International Consortium on Governmental Financial Management

“Working globally with governments, organizations, and individuals, the International Consortium on Governmental Financial Management is dedicated to improving financial management so that governments may better serve their citizens”

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General Information

“Working globally with governments, organizations, and individuals, the International Consortium on Governmental Financial Management is dedicated to improving financial management so that governments may better serve their citizens.”

Our mission includes three key elements. First, it highlights that, within the international community, the International Consortium on Governmental Financial Management (ICGFM or the “Consortium”) is unique - it serves as an “umbrella” bringing together diverse governmental entities, organizations (including universities, firms, and other professional associations), and individuals. At the same time, it welcomes a broad array of financial management practitioners (accountants, auditors, comptrollers, information technology specialists, treasurers, and others) working in all levels of government (local/municipal, and national). Additionally the mission statement emphasizes the organization’s commitment to improving government infrastructure so that the needs of the people are better met. Our programs provide activities and products to advance governmental financial management principles and standards and promote their implementation and application.

Internationally, the Consortium: (1) sponsors meetings, conferences, and training that bring together financial managers from around the world to share information about and experiences in governmental financial management; and (2) promotes best practices and professional standards in governmental financial management and disseminates information about best practices and professional standards to our members and the public. ICGFM provides three options for membership:

1. **Sustaining Members**: organizations promoting professional development, training, research or technical assistance in financial management; willing to assume responsibility for and to actively participate in the affairs of the Consortium. Each Sustaining Member has a seat on the ICGFM Board of Directors. (Dues: $1,000)

2. **Organization Members**: government entities with financial management responsibilities, educational institutions, firms, regional and governmental organizations, and other professional associations. Six organization members serve on the ICGFM Board of Directors. (Dues: $250/$125*)

3. **Individual Members**: persons interested in or dedicated to activities directly related to financial management and who wish to be members in their own right. Six members of the ICGFM Board of Directors will be selected from among all individual members. (Dues: $100/$50*)

4. **Student Members**: persons enrolled at a college or university who are interested in financial management are eligible and will enjoy the benefits of Individual Members. (Dues: $25/$15*)

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Access to reliable information and inter-organizational cooperation are two important factors that contribute to organizational effectiveness. Our Journal has focused the attention of our readers on these factors many times in the past. In this issue of the Journal we discuss some related matters that can affect the reliability or trustworthiness of public activities. As usual, much of the information in the articles relates to circumstances in specific countries, however, the issues addressed are universal and the problems described may occur anywhere. All of the articles in this issue offer approaches for consideration that might improve accountability with the goals of providing better information about public assets and improving the lives of ordinary citizens.

In the first article, the author examines accounting approaches for heritage assets that have been proposed in the public sector accounting literature and the impact such approaches have on the Net Worth and Performance Statements. The author suggests a Practical Accounting Approach for heritage assets, by which the exaggeration of net worth and the distortion of performance statement can be overcome.

The second article describes how measures of service-level solvency of local governments can be developed from an accounting perspective and how the measures were implemented to analyse service-level solvency of local governments in Indonesia. The article makes the point that Local administrators must take a number of actions to present fairly the financial position of public institutions.

In the third article, the author describes the many efforts to improve accountability in the Iraqi public sector. The article makes the point that while auditing rules were adequate for the past government revenue environment, there will be a need to improve auditing rules in the face of new kinds of government revenues such as a Value Added Tax. The article suggests that such audit rule improvements will result in the need to make improvements in the overall auditing system. It also describes the increasing role audit institutions will play in ensuring transparency and accountability in Iraq.

The fourth article draws attention to the problem of corruption, which can interfere with the transmission of information, disturb institutional balance, and increase transaction costs. It points out the need to introduce a number of anti-corruption solutions in Guyana, including implementation of legislation to protect persons who report in good faith, allegations of corrupt behaviour. It also describes an urgent need to regulate campaign financing for political parties.

In the last article, the author presents a brief overview of the history of public sector accounting.

We hope the articles in this issue will stimulate discussion on contemporary problems of public organizations. If you would like to participate in such discussions please start thinking about contributions for the next issue of this Journal, participating in the ICGFM blog, and/or attending future ICGFM events. We would also be pleased to receive reviews and suggestions of other resources that we should refer to in future issues. Send them to icgfm@icgfm.org.

We look forward to hearing from you!
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A Practical Accounting Approach for Heritage Assets under Accrual Accounting: With Special Focus on Egypt

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Abstract

Whilst the last 25 years have witnessed some efforts over how heritage assets might be accounted for and whether the heritage assets are sufficiently different to merit different treatment, there is no uniformity of accounting treatment for heritage assets in the public sector accounting literature and among the countries that have already adopted full accrual accounting in their public sector (such as, New Zealand, UK, Australia, USA and Canada). In addition, even though the debate of accounting for heritage has proposed different accounting approaches for heritage assets, it did not consider the impact of adoption of these accounting approaches on Net Worth and Statement of Financial Performance. The paper aims to examine the current accounting approaches for heritage assets and their impact on the Net Worth and Performance Statement and to suggest a Practical Accounting Approach for heritage assets, by which the exaggeration of net worth and performance statement distortions may be overcome.

The proposed practical accounting approach for heritage assets is based on two sub-approaches: 1- **Assets-Liabilities Matching Approach**: Capitalize if the information on cost or value of heritage assets is available and heritage assets can be disposed, and hence they can be used to match the liabilities (Unrestricted Heritage Assets). According to this approach, heritage assets should be included in the statement of financial position and their revenues and costs should be included in the statement of financial performance. 2- **Non- Assets-Liabilities Matching Approach**: Do not capitalize if the heritage assets cannot be disposed, and hence they cannot be used to match the liabilities even if information on cost or value is available. (Restricted Heritage Assets). According to this approach, heritage assets should not be included in statement of financial position and should be treated as trust/agent assets. Therefore, each country should create a Trust/Agent Assets Statement where heritage assets are stated in physical units and not in financial values. So in order to account for the revenues and costs related to heritage assets, each county should create a Trust Fund (Agent Fund). This fund includes all the revenues and costs related to heritage assets in each country. The resulting trust fund balance would be reported as either a liability or an asset in the balance sheet.

Introduction

During the 1980s, there was a move in many developed countries (e.g., Organization for Economic Cooperation and Development [OECD] countries) towards an administrative revolution. This revolution is characterized by managerial freedom, market-driven competition, business-like service delivery, value-for-money, results-based performance, client orientation, and a pro-market culture. These aspects of the administrative revolution have been described collectively as New Public Management (NPM) (Hood, 1991 and 2005; Haque, 2002; Ball and Grubnic, 2008; Kearny and Hays, 1998; Kickert, 1997; Kelly, 1998). The move towards NPM has required the reforming of public sector accounting through the adoption of accrual accounting in the public sector. One implication of the transition to accrual accounting in the public sector is that all governmental entities are required to identify and value their fixed assets in order to be able to prepare their balance sheets. In reality, the identification, valuation and recognition of fixed assets in the public sector are not easy tasks since these assets have existed for decades and have been acquired in different ways (Ouda, 2005). This in turn makes the identification and valuation process of those assets more difficult. While the identification and valuation of government fixed assets are generally difficult, heritage assets are considered to be most difficult due to their specific nature and characteristics.
Heritage assets are defined as assets with historic, artistic, scientific, technological, geophysical or environmental qualities that are held and maintained principally for their contribution to knowledge and culture and this purpose is central to the objectives of the entity holding them (UK –ASB, 2006). They are maintained and controlled by the government for cultural, historic, recreation and other community purposes rather than for the purpose of income generation (Barton, 2000). Examples of heritage assets comprise work of arts, antiquities, collection of rare books, historical monuments, conservation areas, historical buildings, archaeological sites, and nature reserves. The heritage assets must be preserved and maintained in a good state in such a way to ensure a long and indefinite life, they are considered as public goods and made available for the public, and they may be funded by taxation or private donations (Barton, 2005). For accounting purposes, the following important characteristics of the heritage assets have been determined by the UK-ASB (2006):

1. Their value in cultural, environmental, educational and historical terms is unlikely to be fully reflected as a financial value based purely on a market price;
2. Legal and/or statutory obligations may impose prohibitions or severe restrictions on disposal by sale;
3. They are often irreplaceable and their value may increase over time even as their physical condition deteriorates;
4. It may be difficult to estimate their useful lives, which in some cases could be several hundred years. Based on these specific characteristics, the heritage assets seem to be largely different from other government assets (e.g., property, plant and equipment, infrastructure assets, military assets, etc.) and private sector assets.

This has been indicated by the prior literature in the last 25 years, as the financial reporting of Heritage Assets has become a highly problematic issue for the public sector entities holding those assets. Based on the New Public Management (NPM) practices, these entities are required to report to stakeholders on a model disclosing the economic values for all assets under their control. In addition, the capitalization of heritage assets can have different effects on the net worth of different countries, as these effects will differ according to the volume of heritage assets that are owned by each country. For example, the city of Luxor in Egypt hosts one third of the monuments and antiquities of the world (heritage assets). Therefore, the capitalization of all heritage assets in Egypt will lead to the exaggeration of net worth, which may give an indication that Egypt has huge positive economic/financial resources. In fact, this is untrue as Egypt is suffering from a large public debt and budget deficit. Furthermore, if heritage assets have no financial value to the governmental entity, then it is misleading to match them against government liabilities. They are not resources, which can be used to generate cash for discharge of liabilities, and their inclusion in a balance sheet is misleading to management and to creditors (Carnegie and Wolnizer, 1995). Moreover, immediate expensing of the heritage assets will lead to the distortion of the statement of financial performance (Stanford, 2005). Accordingly, there is a lack of a practical accounting approach for heritage assets that can overcome the exaggeration of net worth and distortion of the performance statement.

Consequently, the main objective of the paper is to examine the existing accounting approaches for heritage assets and their impact on the Net Worth and Performance Statement and to suggest a Practical Accounting Approach for heritage assets, by which the exaggeration of net worth and the distortion of performance statement may be overcome.
To tackle the main objective of this paper, the following questions may be raised:

1. Do heritage assets meet the definition of assets?
2. Can heritage assets be considered as a separate class of assets rather than a separate class of property, plant and equipment?
3. What are the current accounting approaches for heritage assets?
4. What will be the impact of a full capitalization approach on the net worth and of an expensing approach on the performance statement in Egypt?
5. What is the accounting approach that is best suitable for accounting for heritage assets?

The paper is structured as follows: 1) the first section focuses on examining the existing accounting approaches for heritage assets and their impact on the net worth and performance statement; 2) the second section is devoted to proposing a practical accounting approach for heritage assets by which the exaggeration of net worth and distortion of performance statement may be avoided; and 3) the third section contains the conclusion.

1. Current Accounting Approaches for heritage assets

While the debate on accounting for heritage assets under accrual accounting has been ongoing for more than two decades, there is no definitive or legal definition of heritage assets and there is no consensus about a unified or better accounting treatment for heritage assets (Mautz, 1988; Pallot, 1990 & 1992; Rowles, 1991; Wolnizer, 1995 & 1996; Micallef and Peirson, 1997; Carnegie and Ström, 1997; Carnegie and Wolnizer, 1999; Barton, 2000; and Hooper and others, 2005). The lack of consensus among the standard-setters, opponents and supporters can raise the following questions: Do heritage assets meet the definition of assets? Can heritage assets be considered as a separate class of assets rather than a separate class of property, plant and equipment?

Generally, in order to capitalize an item in the balance sheet, this item should follow two steps. These two steps are identified in IASB and IPSAS 1, 16, and 17 as follows:

a) whether the item meets the definition of an asset;
b) whether the item satisfies the recognition criteria.

The international Accounting Standards Board (IASB) (formerly known as IASC) defines an asset in the following way: “an asset is a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise (IASB, 1989, Para.49). The IASB definition refers only to future economic benefits. However, the PSC-IFAC, in common with other public sector standard setters, sees that the definition of an asset needs to incorporate both economic benefits and service potential. Where IPSAS 1 Presentation of Financial Statements, paragraph 6, defined assets as follows: Assets are resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.

While the above-mentioned definition is generally valid for the public sector capital assets, the heritage assets are defined as assets with historic, artistic, scientific, technological, geophysical or environmental qualities that are held and maintained principally for their contribution to knowledge and culture and this purpose is central to the objectives of the entity holding them (UK –ASB,2006). Also IPSAS 16 & 17 identified two criteria that can be used for determining when an asset should be recognized:

(a) It is probable that future economic benefits or service potential associated with the asset will flow to the entity; and
(b) The cost or fair value of the asset to the entity can be measured reliably.
1.1 Do heritage assets meet the definition of assets?

The accounting literature has made clear that there are different standpoints about whether or not the heritage assets meet the definition of an asset. On the one hand, Stanford (2005) sees that the IPSAS definition of assets as “resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity,” appears sufficiently wide to comprise most of the items commonly referred to as “heritage assets”. On the other hand, he is of the view that if the entity has no intention to use the asset for operational purposes, put it on display or use it for cultural or educational purposes, in such cases, it is questionable whether such assets are likely to give rise to service potential and therefore whether they should be capitalized.

On the contrary, the UK Accounting Standards Board issued Financial Reporting Standard (FRS) 30, Heritage Assets in 2009 (hereafter ASB-FRS 30). The ASB-FRS 30 sees that, conceptually, heritage assets are assets. They are central to the purpose of an entity such as a gallery or museum: without them, the entity cannot function. An artifact held by the Egyptian Museum might be realizable for cash and it might generate income indirectly through admission charges. However, the most important thing is that the museum needs the artifact to function as a museum. The artifact is held and maintained to serve some purposes such as educational and cultural or it can be preserved for future display or for academic or scientific research. The ASB-FRS 30 has further argued that the future economic benefits associated with the artifact are primarily in the form of its service potential rather than cash flows.

Accordingly, the ASB-FRS 30 is in view that by virtue of the service potential they provide, heritage assets meet the definition of an asset; that is, they provide rights or other access to future economic benefits controlled by an entity as result of past transactions or events. Consequently, it can be inferred that heritage assets meet the definition of assets as they can provide future economic benefits in the form of service potential and they are held and maintained principally for their contribution to knowledge and culture and this purpose is central to the objectives of the entity (e.g., Museum) holding them.

1.2 Can heritage assets be considered as a separate class of assets rather than a separate class of property, plant and equipment?

Heritage assets are one of the public sector assets that have been subjected to diversity of concepts, terminology and classification. Some authors called heritage assets as community assets (e.g., Pallot, 1990 and 1992) although the community assets include some assets that are not essentially pure heritage assets such as urban parks and sports-grounds; public infrastructure assets; national parks; and public road and rail systems. Basically, community assets is a broad term and we need to distinguish heritage assets from those community assets that can be for sale and used for economic purposes. For example, many of the national parks in Egypt have been used for other purposes such as building houses for youths. Therefore, the pure heritage assets (such as museum and gallery collections, other works of art, national archives; and archaeological sites, ruins, burial sites, monuments and statues) should be distinguished from other community assets (such as national parks; public road and rail systems). Heritage assets cannot be replaced or sold due to the existence of legal, social or cultural restrictions. Thus, they are considered as Restricted Assets.

In addition, some other authors consider the heritage assets as public goods/public facilities (Barton, 2000 and Mautz, 1988). The term public goods is also a broad term as most public sector assets can be considered as public goods. For instance, public roads are public goods and archaeological sites are also public goods. While the public roads are used for facilitating the daily life of the public and can be used for economic purposes, they are different from the...
heritage assets that are mainly held for their contribution to knowledge and culture purposes (such as works of art, history books and national archives). Moreover, the public roads could be replaced or changed. For example, some public roads in Egypt have been changed/cancelled due to the need for expanding the constructed area of some cities, and hence, the government has constructed a new public road outside the city.

In addition, most authors forget one essential point, which is the period of time that needs to pass before considering any asset as a heritage asset. Many countries are setting some timing conditions for considering any asset as a heritage asset. For example, the Egyptian Government considers any public asset as a heritage asset if it has existed for more than 100 years. According to Egyptian Law no. 117 of 1983 as amended by law no.3 of 2010 - “Any real-estate or chattel is considered an antiquity whenever it meets the following conditions:

- To be the product of Egyptian civilization or the successive civilizations or the creation of art, sciences, literature, or religion that took place on the Egyptian lands since the pre-historic ages and during the successive historic ages till before 100 years ago.
- To be of archaeological or artistic value or of historic importance as part of the different aspects of Egyptian civilizations or any other civilization that took place on the Egyptian lands.
- To be produced and existed on the Egyptian lands and of a historical relation thereto and also the mummies of human races and beings contemporary to them are considered like any antiquity which is being registered in accordance with this law.”

Actually, the aforementioned three conditions are sufficient to consider the heritage assets as a separate class of assets rather than a separate class of property, plant and equipment. The heritage assets should be the product of the country civilization, should take place on the country’s land and been in existence for more than 100 years. They must be of archaeological or artistic value or of historic importance and they must have been produced and existed on the country’s land. In addition, it can be argued that for most assets that have existed for more than 100 years, their costs have already been depreciated. Therefore, when these assets transferred to heritage assets, there should be no book values as their values have already been depreciated during the last 100 years. Furthermore, most accounting standard-setters (such as IFAC, 2006, ASB, 2009, and IPSAS 17) have discussed a number of specific characteristics, which can enhance the aforementioned argument in considering heritage assets as a separate class of assets rather than a separate class of property, plant and equipment. These are:

- they are often irreplaceable and their value may increase over time even if their physical condition deteriorates;
- they are rarely held for their ability to generate cash inflows or sale proceeds and there may be legal or social obstacles to using them for such purposes;
- they are protected, kept unencumbered, cared for and preserved;
- it may be difficult to estimate their useful lives, which in some cases could be several hundred years and they may incur high maintenance costs;
- their value in cultural, environmental, educational and historical terms is unlikely to be fully reflected as a financial value based purely on a market price; and
- they are often described as inalienable, i.e. the entity cannot dispose of them without external consent.

