of Economic Research, Working Paper Series, Working Paper 11106, p.

system continued and the system reached at its final structure by “System of National Accounts-1993” in which financial flows and balances and their relations with the production process also included.

The scope of SNA-1993 is very wide in comparison with other government reporting systems because SNA reports whole of the national economy. SNA-1993 records all transactions in the economy and it provides data about the national income of the country. By use of this data it provides information to see the development in the whole of national economy and to compare developments in different countries. By this comprehensive data about the national economies, SNA-1993 provides information through which users can analyze the current condition of the economy, can do forecasting about future of the economic conditions, can build economic models to use in decision making, can analyze the structure of the economy and can have information to use in social analysis on country. Moreover, Gross Domestic Production and National Income also provide information to evaluate the performance of the whole economy.

National output production is the main concern of SNA-1993 system and it provides opportunity to have statistics on national output via classifications. SNA-1993 provides classification of final expenditure as consumption, investment and export, classification of industry as manufacturing, construction, wholesale etc., classification of the type of income as wages, interest, profit etc. and classification of economic sectors as general government, corporations and households. This powerful classification characteristic helps to analyze any issue in the economy. Moreover, SNA-1993 system classifies assets and liabilities in the economy. The balance sheet presented according to SNA-1993 is shown in Table-2 below.

TABLE-2

Balance Sheets Accounts

BALANCE SHEET ACCOUNTS

| Assets | | BALANCE SHEET ACCOUNTS | | | | | | | | Liabilities and net worth | | | | | | | | | | |
|------------------------------|---|---------------------------|------|---------------|---------|-------------|--------------------|------------------------|----------------------------|---|-----------------------------------|----------------------------|------------------------|--------------------|-------------|------------------------------|---------------|----------------------------|---------------------------|-------|
| | | S.1 | S.15 | S.14 | S.13 | S.12 | S.11 | | | S.11 | S.12 | S.13 | S.14 | S.15 | S.1 | Corresponding entries of the | | | | |
| Corresponding entries of the | | Rest of the world account | | total economy | NPIS Hs | House holds | General government | Financial Corporations | Non-financial corporations | Transactions, other flows, stocks and balancing items | | Non-financial corporations | Financial Corporations | General government | House holds | NPI SHs | total economy | Goods and services account | Rest of the world account | Total |
| IV.1. | | | | | | | | | | AN | Non-financial assets | | | | | | | | | |
| Opening | x | | | x | X | X | X | x | x | AN.1 | produced assets | | | | | | | | | |
| Balance | x | | | x | X | X | X | x | x | AN.11 | fixed assets | | | | | | | | | |
| Sheet | x | | | x | X | X | X | x | x | AN.12 | Inventories | | | | | | | | | |
| | x | | | x | X | X | X | x | x | AN.13 | Valuables | | | | | | | | | |
| | x | | | x | X | X | X | x | x | AN.2 | Non-produced assets | | | | | | | | | |
| | x | | | x | X | X | X | x | x | AN.21 | Tangible non-produced assets | | | | | | | | | |
| | x | | | x | X | X | X | x | x | AN.22 | Intangible non-produced assets | | | | | | | | | |
| | x | | | x | X | X | X | x | x | AF | Financial assets/liabilities | | x | x | x | x | x | x | x | x |
| | x | | x | x | X | X | X | x | x | AF.1 | Monetary gold and SDRs | | x | x | x | x | x | x | x | x |
| | x | | x | x | X | X | X | x | x | AF.2 | Currency and deposits | | x | x | x | x | x | x | x | x |
| | x | | x | x | X | X | X | x | x | AF.3 | Securities other than shares | | x | x | x | x | x | x | x | x |
| | x | | x | x | X | X | X | x | x | AF.4 | Loans | | x | x | x | x | x | x | x | x |
| | x | | x | x | X | X | X | x | x | AF.5 | Shares and other equities | | x | x | x | x | x | x | x | x |
| | x | | x | x | X | X | X | x | x | AF.6 | Insurance technical reserves | | x | x | x | x | x | x | x | x |
| | x | | x | x | X | X | X | x | x | AF.7 | Financial derivatives | | | | | | | | | |
| | x | | x | x | X | X | X | x | x | AF.8 | Other accounts receivable/payable | | x | x | x | x | x | x | x | x |
| | x | | x | x | X | X | X | x | x | B.90 | Net worth | | | | | | | | | x |
| IV.2 | | | | | | | | | | Total Changes in assets/liabilities | | | | | | | | | | |
| Changes | x | | | x | X | X | X | x | x | AN | Non-financial assets | | | | | | | | | |
| in | x | | | x | X | X | X | x | x | AN.1 | produced assets | | | | | | | | | |
| Balance | x | | | x | X | X | X | x | x | AN.11 | fixed assets | | | | | | | | | |
| sheet/1 | x | | | x | X | X | X | x | x | AN.12 | Inventories | | | | | | | | | |
| | x | | | x | X | X | X | x | x | AN.13 | Valuables | | | | | | | | | |
| | x | | | x | X | X | X | x | x | AN.2 | Non-produced assets | | | | | | | | | |
| | x | | | x | X | X | X | x | x | AN.21 | Tangible non-produced assets | | | | | | | | | |
| | x | | | x | X | X | X | x | x | AN.22 | Intangible non-produced | | | | | | | | | |

| | | | | | | | | | assets | | | | | | | | | |
|---------|---|---|---|---|---|---|---|---|---------|-------------------------------------|---|---|---|---|---|---|---|---|
| | x | x | x | X | X | X | x | x | AF | Financial assets/liabilities | x | x | x | x | x | x | x | x |
| | x | x | x | | | X | x | | AF.1 | Monetary gold and SDRs | | | | | | | | x |
| | x | x | x | X | X | X | x | x | AF.2 | Currency and deposits | x | x | x | | | | | x |
| | X | x | x | X | X | X | x | x | AF.3 | Securities other than shares | x | x | x | | | | | x |
| | X | x | x | | X | X | x | x | AF.4 | Loans | x | | x | x | x | | | x |
| | X | x | x | X | X | X | x | x | AF.5 | Shares and other equities | x | x | | | x | x | | x |
| | X | x | x | | X | | x | x | AF.6 | Insurance technical reserves | | x | | | | | | x |
| | | | | | | | | | AF.7 | Financial derivatives | | | | | | | | |
| | X | x | x | X | X | X | x | x | AF.8 | Other accounts receivable/payable | x | | x | x | | | | x |
| | | | | | | | | | B.10 | Changes in net worth, total due to: | x | x | x | x | x | x | | x |
| | | | | | | | | | B.10.1 | saving and capital transfers | x | x | x | x | x | x | | x |
| | | | | | | | | | B.10.2 | Other changes in volume of assets | x | x | x | x | | | | x |
| | | | | | | | | | B.10.3 | Nominal holding gains/losses | x | x | x | x | x | x | | x |
| | | | | | | | | | B.10.31 | Neutral holding gains/losses | x | x | x | x | x | x | | x |
| | | | | | | | | | B.10.32 | Real holding gains/losses | x | x | x | x | x | x | | x |
| IV.3 | X | | x | X | X | X | x | x | AN | Non-financial assets | | | | | | | | |
| Closing | X | | x | X | X | X | x | x | AN.1 | produced assets | | | | | | | | |
| Balance | X | | x | X | X | X | x | x | AN.11 | fixed assets | | | | | | | | |
| sheet/1 | X | | x | X | X | X | x | x | AN.12 | Inventories | | | | | | | | |
| | X | | x | X | X | X | x | x | AN.13 | Valuables | | | | | | | | |
| | X | | x | X | X | X | x | x | AN.2 | Non-produced assets | | | | | | | | |
| | X | | x | X | X | X | x | x | AN.21 | Tangible non-produced assets | | | | | | | | |
| | X | | x | X | X | X | x | x | AN.22 | Intangible non-produced assets | | | | | | | | |
| | X | x | x | X | X | X | x | x | AF | Financial assets/liabilities | x | x | x | x | x | x | | x |
| | x | x | x | X | X | X | x | x | AF.1 | Monetary gold and SDRs | | | | | | | | x |
| | x | x | x | X | X | X | x | x | AF.2 | Currency and deposits | x | x | x | x | x | x | | x |
| | x | x | x | X | X | X | x | x | AF.3 | Securities other than shares | x | x | x | x | x | x | | x |
| | x | x | x | X | X | X | x | x | AF.4 | Loans | x | | x | x | x | x | | x |
| | x | x | x | X | X | X | x | x | AF.5 | Shares and other equities | x | x | x | | x | x | | x |
| | x | x | x | X | X | X | x | x | AF.6 | Insurance technical reserves | x | x | x | | x | x | | x |
| | | | | | | | | | AF.7 | Financial derivatives | | | | | | | | |
| | x | x | x | X | X | X | x | x | AF.8 | Other accounts receivable/payable | x | x | x | x | x | x | | x |
| | | | | | | | | | B.90 | Net worth | x | x | x | x | x | x | | x |

/1 Differences between data on individual items and totals of holding gains/losses may not be entirely due to round errors

Source: About the System of National Accounts, XIII, The Balance Sheet, <http://unstats.un.org/unsd/sna1993/toclev8.asp?L1=13&L2=3>

1.5.2. Government Finance Statistics (GFS-2001)

“The Government Finance Statistics system (GFS system) is a set of economic and statistical concepts, accounting rules, and classification guidelines for organizing data on general government sector operations in a systematic manner”.²⁴ GFS-2001 system was designed by IMF to encourage governments to provide financial information that can be used for comparison. The first version of the GFS-2001 was designed in 1986 by IMF. IMF improved the 1986-GFS system in 2001. There are some differences between the 1986 version and 2001 version of the GFS system. The main change in GFS-2001 system is that it became in compliance with SNA-1993 system. By this way, data provided from GFS-2001 became suitable to be used to set data of SNA-1993 system.

GFS-1986 system was a cash basis system. GFS-2001 system is an accrual basis system like SNA-1993. In GFS-1986 system, because of being cash basis, non-monetary transactions were recorded in memorandum accounts, in GFS-2001 system, non-monetary transactions are recorded entirely. In GFS-1986 system, all financial assets, non-financial assets and liabilities were not recorded; in GFS-2001 system all assets and liabilities are recorded.

The objective of GFS-2001 system is to provide statistical data, information related to the operations and net worth of central, state, and local government sub-sectors of the general government sector. The scope of GFS-2001 system is small in comparison with SNA-1993 system, because SNA-1993 system provides data for the whole of the national economy, but GFS-2001 system provides data only related to government sector. Households or corporations are not included in GFS-2001 system. Information provided by GFS-2001 can be used by policy makers, analysts, citizens and creditors to analyze and examine the developments in the financial operations of government, the financial position, the liquidity situation of the government. Data provided by the GFS-2001 can be used for these objectives because it gives opportunity of developing a series of measures, analyzing transactions between levels of government, analyzing specific government operations, and net wealth of the general government, government sector.

The structure of GFS-2001 is comprehensive that the system includes information about opening and closing balances of all assets and liabilities and net worth via Balance

²⁴ IFAC-PSC, Study 11, p.3

Sheet. System provides these data by recording all transactions of economic flows which cause changes in assets and liabilities.

Structure of the GFS-2001 Analytical Framework can be seen below in Table-3.

Table – 3
STRUCTURE OF THE GFS ANALYTIC FRAMEWORK

| <u>STOCKS</u> | <u>FLOWS</u> | | <u>STOCKS</u> |
|-----------------------|--------------------------------------|--|----------------------|
| Opening Balance Sheet | St. of Gov. Operations | St. of Other Economic Flows | Closing BalanceSheet |
| Net worth | Revenue-Expense equals | Change in net worth due to other economic flows equals | Net worth |
| equals | equals | equals | equals |
| Non-financial assets | Transactions in non financial Assets | Holding gains and other volume changes in nonfinancial assets | Nonfinancial Assets |
| plus | plus | plus | plus |
| Net financial worth | Net lending/ borrowing | Change in net worth due to other economic flows equals | Net financial worth |
| equals | equals | equals | equals |
| Financial assets | Transactions in financial assets | Holding gains and other volume changes in | Financial assets |

| | | | | |
|--------------|--|-----------------------------|---|--------------|
| minus | | minus | minus | minus |
| Liabilities | | Transactions in liabilities | financial assets Holding gains and other volume changes in liabilities | Liabilities |

Source: GFS Manual-2001, IMF, page 37

Balance Sheet exhibits opening and closing balances in which opening stock and closing stocks, net worth of the general government sector can be seen. Balance Sheet prepared according to GFS-2001 is in Table-4.

Table – 4
Balance Sheet in GFS-2001

| | Opening Balance Sheet | Closing Balance Sheet |
|--|-----------------------|-----------------------|
| <p>NET WORTH</p> <p>NON-FINANCIAL ASSETS</p> <p>Fixed assets</p> <p>Inventories</p> <p>Valuables</p> <p>Nonproduced assets</p> <p>FINANCIAL ASSETS</p> <p>Domestic</p> <p>Currency and deposits</p> <p>Securities other than shares</p> <p>Loans</p> <p>Shares and other equity</p> <p>Insurance technical reserves</p> <p>Financial derivations</p> <p>Other accounts receivable</p> <p>Foreign</p> <p>Currency and deposits</p> <p>Securities other than shares</p> <p>Loans</p> <p>Shares and other equity</p> <p>Insurance technical reserves</p> <p>Financial derivations</p> <p>Other accounts receivable</p> <p>Monetary Gold and SDRs</p> <p>LIABILITIES</p> <p>Domestic</p> <p>Currency and deposits</p> <p>Securities other than shares</p> <p>Loans</p> <p>Shares and other equity</p> <p>Insurance technical reserves</p> <p>Financial derivations</p> <p>Other accounts receivable</p> <p>Foreign</p> <p>Currency and deposits</p> <p>Securities other than shares</p> <p>Loans</p> <p>Shares and other equity</p> <p>Insurance technical reserves</p> <p>Financial derivations</p> <p>Other accounts receivable</p> | | |

Source: GFS Manual-2001, IMF, page 45

Flows which are from transactions that cause changes in the assets and liabilities, so net worth of the government are recorded in the system. These flows are exhibited in the “Statement of Government Operations” which includes transactions in revenue,

expense, the net acquisition of non-financial assets, the net acquisition of net assets and the net incurrence of net assets. The Statement is presented in Table-5.

Table – 5

STATEMENT of GOVERNMENT OPERATIONS in GFS-2001

| STATEMENT OF GOVERNMENT OPERATIONS |
|--|
| TRANSACTIONS AFFECTING NET WORTH |
| REVENUE |
| Taxes |
| Social contributions |
| Grants |
| Other revenue |
| EXPENSE |
| Compensation of employee |
| Use of goods and services |
| Consumption of fixed capital |
| Interest |
| Subsidies |
| Grants |
| Social benefits |
| Other expense |
| NET/GROSS OPERATING BALANCE-1 |
| TRANSACTIONS IN NONFINANCIAL ASSETS |
| NET ACQUISITION NONFINANCIAL ASSETS-2 |
| Fixed assets |
| Change in inventories |
| Valuables |
| Nonproduced assets |
| NET LENDING/BORROWING-3 |
| TRANSACTIONS IN FINANCIAL ASSETS AND LIABILITIES(FINANCING) |
| NET ACQUISITION OF FINANCIAL ASSETS |
| Domestic |
| Foreign |
| NET INCURRENCE OF LIABILITIES |
| Domestic |
| Foreign |

Source: GFS Manual-2001, IMF, page 38

1. The net operating balance equals revenue minus expense. The gross operating balance equals revenue minus expense other than consumption of fixed capital.

2. Acquisitions minus disposal and consumption of fixed capital.

3. Net lending/borrowing equals the net operating balance minus the net acquisition of non-financial assets. It is also equal to the net acquisition of financial assets minus the net incurrence of liabilities.

Flows that are resulted from other economic flows also included in the system. These flows are presented in the “Statement of Other Economic Flows”. This statement shows records of change in net worth resulting from other economic flows. These other economic flows are holding gains; resulted from changes in the value of assets and liabilities and changes in the volume of assets; as changes in the quality of assets. The “Statement of Other Economic Flows” can be seen below in Table-6.

Table - 6
STATEMENT OF OTHER ECONOMIC FLOWS

| |
|---|
| CHANGE IN NET WORTH RESULTING FROM OTHER ECONOMIC FLOWS |
| NON FINANCIAL ASSETS |
| Holding gains |
| Other volume changes |
| FINANCIAL ASSETS |
| Holding gains |
| Other volume changes |
| LIABILITIES |
| Holding gains |
| Other volume changes |

Source: GFS Manual-2001, IMF, page-43

“The basic concepts, classifications and definitions employed in the GFS-2001 system manual depend on economic reasoning and principles that should be valid universally regardless of the circumstances in which they are applied”.²⁵ For this reason, the GFS system can be applied by all countries in the world and it can provide data to analyze, examine and compare the economic condition of the governments, therefore it serves as an important tool for accountability and transparency.

1.5.3. European System of National and Regional Accounts - (ESA-1995)

“The European System of National and Regional Accounts (ESA-95) is an internationally compatible accounting framework for a systematic and detailed description of a total

²⁵ GFS Manual 2001, IMF, p. 1

economy (that is a region, country or group of countries), its components and relations with other total economies.²⁶

ESA-95 was developed to provide comparable and systematic data for European Countries in a harmonized manner. This is the improved and revised version of the “Economic System of Integrated Economic Accounts” which was published in 1970. ESA-95 has a statutory characteristic and it binds members of European Union because it is published as a Regulation of European Union. ESA-95 system is prepared in harmony with other reporting systems, such as SNA-93 system and GFS-2001 system. “It is also an accrual basis system, it records flows on an accrual basis, when economic value is created, transformed or extinguished, or when claims and obligations arise are transformed or cancelled.”²⁷ ESA-95 is like SNA-93 and different from GFS-2001 includes general government as one of the sectors in the economy and it produces statistics for the total of the economy. According to IFAC-PSC, “ESA-95 is consistent with the SNA-with respect to definitions, accounting rules and classifications used.”²⁸ However, there are some differences between the two systems. These differences are result of different objectives of ESA-95 system. ESA-95 is designed to provide more detailed information on sectors of economy, regional developments, foreign economies and more flexible and comprehensive presentation of statistics. For these reasons, ESA-95 has more clarification on the classification of output by sector, contains European Union specific classifications, it contains classification of external transactions. SNA-93 provides information for one year periods but ESA-95 can provide information for 6-months or 3-months periods. Because of being so comprehensive and including European Union specific statistics, system is accepted as the main tool that provides social and economic statistics in EU.

ESA-95 framework is composed of two sets of tables:

1- the sector accounts; which provide a systematic information on different stages of economic process, like production, generation of income, distribution of income, redistribution of income, use of income and financial and non-financial accumulation. Table-7, Table-8 and Table-9 below are examples for ESA-95 system and exhibit

²⁶ ESA-1995, article 1.01

²⁷ ESA-1995, article 1.57

²⁸ IFAC-PSC, Study 11, p. 191

information about production, generation of income by industries, and use of GDP, respectively.

Table - 7

GROSS DOMESTIC PRODUCT and GROSS NATIONAL INCOME 1995-2003

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 |
|--|----------|----------|----------|----------|----------|----------|----------|----------|----------|
| Current Prices | | | | | | | | | |
| 1 Output, basic prices | X | X | X | x | x | X | X | X | x |
| 2 Intermediate consumption | X | X | X | x | x | X | X | X | x |
| Value added, basic prices (1 minus 2) | | | | | | | | | |
| 3 | X | X | X | x | x | X | X | X | x |
| 4 Net taxes on products | X | X | X | x | x | X | X | X | x |
| Gross Domestic Product (3 plus 4) | | | | | | | | | |
| 5 | X | X | X | x | x | X | X | X | x |
| Plus: primary incomes from the rest of the world | X | X | X | x | x | X | X | X | x |
| Less: primary incomes to the rest of the world | X | X | X | x | x | X | X | X | x |
| 6 Gross National Income | X | X | X | x | x | X | x | X | x |

Source: Gross Domestic Product 1995-2003 (First Release), Statistical Office of the Republic of Slovenia, http://www.stat.si/eng/novice_poglej.asp?ID=213

Table – 8
VALUE ADDED by ACTIVITIES at BASIC PRICES and GROSS DOMESTIC
PRODUCT 1995-2002

| Current Prices | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Agriculture, hunting, | | | | | | | | |
| A forestry | x | X | X | x | x | X | x | X |
| B Fishing | x | X | X | x | x | X | x | X |
| C Mining and quarrying | x | X | X | x | x | X | x | X |
| D Manufacturing | x | X | X | x | x | X | x | X |
| Electricity, gas, steam | | | | | | | | |
| E and water supply | x | X | X | x | x | X | x | X |
| F Construction | x | X | X | x | x | X | x | X |
| Wholesale and retail | | | | | | | | |
| G trade, motor vehicle repair | x | X | X | x | x | X | x | X |
| H Hotels and restaurants | x | X | X | x | x | X | x | X |
| Transport, storage, | | | | | | | | |
| I communications | x | X | X | x | x | X | x | X |
| J Financial intermediation | x | X | X | x | x | X | x | X |
| Real estate, renting and | | | | | | | | |
| K business activities | x | X | X | x | x | X | x | X |
| Public administration and | | | | | | | | |
| L compulsory soc. Security | x | X | X | x | x | X | x | X |
| M Education | x | X | X | x | x | X | x | X |
| N Health and social work | x | X | X | x | x | X | x | X |
| Other community, social | | | | | | | | |
| O and personal services | x | X | X | x | x | X | x | X |
| Private households with | | | | | | | | |
| P employed persons | x | X | X | x | x | X | x | X |
| Total of branches | x | X | X | x | x | X | x | X |
| FISIM | x | X | X | x | x | X | x | X |
| Total value added, basic prices | x | X | X | x | x | X | x | X |
| Taxes on products | x | X | X | x | x | X | x | x |
| Less: subsidies on products | x | X | X | x | x | X | x | x |
| Total gross domestic product | x | X | X | x | x | X | x | x |

Source: Gross Domestic Product 1995-2003 (First Release), Statistical Office of the Republic of Slovenia, http://www.stat.si/eng/novice_poglej.asp?ID=213

Table – 9
USE of GDP

| Current Prices | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Total Domestic Consumption | X | X | x | x | X | x | x | x |
| Final consumption | X | X | x | x | X | x | x | x |
| Households | X | X | x | x | X | x | x | x |
| NPISH's | x | X | x | x | X | x | x | x |
| General government | x | X | x | x | X | x | x | x |
| Individual | x | X | x | x | X | x | x | x |
| Collective | x | X | x | x | X | x | x | x |
| of which actual individual consumption | x | X | x | x | X | x | x | x |
| Gross capital formation | x | X | x | x | X | x | x | x |
| Gross fixed capital formation | x | X | x | x | X | x | x | x |
| Changes in inventories and valuables | x | X | x | x | X | x | x | x |
| Surplus with the rest of the world | x | X | x | x | X | x | x | x |
| Exports of goods and services | x | X | x | x | X | x | x | x |
| Goods (fob) | x | X | x | x | X | x | x | x |
| Services | x | X | x | x | X | x | x | x |
| Less: imports of goods and services | x | X | x | x | X | x | x | x |
| Goods (fob) | x | X | x | x | X | x | x | x |
| Services | x | X | x | x | X | x | x | x |
| Gross domestic product | x | X | x | x | X | x | x | x |

Source: Gross Domestic Product 1995-2003 (First Release), Statistical Office of the Republic of Slovenia, http://www.stat.si/eng/novice_poglej.asp?ID=213

The sector accounts also include balance sheets to provide information on assets liabilities and net worth at the beginning and end of the period.

