

September, 20, 2007

Financial Analysis of Palestinian Local Government

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Research paper

Abstract

This study aims to examine the major merits of the Palestinian accounting and budget systems as well as to identify major financial problems and obstacles facing the Palestinian municipalities in order to recommend reforms and point out the best choices of increasing internal revenues. The study used both financial analysis of actual and budgeted data as well as a survey instrument; thus a special questionnaire was articulated to collect the perceptions of the financial managers of the Palestinian local governments. The study found that about 85% of the Palestinian local government are using cash basis, 64% of the accounting systems in the municipalities are using the same chart of account for both actual financial accounts and budget statements. Only 42% are using profit centers, the accuracy of estimated budget figures are so far from that actual revenues and expenditures at the end of the fiscal years. Moreover, there is a high percentage of debt due on the municipal residents, low share of taxes to the total revenues of municipalities, and a weak accounting transparency system.

1. Introduction:

The Palestinian local governments are organized through two laws that are directly related to the local government functioning (PNA, 1996; PNA, 1997;; and PNA, 1999). The first law is the one articulated for “elections for local Authorities Law of 1996”, however, local

elections have not been held until May 2005, before that date, the Ministry of Local Governments has appointed Local Government Units' mayors and council members. The second local government law was approved in 1997, which sets out the formation, financing and responsibilities of elected local councils and mayors. The responsibilities included creation and maintenance of roads, water and electricity supplies, building permits, providing health and environment service (PNA, 1997). A third law was issued that related to organizing the financial aspects of running the Palestinian local government. In addition, the ministry of local government introduced many regulations that organized and monitored the work of local administrations such as the payroll system for the municipality employees. Accordingly, it may be stated that local government in Palestine aimed to establish elected local units to provide local services that are funded by taxes and local fees, under the supervision of the central government (Sabri, 2003).

The Palestinian local government sector including municipality councils and village councils offer services to local residents as stated by the related laws. They are authorized to impose certain taxes to finance their activities. There are many types of taxes that exist in the West Bank that include the property taxes, license fees, and educational tax which is imposed on the residents of municipalities, and other three different types of taxes imposed on the residents of the village councils. The Palestinian municipal sector is classified into four categories, based on number of population. The number of local government councils has increased significantly since the emergence of the Palestinian National Authority and up till now. For example, the number of local governments was about 29 municipality and 91 village councils in 1994 (Sabri, 1994), the number increased to 108 municipality and 51 village councils in 2000 (PNA, Ministry of local government, 2000). Today, in 2006 there are about 133 municipality and 292 village councils and 94 project committees as presented in the manual of the municipalities association (APLA, 2006).

The annual allocated budget of the local government increased from about five million dollars in 1967, to 53 million in 1980, while it reached about 90 million in 1993, however, since the establishment of the PNA, the total local government budgets value increased significantly, reaching about 280 million in 2004, (Sabri, 1994 and Sabri and Jaber, 2006).

The major income of the local governments' budget also diverge from one municipality to another due to the fact that the majority of Palestinian municipalities own and run the water, electricity projects, while others don't have such projects. However, in general the major incomes come from taxes, fees of buildings, water revenues, electricity revenues, rent of owned properties, and other special fees besides the allocated funds from the central government such as the petroleum and transportation fees. The collected local taxes and fees are supposed to be the first source of revenues, as it was estimated to be about 22% of the local government revenues between the period (1995 and 2004). The property tax is the main local tax, which formed about 18% of the total regular revenues of the Palestinian municipalities. Palestinian municipalities also get aids from Arab and International countries in order to cover developmental projects, and / or the establishment of hospitals and schools.

