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Impact of Firms Earnings

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Highlights

Study on the Islamic Banks

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CONTENTS OF THE ISSUE

- i. Copyright Notice
 - ii. Editorial Board Members
 - iii. Chief Author and Dean
 - iv. Contents of the Issue
-
- 1. "Impact of Firms Earnings and Economic Value Added on the Market Share Value: An Empirical Study on the Islamic Banks in Bangladesh". ***1-4***
 - 2. Accountability of Accounting Stakeholders. ***5-10***
 - 3. An Exploratory Study of Management Accounting Practices in Industrial Companies in Jordan (Case Study- Industrial Companies- ASE). ***11-20***
 - 4. Contribution of Khat Kellas and the Impacts of its Closure to Ethiopian Economy (the Case of Hararghe Khat Kella). ***21-29***
-
- v. Fellows and Auxiliary Memberships
 - vi. Process of Submission of Research Paper
 - vii. Preferred Author Guidelines
 - viii. Index



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"Impact of Firms Earnings and Economic Value Added on the Market Share Value: An Empirical Study on the Islamic Banks in Bangladesh"

By Helaluddin Ahmed

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Abstract- This paper focuses on identifying the relationship among the firms' earnings, economic value added and the shareholders' value of the selected Islamic Banks in Bangladesh. The data of this study composed of five selected Islamic Banks of Dhaka Stock Exchange (DSE) covering the period of five years from 2009 to 2013. Correlation method has been utilized to find out the relationship whereas simple regression method has been used to identify the impact of firm earnings and the economic value added on change in the stock price. Findings reveal that there is strong association among the firms' earnings per share, economic value added per share and the market price per share. Furthermore it is also reveal that share price of Islamic Banks in Bangladesh can be explained more significantly by the economic value added than the banks' traditional measures of earnings.

Keywords: *earnings per share, economic value added, market share value, islamic banks of bangladesh.*

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"Impact of Firms Earnings and Economic Value Added on the Market Share Value: An Empirical Study on the Islamic Banks in Bangladesh"

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Abstract- This paper focuses on identifying the relationship among the firms' earnings, economic value added and the shareholders' value of the selected Islamic Banks in Bangladesh. The data of this study composed of five selected Islamic Banks of Dhaka Stock Exchange (DSE) covering the period of five years from 2009 to 2013. Correlation method has been utilized to find out the relationship whereas simple regression method has been used to identify the impact of firm earnings and the economic value added on change in the stock price. Findings reveal that there is strong association among the firms' earnings per share, economic value added per share and the market price per share. Furthermore it is also reveal that share price of Islamic Banks in Bangladesh can be explained more significantly by the economic value added than the banks' traditional measures of earnings.

Keywords: earnings per share, economic value added, market share value, islamic banks of bangladesh.

I. INTRODUCTION

It is obvious that every firm tries to maximize their wealth by producing more income from their regular business activities. In a competitive stock market investors always interest regarding the share price of the firm rather than the return on equity. A number of traditional accounting measurement vastly used by the users of accounting information to evaluate the firms' performance, i.e. earnings per share, return on equity, return on assets, etc. In a high vulnerable stock market investor always try to use the sophisticated techniques to measure the firms' value. Islamic Banks in Bangladesh are the pioneer to use different modern techniques to measure the banks' value along with their Shariah based banking system. As the conventional banking systems follow the philosophy of capitalism and interest which is forbidden according to Islamic Shariah, the Muslims made the first move toward the Islamic financial system was observed in the second half of 20th century when the Muslim world got liberation from colonial powers (Hanif, 2011). The most effective factor making Islamic banking attractive to the investors is devotion to the rules of Shariah. They disclosed their financial information more evidently to measure the

economic sustainability. Economic Value Added (EVA) is one of the technique which disclosed in their financial assertions to ascertain their banking performance more precisely.

II. LITERATURE REVIEW

The concept of Economic Value Added (EVA) is not a very longstanding business performance measurement. A number of studies claim that EVA is vastly correlated with stock returns. Economic Value Added originates stock prices more than other accounting based performance indicators (Stewart, 1995; Medeiros, 2005). In his research, Lefkowitz (1999) analyzed the US companies which reveals that EVA is better correlated with stock returns as compared to old-fashioned performance measures. They indicate EVA as a reliable guide to understand the firm's value. In another study focus that EVA is a better way to enhance future earnings predictions. Machuga et al. (2002). Lehn & Makhija (1997) investigated the degree of correlation between different performance measures and stock market returns which indicate that EVA is the most highly correlated measure with stock returns. Various Studies are also conducted on Incremental information content tests of EVA and provide evidences that it adds significant explanatory power to the firms' earnings per share (EPS) in explaining share market price. Bao and Bao (1998) studied the abnormal economic earnings of US firms and indicate that EVA is an important factor in market returns and its explanatory power is higher than that of accounting earnings. Chen and Dodd (1997) reported that EVA measure delivers relatively more information than the traditional measures of accounting returns. They also found that EVA and Residual Income variables are highly correlated and identical in terms of association with stock returns. Worthington and West (2004) provided Australian evidences regarding the information content of EVA and concluded that stock returns to be more closely associated with EVA than residual income, earnings and net cash flow.

There are some studies that do not support the claim that EVA provides better stock returns. Biddle et al. (1997 and 1999), analyzed a sample of firms over the

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period 1984-93 by comparing the stock market adjusted returns against EVA, Residual Income and Operating Cash Flow. The results do not support that EVA dominates traditional performance measures in its association with the stock market returns. Ismail (2006) conducted a study on EVA and its association with stock returns viz- a- viz accounting earnings and stock returns and found that net operating profit after taxes and net income outperform EVA in explaining stock returns. Further, this study states that accruals and operating cash flows have significant incremental information content than EVA. Peterson and Peterson (1996) analyzed traditional and value-added measures of performance and their relationship with stock returns. Their findings state that traditional measures are not empirically less related to stock returns than return on value added measures. Kyriazis and Anastassis (2007) in their study of Greek firms concluded that relative information content tests reveal that net and operating income appear to be more valuable than EVA. EVA components add only marginal information content as compared to accounting profit.

III. OBJECTIVES

The objective of the study is to identify the impact of firms' earnings and the economic value added on the firms' market share value. Specifically, this study attempted to:

- Identify the relationship among the firms' market share value, economic value added and traditional earnings.
- Examine the effect of firms' economic value added on the market share price of the Islamic Banks in Bangladesh.
- Examine the effect of traditional earnings on the market share price of the Islamic Banks in Bangladesh

The null hypothesis (H0) formulated and tested for the study is:

Economic Value Added (EVA) has more significant effect on Market Share Value than Earnings per Share (EPS) of the Islamic banks in Bangladesh.

IV. DATA COLLECTION AND SAMPLING DESIGN

The data for this study consist of five selected Islamic Banks in Bangladesh whose ordinary shares were listed on the Dhaka Stock Exchange (DSE) throughout the period of five years from 2009 to 2013 collected from the DSE data base via referring to Annual Reports of the Banks. The sample selected from the seven listed Islamic Banks in Bangladesh. Two banks have been excluded from this study due to unavailability of data.

V. METHODOLOGY

Quantitative research approach was employed to find out the findings of the research study. Correlation and simple linear regression methods have been utilized in order to arrive at the end result of the study. Dependent and independent variables used in the study are as shown in table-1 below:

Table 1 : Variables Description

Table-1: Variables	Description
Dependent	
MVPS	Market Value per Share
Independent	
EPS	Earnings per Share
EVAPS	Economic Value Added per Share

The market value per share (MVPS) is a financial metric that investors use to determine whether or not to purchase a stock. It is not an accounting, or historical, measure of the value of stock like the book value per share, which is based on the information from a company's balance sheet. In this study, annual market price per share has been use as the proxy of market value per share. This can be calculated by dividing the total market value of equity with the number of outstanding shares. To simplify the calculation price-earnings (P/E) ratio has been used in this study to get the annual market value per share:

$$\text{Annual Market Value per Share} = \text{P/E ratio} \times \text{Earnings per share}$$

The price earnings ratio or P/E ratio is a market prospect ratio that computes the market value of a stock relative to its earnings by comparing the market price per share by the earnings per share. In other words, the price earnings ratio shows what the market is willing to pay for a stock based on its current earnings.

Besides, this study select Earnings per share (EPS) of the banks as the proxy of traditional earnings measures, also called net income per share. This is a market prospect ratio that measures the amount of net income earned per share of stock outstanding. This is the amount of money each share of stock would receive if all of the profits were distributed to the outstanding shares at the end of the year. Earnings per share is also a calculation that shows how profitable a company is on a shareholder basis. So a larger company's profits per share can be compared to smaller company's profits per share.