2- the input-output framework and accounts by industry; these accounts provide more detailed information on production process. For example, they provide statistics concerning cost structures of production, income generated and employment. Moreover, these accounts provide information about the flows of goods and services as imports, exports, final consumption, and capital formation by a sector.

ESA-95 system also produces information about concepts of population and employment. For this reason, it can provide tables which includes per person or per employee statistics. An example table that includes per capita statistics is presented in Table-10 below.

Table – 10
GDP per CAPITA

| Regional Gross Domestic Product per capita, thousand SEK | | | | | | | | | |
|---|------|------|------|------|------|------|------|------|------|
| County | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
| Stockholm | x | X | X | X | X | x | x | X | X |
| Uppsala | x | X | X | X | X | x | x | X | X |
| Södermanland | x | X | X | X | X | x | x | X | X |
| Östergötland | x | X | X | X | X | x | x | X | X |
| Jönköping | x | X | X | X | X | x | x | X | X |
| Kronoberg | x | X | X | X | X | x | x | X | X |
| Kalmar | X | X | X | X | X | x | x | X | X |
| Gotland | X | X | X | X | X | x | x | X | X |
| Blekinge | X | X | X | X | X | x | x | X | X |
| Skane | X | X | X | X | X | x | x | X | X |
| Halland | X | X | X | X | X | x | x | X | X |
| Vastra | | | | | | | | | |
| Götaland | X | X | X | X | X | x | x | X | X |
| Varmland | X | X | X | X | X | x | x | X | X |
| Örebro | X | X | X | X | X | x | x | X | X |
| Vastmanland | X | X | X | X | X | x | x | X | X |
| Dalarna | X | X | X | X | X | x | x | X | X |
| Gavleborg | X | X | X | X | X | x | x | X | X |
| Vasternorrland | X | X | X | X | X | x | x | X | X |
| Jamtland | X | X | X | X | X | x | x | X | X |
| Vasterbotten | X | X | X | X | X | x | x | X | X |
| Norrboten | X | X | X | X | X | x | x | X | X |

Source: Statistics Sweden, http://www.scb.se/templates/Publikation_192196.asp

ESA-95 is an internationally compatible, consistent, operational, well-established, flexible, multi-purpose and harmonized system with other social and economic statistics.

Comprehensive and detailed framework and these characteristics of ESA-95 make it a good tool for providing information that can be used for analysis and policy making. It gives opportunity to evaluate;

- i) the structure of the economy, example: by region, industry, sector information
- ii) specific parts or aspects of the economy, example: government, finance sector
- iii) the development of the total economy over time

iv) total economy in relation to other economies²⁹

This statistics are used especially in determination of European monetary policy, in granting monetary support to regions in the EU, and in the determination of resources of the EU.

Statistical units and their groupings are one of the main features of ESA-95 system. System groups institutional units into sectors on the basis of their principal functions, behavior and objectives in order to produce information on income, expenditure, financial flows and balance sheets of them. Institutional groups and sectors those constitute the economy are non-financial corporations, financial corporations, general government, households, non-profit institutions serving households. It is possible to provide information of the balance sheet accounts, and economic flows of any sector of the economy, so of the government sector. Moreover, general government sector is divided into four sub-sectors in the system. These sub-sectors are central government, state government, local government and social security. Therefore, it can be possible to acquire statistics and statements from the system those can be used for the analysis and evaluation of the sub-sectors of the general government.

1.5.4. Government Financial Reporting

1.5.4.1. Qualitative Characteristics of Financial Reporting

As stated by IFAC,

“Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. They are applicable to financial statements, regardless of the basis of accounting used to prepare the financial statements. The four principal qualitative characteristics are understandability, relevance, reliability and comparability”.³⁰

On the issue, Australian Accounting Research Foundation states that,

“General purpose financial reports shall include all financial information which satisfies the concepts of relevance and reliability, and which passes the materiality test. General purpose

²⁹ From: European System of National Accounts, paragraph 1.03,

<http://forum.europa.eu.int/irc/dsis/nfaccount/info/data/esa95/en/titelen.htm>

³⁰ International Public Sector Accounting Standard, Financial Reporting Under Cash Basis of Accounting, IFAC Public Sector Committee, Updated 2006, Appendix 4, Qualitative Characteristics of Financial Reporting, p. 118

financial reports shall be presented on a timely basis and in a manner which satisfies the concepts of comparability and understandability”.³¹

As can be understood by the studies from which quotations made above there are four main qualitative characteristics of financial reports those assure the quality of them. These are understandability, relevance, reliability and comparability. These qualitative characteristics are universal, that they are valid not only for government financial reporting but also for private sector financial reporting.

Understandability is the quality of financial reports that exist when users are able to comprehend the meaning of the information in the reports. However, the users of reports should have some properties also. Initially, users of reports should be capable of understanding the information presented in the reports. Users should have sufficient knowledge and education to understand the reports. They should know environment in which the entity operated and should know the essence of the operations of the entity. Moreover, they should have eagerness to understand the reports and they should pay sufficient time and energy to study the information presented in financial reports. Understandability is an important characteristic of financial reports but reliability and materiality are other characteristics that reports should have, even they are accepted as more important than understandability. For this reason, preparers of reports should not give up presenting some complex information and applications as result of their being very complex. Users can provide expertise to understand complex issues in reports, for this reason those complex events and transactions that can led users make inappropriate decisions should be disclosed in financial reports.

“**Relevance** means that quality of financial information which exists when that information influences decisions by users about the allocation of scarce resources by:

- a-) helping them from predictions about the outcomes of past, present and future events; and/or
 - b-) confirming or correcting their past evaluations;
- and which enables users to assess the rendering of accountability by preparers”.³²

Financial reports should disclose sufficient information about the resources of the entity to give users opportunity of evaluating the financial condition of the entity. Information in financial reports is used by users to make predictions about the future of the entity

³¹ Australian Accounting Research Foundation, Qualitative Characteristics of Financial Information, Statement of Financial Concepts, SAC3, , p. 14, <http://www.aasb.com.au/>

³² Australian Accounting Research Foundation, SAC3, p. 5

and to understand the current situation of the entity. Financial reports should include sufficient information and should include all the information to help users to be successful in their decisions. Materiality is the concept that helps us in this point, because materiality necessitates the financial reports to include all information that lack of which can bring to users make bad decisions and misunderstand the condition of the entity.

“**Reliability** means that quality of financial information which exists when that information can be depended upon to represent faithfully and without bias or undue error , the transactions or events that either it purports to represent or could reasonably be expected to represent”.³³

Financial reports should take substance over form, which reports should disclose and include the real economic information about events and real economic value of events should be accepted as more important than legal forms. Sometimes legal necessities may not give real information about the events; reports should give information about the real condition of events faithfully instead of just providing legal necessities. Information in financial reports, statements should be free from bias; preparers of statements should refrain from influencing the decisions of users. Statements should also be free from errors those mislead the users. Statements should include all relevant information; information about events those are not certain but have possibility to occur in the future should be disclosed in the financial statements, properly in notes of financial statements. Valuation is necessary concerning some applications, especially valuation of assets is important for entities, preparers should be fair and prudent during valuation and they should refrain from applying misleading valuation and measurement methods.

Comparability exists in financial reports when users are able to identify similarities and differences between the information disclosed in the reports and the information in other reports. Financial reports should give users opportunity to compare the entity with other entities and with other periods of the same entity. To provide comparability financial reports should include information about the accounting policies applied and changes and effects of changes in accounting policies over reports. To strengthen

³³ Australian Accounting Research Foundation, SAC3, p. 5

comparability preparers of financial reports should be consistent in the accounting policies that they apply. However, this should not led the preparers to never change the policies and applications, because economic environment is something flexible and many innovations occurs there and accounting policies should be changed to be in line with these changes. Consistency should not be applied in a strict manner but should be refrained from unnecessary changes in policies and applications.

1.5.4.2. Purposes of Financial Statements

Financial statements include information concerning the financial position of the entity and the transactions undertaken by the entity. General purpose financial statements are prepared to disclose information about the financial position, financial performance and cash flows of the entity. This information is necessary and helpful for decision makers to see the current condition and predict the future condition of the entity. Decision makers, managers can predict future resources necessary to sustain activities and services of the entity. Compliance with legal requirements as appropriation limits can be controlled in general purpose financial statements. Moreover, financial statement improves accountability which is important especially for public sector entities. General purpose financial statements give this opportunity as stated by IFAC, via;

- “* providing information about sources, allocation and uses of financial resources,
- * resources, providing information about how the entity financed its activities and met its cash requirements,
- * providing information that is useful in evaluating the entity’s ability to finance its activities and to meet its liabilities and commitments,
- * providing information about the financial condition of the entity and changes in it,
- * providing aggregate information useful in evaluating the entity’s performance in terms of service costs, efficiency and accomplishments”.³⁴

1.5.4.3. Government Reporting in Cash Basis System

Financial statements that should be prepared under cash basis of accounting are determined in International Public Sector Accounting Standard 2 “Financial Reporting under Cash Basis of Accounting” (Standard for this part). This standard describes the presentation of general purpose financial statements. Except from the general purpose

³⁴ IPSAS 1-Presentation of Financial Statements, paragraph 13

financial statements it is possible to prepare some other more detailed financial statements in cash basis accounting. As mentioned before in cash basis accounting part cash basis accounting records transactions and events when the cash is received and when the cash payment occurs. For this reason one of the general purpose financial statements is “Statement of Cash Receipts and Payments”. This statement includes information about cash payments, cash receipts and cash balances at the end of the period. Again as mentioned before cash basis accounting system has evolved in line with the budget applications and because of the importance of budget in public sector, for this reason the other general purpose financial statement in cash basis accounting is the statement that compares the final budget and the original budget.

The objective of financial statements in cash basis according to the Standard is to prepare comprehensive and transparent financial reporting of cash receipts, cash payments and cash balances of the entity. Moreover, the comparison of the financial activities with other entities and previous periods is another objective. Standard does not regulate special purpose financial statements and only presents rules for the preparation of general purpose financial statements, but it encourages the presentation of some supplementary information in the notes of the financial statements. General purpose financial statements can be prepared for an entity or they can be prepared in a consolidated manner for more than one entity, as for the whole government.

Paragraph 1.3.4 of the Standard is as follows;

“An entity should prepare and present general purpose financial statements which include the following components:

a) ***a statement of cash receipts and payments which;***

i) recognizes all cash receipts, cash payments and cash balances controlled by the entity; and

ii) separately identifies payments made by third parties on behalf of the entity in accordance with paragraph 1.3.24 of this Standard;

b) ***accounting policies and explanatory notes;*** and

c) when the entity makes publicly available its approved budget, ***a comparison of budget and actual amounts*** either as a separate additional financial statement or as a budget column in the statement of cash receipt and payments in accordance with paragraph 1.9.8 of this Standard.³⁵”

³⁵ IPSAS 1, paragraph 1.3.4

1.5.4.3.1. Cash Receipts and Payments Statement

In paragraph 1.3.12 of the Standard information that should be presented in the “Statement of Cash Receipt and Cash Payments” are regulated. According to the paragraph this financial statements should present total cash receipts and cash payments of the entity in a proper classification basis. Moreover, statement should present the beginning and closing cash balances of the entity.

Except from those situations described in the Standard, cash receipts and cash payments should be presented in gross basis. Standard necessitates proper classification of cash receipts and payments, proper line-items and headings those will be helpful to give more understandable, comparable information which will enhance the transparency, and accountability.

Standard necessitates the disclosure of payments made by third parties on behalf of the entity and this issue is regulated in paragraph 1.3.24 of the Standard. According to mentioned paragraph if a third party directly settles the obligations of the entity or purchases goods and services for the benefit of the entity these transactions should be disclosed separately in the “Statement of Cash Receipt and Payments”.

An example of the “Statement of Cash Receipts and Payments” for whole government is shown below in Table-11, and it is a consolidated statement that includes the cash receipts and payments of the entities under the government as ministries;

Table - 11
CONSOLIDATED FINANCIAL STATEMENTS FOR GOVERNMENT X
CONSOLIDATED STATEMENT OF CASH RECEIPT AND PAYMENTS FOR YEAR ENDED
31 DECEMBER 200X

| (in thousand of currency unit)- | -----200X----- | | -----200X-1----- | |
|---------------------------------|--|---------------------------------|--|---------------------------------|
| | Receipts/ (Payments) controlled by entity | Payments by third parties | Receipts/ (Payments) controlled by entity | Payments by third parties |
| RECEIPTS | | | | |
| <i>Taxation</i> | | | | |
| Income tax | x | - | x | - |
| Value-added tax | x | - | x | - |
| Property tax | x | - | x | - |
| Other taxes | <u>x</u> | - | <u>x</u> | - |
| | X | - | X | - |
| <i>Grants and Aid</i> | | | | |
| International agencies | x | x | x | x |
| Other grants and aid | <u>x</u> | <u>x</u> | <u>x</u> | <u>x</u> |

| | | | | |
|---|------------|------------|------------|------------|
| | X | X | X | X |
| Borrowings | | | | |
| Proceeds from borrowings | X | - | X | - |
| Capital Receipts | | | | |
| Proceeds from disposal of plant and equipment | X | - | X | - |
| Trading Activities | | | | |
| Receipts from trading activities | X | - | X | - |
| Other Receipts | <u>X</u> | <u>X</u> | <u>X</u> | <u>X</u> |
| Total Receipts | <u>X</u> | <u>X</u> | <u>X</u> | <u>X</u> |
| | | | | |
| <u>PAYMENTS</u> | | | | |
| Operations | | | | |
| Wages, salaries and employee benefits | (x) | (x) | (x) | (x) |
| Supplies and consumables | <u>(x)</u> | <u>(x)</u> | <u>(x)</u> | <u>(x)</u> |
| | (X) | (X) | (X) | (X) |
| Transfers | | | | |
| Grants | (x) | - | (x) | - |
| Other transfer payments | <u>(x)</u> | <u>-</u> | <u>(x)</u> | <u>-</u> |
| | (X) | - | (X) | - |
| Capital Expenditures | | | | |
| Purchase/constructions of plant and equipment | (x) | (x) | (x) | (x) |
| Purchase of fin. instruments | <u>(x)</u> | <u>-</u> | <u>(x)</u> | <u>-</u> |
| | (X) | - | (X) | - |
| Loan and Interest Repayments | | | | |
| Repayment of borrowings | (x) | - | (x) | - |
| Interest payments | <u>(x)</u> | <u>-</u> | <u>(x)</u> | <u>-</u> |
| | (X) | - | (X) | - |
| Other Payments | | | | |
| | <u>(X)</u> | <u>(X)</u> | <u>(X)</u> | <u>(X)</u> |
| Total Payments | <u>(X)</u> | <u>(X)</u> | <u>(X)</u> | <u>(X)</u> |
| Increase/(Decrease) in Cash | <u>X</u> | <u>-</u> | <u>X</u> | <u>-</u> |
| | | | | |
| Cash at the beginning of year | <u>X</u> | <u>N/A</u> | <u>X</u> | <u>N/A</u> |
| Increase/(Decrease) in Cash | <u>X</u> | <u>N/A</u> | <u>X</u> | <u>N/A</u> |
| | | | | |
| Cash at end of year | <u>X</u> | <u>N/A</u> | <u>X</u> | <u>N/A</u> |

N/A: Not Applicable

Source: International Public Sector Accounting Standard 2 "Financial Reporting Under the Cash Basis of Accounting", Appendix 1a-A Government.

1.5.4.3.2. Compliance with Budget Appropriations Statement

“An approved budget is the expenditure authority derived from laws, appropriation bills, government ordinances and other decisions related to the anticipated revenue or receipts for the budgetary period”.³⁶ Budgetary period is generally one year but multi year budgets may also be approved. However, those anticipated revenues and receipts may not realize at the end of the budgetary period. During the budget period there can be some changes in the anticipations about the budget. For this reason some supplementary appropriations may be necessary, or there can be cancellation of some appropriations because of decreasing revenues as result of unexpected events. Statement gives opportunity of comparison between the original approved budget, the final budget that has taken shape as result of supplementary appropriations or shortages of appropriations during the budget period, and the actual budget.

Some entities may not be obliged to publicize their budget because of security or similar reasons, and this Standard takes the comparison of actual and approved budget for only those entities that have to publicize their budgets. According to the Standard comparison can be presented in a column of the Statement of Cash Receipts and Payments, or as a separate financial statement. But Statement of Cash Receipts and Payments should be prepared in comparable basis with budget to present the comparison in a column of the Statement.

According to the Standard, reasons of transforming from the original approved budget to final budget should be disclosed in the notes to the financial statements or in a separate report. If these reasons are disclosed in a separate report, there should be an attribution to this report in the notes of the financial statements.

Example of this Statement is below in Table-12;

³⁶ IPSAS-2, Cash Flow Statements, paragraph 1.9.1.

Table – 12

**STATEMENT OF COMPARISON OF BUDGET AND ACTUAL AMOUNT
For Government X for the year ended 31 December 200X
Budget Approved on the Cash Basis
(Classification of Payments by Functions)**

| (in thousand of currency units) | Actual Amounts | Final Budget | Original Budget | Difference: Final and Actual |
|---|-------------------|-----------------|--------------------|---------------------------------|
| CASH INFLOWS | | | | |
| Taxation | X | X | X | X |
| Aid agreements | X | X | X | X |
| International agencies | X | X | X | X |
| Other grants and aid | X | X | X | X |
| Proceeds: borrowing | X | X | X | X |
| Proceeds: disposal of plat and equipment | X | X | X | X |
| Trading activities | X | X | X | X |
| Other receipts | X | X | X | X |
| Total Receipts | X | X | X | X |
| CASH OUTFLOWS | | | | |
| Health | X | X | X | X |
| Education | X | X | X | X |
| Public order/safety | X | X | X | X |
| Social protection | X | X | X | X |
| Defense | X | X | X | X |
| Housing and community amenities | X | X | X | X |
| Recreational, cultural and religion | X | X | X | X |
| Economic affairs | X | X | X | X |
| Other | X | X | X | X |
| Total Payments | X | X | X | X |
| NET CASH FLOWS | X | X | X | X |

Source: International Public Sector Accounting Standard 2”Financial Reporting Under the Cash Basis of Accounting”, Appendix 1a-A Government.

1.5.4.3.3. Notes to the Financial Statements

According to the Standard

“notes of the financial statements should;

- i) present information about the basis of preparation of the financial statements and the specific accounting policies selected and applied for significant transactions and other events; and
- ii) provide additional information which is not presented on the face of the financial statements but is necessary for a fair presentation of the entity’s cash receipts, cash payments and cash balances”.³⁷

Notes should be presented in a systematic way and there should be an attribute in each item of the financial statement to the related note. Accounting policies should provide

³⁷ IPSAS-2, paragraph 1.3.32.

the financial statements to be understandable, relevant, reliable, neutral and comprehensive.

1.5.4.3.4. Other Issues Presented in Cash Basis Accounting System

The standard encourages the presentation of some information in cash basis with the general purpose financial statements. However, presentation of this information is not compulsory according to the Standard. But it is believed that if this information disclosed it can improve the accountability and transparency objective of financial statements and accounting.

Assets those are not cash but have the potential of providing future service or economic potential are supposed to be beneficial for decision making. Liabilities are also accepted necessary for a healthier decision making. For this reason disclosure of assets and liabilities of the entity is encouraged. Extraordinary items are encouraged to be presented separately from other items. Disclosures of major class of cash flows, related party transactions, borrowings, rearrangement of financial statements in hyperinflationary economic conditions is also encouraged by the Standard.

Example for Assets and Liabilities Disclosure is in Table-13.

Table-13

DISCLOSURE of ASSETS and LIABILITIES

Assets and Liabilities

| In thousands of currency units | <u>200X</u> | <u>200X-1</u> |
|--------------------------------|-------------|---------------|
| Plant and equipment | x | x |
| Land and buildings | x | x |
| Property within city limits | x | x |
| Buildings at cost | x | x |
| Buildings at valuation | <u>x</u> | <u>x</u> |

Source: International Public Sector Accounting Standard 2 "Financial Reporting Under the Cash Basis of Accounting", Appendix 2.

1.5.4.4. Government Financial Reporting in Accrual Basis System

General purpose financial statements according to International Public Sector Accounting Standards are Statement of Financial Position, Statement of Financial

Performance, Cash Flow Statement, Statement of Changes in Equity and Explanatory Notes. However, there are some other statements that are prepared in many applications of public sector accrual basis accounting. These supplementary financial statements are Statement of Borrowings, Statement of Unappropriated Expenses and Capital Expenditures, Statement of Emergency Expensed and Capital Expenditures, Statement of Trust Money, Other Additional Statements Necessary to Fairly Disclose the Financial Condition of the Entity.

1.5.4.4.1. Statement of Financial Position

Statement of Financial Position discloses the assets and liabilities of the entity in reporting date. It has the same characteristics with Balance Sheet of business accounting. Current and non-current assets and liabilities can be presented separately or not according to the nature of the operations of the entity. If distinction between current and non-current assets and liabilities is not applied the assets and liabilities should be written according to liquidity. If distinction is applied; assets that are

“expected to be realized in or is held for consumption in the normal course of the entity’s operating cycle, assets that are held primarily for trading purposes or for short-term and expected to realized within twelve months of the reporting date, and assets that are cash or a cash equivalent should be disclosed as current assets and all other assets should be disclosed as non-current assets”³⁸,

liabilities that are expected to be settled in the normal course of the entity’s operating cycle, or that are due to be settled within twelve months of the reporting date should disclosed as current liability and other liabilities should be disclosed as non-current liabilities.