Accordingly, it can be inferred that heritage assets are accounted for as a distinct category of assets because their value is unlikely to be fully reflected in a financial value or price. Many
are unique, meaning their value may increase, rather than depreciate, even if the physical condition deteriorates. In addition, heritage assets may incur high maintenance costs and their life might be measured in hundreds of years. Moreover, heritage assets are restricted assets as there are legal, cultural or social obstacles to selling or disposing of them.

1.3 Current accounting approaches for heritage assets

The accounting literature for heritage assets has proposed different options of accounting for heritage assets under accrual accounting as follows:

- Full Capitalization of both new acquisition and retrospectively acquired items.
- Capitalization of new acquisitions with no recognition of heritage assets acquired before the adoption of accrual accounting.
- A non-capitalization approach and expensing of heritage items
- Provision of extensive information through disclosure

- Full Capitalization of both new acquisition and retrospectively acquired items

According to the full capitalization approach, where an entity can obtain reasonable current values for the majority of heritage assets held, these values should be reported in the balance sheet (ASB, 2006). In other words, this approach would require each public sector entity to recognize and capitalize the heritage assets, including those acquired in previous and recent accounting periods, in the balance sheet where information on cost or value is available. One merit of this approach is that this would ensure a consistent accounting treatment for the previously and recently acquired heritage assets. Also the full capitalization of heritage assets will assist in informing the funders and financial supporters about the value assets held, reporting on stewardship of the assets by the owner entity and informing the decision-makers about whether resources are being used appropriately (ASB-2006).

In addition, if heritage assets are not capitalized, the balance sheet will not provide a complete picture of an entity’s financial position. For this reason, it is better to report heritage assets in the balance sheet where information is available on cost or value rather than leave these assets out of the balance sheet. The ASB-FRS 30 considers the best financial reporting is achieved when heritage assets are reported as tangible assets at values that provide useful and relevant information at the balance sheet date. Accordingly, the ASB-FRS 30 sees that the current valuation will be more useful than historical cost, although it is acknowledged there can be difficulties in obtaining valuations for heritage assets. In fact, most accounting standard-setters prefer that heritage assets should be report at current value rather than at historical cost. This is due to the fact that many heritage assets were acquired sometime in the past; the passage of time and the subsequent changes in market values – where they exist and which can be unpredictable – mean that historical cost is not a useful guide to their value. This means that over time the historical cost will not be useful and relevant for the reporting of heritage assets.

In fact, the main issue here is to consider the impact of full capitalization of heritage assets on the Net Worth for a country like Egypt and whether this impact is consistent with the reliability, credibility, relevance and comparability of accounting information and to see to what extent the reporting of heritage assets in the balance sheet will be misleading to creditors and to management.

In order to discuss this impact, we should take into considerations some points such as: history and culture of nations are not for sale; volume of heritage assets owned by each country and its impact on net worth should be taken into account; and usefulness of accounting information to the stakeholders. In addition, we assume that there is available information on cost or value of
heritage assets. Taking the above-mentioned points into account and studying the situation of a country like Egypt can demonstrate to what extent the full capitalization approach may affect the net worth in Egypt. Egypt hosts different types of heritage assets such as:

- Pharaonic antiquities;
- Greco-Roman antiquities;
- Islamic-Coptic antiquities; and
- Recent antiquities.

In fact, the city of Luxor in Egypt hosts one third of the monuments and antiquities of the entire world (Pharaonic Heritage Assets only). So if we add the other Pharaonic antiquities in other cities and the Greco-Roman antiquities, Islamic-Coptic antiquities and recent antiquities, we will find that Egypt possesses around two thirds of the world’s heritage assets. Assuming that there is available information on value or cost of the two thirds of heritage assets, the question is: How much will be the amount of the two thirds of heritage assets? In fact, nobody can imagine how much this amount is, but presumably it would be trillions of dollars. So if these heritage assets were to be capitalized in the balance sheet of the Egyptian government, nobody can imagine the volume of the positive net worth. Therefore, the full capitalization of all heritage assets in Egypt will result in the exaggeration of net worth, which indicates that Egypt has huge positive economic/financial resources (net worth). In fact, this is untrue as Egypt is suffering from a large public debt and budget deficit. The question here is: Assuming that the information on cost or value of heritage assets is available, can the Egyptian Government dispose/sell heritage assets and use them to match the liabilities? Based on the aforementioned assumption that history and culture of nations are not for sale, no Egyptian Government has dared/attempted to perform such an act. Then, the question is: what is the benefit of having financial values that cannot be used to match the liabilities, to repay the debts, or to cover the budget deficit? Furthermore, what is the usefulness of inclusion of such information in the financial statements for the stakeholders? Therefore, the inclusion of such information will mislead the fair presentation of the actual financial position of government and the reliability of financial information. In fact, heritage assets are held and maintained principally for their contribution to knowledge and culture of present and future generations. Accordingly, I can infer that while the information on cost or value of heritage assets is available and heritage assets meet the definition of an asset and the two recognition criteria, the inclusion of heritage assets in the balance sheet where there are restrictions on their disposal and hence on using them to match liabilities is misleading to the stakeholders. It also contravenes essential accounting requirements that reported information should reflect qualitative characteristics of relevance, reliability, consistency, comparability and verifiability, in order to be useful to the users.

- **Capitalization of new acquisitions with no recognition of heritage assets acquired before the adoption of accrual accounting.**

This approach has been used in the UK in 2001 when public-benefits entities adopted the FRS 15. This approach aims at capitalizing the newly acquired heritage assets and not capitalizing the similar heritage assets that have been acquired in the past (before the adoption of accrual accounting). This approach is known as a mixed approach. Some claim that this approach appears to have some practical advantages in that reliable cost information is readily available for recent purchases and there is no requirement for retrospective valuation where cost information might not be available (ASB, 2006). However, this approach suffers from some shortcomings as follows: - Inconsistent treatment of similar assets: within the same class of assets there are two accounting policies (capitalization and non-capitalization approach) applied. For instance, a gallery or a museum may own two similar heritage assets, one was acquired some time ago and is not capitalized in the balance sheet, whereas the other was acquired...
recently and has been capitalized at the market value. The different accounting treatment can lead to confusion with respect to the statement of financial position and statement of financial performance of the gallery or the museum. – **Subsequent expenditure**: Inconsistent accounting treatment will lead to different treatment for subsequent expenditure. For instance, the restoration costs that may extend the life of a historical building should be capitalized. However, if these costs were related to a historical building not capitalized, then these costs would be expensed. Accordingly, the inconsistent treatment has led to different treatment for the same costs for similar assets. In addition, the capitalization of some assets and non-capitalization of other assets will lead to incomplete financial information. Therefore, the adoption of this approach will lead to different accounting problems and does not solve the dilemma of accounting for heritage assets.

- **Non-capitalization approach and expensing of heritage items**

Under this approach, the public sector entities are not allowed to capitalize heritage assets whether those assets were acquired recently or in the past. This would ensure that an accounting policy is applied consistently to all heritage assets. In addition, the adoption of this approach will avoid the above-mentioned problems under the mixed approach. However, the main problem of applying this approach is that it will lead to the distortion of the performance statement since the acquisition of a heritage asset will be recorded as an expense in the performance statement. In fact, this could be seen to misrepresent the substance of the transaction in that an asset has been acquired and has not been consumed. This distorts the level of reported expenses and does not properly reflect financial performance (ASB, 2006). Moreover, reporting the full proceeds from the disposal of heritage assets as income in the performance statement is also distorting (ASB, 2006). In an attempt to avoid this distortion, it is proposed that under a non-capitalization approach the acquisition and disposal of heritage assets should be presented separately from the statement of financial performance. This is the main aim of the last option, which is disclosure approach.

- **Provision of extensive information through disclosure (Disclosure Approach)**

A disclosure approach agrees with non-capitalization approach in that public entities would not be required to capitalize heritage assets acquired in the past or during the current period. Instead, the public entities should provide sufficient disclosure on the reasons for not adopting the capitalization approach, the nature and number of heritage assets held, the purpose for their preservation and financial information on acquisitions and disposals within the reporting period (IFAC, 2005 and Stanford, 2005). Unlike the non-capitalization approach, under a disclosure approach it is proposed to segregate heritage asset transactions (such as acquisition, disposal and major restoration costs) from the income and expenditure account (performance statement) for the reporting period. IFAC and Stanford (2005) believe that presentation of acquisition of a heritage asset as an expense would be wrong as an asset has been acquired which has not been consumed. This distorts the level of reported expenses and does not properly reflect financial performance. The UK ASB (2005) proposes that heritage asset transactions should be presented in a separate statement clearly distinguished from financial performance. It is considered that this approach will provide users with a clearer picture of heritage asset transactions for the reporting period.

However, while the disclosure approach has attempted to avoid the distortion of the performance statement, it did not avoid the disadvantages of the non-capitalization approach and did not provide an appropriate accounting approach for heritage assets. While it proposes the segregation of heritage asset acquisition, disposal and major restoration costs from the income and expenditure account for the reporting period, it remains silent on how to account for not capitalizing heritage assets and how to treat the revenues or costs related to heritage assets. In
addition, it did not provide information on the format and shape of the separate statement. Accordingly, it can be inferred that the aforementioned four approaches did not provide a unified and appropriate accounting approach and the accounting for heritage assets remains an unresolved problem.

2. A Practical Accounting Approach for Heritage Assets under Accrual Accounting

As earlier noted, the previously discussed accounting approaches have led to inconsistent accounting treatment for heritage assets, which results in distortion of statement of financial performance or exaggeration of net worth of a country. With respect to capitalization or non-capitalization of heritage assets, the accounting literature for heritage assets has been focused on whether information on cost or value of heritage assets is available or not. If it is available then heritage assets should be capitalized and if it is not available then heritage assets should not be capitalized regardless of whether heritage assets can be sold/disposed and can be matched to the liabilities or not. The accounting literature does not take into consideration whether or not there are legal, cultural and/or social restrictions on disposal of heritage assets.

In addition, the accounting literature does not recognize the consequences of capitalization and non-capitalization of heritage assets on the net worth and the performance statement, respectively. This can lead to exaggeration of net worth if one country like Egypt, which possesses at least one-third of worldwide heritage assets, has capitalized all its heritage assets. It can also lead to distorting the performance statement if the Egyptian government has not capitalized the heritage assets and expensed them in the revenue and expenditures accounts. Therefore, in order to improve the quality of financial reporting of governmental entities, overcome the exaggeration of net worth and distortion of the statement of financial performance, and to provide suitable information for decision–making and stakeholders needs, there is an urgent need to develop a new Accounting Approach that focuses on consistent and transparent accounting treatment for heritage assets, which I might call a Practical Approach.

In fact, the accounting for heritage assets should not focus only on the technical accounting side but also on the reliability, credibility and usefulness of accounting information for different stakeholders and its impact on the decision-making. Therefore, the proposed Practical Approach should consider the specific nature of heritage assets and be consistent with the reliability, credibility, relevance and comparability of accounting information. The Practical Approach is based on the earlier proposed solutions whether by authors or by professional bodies (Barton, 2000, Stanford, 2005, Pallot, 1990, 1992, ASB, 2006, ASB-FRS 11, 15 and 30, FASAB 2005, and IPSAS 17) and the following assumptions:

- History and culture of nations are not for sale;
- The main task of accounting and accountants is not to mislead stakeholders but to assist them in making the right decision. Accordingly, the benefits of the capitalization of heritage assets must be matched to the liabilities;
- The issue is not to focus only on the technical side of accounting for heritage assets but also on reliability, relevance, credibility, verifiability and comparability of accounting information that is included in the financial statements and its usefulness to different stakeholders;
- The legal, cultural and social restrictions on heritage assets are considered as barriers to their disposal. Therefore, restrictions should be considered in deciding on whether heritage assets should or should not be capitalized;
In order for governmental entities to avoid the exaggeration of net worth or distortion of the statement of financial performance, the main issue is not only whether or not information on cost or value of heritage assets is available, but also whether or not heritage assets can be disposed and used to match liabilities;

Where information on cost or value of heritage assets is available and heritage assets can be sold/disposed (no legal, cultural and/or social restrictions on these assets - Unrestricted Assets) and can be used to match the liabilities, then they should be capitalized. (this we might call: Assets-Liabilities Matching Approach);

Where information on cost or value of heritage assets is not available or available but due to existence of the legal, cultural and/or social restrictions on the disposal of heritage assets and they cannot be sold and considered as financial resources to match the liabilities (Restricted Assets), then they should not be capitalized. (this we might call: Non-Assets-Liabilities Matching Approach); and

Heritage assets are custodial in nature and the government is the custodian.

2.1 The Practical Approach:

Under this approach, the two recognition criteria (stated in IPSAS 16 & 17) that can be used for determining when an asset should be recognized, should be extended to include one more criterion that can be used for deciding on whether or not to recognize heritage assets. These are as follows:

a) It is probable that future economic benefits or service potential associated with the asset will flow to the entity;

b) The cost or fair value of the asset to the entity can be measured reliably.

In addition:

c) There are no legal, cultural and/or social restrictions on the disposal of the asset.

Consequently, the practical approach will focus on whether the information on cost or value of heritage assets is available and whether heritage assets can be disposed/sold, and hence they can be used to match against liabilities. The practical approach considers whether there are legal, cultural and social restrictions on the disposal of heritage assets. If there are legal, cultural and social restrictions on the disposal of heritage assets (Restricted Heritage Assets), then the capitalization of heritage assets will be misleading to creditors because they are not accessible. If there are no legal, cultural and social restrictions on the disposal of heritage assets and the information on cost and value of heritage assets is available, then the capitalization of heritage assets will not lead to misleading of the stakeholders as they can be matched to liabilities (Unrestricted Heritage Assets). In addition, the practical approach recognizes the consequences of accounting treatment of heritage assets on the net worth and performance statement and its impact on reliability of financial information that is provided in the financial statements. Consequently, The Practical Approach will be based on the following two sub-approaches:

- **Assets-Liabilities Matching Approach**: Capitalize if the information on cost or value of heritage assets is available and heritage assets can be disposed, and hence they can be used to match against liabilities. (Unrestricted Heritage Assets); and

- **Non-Assets-Liabilities Matching Approach**: Non-Capitalization if the information on cost or value is not available or available but heritage assets cannot be disposed, and hence they cannot be used to match against liabilities. (Restricted Heritage Assets).
2.1.1 Assets-Liabilities Matching Approach:

Under this approach, heritage assets are considered as legally, culturally and socially unrestricted assets. The information on their cost or value is available and they can be used to match against liabilities. Accordingly, they should be capitalized in the balance sheet at current value. An obvious example of heritage assets that can follow this approach in Egypt is the Heritage Presidential Palaces. Due to the financial problems after the January 25th revolution, many Egyptians economists argue that these problems may be solved through the disposal of presidential palaces in Egypt, which are not in use. In fact, this option has already been applied in Tunisia in 2012 as a solution to their financial problem after the revolution in that country.

The adoption of Assets-Liabilities Matching Approach does not require completely new accounting standards. In fact, there are different accounting standards that have been developed and can be used by this approach such as UK-ASB-FRS 11, 15, and 30 and the Accounting Guideline GRAB 103 of Republic of South Africa. However, in order for these accounting standards to be consistent with the practical approach, there should be some amendments to these standards. For instance, UK-ASB-FRS 30 requires that heritage assets be reported in the balance sheet where information on cost or value is available. The Assets-Liabilities Matching Approach agrees with this context. In addition, it clearly should be stated that there are no legal, cultural and/or social restrictions on the disposal of heritage assets, and hence, they can be used to match against liabilities. After making this amendment, this approach can follow the above-mentioned Accounting Standards. According to FRS 30 an entity should report heritage assets as tangible assets and recognize/measure these assets in accordance with FRS 15. Tangible fixed assets are subject to the requirements set out in paragraphs 19 to 25 (FRS 30).

Recognition and Measurement

19. Where information is available on the cost or value of heritage assets and heritage assets can be disposed and matched against liabilities:
   (i) they should be presented in the balance sheet separately from other tangible fixed assets;
   (ii) the balance sheet or the notes to the accounts should identify separately those classes of heritage assets being reported at cost and those at valuation; and
   (iii) changes in the valuation should be recognised in the statement of total recognised gains and losses, except for impairment losses that should be recognised in accordance with paragraph 24.

20. Where assets have previously been capitalised or are recently purchased, information on their cost or value will be available. Where this information is not available, and cannot be obtained at a cost which is commensurate with the benefits to users of the financial statements, the assets will not be recognised in the balance sheet and should be treated in accordance with the Non-Assets-Liabilities Matching Approach.

21. Valuations may be made by any method that is appropriate and relevant.

22. There is no requirement for valuations to be carried out or verified by external assessors, nor is there any prescribed minimum period between valuations. However, where heritage assets are reported at valuation, the carrying amount should be reviewed with sufficient frequency to ensure the valuations remain current.

Depreciation and Impairment

23. Depreciation need not be provided on heritage assets which have indefinite lives.

24. The carrying amount of an asset should be reviewed where there is evidence of impairment, for example where it has suffered physical deterioration or breakage or new doubts arise as
to its authenticity. Any impairment recognised should be dealt with in accordance with the recognition and measurement requirements of FRS 11 ‘Impairment of fixed assets and goodwill’. The objective of FRS 11 is to ensure that:

a. Fixed assets and goodwill are recorded in the financial statements at no more than their recoverable amount;

b. Any resulting impairment loss is measured and recognised on a consistent basis; and

c. Sufficient information is disclosed in the financial statements to enable users to understand the impact of the impairment on the financial position and performance of the reporting entity.

FRS 11 sets out the principles and methodology for accounting for impairments of fixed assets and goodwill. It replaces the previous approach whereby diminutions in value were recognized only if they were regarded as permanent. Instead, the carrying amount of an asset is compared with its recoverable amount and, if the carrying amount is higher, the asset is written down. Recoverable amount is defined as the higher of the amount that could be obtained by selling the asset (net realizable value) and the amount that could be obtained through using the asset (value in use). Value in use is calculated by forecasting the cash flows that the asset is expected to generate and discounting them to their present value. Where individual assets do not generate independent cash flows, a group of assets (an income-generating unit) is tested for impairment. Impairment tests are only required when there has been some indication that impairment has occurred.