Economic value added (EVA), developed by Stern Stewart & Company, is the difference between the firm's after-tax return on capital and its cost of capital. Stewart and G. Bennet (1991) defined EVA as residual return that subtracts the cost of invested capital from net operating profit after tax. EVA is equal to the economic book value of the capital at the beginning of the year

and the difference between its return on capital and cost of capital. The concept of EVA helps in understanding the value creation process. The formula for calculating EVA is as follows:

$$EVA = NOPAT - k \times \text{Capital}$$

Where, NOPAT means Net operating profits after tax. k refers the firms weighted average cost of capital and capital represents equity plus long-term debt of the company at the start of the period.

The following regression model has been developed based on the mentioned variables to assess the objectives of the study:

$$MVPS_{i,t} = \alpha + \beta_1 EVAPS_{i,t} + \beta_2 EPS_{i,t} + \epsilon$$

In this model, $MVPS_{i,t}$ means Market Value per Share of an individual company in a specific time period and $EVAPS_{i,t}$ measures the Economic Value Added of an individual company in the same time period. $EPS_{i,t}$ represents the Earnings per share of an individual company in the same time period. ' α ' denotes the constant and ' ϵ ' represents the error terms.

VI. FINDINGS

The following table-2 shows the descriptive statistics of the dependent and independent variables of the study. The values of standard deviation indicate the consistency of EPS (1.03) and EVAPS (1.33) over the five years. But relatively high standard deviation (23.9) of MVPS indicates a vulnerable share market exists in the study period.

Table 2 : Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
MVPS	25	13.30	107.52	41.3732	23.89860
EPS	25	.30	5.41	1.9972	1.02819
EVAPS	25	1.42	6.02	2.9276	1.33098
Valid N (listwise)	25				

Table-3 : Correlations

		MVPS	EPS	EVAPS
MVPS	Pearson Correlation	1	.631**	.834**
	Sig. (2-tailed)		.001	.000
	N	25	25	25
EPS	Pearson Correlation	.631**	1	.650**
	Sig. (2-tailed)	.001		.000
	N	25	25	25
EVAPS	Pearson Correlation	.834**	.650**	1
	Sig. (2-tailed)	.000	.000	
	N	25	25	25

** . Correlation is significant at the 0.01 level (2-tailed).

The above table-3 illustrates the correlation matrix between the independent variables and dependent variable used in the study. It is apparent from the table that the relationship was found to be strongly positive and statistically significant for all the variables used in the study. A closer look in this table reveals that EVAPS (0.834) has stronger relationship with MVPS than that of EPS (0.631).

Table 4 : Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.842 ^a	.709	.682	13.47233

a. Predictors: (Constant), EVAPS, EPS

In table-4, the value of R, coefficient of correlation, is 0.842. This indicate a strong relationship between the dependent and independent variable while the coefficient of determination, adjusted R² is 0.682 which mean that about 31.8% of the dependent variable is accounted for by the independent variables and the remaining 68.2% is accounted for by the other variable.

Table 5 : Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-4.338	6.877		-.631	.535
	EPS	3.584	3.520	.154	1.018	.320
	EVAPS	13.169	2.719	.733	4.843	.000

a. Dependent Variable: MVPS

In table-5, the regression coefficient of EPS is 3.584 while regression coefficient of EVAPS is 13.169 and the beta coefficient is 0.154 and 0.733 respectively. This indicate that EVAPS has more influence on the MVPS than EPS. The level of significance of EVAPS is 0.00 which is less than 5% significant level. Hence it is statistically significant. On the other hand, significance level of EPS is 32% which is less than 95% confidence level. This explains that EPS have some influence on MVPS but it is not statistically significant. Therefore, the null hypothesis which states that EVPS has more significant effect on MVPS than EPS is hereby accepted.

VII. CONCLUSION

This study provides preliminary empirical evidence suggesting that the determination of market share price of Bangladeshi Islamic Banks are not independent. It reveals that other factors are probably

found to be better predictors of estimating the market share price than the independent variables used in the study. Hence, there is a vast scope for further researches in this area to find out the factors influencing the market share price of the Islamic Banks in Bangladesh. Future researches can be conducted with the same study on the other sectors in Bangladesh. Based on the results of the study, it can be deduced that market value of share is more explained by the economic value added than the traditional measures of profitability which is consistent with the findings of Lefkowitz (1999), Machuga et al. (2002), Lehn & Makhija (1997), etc. This study provides additional evidence that there is positive relationship exists among the economic value added, earnings and market share value in the Islamic Banks in Bangladesh. The study also proves that earnings of Islamic Banks in Bangladesh has some influence on determining the market share price though it is not statistically significant.

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Accountability of Accounting Stakeholders

By Md. Azim & Jesmin Ara

World University of Bangladesh

Abstract- The aim of this study is to depict the accountability of various stakeholders of accounting to ensure the accountability of accounting. The study identifies that responsibility, roles, sincerity, professional expertise of accounting stakeholders and ethical environment can ensure relevant, reliable and consistent accounting information which ultimately ensure the accountability of accounting. So, every stakeholder should act rationally on their aspects to uphold the accountability of accounting and this will make the accounting information useful to the users.

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Keywords: *accounting, accountability, stakeholder of accounting, responsibility of the accounting stakeholder, reliable and relevant accounting information.*

I. INTRODUCTION

Accounting is a language of business but this language is not useful if the information provided by accounting are not relevant, reliable and consistent. To get useful information accountable accounting is necessary. Accounting will ensure the accountability only when all the stakeholders related to accounting perform their respective responsibilities or roles. Day by day accounting profession has become dynamic due to changing environment of business and needs of accounting users. Accounting will lose its accountability if there is a crisis of reliable and relevant accounting information.

Since previously many accounting scandals have been observed, it is necessary to ensure the accountability of accounting stakeholders to get reliable and relevant accounting information because only accounting standards will not be able to bring the desired outcomes of accounting. So the objective of this study is to show that accountability of accounting depends on the accountability of the accounting stakeholders.

II. METHODOLOGY OF THE STUDY

It is considered that suitable accounting rules, regulation, and systems can provide relevant and reliable accounting information which will help the accounting information users to make useful economic decisions but if the stakeholders of accounting are not sincere to uphold the accountability of accounting standards then it is necessary to ensure that all the

accounting stakeholders are performing their roles, responsibility.

So this study focuses the accountability of accounting on the basis of responsibility or rules of the accounting stakeholders.

III. LITERATURE REVIEW

Accountability can be defined by the responsibility to execute a desired role. Dykstra (1939) says, "In ethics and governance, accountability is answerability, blameworthiness, liability, and the expectation of account-giving." Watkins (2007) says, "An accountability view of accounting might offer a useful grounding with respect to maintaining a better sense of the profession through an ever-changing business environment." Accountability relates to the objectives of financial reporting—the base upon which all accounting practices must be founded (Beechy, 2007). Accountability is often presented as a means by which to achieve the collective and individual goods of democracy, justice, administrative performance, and ethical conduct in governance (Dubnick and Justice 2004). Barata et al. (1999) say, "Accountability has been defined as the obligation of anyone handling resources, public office or other position of trust to report on the intended use of the resources of the designated office." Earl and LeMahieu (1997) say, "Accountability is the conversation about what the information means and how it fits with everything else that we know, and about how to use it to make positive changes." Bovens (2005) says, "In modern political discourse, 'accountability' and 'accountable' no longer convey a stuffy image of bookkeeping and financial administration, but they serve as synonyms for fair and equitable governance." Lerner and Tetlock (1999) say, "Accountability is a logically complex construct that interacts with characteristics of decision makers and properties of the task environment to produce an array of effects -- only some of which are beneficial."

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 account, scrutinized, and being required to give an account or explanation. (en.wikipedia.org/wiki/Accountability).

To maintain the accountability of accounting many scholars have shown their opinions. Rika et al., (2008) say, "To improve standards of accounting and accountability, it will be necessary to revise accounting

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procedures, automate accounting systems, upgrade accounting skills and decentralize accounting functions." Barata and Thurston (1999) say, "Stakeholders in the accountability process cannot effectively perform their accountability obligations nor be held properly accountable unless the evidence of their actions is made available through organized, secure, yet easily accessible means. To achieve this, reliable documentary evidence in the form of records must be consistently provided. Records are the indispensable foundation of the accountability process. Without reliable and authentic documentary evidence underpinning all essential accountability processes, government, civil society and the private sector cannot ensure transparency, guarantee accountability or allow for the exercising of good governance." Watkins, (2007) says, "One must consider the unique competencies accounting comprises. One could, for example, select from among the elements of decision usefulness, stewardship, control, fairness, attestation, relevance, reliability, representational faithfulness, and accountability for the grounding norms for both accounting information and accountants' competencies."