Statement of Financial Position should include line items which present,

- “* property, plant and equipment,
- * intangible assets,
- * financial assets,
- * investments accounted for using the equity method,
- * inventories,
- * recoverable from non-exchange transactions, including taxes and transfers,
- * receivables from exchange transactions,
- * cash and cash equivalents,

³⁸ IPSAS 1, Paragraph 79

- * taxes and transfers payable,
- * payables under exchange transactions,
- * provisions,
- * non-current liabilities,
- * minority interest,
- * net assets/equity,” as a minimum.³⁹

Additional line items should also be disclosed in the face of the Statement if it is necessary for fair presentation of financial condition according to the nature of the operations of the entity.

Government entities generally have no share capital, in this situation entity should disclose;

“ **a**) net assets/equity, showing separately:

(i) contributed capital, being the cumulative total at the reporting date of contributions from owners, less distributions to owners;

(ii) accumulated surpluses or deficits;

(iii) reserves, including a description of the nature and purpose of each reserve within net assets/equity; and

(iv) minority interests; and

(b) the amount of a distribution (other than the return of capital) proposed or declared after the reporting date but before the financial statements were authorized for issue,”⁴⁰

either on the face of the Statement or in the notes to the Statement. However, if the entity has share capital, in addition to the above mentioned issues, the entity should disclose,

“(a) for each class of share capital:

(i) the number of shares authorized;

(ii) the number of shares issued and fully paid, and issued but not fully paid;

(iii) par value per share, or that the shares have no par value;

(iv) a reconciliation of the number of shares outstanding at the beginning and at the end of the year;

(v) the rights, preferences and restrictions attaching to that class, including restrictions on the distribution of dividends and the repayment of capital;

(vi) shares in the entity held by the entity itself or by controlled entities or associates of the entity; and

³⁹ IPSAS 1, Paragraph 89

⁴⁰ IPSAS 1, Paragraph 97

(vii) shares reserved for issuance under options and sales contracts, including the terms and amounts;

(b) a description of the nature and purpose of each reserve within net assets/equity;

(c) the amount of dividends that were proposed or declared after the reporting date but before the financial statements were authorized for issue; and

(d) the amount of any cumulative preference dividends not recognized,⁴¹

either on the face of the Statement or in the notes to the Statement.

Table-14 below is the Statement of Financial Position for New Zealand Government at 30 June 1997.

Table – 14
STATEMENT of FINANCIAL POSITION

| As at 30 June 207 | | | | | |
|-----------------------------------|---------------|--|------|---------------|---------------|
| 30 June 1997 Forecast | | | Note | Actual | |
| Budget | Estimated | | | 30 June | 30 June |
| \$m | \$m | | | 1997 | 1996 |
| | | | | \$m | \$m |
| ASSETS | | | | | |
| 48 | 51 | Cash and Bank Balances | 6 | 196 | 344 |
| 8,323 | 6,277 | Marketable Securities and deposits | 7 | 7,581 | 9,062 |
| 2,951 | 2,861 | Advances | 8 | 2,871 | 3,457 |
| 4,878 | 5,080 | Receivables | | 5,091 | 4,782 |
| 318 | 333 | Inventories | | 295 | 336 |
| State Owned enterprises and Crown | | | | | |
| 18,739 | 17,414 | Entities | 9 | 18,483 | 18,487 |
| 214 | 205 | Other investments | 10 | 214 | 211 |
| 13,927 | 14,449 | Physical assets | 11 | 14,502 | 13,925 |
| 646 | 559 | Commercial forests | 12 | 505 | 551 |
| 7,603 | 7,832 | State highways | 13 | 8,210 | 7,759 |
| 6 | 7 | Intangible assets | | 20 | 7 |
| 200 | - | Contingency capital provision | | - | - |
| 57,853 | 55,086 | TOTAL ASSETS | | 57,968 | 58,921 |
| LIABILITIES | | | | | |
| 3,317 | 4,110 | Payables and provisions | 14 | 4,457 | 4,070 |
| 1,719 | 1,734 | Currency issued | | 1,741 | 1,657 |
| 38,719 | 34,799 | Borrowings | | 35,972 | 41,500 |
| 8,156 | 8,398 | Pension Liabilities | 15 | 8,328 | 8,332 |
| 51,902 | 49,041 | TOTAL LIABILITIES | | 50,498 | 55,577 |
| 5,951 | 6,027 | TOTAL ASSETS LESS TOTAL LIABILITIES | | 7470 | 3,344 |
| CROWN BALANCE | | | | | |
| 1,717 | 979 | Accumulated operating balance | 16 | 468 | -1,550 |

⁴¹ IPSAS 1, Paragraph 100

| | | | | |
|--------------|--------------|-----------------------|-------------|--------------|
| 4,234 | 5,048 | Revaluation reserve | 7,002 | 4,984 |
| 5,951 | 6,027 | CROWN BALANCES | 7470 | 3,344 |

The accompany Notes are integral part of these Statements.

Source: (Financial Statements of the Government of New Zealand, For the year ended 30 June 1997, page 41).

1.5.4.4.2. Statement of Financial Performance

Statement of Financial Performance discloses revenues and expenditures of the government entity. Main revenues of government entities are taxes collected from the citizens. And expenses of government entities are generally non-exchange payments.

According to the IPSAS,

“As a minimum, the face of the statement of financial performance should include line items which presented the following amounts:

- (a) revenue from operating activities;
- (b) surplus or deficit from operating activities;
- (c) finance costs;
- (d) share of net surpluses or deficits of associates and joint ventures accounted for using the equity method;
- (e) surplus or deficit from ordinary activities;
- (f) extraordinary items;
- (g) minority interest share of net surplus or deficit; and
- (h) net surplus or deficit for the period”.⁴²

Additional line items should be used in the Statement if the nature of the operations of the entity necessitates that for fair presentation of financial performance. Revenues and expenditures from operating activities should be distinguished from other revenues and expenditures. Operating activities are those which are done to accomplish primary objectives of the entity. For example, for a local government selling a vehicle is not an operating activity and for this reason the revenue acquired by selling a vehicle is not part of operating revenue.

Expenses of the entity can be disclosed in two different ways in the Statement. The first one is the functional classification, in which expenses are disclosed according to the function of the expenditure, as health, education and defense. The second one is the

⁴² IPSAS 1, paragraph 101

classification according to the nature of the expense, as salaries and employee benefits, depreciation and amortization expense, other operating expenses.

The Statement of Financial Performance discloses the financial result of the activities of the entity. Net surplus or deficit for the period can be seen by the Statement. However, because of not having making profit as the main objective, the surplus or deficit can not be the only indicator of the performance of government entities. The entity should continue its services and its potential in this issue should be taken into consideration when evaluating the performance of the entity. Cost of the services provided and the use resources by the entity can be helpful for this evaluation.

Examples for Statement of Financial Performance are below in Table-15 and Table-16;

Table- 15
EXAMPLE-1 for STATEMENT of FINANCIAL PERFORMANCE
Public Sector Entity, Statement of Financial Performance for the Year
Ended 31 December 20X2
(The Classification of Expenses by Function)
(In thousands of currency units)

| | 20X2 | 20X1 |
|--|----------|----------|
| Operating revenue | | |
| Taxes | X | X |
| Fees, fines, penalties and licenses | X | X |
| Revenues from exchange transactions | X | X |
| Transfers from other government entities | X | X |
| Other operating revenues | X | X |
| Total operating revenue | <u>X</u> | <u>X</u> |
| Operating expenses | X | X |
| General public services | X | X |
| Defense | X | X |
| Public order and safety | X | X |
| Education | X | X |
| Health | X | X |
| Social protection | X | X |
| Housing and community amenities | X | X |
| Recreational, cultural and religion | X | X |
| Economic Affairs | X | X |
| Environmental protection | X | X |
| Total operating expenses | <u>X</u> | <u>X</u> |
| Surplus/(deficit) from operating activities | X | X |
| Finance costs | (X) | (X) |
| Gains on sale of property, plant and equipment | <u>X</u> | <u>X</u> |

| | | |
|---|------------|------------|
| Total non-operating revenue (expenses) | <u>(X)</u> | <u>(X)</u> |
| Surplus/(deficit) from ordinary activities | X | X |
| Minority interest share of surplus/(deficit) | <u>(X)</u> | <u>(X)</u> |
| Net surplus/(deficit) before extraordinary items | X | X |
| Extraordinary items | (X) | (X) |
| Net surplus/(deficit) for the period | <u>X</u> | <u>X</u> |

Source: IPSAS 1-Presentation of Financial Statements, Appendix 1

Table – 16
EXAMPLE-2 for STATEMENT of FINANCIAL PERFORMANCE
Public Sector Entity, Statement of Financial Performance for the Year
Ended 31 December 20X2
(Illustrating the Classification of Expenses by Nature)

| | 20X2 | 20X1 |
|--|-------------|-------------|
| Operating revenue | | |
| Taxes | X | X |
| Fees, fines, penalties and licenses | X | X |
| Revenues from exchange transactions | X | X |
| Transfers from other government entities | X | X |
| other operating revenues | X | X |
| Total operating revenue | <u>X</u> | <u>X</u> |
| Operating expenses | X | X |
| Wages, salaries and employee benefits | X | X |
| Grants and other transfer payments | X | X |
| Supplies and consumables used | X | X |
| Depreciation and amortization expenses | X | X |
| Other operating expense | X | X |
| Total operating expenses | <u>X</u> | <u>X</u> |
| Surplus/(deficit) from operating activities | X | X |
| Finance costs | X | X |
| Gains on sale of property, plant and equipment | X | X |
| Total non-operating revenue (expenses) | <u>(X)</u> | <u>(X)</u> |
| Surplus/(deficit) from ordinary activities | X | X |
| Minority interest share of surplus/(deficit) | <u>(X)</u> | <u>(X)</u> |

| | | |
|---|----------|----------|
| Net surplus/(deficit) before extraordinary items | X | X |
| Extraordinary items | (X) | (X) |
| Net surplus/(deficit) for the period | <u>X</u> | <u>X</u> |

Source: IPSAS 1-Presentation of Financial Statements, Appendix 1

1.5.4.4.3. Cash Flow Statement

Cash Flow Statement gives information about the cash flows of the government entity; from which sources cash is generated, for what kind of services cash is spent and the cash balance and changes in the cash balance of the entity. Cash flows of entities can be related to operating activities, financing activities or investing activities. Cash flows from activities other than financing and investing are accepted as operating activities and cash flows from these activities are recorded as operating cash flow. For example, revenue from taxation, grants, fees, sale of goods and services and cash transfers from other government agencies are recorded as cash inflow, payments related to realization of main objectives of the entity like cash payments to suppliers or employees are recorded as operating cash outflows. Cash payment to buy a physical asset, a plant or cash payment to acquire equity or debt of another entity are recorded as investing cash outflow and cash receipt from sale of a physical asset, plants or from sale of equity or debt instrument are recorded as investing cash outflow. Cash payment to discharge government debt is a financing cash outflow and cash flow from issuing a government debt, or cash flow from a loan or borrowing are financing cash inflow.

Information presented in the Cash Flow Statement provides idea about future cash needs of the entity. Managers and other decision makers can have prediction about the liquidity of the entity; can predict cash necessities of the entity in the future. Moreover, they can plan the amount necessary to be borrowed in order to replace physical assets that are necessary to sustain services of the government entity. “A Cash Flow Statement, when used in conjunction with other financial statements, provides information that enables users to evaluate the changes in net assets/equity of the entity, its financial structure (including its liquidity and solvency) and its ability to affect the

amounts and timing of cash flows in order to adapt changing circumstances and opportunities.”⁴³

There are two methods available to prepare Cash Flow Statement; these are direct method and indirect method. In the Direct Method, “major classes of gross cash receipts and gross cash payments are disclosed”.⁴⁴ Cash inflows and outflows are disclosed according to their classes and cash flows from operating activities, investing activities and financing activities are disclosed separately in direct method.

An example of Cash Flow Statement prepared according to Direct Method is presented Table-17 below;

Table – 17
CASH FLOW STATEMENT
(for an entity other than financial institution)
Direct Method Cash Flow Statement

Public Sector Entity, Consolidated Cash Flow Statement for the Year Ended in 31 December 20X2 (In thousand of currency unit)

| CASH FLOW FROM OPERATING ACTIVITIES | 20X2 | 20X1 |
|---|-------------|-------------|
| Receipts | X | X |
| Taxation | X | X |
| Sales of goods and services | X | X |
| Grants | X | X |
| Interest received | X | X |
| Other receipts | X | X |
| Payments | | |
| Employee costs | (X) | (X) |
| Superannuation | (X) | (X) |
| Suppliers | (X) | (X) |
| Interest paid | (X) | (X) |
| Other payments | (X) | (X) |
| Net cash flows from operating activities | X | X |
| | | |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchase of plant and equipment | (X) | (X) |
| Proceeds from sale of plant and equipment | X | X |
| Proceeds from sale of investments | X | X |
| Purchase of foreign currency securities | (X) | (X) |
| Net cash flows from investing activities | (X) | (X) |
| | | |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |

⁴³ IPSAS 2, paragraph 6

⁴⁴ IPSAS 2, paragraph 27-(a)

| | | |
|---|----------|----------|
| Proceeds from borrowings | X | X |
| Repayment of borrowings | (X) | (X) |
| Distribution /dividend to government | (X) | (X) |
| Net cash flows from financing activities | <u>X</u> | <u>X</u> |
| Net increase/(decrease) in cash and cash equivalents | X | X |
| Cash and cash equivalents at the beginning of period | X | X |
| Cash and cash equivalents at the end of the period | <u>X</u> | <u>X</u> |

Source: IPSAS 2- Cash Flow Statements, Appendix 1

In the Indirect Method, the net cash flow from operating activities is determined by adjustment of net surplus or deficit from ordinary activities for the effects of changes in inventories and operating receivables and payables, non-cash items as depreciation, all other items for which the cash effects are investing and financing cash flows and the extraordinary items which are classified as operating cash flows.

An example of Cash Flow Statement prepared according to Indirect Method is presented in Table-18 below;

Table – 18
CASH FLOW STATEMENT
(for an entity other than financial institution)
Indirect Method Cash Flow Statement

Public Sector Entity, Consolidated Cash Flow Statement for the Year Ended in 31 December 20X2 (In thousand of currency unit)

| | 20x2 | 20x1 |
|---|----------|----------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Surplus or deficit | X | X |
| Non-cash movements | | |
| Depreciation | X | X |
| Amortization | X | X |
| Increase in provision for doubtful debts | X | X |
| Increase in payables | X | X |
| Increase in borrowings | X | X |
| Increase in provisions relating to employee costs | X | X |
| (Gains)/losses on sale of property, plant and equipment | (X) | (X) |
| (Gains)/losses on sale of investments | (X) | (X) |
| Increase in other current assets | (X) | (X) |
| Increase in investments due to revaluation | (X) | (X) |
| Increase in receivables | (X) | (X) |
| Net cash flows from operating activities | X | X |

**CASH FLOWS FROM INVESTING
ACTIVITIES**

| | | |
|---|------------|------------|
| Purchase of plant and equipment | (X) | (X) |
| Proceeds from sale of plant and equipment | X | X |
| Proceeds from sale of investments | X | X |
| Purchase of foreign currency securities | (X) | (X) |
| Net cash flows from investing activities | (X) | (X) |

**CASH FLOWS FROM FINANCING
ACTIVITIES**

| | | |
|--------------------------------------|-----|-----|
| Proceeds from borrowings | X | X |
| Repayment of borrowings | (X) | (X) |
| Distributions/dividend to government | (X) | (X) |

Source: IPSAS 2- Cash Flow Statements, Appendix 1

1.5.4.4.4. Statement of Changes in Net Assets/Equity

Statement of Changes in Equity should disclose

“the net surplus or deficit for the period, each item of revenue and expense, which, as required by other Standards, is recognized directly in net assets/equity, and total of these items, and the cumulative effect of changes in accounting policy and the correction of fundamental errors dealt with under benchmark treatments in (International Public Sector Accounting Standard) IPSAS 3.”⁴⁵

Moreover, transfers to and from owners, accumulated balance of surpluses or deficits should also be disclosed in the Statement or in the notes.

Changes in net assets/equity during the period give information about the increase or decrease in the wealth of the entity. Example is in Table-19.

⁴⁵ IPSAS 1, paragraph 114

Table-19
Statement of Movement in Equity

for the year ended 30 June 1997

| 30 June 1997 Forecast | Budget | Estimated | Actual | Note | Actual | 30 June | 30 June |
|-----------------------|--------------|---|--------|-----------|--------------|--------------|---------|
| \$m | \$m | \$m | \$m | | 1997 | 1996 | |
| \$m | \$m | \$m | \$m | | \$m | \$m | |
| 3,193 | 3,344 | OPENING CROWN BALANCE | | | 3,344 | -3,159 | |
| 2,758 | 2,448 | Operating balance for the period | | | 1,908 | 3,314 | |
| - | 235 | Net revaluations | | | 2,218 | 3,189 | |
| 2,758 | 2,683 | Total Recognized Revenues and Expenses | | | 4,126 | 6,503 | |
| 5,951 | 6,027 | CLOSING CROWN BALANCE | | 16 | 7,470 | 3,344 | |

Source: Financial Statements of the Government of New Zealand, For the Year Ended 30 June 1997, page 42

1.5.4.4.5. Explanatory Notes

Explanatory notes are notes to the financial statements which give detailed information about the items disclosed in the financial statements. Important accounting policies that are applied during the period, analysis and narrative description of information that is presented on the face of the financial statements are presented in the notes of financial statements. Moreover, some important information, such as commitments and contingencies, which is not presented in the face of the financial statements, is also disclosed in the notes.

“Notes to the financial statements should be presented in a systematic manner. Each item on the face of the statement of financial performance, statement of financial position and cash flow statement -should be cross-referenced to any related information in the notes.”⁴⁶ This systematic presentation helps the decision makers to see details of the information that is disclosed on the face of the financial statements. For this reason preparers of financial statements should disclose all details that are necessary for fair presentation in the notes to the financial statements.

⁴⁶ IPSAS 1, paragraph 122

1.5.4.4.6. Statement of Borrowings

Statement of Borrowings presents information about the financial assets and financial liabilities of the entity. Outstanding debts and financial assets are presented in the Statement and it can be possible to see net debt of the public entity. And changes in public debt can be seen in this statement. Outstanding debts consist of domestic currency debts and foreign currency debts. Financial assets consist of marketable securities and deposits and advances and cash. The difference between total outstanding debts and total financial assets gives the net public debt (net debt of the entity).

In the statement book values, nominal values and current market values of debts and financial assets can be presented. Moreover, the Statement can be prepared in a manner that classifies the debts and financial assets according to due time, and maturities. An example is presented in Table-20.

Table - 20
STATEMENT OF BORROWINGS

| at 30 June 1997-Book values | | | Actual | |
|---|---------------|--------------------------------------|---------------|---------------|
| 30 June 1997 Forecast | | | 30 June | 30 June |
| Budget | Estimated | | 1997 | 1996 |
| \$m | \$m | | \$m | \$m |
| OUTSTANDING DEBT | | | | |
| New Zealand Dollar Debt | | | | |
| 21,027 | 19,968 | Government stock | 20,092 | 21,222 |
| 7,018 | 6,534 | Treasury bills | 6,311 | 6,948 |
| 613 | 668 | Loans and foreign exchange contracts | 672 | 982 |
| 1,260 | 1,228 | Reserve Banks bills | 1,236 | 1,249 |
| 818 | 757 | Earthquake Commission deposits | 811 | 795 |
| 589 | 465 | Retail stock | 503 | 551 |
| 31,335 | 29,620 | Total New Zealand Dollar Debt | 29,625 | 31,747 |
| Foreign Currency Debt | | | | |
| 4,359 | 2,917 | United States dollars | 2,976 | 5,110 |
| 1,583 | 1,128 | Japanese yen | 1,578 | 2,542 |
| 1,433 | 1,134 | European and other currencies | 1,793 | 2,101 |
| 7,375 | 5,179 | Total Foreign Currency Debt | 6,347 | 9,753 |
| 38,710 | 34,799 | TOTAL OUTSTANDING DEBT | 35,972 | 41,500 |
| Less | | | | |
| FINANCIAL ASSETS | | | | |
| Marketable Securities and Deposits | | | | |
| 200 | 726 | New Zealand dollars | 848 | 778 |
| 4,770 | 2,911 | United States dollars | 3,014 | 3,129 |
| 1,583 | 1,285 | Japanese yen | 1,734 | 2,698 |

| | | | | |
|---|---------------|---|---------------|---------------|
| 1,770 | 1,355 | European and other currencies | 1,985 | 2,457 |
| 8,323 | 6,277 | Total Marketable Securities and Deposits | 7,581 | 9,062 |
| Advances and Cash | | | | |
| Advances to State-owned enterprises and | | | | |
| 1,065 | 862 | Crown entities | 862 | 1,954 |
| 1,792 | 1,883 | Student loans | 1,884 | 1,392 |
| 94 | 116 | Other advances | 125 | 111 |
| 48 | 51 | Cash | 196 | 344 |
| 2,999 | 2,912 | Total Advances and Cash | 3,067 | 3,801 |
| 11,322 | 9,189 | TOTAL FINANCIAL ASSETS | 10,648 | 12,863 |
| 27,388 | 25,610 | NET PUBLIC DEBT | 25,324 | 28,637 |
| 28,136 | 25,982 | Net New Zealand-dollar debt | 25,744 | 27,233 |
| -748 | -372 | Net foreign-currency debt | -420 | 1,404 |
| 27,388 | 25,610 | NET PUBLIC DEBT | 25,324 | 28,637 |

Source: Financial Statements of the Government of New Zealand, For the Year Ended 30 June 1997, page 49

1.5.4.4.7. Statement of Unappropriated Expenditure, Expenses and Liabilities

Appropriation is the statutory authorization of the Parliament to expend public money, and Parliament determines the limits and programs of appropriations by Budget Code. "Statement of Unappropriated Expenditure, Expenses and Liabilities presents the amounts of expenditure, expenses and liabilities spent or incurred in excess of or without appropriation of Parliament."⁴⁷ Validating legislation is necessary for the excess amounts. Example of Statement of Unappropriated Expenditure, Expenses and Liabilities is given in Table-21 below.