Donations

25. The receipt of donations of heritage assets should be reported in the Performance Statement at valuation. Where, exceptionally, it is not practicable to obtain a valuation of heritage assets acquired by donation, the reasons why should be stated. Disclosures should also be provided on the nature and extent of significant donations of heritage assets.

2.1.2 Non-Assets-Liabilities Matching Approach:

According to this approach, heritage assets are considered as legally, culturally and socially restricted assets and they should not be capitalized in the balance sheet but treated as Agent Assets, Trust Assets, Custodial Assets, or Pass-Through Assets. This approach agrees with Barton (2000 and 2005) that the government holds the heritage assets in trust for present and future generations and has a responsibility to protect and preserve them. The costs of protecting and maintaining them should be borne by each generation as they enjoy the benefits from them. As trust assets, public heritage assets should not be included in the government’s own statement of assets and liabilities. They should not be regarded as part of the government’s financial position and be available to meet its financial commitments. In trust accounting, the trustee is obliged to keep trust assets separate from its own assets and to report them separately (Barton, 2000). This means that the heritage assets are beyond the financial position of the government. The most obvious examples of heritage assets in Egypt that can follow this approach are the Pharaonic antiquities, Greco-Roman antiquities, and Islamic-Coptic antiquities, which include museum and gallery collections, other works of art, national archives; and archaeological sites, ruins, burial sites, monuments and statues.

Consequently, each country should create an Agent/Trust Assets Statement where heritage assets are stated in physical units, not in financial values. The statement of trust assets should include a description of major categories (types), physical units added and withdrawn during the year, and a description of the methods of acquisition and withdrawal. In addition, an explanatory
note (note disclosure) should supplement the statement of trust assets. The note disclosure related to heritage assets should provide the following: (FASAB, 2005)

a. A concise statement explaining how they relate to the mission of the entity.

b. A brief description of the entity’s stewardship policies for heritage assets.

Stewardship policies for heritage assets are the goals and principles the entity established to guide its acquisition, maintenance, use, and disposal of heritage assets consistent with statutory requirements, prohibitions, and limitations governing the entity and the heritage assets.

c. A concise description of each major category of heritage assets. The appropriate level of categorization of heritage assets should be meaningful and determined by the preparer based on the entity’s mission, types of heritage assets, and how it manages the assets.

d. Heritage assets should be quantified in terms of physical units. For each major category of heritage assets (identified in c above) the following should be reported:

1. The number of physical units by major category;

2. The number of physical units by major category that were acquired and the number of physical units by major category that were withdrawn during the reporting period; and

3. A description of the major methods of acquisition and withdrawal of heritage assets during the reporting period. This should include disclosure of the number of physical units transferred to and/or from the entity and the number of physical units acquired through donation. In addition, the fair value of heritage assets acquired through donation during the reporting period should be disclosed, if known and material.

Furthermore, heritage assets held in trust may generate revenues indirectly through admission charges and incur costs such as restoration and maintenance costs. So in order to account for the revenues and costs related to heritage assets, each country should create a Trust Fund (Agent Fund). This fund will include all the revenues and costs related to heritage assets in that country. The balance of the trust fund would be reported as either a liability or an asset in the balance sheet. If this balance is positive, then it will be considered as an asset (fund surplus) and the increasing of the net worth will be called Heritage Net Worth. Moreover, if it is negative (fund deficit), then it will be considered as a liability and the decrease in the net worth will be called as Negative Heritage Net Worth.
Conclusion

Whilst the debate concerning the appropriate approach of accounting for heritage assets started more than two decades ago and still continues on unabated, there is no consensus about an internationally acceptable accounting approach. The accounting approaches proposed in the public sector accounting literature do not provide an appropriate accounting approach and the accounting for heritage assets remains an unresolved problem. These approaches do not take into consideration if there are legal, cultural and/or social restrictions on the disposal of heritage assets. In addition, they do not recognize the consequences of capitalizing and not capitalizing heritage assets on the net worth and the performance statements, respectively. Capitalizing all heritage assets may lead to exaggeration of net worth if one country like Egypt, that possesses two-thirds of worldwide heritage assets, has capitalized all its heritage assets. It also can lead to the distortion of the performance statement if the Egyptian government has not capitalized the heritage assets and expensed them in the account of revenue and expenditures. Therefore, in order to improve the quality of financial reporting of governmental entities and to overcome the exaggeration of net worth and distortion of the statement of financial performance, there is an urgent need to develop a new Accounting Approach that focuses on consistent and transparent accounting treatment for heritage assets and to avoid the exaggeration of net worth and distortion in the performance statement. This approach is proposed in this paper. It is called a Practical Approach. The Practical Approach has been based on the following two sub-approaches:

- **Assets-Liabilities Matching Approach**: Capitalize if the information on cost or value of heritage assets is available and heritage assets can be disposed, and hence they can be used to match against liabilities. *(Unrestricted Heritage Assets).* According to this approach, heritage assets should be included in the statement of financial position. In addition, the revenues and costs related to heritage assets should be included in the statement of financial performance. The adoption of Assets-Liabilities Matching Approach does not require completely new accounting standards. In fact, there are different accounting standards that have been developed and can be used by this approach such as UK-ASB-FRS 11, 15, and 30 and the Accounting Guideline GRAB 103 of Republic of South Africa. However, in order for these accounting standards to be consistent with the practical approach, there should be some amendments to these standards.

- **Non-Assets-Liabilities Matching Approach**: Do not capitalize if the heritage assets cannot be disposed, and hence they cannot be used to match against liabilities even if information on cost or value is available. *( Restricted Heritage Assets).* According to this approach, heritage assets should not be included in the statement of financial position and should be treated as trust/agent assets. Therefore, each country should create a Trust/Agent Assets Statement where heritage assets are stated in physical units, not financial values. So in order to account for the revenues and costs related to heritage assets, each country should create a Trust Fund *(Agent Fund).* This fund will include all the revenues and costs related to heritage assets in each country. The balance of the trust fund would be reported as either a liability or an asset in the balance sheet.
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Analysing Service-Level Solvency of Local Governments from Accounting Perspective: A Study of Local Governments in the Province of Yogyakarta Special Territory, Indonesia

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Abstract

This study aims to develop measures of service-level solvency of local government from an accounting perspective and to implement the measures to analyze service-level solvency of local governments in the Province of Yogyakarta Special Territory. The metrics are the first instruments developed in Indonesia to measure service-level solvency of local governments using accounting information. The metrics consist of total assets per capita, total equities per capita, total fixed assets per capita, total expenditures per capita, total public expenditures per capita, and total capital expenditure per capita. The metrics can be used as indicators to assess how sound a local government achieves its objectives.

The analysis of service-level solvency of local governments during the period of 2010-2012 was done by using time-series and cross-sectional analysis. Results of analysis show that all local governments showed improvement trends. Kabupaten Kulon Progo was the best local government compared with other regency local governments; Kabupaten Gunungkidul demonstrated an accelerated trend compared with other regency local governments; and Kabupaten Sleman and Kabupaten Bantul showed decreasing trends compared with its compatriot.

1. INTRODUCTION

1.1 Background

Indonesia is a unitary state that implements a decentralized governance system by granting autonomy to local governments. Local government (LG) autonomy is the delegation of all authorities and submission of all the central government’s affairs, except the affairs of foreign policy, defense, security, judicial, monetary and national fiscal, and religion to LGs within the framework of democracy and national development by involving local people’s aspirations and participation (Local Government Amendment Act, 2004). Thus, the development in a region will be based on its people’s economic and political aspirations.

One aspect of LG autonomy is fiscal decentralization. Fiscal decentralization is a process of distribution of funds from the higher levels of government to the lower levels of government to support the delegation of authority and submission of some of the higher level government’s affairs to the lower level governments (Fiscal Balance between Central and Local Government Act, 2004). Fiscal decentralization is a logical consequence of the implementation of regional

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autonomy with respect to the concept of money follows functions\textsuperscript{2}, which means that the transfer or delegation of central government authorities must be accompanied by the allocation of funds needed to exercise these powers. Fiscal Balance between Central and Local Government Act (2004) authorises LGs to obtain financial resources in the form of assurance from the central government (i.e., decentralization fund) in accordance with the affairs of the central government that were handed over to LGs, collect and utilize taxes and levies, obtain the results of national resources in their area, and manage regional assets and obtain sources of legitimate income and sources of financing.

In the framework of LG autonomy, each LG is granted rights to design their own policies to achieve national objectives as long as they are congruent with the central government’s strategic plan. The central government only provides principles of managing local finance to LGs rather than detailed rules it provided previously. As a result, each LG has its own programs and activities based on its people’s perceptions, both economically and politically. The implementation of those programs and activities is financed through the LG budget. Because each LG has different programs and activities, each LG will have a different budget allocation. In turn, the quantity and quality of services and goods provided to the public will be different for each local government. As a result, the service-level condition of each LG varies. This study defines service-level solvency of local government in terms of the capacity of local government to supply and maintain the level of services it provides to the community (Wang and others, 2007).

1.2 Research Problem

Based on the background as stated above, the following question is raised: “How good is a local government’s capacity to supply and maintain services at a certain standard and quality needed and requested by its people?” Studies assessing quality of services and goods provided by local governments are frequently done, either by scholars or professional bodies. For example, in Indonesia there are indices of public satisfaction toward local government services and indices of public services. In Spain, to measure service-level solvency, Zafra-Gomez and others (2009a, 2009b, 2009c) use indicators of the grade of services supplied by local government. The types of services are basic services in every local government, which are roads and highways, public parks, street lighting and waste collection.

However, research analyzing service-level solvency of local government from the accounting perspective is limited. To the author’s knowledge, no research has been done in Indonesia. This situation motivated the author to analyze local government’s capacity to supply and maintain services to its people by using accounting information.

\textsuperscript{2} Concept of money follows functions referring to the budget allocation which is based on the functions of each level of local government entrusted by the law to it in order to avoid overlapping of functions and activities performed by each level of local government (State Finance Act 17, 2003).
1.3 Research Objectives

Two main objectives of this study are to develop measures of service-level solvency of local government from the accounting perspective; and to implement the measures to analyze service-level solvency of local governments in the Province of Yogyakarta Special Territory.

1.4 Research Contribution

This study offers new measures of service-level solvency of local governments by using audited financial information derived from financial statements. Advantages of using such information are objectivity and reliability because the information has been verified by the Supreme Audit Office (SAO). Another advantage is that the information is publicly available and annually released by the SAO.

The measures of service level solvency are analogous to measures of profitability in the business sector. In the business sector, because the main objective of the organization is to maximize stakeholders’ value through profit maximization, the measures are developed to assess how far the organization achieves this objective with ratios related to the organization’s profitability (i.e., ROI, ROE, profitability index). In the public sector organization, measures of service-level solvency can be referred to as indicators of how well a local government achieves its objectives through delivering goods and services to its community.

2. LITERATURE REVIEW

2.1 Definition of Service-Level Solvency of Local Government

Only a few scholars have defined the meaning of service-level solvency of local government. Groves and others (1981) and Nollenberger and others (2003) define it as local government capability to supply services in the quantity and quality that are needed and requested by its people; whereas Chaney and others (2002) state it as local government’s ability to maintain the provision of basic government services. Almost similar to Chaney and others’ definition, Kamnikar and others (2006) define service-level solvency as the capability of local government to maintain the sustainability of local government general services to the public. In their study, Wang et al. (2007) state that service-level solvency is the capacity of local government to supply and maintain the level of services it provides to the community.

Chaney and others (2002) and Kamnikar and others (2006) measure service-level solvency as a comparison of unrestricted net assets to total expenses (i.e., Unrestricted net assets/Total expenses). Chaney and others (2002) argue that unrestricted net assets are an appropriate indicator because they show the accumulation of net assets available to provide services to the community. However, the use of the indicator Unrestricted net assets/Total expenses might not be appropriate to show a local government’s capability to preserve the pre-existing fundamental government services because it is the total assets, not only the unrestricted assets, that are used by local government to provide services to the community in the future. In addition, the denominator of the ratio should be population size, instead of expenses, so that the indicator demonstrates the resource level available to serve one citizen.
Dennis (2004) measures service-level solvency using several ratios, which are outstanding general long-term debt per resident, general fund operating revenues per resident, general fund expenditures per resident, debt service fund expenditures per resident, and capital projects fund expenditures per resident. Unfortunately, Dennis did not explain the logical framework to develop the ratios.

Wang and others (2007) use ratios \( \text{Total taxes / Population}; \text{Total revenues / Population}; \text{and Total expenses / Population} \) to measure service-level solvency. They argue that higher tax per capita indicates a higher tax burden for residents and a lower service-level solvency; higher revenue per capita indicates a higher revenue burden for a resident to pay and a lower service level solvency; and higher expenses per capita indicate a more expensive government and a lower service-level solvency to sustain such expense level.

The use of the ratios total taxes to population and total revenues to population is not appropriate to reflect the dimension of service-level solvency (i.e., the capability of local governments to supply and to maintain service quality at certain standards that the community needs and requests) because the resources used by local governments to provide services and goods to the community in the future are the total assets, instead of total taxes or total revenues.

Rivenbark and others (2009, 2010) measure local government’s ability to continue service provision by using a ratio of fund balance to total expenditures. They explained that a high ratio suggests that a local government can continue to provide uninterrupted services.

### 2.2 Developing Measures of Service-Level Solvency in the context of Indonesia

This study develops measures of service-level solvency based on the definition of service-level solvency as \textit{the capacity of local government to supply and maintain the level of services it provides to the community} (Wang and others, 2007); and the accounting information provided by audited financial statements of local governments in Indonesia. The audited financial statements consist of a balance sheet, a statement of budget realization, and a cash flow statement.

#### 2.2.1 Determining numerator of service-level solvency

The phrase “\textit{the capacity of local government …..}” is used as a basis to determine the numerator of the ratio.” This phrase refers to all of the resources owned by local government to provide services to the community. The resources could include human resources, natural resources, facilities and all assets owned by local government. From the perspective of financial accounting, the information regarding the capacity of local government to serve its community is depicted in the value of assets in the balance sheet statement and/or in the amount of expenditures in the budget realization statement. Therefore, the value of assets or the amount of expenditures will be used as the numerator of ratios.

**Value of assets as numerator**

The value of assets informs the accumulated resources owned by a local government to provide services and goods to its community since it has been established, while the amount of expenditure informs the amount of goods and services committed by a local government to its community in a certain year. Therefore, the financial information of value of assets is more...
powerful than information of amount of expenditure in interpreting service-level solvency of a local government.

One can use value of total assets, value of total equities, or value of fixed assets as the numerator. Total assets indicate the accumulation and availability of resources owned by local governments in serving the community for the future (Chaney and others, 2002). On the other hand, total equities are the net assets, which is the difference between total assets and total liabilities. This can be thought of as assets not claimed by creditors. These assets are the net resources available to provide services in the future (Chase & Philips, 2004). Finally, total fixed assets refer to tangible assets that have a functional age of more than 12 months for use in local Indonesian government activities or by the public (Government Regulation 24/2005; 71/2010).

**Expenditure as numerator**

Amount of expenditures indicates the size of commitment of local government to serve its resident in a certain year. The more expenditure spent by a local government should be followed by the more services and goods (either quantity or quality) delivered by local government to the community. One can use the amount of total expenditure, amount of public expenditure, or capital expenditure as the numerator. Unfortunately, in Indonesia, the information about amount of public expenditure is not available in the current structure of local government budget or statement of budget realization. Before fiscal year 2006, the structure of local government provided information about the amount of public expenditure.

### 2.2.2 Determining denominator of service-level solvency

To determine the denominator of the ratio the phrase “... to the community” is used as the basis.” This phrase refers to the number of people living in the area of local government. Therefore, the denominator of ratios should be the number of people served by the local government.

Based on the explanation above, the ratios to measure service-level solvency of a local government from the accounting perspective are as follows:

**Exhibit 1: Measures of service-level solvency from accounting perspective**

| Ratio A | Total assets / Population size |
|---------|-------------------------------|
| Ratio B | Equities / Population size    |
| Ratio C | Fixed assets / Population size|
| Ratio D | Total expenditures (constant rupiah) / Population size |
| Ratio E | Public expenditures (constant rupiah) / Population size |
| Ratio F | Capital expenditure (constant rupiah) / Population size |

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Growing value of those ratios shows increasing quantity and quality of service level-solvency delivered by a local government to its residents. However, it cannot be concluded whether or not the existing condition of local government is good, because there is no threshold that distinguishes a good and a weak condition for service-level solvency. However, in general, the higher the ratio of service-level solvency, the better is the service-level solvency.

3. RESEARCH METHODS

3.1 Data and Data Sources

Data utilized in this study consists of audited financial statements, population size, and inflation rate. The audited financial statements of local government include balance sheet, statements of budget realization, and statement of cash flows from 2010 to 2012. Those financial statements are sourced from the Supreme Audit Office of Republic of Indonesia. The opinions of all the financial statements are unqualified opinion or qualified opinion so that the quality of financial information is reliable.

Data of inflation rate are sourced from the Central Bureau of Statistics of the Republic of Indonesia (Biro Pusat Statistik). The inflation rate for the Province of Yogyakarta Special Territory was 3.83% in 2011 and 4.23% in 2012 (Biro Pusat Statistik, 2013). These data are used as discount factors to adjust the purchasing power of local government expenditures in 2011 and 2012 to the base year 2010. Therefore the expenditure sizes of year 2010, 2011, and 2012 are comparable.

Data of population size for year 2010 and inflation rate from 2010 to 2012 are derived from the Central Bureau of Statistics of the Republic of Indonesia. Data for population size for year 2010 are actual data because in that year the Central Bureau of Statistics conducted decennial census of population, whereas data for year 2011 and 2012 are predicted data. To estimate the population size for the year 2011 and 2012, this study uses the results of the study done by Bappenas RI³, Biro Pusat Statistik, and United Nations Population Fund (2005) which state that the average growth of population size for the Province of Yogyakarta Special Territory between 2000 and 2025 is 0.81%. Therefore, the predicted population size year for 2011 is equal to actual population size year 2010 times 1.008 and the predicted population size for year 2012 is equal to estimated population size for year 2011 times 1.008.