2. Significance of the Study

The importance of the local governments arises from the important services that are offered for residents living in their local communities. The local governments are obliged to undertake the function or at least monitor the situation and provide any of the services that are lacking and are not being provided by another agency; therefore, it's worth mentioning that several factors make this study significantly important. To start with, this study comes upon the completion of the election process in almost all Palestinian municipalities (which came after about a quarter century). Today in 2006, about 80% of the total Palestinian municipalities are ruled by elected mayors and councils, while about 20% of municipalities and village councils (which form about 62 councils) are still ruled by appointed citizens from the central government. A second issue that must be tackled is the collection of local taxes and other fees such as the prices of water and electricity offered to residents by local councils, such fees are considered immaterial compared to the total allocated budget of local councils and municipalities. As for collecting other fees and the prices of water and electricity offered to residents, this issue is also facing a failure as the total debt on residents increased from 10% to 200% of the annual budget in the majority of the Palestinian municipalities in the West Bank. As for the Gaza Sector municipalities, the total due debt is about 65 million US\$ as in 2005, and it's increasing about 10 million US\$ annually in the last

three years. This amount forms about 171% of the annual budget (PNA, 2006a and 2006b, Financial Statues of Municipalities).

Accordingly, there is a timely need to implement such a study; as the study aims to analyze merits and problems facing the Palestinian local governments' accounting and budget systems, in order to suggest relevant recommendations, which will increase transparency and accountability in managing of the local governments. The study includes analysis of major revenues and expenditures of local governments and perceives the opinions of municipalities' official regarding various, accounting and financial issues. In more details, this study aims to answer the following questions:

1. What are the major merits of the Palestinian accounting and budget systems?
2. What are the major financial problems /obstacles facing the Palestinian municipalities?
3. What are the current main resources of funds and other revenues of the Palestinian local councils?
4. What are the best alternatives to increase the internal revenues of local municipalities as perceived by the local officials?
5. To what extend are municipal projects such as water, electricity and wastage are considered profitable to the Palestinian municipalities?
6. To what extend is the annual estimated budget data accurate compared to actual data in case of the Palestinian municipalities?

3. Review of Literature:

Review of literature regarding Palestinian local governments: The debate about efficiency, transparency of accounting and financial issues of the local governments is getting more consideration all over the world; consequently, the Palestinian experience is not an exception. For example some studies discussed the issue of municipal taxation (Sabri, 1994; Sabri, 2001; Sabri, 2004; Sabri, 2000; Sabri & Jaber, 2006; IMF, 2003; World Bank, 1999 and World Bank, 2004), which recommended the need to reform and enhance the tax system as a major revenue source for Palestinian local governments. Other issues such as accounting and auditing reforms and to use electronic applications were explored in the Palestinian local

governments. For example, Sabri and Al- Haj (2006) found that there is a need to issue the related bylaws of employees system as stated by Article 19 of the Local government law No. 1 of 1997, which has not been issued yet, as well as to establish a unified retirement provident fund law. Sabri and Jaber (2007) study found that the efficiency of the local government is still limited in the Palestinian municipalities, and the major managerial problems are similar to other experiences of emerging countries such as the undefined local-central relation, the low participation and involvement of citizens in municipalities' activities, and the lack of transparency. Finally, a UNDP report (2005) stated that Palestinian local government system was an extension of the central authority and was used as a mean of control by the ruling power rather than as a vehicle for social and economic development (Diagnostic report, UNDP, 2005).

Review of literature regarding International experience in local governments: the major debates are taking place all over the world regarding the financial, auditing and controlling aspects of local governments. Caperchione (2002) described the measures that were introduced in the accounting system of Italian local governments, which were supposed to improve the overall quality of decisions and increase public efficiency, he found that after six years of such changes, the expected results were disappointing and there was no evidence of significant improvement. Ryan, et al., (2002) examined the quality of the annual reporting by local governments in Queensland, and indicated that although the quality of reporting by local governments has improved over time, councils generally do not report information on of needed aspects. LAPSLEY and PALLOT (2000) found that management accounting has been adopted and they were at the centre of changing the local governments' management in New Zealand while it has a limited role in the UK local government. McCluskey, and Franzsen (2005) investigated the potential role of property taxes as a revenue source for local government in Tanzania and concluded that the property tax system as designed for Tanzania was not sustainable and suggested a range of possible improvements. Afonso and Fernandes (2006) assessed the expenditure efficiency of Portuguese local governments and found that municipalities could achieve, on average, the same level of output allegedly by using around one third fewer resources. Boyne (2000) examined the Best Value performance indicators, and concluded that the cost of regulation may outweigh the benefits. Nyman, et al. (2005)

described the ongoing debate of the ways to enhance accountability and transparency in order to avoid future scandals in the local government in Sweden, and reported that neither better accounting nor better auditing systems alone would resolve the dilemma in improving accountability.