Table-21
STATEMENT OF UNAPPROPRIATED EXPENDITURE, EXPENSES AND LIABILITIES

| Department Vote Appropriation | Unappropriated exp, expenses or liabilities approved by Min. Of Fin. \$000 | Unappropriated exp, expenses or liabilities amount requiring validating legislation \$000 | Amount Appropriated \$000 |
|---|--|---|------------------------------|
| Ministry of Commerce | | | |
| Registration and granting of intellectual property rights | X | X | X |
| Registration of statutory information | X | X | X |
| Public provision of registered information | X | X | X |
| Policy advice-Communications | X | X | X |

⁴⁷ Financial Statements of the Government of New Zealand, For the Year Ended 30 June 1997, p. 67

| | | | |
|--------------------------------|----------|----------|----------|
| Department of Conservation | X | X | X |
| Department of Courts | X | X | X |
| Crown Law Office | X | X | X |
| Ministry of Education | X | X | X |
| Ministry of Forestry | X | X | X |
| Government Superannuation Fund | X | X | X |
| Ministry of Health | X | X | X |
| Inland Revenue Department | X | X | X |
| Ministry of Justice | X | X | X |
| Land Information New Zealand | X | X | X |
| New Zealand Defense Force | X | X | X |
| Parliamentary Services | X | X | X |
| The Police | X | X | X |
| Serious Frauds Office | X | X | X |
| Social Welfare | X | X | X |
| The Treasury | X | X | X |
| Ministry of Women's Affairs | X | X | X |
| TOTAL | X | X | X |

Source: Financial Statements of the Government of New Zealand, For the Year Ended 30 June 1997, page 67, 68, 69, 70, 71 and 72

1.5.4.4.8. Statement of Emergency Expenditures, Expenses and Liabilities

Statement of Emergency Expenditures, Expenses and Liabilities presents details of expenditures, expense and liabilities that are incurred as result of unpredicted events as war, earthquake, contagious diseases or catastrophes.

1.5.4.4.9. Statement of Trust Money

Trust money is the amounts taken from citizens to give back to them after realization of something. The Statement presents the trust money according to the type of the trust money. Trust money is taken by public entities according to statutory necessities.

1.5.4.4.10. Statement of Commitments

This Statement presents the amounts of commitments. This information is necessary for decision makers to see future possible liabilities of the government entity. It is possible to present the commitments by type or by term. Statement of Commitments is given in Table-22.

Table – 22
STATEMENT OF COMMITMENTS

As of 30 June 1997

| By type | As at 30 June 1997 \$m | As at 30 June 1996 \$m |
|---|---------------------------|---------------------------|
| CAPITAL COMMITMENTS | | |
| Specialist military equipment | 633 | 558 |
| Land and building | 70 | 61 |
| Other plant and equipment | 63 | 81 |
| Investments | 189 | 155 |
| State-owned enterprises and Crown entities | 1000 | 498 |
| Total Capital Commitments | 1955 | 1353 |
| OPERATING COMMITMENTS | | |
| Non-cancelable accommodation leases | 764 | 824 |
| Other non-cancelable leases | 3523 | 1175 |
| Non-cancelable contracts for the supply of goods and services | 519 | 468 |
| Other operating commitments | 875 | 784 |
| State-owned enterprises and Crown entities | 3474 | 2726 |
| Total Operating Commitments | 9155 | 5977 |
| TOTAL COMMITMENTS | 11110 | 7330 |

Source: Financial Statements of the Government of New Zealand, For the Year Ended 30 June 1997, page 52

1.5.4.4.11. Statement of Contingent Liabilities

This Statement presents the amounts of contingent liabilities. This information is also helpful for decision makers to see future possible liabilities of the government entity as in the case of Statement of Commitments. Statement is in Table-23.

Table - 23

| STATEMENT OF CONTINGENT LIABILITIES | | |
|--|---------------------------------|---------------------------------|
| as of 30 June 1997 | | |
| | 30 June 1997 \$m | 30 June 1996 \$m |
| Quantifiable Contingent Liabilities | | |
| Guarantees and Indemnities | 373 | 458 |
| Uncalled Capitals | 2,250 | 2,283 |
| Legal Proceedings and Disputes | 669 | 1,019 |
| Other Contingent Liabilities | 1,203 | 1,250 |
| TOTAL QUANTIFIABLE CONTINGENT LIABILITIES | 4,495 | 5,010 |

Source: Financial Statements of the Government of New Zealand, For the Year Ended 30 June 1997, page 53

1.5.4.4.12. Any Additional Information and Explanations Needed to Fairly Reflect the Financial Operations and Position of the Government Reporting Entity

Other information necessary to fairly present the financial condition of the entity should be presented via other financial statements.

1.6. FINANCIAL STATEMENT ANALYSIS

Financial statement analysis is used to evaluate the financial condition of private sector companies more than a century. In first years some naïve and archaic methods were used but in time more sophisticated and comprehensive methods have been developed. Widely used examples of these techniques are common-size technique, trend analysis, ratio analysis and comprehension technique. Financial statement analysis is used for different objectives, for instance to predict the short-term liquidity of a company, or to evaluate the performance of the activities of a company. Despite financial analysis has long history in private sector, application of it for government entities is a recent issue. Moreover, it is not possible to fix the techniques used in the private sector for financial analysis of public entities. This is mainly because of the objectives of public sector entities. Different from private companies, public sector entities does not aim to achieve maximum profit. Their main objective is to provide goods and services for the society in the most efficient and effective manner. Moreover, different public entities have different objectives and different operation structures. This also prevents the establishment of one unique financial analysis system for the whole public sector. However, there are some attempts to establish financial statement analysis techniques for public sector entities and it can be said that in the long-run some methods, widely accepted ratios will be established, as in the case of private sector.

To have reliable results from financial statement analysis financial statements should be prepared in a healthy and reliable manner, the inside and environment of the entity should be known well, the characteristics and objectives of the entity subject to analysis should be known, analyst should have detailed information about the accounting policies of the entity and risks related to the commitments and contingencies of the entity.

1.6.1. History of Financial Statement Analysis

Financial statement analysis has emerged initially in United States in the second half of the nineteenth century. This development has emerged because of the changes in the nature of the companies. Big companies started to take the place of small family companies in this period. Big companies necessitated huge financial support and this development necessitated a developed financial system and lending from financial markets. Banks demanded to see the financial condition of the companies to lend them. They wanted to predict whether companies will be able to pay the loans back or not. And this need caused the development of financial statement analysis methods, mainly the credit analysis. Financial statement analysis techniques applied first by banks for this reason. Moreover, another change in this period was that the management has changed in big companies. Different from small family companies in big companies the managers become to be professional managers instead of family members. However, there were some risks for the shareholders in this type of management. Shareholders invested to companies and they were not participated in the management. For this reason, they demanded to understand the financial condition and performance of the companies. This need also led to the development of financial statement analysis techniques, especially the profit analysis techniques.⁴⁸

In these years, the diversification of current and non-current assets and liabilities and comparative basis of analysis techniques practiced for the first time. In 1890's the comparison of current assets with current liabilities emerged to understand the short-term debt payment power of companies. Current ratio can be accepted as the first ratio used to evaluate the financial condition of companies. As stated by Horrigan, "Truly, the usage of ratios in financial statement analysis can be said to be to have begun with the advent of the current ratio".⁴⁹ However, it was so important ratio that it is still used in financial statement analysis and it is accepted as one of the most crucial ratios.

After these years, in first years of 20th century various ratios commenced to be used. Analysts started to study the relations between these ratios. Absolute ratios and relative ratio criteria were also applied for the first time in financial statement analysis in these

⁴⁸ From: James O. Horrigan, A Short History of Financial Ratio Analysis, The Accounting Review, April 1968, p. 284, 285

⁴⁹ James O. Horrigan, p. 285

years. With Wall's (Alexander Wall, Study of Credit Barometrics, Federal Reserve Bulletin, March, 1919, 229-243) study profit margins started to be used and du Pont Company improved these margins via usage of three related ratios. These three ratios were return on investment ratio (profits/total assets), profit margin ratio (profits/sales) and capital turnover ratio (sales/total assets). Another important development in this period was the use of common-size technique for the first time in the analysis of balance sheets. Lawrence Chamberlain has developed this method in his book called "The Principles of Bond Investment" (Lawrence Chamberlain, 1911). In the next decade, industry ratio data were prepared and comparison of the companies' ratios with industry ratios has started. Moreover, in 1925 trend analysis has started for the analysis of financial statements by Stephen Gilman (Stephen Gilman, Analyzing Financial Statements, The Ronald Press Company, New York, 1925). Gilman criticized ratio analysis technique and recommended examination of the trends of the items of financial statements. In 1930s and 1940s, the success and relevance of ratios taken into consideration, and some empirical studies have been made to assess the reliability of ratios that are used for analysis. Some of these ratios are proved to be very predictive to assess the financial condition of the companies. Merwin's (Charles L. Merwin, Financing Small Corporations: In Five Manufacturing Industries, 1926-36, National Bureau of Economic Research, 1942) study was important which determined net working capital to total assets, net worth to debt and current ratio as strongly predictive to determine the continuity and discontinuity of companies. Similar studies continued also after 1950, for example Beaver (William B. Beaver, Financial Ratios as Predictors of Failure, Empirical Research in Accounting: Selected Studies, 1966, University of Chicago, 1967, pp.71-111) improved the study of Merwin and proved the ability of some ratios to predict the failure of companies five years earlier. Another ability of ratios discovered in this period is their ability to give ideas about the characteristics of companies. Some companies were more aggressive and risk-taker and some were more conservative and risk-adverse. This information was helpful for investors.

For the financial analysis, the evaluation of financial analysis results is more important than the calculation of ratios or comparing data of two periods or companies. For this reason, analysts should have comprehensive knowledge about the environment and inside-operations of the companies. Moreover, experience and intuition of the analyst

are important to foresee the future of the company. Consequently, it should be stated that financial statement analysis techniques have developed continuously since their first emergence and this development will continue as result of studies and changes in economic and financial conditions.

1.6.2. Objectives of Financial Statement Analysis

There are various users of financial statements. These users have different objectives to analyze financial statements and to predict about the future of the entities. For example, creditors, share holders, managers and state have different objectives for analyzing financial statements. Therefore, it is possible to state that objectives of financial statement analysis are determined by the users.

Objectives of Equity Investors: Equity investors are the share holders of the entity. They are the owners of the capital of the entity and for this reason they have got great risk about their investment. Because of judicial structure owners of the entity has the right to get their investment from the entity after all other creditors taken their share in case of failure. However, as result of being exposed to the greatest risk share holders got the opportunity of acquiring maximum profit from their investment to stocks. For this reason, they demand to foresee the future of the entity. Two components are important in determination of the future yield of the stocks. These are the amount of the dividends and the future price of the stocks. If the dividends of the stock and its future market price are high the profit is maximized by the investor. Present value theory is used to predict the value of the stock of the entity. Present value method is first set forth by John B. Williams (the theory of investment value, Cambridge, Mass: Harvard University Press, 1938). According to this theory as stated by Bernstein and Irwin, " the present value of a share of a stock is equal to the sum of all dividends expected to be received from it, discounted to the present at an appropriate rate of interest."⁵⁰ After this various valuation techniques have improved. However, these methods can not provide certain results about the values of stocks because they include some predictions about future dividends, discount rates, future value of stocks. Any mistake in predictions of these components can cause mistakes about the present value of stocks.

⁵⁰ Leopold A Bernstein, Richard D. Irwin, Financial Statement Analysis Theory, application and interpretation, Inc.1974, p. 38

Objectives of Creditors: Creditors give financial support to entities and they take interest as result of this support. Moreover, they demand for the principal in due time. For this reason, they should know about the future financial condition of the entity to guarantee repayment of the credit. Credit may be provided for short-term or for long-term. According to the due of the credit creditors seek for different characteristics of financial conditions of entities. If the credit is a short-term credit, creditors want to know about the liquidity, short-term payment power of entity. If the credit is a long-termed, they want to know about the solvency of the entity. Financial statement analysis helps creditors to foresee the future cash repayment ability of entities.

Objectives of Management: The main objective of the management is to maximize the profit of the entity and to realize the continuity of the entity. For this reason, management should understand the results of their operations and the future credit needs of the entity and problems about the financial condition and management of the entity. Moreover, managers are responsible to shareholders and if their performance is not found satisfactory they may loose their job. For this reason, financial statement analysis is used by managers. They try to understand and foresee problems about the management of the entity and they try to solve these problems.

Objectives of State: State also analyzes the financial statements to predict the income of entities which is necessary to anticipate the tax income of the state. Moreover, the financial condition of the entities affects the whole economy. For example, if the companies in the economy have great foreign debt this makes the economy of the country very sensitive against a fluctuation in the exchange rates. Moreover, financial condition of some strategic entities may be important for the state. Therefore, state uses financial statement analysis to plan the income and expenditures of the government and to foresee future problems in the economy.

Objectives of Other Interested Parties: Some other interested groups also analyze financial statements to understand the condition of the entities. Rivals of the entities may analyze the financial statements of entities to understand the condition and to predict the future actions of entities. Moreover, companies in the sector may analyze the condition of the most successful entities of the sector to have the same ratios, financial structure of this entity. Another group may be accepted as labor unions which may analyze the condition of an entity. They may use results of analysis during bargaining

process. For example, if the profit of the entity increases continuously they may demand for high wage rates.

1.6.3. Financial Statement Analysis Techniques

There are various financial statement analysis techniques. Each of these techniques generally helps the analysts to understand the financial condition of the entity in different aspects. One of the technique is not sufficient to evaluate the entity in a detailed way and they should be used together and results should be evaluated together to understand the financial condition of an entity.

1.6.3.1. Comparative Analysis

Comparative analysis is the comparison and examination of the accounts of financial statements of different periods. Comparative analysis is a dynamic analysis method because of providing opportunity of evaluating financial statements of different periods. Via comparative analysis it is possible to see the changes in the condition of the entity. By this way it can be possible to examine reasons of the changes in the accounts and to foresee the future developments in the condition of the entity. In high inflation periods there may be important changes in the amounts of accounts and this may bring to misinterpretation of the financial statements. For this reason, accounts of old period's financial statements should be modified to the current values and changes in accounts should be evaluated after this.

Another aspect of comparative analysis is the comparison of the financial condition, accounts and financial statements of companies with other companies.

1.6.3.2. Trend Analysis

Trend analysis is the method in which financial statements are evaluated via examination of changes, the magnitude and direction of changes of the amounts of accounts. In this technique, one year is accepted as the base year and values of other years are counted according to their relation with this year. The values of accounts of base year are accepted as 100 and other periods' values, which are index numbers, are counted according to their relation with this year's amounts. This technique is also a dynamic technique because of providing opportunity of comparing different period values. In this method it is necessary to count and examine the values of many periods.

Because it can be possible to see the trend of the accounts only in long run. In the short run, the trends may be insufficient to have realistic opinion about the entity. There can be misleading trends that are result of extraordinary period. However, in the long run effects of extraordinary periods are insignificant and analyst can evaluate the changes in the financial condition of the entity more accurately.

1.6.3.3. Common-Size Analysis

In this technique, the proportions of single items of groups or subgroups are counted and evaluated. For the balance sheet, the debt side and credit side are accepted as one hundred and proportions of items of balance sheet are counted. Moreover, it can be possible to acknowledge the short term assets or equity, main groups of balance sheet, as one hundred and proportions of items of these groups are evaluated. For the analysis of income statement the net sales account is accepted as one hundred and the proportion of other items are counted. To examine the proportions, so the importance of items and changes of these items in the financial statements helps the decision makers to understand the most important items of the financial statements. By this information they can decide in a more effective way and they can pay fair attention to items of financial statements. For example, for a production company, the labor costs, tangible assets and stocks have generally more proportion in comparison with lands or marketable securities accounts. Any important change in the proportion of these items may be a big deal for the company. And common-size technique gives the decision makers to see these changes and to act according to these changes.

1.6.3.4. Ratio Analysis

Ratio analysis is the most popular and widely used analysis technique. “A ratio expresses the mathematical relationship between one quantity to another”.⁵¹ These relations between the items of the financial statements help the decision makers and analysts to understand the financial condition of the entity. Some ratios can give information alone but sometimes it may be necessary to examine more than one ratio together. It can be possible to count thousands of ratios via using items of financial statements but it is necessary to use meaningful ratios those give information about the

⁵¹ Leopold A Bernstein, Richard D. Irwin, p. 67

condition of the entity. For example, some ratios give information about short-term debt payment power of the entity, some are helpful to evaluate long-term debt payment power. It can also be possible to evaluate the efficiency and profitability of the entity via some ratios. For this reason, ratios are generally examined in groups according to their functions and these groups of ratios can be used according to the objective of the analysis.

1.6.3.4.1. Liquidity Ratios

Liquidity ratios are used to understand the short-term debt payment power of entities. Short-term debt payment power is crucial for companies. Some companies may be very profitable but if it does not plan its cash flows it may have some problems to realize their liabilities. A very profitable entity may fail because of not being able to pay its short-term debts. Liquidity ratios give information about liquidity of entities and it is generally used by creditors who provide short-term financial support to entities. Of course, they are examined by the management of the entities to foresee payment power of entities.

The most common liquidity ratios are those shown below and as other groups of ratios they should be evaluated together to understand the liquidity of entities deeply.

- 1. Current Ratio:** $\text{Current Assets} / \text{Current Liabilities}$
- 2. Quick or Acid-Test Ratio :** $(\text{Current Assets} - \text{Inventories}) / \text{Current Liabilities}$
- 3. Cash Flow Liquidity Ratio:** $(\text{Cash} + \text{Marketable Securities}) / \text{Current Liabilities}$
- 4. Days Sales in Receivables:** $\text{Amounts Receivable} / (\text{Credit Sales} / 360)$
(Collection Period)
- 5. Inventory Turnover:** $\text{Cost of Goods Sold} / \text{Average Inventory During Period}$

1.6.3.4.2. Solvency Ratios

Solvency ratios are used to understand the long-term debt payment power of entities. Long term debt is generally a cheaper source than equity to finance capital investments for this reason entities aims to get long-term credit from financial markets. However, they should use this source in an efficient way to repay the debt. Long term debt should be used to increase the productivity of the entity instead of to pay current expenditures.

Solvency ratios are generally used by the long-term creditors to understand the interest and principal repayment of the entity.

The most common solvency ratios are those shown below;

1. **Net Worth to Total Debt:** Net Worth / Total Debt
2. **Net Worth to Long-term Debt:** Net Worth / Long-Term Debt
3. **Net Worth to Fixed Assets:** Net Worth / Fixed Assets
4. **Times Interest Earned:** Income Before Interest and Taxes / Interest Expense

1.6.3.4.3. Operations Ratios

Operations ratios are used to understand the success of the management of the entity. They give information on the efficiency of the activities of the entity. They are used to understand whether the assets, capital of the entity are used in an efficient way. Operation ratios are used by management, long-term creditors and share holders. The most widely used operation ratios are those shown below;

1. **Sales to Accounts Receivables:** Sales / Accounts Receivables
2. **Inventory Turnover:** Cost of Goods Sold / Average Inventory During Period
3. **Sales to Inventories:** Sales / Inventories
4. **Sales to Working Capital:** Sales / Working Capital
5. **Sales to Assets:** Sales / Assets
6. **Sales to Fixed Assets:** Sales / Fixed Assets

1.6.3.4.4. Profitability Ratios

Main objective of entities is to maximize their profit. For this reason profitability ratios are very important to evaluate the success of entities. If the entity can not get profit as result of its operations and as result of their use of assets put under its control it may be more rational to stop operations of the entity and to use the capital in a different investment. Profitability ratios are very important for management and stock holders. Because, profitability is the main indicator of the success of the management and it is the main objective of the stock holders, which is the return of their investment. Moreover, profitability ratios are important for the long-term creditors because a company that can not get profit from its operations can not pay its long-term debts.

The most widely used profitability ratios are those shown below;

1. **Gross Margin Ratio:** Gross Profit / Sales

2. **Operating Profit to Sales:** Operating Profit / Sales
3. **Pretax Income to Sales:** Pretax Income / Sales
4. **Net Income to Sales:** Net Income / Sales
5. **Net Profit to Equity:** Net Profit / Equity
6. **Net Profit to Assets:** Net Profit / Assets

1.6.3.4.5 Du Pont Method

Du Pont analysis is the method that uses three ratios to evaluate the financial condition of a company. These ratios were first used by du Pont Company in the analysis of financial statements. It includes profit ratio, and turnovers and it examines the relationship between these ratios. Three ratios used in the du Pont analysis are assets to equity ratio, profit margin ratio (profits/sales) and capital turnover ratio (sales / total assets). As claimed by Horrigan, “This system held promise for providing a framework wherein ratios could be developed in a logical fashion”.⁵² And it could be possible to evaluate the efficiency and profitability of an entity via these three ratios, du Pont System.

$$\frac{\text{Total Assets}}{\text{Equity}} \quad \times \quad \frac{\text{Profit}}{\text{Sales}} \quad \times \quad \frac{\text{Sales}}{\text{Total Assets}} \quad = \quad \frac{\text{Profit}}{\text{Equity}}$$

1.6.4. Financial Statement Analysis for Government Agencies

Financial statement analysis tools and techniques are being used for more than a century in the private sector to understand the financial condition of companies. In first applications techniques were very simple and they were far away from providing detailed information about the companies but in time many sophisticated techniques have been developed and today it can be mostly possible to predict future of companies in private sector. However, financial statement analysis is a very new concept for public sector. This is mainly because of basic differences between private and public sector entities. Initially, public sector entities do not have profit maximization objective. For public sector entities the main objective is to provide most efficient, economic and effective service to society. Even, commercial based public entities have an objective more than just maximizing profit. For this reason, it was not easy to establish analysis techniques those can be used to evaluate the success of public entities via transferring

⁵² James O. Horrigan, p. 286

techniques directly from private sector applications. It was a complex issue and it was changing according to the nature of the public entity. In the private sector the main objective of all companies is profit maximization but in the public sector entities have different objectives, essence of which is public benefit. For this reason, it is necessary to apply different ratios and techniques for each public entity. Secondly, there was not a conscious demand concerning to evaluate the financial condition of public entities. Citizens were not interested in the financial condition of government entities and managers also were not enthusiastic about developing techniques those could be used to evaluate their success in an objective and scientific manner. Thirdly, financial statements of cash basis accounting were not providing comprehensive data for analysis. Cash basis accounting was the main accounting system used for public sector and this prevented development of financial statement analysis methods.

However, there emerged some problems concerning the financial conditions of public entities. Public debts increased in time and debt repayment and interest payments have become the most important part of budgets even in most developed countries. This development diminished the quality of services in time, and public demanded for more rational management of public entities. The demand for more information to prevent financial problems caused the accrual basis accounting system become widespread. And, comprehensive and fair data of financial statements of accrual basis accounting gave opportunity of analysis. Moreover, there emerged financial failures of local governments in countries like U.S.A. Some municipalities failed financially and it became a necessity to foresee future economic condition of these municipalities. Especially, in U.S.A, where municipalities were financing their services via funds from financial markets as result of existence of risk of not having the re-payment in due time and possibility of failure of the municipalities, financial statement analysis applications started to be used. Moreover, as result of the evolution in the understanding of democracy, citizens demanded for more accountable and transparent public sector. Society attached more importance to their resources and interested in scrutinizing their usage via many different ways, as non-governmental organizations. This conscious is another reason for the development of more comprehensive financial system and more examinable financial statements.