The stakeholders of accounting can be classified as: i) regulators, ii) preparers, iii) researchers, iv) users etc. Weygandt et al. (2012) say "There are two broad groups of users of financial information: internal users and external users. Internal users of accounting information are managers who plan, organize, and run the business. These include marketing managers,

production supervisors, finance directors, and company officers. External users are individuals and organizations outside a company who want financial information about the company. The two most common types of external users are investors and creditors. Investors (owners) use accounting information to make decisions to buy, hold, or sell ownership shares of a company. Creditors (such as suppliers and bankers) use accounting information to evaluate the risks of granting credit or lending money. Financial accounting provides economic and financial information for investors, creditors, and other external users. The information needs of external users vary considerably. Taxing authorities, such as the National Board of Revenue, want to know whether the company complies with tax laws. Regulatory agencies, such as the Securities and Exchange Commission, want to know whether the company is operating within prescribed rules. Customers are interested in whether a company will continue to honor product warranties and support its product lines. Labor unions want to know whether the owners have the ability to pay increased wages and benefits."

IV. DISCUSSIONS

Before discussing the accountability of the accounting stakeholders, it is necessary to know who the stakeholders of accounting are. This study classifies the stakeholders of accounting into three categories: i) International Bodies, ii) Regional Bodies, and iii) Local Bodies. The details of the stakeholders are depicted in the following diagram:

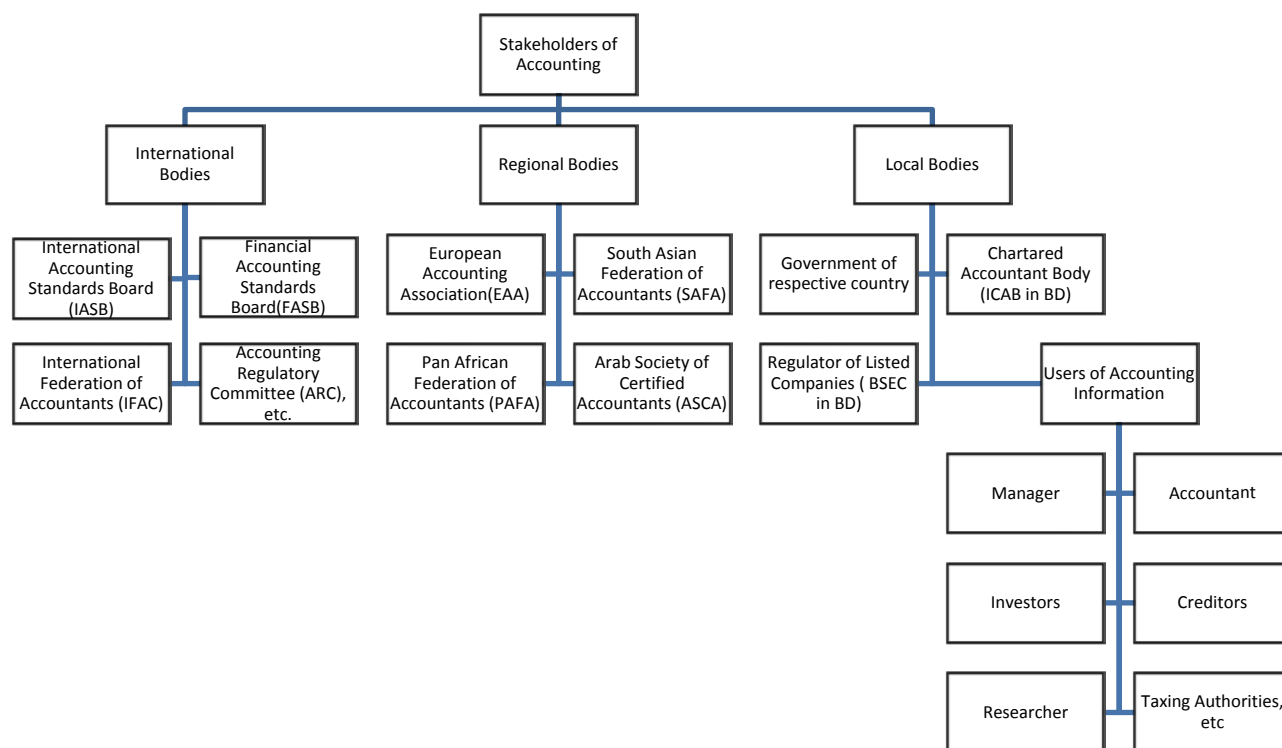


Figure 1 : Various stakeholders of accounting

a) *Accountability of International Bodies*

Since comparability and consistency of accounting information are expected by every stakeholders of accounting, so there should be one International Accounting Body where every country (who prepares financial statements, especially UK's IASB and USA's FASB, since they are the big stakeholders of accounting in the world) will participate and collaborate to get a uniform accounting standards which should be the single set base-accounting-standards for every country. This international body must maintain a platform where the stakeholders of Regional Bodies and Local Bodies can share their experiences regarding their accounting practices and problems facing while formulating accounting standards. Annually this International Accounting Body should arrange an annual meeting to discuss various matters regarding uniform accounting standards and by such meeting mutual understanding and cooperation among the stakeholders of accounting throughout the world will be increased which is very necessary to get desired uniform accounting standards. The most important thing is that the standard resulted from the participation of world's all accounting stakeholders should be free and easily accessible to all and there should an option in the website where any stakeholder can make any query to know any clarification/explanation regarding the standards, rules, principles, practices etc.

b) *Accountability of Regional Bodies*

The regional bodies should cooperate between International Bodies and Local Bodies. They should act as a disseminator of international accounting standards of International Accounting Body to the national level accounting bodies. They should ensure that national governments, national accounting bodies are participating to uphold the accountability of accounting through proper education, training and practices. Regional bodies should identify the difficulties and discrepancies of accounting practices of accounting profession and to do this they should provide a congenial platform so that all national accounting bodies can exchange their views and experience regarding to uphold the accountability of accounting.

The regional body should maintain a website where the regional accounting practitioners will be able to share their day to day experiences. Suppose in a region there is a practice of various estimation regarding an accounting standard (i. e., one institution guess that their machine will last for 10 years, on the other hand there is another institution which guess that same machine will last for 14 years, so in average that machine is lasting for 12 years and this 12 years can be considered as the estimated life of that machine). In this way those regional accounting practitioners can know

the subjective estimation regarding various accounting treatment by which they can reach to a unique estimation and that type of unique estimation will create consistent accounting information. As a result there will be relevant and reliable information which will increase the consistency of accounting information throughout the regional level.

c) *Accountability of Local Bodies*

i. *Government of respective country*

The accountability of government is most significant as it is the supreme body in a country. It should be committed to ensure the transparency in maintaining the accountability of accounting. Since it has the legislation power, it should assign the particular authority to revise and monitor the systems of accounting. It should assign the authority (Taxing authority, Labor and Corporate Laws authority, Regulators of Public Corporations, Certified Public Accountants) with the suitable responsibility to maintain the accountability of accounting. The government should sponsor all types of cost to maintain such activities. The government should ensure that there is an existence of high-quality practices of accounting standards by professional accountants to uphold the accountability of accounting.

ii. *Chartered Accountant Body (ICAB in BD)*

Chartered Accountant Body act as a national regulator of auditing profession. So this accounting body has a great role in maintaining the accountability of accounting. To uphold the accountability of accounting it has to perform various responsibility such as attracting graduates to be the member of the body and providing training them with the latest developments of accounting standards. Although Chartered Accountant body is a national body, they have to adopt and work with the international accounting standards which is very essential to ensure the consistency worldwide. Maintaining accountability becomes very easy when this national regulator are accountable to perform various activities with sincerity such as: i) arranging symposiums and seminars to disseminate professional accounting knowledge towards the auditing firms, accounting professionals, ii) providing auditing services with accountability to all sectors including industry, commerce or public service throughout the country, iii) protecting and maintaining professional independence of auditors and implement professional supervision standards over them as a means of advancing the professions of accounting and auditing, iv) developing and facilitating the circulation and exchange of academic and professional knowledge among accountants and other professionals through professional research, v) ensuring sound professional ethics and code of conduct by its members, vi)

providing professional expertise in Accounting, Auditing, Taxation, Corporate Laws, Management Consultancy, Information Technology and related subjects, vii) fostering acceptance and observance of International Accounting Standards (IAS) and International Standards on Auditing (ISA), viii) having up-to-date of latest developments in Accounting techniques, Audit methodology, Information technology, Management consultancy and related fields, etc. They should work independently to ensure the reliability of a company's financial disclosure which is done by the auditor's report. There should be annual publication to introduce the latest practices.

iii. *Regulator of Listed Companies (BSEC in BD)*

This is a most important authority to maintain the accountability of accounting because it has roles to perform regulating activities by coordinating several stakeholders, namely, listed public companies, government and auditing authority. It monitors whether the listed companies are producing financial statements with reliable, relevant and consistent information which ensure the accountability of accounting. It suggests the auditing authority to be enriched to ensure best auditing. It recommends the government to legislate appropriate rules (on taxation, business law and related matters) to uphold the integrity of the accounting profession. So it should be more conscious to maintain accountability by enhancing organizational reporting, raising awareness in accounting profession.

