Chapter 27
Financial Control and Ratio Analysis in Local Governments

Ali Kablan
Istanbul University, Turkey

ABSTRACT

Local governments have to use their sources in the most efficient way against increasing service demands. Local governments’ incomes are to be collected regularly and in accordance with the conditions, and their expenses are to be spent in the most efficient way. These depend on the healthy operation of budget, accounting, and financial control systems related to them. Progress of the system shall be controlled in local governments, and this data shall be analyzed and presented to the higher authorities as reports. Today, only official reports take place in local governments, and there is no analysis related to control. This causes the deterioration of the balance of income and expenditure and affects service presentation and service quality in a negative way. Financial structure of local governments is the most important issue that determines the quality and aspect of the services provided to the region. The efficiency of local qualified incomes, transfers of local management, and size of the resources caused of borrowing play an important role in forming the financial structure (Kurtuluş, 2006, p. 28). Therefore, management and financial analysis ratios are needed. Due to these ratios, establishing a control system can be used in management. In this study, financial resources in public management are analyzed, ratios related to these financial resources are included, and a suggestion for financial implementation for local governments is promoted.

INTRODUCTION

Financial table analysis in private sector emerged by change of company structures in USA in the second half of 19th century. In this period, big companies started to replace family companies, these big companies required big financial resources. Big companies which cannot supply their source needs from their equities, were in debt from their financial markets. Lenders, to predict the money they gave to be returned or not, in order to determine financial status of the companies,
started to implement financial table analysis. In addition, the emergence of large companies, caused professional managers other than family members to take role in company managements. Also the shareholders who assign professional managers for managements required to measure success of the managers and this need caused financial table analysis to emerge (Horrigan, 1968:285). In the first implementations, assets are classified as current assets and non-current assets, by comparing current assets with short term liabilities in 1880’s, “Current Ratio” has emerged and as Horrigan expresses, “the use of rates in financial table analysis started by expressing current ratios”. With ongoing studies, financial analysis methods are used to determine financial status of the companies in decision making period and to make predictions for the future, commonly by the financial table users today.

Despite financial tables analysis has such a long past for private sector and there are many studies made in this subject, financial tables analysis studies for public sector therefore public institutions started too late. The most important reason of this delay is that the aims of public institutions are different from the privates. While aim of the companies are profit maximization in private sectors, aim of the public institutions are providing services to the community. Not only public institutions in the general management, also public institutions which are legally established and operating in accordance with private provisions, put public interest forward of the profit maximization. In addition, because of public institutions undertake different duties and are formed in different forms, it hasn’t been possible to suggest analysis techniques for all public institutions. For these reasons, to transfer analysis techniques based on determining profit and developed for private sector, to the public sector, and to implement these techniques for public sector has not been able. As a second reason, it is possible to consider no demand comes from the community related to analysis of financial status of the public institutions. As stated before, upon shareholders using financial table analysis in the private sector and credit organizations request for analysis techniques, these studies started and analysis techniques were developed, however, because such a demand was not set forth by the public institutions financial table users, studies could not be started in this subject in early time. Another reason of non-development of the financial table analysis in public sector, is the usage of cash-based accounting system commonly in public institutions. Due to the importance of budget in public institutions, record need emerged because of budget usage and in this historical development period, cash-based accounting system is implemented in public sector. Due to narrow scope of cash-based accounting system and financial tables produced in this system do not contain appropriate information for analysis, it has not been possible to develop financial table analysis techniques.

However, due to the concepts of transparency and accountability came forward lately especially in well-developed countries, interest has increased in financial status and resource usage in public institutions, for this reason, accrual based accounting system which contain financial activities in detail grew up and studies related to the analysis of the financial tables produced from this system became available. Today many country passed up accrual based accounting system in public sector and some part still make studies in this subject. In the last 30 years, studies relates to develop analysis techniques on financial tables of public institutions are done especially by professional organizations and academicians. Most important studies in this case are done on local governments. The reason of this, local governments have troubles to pay their debts which supply some of their investments from money markets by borrowing, in USA where private sector financial analysis methods are implemented first. Especially in 1970’s municipalities of big and important cities