Today, there are some improvements in the financial statement analysis techniques for public sector. Some studies and analysis techniques were developed for local government financial condition analysis by International City Management Association (ICMA), by Brown (W. Kenneth Brown, 1993, The Ten Point Test of Financial Condition: Towards an Easy Assessment Tool for Smaller Cities, Government Finance Review 9(6): 21-26) and by some private sector companies, as Moody's. Moreover, organizations as Canadian Institute of Chartered Accountants prepared some reports (Indicators of Government Financial Condition, CICA) concerning indicators of financial condition of government entities, in which sustainability, flexibility and vulnerability of public entities are accepted as means of analysis and it was attempted to examine these characteristics of government entities. Some studies recommended analysis methods to predict solvency of public entities. Especially, financial statement analysis methods for local governments have improved today. This is mainly because of greatness of shares of local governments in public sector in developed countries. Secondly, there are many local governments and it can be possible to test the success of analysis systems for local governments. Despite cities have different economic and social characteristics; it can be possible to group cities according to their main characteristics. While some could be categorized as small and depending on agricultural economic activity, some could be categorized as big and depending on trade or service sector. By these categorization studies, it can be possible to determine optimum ratios and values for groups of cities for healthy economic condition. Moreover, for other public entities it can also be possible to determine ideal values and financial conditions by examining long term trends and effectiveness and success of these entities.

All these studies improved the analysis techniques for government entities and in the long run via more studies undertaken and via having opportunity of examining longer term data more trustworthy analysis techniques would be developed for public sector as in the case of private sector.

2. RECENT REGULATIONS IN TURKEY TO IMPROVE ACCOUNTABILITY, TRANSPARENCY AND EFFICIENCY ON FINANCIAL MANAGEMENT

2.1. RECENT FINANCIAL REGULATIONS TO IMPROVE ACCOUNTABILITY, TRANSPARENCY AND EFFICIENCY IN TURKEY

Turkey has experienced many financial crises in last two decades and economy had to cope with strong recessions. The last economic crisis was in 2001 and it was the deepest crisis in history of Turkish Republic. The main reasons of these crises were accepted as mal-administration. Actually mal-administration was because of unsuccessful public financial management. There were many problems and criticisms concerning the financial management and control system.

Initially, The Code (1050-Muhasebe-i Umumiye – General Accounting Code) regulating the public sector financial condition was a very old code and it was insufficient in terms of fulfilling the necessities of dynamic public sector.

The scope of financial management and budget was not comprehensive; there were many administrations out of the budget as funds and working capital administrations. These administrations used to have various codes and it was not possible to coordinate public revenues and expenditures in this environment. This situation also brought to an increase in the amount of public resources out of budget.

The relation between development plans and budget was deteriorated. This caused the lack of planning in public administration.

Another problem was that the public resources were not used in an economic, efficient and effective way. This was because of lack of accountability of administrators in an objective manner. There was a strict pre-expenditure control which was creating red-tape and preventing the public entities to act in time. There was an unbalance in the authority-responsibility relation. Those had authority in administrations did not have same responsibility and this was causing lack of accountability and waste of resources. The administrators of public entities did not have much to say concerning their entity's budget. This was another problem which was preventing rational use of resources.

The audit scope of Turkish Court of Accounts (Supreme Audit Institution of Turkey) was tight and there were many public entities out of any independent and external audit.

The coding system of budget was insufficient, therefore it was not possible to produce

reports those could be used in planning and decision making. The accounting system used was modified cash basis system, and it was not providing any information concerning the assets and liabilities of the public entities, so public sector. Many modern applications used in developed countries in public financial management were not available in the system. These can be numerated as strategic planning, budgeting for more than one year, effective internal control and internal audit. Lastly, it is necessary to mention that there was no infrastructure in IT management of financial sector; it was not possible to consolidate public revenues and expenditures in time.

Because of these problems in the public sector financial management, resources of the country could not be managed in a rational and efficient way and crises occurred. Society demanded for more rational financial management, moreover the international relations with organizations as IMF, EU and World Bank also necessitated a reform in the financial management system. As result of these developments Turkish public financial management has experienced a reform after 2001 which is still continuing.

The main developments in financial management system are Code 5018-Public Financial Management and Control Code, Court of Accounts Code (Draft), Regulations concerning the application of Analytical Budget, Regulations concerning the Accrual Based Accounting applications.

2.1.1. Public Financial Management and Control Code (5018)

Public Financial Management and Control (Code-5018), can be accepted as the constitution of public financial management and control system. The Code has determined the main framework of financial system and gave many responsibilities to various public administrations which necessitated lots of regulations.

Code 5018 has re-regulated lots of issues those were regulated in the previous code, Code 1050, and at the same time it has adapted some new concepts, regulations and applications to the financial system.

Initially, the scope of the budget has changed and expanded. There were General Budget and Supplementary Budget in the previous system. Moreover, there was the budget of local administrations. By the Code 5018, these budgets are eliminated and Central Administration Budget established. This Budget includes expenditures and revenues of general budget administrations, special budget administrations and

Regulatory and Supervisory Agencies. Those administrations in the Central Administration Budget abide to same financial management and control system. An important progress in the new system is that all revenues and expenditures of the administrations will be managed within the budget which improves accountability and transparency.

In addition to Central Administration Budget there are Social Security Institutions and Local Government Budgets in the new system.

One of the main objectives of the Code 5018 is enhancing accountability and transparency. This was accepted as the main reason of maladministration in previous years and for this reason during the negotiations on the issue EU asked for more accountable and transparent administration in public sector. Responsibilities and authority of staff have been determined in a detailed way and responsibilities have been expanded and superior managers became responsible of their actions. State entities have become obliged to prepare strategic plans, three year budgets and annual reports via which it became possible to criticize managers in terms of their success of accomplishing anticipated goals. Budgets' including of all revenues and expenditures of entities is another progress that improved the transparency. A more comprehensive accounting system is another progress of the Code to improve accountability and transparency.

Code 5018 aimed a system in which resources are used in an efficient, economic and effective way. Budgets are supposed to be prepared and capital expenditures are supposed to be incurred according to Cost-Benefit and cost effectiveness analysis. Resources are supposed to be used according to strategic plans and for significant necessities initially. Code aims to establish the relation between development plans and budgets of entities again and to improve rational use of resources.

Code 5018 determined the framework of the new accounting system in the public sector. According to the Code all transactions will be recorded in the accounting system, the accounting system will be in line with international generally accepted accounting principals, and international accounting standards, the reporting of the accounting system will be sufficient to provide good tools for decision making. The accounting staff will be certified and will have professional knowledge.

Another new issue in the Code 5018 is the preparation of financial statistics. Financial statistics will be prepared monthly or quarterly and will be reported according to the Code. These financial statistics will be controlled and evaluated by Turkish Court of Accounts which will guarantee the quality of statistics.

Internal control is another issue which has been regulated in the Code 5018 in a detailed way. Internal control is the control of the management on operations of the entity. Via an improved internal control it is aimed to increase the quality of operations, to prevent waste of resources, to guarantee the operations of administrations be in line with laws and regulations.

Internal audit is also regulated in the Code 5018. According to Arcagök, “Internal audit is an objective, independent assurance system that has been developed to improve the value of operations of entities”.⁵³ Internal audit also provide counseling service for the management to improve the quality of the operations. Internal auditors are predicting risks that entity is face to and try to minimize these risks. Moreover, they control the completeness, accuracy and trustworthy of data and reports of the entity. Internal auditors perform regulatory audit, performance audit, financial audit, IT technology audit and system audit. Moreover, they prepare reports for external auditors and they assist external auditors. Because of having so important tasks internal auditors are regulated in an independent environment without effect of managers of entities, and their appointment are supposed to be done by Ministers. The quality of internal auditors is also assured via certificates as in the case of accountants.

External audit is another issue regulated in the Code 5018. Actually external audit was performed by Turkish Court of Accounts (TCA) for long time but Code has gave more tasks to TCA and it regulated modern external audit applications for TCA. The scope of external audit has been expanded. Many administrations, as social security institutions, regulatory and supervisory agencies, those were not subject to external audit before are taken into the scope of the audit of TCA by Code-5018. By performance, financial and regulatory audits and by reporting results of these audits to Parliament transparency and accountability are improved.

47 M. Sait Arcagök, Yeni Kamu Mali Yönetim ve Kontrol Sistemi Adlı Seminer Notları,p. 62

2.1.2. Court of Accounts Code (Draft)

As in the other parts of the public financial management and control, there were some problems concerning the external auditing in Turkey. Problems in the external audit were described by the Expertise Commission which has defined problems in public financial system during the preparation of 8th Five Year Development Plan. According to the report of the Expertise Commission, the external audit was not effective because of obsolete operating of public financial system. The audit profession was not developed sufficiently, there were many entities out of the scope of the audit, modern audit practices have not been used, audit techniques and methods have not been used in a systematic manner, IT technology opportunities have not been used in audit practices, there were not sufficient trainee for auditors and there were not sufficient cooperation between auditors.⁵⁴

In line with the regulations in the public financial management and control system via Code 5018, a draft code of Turkish Court of Account was prepared to complete the audit phase of the reform and currently it is waiting in the Parliament to be enacted. Actually, the TCA Code was supposed to be accepted in the Parliament a few years ago. The draft has been prepared according to the framework determined in the Code 5018. According the Code 5018, the objective and tasks of external audit is to audit expenditures of public administrations in terms of compliance with regulations and effective, efficient and economic usage of resources. Moreover, to realize the transparency and accountability TCA supposed to report to Parliament on many issues. According to the Code 5018, external audit should be conducted in line with international audit standards in a modern manner. Code 5018 gave TCA three main audit tasks which are compliance of operations with regulations, financial audit in which auditee is evaluated in terms of recording of transactions and trustworthy of financial reports, and performance audit that is used to evaluate efficient, economic and economical usage of resources. In the current TCA Code, the main task of TCA is to do compliance audit. Performance audit is also task of TCA after a change in the TCA

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- ⁵⁴ From: Sayıştay Denetçileri Bayram Barun, Mustafa Ekinci, and Özlem Temizel, Kamu Mali Yönetiminin Etkinliğinin Sağlanmasında Dış Denetimin Rolü, p. 24, “Mali Yapılanma Sürecinde Stratejik Yönetim ve Sosyal Güvenlik Sisteminin Kamu Maliyesine Etkileri” konulu 22. Maliye Sempozyumu, 09-13 Mayıs 2007, Antalya-Belek

Code in 1994 but it is not sufficiently significant and widespread in the operations of the TCA at the moment. The Draft Code attaches same importance to both compliance audit and performance audit. Moreover, financial audit is a new task for TCA in the Draft which is prepared in compliance with Code-5018.

As mentioned before the external audit should be done in line with international audit standards. International audit standards for state audit are those prepared by INTOSAI (International Organization of Supreme Audit Institutions). The principles of INTOSAI Audit Standards were determined in Lima Declaration during the IX. Congress of INTOSAI. In Europe, there are no independent audit standards available but European Union has prepared an INTOSAI Audit Standards Europe Application Guide to be used during audit profession. All these international documents have been used in the preparation of TCA Draft Code and the aim of conducting audit practice in line with international audit standards is going to be realized. Moreover, to accomplish tasks given to it by Code-5018 and will be given after the enactment of new TCA Code, TCA has carried out a project with National Audit Office of U.K. and prepared financial audit, performance audit and IT audit guides to extend the audit practice which is in compliance with international audit standards.

The scope of audit of TCA has been extended in the Draft Code in line with Code 5018 and in line with necessities of international audit standards. Those administrations numerated in Code 5018, some special administrations, state economic enterprises, those organizations affiliated to public administrations, public funds, international organizations which should be audited according to international agreements are under the audit scope of TCA in the Draft Code. Via this, it is certain that accountability and transparency in the public sector will be enhanced.

In the current Code (Code 832) TCA supposed to do reporting to Parliament only on compliance of final results of accounts to budget appropriations. However, according to the Draft Code, TCA will have many reporting tasks which will improve the accountability and transparency. Reports those will be submitted to the Parliament regularly by TCA are, External Audit General Evaluation Report, Operations General Evaluation Report, Financial Statistics Evaluation Report, State Economic Enterprises Annual Evaluation Report, Statement of General Compliance, and other reports.

External Audit General Evaluation Report will be a report on the results of financial and performance audits practiced on public entities. Result of audits of public entities will be consolidated and submitted to Parliament.

Operation General Evaluation Report is planned to be on the annual operation reports of public administrations, annual operation report of local administrations that is prepared by Ministry of Interior Affairs, and general annual operation report that is prepared by Ministry of Finance. External Audit General Evaluation Report will evaluate these annual reports and it will be submitted to Parliament.

Financial Statistics Evaluation Report will be a report in which trustworthy of financial statistics announced by Ministry of Finance is evaluated.

State Economic Enterprises Annual Evaluation Report will be a report in which these entities are evaluated.

Moreover, performance audit reports which are currently submitted to Parliament actually will be prepared and submitted to Parliament, concerning the issues on which they are conducted, more often.

After enactment of the Draft Code of TCA, most of the public entities and resources will be audited in different aspects and results of these audit practices will be reported to Parliament and will be publicized. It is doubtless that these improvements will also improve accountability and transparency and will lead to efficient, effective and economic usage of resources.

2.1.3. Regulations Concerning Analytical Budget Application

There were many problems in the previous budget system; program based budget system and analytical budget applications have put in force to solve these problems. What were the criticisms concerning the previous budget system? Initially, the budget was not including many revenues and expenditures. The budget preparation and application periods were not done in a rational manner. The realized budget results were extremely different from the amounts anticipated in the budget law. The budget system was not sufficient to analyze and make decisions in an efficient way. There were no connection between accounting system and budget coding system. A good IT system for budget was not available, and this was preventing the administrators to evaluate the results of budget applications in time and in a comprehensive manner.

To end these problems the scope of budget has been extended to include almost all revenues and expenditures and analytical budget system has started to be used in budget system. The coding system of analytical budget has been established in line with international coding systems and in compliance with accrual based accounting system. “The coding system of budget has been prepared to record the financial statistics of state in a more systematic, coherent, analyzable and measurable way”.⁵⁵

Analytical budget system gives opportunity of determination of responsible staff via detailed institutional coding. It provides functional coding which was not available in the program based budget system. Its coding system can be applied in all government agencies so it can be possible to compare budgets of different agencies and different periods. Moreover, because of being prepared in line with international coding systems analytical budget gives the opportunity of applying international comparisons. It is possible to measure and analyze the results of budget applications.

Analytical budget system improves the accountability and transparency via its enumerated characteristics.

There are four type of classification in the analytical budget system. First one is institutional classification. There are four code levels in the institutional classification system and it is used to record the budget realizations according to political and administrative agencies. It is helpful to measure the performance, budget applications of responsible staff.

Second classification is functional classification. Functional classification is used to record the type of the government activities. It is used to measure and analyze budget applications according to state activities. The amount that has been spent for type of services can be measured and the trend of these amounts can be analyzed via functional classification.

Third classification is finance type classification. Finance classification is used to see the source of the expenditure, from which budget does it financed.

The last classification is economic classification. Economic classification is used to evaluate the results of budget applications on economy, income distribution and market

⁵⁵ Gülden Güzel, Kasım 2006, seminer notları, p. 54

and to plan these effects. Classifications according to analytical budget application are presented in Table-24 below.

Table-24

CLASSIFICATION ACCORDING to ANALYTICAL BUDGET SYSTEM

| Institutional | | | | Functional | | | | Financial | Economic | | EXPLANATION | AMOUNT | |
|---------------|----|-----|----|------------|----|-----|----|-----------|----------|----|------------------------|--------|--------|
| I | II | III | IV | I | II | III | IV | I | I | II | | Debt | Credit |
| 97 | | | | | | | | | | | UNIVERSITY | | |
| | 53 | | | | | | | | | | OSMANGAZI U. | | |
| | | 02 | | | | | | | | | GENERAL SECRETARIA | | |
| | | | 24 | | | | | | | | LAW COUNSELING | | |
| | | | | 01 | | | | | | | GENERAL PUBLIC SERVICE | | |
| | | | | | 3 | | | | | | GENERAL SERVICE | | |
| | | | | | | 9 | | | | | OTHER GENERAL SERVICE | | |
| | | | | | | | 00 | | | | | | |
| | | | | | | | | 2 | | | SUPPLEMENTARY BUDGET | | |
| | | | | | | | | | 01 | | STAFF EXPENDITURES | | |
| | | | | | | | | | | 2 | CONTRACTED STAFF | | |

Source: Fikret Çöker, Tahakkuk Esaslı Devlet Muhasebesi, Sayıştay Denetçi Yardımcılarına Verilen Kurs Notu, Nisan 2005, p. 18

2.1.4. Regulations Concerning Accrual Basis Accounting

As other components of public financial management there occurred a recent reform in the accounting system used in the public sector. Initially there were different accounting systems in different state agencies and this was preventing consolidation and comparison. The most commonly used accounting system was modified cash basis system. The system was mainly related to budget and it was not including assets, liabilities and commitments of the entities. Moreover, because of not recording many transactions, and in time it was not possible to report in a healthy manner.

This problem aimed to be solved via application of accrual based accounting system. In Code 5018, the characteristics of accounting system determined, and it was describing accrual based accounting system in article 50. Moreover, in the Code it was put in order that the budget realizations should be recorded also. For this reason, in the new accounting system two different records are kept, one is in accrual basis for accounting reporting and one is for cash basis for budget reporting. Furthermore, state agencies in

the scope of the Code 5018 are regulated to use the same accounting system which solved the problem of different accounting systems.

To see the results of the new system some pilot studies have been realized in some government agencies. The results of pilot studies were thought satisfactory. The events have been recorded in accrual basis, when they occurred, all the activities of entities were recorded by the accounting system, tangible assets have been recorded, and detailed and classified data have been produced. The accounting system also provided data as liabilities for future periods those can be used for cash planning and budget preparation.⁵⁶

After the success of the pilot applications, the accrual basis accounting system has been started to be used in general budget administrations in 2004, after Code 5018's coming in force another accounting regulation has been put in order for the periods after 01.01.2006. Furthermore, the Accounting Regulation for Local Administrations has been put in order for the period started on 01.01.2006 and The Accounting Regulation for Working Capital Administrations has been put in order for the period started on 01.01.2007.

Consequently, by many new regulations in public financial management and control system in line with the principles determined in Code 5018 it is aimed to create more democratic, transparent and accountable public administration, and efficient and economic use of resources.

2.1.5. Law on the Right to Information

Law on the Right to Information is another regulation enacted in Turkey to improve the accountability and transparency. Right to know, freedom of information is seen as part of human rights and freedoms in the world and they take place in many international regulations and agreements as United Nations Universal Declaration of Human Rights and European Convention on Human Rights. Citizens should reach at information about the activities of state agencies, about activities related to them, about use of public resources to decide on the success of the state agencies and to scrutinize these agencies.

• ⁵⁶ From: Tahakkuk Esaslı Devlet Muhasebesi Pilot Uygulama Sonuçları, T.C. Maliye Bakanlığı Muhasebat Genel Müdürlüğü, Mayıs 2003, p. 16-22

Actually, since 01 November 1984 there is a law in force in Turkey which is called “Law on the Right of Petition” which was providing the citizens and foreigners the right to apply Turkish National Assembly and state agencies but this law was not a comprehensive law and it was not providing a good mechanism for the applicants. State agencies were not paying necessary attention to the commands of this law and most of the petitions were not responded. The “Law on the Right to Information” has been enacted in 24 April 2004 to improve the information rights of citizens and to improve the accountability and transparency in the country.

As stated in the first article of the “Law on the Right to Information”, “the objective of the law is to regulate the procedure and the basis of the right to information according to the principles of equality, impartiality and openness that are the necessities of a democratic and transparent government”.⁵⁷ In the second article the scope of the law, which is very comprehensive, is regulated. According to this article it is possible to apply public institutions and the professional organizations which qualify as public institutions. The scope has been clarified by the regulation on the Law and Central Administration agencies and those are affiliated and connected to these agencies, local administrations except village administrations, and those are affiliated and connected to these local administrations and their associations and firms, Turkish Central Bank, İstanbul Exchange Market, universities and all institutes, enterprises, funds and other organizations those have public legal personality have been taken into the scope of the law.

The law states that “everyone has the right to information”.⁵⁸ Moreover, foreigners domiciled in Turkey and foreign legal entities operating in Turkey can exercise the right on the condition that the information is related to them or the field of their activities and on the basis of the principle of reciprocity. Those institutions in the scope of the law are determined obliged to provide information to applicants with the exceptions set out in the law. The law regulates the application process in a detailed way. The application regulated in easy way, it is possible to apply even by e-mail. Moreover, Board of Review has been established in the law and applicants are given opportunity of appealing the Board.

⁵⁷ Turkish Law on the Right to Information, Law No:4982, Article 1

⁵⁸ Turkish Law on the Right to Information, Law No:4982, Article 4

Some restrictions are set in the law related to the information and documents pertaining the state secrets, economical interests of the State, state intelligence, administrative investigation, judicial investigation and prosecution, privacy of the individuals, privacy of communication, trade secrets, intellectual property, institutions' internal relations, institutions' internal opinions, information notes and recommendations.

Sanctions are also determined in the law for the officials those do not follow the application of the law. According to the law, beside general provisions of criminal law they "shall be subject to disciplinary sanctions as provided in the relevant regulations of personnel regime".⁵⁹

The Regulation related to the Law has been enacted in 27.04.2004 and details and essences of the law and application mechanism have been determined.

Because of providing the citizens the right of accessing information about the state activities the law has improved the openness, accountability and transparency for the state.

3. A STUDY ON CITY MUNICIPALITIES OF TURKEY: RELATIONSHIP BETWEEN SOCIOECONOMIC LEVEL AND FINANCIAL CONDITION

3.1. NEED FOR THE STUDY

As it was studied in second part of the thesis, in last decade many new Codes and Regulations have been enacted in Turkey on public financial management and control system. The main code enacted in the area is Code-5018 which has reorganized the philosophy of the financial management and control system of public sector. It has re-established the old system which was continuing without any significant change since 1927. Code-5018 determined the framework of the system and other complementary laws and regulations were enacted to apply the system. The main philosophy of the new system is accountable and transparent financial management and a rational, strong, modern and effective control over administrations. Many new concepts took place in Code 5018 in line with this general objective. The institutions of old financial management and control system have been improved and modernized. Moreover, some new institutions have been established which were not available in the previous system.