In context of Bangladesh, the BSEC should circular compliance issue to establish effective control mechanism by every company to avoid: poor tone at the top, lack of competent personnel in oversight roles, lack of independent checks/audits, lack of employee fraud education, lack of clear lines of authority, lack of reporting mechanism, lack of internal control, override of existing internal controls, lack of management review etc. This will ensure that financial reports prepared by the companies will satisfy the interest groups' necessities. At times BSEC should make survey/research to know whether the users of accounting information are satisfied which ultimately ensure the accountability of accounting. It should ensure that all the companies make the annual reports available in their website which will facilitate the researcher to find out any anomalies contained in those annual reports through analysis and research.

iv. *Accountant*

Accountants are closely related with preparing accounting information. To ensure the accountability of accounting accountants should be careful and knowledgeable in their professional activities because their negligence hampers the true fact of accounting information. On the other hand an accountant is responsible for the authenticity and exactness of the

financial statements even if errors were not made by them. So an accountant should be expert in accounting principles, rules, and standards to avoid errors of accounting treatment. Accountants need various skills to uphold the accountability of accounting such as international accounting standards, current accounting practices, taxation and VAT knowledge, internal and external audit knowledge, recording and summarizing transactions, professional course completion from ICAB or ICMA, knowledge on accounting software, knowledge on interest of internal and external users of accounting information etc.

v. *Investors*

Investors are interested to see summary explanation of a company on issues in the decision process. There are two types of investor: i) present investor and ii) potential investor. Present investors seek information to decide whether they should continue their investment and potential investors seek information to decide whether they should buy shares of company or invest somewhere else. Investors are concerned about risk and return in relation to their investments. They also need to be able to assess whether a business will be able to pay dividends, and to measure the performance of the business' management overall. To take investment decision all investors require relevant, reliable, and easy understanding information. So the accountability of the investor should be to inform the regulator whether they are satisfied or not with the provided accounting information. This will help the regulator to take necessary steps to uphold the accountability of accounting.

vi. *Creditors*

There are two types of creditors: i) suppliers and trade creditors ii) financial creditors. Both types of creditors must be competent to analyze the financial statements before extending credit to a company. So to maintain the accountability of accounting they have roles by criticizing fraud statements and avoiding them from giving credit.

vii. *Employees*

The accountability of the employee regarding accounting fully depends on their ethical behavior. Most of the cases, employees know what is happening, what is going to be happened, what is the financial performance, what is the financial position of the company. Since they are aware about those information, then they can compare between actual results and presented results in the annual reports. If they find any discrepancy, then they should inform it to the particular regulator to uphold the accountability of accounting.

viii. *Manager*

Management has the ability to determine the form and content of the information presented in

financial statements. Most of the cases management may try to manipulate the entity's financial statements because there are clear incentives for the managers to do this as their pay is usually tied to company performance. If there is any misrepresentation of financial performance and financial position of a company then the management is responsible for that fraud. So the accountability of accounting mostly depends on their wish whether they are interested or not to uphold the integrity of accounting. If management are committed to ethical values then relevant, reliable and consistent accounting information will be easy to produce which ultimately ensure the accountability of accounting.

ix. *Investment analysts*

Investment analysts use financial and other information in order to analyze the competitive performance of a business. While analyzing the financial

data they can understand whether there is a consistency of accounting information or not. So in accountability context of view they can help to uphold the accountability of accounting by providing the facts of any inconsistency in accounting information.

x. *Researcher*

The universities should be the factory of producing new knowledge and techniques. Hence teachers of universities should dedicate themselves in research work spontaneously. They should invent various knowledge to solve various types of problems. There are many models already invented to identify any fraud existence in financial statements and those models can be used to identify the fairness of financial data through research, even they should invent new model to compete with the new challenges of fraudulences. Hence the researcher can contribute in upholding the accountability of accounting.

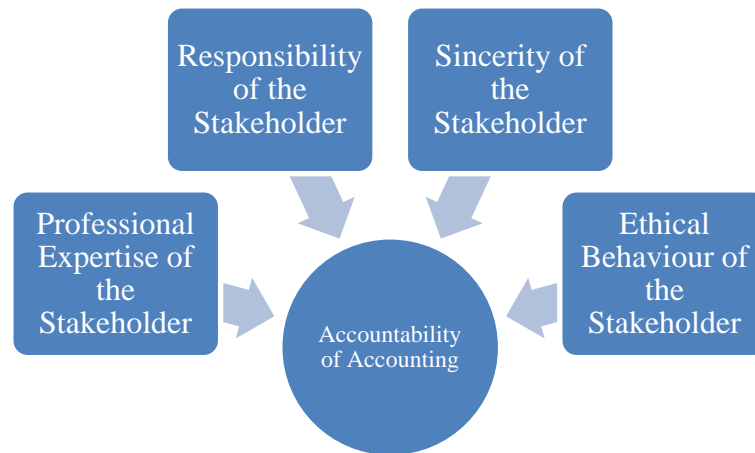


Figure 2 : Factors affecting the accountability of accounting

V. CONCLUSIONS AND RECOMMENDATIONS

Since accounting is the language of a business, accounting information will be useful only if accounting produce reliable, relevant and consistent information which depends on maintaining the accountability of accounting. Accountability of accounting depends on the accountability of the accounting stakeholders. If there is situation where someone has been refused to be accountable, then accountability fails to bud in the society. So an environment is needed to practice accountability by the stakeholders of accounting which will ultimately ensure the accountability of accounting and it is possible only when there is an existence of ethical society. All the stakeholder should perform their best to uphold the accountability and they should consider it as an accountability corporate social responsibility.

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An Exploratory Study of Management Accounting Practices in Industrial Companies in Jordan (Case Study- Industrial Companies- ASE)

By Dr. Muhannad Akram Moqbel & Dr. Ashraf Mohammad Al-Rjoub

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Abstract- This study aimed to investigate the application of the industrial sector companies for the management accounting concepts during the preparation the budgets that recognized by the managerial accounting. Where the main budgets in the management accounting concepts are: Master budget, Financial Budget, Cash-Flow budget, Static budget & Operational budget, but the researcher except the Static budget in this study because it uses for the public and nonprofit sectors, and this study aims to investigate the Industrial sector in ASE-Jordan and all of these companies are profitability.

Keywords: *management accounting, industrial sector, ase, master budget, financial budget, cash-flow budget, static budget, operational budget.*

GJMBR - D Classification : *JEL Code : M40*



AN EXPLORATORY STUDY OF MANAGEMENT ACCOUNTING PRACTICES IN INDUSTRIAL COMPANIES IN JORDAN CASE STUDY INDUSTRIAL COMPANIES ASE

Strictly as per the compliance and regulations of:



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The study relied on a random sample consisting of (20) companies of industrial sector companies in ASE-Amman Stock Exchange, and to serve the purpose of this study, the researcher distributed Questionnaire to several different segments in each company: Financial Managers, Accounts Mangers & Accountants.

This study found that the companies in the Industrial sector in Jordan apply the concepts of management accounting during the preparation the several types of budgets but with varying degrees.

Keywords: management accounting, industrial sector, ase, master budget, financial budget, cash-flow budget, static budget, operational budget.

I. INTRODUCTION

Management Accounting produces information primarily for internal use by the company's management. The information produced is generally more detailed than that produced for external use to enable effective organization control and the fulfillment of the strategic aims and objectives of the entity. Information may be in the form budgets and forecasts, enabling an enterprise to plan effectively for its future or may include an assessment based on its past performance and results. The form and content of any report produced in the process is purely upon management's discretion. But cost accounting is a branch of management accounting and involves the application of various techniques to monitor and control

costs. Its application is more suited to manufacturing concerns.

Managerial accounting reports help small business owners and managers monitor the company's performance and are prepared frequently throughout accounting periods as needed. Depending on the type of project and the time-sensitivity of the information, an owner or manager may request reports quarterly, monthly, weekly or even daily.

And the most important practice in the Managerial accounting is the Budget reports; which help small business owners analyze their company's performance and, if the business is big enough, managers analyze their department's performance and control costs. The estimated budget for the period is usually based on the actual expenses from prior years. If the small business as a whole or a specific department was substantially over budget in a previous year and cannot find feasible ways to trim costs, the budget for future years may need to be increased to a more accurate level. Owners and managers can also use budget reports to provide incentives to employees. In this case, some of the funds budgeted may be given out up as bonuses to employees for meeting specific financial goals.

Another practice in Managerial accounting is cost reports, which show expenses for a specific project. They are usually matched with an estimate of revenue so the company can evaluate the job's profitability. This helps identify higher-earning areas of the business so the company can focus its efforts there instead of wasting time and money on jobs with low profit margins. Job cost reports are also used to analyze expenses while the project is in progress so managers can correct areas of waste before the costs escalate.