4. Methodology

This study aims to examine the present situation of Palestinian local municipalities in order to suggest possible ways and means of reforms. The study used various research instruments to analyze the major revenues and expenditures as well as to perceive the opinions of municipalities' officials regarding various financial issues in order to increase the efficiency of Palestinian municipalities' services as well as to increase accountability. To accomplish the various research objectives, the following methods were used in this study:

First: Financial Analysis of the Palestinian municipalities has been conducted to answer the related stated questions in the study. The financial analysis was comprehensive and covered various aspects, in order to examine major strengths and weaknesses which may lead to specific recommendations regarding financial and budget reforms. The study analyzed actual data of Palestinian local councils for three years to point out the distributed ratios of both expenditures and revenues (2003 - 2006). The analysis covered analysis of profit centers run by selected municipalities in Palestine for the period from 2003 to 2006. It was also extended to compare actual and budgeted data to present the difficulties of estimating and articulating budget statements in the case of Palestinian municipalities. The issue of labor cost, as one major item of the total expenditures and the total debt due on the residents of Palestinian municipalities, has been tackled.

Second: A special questionnaire was developed to collect the perception of the municipality officials of Palestinian municipalities, in order to answer the other relevant questions of the study. A pilot study was carried out in order to test the validity and reliability of the questionnaire. The pilot study included selected sample of top financial staff as well as mayors of Palestinian municipalities. Accordingly, the final research instrument was

formulated in Arabic, and a major letter from the researchers was attached to the questionnaire. The total number of municipalities in Gaza Strip is about 25 municipalities, 5 municipalities are identified as group A, while the other 20 municipalities are classified as group B, C, and D. In the West Bank, there are 106 municipalities as existed in 2006 (APLA, 2006), of the total, 9 municipalities are classified as Group A, while the others are classified between B, C, and D. The study selected the 35 municipalities from different classifications from the official list of municipalities published by the Association of Palestinian Local Authorities (APLA, 2006). The officials who filled out the questionnaire were either the Mayer, or the financial manger. At the end, the number of respondents was about 27 questionnaires which form about 80% of the total target sample.

5: Findings of the Study:

This study intended to analyze the financial aspects of the Palestinian local authorities, in order to suggest reforms policy, which may lead to increase the efficiency and transparency of the local governments' councils. Accordingly, and based on the stated purposes of the study as presented in the first part of this paper, this section is divided into the following sections:

1. Merits of accounting and budget systems in the Palestinian municipalities.
2. The existed financial problems in the Palestinian municipalities.
3. The best alternatives to increasing internal revenues.
4. Financial Analysis of the Revenues and expenditures.

5.1: Merits of accounting and budget systems: In order to point out the major features of Palestinian municipalities, the questionnaire included selected questions to indicate the major features of accounting and budget systems as they exist in the Palestinian municipalities. According to the findings of the study in this regard, it may be stated that the majority (85%) of Palestinian municipalities are using the cash basis of accounting, compared to 15% of the municipalities using the accrual basis as presented in Table No. 1.

Table 1

The major features of accounting and budgets systems as they exist in the Palestinian Municipalities

Major features of accounting and budgets systems	Yes
Using accounting cash basis	85%
Using modified Accrual basis	15%
Budget items along with chart of accounts for the financial system	64%
Preparing monthly and quarterly reports periodically	96%
Preparing final statements for the annual budget	85%
Using profit and cost centers	42%
Budget is a part of accountancy system	30%

In addition, the table shows that only 64% of the Palestinian municipalities are using a unified standard chart of accounts for both budgeting statements and financial accounts, while about 36% of the municipalities are using a separate chart of accounts for each system. Moreover, only 42% of the Palestinian municipalities are using profit centers as part of their financial systems. If we move to the major features of the budgeting system, we find that about 94% of municipalities prepare periodically monthly and quarterly reports, and 85 % prepare final statements annually at the end of the fiscal years. On the other hand, only 30% are using the budget system as a part of the financial accounting system, in which the majority of the Palestinian municipalities are using budget statements as estimated reports for comparison purposes.