⁵⁹ Turkish Law on the Right to Information, Law No: 4982, Article 29

However, what was the reason of these comprehensive changes, which can easily be named as “reform”. There are two main reasons, the first one was the results of the mal-administration and lack of accountability and transparency, which are crises and continuously increasing budget deficits and domestic and foreign debts. The second reason was the necessities of the relations with and commitments to international and supranational organizations, as EU, IMF and World Bank. Turkey had huge amount of debt to World Bank and IMF and these organizations demanded more effective, economic and efficient administration which could be realized via accountable and transparent financial administration and developed information systems, as budget coding and accounting systems. EU was also demanding for a transparent and accountable administration because this characteristic of public administration was accepted in this community as one of the main components of democracy and they could not accept a country to EU with an archaic public financial management and control system.

The reform has been realized mostly and other regulations necessary to complete the reform are planned to be enacted soon. However, what about the application? It is certain that laws and regulations are mandatory for the improvement of the societies. But, does not a background necessary for a good application process?

Since the “Administrative Reforms” which was declared in 1839, in history of Turkish administration and democracy almost all the laws and regulations which causes reforms and improves the rights of society have been realized by the politicians without strong and conscious demand of the society. Mainly for this reason, generally there emerge some problems in application phase of the regulations. The ideas and views of public servants does not change easily and as fast as regulations, for this reason the application can not be successful as anticipated and aimed in the regulations. Citizens do not be aware of their rights and they are not knowledge equipped to seek for their rights and scrutinize the activities of administration. I have witnessed one of these problems when I was preparing an assignment for the “Local Governments” class at university. I with other team members have prepared an assignment concerning the environmental problems in Turkey. During our study we have witnessed that the protection of environment was one of the main tasks of State according to Constitution of Turkish Republic. 56th Article of Constitution is as follows;

“Everyone has the right to live in a healthy and balanced environment. It is the State’s and citizens’ duty to improve environment, protect environment health and prevent environmental pollution”. The Environmental Code No: 2872 was enacted in 1983 and many by-laws and regulations to prevent air pollution, to eliminate solid and hazardous wastes, to refine water wastes were enacted. The system was concrete and it was seen as if there were no problems available concerning the environment protection and waste management. However, we were all aware that it was not working well in Turkey and pollution was an important problem especially in industrialized cities of the country. I come up against the same issue during the “International Symposium on Environmental Audit” which was held on May 2007 during the 145th Anniversary Celebrations of Turkish Court of Accounts. One of the participants of the Symposium Prof. Ülkü Yetiş, from Middle East Technical University, presented the situation in Turkey concerning Control of Hazardous Wastes.⁶⁰ According to Prof. Yetiş, the hazardous wastes produced is 2.6 million tons in Turkey annually and only small amount of these wastes are recycled and disposed in a convenient way. Despite there were necessary legal structure application was far from being sufficient.

Why do we have this kind of problems in application phase? It may be because of the previously mentioned problem of Turkish democracy and administration. We follow the trends in the world; we enact laws and regulations which were successfully applied in developed countries with five or ten years lag generally, but the application generally can not be successful in Turkey as in the origin countries. We prefer to enact the modern and democratic regulations of developed counties instead of providing the social and economical conditions necessary for the healthy application of these laws and regulations. For example, as mentioned above almost all regulations are available concerning the environment protection and waste management but if the managers of local and central governments, citizens and managers of factories does not be aware of the importance of the protection of the environment these can not be applied in successful manner. If media and education system does not emphasize the significance of environment to society, citizens ignore the applications and administrations do not be so enthusiastic about realizing their tasks determined by regulations.

⁶⁰ Prof. Ülkü Yetiş, Hazardous Waste Management in Turkey, Paper Presented in “International Symposium on Environmental Audit”, May 2007, Ankara

3.2. OBJECTIVE OF THE STUDY

This problem which is common in Turkish administration is also valid for the new regulations on public financial management and control system. There may be problems in the application phase, the accountability and transparency, so efficient, effective and economic use of public sources may not be realized. The administrators of the organizations may not give the rights of the citizens and they may ignore some tasks regulated in laws and regulations. For example, administrators are generally reluctant concerning giving information about their activities despite being regulated in Right to Information Act. Many citizens should be obliged to sue to get the information or data they demand to acquire. So, from my point of view, it is a must to provide the socioeconomic conditions for the successful application of accountable and transparent administration, via which efficient, effective and economic use of resources will be realized and the financial condition of institutions will be improved.

It may be accepted that those are more educated, are richer, those have better life standards and more developed cultural activities know and seek for their rights better than others. For this reason, it should be supposed that accountability and transparency are more improved in socio-economically developed regions of Turkey. As result of this, the administrations are more efficient, effective and economic in socio-economically developed parts of the country so, the financial conditions of administrations are better and healthier. In this study, it is aimed to examine the relationship between the socio-economic development levels of regions and the financial conditions of the administrations in those regions.

The objective of the study is that to empirically exhibit the relation between socioeconomic development level of country and good administration, rational use of public sources. It is believed if this relation will be a critical to the politicians' preferences which is hoped to affect their preferences at the same time. They may give more importance to socio-economic conditions for application of laws and regulations, instead of believing that enacting the laws is the only solution of problems. Moreover, it is believed that results will give an idea about the financial condition of municipalities and an opportunity to analyze current financial situation of municipalities.

3.3 RESEARCH QUESTION

The city municipalities have been chosen as the subject of the study. The main reason of this preference is the closeness between citizens and local governments which was mentioned before in the thesis. Local governments are closer to citizens; their activities are under more direct scrutiny of the citizens. They had to be transparent and accountable towards citizens and non-governmental organizations, as Commerce Chambers, Craftsmen's Associations, district representatives and unions, even before the regulations concerning accountability and transparency were enacted. Because, these power groups search for their benefits and the local governments are not so strong to abstain from their demands. If they do not respond their demands they may easily lose public support and they may face risk of not being re-elected. For this reason, the relation between the cities' socioeconomic development level and quality of their administration, so financial condition was significant before the new regulations despite the tools for transparency and accountability were not complete. Now, as result of new regulations we have more tools to measure success and financial health of cities and one of these tools, which are the financial statements provided by accrual basis accounting, will be used in this study to examine the relationship between socio-economical development level and financial condition of cities.

Consequently, the null hypothesis is stated as;

H₀: There is no significant relationship between socio-economic development indicators of cities and financial condition of local governments (municipalities) of these cities?,

And,

H₁: There is a significant relationship between socio-economic development indicators of cities and financial condition of local governments (municipalities) of these cities?

3.4 RESEARCH DESIGN

In this research study, multiple regression analysis is going to be used, in which indicators of socio-economic development are independent variables and financial condition ratios of city municipalities are dependent variables.

DESCRIPTION OF VARIABLES:

Independent Variables:

Socio economic development has many aspects and it is determined by many factors. These factors can be numerated as health service condition, industrial development, agriculture, trade, literacy, accommodation infrastructure, high education level, employment, population, income level, and geographical situation. Actually, there are many indicators those can be used to represent socio-economic development factors but most representative ones and easily acquirable indicators are used in the study as independent variables. Many of the indicators for social and economic condition for cities are not available in the Turkish Statistics Institution and those are available in this institution's web page and Yearbook has been preferred. For this reason, the population for one doctor in the city has been chosen as the indicator of health service condition, the number of industry companies is used for industrial development factor, usable agricultural area is used for agriculture, monetary value of export is used for trade, percentage of literate people is used for literacy level, the increase of habitation is used for accommodation infrastructure factor, percentage of high educated people is used for high education level factor, unemployment rate is used for employment factor, population density and increase rate of population are used for population factor, gross income per person is used for income factor, and to be in the seaside is used for geographical situation factor. The indicators have been provided from web page of Turkey Statistics Institution and Turkey's Statistical Yearbook 2005.

Therefore, socio-economic development factors and the indicators used to represent these factors can be presented in the Table-25 as,

Table – 25

SOCIOECONOMIC DEVELOPMENT FACTORS and INDICATORS

| SOCIOECONOMIC DEVELOPMENT FACTOR | INDICATOR USED |
|---|-------------------------|
| HEALTH SERVICE CONDITON | POPULATION PER A DOCTOR |
| INDUSTRIAL DEVELOPMENT | # OF INDUSTRY COMPANIES |

| | |
|--------------------------------|---|
| AGRICULTURE | USABLE AGRICULTURE AREA |
| TRADE | MONETARY VALUE OF EXPORT |
| LITERACY LEVEL | RATE OF LITERATE PEOPLE |
| ACCOMODATION INFRASTRUCTURE | INCREASE RATE OF HABITATION |
| HIGH EDUCATION LEVEL | RATE OF HIGH EDUCATED PEOPLE |
| EMPLOYMENT CONDITION | UNEMPLYMENT RATE |
| POPULATION | POPULATION DENSITY AND INCREASE RATE OF POPULATION |
| INCOME LEVEL | INCOME PER CAPITA |
| GEOGRAPHICAL SITUATION | TO BE IN THE SEASIDE |

The independent variables for cities are shown in Table-26 below.

Table – 26
INDEPENDENT VARIABLES FOR CITIES

| CITIES | POP. FOR A DOCTOR | # OF INDUSTRY COMPANIES | USABLE AGRIC. AREA | VALUE OF EXPORT (MILLION \$) | RATE OF LITERATED | INCREASE RATE OF INHABITATION | RATE OF HIGH EDUCATED | UNEMPLOYMENT RATE | POP. GROWTH RATE | POP. DENSITY | INCOME PER CAPITA | TO BE IN THE SEASIDE |
|-----------|-------------------|-------------------------|--------------------|------------------------------|-------------------|-------------------------------|-----------------------|-------------------|------------------|--------------|-------------------|----------------------|
| ADANA | 664 | 48661 | 596,002 | 472 | 86.88 | 134.4 | 4.16 | 14.25 | 17.71 | 133 | 2339 | 1 |
| ADIYAMAN | 1,587 | 9691 | 285,330 | 0 | 79.83 | 148.9 | 2.73 | 11.11 | 19.98 | 73 | 918 | 0 |
| AFYON | 1,139 | 14909 | 580,697 | 8 | 88.26 | 89.3 | 3.43 | 4.98 | 9.47 | 57 | 1263 | 0 |
| AMASYA | 1,071 | 8945 | 229,379 | 0 | 87.39 | 77.4 | 3.66 | 4.86 | 1.65 | 64 | 1439 | 0 |
| ANKARA | 239 | 130013 | 1,263,481 | 1212 | 93.26 | 80.3 | 10.07 | 10.95 | 21.37 | 163 | 2752 | 0 |
| ARTVIN | 1,129 | 5572 | 32,662 | 49 | 86.80 | 81.7 | 3.91 | 7.04 | -10.33 | 26 | 2137 | 1 |
| BOLU | 615 | 7262 | 131,668 | 0 | 89.63 | 86.5 | 4.32 | 4.53 | 2.9 | 33 | 4216 | 0 |
| BURDUR | 958 | 7231 | 162,157 | 0 | 89.67 | 64.4 | 4.25 | 4.69 | 0.74 | 38 | 1951 | 0 |
| ÇORUM | 1,301 | 15772 | 602,768 | 31 | 83.11 | 115.2 | 2.74 | 5.43 | -1.92 | 47 | 1654 | 0 |
| DENİZLİ | 636 | 32683 | 377,604 | 451 | 89.57 | 105.4 | 4.32 | 4.08 | 12.4 | 73 | 2133 | 0 |
| ELAZIĞ | 523 | 12402 | 191,390 | 0 | 82.31 | 101.3 | 3.96 | 10.73 | 13.39 | 67 | 1704 | 0 |
| ERZİNCAN | 1,488 | 4443 | 170,911 | 0 | 87.16 | 73.1 | 3.68 | 6.76 | 5.71 | 27 | 1158 | 0 |
| ESKİŞEHİR | 528 | 22342 | 563,984 | 263 | 92.94 | 71.3 | 5.91 | 8.43 | 9.61 | 51 | 2513 | 0 |
| GAZİANTEP | 792 | 34432 | 376,648 | 1095 | 83.78 | 143.5 | 2.44 | 11.4 | 24.05 | 24 | 1593 | 0 |
| İSTANBUL | 433 | 347617 | 83,669 | 30970 | 93.39 | 146.2 | 7.06 | 12.72 | 33.07 | 1928 | 3063 | 1 |
| İZMİR | 361 | 119552 | 351,458 | 12771 | 91.86 | 112.4 | 7.16 | 10.8 | 22.38 | 281 | 3215 | 1 |
| K. MARAŞ | 1,186 | 18098 | 441,300 | 78 | 83.42 | 150.9 | 2.82 | 7.83 | 11.41 | 70 | 1584 | 0 |
| KARAMAN | 1,121 | 5499 | 340,082 | 50 | 89.72 | 159.6 | 3.12 | 6.46 | 12.24 | 27 | 2012 | 0 |
| KOCAELİ | 707 | 34447 | 105,971 | 8556 | 92.04 | 174.2 | 4.38 | 8.32 | 27.04 | 334 | 6165 | 1 |
| KÜTAHYA | 1,463 | 17622 | 356,960 | 0 | 89.09 | 142.9 | 3.02 | 4.71 | 12.81 | 55 | 1805 | 0 |
| MERSİN | 882 | 43174 | 400,196 | 2527 | 89.16 | 212.9 | 4.49 | 1.22 | 26.47 | 107 | 2452 | 1 |
| MUĞLA | 785 | 38343 | 243,069 | 167 | 92.72 | 243.5 | 6.56 | 4.29 | 23.97 | 56 | 3308 | 1 |
| NEVŞEHİR | 1,016 | 9929 | 334,470 | 0 | 88.41 | 87.1 | 3.88 | 4.76 | 6.81 | 58 | 2117 | 0 |
| RİZE | 1,204 | 9456 | 54,499 | 211 | 87.66 | 113.3 | 3.47 | 10.25 | 4.8 | 93 | 1897 | 1 |
| SAKARYA | 1,117 | 20471 | 196,165 | 151 | 90.85 | 98.3 | 3.38 | 7.08 | 10.13 | 156 | 2108 | 1 |
| TEKİRDAĞ | 857 | 22541 | 386,260 | 1191 | 93.01 | 291.8 | 4.63 | 6.3 | 28.52 | 99 | 2498 | 1 |
| TRABZON | 813 | 21091 | 102,100 | 402 | 88.49 | 185.7 | 4.67 | 8.29 | 20.31 | 209 | 1506 | 1 |
| UŞAK | 942 | 10246 | 227,164 | 31 | 87.54 | 105.2 | 3.48 | 5.66 | 10.42 | 60 | 1436 | 0 |
| YALOVA | 777 | 6052 | 15,189 | 21 | 92.93 | 380.4 | 6.04 | 8.14 | 22.13 | 199 | 3463 | 1 |
| YOZGAT | 2,182 | 10522 | 799,688 | 0 | 86.17 | 139.5 | 2.38 | 6.78 | 16.55 | 49 | 852 | 0 |

Dependent Variables:

Financial ratios those exhibits the financial condition of the municipalities are used as the independent variables. Financial ratios used in the study as dependent variables are taken from a very recent study of Xiaohu Wang, Lynda Dennis and Yuan Sen (Jeff) Tu called “Measuring Financial Condition: A Study of U.S. States”.⁶¹ This study does not a recent study only but also recommending ratios those can be calculated via basic financial statements (Statement of Financial Condition and Statement of Financial Performance) prepared according to accrual basis accounting system. For this reason, ratios are applicable for Turkish municipalities also.

There are 11 ratios in the study and these ratios are used to measure four financial aspects of municipalities. These are cash solvency, budget solvency, long-run solvency and service solvency of municipalities. Ratios those are used to determine these financial aspects of municipalities will be used as dependent variables.

Cash Solvency: There are three ratios used to measure cash solvency. It is an important indicator of financial condition. Cash solvency presents the short term debt payment ability of municipalities. If a municipality can not pay its short term debts it can be obliged borrow and its interest expenditures increases. Moreover, it loses trustworthiness. Staff payments are one of the most important expenditures of the municipalities. Generally, municipalities prefer to not pay wages of the staff when they live a cash shortage. And this decreases the support for the administrations. Moreover, if the payments to contractors can not be realized in due time this may make the contractors take the late payment risk into consideration when determining the price of services. This situation also increases the expenditures of municipalities in the long run. Three ratios those will be used in this study to determine cash solvency are cash ratio, quick ratio and current ratio.

⁶¹ Wang Xiaohu, Dennis Lynda, Sen (Jeff) Tu Yuan, Measuring Financial Condition: A Study of U.S. States, Public Budgeting and Finance, Summer 2007

Budget Solvency: There are two ratios recommended in the study to measure budget solvency. The balance between income and expenditures is one of the main indicators of financial health. The expenditures should not be more than income. If this continues for long periods it may not be possible to sustain the services and the interest expenditures for repayments of debts may decrease the sources that are available to provide services to society. Therefore, budget deficit is not a good sign for the financial condition of the municipality. Operating ratio and Surplus (Deficit) per capita ratios are used for budget solvency.

Long-run Solvency: There are three indicators available in the study to measure the long-run solvency of the municipalities. Long-run solvency presents the long run debt payment power of the public administrations. Municipalities may borrow in the long-term from the financial markets or from Treasury to realize huge investments. However, if their long run debt payment strength is not sufficient they may not be able to find new funds to continue their services and to realize necessary investments. Moreover, even they find some funds because of high risk they may be obliged to pay high interests. This causes the irrational use of public sources. Ratios used to indicate long-run solvency are net asset ratio, long term liability ratio and long term liability per capita ratio.

Service Solvency: There are three ratios in the study to measure service solvency. The service solvency measures the ability of sustaining service quality and quantity. If current expenditures are high it may not be easy to continue the quantity and quality of the current service in the long run. If the taxes and revenues are high it may not be possible to increase the revenues via new taxes or other income sources because it may cause reaction of citizens and new taxes and income sources may cause the citizens become poorer. Ratios those will be used in the thesis to represent service solvency are tax per capita, revenue per capita and expenses per capita.

Ratios used in the study to determine the financial condition of city municipalities are presented in Table-27 below;

| Table – 27 | | | |
|-------------------|---------------------------------------|---|---------------------------------|
| RATIOS | | | |
| 1 | Cash Ratio | $(\text{Cash} + \text{Cash Equivalents} + \text{Investments}) / \text{Current Liabilities}$ | CASH SOLVENCY RATIOS |
| 2 | Quick Ratio | $(\text{Cash} + \text{Cash Equivalents} + \text{Receivables}) / \text{Current Liabilities}$ | |
| 3 | Current Ratio | $\text{Current Assets} / \text{Current Liabilities}$ | |
| 4 | Operating Ratio | $\text{Total Revenues} / \text{Total Expenses}$ | BUDGET SOLVENCY RATIOS |
| 5 | Surplus/Deficit Per Capita | $\text{Total Surplus (Deficit)} / \text{Population}$ | |
| 6 | Net Asset Ratio | $\text{Net Assets} / \text{Total Assets}$ | |
| 7 | Long Term Liability Ratio | $\text{Long-term Liabilities} / \text{Total Assets}$ | LONG-RUN SOLVENCY RATIOS |
| 8 | Long Term Liability per Capita | $\text{Long-term Liabilities} / \text{Population}$ | |
| 9 | Tax per Capita | $\text{Total Taxes} / \text{Population}$ | |
| 10 | Revenue per Capita | $\text{Total Revenues} / \text{Population}$ | SERVICE SOLVENCY RATIOS |
| 11 | Expenses per Capita | $\text{Total Expenses} / \text{Population}$ | |

The dependent variables for city municipalities, which are determined according to the financial statements (Financial Condition Statement and Financial Performance Statement), are as follows in Table-28;