3.2 Sample

This study focuses on all local governments in the Province of Yogyakarta Special Territory. There are five local governments in the province, which are one municipal local government (called Kota) and four district local governments (called Kabupaten). The five local governments are Kota Jogjakarta, Kabupaten Sleman, Kabupaten Bantul, Kabupaten Kulon Progo, and Kabupaten Gunung Kidul. Reasons to use local governments in the Province of Yogyakarta Special Territory are:

³ Bappenas RI is the ministry of national planning of The Republic of Indonesia.
1. Local governments in the Province of Yogyakarta Special Territory have adequate quality of financial information as indicated by the opinions (i.e., unqualified opinion or qualified opinion) given the Supreme Audit Board.

2. The similarity of characteristic of local government in terms of socioeconomic, such as level of education of community, wealth of the community, and revenue base of local government.

3.3 Research Procedures

The steps taken in this study are as follow.

a. Develop measures of service-level solvency of local government from the perspective of financial accounting information. This step has been discussed in the literature section of this study.

b. Analyze service-level solvency of local governments in the Province of Yogyakarta Special Territory. The steps taken were as follows:

1. Calculate the measures of service-level solvency.

2. Adjust the purchasing power of local government expenditures for years 2011 and 2012 to the base year 2010. The adjustments are taken by discounting the amount of expenditure of a certain year with the inflation rates. The inflation rate in year 2011 was 3.83% and 4.23% in year 2012 (Biro Pusat Statistik, 2013). The adjustment of local government expenditures for year 2011 is taken by dividing amount of expenditure for year 2011 with \(1 + \text{inflation rate in year 2011}\); and the adjustment of expenditure for year 2012 is done by dividing expenditure in year 2012 with \((1 + \text{inflation rate for year 2011})\) times \((1 + \text{inflation rate for year 2012})\). Therefore the expenditure sizes of years 2010, 2011, and 2012 are comparable.

   The value of total assets and fixed assets for years 2011 and 2012 are not adjusted because the values of those assets are presented in their historical values.

3. Do time-series analysis and cross-section analysis.

4. FINDINGS AND DISCUSSION

4.1 Implementing Measures of Service-Level Solvency

The following Tables 1 through 5 show results from the calculation of ratios of service-level solvency.
### Table 1: Ratio of total expenditure per capita (constant rupiah) from 2010 to 2012 and its growth

| Local Government | Population size | 2010 | 2011 | 2012 | 2010 | 2011 | 2012 | 2010 | 2011 | 2012 | Growth |
|------------------|----------------|------|------|------|------|------|------|------|------|------|--------|
| Kota Jogja       | 387,813        | 390,954 | 394,121 | 839,866,480,661.43 | 897,638,936,090.75 | 946,021,668,730.59 | 2,165,648.08 | 2,296,020.20 | 2,400,331.45 | 10.84% |
| Kab. Sleman      | 1,090,359      | 1,099,191 | 1,108,094 | 1,131,602,398,904.14 | 1,230,911,263,133.29 | 1,313,412,293,866.52 | 1,037,825.52 | 1,118,833.92 | 1,185,298.22 | 14.21% |
| Kab. Bantul      | 911,054        | 918,434 | 925,873 | 1,012,356,847,235.49 | 1,109,396,082,373.08 | 1,185,413,572,664.76 | 1,111,193.02 | 1,207,922.01 | 1,280,320.05 | 15.22% |
| Kab. Kulon Progo | 388,759        | 391,908 | 395,082 | 610,929,785,005.54 | 750,021,354,170.86 | 812,661,985,680.61 | 1,571,487.18 | 1,913,769.19 | 2,056,943.01 | 30.89% |
| Kab. Gunungkidul | 675,175        | 680,644 | 686,157 | 722,210,904,271.50 | 860,899,872,238.97 | 946,239,655,788.82 | 1,069,664.76 | 1,264,831.51 | 1,379,042.22 | 28.92% |

### Table 2: Ratio of total capital expenditure per capita (constant rupiah) from 2010 to 2012 and its growth

| Local Government | Population size | 2010 | 2011 | 2012 | 2010 | 2011 | 2012 | 2010 | 2011 | 2012 | Growth |
|------------------|----------------|------|------|------|------|------|------|------|------|------|--------|
| Kota Jogja       | 387,813        | 390,954 | 394,121 | 53,800,453,105.00 | 56,969,191,059.42 | 81,624,701,069.63 | 138,727.82 | 145,718.29 | 207,105.68 | 49.29% |
| Kab. Sleman      | 1,090,359      | 1,099,191 | 1,108,094 | 99,812,269,370.81 | 122,467,003,956.65 | 129,462,346,988.96 | 91,540.74 | 110,520.38 | 139,827.35 | 20.73% |
| Kab. Bantul      | 911,054        | 918,434 | 925,873 | 123,249,280,474.00 | 135,282.08 | 128,418,346,988.96 | 2,309,516.46 | 167,118.29 | 207,105.68 | 49.29% |
| Kab. Kulon Progo | 388,759        | 391,908 | 395,082 | 46,582,088,894.00 | 122,467,003,956.65 | 129,462,346,988.96 | 91,540.74 | 110,520.38 | 139,827.35 | 20.73% |
| Kab. Gunungkidul | 675,175        | 680,644 | 686,157 | 47,001,128,396.00 | 106,926,200,425.21 | 151,873,858,318.16 | 69,613.25 | 157,095.65 | 221,339.76 | 188.55% |

### Table 3: Ratio of total assets per capita from 2010 to 2012 and its growth

| Local Government | Population size | 2010 | 2011 | 2012 | 2010 | 2011 | 2012 | 2010 | 2011 | 2012 | Growth |
|------------------|----------------|------|------|------|------|------|------|------|------|------|--------|
| Kota Jogja       | 387,813        | 390,954 | 394,121 | 3,245,300,448,724.10 | 3,343,809,667,230.65 | 3,648,019,396,752.77 | 8,368,209.55 | 8,552,942.87 | 9,256,089.52 | 10.61% |
| Kab. Sleman      | 1,090,359      | 1,099,191 | 1,108,094 | 2,518,251,118,898.95 | 2,834,513,799,504.95 | 3,166,642,256,976.37 | 2,025,441.08 | 2,269,544.53 | 2,371,775.04 | 17.10% |
| Kab. Bantul      | 911,054        | 918,434 | 925,873 | 2,311,588,911,869.80 | 2,630,802,970,055.98 | 2,988,402,710,589.37 | 2,537,268.82 | 2,864,445.67 | 3,119,653.76 | 22.95% |
| Kab. Kulon Progo | 388,759        | 391,908 | 395,082 | 1,047,032,990,116.28 | 1,135,893,287,967.84 | 1,270,642,243,307.02 | 2,025,441.08 | 2,269,544.53 | 2,371,775.04 | 17.10% |
| Kab. Gunungkidul | 675,175        | 680,644 | 686,157 | 1,367,527,181,432.20 | 1,544,751,680,038.91 | 1,627,410,364,289.39 | 2,025,441.08 | 2,269,544.53 | 2,371,775.04 | 17.10% |
Table 4: Ratio of total equities per capita from 2010 to 2012 and its growth

| Local Government | Population size | Total equities | Total equities per capita | Growth |
|------------------|----------------|----------------|---------------------------|--------|
|                  | 2010 | 2011 | 2012 | 2010 | 2011 | 2012 | 2010 | 2011 | 2012 | 2010 |
| Kota Jogja       | 387,813 | 390,954 | 394,121 | 3,241,311,008,215.98 | 3,388,994,467,852.00 | 3,644,746,036,572.37 | 8,357,922.76 | 8,539,871.78 | 9,247,784.05 | 10.65% |
| Kab. Sleman      | 1,090,359 | 1,099,191 | 1,108,094 | 2,378,003,061,378.13 | 2,829,436,711,293.67 | 3,160,990,221,904.82 | 8,180,935.88 | 8,574,108.55 | 8,852,636.34 | 30.80% |
| Kab. Bantul      | 911,054 | 918,434 | 925,873 | 2,310,803,383,657.99 | 2,630,304,220,488.46 | 2,881,980,241,464.33 | 2,536,406.61 | 2,863,902.63 | 3,112,717.09 | 22.72% |
| Kab. Kulon Progo | 388,759 | 391,908 | 395,082 | 1,044,888,105,961.46 | 1,132,014,838,258.42 | 1,263,836,933,275.94 | 2,687,752.84 | 2,888,471.25 | 3,198,919.84 | 19.02% |
| Kab. Gunungkidul | 675,175 | 680,644 | 686,157 | 1,365,800,077,099.57 | 1,543,971,831,246.82 | 1,627,080,851,402.77 | 2,022,883.07 | 2,268,398.78 | 2,371,294.81 | 17.22% |

Table 5: Ratio of total fixed assets per capita from 2010 to 2012 and its growth

| Local Government | Population size | Total fixed assets | Total fixed assets per capita | Growth |
|------------------|----------------|-------------------|-----------------------------|--------|
|                  | 2010 | 2011 | 2012 | 2010 | 2011 | 2012 | 2010 | 2011 | 2012 | 2010 |
| Kota Jogja       | 387,813 | 390,954 | 394,121 | 3,005,251,743,213.16 | 3,073,463,152,914.48 | 3,122,183,232,908.76 | 7,749,228.99 | 7,861,438.71 | 7,921,889.76 | 2.23% |
| Kab. Sleman      | 1,090,359 | 1,099,191 | 1,108,094 | 2,229,592,426,782.81 | 2,504,501,327,118.97 | 2,619,694,035,946.66 | 2,044,824.16 | 2,278,495.31 | 2,364,143.47 | 15.62% |
| Kab. Bantul      | 911,054 | 918,434 | 925,873 | 2,164,887,631,044.59 | 2,438,010,828,531.10 | 2,614,656,237,150.17 | 2,376,245.13 | 2,654,531.58 | 2,823,990.62 | 18.84% |
| Kab. Kulon Progo | 388,759 | 391,908 | 395,082 | 896,600,773,942.78 | 973,784,613,410.33 | 1,112,990,755,010.08 | 2,306,315.16 | 2,484,727.90 | 2,617,110.43 | 22.15% |
| Kab. Gunungkidul | 675,175 | 680,644 | 686,157 | 1,189,477,988,537.00 | 1,544,751,680,308.91 | 1,627,410,364,289.39 | 1,761,732.87 | 2,269,544.53 | 2,371,775.04 | 34.63% |
The tables above show that Kota Jogjakarta has highest values with significant difference for all the ratios of service-level solvency compared to other local governments. For example, in 2012 Kota Jogjakarta has Rp9,256,089.52 total assets per capita and Rp7,921,889.76 fixed assets per capita, whereas Kabupaten Bantul only has Rp3,119,653.76 and Rp2,823,990.62 for those ratios consecutively. This fact suggests that Kota Jogjakarta should not be compared with other local governments because it is not equivalent with other local governments. It has different characteristics. Kota Jogjakarta is a municipal local government, whereas the others are district local governments. Therefore the next analysis will exclude Kota Jogjakarta from discussion. Rivenbark and others (2009, 2010) and Zafra-Gomez and others (2009a, 2009b, 2009c) argue that one should create a cluster of equivalent groups of local governments before doing further analysis. The discussion will focus on four district local governments that are considered comparable based on the author’s judgment. The following paragraph will discuss the results of each measure of service-level solvency.

Total expenditure per capita (constant rupiah)

Table 1 shows that all local governments showed increasing trends for this ratio from 2010 to 2012. This condition showed an increasing commitment of local governments to deliver goods and services to the public for a specific year. For example, in 2010 Kabupaten Kulon Progo dedicated Rp1,571,487.18 to serve each resident and increased it to Rp2,056,943.01 in 2012 after eliminating the effect of inflation. This situation indicated that there was improvement in expenditure power of Kabupaten Kulon Progo to serve its community. The highest growth of this ratio with a rate of 30.89% belonged to Kabupaten Kulon Progo; whereas Kabupaten Sleman experienced the lowest growth with a rate of 14.21%. In addition, Table 6 reports the ranking of adjusted total expenditure (constant rupiah) per capita for the local governments from 2010 to 2012.

| Ranking | Total adjusted expenditure per capita (constant rupiah) |
|---------|-------------------------------------------------------|
|         | 2010        | 2011        | 2012        |
| 1       | Kulon Progo | Kulon Progo | Kulon Progo |
| 2       | Bantul      | Gunungkidul | Gunungkidul |
| 3       | Gunungkidul | Bantul      | Bantul      |
| 4       | Sleman      | Sleman      | Sleman      |

Table 6 shows that Kabupaten Kulon Progo had the strongest position for this ratio from 2010 to 2012. On the other hand, Kabupaten Sleman was placed as the weakest condition relative to other local governments. Kabupaten Gunungkidul demonstrated an acceleration trend for this ratio and overtook Kabupaten Bantul in 2011. In turn, Kabupaten Bantul was down-graded to ranking 3.

\[1 \text{ USD} = 11,627,907 \text{ Indonesian rupiahs}\]
**Total capital expenditure per capita (constant rupiah)**

Table 2 reports that all local governments have improved their capital expenditure per capita from 2010 to 2012. For example, in 2010 Kabupaten Bantul spent Rp135,282.08 per each resident to invest in fixed assets for serving its people. This figure was increased to Rp139,827.35 in 2012 after taking out the effect of inflation. This fact showed an improvement in capacity of a local government in delivering services to its community.

The best improvement was recorded by Kabupaten Gunungkidul with a rate of growth of 217.9%. As a result, Kabupaten Gunungkidul increased dramatically its ranking from the lowest in 2010 to number 2 in 2012. However, Kabupaten Bantul only made an improvement with rate of growth of 3.36% during 2010 to 2012. In turn, its ranking drops sharply from number 1 in 2010 to number 3 in 2012. Kabupaten Sleman also experienced a similar decreasing trend as Kabupaten Bantul. It was in the lowest ranking for 2011 and 2012. Table 7 reports the ranking of adjusted total capital expenditure per capita for local governments from 2010 to 2012.

**Table 7: Ranking of adjusted total capital expenditure per capita from 2010 to 2012**

| Ranking | Total capital expenditure per capita (constant rupiah) |
|---------|------------------------------------------------------|
|         | 2010 | 2011 | 2012 |
| 1       | Bantul | Kulon Progo | Kulon Progo |
| 2       | Kulon Progo | Gunungkidul | Gunungkidul |
| 3       | Sleman | Bantul | Bantul |
| 4       | Gunungkidul | Sleman | Sleman |

**Total assets per capita and total equities per capita**

Table 3 and Table 4 report that the two ratios show that all local governments demonstrate increasing trend from 2010 to 2012. In 2010, for example, total assets per capita and total equities per capita for Kabupaten Bantul are Rp2,537,268.82 and Rp2,356,406.61, respectively. Those figures mean that Kabupaten Bantul had capacity of Rp2,537,268.82 of assets or Rp2,356,406.61 of equities to serve each resident. In 2012 this capacity increased to Rp3,119,653.76 per capita for assets and Rp3,112,717.09 per capita for equities.

Kabupaten Sleman experienced the highest growth during this period with a rate of growth of 30.80% for ratio total assets per capita and 23.74% for ratio total equities per capita. On the other hand, Kabupaten Gunungkidul showed the smallest rates which are 17.10% for ratio total assets per capita and 17.22% for total equities per capita.

Looking from cross sectional analysis, the pattern of position for all local governments is similar from 2010 to 2012. Table 8 reports the ranking of ratio total assets per capita and ratio total equities per capita for local governments from 2010 to 2012.
Table 8: Ranking of total assets per capita and total equities per capita from 2010 to 2012

| Ranking | Total Assets per capita | Total Equities per capita |
|---------|------------------------|--------------------------|
|         | 2010 | 2011 | 2012 | 2010 | 2011 | 2012 |
| 1       | Kulon Progo | Kulon Progo | Kulon Progo | Kulon Progo | Kulon Progo | Kulon Progo |
| 2       | Bantul | Bantul | Bantul | Bantul | Bantul | Bantul |
| 3       | Sleman | Sleman | Sleman | Sleman | Sleman | Sleman |
| 4       | Gunungkidul | Gunungkidul | Gunungkidul | Gunungkidul | Gunungkidul | Gunungkidul |

Kabupaten Kulon Progo had the highest values for both ratios followed by Kabupaten Bantul, Kabupaten Sleman, and Kabupaten Gunung Kidul consecutively. Although Kabupaten Sleman had demonstrated the highest growth for the period between 2010 and 2012, its level was always in the second lowest values for both ratios for the period.

Total fixed assets per capita

Table 5 shows that all local governments showed upward trends for this ratio from 2010 to 2012. Such trends indicate improvements of service-level solvency for all local governments. Kabupaten Gunungkidul showed the highest rate of growth, which was 34.63% and Kabupaten Sleman had the lowest rate of 15.62%. In 2010, total fixed assets per capita of Kabupaten Gunung Kidul was Rp1,761,732.87 meaning that it had Rp1,761,732.87 value of fixed assets to serve each resident. This figure increased to Rp2,371,775.04 value of fixed assets per resident in 2012. This fact showed an improving service-level of local government. Table 9 reports the ranking of total fixed assets per capita for local governments from 2010 to 2012.

Table 9: Ranking of Total fixed assets per capita from 2010 to 2012

| Ranking | Total Fixed Assets per capita |
|---------|-----------------------------|
|         | 2010 | 2011 | 2012 |
| 1       | Bantul | Bantul | Bantul |
| 2       | Kulon Progo | Kulon Progo | Kulon Progo |
| 3       | Sleman | Sleman | Gunungkidul |
| 4       | Gunungkidul | Gunungkidul | Sleman |

The pattern of ranking of service-level solvency of the two highest ranks for period 2010-2012 was similar, with Kabupaten Bantul in the first rank followed by Kabupaten Kulon Progo in the second rank. However, the pattern for the lowest rank was changed where Kabupaten Gunung Kidul was in this position in 2010 and 2011 and then was replaced by Kabupaten Sleman in 2012. This situation demonstrated that Kabupaten Gunungkidul had improved significantly its service-level. This situation was supported by the increasing trend of ratio adjusted capital expenditure per capita for Kabupaten Gunungkidul.