On the other side the Managerial accounting use the Inventory and Manufacturing reports to make their manufacturing processes more efficient. These reports generally include items such as inventory waste, hourly labor costs or per-unit overhead costs. The manager can then compare different assembly lines within the company to see where one can improve or to offer bonuses to the best-performing departments.

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Managerial accounting approaches a company's financial situation in an operational way, giving information in a manner that supports managers in planning and control procedures. Various budget formats in managerial accounting influence how a manager forecasts department activity and how he addresses progress or shortfall to meet goals. Companies may use several types of managerial budgets concurrently:

a) *Master Budget*

A master budget is a comprehensive projection of how management expects to conduct all aspects of business over the budget period, usually a fiscal year. The master budget summarizes projected activity by way of a cash budget, budgeted income statement and budgeted balance sheet. Most master budgets include interrelated budgets from the various departments. Managers typically use these subset budgets to plan and set performance objectives. Master budgets are generally used in larger businesses to keep many managers on the same page.

b) *Operational Budgets*

The operational budget covers revenues and expenses surrounding the day-to-day core business of a company. Revenues represent sales of products and services; expenses define the costs of goods sold as well as overhead and administrative costs directly related to producing goods and services. While budgeted annually, operating budgets are usually broken down into smaller reporting periods, such as weekly or monthly. Managers compare ongoing results to budget throughout the year, planning and adjusting for variations in revenue.

c) *Cash flow Budget*

A cash flow budget examines the inflows and outflows of cash in a business on a day-to-day basis. It predicts a company's ability to take in more money than it pays out. Managers monitor cash flow budgets to pinpoint shortfalls between expenses and sales -- times when financing may be needed to cover overheads. Cash flow budgets also suggest production cycles and inventory levels so that a company's resources are available for activity, not sitting idle on warehouse shelves.

d) *Financial Budget*

A financial budget outlines how a business receives and spends money on a corporate scale, including revenues from core business plus income and costs from capital expenditures. Managing assets such as property, buildings, investments and major equipment may have a significant effect on the financial health of a company, particularly through the peaks and troughs of daily business. Executive managers use financial budgets to leverage financing and value the company for mergers and public offerings of stock.

e) *Static Budget*

A static budget contains elements where expenditures remain unchanged with variations to sales levels. Overhead costs represent one type of static budget, but these budgets aren't confined to traditional overhead expenses. Some departments may have a fixed amount of money set in budget to spend, and it is up to managers to make sure such amounts are spent without going over-budget. This condition occurs routinely in public and nonprofit sectors, where organizations or departments are funded largely by grants.

II. THE STUDY PROBLEM

The problem of this study arise from the main question in this study: Do the industrial sector's companies in Jordan have adopted all of kinds of budgets that are recognized by management accounting? From this question the researcher will try to investigate in the real implementation for the type of the budgets above. But it have to except the last type of these budgets - static budget- because it use for the public and nonprofit sectors, and this study aim to investigate the reality in the Industrial sector in ASE-Jordan and all of these companies are profitability companies.

III. THE STUDY IMPORTANT

The management accounting so important, but in the same time management accounting information is proprietary; public companies are generally not required to disclose management accounting data nor much detail about the systems that generate this information. Typically, companies disclose very little management accounting information to investors and analysts beyond what is imbedded in financial reporting requirements. Even very basic information, such as unit sales by major product category, or product costs by product type, is seldom reported, and when it is reported one can be sure that management believes voluntary disclosure of this information will be viewed as "good news" by the marketplace.

Because the reason above the researcher tries to access to the company's reports and evaluation the extent of application the different types of the management accounting's budgets.

IV. LITERATURE REVIEW

a) *The Study of (Frank James Lexa, Tushar Mehta, Abraham Seidmann)*

Managerial Accounting Applications in Radiology (2005) *American College of Radiology*. J Am Coll Radiol 2005;2:262-270.

Managerial accounting uses a variety of tools to make business decisions more rational and more

scientific, it is important for radiology managers to know the structure of the costs of a radiology practice: Which are fixed? Which are marginal? How will events, both internal to the organization and external, change them? How can they be controlled?

The service activity costing model helps managers understand the costs of services. It supersedes traditional costing by explicitly considering the costs of both used and unused service capacity. Managers use service activity costing to develop better models of their cost structures, and this in turn will allow more nuanced contract negotiation and evaluation of proposed changes

b) The Study of (Frank H. Selto, Sally K. Widener)

New Directions in Management Accounting Research: Insights from Practice (2002), Advances in Management Accounting. University of Colorado at Boulder workshop and the AAANZ.

There is no shortage of interesting, potentially influential management accounting research questions. From an analysis of published research and practice articles, this study has identified many more than could be reported here. Even where research and practice topics appear to correspond, considerable divergence in questions exists. Identified research questions offer opportunities for ALL persuasions of accounting researchers. Synergies between management accounting and accounting information systems seem particularly obvious and should not be ignored. Furthermore, research methods mastered by financial accountants and auditors can be applied to management accounting research questions. Even with efforts to design practice-oriented management accounting research for publishes ability; challenges to broader participation and publication might remain. Some of the challenges to publishing this type of management accounting research might include lack of institutional knowledge of authors, reviewers, and editors. To be credible, authors must gain relevant knowledge to complement their research method skills. For example, research on management control of information technology and strategic planning should be preceded by knowledge of the three domains, in theory and practice. Furthermore, editors and reviewers who want to support publication of practice-oriented research should be both knowledgeable of practice and open minded, particularly with regard to less objective sources of data. However, it does not seem necessary or desirable to lower the bar on theory or methods of analysis to promote more innovative research. In summary, we hope that this paper encourages management accounting researchers to take on the challenges of investigating interesting, innovative questions oriented to today's business world and practice of management accounting.

c) The study of (Caroline Lambert, Samuel Sponem)

Roles, authority and involvement of the management accounting function: a multiple case-study perspective, (2009) the Accounting department ESSEC seminar, France, and at the seminar of Ecole de Comptabilité de l'Université Laval, Québec, Canada.

This paper's contributions try to develop an empirically based typology of the management accounting functions, drawing on twelve case studies and seventy three interviews, and identify four styles of management accounting functions: the discrete, the safeguarding, the partner, and the omnipotent management accounting functions. We show that these styles are closely linked to the dominant logic in each organization and our findings bring to light a variety of roles tied to the management accounting function. Some of these roles facilitating local decision making or discretely controlling managerial behavior have been previously identified in the literature. Detailed analysis of the work carried out by management accountant's shows that these traditional roles can lead to both unexpected benefits (e.g. fostering creativity) and unforeseen drawbacks (e.g. drift in governance). It also reveals several unexpected roles centralizing power or socializing managers and offers a more enriched understanding of management accounting practice. Our research confirms that the 'myth' of the management accountant business partner—who is close to and heeded by operational managers—is not as commonplace as we may be led to believe (Burns and Baldvinsdottir, 2005).

d) The Study of (Christina Wiwik Sunarni) Management Accounting Practices and the Role of Management Accountant

Evidence from Manufacturing Companies throughout Yogyakarta, Indonesia, (2013) Review Integrative of Business and Economic Research Vol 2(2).

The result of the analysis revealed that management accounting practices in Yogyakarta's manufacturing companies were dominated by traditional management accounting practices, however the most important practices was differ between medium and big-scale companies. The most vitally important management accounting practices was profit improvement for medium and budgeting for big-scale. There also significantly Difference between the two groups in terms budgeting and fixed assets investment planning. Consistent to the first finding, the budgets were also consider as the most vitally important management accounting tools for those two groups. The traditional management accounting tools were perceived more important rather than the contemporary ones. This finding obviously supports the use of traditional management accounting in manufacturing

companies recently. The result findings were in line to research done by Rahman, Tew and Omar (2002), Adelegan (2004)), Nishimura (2002), Rahman, Tew and Omar (2002) and Omar, Rahman and Abidin (2002) in Mahfar and Omar (2004 Management accountants in Yogyakarta must change their role become more strategic role rather than administrative or operational role. The result indicated that management accountants in Yogyakarta more emphasizing in traditional roles. Their roles were perceived less important than peers. They have to promote the use of contemporary or advanced management accounting tools in order to enhance the quality of management.

e) The study of (Hassan Yazdifar Mathew Tsamenyi)

Management accounting change and the changing roles of management accountants: a comparative analysis between dependent and independent organizations, (2005), Journal of Accounting & Organizational Change 1,2 (2005) 180-198

Management accounting change and the changing roles of management accountants has dominated both the professional and academic accounting literature in recent years. This paper aims to contribute to these debates by providing evidence from a sample of management accountants working in both dependent (group) and independent (non-group) organizations in the U.K, one thousand (qualified) members of the Chartered Institute of Management Accountants (CIMA), U.K., were randomly selected from the association's database for a postal survey questionnaire. In all, 279 professionally qualified management accountants in both types of organizations responded to a postal survey questionnaire (58 percent from dependent and 42 percent from independent organizations respectively).