Table – 28
DEPENDENT VARIABLES FOR CITIES

| CITIES | CASH RATIO | QUICK RATIO | CURRENT RATIO | OPERATING RATIO | SURPLUS/DEFICIT PER CAPITA | NET ASSET RATIO | LT LIABILITY RATIO | L-T LIABILITY PER CAPITA | TAX PER CAPITA | REVENUE PER CAPITA | EXPENSES PER CAPITA |
|-----------|------------|-------------|---------------|-----------------|----------------------------|-----------------|--------------------|--------------------------|----------------|--------------------|---------------------|
| ADANA | 0.009 | 0.034 | 0.562 | 1.138 | 14.238 | -3.744 | 4.07 | 375.433 | 82.11 | 117.116 | 102.878 |
| ADIYAMAN | 0.036 | 3.21 | 1.343 | 1.231 | 13.76 | 0.652 | 0.153 | 12.029 | 39.346 | 73.428 | 59.668 |
| AFYON | 0.354 | 0.753 | 1.633 | 1.016 | 0.71 | 0.281 | 0.65 | 57.717 | 24.163 | 44.968 | 44.258 |
| AMASYA | 0.006 | 0.257 | 0.511 | 0.805 | -12.813 | 0.924 | 0.024 | 15.176 | 27.893 | 52.919 | 65.733 |
| ANKARA | 2.674 | 3.474 | 6.848 | 1.016 | 4.171 | 0.944 | 0 | 0.144 | 219.628 | 260.723 | 257.947 |
| ARTVIN | 6.259 | 6.733 | 7.354 | 0.947 | -1.968 | 0.922 | 0 | 0 | 16.005 | 35.026 | 36.994 |
| BOLU | 0.023 | 0.153 | 0.215 | 0.787 | -27.936 | -0.973 | 0.122 | 5.865 | 50.651 | 103.503 | 131.438 |
| BURDUR | 0.063 | 1.456 | 1.458 | 0.917 | -5.879 | 0.96 | 0.959 | 8.69 | 40.533 | 65.549 | 70.981 |
| ÇORUM | 0.059 | 0.985 | 1.457 | 0.979 | -1.93 | 0.386 | 0.018 | 0.508 | 41.584 | 92.087 | 94.017 |
| DENİZLİ | 0.076 | 0.235 | 0.399 | 0.386 | -236.024 | 0.682 | 0.166 | 18.951 | 64.367 | 148.605 | 384.629 |
| ELAZIĞ | 0.041 | 0.463 | 1.086 | 0.998 | -0.343 | 0.883 | 0.012 | 2.845 | 68.483 | 124.017 | 124.36 |
| ERZİNCAN | 0.009 | 0.009 | 0.099 | 0.944 | -5.609 | -3.879 | 0 | 0 | 43.45 | 95.292 | 100.901 |
| ESKİŞEHİR | 2.558 | 2.567 | 3.215 | 1.632 | 54.195 | 0.836 | 0.048 | 29.066 | 99.556 | 140.011 | 85.816 |
| GAZİANTEP | 0.281 | 1.121 | 1.21 | 0.77 | 28.251 | 0.276 | 0.645 | 138.341 | 74.207 | 94.340 | 122.591 |
| İSTANBUL | 0.312 | 1.406 | 2.701 | 1.933 | 151.726 | 0.964 | 0.009 | 24.402 | 6.654 | 314.316 | 162.589 |
| İZMİR | 0.841 | 0.983 | 1.877 | 1.305 | 48.437 | 0.949 | 0.017 | 16.434 | 5.555 | 210.951 | 158.665 |
| K. MARAŞ | 0.022 | 1.515 | 1.898 | 1.404 | 26.614 | -0.428 | 1.007 | 34.955 | 49.98 | 92.458 | 62.072 |
| KARAMAN | 0.234 | 0.673 | 0.748 | 1.046 | 5.642 | 0.286 | 0 | 0 | 37.893 | 123.665 | 123.656 |
| KOCAELİ | 0.014 | 0.347 | 0.359 | 0.915 | -40.74 | 0.231 | 0.668 | 5609.55 | 348.61 | 439.768 | 931.149 |
| KÜTAHYA | 0.701 | 1.755 | 2.265 | 1.3 | 18.873 | 0.731 | 0.021 | 0.641 | 38.656 | 106.745 | 62.904 |
| MERSİN | 1.447 | 1.605 | 3.082 | 1.871 | 45.457 | 0.456 | 0.44 | 64.927 | 82.129 | 97.635 | 52.178 |
| MUĞLA | 0.505 | 1.44 | 4.14 | 1.214 | 5.142 | 0.976 | 0 | 0 | 13.499 | 29.119 | 23.976 |
| NEVŞEHİR | 0.001 | 0.002 | 0.341 | 0.914 | -5.742 | 0.46 | 0.106 | 10.137 | 34.415 | 61.304 | 67.046 |
| RİZE | 0.297 | 1.228 | 1.534 | 0.354 | -155.783 | 0.059 | 0.704 | 78.259 | 41.427 | 85.248 | 241.028 |
| SAKARYA | 0.031 | 0.045 | 0.767 | 0.967 | -3.664 | -0.668 | 1.544 | 338.668 | 72.35 | 201.976 | 111.627 |
| TEKİRDAĞ | 0.019 | 0.116 | 0.137 | 0.376 | -41.935 | 0.833 | 0.203 | 3.384 | 13.362 | 25.256 | 67.191 |
| TRABZON | 0.023 | 0.205 | 0.207 | 0.398 | -104.912 | 0.854 | 0.06 | 20.14 | 11.339 | 69.288 | 174.2 |
| UŞAK | 0.125 | 0.539 | 0.83 | 0.721 | -52.272 | -0.192 | 0.578 | 50.317 | 65.591 | 140.021 | 187.1 |
| YALOVA | 0.012 | 0.394 | 0.755 | 0.508 | -151.618 | -0.231 | 0.208 | 23.726 | 74.097 | 156.677 | 308.295 |
| YOZGAT | 0.005 | 0.101 | 0.522 | 1.139 | 0.211 | 0.941 | 0 | 0 | 0.014 | 32.764 | 1.517 |

3.5 DATA COLLECTION PROCEDURE

Independent variables are taken from web page and Turkey's Statistical Yearbook-2005 of Turkey Statistics Institution. However, the data for independent variables are not for the year 2006. This is because of the Institution's not conducting study on the variables for cities each year. For this reason, the recent variables available for cities have been used as independent variables. Despite not being 2006 data, data used shows the variables of cities, so development level of cities in a comparative manner.

The years of data for variables used are presented in Table-29 below;

Table – 29
YEARS of INDEPENDENT VARIABLES

| VARIABLE | YEAR |
|------------------------------|--|
| POPULATION FOR A DOCTOR | # of Doctor: 2002 data, Population: 2000 |
| # OF INDUSTRY COMPANIES | 2002 data |
| USABLE AGRICULTURE AREA | 2004 data |
| MONETARY VALUE OF EXPORT | 2005 data |
| RATE OF LITERATE PEOPLE | 2000 data |
| INCREASE RATE OF HABITATION | From 1984 to 2000 |
| RATE OF HIGH EDUCATED PEOPLE | 2000 data |
| UNEMPLOYMENT RATE | 2000 data |
| POPULATION DENSITY | 2000 data |
| INCOME PER CAPITA | 2001 data |
| INCREASE RATE OF POPULATION | From 1990 to 2000 |
| TO BE IN THE SEASIDE | Not applicable |

Concerning the dependent variables, financial condition ratios of cities, it is believed that the data collection studies on the financial statements of municipalities was at the same time a test concerning the application of new regulations and the accountability and transparency philosophy of these regulations. In the study, it was aimed to collect the financial statements of 81 city municipalities of Turkey. The "Access to Information Application" sections of web pages of municipalities, which are designed in line with

the “Regulation concerning Turkish Law on the Right to Information”, have been used to collect financial statements of municipalities. Many of the municipalities had “Right to Information Application” section in the web page, and for some municipalities those do not have this part it was possible to apply by sending an e-mail. As result of this attempt, it became possible to apply 60 municipalities for collecting financial statements. By this way, application to at almost 75 % of municipalities became possible. However, despite this high rate of application, the rate of responses was extremely low. Among 60 municipalities, only ten municipalities responded and send the financial statements without further other call, moreover some of these municipalities send the financial statements very late. This number was not providing enough data to apply regression analysis. For this reason, the data collection has been extended to telephone calls. The Right to Information Departments or Financial Management Departments of municipalities has been called and the financial statements of the municipalities for 2006 year have been requested. As result of this attempt it became possible to collect financial statements of 30 city municipalities.

Among 30 municipalities 2 of these cities are from Mediterranean Region, 2 of them are from East Anatolian Region, 6 of them are from Aegean Region, 3 of them are from South East Anatolian Region, 8 of them are from Middle Anatolian Region, 5 of them are from Marmara Region and 4 of them are from Black sea Region of the country. Cities according to regions are shown in Table-30 below.

Table – 30
REGIONS and CITIES USED in the ANALYSIS

| REGION | CITY |
|-----------------------|---|
| MEDITERRANEAN | ADANA, MERSİN |
| EAST ANATOLIAN | ELAZIĞ, ERZİNCAN |
| AEGEAN | DENİZLİ, İZMİR, KÜTAHYA, MUĞLA, UŞAK, AFYON |
| SOUTH EAST ANATTOLIAN | GAZİANTEP, K. MARAŞ, ADIYAMAN |
| MIDDLE ANATOLIAN | ANKARA, BOLU, ÇORUM, ESKİŞEHİR, KARAMAN, YOZGAT, BURDUR, NEVŞEHİR |
| BLACK SEA | AMASYA, ARTVİN, RİZE AND TRABZON |
| MARMARA | İSTANBUL, SAKARYA, TEKİRDAĞ, KOCAELİ, YALOVA |

Actually, this data collection phase of the study was providing clues concerning the application of Law on the Information Act, so transparency and accountability understanding of administrations. Initially, some of the municipalities have not established web based application infrastructure despite it is one of the most widely used and easiest communication tools today and it is an obligation according to the “Regulation on the Essences of the Law on the Right to Information”. Secondly, many municipalities have not checking the web based applications, because when I have called them I realized that most of the municipalities were not aware of my application. Their computer systems were not working well or they were not checking the computer based applications. Thirdly, the understanding of transparency and accountability was so superficial that despite it was stated by some Heads of Financial Departments that financial statements will be send, they have not been sent. Lastly, and from my point of view it was the worst of all, Kayseri Metropolitan Municipality has responded that financial statements of the municipality can not be send in accordance with 34th article of Regulation that regulates essences of the Law on the Right of Information, which gives the administrations right of not giving information to applicants because of the issue’s being related to “Commercial Secrets”.

As result of data collection attempts financial statements of 30 municipalities have been collected.

Despite it could not be possible to collect financial statements of all city municipalities, 30 cities represents 37% of 81 cities of Turkey, therefore it is believed that these cities form sufficient sample for the research and they represent the population, cities of the country.

3.6. PROCEDURE

The objective of the study is to find out the significant relationship between the socioeconomic development indicators of cities and financial condition ratios of the municipalities of these cities. The best method to determine this relationship is multiple linear regression analysis.

Initially, a correlation analysis was performed on independent variables and dependent variables to determine the relationship between independent variables and financial ratios. These results are shown below in Table-31.

**Table – 31
CORRELATIONS BETWEEN INDEPENDENTS AND DEPENDENTS**

| | | Doctor | # of Ind.Comp. | Agr. Area | Export | Rate of Literacy | Inc. Rate of Inhab. | Rate of High Educ. | Unemp. Rate | Pop. Density | Income per capita | Pop. Inc. Rate | Seaside |
|-------------------------|---------------------|--------|----------------|-----------|--------|------------------|---------------------|--------------------|-------------|--------------|-------------------|----------------|---------|
| Cash Ratio | Pearson Correlation | -,146 | ,063 | ,123 | -,024 | ,137 | -,210 | ,300 | ,017 | -,059 | ,054 | -,294 | ,160 |
| | Sig. (1-tailed) | ,220 | ,371 | ,258 | ,449 | ,235 | ,132 | ,054 | ,464 | ,379 | ,388 | ,057 | ,199 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |
| Quick Ratio | Pearson Correlation | -,020 | ,104 | ,098 | ,009 | -,085 | -,179 | ,215 | ,123 | -,002 | -,054 | -,239 | ,050 |
| | Sig. (1-tailed) | ,459 | ,292 | ,303 | ,481 | ,328 | ,171 | ,127 | ,259 | ,496 | ,389 | ,396 | ,102 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |
| Current Ratio | Pearson Correlation | -,231 | ,287 | ,299 | ,098 | ,188 | -,132 | ,515** | ,077 | ,090 | ,077 | -,082 | ,141 |
| | Sig. (1-tailed) | ,110 | ,062 | ,054 | ,303 | ,159 | ,244 | ,002 | ,343 | ,319 | ,342 | ,333 | ,229 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |
| Operations Ratio | Pearson Correlation | -,041 | ,493** | ,225 | ,471** | ,040 | -,134 | ,191 | ,081 | ,418* | ,050 | ,239 | -,008 |
| | Sig. (1-tailed) | ,415 | ,003 | ,116 | ,004 | ,417 | ,240 | ,156 | ,336 | ,011 | ,397 | ,102 | ,483 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |

| | | Doctor | # of Ind.Comp. | Agr. Area | Export | Rate of Literacy | Inc. Rate of Inhab. | Rate of High Educ. | Unemp. Rate | Pop. Density | Income per capita | Pop. Inc. Rate | Seaside |
|----------------------------|---------------------|--------|----------------|-----------|--------|------------------|---------------------|--------------------|-------------|--------------|-------------------|----------------|---------|
| Surplus/deficit per capita | Pearson Correlation | -,032 | ,477** | ,218 | ,457** | -,032 | -,223 | ,123 | ,218 | ,0395* | -,023 | ,175 | -,061 |
| | Sig. (1-tailed) | ,434 | ,004 | ,124 | ,006 | ,434 | ,119 | ,259 | ,123 | ,015 | ,452 | ,178 | ,374 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |
| Net Asset Ratio | | Doctor | # of Ind.Comp. | Agr. Area | Export | Rate of Literacy | Inc. Rate of Inhab. | Rate of High Educ. | Unemp. Rate | Pop. Density | Income per capita | Pop. Inc. Rate | Seaside |
| | Pearson Correlation | -,240 | ,234 | ,226 | ,176 | ,113 | ,107 | ,239 | ,103 | ,154 | ,055 | ,222 | ,141 |
| | Sig. (1-tailed) | ,105 | ,111 | ,119 | ,181 | ,280 | ,291 | ,105 | ,297 | ,213 | ,389 | ,124 | ,233 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |
| LT Liability Ratio | | Doctor | # of Ind.Comp. | Agr. Area | Export | Rate of Literacy | Inc. Rate of Inhab. | Rate of High Educ. | Unemp. Rate | Pop. Density | Income per capita | Pop. Inc. Rate | Seaside |
| | Pearson Correlation | -,079 | -,057 | ,088 | -,102 | -,105 | -,042 | -,167 | ,350* | -,061 | ,019 | ,033 | ,258 |
| | Sig. (1-tailed) | ,340 | ,382 | ,322 | ,295 | ,291 | ,412 | ,189 | ,029 | ,374 | ,461 | ,430 | ,085 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |
| LT Liability per capita | | Doctor | # of Ind.Comp. | Agr. Area | Export | Rate of Literacy | Inc. Rate of Inhab. | Rate of High Educ. | Unemp. Rate | Pop. Density | Income per capita | Pop. Inc. Rate | Seaside |
| | Pearson Correlation | -,120 | -,005 | -,161 | ,196 | ,181 | ,094 | -,009 | ,087 | ,098 | ,685** | ,253 | ,256 |
| | Sig. (1-tailed) | ,264 | ,489 | ,198 | ,149 | ,170 | ,310 | ,481 | ,324 | ,304 | ,000 | ,089 | ,086 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |
| Tax per capita | | Doctor | # of Ind.Comp. | Agr. Area | Export | Rate of Literacy | Inc. Rate of Inhab. | Rate of High Educ. | Unemp. Rate | Pop. Density | Income per capita | Pop. Inc. Rate | Seaside |
| | Pearson Correlation | -,094 | -,037 | -,043 | ,080 | ,159 | -,038 | ,092 | ,084 | ,003 | ,527** | ,160 | ,061 |
| | Sig. (1-tailed) | ,311 | ,423 | ,411 | ,337 | ,201 | ,422 | ,315 | ,329 | ,494 | ,001 | ,200 | ,375 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |

| | | Doctor | # of Ind.Comp. | Agr. Area | Export | Rate of Literacy | Inc. Rate of Inhab. | Rate of High Educ. | Unemp. Rate | Pop. Density | Income per capita | Pop. Inc. Rate | Seaside |
|-------------------------|---------------------|---------|----------------|-----------|--------|------------------|---------------------|--------------------|-------------|--------------|-------------------|----------------|---------|
| Revenue per capita | Pearson Correlation | -,492** | ,552** | -,009 | ,613** | ,420* | -,003 | ,450* | ,381* | ,544** | ,677** | ,252 | ,431** |
| | Sig. (1-tailed) | ,003 | ,001 | ,482 | ,000 | ,010 | ,493 | ,006 | ,019 | ,001 | ,000 | ,009 | ,009 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |
| Expenditures per capita | Pearson Correlation | -,337* | ,097 | -,173 | ,236 | ,301 | ,151 | ,197 | ,160 | ,168 | ,703** | ,290 | ,244 |
| | Sig. (1-tailed) | ,034 | ,305 | ,180 | ,105 | ,053 | ,213 | ,148 | ,199 | ,187 | ,000 | ,060 | ,097 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |

** Correlation is significant at the 0.01 level (1-tailed)

* Correlation is significant at the 0.05 level (1-tailed)

As result of the correlation analysis between independent variables and (dependent variables) financial condition ratios of city municipalities there emerged significant relationship between some independent variables and some dependent variables. The results are presented in the Table-32 below;

Table - 32

| INDEPENDENT VARIABLES WITH SIGNIFICANT CORRELATION TO DEPENDENT VARIABLES AS RESULT OF CORRELATION ANALYSIS | | |
|--|--|--|
| DEPENDENT VARIABLE | # OF INDEPENDENT VARIABLES WITH SIGNIFICANT CORRELATION | INDEPENDENT VARIABLES WITH SIGNIFICANT CORRELATION |
| CASH RATIO | 0 | NO INDEPENDENT VARIABLE WITH SIG. CORRELATION |
| QUICK RATIO | 0 | NO INDEPENDENT VARIABLE WITH SIG. CORRELATION |
| CURRENT RATIO | 1 | RATE OF HIGH EDUCATED |
| OPERATIONS RATIO | 3 | # OF IND. COMPANIES, EXPORT, POPULATION DENSITY |
| SURPLUS/DEFICIT PER CAPITA | 3 | # OF IND. COMPANIES, EXPORT, POPULATION DENSITY |
| NET ASSET RATIO | 0 | NO INDEPENDENT VARIABLE WITH SIG. CORRELATION |
| LONG TERM LIABILITY RATIO | 1 | UNEMPLOYMENT RATE |
| LONG TERM LIABILITY PER CAPITA | 1 | INCOME PER CAPITA |
| TAX PER CAPITA | 1 | INCOME PER CAPITA |
| REVENUE PER CAPITA | 9 | POPULATION FOR ONE DOCTOR, # OF IND. COMPANIES, EXPORT, RATE OF LITERACY, RATE OF HIGH EDUCATED, UNEMPLOYMENT RATE, POPULATION DENSITY, INCOME PER CAPITA, SEASIDE |
| EXPENDITURES PER CAPITA | 2 | POPULATION FOR ONE DOCTOR, INCOME PER CAPITA |

Secondly, the correlations between independent variables have been calculated to find out the multicollinearity between independent variables and to understand the reason of some independent variables' not taking place in regression models.

**Table – 33
CORRELATIONS OF INDEPENDENT VARIABLES**

| CORRELATIONS | | Doctor | # of Ind.Comp. | Agr. Area | Export | Rate of Literacy | Inc. Rate of Inhab. | Rate of High Educ. | Unemp. Rate | Pop. Density | Income per capita | Pop. Inc. Rate | Seaside |
|----------------------------|---------------------|---------|----------------|-----------|--------|------------------|---------------------|--------------------|-------------|--------------|-------------------|----------------|---------|
| Doctor | Pearson Correlation | 1,000 | -,464** | ,005 | -,378* | -,510** | -,047 | -,725** | -,292 | -,324 | -,570** | -,339 | -,285 |
| | Sig(1-tailed) | , | ,005 | ,489 | ,020 | ,002 | ,403 | ,000 | ,059 | ,040 | ,000 | ,034 | ,063 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |
| # of Ind.Comp. | Pearson Correlation | -,464** | 1,000 | ,088 | ,924** | ,391* | ,001 | ,599** | ,450* | ,924** | ,263 | ,515** | ,296 |
| | Sig(1-tailed) | ,005 | , | ,323 | ,000 | ,016 | ,498 | ,000 | ,006 | ,000 | ,080 | ,002 | ,056 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |
| Agr. Area | Pearson Correlation | ,005 | ,088 | 1,000 | -,174 | ,000 | -,199 | ,259 | ,093 | -,191 | -,207 | ,124 | -,381* |
| | Sig(1-tailed) | ,489 | ,323 | , | ,179 | ,500 | ,146 | ,083 | ,312 | ,156 | ,136 | ,258 | ,019 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |
| Export | Pearson Correlation | -,378* | ,924** | -,174 | 1,000 | ,364* | ,047 | ,426* | ,390* | ,946** | ,377* | ,494* | ,376* |
| | Sig(1-tailed) | ,020 | ,000 | ,179 | , | ,024 | ,402 | ,009 | ,016 | ,000 | ,020 | ,003 | ,020 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |
| Rate of Literacy | Pearson Correlation | -,510** | ,391* | ,000 | ,364* | 1,000 | ,280 | ,703** | -,125 | ,341 | ,615** | ,349 | ,448* |
| | Sig(1-tailed) | ,002 | ,016 | ,500 | ,024 | , | ,067 | ,000 | ,255 | ,033 | ,000 | ,029 | ,007 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |
| Inc. Rate of Inhab. | Pearson Correlation | -,047 | ,001 | -,199 | ,047 | ,280 | 1,000 | ,139 | -,027 | ,097 | ,295 | ,609** | ,522** |
| | Sig(1-tailed) | ,403 | ,498 | ,146 | ,402 | ,067 | , | ,232 | ,443 | ,306 | ,057 | ,000 | ,002 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |
| Rate of High Educ. | Pearson Correlation | -,725** | ,599** | ,259 | ,426* | ,703** | ,139 | 1,000 | ,254 | ,396* | ,482** | ,411* | ,324 |
| | Sig(1-tailed) | ,000 | ,000 | ,083 | ,009 | ,000 | ,232 | , | ,088 | ,015 | ,004 | ,012 | ,040 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |
| Unemp. Rate | Pearson Correlation | -,292 | ,450* | ,093 | ,390* | -,125 | -,027 | ,254 | 1,000 | ,395* | ,049 | ,340 | ,220 |
| | Sig(1-tailed) | ,059 | ,006 | ,312 | ,016 | ,255 | ,443 | ,088 | , | ,015 | ,398 | ,033 | ,122 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |
| Pop. Density | Pearson Correlation | -,324 | ,924** | -,191 | ,946** | ,341 | ,097 | ,396* | ,395* | 1,000 | ,275 | ,462* | ,354 |
| | Sig(1-tailed) | ,040 | ,000 | ,156 | ,000 | ,033 | ,306 | ,015 | ,015 | , | ,070 | ,005 | ,027 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |
| Income per capita | Pearson Correlation | -,570** | ,263 | -,207 | ,377* | ,615** | ,295 | ,482** | ,049 | ,275 | 1,000 | ,348 | ,466** |
| | Sig(1-tailed) | ,000 | ,080 | ,136 | ,020 | ,000 | ,057 | ,004 | ,398 | ,070 | , | ,030 | ,005 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |

| | | | | | | | | | | | | | |
|-----------------------|---------------------|-------|--------|--------|--------|-------|--------|-------|------|-------|--------|-------|-------|
| Pop. Inc. Rate | Pearson Correlation | -,339 | ,515** | ,124 | ,494** | ,349 | ,609** | ,411* | ,340 | ,462* | ,348 | 1,000 | ,410* |
| | Sig(1-tailed) | ,034 | ,002 | ,258 | ,003 | ,029 | ,000 | ,012 | ,033 | ,005 | ,030 | , | ,012 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |
| Seaside | Pearson Correlation | -,285 | ,296 | -,381* | ,376* | ,448* | ,522** | ,324 | ,220 | ,354 | ,466** | ,410* | 1,000 |
| | Sig(1-tailed) | ,063 | ,056 | ,019 | ,020 | ,007 | ,002 | ,040 | ,122 | ,027 | ,005 | ,012 | , |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |

** Correlation is significant at the 0.01 level (1-tailed)

* Correlation is significant at the 0.05 level (1-tailed)

Finally, regression analysis has been applied to find out the relationship between dependent variables and independent variables that have significant correlations with dependent variables. Stepwise regression analysis has been applied in SPSS Statistics Computer Program. Stepwise regression model uses the most related independent variable in first step and then other related independent variables in next steps to find out the regression model. This analysis has been applied for all 11 financial ratios (dependent variables). As result of Regression Analysis the regression relations have been achieved. However, it was seen that no regression relation is available for some dependent variables (financial ratios). Moreover, for some dependent variables the regression model does not include some independent variables which have significant correlation with the financial ratios. The results of regression analysis and regression models for each financial ratio are shown below.