Although Kabupaten Sleman showed an improvement in this ratio from 2010 to 2012, the improvement was slower when compared to Kabupaten Gunung Kidul. This situation was
consistent with the trend in ratio of adjusted capital expenditure per capita which also showed a declining trend for Kabupaten Sleman.

It is a surprise that Kabupaten Sleman, which is perceived by the community as the leading local government in the Province of Yogyakarta Special Territory, was in the bottom line as it has the worst service-level solvency. On the other hand, Kabupaten Kulon Progo, which is frequently perceived as an “underdog” local government in the Province of Yogyakarta Special Territory, showed an amazing trend as the best local government in service-level solvency. These facts show that service-level provided by local government seen from the perspective of accounting could be different from other perspectives. However, it should be similar.

5. CONCLUSION

Based on findings and the discussion in the previous section, this study concludes that:

1. To analyse a certain condition of local government (in this study the condition is service-level solvency) an analyst should create a cluster consisting of local governments with comparable (i.e., equivalent) characteristics;

2. There was improvement of service-level solvency for all local governments during 2010 – 2012 as shown by upward trends for all ratios of service-level solvency with a variety of rate of growth;

3. Kabupaten Kulon Progo was the best in service-level solvency compared to other regency local governments in the Province of Yogyakarta Special Territory during the period of 2010-2012;

4. Kabupaten Gunungkidul demonstrated an accelerated trend of service-level solvency during period of 2010-2012 compared with other regency local government in the Province of Yogyakarta Special Territory; and

5. Kabupaten Sleman and Kabupaten Bantul showed decreasing trends of service-level solvency during period of 2010 – 2012 compared with its compatriots in the Province of Yogyakarta Special Territory.

6. LIMITATION AND SUGGESTIONS FOR FUTURE RESEARCH

The financial information regarding the value of fixed assets is presented in the balance sheet as historical cost without deducting the accumulated depreciation. Those values should show the book values, which are the historical cost minus accumulated depreciation of those assets. The information of book values is fairer than historical value.

Up to now most of local governments in Indonesia have not yet presented the information of accumulated depreciation of fixed assets in their balance sheets, although the Governmental Accounting Standards requires such information in presenting fixed assets. Therefore, this study strongly suggests that local governments in Indonesia implement the requirement of presenting accumulated depreciation of fixed assets as stated in Governmental Accounting Standards.

The use of ratio of total expenditure per capita needs to be refined because not all of the total expenditure is utilized to provide services to the public. Therefore, future research should refine the measures by proposing ratios that are more representative of local government expenditures devoted to the public.

Regulators in the Ministry of Home Affairs should reconsider the structure of local government budget so that the structure of said budget can provide information regarding expenditures
devoted to the community. Such structure had been implemented during the period of 2002-2005. However, since 2006, the previous structure changed to a new structure, which resulted in difficulties determining the amount of public expenditure.

The information regarding population size, except for data in 2010, is predictive information because it is estimated based on prediction of population growth. It is understandable that the accurate information of population size can only be obtained through population census that is only done every ten years by the central government.

7. REFERENCES

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The Innovative Approach for Accounting and Accountability of Government Revenues in Iraq(1)

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Abstract

This study indicates that accountability of the Iraqi Government’s revenue procedures are sufficient, adequate, and well developed and describes new control bodies that parliament has created (such as the Commission of Integrity) in addition to the Board of Supreme Audit (BSA) – the Iraqi Supreme Audit office that was established to fight financial and managerial corruption. It examines the Iraq Government’s accountability approach from a theoretical and empirical perspective. The theoretical perspective includes a literature review that describes various aspects of accountability in Iraq such as audit of revenues, performance audits, taxation policy, and the sources of governmental income. While the empirical side includes an examination of the economic influence of government revenues in Iraq, it also includes the different sources of Iraq government income, the governmental control bodies, and the auditing procedures used by the BSA. This research considers the contribution of oil and tax revenues to the Iraqi Government. It shows that the Iraqi Government depends almost totally on oil revenues (about 93% in 2012).

The study suggests that the State should increase its role in controlling expenditures and developing revenue streams in other sectors. Although there is an emphasis on financial and budgetary measures for financial accountability, the use of non-financial measures in determining outcome accountability is increasing.

1. Introduction

In Iraq, accountability of revenue audit, as an important domain of public auditing, has been engaging the attention of the Board of Supreme Audit (BSA) and in other institutions (namely the Commission of Integrity and the Inspector General of each ministry) for quite some time. Normally, the Ministry of Finance has its own financial control on its directorates, especially for revenues and expenditures. While the Commission of Integrity was linked to parliament for special duty, which is related to financial and managerial corruption, its reports were submitted to the Justice Ministry and to the Integrity Committee at the parliament when it involved major corruption. Although government revenues are derived from two sources, tax receipts and non-tax receipts, the major source of national revenues are tax receipts raised through fiscal statutes.

The taxation policy of a government generally seeks to apply the following desirable fiscal principles (ASOSAI report, 2010: 2):

(a) The subjects of every State ought to contribute to the support of the Government as nearly as possible in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the State. The observation or neglect of this maxim reflects what is called the equality or inequality of taxation.

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(1)“This research is funded by the Deanship of Research and Graduate Studies in Zarqa University /Jordan”
(b) The tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person.

(c) Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it.

(d) Every tax ought to be so contrived as both to take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state.

Most developing countries are interested in governmental revenues because they play a significant role in and provide the means to build the economic base. Developing countries are, therefore, looking to increase their revenues from different sources. It is important to find the best method to control these revenues and achieve the necessary development in different fields that the government wishes to support. A new approach to building economic and social infrastructure emerged at the end of the twentieth century, which is related to the privatization of public projects. This approach has been tried in fully developed nations and is also relevant in developing countries. Whilst privatization provides a method of resourcing more development, auditing bodies still need to address accountability and audit the use of public funds. Although privatization might be beneficial in increasing government revenues, it still requires more attention from the high auditing institutions in their accountability and audit roles because of the impact on tax revenues.

In summary, the main concern of a modern state is to provide services to its citizens and lead the country on the path toward development. The state can discharge its duties only if sufficient resources are at its command. These resources are generated through various government revenues.

Research on government revenue resources has been carried out in one of the developing countries, namely Iraq, for two reasons. The first was the rapid dependence of the country on oil revenues and an emergence of foreign investment in different sectors. Second was the new direction, since 2003, of a democratically elected regime, including central, provincial and local governments, and an effective parliament.

The objectives, problems, scope and methodology of this research are below:

1.1 Research Objectives

The research seeks to realize the following objectives:

1. To measure the State's dependence on oil revenues relative to other revenues.
2. To develop and increase dependence on other revenues.
3. To highlight and to ensure that auditing of governmental revenue in Iraq is sufficient.

1.2 Research Problem Statement

The research problem focuses on how the researcher can measure the contribution of oil and tax revenues to government revenues in Iraq, the accountability and audit of governmental revenues, and their percentage of total revenues.

1.3 Methodology

This research paper will cover both theoretical and empirical materials. The theoretical side defines the accountability, audit revenues, performance audit, taxation policy and the kinds of governmental revenues. The empirical research includes studying the economic influence of
Iraqi government revenues using actual numbers, different types of government revenues, and the BSA auditing procedures.

Different materials, articles, reports, and sites have been used to assist in writing the research paper. The paper attempts to:

1. Show varying sources of governmental revenues.
2. Define the auditing procedures control bodies.
3. Link the legislation related to government revenues.

The research will present, in brief, these subjects from the researcher's point of view. Thus, the paper seeks to fill an important gap in the literature by exploring the need for accountability of government revenues, and in particular taxes.

The remaining portion of this paper is organized as follows: Section two provides a review of literature; Section three is an overview of the meaning of accounting and accountability, including internal and external indicators; Section four presents types of government revenues; Section five presents control bodies, audit planning, auditing methods of government revenues, and human resource management; Section six includes a discussion on current trends and; Section seven includes findings, limitations, further studies and conclusions.

2. Literature Review

The audit process is superimposed on an accountability framework. A traditional definition of accountability is the obligation to answer for a responsibility conferred. This definition often is interpreted as implying two distinct and often unequal partners: one who confers and the other who is obliged to answer. In so doing, it does not reliably address several realities in today's public management. These include (OAG, 2005: 16):

- The emergence of alternative delivery approaches, such as arrangements between the federal and provincial governments, where responsibilities may not be conferred from a senior party to a junior one, but agreements nonetheless assume accounting for results;
- The call for a significantly increased focus on performance-based management and results in the public sector; and
- The importance of transparency as an essential feature of public sector accountability.

Beechy (2007) mentioned in his study that "a different concept of accountability is embodied in the Canadian accounting standard on non-profit organizations (NPO) accounting” (p. 4). The CICA Handbook emphasizes the purpose of the statement of operations, section 4400:

…provides information about the cost of the organization's service delivery activities for the period and the extent to which these expenses were financed or funded by contributions and other revenue. The information provided in the statement of operations is useful in evaluating the organization's performance during the period, including its ability to continue to provide services, and in assessing how the organization's management has discharged its stewardship responsibilities."

In recent years, many studies [Pollitt (1993), Kloot (1999), Barton (2000), Gendron, Cooper, and Townley (2001), Earl (2005), and Beechy (2007)] have been conducted in different countries in the area of accountability and auditing. Some of these studies investigated the role of accounting and accountability. Others studies focus on audit and accountability. Kloot (1999)
uncovers a great deal of literature on performance measurement and accountability in government. Governments around the world have invested large amounts of money to develop performance measurement systems - the results of which are mediocre, at best. There is also a growing recognition that financial performance measures alone measure only limited aspects of an organization's performance. In order to improve performance measurement systems and accountability to different stakeholders, non-financial indicators have been developed for the for-profit sector. Prior research in the local government sector in the state of Victoria, Australia, showed low levels of accountability and very little performance measurement taking place. However, significant changes have been imposed on the sector, enhancing local and central accountability, making it more business-like and focusing on the need to measure performance.

This research studied the extent to which performance measurement systems are currently being used in practice in Victorian local government, the factors leading to the use of performance measurement, and the extent of non-financial indicators. The results revealed a substantial increase in the use of performance measurement in the sector, which is related to increased emphasis on accountability and organizational changes imposed on the sector by the state government. The performance of both people and programs is now being measured. Although there is an emphasis on financial and budgetary measures for financial accountability, the use of non-financial measures in determining outcome accountability is increasing. Customer service and quality are two of the areas in which non-financial performance measures are being developed.

Barton (2000) notes that an investigation of public heritage facilities – national parks, art galleries, and museums and so on – revealed that they are now required by professional accounting standards in Australia to be valued and included in government general purpose financial statements as assets. The article explains the nature and significance of public goods and how they differ from private goods. It explains why commercial accounting principles are irrelevant for public heritage facilities because their objectives are social rather than financial and why commercial valuations are irrelevant and unreliable if applied to heritage facilities. Finally, it is contended that the facilities are assets held in trust for the nation by the government and hence should not be included in its general purpose financial reports.

While Gendron and others (2001) investigate the role of the state auditor in Alberta, Canada, an analysis of the Office of the Auditor General of Alberta’s annual reports shows that the role of the Office has significantly changed to promote and encourage the implementation in the public sector of a particular type of accountability informed by new public management. The authors argue that the Office has increased its power to influence politicians and public servants about the merits of its specific understanding of what accountability should be. However, as the Office becomes more powerful, it also becomes more vulnerable to complaints about a lack of independence from the executive branch. Indeed, the Office is now so closely associated with new public management that we believe that it is difficult for the Office to sustain the claim that it is able to provide independent assessments of public-sector administration.

3. Accounting and Meaning of Accountability

Much of the accounting literature assumes that accounting and financial reporting in a country is a function of its environment (Elsayed & Hoque, 2010). Accounting, performance auditing, and accountability can be considered as those parts of the formalized information used by the state organizations to influence the behavior of their managers, which leads to the attainment of organizational objectives. Accounting is gathering, organizing and reporting information that describes performance (Earl & LeMahieu, 1997). A performance audit is a systematic, purposeful, organized, and objective examination of government activities. It provides parliament with an assessment on the performance of these activities based on information,
observations, and recommendations designed to promote accountable government, an ethical and effective public service, good governance, sustainable development and the protection of the state’s legacy and heritage (OAG, 2005: 13).

In light of these new realities, a restatement of the underlying principles, practices and tools of accountability, which incorporates the traditional definition, could be as follows: a relationship based on obligation to demonstrate and take responsibility for performance in light of agreed upon expectations. In this view, accountability is about the requirement to answer for what you have or have not accomplished that is of significance and value. This restatement implies that accountability does not require hierarchical relationships, since there is no necessary "conferring" taking place. Accountability is rather seen to be assumed and/or agreed to by each party in a recognized accountability relationship, even when one party does indeed delegate responsibilities to the other, as in the traditional case.

Earl (2005) has highlighted that accountability and data are the heart of contemporary reform efforts worldwide. Accountability has become the watchword of education, with data holding a central place in the current wave of large-scale reform. The statutory role of the auditors is to provide management with independent and objective assurance on the reliability of financial statements and of certain other information provided by the organization. However, auditing of government revenues plays an important role in decision making. In particular, a fundamental use of accounting information is to help several parties make an effective decision concerning their investment portfolios. This is a vital role of accountability which is the conversation about what the information means, how it fits with everything else that is known, and how to use it to make positive changes (Earl & LeMahieu, 1997).

Pollitt (1993) has noted that the issue of consultant accountability for decisions remains unresolved, and consequently, attempts to identify the role of audit, and the issue of clinical quality, in the wider context of changing attitudes and policies toward professionally provided public services in general. The focus here will be on audit in secondary and tertiary settings, although Pollitt believes that most of the points made are also applicable to general practice.

Accountability is the current mantra both for non-profit organizations and for government (Beechy, 2007). There is a wide range of definitions for accountability. A few of the many definitions that can be found on the Internet are as follows: (more details could be found in Beechy):

1. Accountability has several meanings and is the subject of a broad debate in American governance. Some of the simpler definitions include: responsibility or capable of being held responsible for something: capable of being explained: being held to count, scrutinized, and being required to give an account or explanation .
   (en.wikipedia.org/wiki/Accountability)

2. Accountability is the capacity to account for one's action; or as a representative of one's organization, to account for either your actions or the actions of your organization. The term is usually used in the volunteer sector to refer to the responsibility a non-profit organization has to inform donors of the manner in which their gifts were used.
   envision.ca/templates/profile.asp?ID=56

3. The responsibility of program managers and staff to provide evidence to stakeholders and funding agencies that a program is effective and in conformance with this coverage,
service, legal, and fiscal requirements.

4. The obligation to demonstrate and take responsibility for performance in light of agreed expectations. There is a difference between responsibility and accountability: responsibility is the obligation to act; accountability is the obligation to answer for an action.

Although the context and wording of these definitions vary considerably, their overall sense is that managers are responsible for explaining their actions to outsiders, whether to funders, donors, clients, or the community at large. Perks & Glendinning (1981) made the point that: "Accountability in the private sector is based on conventional financial accounts with emphasis on profit, while, public concern is with aspects other than profitability alone such as social performance" (p. 22). Therefore, performance indicators can play an important role in government revenue - namely in protection of the public. Thus, (Kloot, 1999, p. 565) noted the following: “there is a great deal of literature on performance measurement and accountability in government. Governments around the world have invested large amounts to develop performance measurement systems, the results of which are mediocre at best. There is also a growing recognition that financial performance measures alone measure only limited aspects of an organization's performance. To improve performance measurement systems and accountability to different stakeholders, non-financial indicators have been developed for the for-profit sector”.

However, Barton's study (Barton, 2000, p. 219) talks about the nature and significance of public goods and how they differ from private goods. It explains why commercial accounting principles are irrelevant for public heritage facilities because their objectives are social rather than financial and why commercial valuations are irrelevant and unreliable if applied to them. Gendron and others (2001) posit the role of management has significantly changed to promote and encourage the implementation of a particular type of accountability informed by new management in the public sector.

Iraq, in general, has two accounting systems (on an annual basis): one for government directorates (non-profit organizations), namely a governmental accounting system, and the other one is unified accounting system (UAS) for profit organizations. The Ministry of Finance is responsible of the first one, while the board of supreme audit (BSA) is responsible of the second one. Such solutions promote the control of these expenditures through instructions and regulations issued by the Ministry of Finance and other regulatory authorities. The information about expenditures is a cornerstone by which executing is done as intended. It is an attempt to evaluate the government revenues in meeting the demands of users of the system. Therefore, BSA is responsible for auditing the results of two systems in organizations and issuing its report according to the regulatory requirements. In light of these new realities, a restatement of the underlying principles, practices and tools of accountability, which incorporates the traditional definition, could be a relationship based on obligation to demonstrate and take responsibility for performance in light of agreed upon expectations. Therefore, performance indicators can play an important role in government revenues - namely in protection of the public. In order to improve performance measurement systems and accountability to different parties, non-financial indicators have been developed for the for-profit sector. As there is also a growing recognition that financial performance measures alone measure only limited aspects of an organization's performance. Thus, BSA has used both financial and non-financial indicators in its performance evaluation reports. This includes two main groups of indicators which cover the meaning of accounting and accountability as an innovation model. These groups of indicators are outlined below (the BSA Report: 1994):
1- Internal Indicators

The internal indicators cover information from inside the project (whether in production or service), which includes:

i. Production indicators.
ii. Productivity indicators.
iii. Financial Indicators.
iv. Marketing indicators.
v. Personnel indicators.
vi. Special Indicators, (which relate to the nature of the project).