5.2 Major financial and budget problems

Based on the findings collected by this study and according to the financial analysis of budget data and financial statements of the Palestinian municipalities, various major problems face the Palestinian municipalities as presented in Table No. 2, which shows that the major problems are:

First: the inaccuracy of used budget statements compared to the annual actual financial data. The variance percentages between budget statements and the actual data vary between individual municipalities, and between expenditures items and revenues items and between individual items of revenues. Due to the political and unsettled situation, the actual figures of financial statements are far from the budgeted figures. However, on the average, the variance percentage between budgeted and actual data is about 65% for revenues items, and 40% for

expenditures. This ratio also varies from one fiscal year to another based on the political situation and national stability.

The second major problem is the increasing debt due on the municipal residents including taxes, fees and prices of electricity and water services. The average accumulated debt during the last ten years due on the residents reached equivalent to 125% of the total annual budget in 2006. However, once again, this ratio is much less in some municipalities, while it is higher in others. For example, the due debt of residents ranged from 42% of annual budget as in the case of Al- Bireha municipality to 250% as in Rafah.

The third problem is related to limited tax source of revenue which includes property tax and educational taxes which was about 2% of the total revenues of Palestinian revenues. The ratio of local taxes to household expenditures is about 0.5% in Palestine compared to 2.5% in cities in developed countries. This percentage forms only 0.19% of the GDP compared to 1.13% of the GDP in the developed countries (World Bank, 1999). However, this ratio is much higher in some individual municipalities which don't have utility projects such as Ramallah municipality (28%), the propriety tax which is the main tax imposed by the Palestinian and municipalities have been forming about 17% to 20% of the total regular revenues for the main cities such as Nablus, Hebron and Gaza municipalities (Financial statements of municipalities; 2003-2006).

The fourth problem regards accounting transparency, in which about 88% of the total municipalities don't publish the annual budget for the public, and 54% of the municipalities don't have internal control system.

Table 2
The major financial and budget problems as existed
in the Palestinian Municipalities

Major features of accounting and budgets systems	Yes
Accumulated debt due to Municipalities on residents	125%
Accuracy of estimated budget revenues	35%
Accuracy of estimated budget expenditures	60%
Major revenues come from utility projects	45%
Limited tax share of the Palestinian revenues	2%
No internal control monitor for financial transactions	54%
Annual budget documents are not published to public	88%

5.3: Best alternatives to increasing internal revenues:

The study examined the (municipal officials) opinion about the best recommendations to enhance the internal revenues of the Palestinian municipalities. The findings of the study (as presented in table no. 3) showed that the officials of the local authorities preferred increasing the fees of garbage, increasing the fees of buildings in (A) area, Increasing the fees of violations and fines, re-evaluating of old buildings properties in order to increase property taxes, respectively as ranked by the majority of the participants of the study. The building fees ranged from one JD to 3.5 JD per meter for building houses located in A areas inside municipalities borders. While commercial building fees ranged between one JD to 25 JD per meter.

Table No. 3

Considering fairness and feasibility as suggested by Palestinian Local officials

Suggestions to increase of	Rank
Property taxes and education tax	9
Reevaluation of old properties	4
Fees of buildings in A area	2
Fees of buildings in the commercial area	5
Fees of buildings in areas B & C	10
Prices of electricity	11
Prices of water	12
Fees of violations and fines.	3
Fees of vegetables	6
Fees of extending water and electricity	8
Fees of advertisements and signboards	6
Fees of garbage.	1

5.4: Financial analysis of revenues and expenditures: The financial analysis is based on the actual financial data of the majority of the Palestinian local governments for the period from 2003 and 2006. The financial analysis included both aggregate data as well as some individual municipalities and will be organized in three sub sections:

Firs: the revenues part: The sources of funds for the Palestinian municipalities come mainly from utility projects' revenues which form about 70% of the total municipal revenues, while government continuations and grants form about 11% of the total revenues, taxes form about 2%, and fees and other revenues form about 17% which includes owned

property rent as shown in Table No. 4. However, it should be noted that the distribution of revenues for Palestinian revenues may not be accurate due to the fact that they are using cash basis, and there are many due revenues that are collected in periods that belongs to different fiscal years, especially those related to grants, transfers from ministry of finance, and other due fees. In addition, the distribution ratios of revenues are significantly different from one municipality to another and even for the same municipality from one fiscal year to another. Moreover, there are many items which may change the distribution ratios of revenues such as taxes and VAT refunds and revenues related to international aids. In addition, the allocated funds for development projects are very limited, which don't exceed 14% of the total budgets.

Table No. 4

Sources and uses of funds for the Palestinian municipalities (2003- 2006)

Distribution of Expenditures	Percentage	Distributions of Revenues	Percentage
Utility projects	57%	Utility projects	70%
Health	6%	Grants & government revenues	11%
General Administration	8%	Fees and other revenues	17%
Development expenditures	14%	Taxes	2%
Mechanical, engineering and others	15%		
Of the total of expenditures			
Labor expenditures	37%		
Assets, materials and other expenses	63%		

The important of internal sources of funds is different from one municipality to another. It depends on whether the municipality has utility projects such as water and electricity enterprises, investments, properties for rents and other activities. For example, the water project represents the first revenue item for Gaza municipality, while electricity revenue represents number one revenues for Nablus and Hebron municipalities. Property tax represents the first important source of revenues for Bethlehem and Rammalaha municipalities because electricity and water enterprises are run by independent agencies in these areas. The rents for properties owned by municipalities' forms the second important

source of revenues for Gaza and Bethlehem municipalities. The garbage fees form the third or fourth source of revenues for most of the municipalities. While building fees form the fourth and fifth source of revenues for Palestinian municipalities.

The individual analysis of municipalities provided different perspective from that related to the total municipalities, due to the fact that the distribution of revenues varies from one group of municipalities to another. Some municipalities run the major projects of electricity and water, while others don't have such responsibility; thus the major items of expenditures and revenues are so different. Other municipalities have investments projects such as rented properties and other profitable projects, while other municipalities don't have such projects. For example, the distribution of revenues of the Bethlehem municipality shows that the major internal revenue items are so different than that for all municipalities due to the fact that Bethlehem municipality is not responsible for electricity or water projects. Their major revenues include property taxes, rent of properties, garbage fees, vegetable fees, professional licenses fees and craft license fees respectively. Each single municipality has different distribution of ratios. For example, electricity, water, property tax, building fees and garbage fees represent the major revenues item respectively in the municipality of Nablus, while, water, rent, garbage fees, property tax, and building fees represent the major revenues items respectively in Gaza Strip. As for Ramallah municipality, its worth mentioning that two third of revenues come from three major items including property tax 28%, building fees 24% and garbage fees 12% respectively.

Second: Analysis of expenditures: as expected, the first major items of expenditures is the cost of electricity, water and sewage projects as shown in figure No. 4 The share of such projects (including electricity, water and sewage run by Palestinian municipalities) form about one- third to two- thirds of the total expenditures for the respected municipalities, with an average of 57% from the total expenditures. The development item represents the second important item of the total expenditures. However, it should be noted that a significant part of this item is financed by international aids, and some municipalities don't show allocations to development projects in their financial statements. While, engineering and maintenance items represent the third and fourth important expenditure items of the Palestinian municipalities

budget respectively. For cost item analysis of the municipality expenditures, the cost of labor represents the first and the major cost item in the Palestinian municipalities' budget. It forms about 18% and reaches in some municipalities up to about 50% with an average of 3% for the total Palestinian municipalities. This is due to the high number of employees hired by the Palestinian municipalities that exceed (in some cases) 1500 employees such as in the case of Nablus, Hebron and Gaza municipalities, while the number of employees in some of the Palestinian municipalities is less than 50 employees such as in Birzeit and Azzon municipalities.