A Mann-Whitney analysis of the responses indicates that while some significant differences exist between the views of the two groups, these management accountants agree on several of the management accounting practices and the roles of the management accountant investigated. The study provides further insight into MAS and the changing roles of management accountants. It was earlier hypothesized that significant differences would exist in the perceptions between the two groups. However the weak support for the hypotheses could be explained by the influence of other institutional forces apart from the head office control which is focused on in the paper. Thus, it was recognized that other institutional forces are likely to be at play in shaping the perceptions of the management accountants. This is a limitation of the paper and future research to study the impacts of other institutional factors is recommended.

f) The study of (Adela Breuer, Mihaela Lesconi Frumușanu, Andra Manciu)

The Role of Management Accounting In The Decision Making Process: Case Study Caraș Severin County, (2013), Annales Universitatis Apulensis Series Oeconomica, 15(2), 2013, 355-366.

This study can affirm that, through the detailed analysis performed on the activity, on the internal flow, in terms of value and quantity, related to the expense distribution and the cost development, management accounting is an important component of the accounting information system, with a significant contribution in the management process of an economic entity. Based on the above mentioned, our opinion is that the organization of a second accounting circuit is necessary, like the financial accounting, as the legislative regulations (Accounting Law no. 82/1991) stipulate the indispensability of its organization. From the empirical studies, we could notice that there are a few companies that organize and conduct management accounting, which is especially common in large companies with production profile. We maintain our opinion, by the fact that, regardless of the activity field, it can have but positive results. Related to the name of the second circuit, management account or managerial accounting, we believe that the latter, i.e. managerial accounting, suits its purpose better, i.e. to provide information necessary for the decisions related to cost reduction. Managerial accounting should not be regarded as useful only to the managers, because the management process does not involve only the management of the economic entities, but it regards each employee of the entity, from the worker to the manager.

V. THE POPULATION & THE STUDY SAMPLE

The Population of the Study: The study population is a group of the Industrial Sector Companies listed in the Amman Stock Exchange ASE - Jordan, until the end of fiscal year 2014. And to serve the purposes of this study the researcher exclusion any company in this sector is not published sufficient information available on the official website of the Amman Stock Exchange (www.ASE.com.jo).

The Study Sample: Due to the large size of the companies in the industrial sector in ASE, the researcher selected a random sample (20 companies) from the study population, and these companies have the available published data, budgets and income statement.

And the table below shows the sample of study:

Table (1) : The Study Sample

S.R	Company	Code
1	PETROCHEMICALS	IPCH
2	COMPREHENSIVE	INOH
3	IND./MATCH JEMCO	INMJ
4	JOR INDSTR CHEM	JOIC
5	UNIV CHEM IND	UNIC
6	PREMIER	ACDT
7	ARAB INVEST PROJ	APCT
8	JOR PAPER CARDBG	JOPC
9	PEARL SAN P CONV	PERL
10	EKBAL PRINT CO.	EKPC
11	NAT'L POULTRY	NATP
12	JORDAN POUL PROC	JPPC
13	SINIORA	SNRA
14	ARAB INT'L FOOD	AIFF
15	DAR ALDAWA DV/IV	DADI
16	JORDAN PHARMA	JPHM
17	MID PHARMA IND	MPHA
18	HAYAT PHAR. IND.	HPIC
19	JORDAN IND.RES.	JOIR
20	PHILADELPHIA PHARMA	PHIL

VI. THE STUDY HYPOTHESES

To serve the purposes of the study, the researcher put some hypotheses as follow:

a) The 1st Hypothesis

The Industrial sector companies listed on the Amman Stock Exchange Implements preparation the Master Budget as one of the budget types that recognized by management Accounting.

b) The 2nd Hypothesis

The Industrial sector companies listed on the Amman Stock Exchange Implements preparation the Financial Budget as one of the budget types that recognized by management Accounting.

c) The 3rd Hypothesis

The Industrial sector companies listed on the Amman Stock Exchange Implements preparation the Cash flow Budget as one of the budget types that recognized by management Accounting.

d) The 4th Hypothesis

The Industrial sector companies listed on the Amman Stock Exchange Implements preparation the Operational Budget as one of the budget types that recognized by management Accounting.

VII. THE STUDY MODEL

The Figure below shoes the virtual model for this study:



Figure (1) : Virtual Model

VIII. DATA COLLECTION TOOLS

There are two sources of data in this study:

a) Primary Sources

Were obtained through the design of questionnaire distributed to each of company, it was targeted many Positions in each firm as follow:

- The Financial Manager
- Three Accounts Managers (Chief Accountants)

- Three Accountants (Financial Accountant, Tax Accountants, Cost Accountant)

b) A secondary

Source has been obtained from previous studies in this area, and relying on books, magazines, publications and various reports and statistics published on the official site for Amman Stock Exchange ASE- Jordan

The Table below shows the distribution questionnaire to the targeted group:

Table (2) : Targeted group by distribution questionnaire

The targeted group	No. of Positions	No. of Companies	Total	Recovering
Financial Manager	1	20	20	15
Accounts Managers	3	20	60	55
Accountants	3	20	60	50
Total	7	20	140	120*

*It's clear from the table (2) that the recovering ratio was: (0.86 or 86%).

The researcher use Cronbach's Alpha Coefficient to measure the consistency of the questions in the questionnaire that was introduced to the

Respondents. And the Table No (3) below shows the result of the Cronbach's Alpha Coefficient according with the questionnaire paragraphs:

Table (3) : The result of the Cronbach's Alpha Coefficient

S.R	Area	No. Of Paragraph	Cronbach's Alpha Coefficient	Constancy *
1	Master Budget	4	0.920	0.959
2	Financial Budget	4	0.902	0.950

3	Cash- Flow Budget	4	0.809	0.900
4	Operational Budget	4	0.909	0.953
T	Total	16	0.885	0.941

It's clear from the results shown in the table (3) that the value of Cronbach's alpha coefficient was high for each area, ranging from (0.809 and 0.920). As well as the value of the alpha coefficient for all the paragraphs of the questionnaire (0.885), As well as the

value of constancy was high for each area, ranging from (0.900 and 0.959). As well as the value of the stability of all the paragraphs of the questionnaire (0.941), this means that the reliability coefficient is high.

IX. DATA GATHERING FROM THE PERSONS WHOM ANSWERED THE QUESTIONNAIRE

Table (4) : Questionnaire Result: Master Budget

No.	Subject	arithmetic average	standard deviation
1	Sales and Production	2.59	1.378
2	benefit contributions	2.47	1.164
3	supplies and equipment	2.19	1.195
4	Inventory and Expenses	2.30	1.554

Table (5) : Questionnaire Result: Operational Budget

No.	Subject	arithmetic average	standard deviation
1	costs of goods sold	3.20	2.901
2	administrative costs directly related to producing goods and services	3.55	2.708
3	Revenues	3.42	2.051
4	expenses define the costs of goods sold	3.89	2.334

Table (6) : Questionnaire Result: Cash-Flow Budget

No.	Subject	arithmetic average	standard deviation
1	inflows and outflows	2.89	1.420
2	shortfalls between expenses and sales	2.78	1.232
3	production cycles	2.65	1.215
4	inventory levels	2.90	1.765

Table (7) : Questionnaire Result: Financial Budget

No.	Subject	arithmetic average	standard deviation
1	revenues	3.59	2.887
2	income	3.47	2.121
3	costs	2.66	1.411
4	capital expenditures	3.69	2.454

X. HYPOTHESES TESTING

- a) Test the 1st hypothesis: the Industrial sector companies listed on the Amman Stock Exchange

Implements preparation the Master Budget as one of the budgets types that recognized by management Accounting.

Table (8) : Result of Statistics

Subject	Statistics	The Master Budget
the budgets types that recognized by management Accounting	correlation coefficient	0.779

	The level of significance	0.000
	The size of the sample	20

From the table above the value of the level of significance equals 0.000 and less than 0.05 also, the value of the correlation coefficient is equal to 0.779, which indicates the Industrial sector companies listed on the Amman Stock Exchange Implements preparation the Master Budget as one of the budgets types that recognized by management Accounting.

- b) Test The 2nd Hypothesis: the Industrial sector companies listed on the Amman Stock Exchange Implements preparation the Financial Budget as one of the budget types that recognized by management Accounting.

Table (9) : Result of Statistics

Subject	Statistics	Financial Budget
the budgets types that recognized by management Accounting	correlation coefficient	0.801
	The level of significance	0.000
	The size of the sample	20

From the table above the value of the level of significance equals 0.000 and less than 0.05 also, the value of the correlation coefficient is equal to 0.801, the Industrial sector companies listed on the Amman Stock Exchange Implements preparation the Financial Budget as one of the budget types that recognized by management Accounting.