2- External indicators

The external indicators cover economic, social, political and environmental information for a project and the extent of their effect on the results. This includes:

vii. Economic indicators
viii. Social indicators
ix. Political indicators
x. Environmental Indicators.

All performance evaluation reports contain most of the indicators. The results reveal a substantial increase in the use of performance measurements in the governmental sector related to increased emphasis on accountability and organizational changes imposed by government. Although there is an emphasis on financial measures for financial accountability, the use of non-financial measures in determining outcome accountability is also increasing.

4. Types of Government Revenues

The State does not depend on a single source of revenue, there are several revenue streams that the State relies on to raise funds. These sources vary widely and have developed over time under the influence of changing political and economic forces. The governmental revenues in Iraq can be classified as follows:

i) Oil revenues: make a large contribution to the state budget.

ii) Taxes:
   a- Direct taxes (like income tax, wealth tax, agriculture income and estates taxes including corporations and companies taxes).
   b- Indirect taxes (like commodity taxes, customs and other duty fees).

iii) Revenues of the state enterprises (like the governmental enterprise revenues, capital revenues, revenues of selling and renting state properties, and other revenues).

Table 1 provides an overview of tax revenues as a percentage of GDP, which are classified by revenue sources as a percentage of total revenue.
Table 1. Tax revenue as a percentage of total revenue

| Tax revenue as percentage of GDP | Revenue sources as percentage of total revenue | Others (including Oil revenue) |
|--------------------------------|-----------------------------------------------|-------------------------------|
|                                 | Direct taxes | Indirect taxes | Trade taxes |                                |
| Developing countries (average) * | 18.5         | 29.7           | 28.1        | 27.6                             | 14.6                      |
| Iraq (1993)**                   | 2.3          | 40.5           | 9.7         | 0                                | 49.8                      |
| Iraq (2008)***                  | 7.0          | 0.66           | 0.37        | 0                                | 98.97                     |
| Iraq (2012)***                  | 5.0          | 2.0            | 0.5         | 0                                | 97.5                      |
| Iraq (2013)***                  | 5.5          | 2.1            | 0.6         | 0                                | 97.3                      |

Source: Prepared by the researcher, *ASOSAI report 2010, ** Supreme Audit Board report 1994, *** Ministry of Finance & Ministry of Planning, Baghdad, Iraq (2009), (2012) and (2013).

This table indicates that taxes do not play a significant role in providing financial resources to the state of Iraq and are mainly used as an effective method to tackle disparities in income levels of the citizens, which are the objective of the tax laws in Iraq. Prior to 2005, the wages of all Iraqi state employees were tax exempt. The decrease in tax revenue, as a percentage of total revenue, during the past decade (from 1993 as shown in Table 1) and subsequent to the economic sanction imposed on Iraq in 1990, is due to increased dependence on oil revenues and exemptions of income taxes for all Iraqi governmental employees.

Table 2 illustrates that the percentage of tax revenues relative to both the general state budget and G.D.P. The table illustrates the decline from 1986 to 1993, and increasing thereafter, although it still did not reach the levels of 1993 by 2008 and 2012. In 2013 the estimated budget shows oil revenue in Iraqi Dinars (ID) (120,165,300,000,000 ID) or in US$ ($101,835,000,000) on the base 3,100,000 barrels per day at $90 per barrel. The percentage of tax revenue to oil revenue in 2012 is equal to 3.2%. Non-oil revenues contribute less than 8% of the total public revenues in 2012, and reflect the dominance of oil revenues on public revenues and the low contribution of non-oil activities. However, withholding support for public sector industrial projects puts a significant constraint on economic development in the country's strategic direction. Since industrial development is the key to any subsequent development in other economic sectors, this leads to diversification of income sources.

The expected increase in tax revenues is through tax revenues from foreign oil companies, (2013 estimated 360 billion ID). The corporate income tax rose from 250 billion ID in 2011 to 304 billion ID in 2012, and to 370 billion in 2013, a change of over 21 percent for both 2012 and 2013. Most of the deficit in the Iraqi budget is related to its operating budget. The shortage of investment budget is another reason. In general there is a lack of foreign investment due to the security situation in general and to political conflict, especially between different parties.

The complex tax laws in Iraq and the lack of appropriate management systems in the emergence of the tax difficulties prevent the measure adequate revenue to fund important services provided by the government without a large deficit in the general budget and the consequent effects on the macroeconomic level.
Table (2) Percentage of tax revenue to Expenditure and GDP

| Year (1) | Tax revenue (ID million)(2) | Expenditure budget of state (ID million) (3) | Percentage of (2)/ (3) (4) | G.D.P. (ID million) (5) | Percentage of (2)/ (5) (6) |
|----------|-----------------------------|---------------------------------------------|---------------------------|------------------------|---------------------------|
| 1966     | 68.1                        | 158.6                                       | 42.9                      | 864.4                  | 8.0                       |
| 1976     | 179.8                       | 1,387.7                                     | 13.0                      | 4,696.8                | 3.8                       |
| 1986     | 985.0                       | 3,854.0                                     | 25.6                      | 13,086.0               | 7.5                       |
| 1993     | 2,594.0                     | 6,877.0                                     | 37.7                      | 128,300.0              | 2.3                       |
| 2008     | 728,800.0                   | 56,256,000.0                                | 13.0                      | 10,411,429.0           | 7.0                       |
| 2011     | 5,963,822.0                 | 64,022,625.0                                | 9.2                       | 84,136,000.0           | 7.1                       |
| 2012     | 8,190,200.0                 | 117,500,000.0                               | 7.0                       | 163,872,400.0          | 5.1                       |
| 2013*    | 9,620,000.0                 | 138,000,000.0                               | 7.0                       | 184,000,000.0          | 5.3                       |

Source; Prepared by the researcher, Ministry of Finance, Annual Reports, 1967, 1977, 1994, 2009, 2011, 2012 and 2013* (Estimated Budget) Baghdad, Iraq. ID= Iraqi Dinar, (Each 1$=1180 ID in 2008) (Normally 1 ID = 3.3 US$ before 1993).

In 2008 tax revenues from various sources totaled more than 0.7 trillion Iraqi dinar, or around $530 million, which was an increase of 16% from the previous year. In 2012 there is an even greater improvement of about 37% from 2011; however, taxes still account for just a tiny fraction of government revenue in a state almost entirely reliant on oil.

Taxes include personal and corporate income taxes, excise taxes, and tariffs. Other revenues include social contributions - such as payments for social security and hospital insurance - grants, and net revenues from public enterprises. Normalizing the data, by dividing total revenues by GDP, enables easy comparisons across countries, and provides an average rate at which all income (GDP) is paid to the national level government for the supply of public goods and services.

5. Audit organizations

5.1 The Board of Supreme Audit (BSA)

Diwan of Financial Control is the Arabic name of the Board of Supreme Audit (BSA). The date of its foundation was 1927, when the first Iraqi state audit department was established as a very small department. In 1968, law no. 42 was issued to establish BSA as an independent department of the executive branch, to give it powers to act on behalf of the legislature, to audit the accounts and review the accounting systems, and to act as a financial controller of the state enterprises. The phrase, "financial controller", as applied to BSA, does not mean that they are engaged in the day to day management of the state enterprises. Their role is that of an outside monitoring body examining such matters as the budget.

In 1980, a new law (no. 194) was issued superseding law no. 42. The new law gave the BSA more power and authority to execute its activities and to play a bigger role in the economy. It made the department responsible for financial control in Iraq; therefore, its chairman has been directly linked to the President of the Revolution Command Council. It issues financial and accounting instructions which have to be followed by the accountants in state enterprises, mixed
capital companies and all foreign companies. It is the department responsible for the practice and control of the unified accounting system, according to the resolution no. 1260 in 1982. Also, it has the authority to penalize and prosecute offenders.

In 1990, a new law (no. 6) was issued granting more power to evaluate the performance of state enterprise. The main objectives were to:

1. Audit all the state enterprises, mixed and foreign companies.
2. Provide technical assistance to all state enterprises in the fields of accountancy, administration, and organization.
3. Evaluate the performance and efficiency of state enterprises to ensure correct procedures in using their economic resources.

Currently the BSA is linked to the Parliament and has the same objectives and power. Its annual financial reports are presented to the parliamentary financial committee. The president of BSA has two deputies. Each deputy is responsible for three auditing sectors. Each sector controls a number of ministries and directorates, examples of which are the Finance Ministry and Central Bank.

Each sector is responsible for the external financial assessment of the enterprises in its field and has groups of officials to carry out its duties. If the enterprise administration does not respond to the audit report the matter is reported to the concerned Minister, and if the Minister also fails to respond, the matter is reported to the Prime Minister. The follow up procedure of an audit report is very strict (such as inviting the Minister to appear before the Parliament).

5.2 The Commission of Integrity (COI)

The Commission of Integrity (COI) is an innovation occupation office and an independent governmental body that is responsible for fighting corruption. It was established in Iraq as the Commission on Public Integrity (CPI), pursuant to a statute promulgated by Iraq Governing Council and according to delegation of the dissolved Coalition Provisional Authority (CPA) in order 55 of 2004. In 2005, the Iraqi permanent constitution considered the CPI an independent commission, subject to the Parliament and changed its name to the Commission of Integrity (COI). This change was made through article 102, which states “High Commission for Human Rights, High Independent Electoral Commission and Commission of Integrity are, hereby considered an independent authority, subjected to the Iraqi Parliament and the law of Iraq”.

The COI is designed to prevent corruption, using legal means to implement its function as a high authority consistent with section (3) of the law annexed to the 2004 order 55, that is, to work, as appropriate, for any investigation related purpose. It is divided into two primary areas:

1. Legal - This area has four responsibilities: 1) investigating corruption cases by an investigator under a judge; 2) proposing legislation for the purpose of fighting corruption and fostering the culture of integrity, honesty, transparency, accountability and submission to questioning and fair dealing with government; 3) to require Iraqi officials to disclose their financial status; and 4) to promulgate a code of conduct for public sector employees.

2. Educational, informative and instructive – This area is responsible for developing curriculums to align ethical values, in coordination with the Ministry of Education and the Ministry of Higher Education; preparing research and studies; training; media campaign and mass communication activities; holding symposiums; and educating public sector employees and ordinary people (this includes supporting their demands, through transparency, accountability and investigation).
The Commission consists of six directorates: Investigations, Legal Affairs, Prevention, Education and Public Relations, Non-governmental Organizations, and Administration. The Commission is chaired by a commissioner, which is a minister-level position appointed by the Prime Minister. The commissioner may not be removed, unless his removal is approved by the Parliament - a provision that is applicable to cabinet ministers. The Commission has one deputy commissioner, which is a deputy minister position. The COI is acting under articles 6 and 36 of the UN Convention against Corruption that Iraq has verified, according to law 35 of 2007.

Normally many countries have a three-tier system of raising revenues (ASOSAI report, 2010): (a) federal taxes and non-tax sources, (b) state/provincial taxes and non-tax sources, and (c) local taxes and non-tax sources. In Iraq, revenues are raised through legislation such as:

- The State General Budget Law
- The General Accounting Law
- Taxation Laws
- Customs Law
- Companies Law
- The Distribution of Profits of Public Economic Enterprises Law
- Other Laws

Revenue auditing in Iraq is subject to the Law of the Board of Supreme Audit (No. 6 in 1990) and other laws like the General Accounting Law and the General State Budget Law. Auditing of government revenues aims to review and evaluate the results of the implementation of revenue policies and plans. Governmental revenues are audited with reference to the revenue laws. However, auditors must keep abreast of the following factors:

- Emergence of new sources of revenue and the decline/ abandonment of old ones.
- Change in revenue resources in keeping with economic and political changes.

The audit process is completed in accordance with accountancy standards and principles. Bodies in charge of auditing are authorized to have access to all files concerned with revenues including the review of such files and appropriate, related financial statements.

In fact, the financial control of public revenue is very much a concern of the Board of Supreme Audit. Accordingly procedures are devised to examine the processes used by the various administrative units to achieve their goals and to suggest appropriate measures for avoiding deficiencies that might prevent them from achieving these goals. These procedures are also used to identify systematic weaknesses and individual errors.

5.3 Audit Procedures and Methodologies in Revenue Audit

The methodologies and techniques of revenue audit have evolved over time depending on the local circumstances. The methodologies have been designed to achieve the objectives provided in the audit mandates:

- The object of receipt audit is to seek evidence that revenue is assessed and collected according to law, and errors of omission and collection are avoided. It also seeks assurance that pre and post control systems (described later) operate efficiently and in accordance with the stated objectives in the sovereign and subordinate legislation.
- The collection and accounting systems of government revenues are checked through audits to assess whether internal procedures and controls adequately provide for regular
accounting of collection and allocation, and credit of the collections to the government account.

Despite the variation in the nature and extent of different government revenues, the Board of Supreme Audit in Iraq follows a comprehensive auditing system, which could be summarized as follows:

A) Compliance Audit

This kind of audit control examines the compliance with laws and instructions to estimate, realize, collect, and deposit the revenues, and also verifies that revenues are accounted, recorded, obtained, and classified in accordance with accountancy standards and principles. This audit has two facets:

i) Legitimacy auditing – determines the compliance with law and instructions.

ii) Financial auditing – determines the compliance with known accounting principles followed in applying, classifying, and summarizing the financial data.

B) Performance (Operational) Auditing

This is the most important type of auditing practiced by the Board of Supreme Audit. This includes all financial and non-financial aspects to assure the soundness of statements and the extent of achieving the desired objectives of institutions and their laws. Article 3 of the law of the Board of Supreme Audit provides for an annual plan for performance audits. There was a study under way to evaluate the performance of the tax system in Iraq under the annual audit plan of 2011, as well as the previous two years.

In Canada, the scope of performance audit includes the examination of economy, efficiency, cost-effectiveness, and environmental effects of government activities; procedures to measure effectiveness; accountability relationships; protections of public assets; and compliance with authorities. The subject of the audit can be a government entity or activity (business line), a sectorial activity, or a government-wide functional area (OAG, 2005). Similarly, in Iraq, performance auditing consists of many procedures, which seek to examine:

i. The efficiency of the internal control systems and the effectiveness of other systems and financial procedures, and employee understanding of these systems and procedures and their capabilities to achieve the task;

ii. The efficiency, adequacy, and comprehensiveness of the accounting system in the administrative unit;

iii. The efficiency of data which are produced by the system to meet the user needs in different administrative levels related to planning, implementation, follow-up, and control; and

iv. The efficiency of the laws and legislations (i.e., whether the objectives and financial policies are clear).

5.4 Audit Planning

The Board of Supreme Audit in Iraq prepares an annual general plan of its work and specific plans for different sectors. The Board has specific plans for offices such as Income Tax, Customs, etc. These plans are prepared according to scientific norms depending on the available audit resources. While implementing the audit plans, the Board ensures that the objectives of the plan are administered in an effective and efficient manner while supporting routine activities related to the audit, review, and follow-up. The Board seeks assurance that:

i. The auditees have achieved the policy and program objectives;
Treatment and classification of the revenues were done according to the established accounting standards; and

The related instruction, systems and laws have been applied to the fullest extent.

5.5 Auditing Methods for Government Revenues

The main duty of Board of Supreme Audit is preparing a report in which it explains its opinion about the results of the audit statements according to the produced facts and data. The Board follows several methods of audit checks according to the nature of its work:

i. Pre-control - this task is achieved according to the law and a previous agreement of higher authority in Iraq.

ii. Periodic (immediate) control - the control institutions check the accounts in the same year.

iii. Post-control - the control process focuses on the two operational stages:
   a) The estimation stage - this task is done by the technical departments to check and determine tax.
   b) The implementation, levying, and collection stage - this is done by the department responsible for levying and collection of tax.

5.6 Human Resource Management

BSA membership exceeds 1,700 auditors, which covers the entire country. Revenue auditing has been accepted as a specialized area requiring adequate skill formation and ongoing improvement. Most of the BSA members are responsive to the training needs in this area and are trying to develop or have developed strong task forces to carry out an effective mission in this branch of audit. Various internal and external training courses and workshops are organized by the BSA and the University of Baghdad through the creation of a diploma program in auditing. In order to equip the work force with the necessary theoretical and empirical inputs, this program takes three years to complete.

Since revenue auditing is largely a legalistic audit, the complexities and nuances of the tax laws and case laws have to be clearly understood and appreciated by auditors for any meaningful analysis. Maintenance of a properly documented and accessible system of national and international case laws is necessary to keep the knowledge and information current. In addition, it is necessary to attend many conferences and workshops in many countries.

Stages of the auditing process and the role of the specialized departments in the tax offices are as follows:

A. Audit checking by the technical department is to:
   • Realize the efficiency of internal control systems;
   • Ascertain the accuracy of the tax estimates;
   • Ensure that tax estimates are fair and based on a sound footing and on adequate data;
   • Ensure the soundness of tax procedures; and
   • Ensure that procedures are being followed properly.
B. For departments engaged in collection of revenues, the following checks are applied:

- Ensure that all revenues collected during the financial period in fact represent all the revenues which are due for collection during the period under the laws.
- Comparison of the actual collections with the budget estimate.
- Analysis of the reasons for arrears in collection.
- Ensure that all revenues are deposited in the banks accounts.
- Ensure that all records (journal, ledgers) have been fixed by law.
- Ensure that the system for collection of revenues is working efficiently.
- Ensure that demand notices have been issued to the tax payers.
- Ensure that proceedings have been initiated against tax defaulters.

C. Questionnaire on Internal Control - This method is used for obtaining accurate information related to the soundness of financial procedures by addressing the following points:

- The extent of soundness of the accounting and financial systems and the adequacy of the records used by tax offices;
- The soundness of the internal control systems, which help determine the sample size of the audit; and
- The procedures related to collection of revenues and other procedures are accurate.