Third: analysis of Profit Centers: To examine the financial aspects of special project revenues and expenditures run by the municipalities such as electricity, water and sewage projects, Table No.5 presents examples of the financial data of such centers in the Palestinian local governments between the years 2003 and 2006. The table shows that the profit centers of water and electricity are profitable in the selected sample assuming that residents pay the prices. The contribution margin ratios ranged between 12% and 68% to for water projects, and between 23% and 25% in electricity projects. In addition, other profit centers such as the zoo garden and dynamiter cars are also profitable projects. However, it should be noted here that water and electricity projects may not be profitable in some other municipalities.

Table No. 5
Examples of Profit Centers in the Palestinian Local government Budgets (2003-2006)

Municipalities	Projects	Revenues	Expenditures	Contribution margin
Gaza	Water	18	5.6	12.4
Khan- Yones	Water	2.5	2.2	0.3
Dir- Albalh		0.9	0.5	0.4
Qalqilia	Water	2.7	1.9	0.8
	Electricity	16.7	12.8	3.9
	Sewage			
	Zoo -Garden	1.2	0.9	0.3
	Dynamiter- Cars	0.30	0.24	0.06
Hebron	Electricity	57	43	14
	Water	6.5	3	3.5
Bethlehem	Water	2.5	1	1.5

Sources: Financial Statements of the respected municipalities 2003-2006

6. Conclusion: This study aimed to explore the major obstacles facing the Palestinian local governments including accounting, budget and controlling aspects, in order to suggest relevant recommendations, which will lead to enhance accountability and productivity of Palestinian local governments. Based on the previous presented findings related to the financial analysis of revenues and expenditures of Palestinian municipalities, the perceptions of the officials of Palestinian local authorities found through the used research instrument; the following conclusions may be synthesized as presented in the following sections:

The majority of Palestinian municipalities is still using the cash basis accounting system, and is not using profit centers, moreover, budget data and statements are still not a part of their accounting system, and more than one- third of the municipalities are using separate charts of accounts and coding accounts systems.

To increase the budget revenues of municipalities, the officials suggested increasing the garbage fees and the building fees in designated A areas which is too less than the fees imposed on commercial buildings and re-evaluating the basis for calculating the property taxes for old buildings.

The study found also, that the sources of funds for municipalities come mainly from utility projects' revenues which form more than 70% of the total municipal revenues, while fees and taxes form about 10% for the total West Bank municipalities. Project expenditures represent the highest expenditures item of the municipalities' expenditures, while the rest of the expenditures are distributed into engineering, health, management, and financial expenditures.

In addition, the allocated funds for development projects are very limited, since they don't exceed 14% of the total budgets. The cost of labor expenditure is about 38% of the total municipalities, and ranged between 18% and 50%, it forms more than 30% of the majority of Palestinian municipalities. The utility projects revenues represent a substantial part for the majority of Palestinian municipalities which formed about two third of total budgets for many municipalities.

The majority of utility projects' revenues cover the match expenditures and produce contribution margin to the municipalities that range between 12% and 60%. The majority of utility projects owned by municipalities produce profits assuming that residents pay the prices of such services.

The study also found that there are four major problems facing the Palestinian municipalities, including inaccuracy of estimated budget figures, high percentage of debt due on the municipal residents, low share of taxes to the total revenues of municipalities, and a weak accounting transparency system.

Finally and based on the finding of this study, the following recommendations may be drawn:

Increasing allocated share for development projects from internal sources of the municipalities.

- To incorporate the budget system inside the municipal financial accounting system.
- To use the accrual accounting basis instead of the existed cash bases.
- To use a unified chart of accounts and coding system for all accounts for both accounting and budgeting systems by all municipalities from groups A, B, and C.
- To use the unified forms of budget statements and to publish such statements for the public annually.
- To increase the collected taxes by changing the basis of imposing property tax to a new method of evaluation, such as per meter method considering classifications of land and buildings.

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