3.6.1. Results of Regression Analysis

1- Regression Models for Cash Solvency Ratios:

1.1. Regression Model for Cash Ratio:

There is no independent variable that has significant correlation with Cash Ratio. For this reason no regression analysis has been applied for Cash Ratio.

1.2. Regression Model for Quick Ratio:

There is no independent variable that has significant correlation with Quick Ratio. For this reason no regression analysis has been applied for Quick Ratio.

1.3. Regression Model for Current Ratio:

There is only one independent variable that has significant correlation with current ratio after correlation analysis. This independent ratio is Rate of High Educated in the city. The correlation between rate of high educated and current ratio is 0,515 for Pearson Correlation and the correlation is significant at the 0,01 level (1-tailed). For this reason, Simple Regression Analysis has been applied to find out the relation between rate of high educated and current ratios.

Coefficients

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|-----------------------|-----------------------------|------------|---------------------------|-------|------|
| | B | Std. Error | Beta | | |
| 1 Constant) | | | | | |
| RATE OF HIGH EDUCATED | -,734 | ,804 | | -,913 | ,369 |
| | ,550 | ,173 | ,515 | 3,176 | ,004 |

Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Sig. F Change |
|-------|------|----------|-------------------|----------------------------|---------------|
| 1 | ,515 | ,265 | ,239 | 1,563 | 0.004 |

According to this analysis, the regression equity is;

$$\text{Actual Value of Y (Current Ratio)} = -,734 + ,550 * X (\text{Rate of High Educated})$$

Model shows that approximately 24% of the variance in Current Ratio can be accounted by Rate of High Educated in the city.

2- Regression Models for Budget Solvency Ratios:

2.1. Regression Model for Operations Ratio:

As result of correlation analysis there are 3 independent variables those have significant correlation relation with operations ratio. These independent variables are number of industrial companies, export and population density. The correlation between these independent variables and operations ratio is as follows.

| Operations Ratio | | # of Ind.Comp. | Export | Pop. Density |
|------------------|---------------------|----------------|--------|--------------|
| | Pearson Correlation | ,493** | ,471** | ,418* |
| | Sig. (1-tailed) | ,003 | ,004 | ,011 |
| | N | 30 | 30 | 30 |

These independent variables are used in multiple regression model to find out the regression equation. The result of the regression analysis is as follows;

Coefficients

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---------------------|-----------------------------|------------|---------------------------|--------|------|
| | B | Std. Error | Beta | | |
| (Constant) | -,890 | ,073 | ,493 | 12,130 | ,369 |
| # of IND. COMPANIES | 2,969 | ,000 | | 3,002 | ,006 |

Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Sig. F Change |
|-------|------|----------|-------------------|----------------------------|---------------|
| 1 | ,493 | ,244 | ,217 | ,350 | 0.006 |

Stepwise regression analysis does not put export and population density independent variables into regression model despite these independents have significant correlation with operations ratio. This is to prevent multicollinearity in the model, because there is significant correlation between # of industrial companies and other two independent variables as it can be seen in Table-33.

According to this analysis the regression equity is;

Actual Value of Y (Operations Ratio) = -,890 + 2,969 * X (# of Industrial Companies)

Model shows that approximately 22 % of the variance in Operations Ratio can be accounted by industrial development indicator (# of Industrial Companies) of the city.

2.2. Regression Model for Surplus / Deficit per Capita:

As result of correlation analysis there are 3 independent variables those have significant correlation relation with surplus/deficit per capita. These independent variables are number of industrial companies, export and population density, same with operations ratio. The correlation between these independent variables and operations ratio is as follows.

| | # of Ind.Comp. | Export | Pop. Density |
|---------------------|----------------|--------|--------------|
| Pearson Correlation | ,477** | ,457** | ,0395* |
| Sig. (1-tailed) | ,004 | ,006 | ,015 |
| N | 30 | 30 | 30 |

These independent variables are used in multiple regression model to find out the regression equation. The result of the regression analysis is as follows;

Coefficients

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---------------------|-----------------------------|------------|---------------------------|--------|------|
| | B | Std. Error | Beta | | |
| (Constant) | -33,184 | 13,359 | ,477 | -2,484 | ,019 |
| # of IND. COMPANIES | 0,0005 | ,000 | | 2,875 | ,008 |

Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Sig. F Change |
|-------|------|----------|-------------------|----------------------------|---------------|
| 1 | ,477 | ,228 | ,200 | 63,812 | 0.008 |

Stepwise regression analysis does not put export and population density independent variables into regression model despite these independents have significant correlation with operations ratio. This is to prevent multicollinearity in the model, because there is significant correlation between # of industrial companies and other two independent variables as in the case of operations ratio.

According to this analysis the regression equity is;

Actual Value of Y (Surplus/Deficit per Capita) = -33,184 + 0,0005 * X (# of Industrial Companies)

Model shows that approximately 20 % of the variance in surplus/deficit per capita can be accounted by industrial development indicator (# of Industrial Companies) of the city.

3- Long-Run Solvency Ratios:

3.1. Regression Model for Net Asset Ratio:

There is no independent variable that has significant correlation with Net Asset Ratio. For this reason no regression analysis has been applied for Net Asset Ratio.

3.2. Regression Model for Long-Term Liability Ratio:

There is only one independent variable that has significant correlation with Long-Term Liability Ratio after correlation analysis. This independent ratio is Unemployment Rate

of the city. The correlation between Unemployment Rate of the city and Long-Term Liability Ratio is 0,350 for Pearson Correlation and the correlation is significant at the 0,05 level (1-tailed). For this reason, Simple Regression Analysis has been applied to find out the relation between Unemployment Rate and Long-Term Liability Ratio.

As result of stepwise regression analysis no equation has occurred. For this reason, it is concluded that there is no regression relation between any independent variable those represent the development level of cities and Long-Term Liability Ratio of cities.

3.3. Regression Model for Long-Term Liability per Capita:

There is only one independent variable that has significant correlation with Long-Term Liability per Capita after correlation analysis. This independent ratio is Income per Capita in the city. The correlation between Income per Capita in the city and Long-Term Liability per Capita is 0,685 for Pearson Correlation and the correlation is significant at the 0,01 level (1-tailed). For this reason, Simple Regression Analysis has been applied to find out the relation between Income per Capita and Long-Term Liability per Capita.

Coefficients

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|-------------------|-----------------------------|------------|---------------------------|--------|------|
| | B | Std. Error | Beta | | |
| 1 Constant) | -1222,277 | 323,286 | | -3,781 | ,001 |
| INCOME per CAPITA | ,648 | ,130 | ,683 | 4,973 | ,000 |

Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Sig. F Change |
|-------|------|----------|-------------------|----------------------------|---------------|
| 1 | ,685 | ,469 | ,450 | 756,266 | 0.000 |

According to this analysis, the regression equity is;

Actual Value of Y (Long-Term Liability per Capita) = -1222,277 + ,648 * X (Income per Capita)

Model shows that 45% of the variance in Long-Term Liability per Capita can be accounted by Income per Capita in the city.

4- Service Solvency Ratios:

4.1. Regression Model for Tax per Capita:

There is only one independent variable that has significant correlation with Tax per Capita after correlation analysis. This independent ratio is Income per Capita in the city. The correlation between Income per Capita in the city and Tax Capita is 0,527 for Pearson Correlation and the correlation is significant at the 0,01 level (1-tailed). For this reason, Simple Regression Analysis has been applied to find out the relation between Income per Capita and Tax per Capita.

Coefficients

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|-------------------|-----------------------------|------------|---------------------------|--------|------|
| | B | Std. Error | Beta | | |
| 1 Constant) | -28,940 | 23,337 | | -1,240 | ,225 |
| INCOME per CAPITA | 0,0394 | ,009 | ,621 | 4,195 | ,000 |

Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Sig. F Change |
|-------|------|----------|-------------------|----------------------------|---------------|
| 1 | ,621 | ,386 | ,364 | 54,593 | 0.000 |

According to this analysis, the regression equity is;

$$\text{Actual Value of Y (Tax per Capita)} = -28,940 + ,039 * X (\text{Income per Capita})$$

Model shows that approximately 36% of the variance in Tax per Capita can be accounted by Income per Capita in the city.

4.2. Regression Analysis for Revenue per Capita:

As result of correlation analysis there are 9 independent variables those have significant correlation relation with Revenue per Capita. These independent variables are Population for a Doctor, # of Ind. Companies, Export, Rate of Literacy, Rate of High Educated, Unemployment Rate, Population Density, Income per Capita and to be in the Seaside. The correlations between these independent variables and Revenue per Capita are as follows.

| | | Doctor | # of Ind.Comp. | Export | Rate of Literacy | Rate of High Educ. | Unemp. Rate | Pop. Density | Income per capita | Seaside |
|--------------------|---------------------|---------|----------------|--------|------------------|--------------------|-------------|--------------|-------------------|---------|
| Revenue per capita | Pearson Correlation | -,492** | ,552** | ,613** | ,420* | ,450* | ,381* | ,544** | ,677** | ,431** |
| | Sig. (1-tailed) | ,003 | ,001 | ,000 | ,010 | ,006 | ,019 | ,001 | ,000 | ,009 |
| | N | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 | 30 |

These independent variables are used in multiple regression model to find out the regression equation. The result of the regression analysis is as follows;

Coefficients

| | Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|--------------------|-----------------------------|------------|---------------------------|-------|------|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | -6,002 | 28,885 | ,677 | -,208 | ,837 |
| | INCOME per CAPITA | ,0056 | ,012 | | 4,869 | ,000 |
| 2 | (Constant) | -6,129 | 25,005 | ,571 | -,245 | ,808 |
| | INCOME per CAPITA | ,047 | ,010 | ,402 | 4,578 | ,000 |
| | # of IND. COMPANYY | ,0005 | ,000 | | 3,219 | ,003 |

Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Sig. F Change |
|-------|------|----------|-------------------|----------------------------|---------------|
| 1 | ,677 | ,458 | ,439 | 67,571 | ,000 |
| 2 | ,780 | ,609 | ,580 | 58,494 | ,003 |

Stepwise regression analysis does not put seven of nine independent variables into regression model despite these independents have significant correlation with Revenue per Capita.

According to this analysis the regression equity for Model 2 is;

$$\text{Actual Value of Y (Revenue per Capita)} = -6,129 + 0,047 * X1 (\text{Income per Capita}) + 0,0005 * X2 (\text{\# of Ind. Companies})$$

Model shows that 58 % of the variance in Revenue per Capita can be accounted by two independent variables which are # of Industrial Companies in the city and Income per Capita in the city

4.3. Regression Analysis for Expenses per Capita:

As result of correlation analysis there are 2 independent variables those have significant correlation relation with operations ratio. These independent variables are Population for a Doctor and Income per Capita. The correlation between these independent variables and Expenses per Capita is as follows.

| Expenditures per capita | | Doctor | Income per capita |
|-------------------------|---------------------|--------|-------------------|
| | Pearson Correlation | -,337* | ,703** |
| Sig. (1-tailed) | | ,034 | ,000 |
| N | | 30 | 30 |

These independent variables are used in multiple regression model to find out the regression equation. The result of the regression analysis is as follows;

Coefficients

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|-------------------|-----------------------------|------------|---------------------------|--------|------|
| | B | Std. Error | Beta | | |
| (Constant) | -103,306 | 52,965 | ,703 | -1,950 | ,061 |
| INCOME PER CAPITA | ,112 | ,021 | | 5,232 | ,000 |

Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Sig. F Change |
|-------|------|----------|-------------------|----------------------------|---------------|
| 1 | ,703 | ,494 | ,476 | 123,900 | 0.000 |

Stepwise regression analysis does not put Population for a Doctor independent variable into regression model despite this independent has significant correlation with Expense per Capita. This is to prevent multicollinearity in the model, because there is significant correlation between independent variables as it can be seen in Table-33.

According to this analysis the regression equity is;

Actual Value of Y (Expense per Capita) = -103,306 + ,112 * X (Income per Capita)

Model shows that approximately 48 % of the variance in Expense per Capita can be accounted by Income per Capita in the city.

3.6.2. Summary of Procedure and Regression Analysis

To find out the relation between 12 independent variables, which are social and economic development indicators of cities and financial ratios of the municipalities in these cities, correlation analysis has been conducted initially. The independent variables those have significant correlation with each financial ratios are determined by this analysis. Secondly, stepwise regression analysis has been conducted to see the regression model and independent variables those have significant correlation with financial ratios have take place in the regression models. In this analysis, the most related independent variable is used in the regression equation and others are excluded from the equation if there is correlation between independent variables. Some of the independent variables did not take place in the regression equations despite they have significant correlation with financial ratios. This is mainly because of multicollinearity between the independent variables those are included in the analysis.

As result of regression analysis, seven regression equations are reached at for seven financial ratios and it was examined that there are no regression equation for four financial ratios. The regression equations included one independent variable for most of the financial ratios and two independent variables have take place in the regression equation for Revenue per Capita. The summary of regression equations are shown below in Table-34,

| TYPE OF RATIO (DEPENDENT VARIABLE) | DEPENDENT VARIABLE | # OF INDEPENDABLE VARIABLES IN REGRESSION ANALYSIS | INDEPENDENT VARIABLES IN REGRESSION ANALYSIS |
|------------------------------------|-----------------------------------|--|---|
| CASH SOLVENCY RATIOS | CASH RATIO | 0 | NO INDEPENDENT VARIABLE |
| | QUICK RATIO | 0 | NO INDEPENDENT VARIABLE |
| | CURRENT RATIO | 1 | RATE OF HIGH EDUCATED |
| BUDGET SOLVENCY RATIOS | OPERATIONS RATIO | 1 | # OF IND. COMPANIES |
| | SURPLUS/DEFICIT PER CAPITA | 1 | # OF IND. COMPANIES |
| LONG-TERM SOLVENCY RATIOS | NET ASSET RATIO | 0 | NO INDEPENDENT VARIABLE |
| | L-T LIABILITY RATIO | 0 | NO INDEPENDENT VARIABLE |
| | L-T LIABILITY PER CAPITA | 1 | INCOME PER CAPITA |
| SERVICE SOLVENCY RATIOS | TAX PER CAPITA | 1 | INCOME PER CAPITA |
| | REVENUE PER CAPITA | 2 | # OF IND. COMPANIES, INCOME PER CAPITA |
| | EXPEND. PER CAPITA | 1 | INCOME PER CAPITA |

3.7. CONCLUSIONS AND RECOMMENDATIONS

Three financial ratios are used in the analysis to represent cash solvency of municipalities. These financial ratios are cash ratio, quick ratio and current ratio. As result of the analysis, it was realized that there is no relation between socioeconomic development indicators of cities and cash ratio and quick ratio of city municipalities. And, there is a positive relation between rate of high educated people in the city and current ratio of municipalities. This means that the current ratio of municipalities increases as result of increase in rate of high educated people in the city. Actually, rate of high educated people is a good representative of socioeconomic development level of a city. Because, generally rate of high educated is high in developed cities and at the same time high educated people prefers to work and live in developed cities. This argument can be supported also by the correlation analysis between independent variables, which are development indicators of cities. In Table-33, it can be seen that rate of high educated variable has significant correlation with seven development indicators, which are population for a doctor, # of industrial companies, export, rate of literacy, population density, income per capita and population increase rate. However, despite this relation between rate of high educated and current ratio, generally for cash solvency ratios it is not possible to claim a relation with development level. It is not possible to claim that the short term debt payment strength of developed cities is higher or lower.

Two financial ratios are used to represent budget solvency of municipalities. Budget solvency ratios show the budget balance, income and expenditure level of cities. These ratios are operations ratio which is the ratio of revenues of municipalities to their expenditures and surplus/deficit per capita. Higher operations ratio and higher surplus/deficit per capita mean that the budget balance of city is good. As result of correlation analysis, it was realized that both operations ratio and surplus/deficit per capita has significant correlation with # of industrial companies, export and population density. Moreover, as result of regression analysis, it was seen that # of industrial companies has positive relation with both operations ratio and surplus/deficit per capita. For this reason, it is possible to conclude that industrially developed cities have better budget condition and their income expenditure balance is healthy. Moreover, it is

possible to claim that if the number of industrial companies increases in a city, budget balance of municipality improves.

Three financial ratios are used in the study to represent long term solvency of municipalities. Long term solvency shows the municipalities' ability of paying their long term debts, which in the long run necessary to prevent waste of resources for high interest rates. These three ratios are net asset ratio, long-term liability ratio and long term liability per capita ratio. As result of correlation analysis, it was seen that none of the independent variables, development indicators has significant correlation with net asset ratio and only unemployment rate has significant correlation with long term liability ratio at the 0.05 (1-tailed) level. For this reason, regression analysis has not been applied for net asset ratio and concluded that net asset ratio does not have a relation with development level of cities. Regression analysis is applied for unemployment rate and long term liability. As result of this analysis, no regression relation has emerged and it was concluded that there is no relation between development level and long term debt ratio of cities. For long term liability per capita, the situation was different. As result of correlation analysis, there is significant correlation between income per capita in the city and long term liability per capita ratio at the 0.01 (1-tailed) level. And the regression analysis also back up this relation. As result of regression analysis, it was seen that there is positive relation between income per capita and long term liability per capita ratio. Rich cities have higher amount of long term debt per capita, and municipalities takes more debt by relying on high income of their residents. This may also be result of demand of high life standards and good infrastructure of rich people. People with high income demand for better facilities and municipalities afford these investments by getting into debt and this increases the long term debt of municipalities.

Finally, as fourth financial ratio set, service solvency ratios are used in the study. Service solvency ratios are those used to measure the municipalities' ability of sustain existing service level, quality and quantity of services. Three ratios are used to find out service solvency of municipalities. These are tax per capita ratio, expenses per capita ratio and revenues per capita ratio. As result of correlation analysis, it was seen that there is a significant correlation between income per capita ratio and tax per capita ratio and the relation continued after the application of regression analysis. A positive

relation between income per capita and tax per capita has appeared. For expenses per capita ratio, there are two independent variables with significant correlation which are income per capita and population for a doctor. The regression analysis excluded the population for a doctor indicator and included income per capita with a positive relation with expenses per capita ratio. Lastly, nine development level indicators had significant correlation with revenue per capita ratio. And the regression analysis included two of these indicators with positive relations with revenue per capita. These indicators are income per capita and # of industrial companies. Moreover, the “ADJUSTED R SQUARE” of the regression analysis is 580 which mean that 58 % of the variance in Revenue per Capita can be accounted by Income per Capita in the city and # of industrial companies in the city. In conclusion for service solvency ratios, taxes per capita and expenses per capita ratios are related to income per capita in the city. Municipalities of cities with rich citizens collect more taxes per capita and spend more per capita for their residents. Moreover, municipalities of cities with rich citizens and which have more industrial companies collect more revenue per capita in comparison to other cities. In the first place these results may mean that the financial condition of rich and industrialized cities is good in terms of service solvency. However, despite municipalities of these cities have more tax and other income and they spend more for their residents, they may not sustain this service level and quality. The analysis for long term debt per capita ratio also supports this result because that analysis also showed that long term debt per capita is high in rich cities. Municipalities get into debt to finance their spending in rich cities despite they have high revenues.

Municipalities of rich and industrialized cities get higher tax income, higher revenue and they spend more for their residents. However, municipalities have mainly two types of incomes. These are taxes and incomes other than taxes. Taxes are main income for municipalities. “In 2002, 64.8 % of municipality income was from taxes and the rate is 58.7 % for 2003”⁶². Moreover, about 75% of tax income of municipalities is send to municipalities from general budget tax income. In this situation, it is possible to conclude that an important part of the income of municipalities is transferred from

• ⁶² From: Murat Turhan and Nebi Yılmaz, Belediye Gelirleri, Bilgi Notu, Sayıştay Başkanlığı Eğitim Grubu, Mart 2005, p. 1

central government. This fund transfer method can be used in a more efficient way and the difference between rich and industrialized cities and other underdeveloped cities can be reduced. Moreover, this can stop migrations to big, richer cities and more balanced development can be realized in all over the country. Appearance of extremely big cities as İstanbul and Ankara can be prevented. These cities are bigger than optimum city levels for services, and cost of services can be decreased and resources can be used in more efficient way in more moderate cities.

In conclusion, concerning the thesis;

Ho: There is no significant relationship between socio-economic development indicators of cities and financial condition of local governments (municipalities) of these cities,

it is not possible to conclude that development level of cities and financial condition of these cities have significant relation.

Because, cash solvency ratios have no significant relation with development level and for long term debt solvency of cities only long term debt per capita is related with income per capita in the city.

Concerning, service solvency of municipalities it is possible to argue that rich and industrial cities have higher resources and they spend more than other cities, which means they may not sustain current services in the long term.

Budget solvency ratios are related to industrially development level of cities, which is in line with revenue per capita ratio, that municipalities of industrial cities have good budget balance, because of high revenues.

The results are not very comprehensive and do not support significant relation between socioeconomic development indicators and efficient, effective and economic resource usage of municipalities, so financial condition of municipalities. To prove the effect of transparency and accountability on financial condition those indicators related to education, health, population and geographic situation should also be effective with economic condition of municipalities. This may be because of the limitations about the independent variables, socioeconomic development indicators. Despite financial ratios of municipalities are for 2006, socioeconomic development level indicators of cities are not for 2006. If these indicators were for 2006 the relation would be more reliable. However, the indicators for cities were not available in Türkiye Statistics Institution

because Institution does not make this type of studies for cities annually. On the other hand, despite the indicators are not for year 2006 it is believed that they still represent comparative development levels of cities.

Another issue related to the results of analysis is that, for both correlation and regression, there is a significant relation between economic development level indicators of cities and financial condition. At least one of the income per capita and number of industrial companies indicators has regression relation with operation ratio, surplus/deficit per capita ratio, long-term liability per capita ratio, tax per capita ratio, revenue per capita ratio and expenditure per capita ratio. This means economic situation of cities is more effective on financial condition than other development level indicators, as education, health, infrastructure, geographic situation indicators. Results can be seen in Table-34 explicitly.

Besides the limitation mentioned above on independent variables, there are some other limitations of the study. Initially, accrual basis accounting is used for the first time in 2006 in municipalities of Turkey. Despite financial statements include information about municipalities in a comprehensive way (they exhibit information about all assets, even Municipality Economic Enterprises, and liabilities) there may be some accounting mistakes and financial statements of these municipalities may not exhibit unfair information. It may be healthier to use the financial statements after being audited by external, independent audit institutions. Secondly, only one year data could be used in the study (again because of being first year for accrual basis application) and use of more than one year data can give us more reliable results. However, in this situation yearly data on development indicators should be available in Statistics Institution again.

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