6. Discussion

Government revenues increased as global oil prices remained persistently high for much of 2012. Iraq's contracts with major oil companies have the potential to further expand oil exports and revenues, but Iraq will need to make significant upgrades to its oil processing, pipeline, and export infrastructure to enable these deals to reach their economic potential. The task of rebuilding the country after 2003 remains immense and is made harder by sectarian politics and prolonged violence. Iraq’s reconstruction requires not only the rebuilding of its infrastructure, but also of its economic and social institutions and the creation of a business environment that attracts capital and brings with it new technology and skills to modernize the economy. Iraq’s huge oil reserves could, in principle, provide the revenues needed to finance the reconstruction, but strong institutions and favorable business environment are needed to use these resources effectively. The longer-term outlook is strong as domestic and foreign investment in the hydrocarbon sector is bearing fruit. According to the Ministry of Oil, oil production reached 3.3 million barrels per day (MBPD), of which 2.6 MBPD are exported, and extraction and exports are projected to increase considerably in the years ahead. Nevertheless, Iraq’s economic prospects continue to be subject to significant risks, deriving mainly from institutional and capacity constraints, oil price volatility, delays in the development of oil infrastructure, and an extremely fragile political and security situation.

From 2009, Parliament has taken unprecedented steps and indicted some government ministers through the Integrity Committee, and with the use of financial reports. For example, the Minister of Trade, whose indictment was televised, was accused of corruption, arrested, and imprisoned. Another example of corruption was the case of the Minister of Electricity. He was smuggled from the country because of his US nationality.
The role of the Parliament should be changed to promote and encourage the implementation of a particular type of accountability informed by new public management (for instance the Inspector General of each ministry). Parliament has begun to take important steps in limiting corruption. However, it needs to assume a larger role and increase its power in order to educate politicians and the leading political parties about the merits of the accountability system. It must also give more attention to governmental auditing reports and issue strict instructions to rein in corruption. Table 3 show the influence of country-wide corruption by presenting the audit results from the Commission of Integrity in 2009. Table 4 shows the influence of corruption in the capital (Baghdad) by presenting the audit results from the Commission of Integrity in 2009.

### Table 3. No. of forms checked and Bribes Detected by the Commission of Integrity in Iraq 2009

| Month    | No. Of Forms Checked | No. Of Paying Bribery | % Bribes Detected | Accumulated No. Of Forms Checked | Accumulated No. Of Paying Bribery | % Bribes Detected (Accumulated) |
|----------|----------------------|-----------------------|-------------------|----------------------------------|-----------------------------------|---------------------------------|
| June     | 10,641               | 2,197                 | 20.65%            | 10,641                           | 2,197                             | 20.65%                          |
| July     | 8,059                | 1,533                 | 19.02%            | 18,700                           | 3,730                             | 19.95%                          |
| August   | 7,561                | 1,378                 | 18.32%            | 26,261                           | 5,108                             | 19.45%                          |
| September| 9,653                | 1,438                 | 14.90%            | 35,914                           | 6,546                             | 18.23%                          |
| October  | 15,563               | 2,145                 | 13.78%            | 51,477                           | 8,691                             | 16.88%                          |
| November | 16,647               | 1,905                 | 11.44%            | 68,124                           | 10,596                            | 15.55%                          |
| December | 14,815               | 1,533                 | 10.35%            | 82,939                           | 12,129                            | 14.62%                          |

Source: Commission of Integrity report, 2010, Baghdad, Iraq.

Table 3 above provides a summary of the ratios of the extent of bribery detected by the Commission of Integrity in Iraq during 2009. The table indicates that the percentages of detected bribes reduced from 20.65% in June to 10.35% in December (20.65% to 14.62% in cumulative numbers for the period from June to December). Results summarized in Table 3 for Iraq are consistent with the results provided in Table 4 indicating a reduction of detected bribes in the capital Baghdad from 35.79% in April to 4.97% in December (35.79% to 9.84% in cumulative numbers).
Table 4. No. of forms checked and Bribes Detected by the Commission of Integrity in Baghdad 2009:

| Month    | No. Of Forms Checked | No. Of Paying Bribery | %Bribes Detected | Accumulated No. Of Forms Checked | Accumulated No. Of Paying Bribery | % Bribes Detected (Accumulated) |
|----------|----------------------|-----------------------|------------------|----------------------------------|-----------------------------------|----------------------------------|
| April    | 897                  | 321                   | 35.79%           | 897                              | 321                               | 35.79%                           |
| May      | 1,773                | 445                   | 25.10%           | 2,670                            | 766                               | 28.69%                           |
| June     | 3,445                | 475                   | 13.79%           | 6,115                            | 1,241                             | 20.29%                           |
| July     | 3,338                | 568                   | 17.02%           | 9,453                            | 1,809                             | 19.14%                           |
| August   | 3,883                | 381                   | 9.81%            | 13,336                           | 2,190                             | 16.42%                           |
| September| 4,919                | 404                   | 8.21%            | 18,255                           | 2,594                             | 14.21%                           |
| October  | 7,466                | 542                   | 7.26%            | 25,721                           | 3,136                             | 12.19%                           |
| November | 6,777                | 379                   | 5.59%            | 32,498                           | 3,515                             | 10.82%                           |
| December | 6,505                | 323                   | 4.97%            | 39,003                           | 3,838                             | 9.84%                            |

Source: Commission of Integrity report, 2010, Baghdad, Iraq

7. Findings, Limitations, Further Studies and Conclusions

Revenue audits have been recognized as an important area that requires greater attention and more specialization. In this era of trade globalization and shift to a market economy, every country will be opening avenues of investment. Government fiscal policies and laws will in turn tend to change according to the new economic environment. Consequently audits will have to adapt to the changed pattern of government revenues and with auditing standards revised according to further studies.

For example, a Value Added Tax (VAT) may replace the existing indirect taxes in Iraq and a liberalized tax regime may reduce the tax rates to attract investments without reducing the share of government revenues. Audit institutions will have a role to play in ensuring that appropriate tax laws are in place to translate the changes and also to ensure laws are implemented properly to safeguard government revenues in an era of liberalization. Information Technology (IT) audit is another challenge, which will have to develop momentum in a new Iraq.

The Central Bank has successfully held the exchange rate at about 1,180 Iraqi dinars/US dollar since January 2009. Inflation has remained under control since 2006 as security improved. However, Iraqi leaders remain hard pressed to translate macroeconomic gains into an improved standard of living for the Iraqi populace. Unemployment remains a problem throughout the country despite a bloated public sector. Encouraging private enterprise through deregulation would make it easier for Iraqi citizens and foreign investors to start new businesses. Rooting out corruption and implementing reforms - such as restructuring banks and developing the private sector - would be important steps in this direction.

The government should encourage developed countries to invest in Iraq in different sectors, and not only in the oil sector. Although one method to encourage foreign investment is by issuing appropriate laws, political differences may delay many useful laws in parliament.

The main conclusions that can be drawn from this study relate to government revenues in Iraq. Government revenues depend totally on oil revenues in spite of increasing tax revenues. It is
clear from Table 1 that government revenues in Iraq do not reflect the situation in other developing countries. Although the auditing rules are sufficient for the existing situation, enhancement of audit rules will be needed to address the new kinds of government revenues such as VAT and IT. The researcher recommends that the parliament increase its role in ensuring that most government expenses are legal and far from financial and managerial corruption. Parliament should create and support new control bodies to oversee the new revenues and expenditures. It should address the issue of limited state taxes by reducing exemptions.

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Guyana’s Compliance with the Inter-American Convention Against Corruption and the United Nations Convention Against Corruption

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Introduction

“Corruption is an insidious plague that has a wide range of corrosive effects on society. It undermines democracy and the rule of law, leads to violations in human rights, distorts markets, erodes the quality of life and allows organized crime, terrorism and other threats to human society to flourish...It hurts the poor disproportionately by diverting funds intended for development, undermining a Government’s ability to provide basic services, feeding inequality and injustice and discouraging foreign aid and investment. Corruption is a key element in economic underperformance and a major obstacle to poverty alleviation and development.”

These are the words of former United Nations Secretary-General Kofi Annan in his foreword to the United Nations Convention against Corruption (UNCAC). Mr. Annan goes on to state that UNCAC’s adoption will warn the corrupt that betrayal of the public trust will no longer be tolerated and that it will reaffirm the importance of core values such as honesty, respect for the rule of law, accountability and transparency in promoting development, and making the world a better place for all. He suggested that if the Convention is fully enforced, it will make a real difference to the quality of life of millions of people around the world, and by removing the biggest obstacles to development, it can help achieve the Millennium Development Goals. According to the United Nations, there is no single, universally accepted definition of corruption. For example, the United Nations Convention Against Corruption does not contain a single definition of corruption, but lists several specific types or acts of corruption. There are however several co-called “working definitions” of corruption. For example, the definition used by Transparency International is “the abuse of entrusted power for private gain.” The working definition of corruption adopted by the World Bank Group is more oriented to the public sector. That definition is: “The abuse of public funds and/or office for private or political gain.” Corruption results in the misallocation of scarce resources, and areas in genuine need of developmental assistance are overlooked in preference to those that offer the greatest rewards for the corrupt official. Investor confidence is shaken, and countries that are in dire need of foreign investment are deprived of it. As a result, international flow of goods, services and capital is affected, and investment ratios deteriorate. High levels of corruption are associated with low ratio of investment to GDP, low foreign inflows of direct investment and low levels of capital inflows. They also result in the perpetuation of weak governments through the loss of skills.

1 The United Nations Anti-Corruption Toolkit, 3rd Edition, UNODC, 2004. Available at www.undoc.org/documents/corruption/publications_toolkit_sep04.pdf, p. 10.
2 Frequently asked questions about corruption, Transparency International, Available at www.transparency.org/news_room/faq/corruption_faq.
3 Available at www.u4.no/pdf?file=/document/literature/publications_adb_manyfacesofcorruption.pdf.
Inter-American Convention against Corruption

The Inter-American Convention against Corruption (IACAC) came into force in 1997 and is the first international anti-corruption treaty that has influenced the adoption of a number of other international instruments, including UNCAC and the African Convention against Corruption. The main objectives of IACAC are: (a) to promote and strengthen the development of the mechanisms needed to prevent, detect, punish and eradicate corruption; and (b) to promote, facilitate and regulate cooperation among the Member States to ensure the effectiveness of measures and actions in place to fight corruption.

Preventive measures

The most important aspect of the Convention relates to preventive measures. It covers the following key areas:

- Internal controls and maintenance of books of account;
- Written rules and instructions for the proper execution of duties;
- Conservation and proper use of public resources;
- Government hiring and compensation;
- Procurement of goods and services, and the execution of works;
- Revenue collection and control;
- Codes of conduct, conflicts of interest and other ethical considerations;
- Declaration of income, assets and liabilities;
- Participation of civil society;
- Reporting acts of corruption and whistleblower protection; and
- Oversight arrangements.

Other measures

Other aspects of the Convention include measures to combat transnational bribery; illicit enrichment; unauthorized use of classified or confidential information; extradition proceedings; assistance and cooperation among State parties; identifying, tracing, freezing, seizure and forfeiting property or proceeds from corrupt activities; and bank secrecy laws.

United Nations Convention against Corruption

UNCAC came into force in 2005 and is more detailed than IACAC. The related UN resolution referred to the World Summit on Sustainable Development in South Africa in 2002 where corruption was declared a threat to sustainable development of people. Accordingly, the General Assembly expressed concern about “the seriousness of problems and threats posed by corruption to the stability and security of societies, undermining the institutions and values of democracy, ethical values and justice, and jeopardising sustainable development and the rule of law”.

In addition, the General Assembly expressed concern about the links between corruption and other forms of crime, including money laundering; and cases of corruption that involve vast quantities of assets, which may constitute a substantial portion of State resources. It also considered that corruption is no longer a local matter but a transnational phenomenon that affects all societies and economies, making international cooperation to prevent and control it essential.
The General Assembly further stated that it is convinced that the illicit acquisition of personal wealth can be particularly damaging to democratic institutions, national economies and the rule of law. Accordingly, it asserted that the prevention and eradication of corruption is a responsibility of all States. As such, they must cooperate with one another, with the support and involvement of individuals and groups outside the public sector, such as civil society, non-governmental organizations and community-based organizations, if their efforts in this area are to be effective.

**Preventive measures**

Parties to UNCAC are to develop and implement or maintain effective, coordinated anti-corruption policies that promote the participation of society and reflect the principles of the rule of law, proper management of public affairs and public property, integrity, transparency and accountability. UNCAC specifically refers to the establishment of a body or bodies to promote effective practices aimed at preventing corruption. These bodies should be granted the necessary independence and resources to carry out their functions effectively, free of undue influence.

In relation to the public sector, State parties are to adopt, maintain and strengthen systems for the recruitment, hiring, retention, promotion and retirement of civil servants and non-elected officials based on, among others, efficiency, transparency and objective criteria such as merit, equity and aptitude. In addition, they ensure that appropriate systems are in place for public procurement, based on transparency, competition and objective criteria in decision-making that are effective in preventing corruption.

Other measures include:

- Establishing criteria concerning candidature for and selection to public office, enhanced transparency in the funding of candidates for elected public office, and funding of political parties;
- Maintaining and strengthening systems that promote transparency and prevent conflicts of interest;
- Facilitating simplified access by members of the public to information on government programs and activities;
- Strengthening the integrity of the judiciary and prosecution services to prevent opportunities for corruption among its members;
- Enhancing accounting and auditing standards for the private sector, and ensuring cooperation between law enforcement agencies;
- Participation of individuals and groups outside the public sector to raise public awareness regarding the existence, causes and gravity of and the threat posed by corruption.
- Ensuring comprehensive domestic regulatory and supervisory regime for banks and non-bank financial institutions as well as other bodies particularly susceptible to money laundering, including the establishment of a financial intelligence unit;
- Criminalizing laundering of proceeds of acts of bribery, embezzlement, abuse of functions and other related acts as well as concealment and obstruction of justice; and
- Freezing, seizure and confiscation of proceeds of crime as well as property derived from such proceeds.
Compliance with IACAC and UNCAC

Guyana acceded to the two conventions in 2000 in the case of the IACAC and 2008 in the case of UNCAC. The Organization of American States (OAS) recently completed its fourth round review of Guyana’s compliance with IACAC relating to oversight bodies, which include the Audit Office, Director of Public Prosecution (DPP), Service Commissions and the National Tender and Administration Board (NPTAB). The main recommendations are: (a) these bodies are provided with adequate financial and human resources to enable them to discharge their responsibilities effectively; and (b) an anti-corruption agency be established with specialized units within the Police Force and the Office of the DPP.

Guyana has consistently scored poorly on the Corruption Perception Index (CPI). In 2013, it ranked 136 out 177 countries surveyed with a score of 27 out of 100. In addition, allegations of corrupt behavior are being highlighted in the print media on a routine basis. In view of the current workload of the Police and the Office of the DPP, and their lack experience and expertise in dealing with white collar crimes, it would be more appropriate for anti-corruption legislation to be promulgated to provide for, among others, the establishment of an anti-corruption agency clothed with powers of prosecution, and a special anti-corruption court to deal with offenders.

Anti-money laundering efforts

Guyana is a transit country for cocaine destined for North America, Europe and West Africa. In addition, money laundering is linked to trafficking in drugs, firearms and persons as well as corruption and fraud, and appears to prop up the economy. Only recently, Guyana once again made the international news following the arrest in the United States and Italy of at least two dozen persons attached to criminal networks in New York, Mexico, Southern Italy and Malaysia for planning to ship 1,000 lbs of cocaine from Guyana valued at US$1 billion. Quite recently also, Guyana reportedly joined Mozambique at the bottom of the list of 55 countries that had been evaluated in terms of their anti-money laundering efforts.

Guyana’s record of dealing with drug trafficking and money laundering can best be described as very cosmetic. After many years, legislation was eventually enacted in 2009 but many of the requirements were not implemented, especially as regards the Financial Intelligence Unit. There have also been no significant arrests and prosecutions. In addition, the Caribbean Financial Action Task Force (CFATF) found the legislation to be significantly deficient in terms of its conformity with the standard recommendations used to evaluate countries’ efforts to combat money laundering and terrorist financing. Faced with repeated threat of sanctions, the Government tabled the related amendments. It wanted their urgent passage as presented, contending that: (a) the proposed amendments addressed all the concerns that the CFATF had raised; and (b) if they are not approved, Guyana would be blacklisted.

The combined Opposition felt that the opportunity should be taken to carry out a more comprehensive review of the legislation in view of the problems identified above. The Government was, however, unwilling to consider other aspects of the legislation and insisted that its concern was only with the deficiencies identified by CFATF. As of now, there is still no agreement on the proposed amendments.

The Supreme Audit Office

The main oversight body is the Supreme Audit Office (SAO) whose main responsibility is to audit the public accounts and to report the results to the Legislature. The Organization of American States report commented on the prolonged acting arrangements involving the Auditor General who acted for eight years before being appointed at a time when he was about to retire in his substantive position. The Chancellor of the Judiciary and the Chief Justice have also been
acting in their positions since 2005. Although the report did not refer to the latter two positions, it did concur with the widely held view that lengthy acting arrangements involving holders of key constitutional positions militate against their ability to discharge their responsibilities in an independent, objective and professional manner. These officials are required to be independent of the Executive in the performance of their duties.

The report emphasized the need for the Supreme Audit Office to have more qualified accountants. The Auditor General himself is, however, not a professionally qualified accountant although he is required to supervise the work of Chartered Accountants in public practice contracted to undertake audits on his behalf. In addition, among senior management, there is only one such qualified person. Further, there is an urgent need to promulgate specific rules to avoid, among other things, situations where close family relations are responsible for preparing, certifying and transmitting financial statements for audit on the one hand, and those who oversee the audit of those statements on the other hand. Appearance of recusal is not an option, especially when one occupies a position of influence in the audit entity, and is more than likely to raise questions of credibility in terms of the results. This is more so when one considers that public accountability is far more rigorous, stringent and demanding than that which prevails in the private sector.