- c) Test The 3rd Hypothesis: the Industrial sector companies listed on the Amman Stock Exchange Implements preparation the Cash flow Budget as one of the budget types that recognized by management Accounting.

Table (10) : Result of Statistics

Subject	Statistics	Cash-flow Budget
the budgets types that recognized by management Accounting	correlation coefficient	0.691
	The level of significance	0.000
	The size of the sample	20

From the table above the value of the level of significance equals 0.000 and less than 0.05 also, the value of the correlation coefficient is equal to 0.691, the Industrial sector companies listed on the Amman Stock Exchange Implements preparation the Cash-flow Budget as one of the budget types that recognized by management Accounting.

- d) Test the 4th Hypothesis: the Industrial sector companies listed on the Amman Stock Exchange Implements preparation the Operational Budget as one of the budget types that recognized by management Accounting.

Table (10) : Result of Statistics

Subject	Statistics	Operational Budget
the budgets types that recognized by management Accounting	correlation coefficient	0.709
	The level of significance	0.000
	The size of the sample	20

From the table above the value of the level of significance equals 0.000 and less than 0.05 also, the value of the correlation coefficient is equal to 0.709, the Industrial sector companies listed on the Amman Stock Exchange Implements preparation the Operational Budget as one of the budget types that recognized by management Accounting.

XI. THE STUDY RESULTS

- a) The Industrial sector companies listed on the Amman Stock Exchange Implements preparation the Operational Budget as one of the budget types that recognized by management Accounting.
- b) The Industrial sector companies listed on the Amman Stock Exchange Implements preparation the Cash-flow Budget as one of the budget types that recognized by management Accounting.
- c) The Industrial sector companies listed on the Amman Stock Exchange Implements preparation the Financial Budget as one of the budget types that recognized by management Accounting.
- d) The Industrial sector companies listed on the Amman Stock Exchange Implements preparation the Master Budget as one of the budget types that recognized by management Accounting.
- e) The result of this study indicates that Lower application of these budgets is in the cash flow budget case.
- f) In general, the industrial sector companies apply Preparing budgets in accordance with management accounting concepts. Therefore, this result can be generalized in principle to the all industrial sector companies that formed the study population.

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Contribution of Khat Kellas and the Impacts of its Closure to Ethiopian Economy (the Case of Hararghe Khat Kella)

By Kokobe Seyoum Alemu

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Abstract- The researcher was intended to investigate the contribution of khat kellas and the impacts of its closure to Ethiopian economy the case of Hararghe khat kellas. Primary data has been collected through unstructured interview made to the employees of Oromia revenue bureau and Ethiopian revenue and custom authority and the secondary data has been collected from related documents, reports and books. In this regard, seven consecutive years' data (2005-2011) was collected and analyzed by using ratios, percentage, and table and graph. This study has revealed that Hararghe khat kellas has a number of contribution to Ethiopian economy like employment generation, increase government revenue and decrease local consumption which in turn increases foreign exchange. Even if the government has closed these kellas with the intention of export promotion to increase foreign currency, it was not successful as there is no tax discrimination between khat consumed locally and exported. Tax treatment for both is the same and cannot get what it is intended for. Based on the finding of the study, conclusion and recommendations were forwarded.

Keywords: *khat, tax, harar, hararghe, economy.*

GJMBR - D Classification : *JEL Code: M00*



Strictly as per the compliance and regulations of:



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employment generation, increase government revenue and decrease local consumption which in turn increases foreign exchange. Even if the government has closed these kellas with the intention of export promotion to increase foreign currency, it was not successful as there is no tax discrimination between khat consumed locally and exported. Tax treatment for both is the same and cannot get what it is intended for. Based on the finding of the study, conclusion and recommendations were forwarded.

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I. INTRODUCTION

Despite Ethiopia's vast resource of land, water and labor, it remains among the poorest nation of the world. The country has important growth potential, but this potential is not being realized. The key requirement for Ethiopia to emerge from its existing situation of stalled economic growth is to decrease government deficit through the collection of enough revenue. From those sources of government revenue tax

comprises the largest share which includes different tax bases including khat trade. Khat is a natural stimulant from the khata-adulis plant found in the flowering ever green tree or large shrubs which grows in east Africa and southern Arabia. Originating in Ethiopia, where the largest share come, khat now also grows in Somalia, Kenya, Malawi, Uganda, Tanzania, Congo, Zambia, Zimbabwe, Afghanistan, Yemen and Madagascar (Cox and Rampes, 2003). This plant is known by variety of names such as: QAT and GAT in Yemen, QAAD and GAAD in Somalia, CHAT in Ethiopia. It is also known as JIMA in Oromo language. Ethiopian chat has different local names as well such as: Awoday, Beleche,

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Abomismar, Wondo, Kuda, Faqa, Gelemso, Ye'bahirdar etc... names taken after the type and place of cultivation.

Khat mostly grows in south and eastern Ethiopia and is a major foreign currency earner. Export quality Khat is packed and sent every day to countries that do not ban the plant of which are Djibouti and UK are the major ones (Gebissa, 2004). The local market for Khat is also very huge. Every day fresh khat is transported to the capital and distributed to various areas using Isuzu trucks rapidly. There are also some deliveries that use air transport like Addis Ababa. In south and eastern Ethiopia khat is a part of the community's culture and is never considered as some kind of drugs.

Khat is Ethiopia's third largest export item next to coffee and gold (national bank of Ethiopia report, 2013). Not only top export earner it also plays a considerable role in the local economy, as it is a source of income for many whole sellers, small scale traders and to those businesses that depends on it indirectly. Khat doesn't drive only external revenue but also internal revenue by using khat kellas to impose tax on khat that passes a particular location. In this regard Oromia region has many kellas like shashame, jimma, guji/negele/, Borena/Yabelo/, Finfinne surrounding special zone/dima, Alemgena and Menagesha/ and east and west Hararghe which comprises lion share both in terms of revenue and quantity of khat. Again both east and west hararghe has many kellas like Awoday, Dengego, Babile, Kombolcha, Chinaksen, Gursum, Diredawa airport under east hararghe and Bedesa, bordode, Michata and Hadas under west hararghe.

Different reports of this time by national bank of Ethiopia (annual report, 2014) shows that, the revenue that has been earned in the past from some cash crops has been decreased over the last four and five years. This is most often associated with the decrease in revenue collected from some tax revenue generating items. One among others is khat whose revenue has decreased over the past four and five years. The reduction in Revenue from khat has associated with the closure of some khat kellas.

Khat is one among the cash crop which generates large share of revenue collected in the country. It has strong demand at local and overseas markets and is sold daily in both markets. From the total production in Ethiopia, only 47000 ton (25 %) made its way to the foreign market, out of the 190,000 ton produced by close to 2.5 million farmers cultivating the crop on the total area of 201,115 hector (Abdi Tsegaye, 2014). In the past all these khat is taxed and the government gets larger revenue. Whether it is sold locally or exported it is taxed. It is known that exporters should get a relief from tax to be competent in international market, but there is no ground that 75% of all khat production that consumed locally is to be tax

free. Now the fact is that, the tax revenue from khat is decreasing, so this research will examine the link between closure of the Harar kellas and reduction in the amount of tax collected; the reason for their closure and its consequence.

The intension of this paper is to assess the contribution made by Harar khat kellas and the consequence of its closure to Ethiopian economy to bring evidence on the level of revenue lost because of its closure. Again, the paper has investigated the intension of government in closing this big amount of revenue and the problems Harar khat kellas faced. At the end, the paper concludes by forwarding some policy recommendations.

Although studies have been done on the area before, it does not include khat tax. Thus, this paper tries to fill gap in literature by extending the issue on specific context of khat kellas. Furthermore, the paper would be an input for government in increasing its tax bases and then revenue by providing guide lines for strategy and policy formulation aimed at improving the operational conditions of the participants in the business. Again it will provide solid evidence on the importance of khat kellas and can be used as a base for further study.

II. RESEARCH METHODOLOGY

This research is conducted on longitudinal bases in which data collection for the research was made across time. The secondary data were obtained from different sources like records of Ethiopian revenue and custom authority (ERCA), Oromia revenue agency (ORA), and internet, related web site on the issue, different research and other documents that are specifically related to the topic under study. Primary data were obtained from an unstructured interview made with employees of both ERCA and ORA. To analyze those data concerned with khat kellas, different period data were collected and compared. Therefore the current consecutive seven years (2005-2011) data have been taken and interpreted by using time series analysis like ratio, percentage, table and graph.

III. LITERATURE REVIEW

a) History of khat

Khat is an evergreen perennial shrub plant that belongs to the Celastraceae family. The plant is known with different vernacular names: *Khat* in English and in Arabic, Jimaa in Oromiffaa (language of Oromo people growing the plant extensively in Ethiopia) and *chat* in Amharic (Dechassa, 2001).