The Stabroek News editorial of 30 December 2013, reflecting on the current state of affairs of the Supreme Audit Office, had the following to say:

*The Auditor General’s Office – the premier watchdog on accountability- would now be considered a satellite of central government as opposed to a fearless champion of financial rectitude. The government’s hold on this constitutional office through upper level appointments has seriously eroded its independence as evidenced by its increasingly innocuous annual reports on government accounts and the lack of investigation of major and questionable expenditures by the government.*

In order to strengthen the independence from the Executive of this key oversight body, the relevant legislation should be amended to provide for qualification requirements for the Auditor General as well as limiting his/her tenure of office to, say ten years, in keeping with current trends. The present arrangement is one in which, once appointed, the Auditor General serves until age 65. The first post-Independence Auditor General served for 21 years while the incumbent would have served 18 years upon retirement.

**The Public Service Commission and government hiring**

The Public Service Commission is the constitutionally mandated body responsible for ensuring competitiveness, fairness and transparency in recruitment, transfer, promotion, discipline and retirement of public servants, including setting emoluments and conditions of service. Public servants who are dissatisfied with the decisions of the Commission can address their grievances to the Public Service Appellate Tribunal. However, the Tribunal has not been operational since 1995.

While the OAS report recommended that the Tribunal should be reactivated, some 20 per cent of public servants are employed on a contractual basis at emoluments and conditions of service superior to those employed in the traditional public service. These contracted employees are recruited without the involvement of the Public Service Commission, and there is a lack of transparency. Most of these employees are handpicked individuals, some of whom are retained beyond their retirement age.
It is evident that the Public Service needs to be reformed to provide for, among others, a unified system for recruiting and remunerating public officials, and for the Public Service Commission to be involved, as provided for by the Constitution.

**Public procurement**

Public procurement is governed by the constitutional amendment of 2001 and the Procurement Act of 2003. The OAS report highlighted the need for new regulations to be issued under the Act for debarment procedures and penalties for contractors who perform unsatisfactory work and who pay bribes. The recommendation was based on the widespread concerns over the quality of work produced by contractors and of overpayments made.

A significant shortcoming in the Act relates to the power of the Minister of Finance to appoint the members of the National Procurement and Tender Administration Board (NPTAB) with the reporting relationship to him. The Minister is a key member of Cabinet that offers “no objection” to contracts of G$15 million and over, based on recommendations by the NPTAB. That apart, the continuing failure since 2001 to establish the Public Procurement Commission to ensure that the procurement of goods and services and the execution of works are conducted in a fair, equitable, transparent, competitive and cost-effective manner, remains a source of major concern. Many stakeholders hold the view that the present system in place does not provide them with confidence as to the fairness and transparency in the award of contracts.

The Government is, however, insisting that Cabinet should continue to be involved in the procurement process although the constitutional amendment removes that involvement and vests it with the Commission. As a result, the stalemate between the Government and the political opposition remains unresolved.

**Internal controls and maintenance of books of account**

The Government is yet to promulgate accounting standards to provide a basis for financial accounting and reporting although the related law was passed in 2003 requiring the Minister of Finance to do so. The current system is a cash-based one inherited from the British with little or no modifications over the years. It is therefore outmoded and not reflective of international best practice. Many countries have found it necessary to move away from the cash-based accounting system to one based on accrual accounting, and have adopted the International Public Sector Accounting Standards.

There is also no organized system of internal auditing, especially at larger Ministries, though efforts are being made to implement one at the Ministry of Finance. Strong and effective internal audits will ease the workload of the Audit Office since reliance can be placed on such audits.

**Revenue collection and control**

The Constitution provides all public revenues to be collected promptly and paid over to the central Treasury, out of which all public expenditures are incurred only with the approval of the Legislature. However, since 2002 the Government has been using a state-owned company as a “parallel Treasury” through the diversion of certain state revenues. These include dividends from public enterprises; proceeds from the sale of state properties and other assets; and transfers from other state institutions.

The Government also uses the “intercepted” revenues to meet expenditure without parliamentary approval and there is a lack of transparency. As a result, the National Assembly passed a resolution almost two years ago, calling on the Minister of Finance to, among others: (a) account for the properties that the company has been entrusted with; (b) explain the basis
upon which such properties were disposed of; and (c) hand over the monies and excess funds to the Treasury. To date, the Minister, who is also the Chairman of the company, is yet to comply.

Declaration of income, assets and liabilities

The Integrity Commission Act 1997 provides for the establishment of the Integrity Commission and for securing the integrity of persons in public life. More specifically, the Commission is responsible for monitoring and reviewing annual declarations of assets and liabilities of all politicians and senior government functionaries; and the promulgation of a code of ethics.

The work of the Commission has, however, been stymied for some years now because of the non-appointment of the Commissioners. This prompted the main Opposition Members of Parliament to decline to submit their annual returns. As a result, a significant gap in the fight against corruption remains undefended especially when one considers that quite a number of public officials are flouting unexplained wealth with impunity. Numerous calls for the appointment of members of the Commission remain unheeded.

Other matters

The only civil society organization that is devoted to fighting corruption is the Transparency Institute Guyana Inc. (TIGI) which was established in 2010. It is an affiliate of Transparency International. TIGI’s main role is to create an awareness of the effects of corruption among citizens and what they can do about it. Because of its defensive approach whenever the issue of corruption is raised, the Government, however, is yet to embrace TIGI’s work.

No legislation is in place to protect persons who report, in good faith, allegations of corrupt behavior. There is also an urgent need to regulate campaign financing for political parties. While an Access to Information Act is in place, there have been no requests for information since the appointment of a Commissioner of Information some nine months ago.

Conclusion

The Government of Guyana needs to do more to secure satisfactory compliance with IACAC and UNCAC and to win public confidence that it is seriously committed to tackling corruption. If its efforts are to succeed, the Government needs to cease being in a state of denial about the existence of corruption; stop “circling the wagons”; accept the results of the Corruption Perception Index (CPI) in good faith; and sincerely commit itself to improving the country’s score and ranking on the CPI. Key areas that have fallen short of expectation have been highlighted in this presentation.

Finally, the Government of Guyana needs to embrace the work of Transparency International in a genuine partnership to rid the country of the scourge of corruption that benefits the rich at the expense of the poor and vulnerable.
History of Public Sector Accounting - An Appeal for Research into Pre-Colonial Approaches

Andy Wynne
Director, Public Finance Africa

This is a brief appeal for research to be undertaken to document approaches to public sector accounting in pre-colonial governments. Such historical research will help us address current problems, for example, none of the literature on moving to accrual accounting notes the experience in the British war ministry in the early 1920s.

Accrual based financial statements were actually produced for six years. It was then decided that this approach required additional costs of at least £200,000 a year, but that “the experiment had not led to commensurate economies in administration and seemed unlikely ever to do so”\(^1\). So the experiment was terminated. In 1950 a Parliamentary Committee also carefully reviewed the evidence for the general adoption of accrual accounting and decided that, “no practical advantage would be secured from the adoption of [an accrual]… basis of accounting.

The current approach to public sector accounting on the accrual basis only really dates from the late 20th Century alongside New Public Management. This still remains a contested approach. In contrast there have been many previous civilisations which developed mature and reasonably sophisticated approaches to public financial management.

The first solid evidence of the existence of recording numbers is the *Ishango Bone*, dated from around 20,000 years ago. This was found in 1960 in what is now the Virunga National Park in the Democratic Republic of Congo, near the Ugandan border. The lines cut into the bone are too uniform to be accidental. Archaeologists believe the lines were tally marks to keep track of something, but what that was is not clear.

But numbers, and counting, didn’t truly come into being until the rise of cities. The earliest evidence for this is from about 4,000 BCE in Sumeria (in modern Iraq), one of the earliest human civilizations. With so many people, livestock, crops and artisan goods located in the same place, they needed a way to organize and keep track of it all, as it was used up, added to or traded.

Another source of ancient public sector accounting and audit comes from the Western Zhou dynasty of China (1046–771 BCE) around three millennia ago. Annual, monthly and 10-day bookkeeping reports were prepared for the accountability of public officials. These reports were then subject to audit by an official named the *Zaifu* who undertook an early form of auditing.

Kautilya, the chief minister to a major ruler of India, wrote *The Arthashastra*, a fascinating treatise on governance, in the fourth century BCE (nearly 2,500 years ago). He developed bookkeeping rules to record and classify economic data. He also emphasized the critical role of independent periodic audits and proposed the establishment of two important, but separate, offices - the Treasurer and Comptroller-Auditor as part of public financial management.

In the Athenian state (around 400 BCE), the hallmark was “its concern for the accountability of its officials.” For them, “to have officials accountable was the key to responsible government, unaccountability meant lawlessness.”\(^2\) To this end, officials were required to report on their conduct ten times a year to the Assembly of the Citizens. If the explanations did not meet with

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\(^1\) HMSO (1950) Final Report of the Committee on the Form of Government Accounts, London: HMSO: page 70

\(^2\) Jennifer Tolbert Roberts (1982) *Accountability in Athenian Government*, Madison: University of Wisconsin Press: page 6.
the Assembly’s approval, officials were subjected to a trial, and indeed, where necessary, to impeachment\(^3\).

Aristotle also wrote: “Some officials handle large sums of money: it is therefore necessary to have other officials to receive and examine the accounts. These inspectors must administer no funds themselves. Different cities call them examiners, auditors, scrutineers and public advocates”\(^4\)

The Roman civilisation lasted for over a thousand years. By the time of the first Emperor Augustus (from around 30 BCE), the Roman government had access to detailed financial information\(^5\). The word ‘audit’ is derived from the Latin word ‘audire’, which means ‘to hear’.

The history of accounting is often just seen as European, but the precise origin of the double entry accounting records as outlined by the Italian Pacioli in 1494 is presently unknown. Historical evidence preserved in Turkey and Egypt indicates that the accounting records developed in the early Islamic State were similar to those outlined by Pacioli. As with the European numbering system, the Arabs may have been messengers carrying these techniques from India or even China.

All these examples of historical public financial management practices have been reasonably well researched and documented, but there are many other civilisations where this is not the case, for example:

**Benin Empire** (1440–1897), a large pre-colonial African state in the south of modern Nigeria developed an impressive bronze technology.

**Ashanti Empire** (1701–1894), a pre-colonial state in what is now Ghana. Today, the Ashanti monarchy continues as one of the constitutionally protected, sub-national traditional states within the Republic of Ghana.

**Sokoto Caliphate** (1804–1903), an Islamic empire in northern Nigeria, led by the Sultan of Sokoto, Sa’adu Abubakar. Founded during the Fulani Jihad in the early 19th century, it was one of the most powerful empires in sub-Saharan Africa prior to European conquest and colonization.

In each of these three cases, a reasonably sophisticated system of tax collection was developed. There must have been a recording system for this revenue, how it was kept and what it was spent on. However, almost no research has been done in this area.

Time is now running out. We are now only a generation or so away from these civilisations. But the records and the oral history may soon be lost. Accounting historians need to research and document the public financial management arrangements of these and other cases. This will widen our experience of accounting and ensure that we do not repeat the mistakes of our predecessors. Andy Wynne [andywynne@btinternet.com] would like to hear from anyone with an active interest in this area.

\(^3\) Premchand, A (1999) Public Financial Accountability, *Asian Review of Public Administration*, Vol. XI, No. 2 (July-December).

\(^4\) Day, Patricia and Rudolf Klein (1987), *Accountabilities*, London: Tavistock Publications: page 9.

\(^5\) Oldroyd, David (1995) The role of accounting in public expenditure and monetary policy in the first century AD Roman Empire, *Accounting Historians Journal*, Volume 22, Number 2, Birmingham, Alabama, December, page124.
Invitation to Potential Authors

The *International Journal on Governmental Financial Management* (IJGFM) aims to provide a forum for practitioners, academics and the general public to discuss the many disciplines involved with governmental financial management. These include accounting, auditing, budgeting, debt management, information technology, tax management and treasury management.

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Ideas for articles are welcome and may be discussed with the editor before submission of the full text. The editor is happy to respond to informal inquiries about the suitability of papers for possible publication.

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Flynn, N (2002) ‘Explaining New Public Management: The Importance of Context’, in K McLaughlin, S Osborne and E Ferlie (eds.) New Public Management: current trends and future prospects, London, Routledge

translated books

Adorno, T. W. Negative Dialektic (Frankfurt: Suhrkamp, 1966). Negative Dialectics, E. B. Ashton (trans) (1973) New York, Seabury Press

reference to a report.

World Commission on Environment and Development (1987) Our Common Future (‘The Brundtland Report’) Oxford, Oxford University Press

references to material on the Internet

Dorotinsky, Bill (2008) Public Financial Management Reform: Trends and Lessons, ICGFM DC Forum, June

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International Journal of Governmental Financial Management -  www.icgfm.org/digest.htm
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Nous aimerions être en mesure de publier des articles et des commentaires qui vont :

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   Carnegie, D. *The Leader in You* (New York: Dale Carnegie & Associates, 1993). *Comment trouver le leader en vous*, D. Weyne (trad) (1994) Paris, Hachette

5. **Référence à un rapport:**

   Banque Mondiale (2007) *Rapport sur le développement dans le monde 2007 – Aperçus régionaux : Afrique subsaharienne* (‘Rapport sur Développement et Générations Futures’), Washington DC, The World Bank

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Veuillez prendre contacte avec Zbyslaw (Peter) Dobrowolski - peterdobrowolski@pro.onet.pl – si vous souhaitez discuter du rôle du comité de rédaction et de quelque proposition d’amélioration.
Invitación a posibles Autores

La revista *International Journal on Governmental Financial Management (IJGFM)* es un foro para académicos, profesionales y el público en general para el debate de las muchas disciplinas involucradas en la gestión financiera gubernamental. Éstas incluyen la contabilidad, la auditoría, el proceso presupuestario, la gestión de la deuda, la tecnología de la información, la gestión impositiva y la del tesoro.

Nos gustaría publicar artículos y comentarios que:

- alienten la colaboración entre profesionales y otros que están preocupados por la gestión financiera.
- contribuyan al avance de los principios y normas de la gestión financiera gubernamental, especialmente al describir las buenas prácticas existentes.
- identifiquen problemas o debilidades a través de una crítica de las opiniones actualmente dominantes sobre las reformas de la gestión financiera en el sector público; y
- ayuden a los gerentes financieros del sector público a identificar sus propias soluciones a los retos comunes.

Sería de interés especial recibir contribuciones de individuos o equipos que trabajan en los países en desarrollo. Invitamos a los potenciales autores a consultar los números anteriores de la revista en: [http://www.icgfm.org/journal.htm](http://www.icgfm.org/journal.htm)

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- no más de 20 páginas en espacio sencillo (o de 10.000 palabras);
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Referencias en el texto
Las referencias en el texto a libros, artículos, etc. deben incluir el nombre del autor, el año de publicación y las páginas específicas de las citaciones directas (p. ej., Mickey & Donald, 1968, p. 1). Para más de dos autores, la citación debe ser abreviada así: (Kramdon y otros, 1988, p. 1). Citaciones múltiples al mismo autor en el mismo año deben ser diferenciadas dentro del texto (y en la bibliografía al final) por las letras a, b, c, etc. después del año de publicación. Términos en latín, por ejemplo, et al, ibid o op. cit deben evitarse.

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Donde sea posible, los detalles de la dirección electrónica deber incluirse para materiales disponibles en el Internet. En este caso, la fecha de consulta del material debe ser indicada.

La presentación de las referencias debe seguir la siguiente convención:

1. artículos:
Schick, A (1998) ‘Why Most Developing Countries Should Not Try New Zealand Reforms’, The World Bank Research Observer, Vol.13, No.1, febrero. pp.123-31.
Barrientos, Eduardo Gana (1994) ‘Procesos de integración subregional y coordinación de políticas macroeconómicas’, Información del Comercio Español. 732:8-9. pp. 131-142.

Bekinschtein, José A., Maizal, Nélida. (1994) ‘La integración regional en Asia-Pacífico: Vías de participación.’ Integ. Latinam. 19:1-2. pp. 31-42.

2. libros:
Guthrie, J. Humphrey, C. Jones, L R. & Olson, O., (2005), International Public Financial Management Reform, Information Age Publishing, Greenwich.

Stolovich, Luis. (1993) El poder económico en el MERCOSUR. Centro Uruguay Independiente, Montevideo.

3. citaciones de libros compilados:
Flynn, N (2002) ‘Explaining New Public Management: The Importance of Context’, en K McLaughlin, S Osborne y E Ferlie (eds.) New Public Management: Current Trends and Future Prospects, Londres, Routledge.

Haug, G. (2005) ‘Pluralidad e intereses compartidos de las Universidades Europeas’, en F. Toledo, E. Alcón, y F. Michavila. (eds) Introducción a la contabilidad Financiera: un Enfoque Internacional. Barcelona: Ariel. pp. 35-49.

4. libros traducidos:
Adorno, T. W. Negative Dialektic (Frankfurt: Suhrkamp, 1966). Negative Dialectics, E. B. Ashton (trad.) (1973) Nueva York: Seabury Press.

5. referencia a un informe:
WCED (World Commission on Environment and Development) (1987) Our Common Future (‘The Brundtland Report’); Oxford: Oxford University Press.

6. referencias a material del Internet:
Dorotinsky, Bill (2008) Public Financial Management Reform: Trends and Lessons, ICGFM DC Forum, Junio

http://icgfm.blogspot.com (6 Septiembre 2008)

**Cuadros, diagramas, figuras e tablas**
Todos estos deben denominarse “figuras” y ser numerados consecutivamente en números arábigos con un breve título en letra mayúscula, con etiquetas, etc. El texto debe indicar donde aparece la figura.
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Nos complacería también recibir correspondencia de otros que estén dispuestos a ayudar con el trabajo editorial de la Revista. El trabajo consistiría en revisar potenciales contribuciones, indicando si deben ser aceptadas para publicación y haciendo recomendaciones editoriales para mejorar la calidad de los materiales enviados.

Tenga la bondad de contactar al redactor, Zbyslaw (Peter) Dobrowolski - peterdobrowolski@pro.onet.pl – si le gustaría comentar sobre el papel de la junta editorial y cualesquier sugerencias que usted pudiera ofrecer.