Khat has got the status of cash crop in Ethiopia. It is one of the major sources of foreign exchange earnings to the Ethiopian Economy. Khat has a strong demand at local and overseas markets and is sold daily

in both the markets. The Government collects large sum of foreign exchange earnings and revenues from taxes on export transactions and uses that in government's budgetary expenditures. Notwithstanding, the government does not provide any incentive to the exporters of Khat.

Internationalization in Khat export is currently due to the external pull from the importing countries, their internal network, and the price that Khat governs there. Recognizing the fact that Khat is sold largely by the unorganized sector and entails some social repercussions, the tax imposed on Khat is not so pronounced in the domestic market, which otherwise could offer the government an additional source of revenue. Not only taxation, khat can be a good source of job opportunities for the locals, once recognized. (African Journal of Business Management Vol.5 p.3647)

Khat production and its sale have a long-standing history in Ethiopia. Thought to be originated from Harar, it became popular, in due course, to Oromo and other tribal regions of Ethiopia. However, the volume of the exported Chat was small that time due to the lack of rapid means of delivery (Gebissa, 2004). Large quantities of Chat were imported from Ethiopia to Aden only after the air route was setup across the Red Sea in 1949 (Ward, 2000). Following the development of rail and road transport to Djibouti and Somaliland, it attained a significant surge (Gebissa, 2004). In the decade after the Second World War and between 1954 and 1961, a sizeable amount of arable lands was devoted to khat production in Hararghe (Amare mastication Krikorian, 1973 cited by Gebissa, 2004).

b) Uses of khat

i. Economic use

In Ethiopia, *khat* is an important and potentially lucrative cash crop. The employment opportunity created through the cultivation of *khat* is very high in that large numbers of people are involved in growing, harvesting, sorting, packing, transporting, loading and unloading the commodity. The wood of the plant is commonly used for fuel and due to its resistance to termite it is used in the construction of houses and fencing. It is also used for making rafters, handles of farm tools (hammers and chisels) and handles of household articles such as pots and pans, rolling pins, and to make forks, combs, spoons and for rulers (Dechassa, 2001).

ii. Medicinal use

Processed leaves and roots are used to treat influenza, cough, gonorrhea, asthma and other chest problems. The root is also used for stomachache and an infusion is taken orally to treat boils. (Cox and Rampes, 2003),

iii. Social value

Khat has considerable social value. It is served to welcome and entertain guests, in mourning,

weddings and circumcision ceremonies and collective labor works. *Khat* chewing has its own associated ceremonies like smoking of incense, cigarettes and use of drinks (soft drinks, tea and milk). *Khat* chewing is addictive and has negative physical, economical and social connotations. Although non-users both in rural and urban areas condemn the practice of chewing, the number of people chewing is increasing particularly among the youth. In urban areas, chewing *khat* is a common leisure activity, which, combined with the consumption of it, followed by alcohol, is having an adverse effect on family life. Students and a number of staff in higher education institutions and high schools are using *khat* to "increase" their concentration levels and attention span. (Dechassa, 2001)

iv. Political use

Even though Ethiopia has been the primary beneficiary of khat export, the government has occasionally shown propensity to use khat for political reasons. During the 1962 Ethio-somali war, for instance, Ethiopian authorities withheld khat from Somalia, in the hope that the lack of the leaves might incite the Somalis against their government. Following the war, the ban was lifted after the commanding military general in the region argued in favor of unrestricted flow of khat in to Somalia. His rationale was that increased khat would turn Somalia in to a country of physically unfit and psychologically incompetent addicts who would not be able to field an effective fighting force and devastate their country's economy by draining money to Ethiopia (Gebissa, 2004, pp.104-105)

v. Environmental value

In Hararghe, *khat* is grown in an intensive production system. It is planted in rows on hillsides along terraces in association with different food crops, mainly annuals, and oriented against slopes. As such, khat cultivation plays key role in controlling soil erosion, which is a major threat in the area due to the undulated topography and intensive deforestation for farmland expansion and hence *khat* culture is considered to be the best agro forestry system practiced by farmers. Had it not been for the cultivation of *khat*, the erosion of topsoil would have been severe and possibly disastrous in midland areas of East and West Hararghe zones. (Gemechu, 2002)

c) Effects of khat on human health

Khat is a stimulant with a mild narcotic effect when taken in moderate quantities. However, little is known of the plant's health effects (Hill, 1996). Hill states that *khat* is not clearly addictive, as it has been observed that abrupt withdrawal of *khat* from the habitual consumer does not necessarily lead to withdrawal symptoms. The plant stimulates or charges human bodies for action due to its alkaloid content. Excessive consumption of *khat* is said to induce symptoms of

hallucination or illusion, intoxication and short energy boosting effect. Extended use is also reported to cause emaciation, may be because of suppressed appetite, and impotence. Generally, chewing *khat* causes constipation. It is not clear what is considered moderate consumption and what would amount to be an over dose leading to health related problems.

d) *Forms of consumption*

Khat is grown for its tender leaves and twigs/stems, which are chewed for their mild stimulating effect. They taste sweet to bitter when fresh, based on the type of *khat* consumed. Although the most common way of obtaining the stimulating effect of *khat* is by chewing fresh leaves and soft twigs, consuming dried and pounded materials, in the form of tea, infusion and smoking is also seen. As with most other addictions, when a regular *khat* chewer is not getting *khat* he/she feels uncomfortable, becomes restless and aggressive. In Hararghe a person in such a state is locally known as *jazba* (literally meaning inactive or dull) and the condition of an extraordinary desire for *khat* is called *harara*. During this period one cannot be expected to behave well or to respond positively to any query.

However, when a regular chewer gets *khat*, after about one and half to two hours she/he will become calm as the narcotic effect begins to work. This state of quenching the chewing desire is locally known as *mirqana*. According to key informants, the time taken to get the stimulating effect varies based on the body weight of the person, room temperature and type and quality of the material. It is said that a heavy person will sense the feeling late as compared to a person with less body weight while warm room temperature will hasten the narcotic effect or the excitement. (Dechassa, 2001)

e) *Processing methods for market*

There are a number of procedures and processes employed to ensure the marketable value of the harvested material of *khat*. The consumable part is harvested and put in shawls or plastic sacks at farm level and taken home for sorting and grading by plucking off the leathery leaves and trimming the long stems.

The selected material and the unfit/unmarketable portion, locally called *garaba*, are separated. The unfit part is set aside for animal feed and as compost material for later use as manure. The selected and marketable part is tied into *haqara*/bundle (40-60 selected slender twigs) and splashed with water to keep the product wet and fresh and then wrapped with fresh leaves and twigs of different plants and grasses. The bundles of the commodity will finally be placed in burlap or plastic bag, sack or shawl ready for transport to market for sale. The way the commodity is packed varies depending on the distance to the final

destination and the purpose it is sent for (local consumption or export) (Dechassa, 2001).

f) *Marketing: volume and earnings*

In Ethiopia, *khat* is used for direct consumption, local sale and for export. The quality, prices and taxation rate of export *khat* are quite high as compared to that used for local consumption. For example, the tax for locally used *khat* is Birr 3 per kg while the levy for exportable *khat* is Birr 6 per kg. *Khat* appears to make a significant contribution to the foreign currency earnings of Ethiopia.

It is exported to various parts of the world including Djibouti, UK (London), Somalia, and a number of Arab Countries. Exports have increased dramatically. In 1999/2000 Birr 0.464 billion worth of *khat* was exported to different countries and ranked second replacing hides and skins in export revenue (The Reporter, 2000). The above figures do not, however, include the huge volume of *khat* smuggled to different countries. Despite the economic benefits drawn from *khat*, some countries, including the Ethiopian government, have repeatedly attempted to limit the production and export of *khat* and forced replacement of the crop with coffee, in accordance with proposals made by the United Nations Commission on Narcotic Drugs (Huffnagel, 1961 cited by dechassa).

Farmers generally sell their *khat* to buyers who directly come to the field and negotiate a price with the producer. When farmers take the commodity to local wholesale markets they mostly do not sell it directly to traders, rather they sell through regular brokers (locally known as *qaqabi*) who negotiate on the price on behalf of the farmer/owner. Each trader has a number of brokers and operates through them. After negotiation on the price with the buyer, if the farmer agrees to the offer by the buyer, the broker sells the material to the buyer and receives a 10% commission from the farmer/seller but allegedly not from the buyer.

IV. DATA PRESENTATION AND ANALYSIS

Khat production and sale have a long standing history in Ethiopia. Millions of farmers in Ethiopia drive their income from the production and sale of *khat* leaves. This is partly true for the distributors and retailers in urban centers of Ethiopia-particularly in Harar, Direedawa and Addis Ababa, who are involved in distributing the product in the domestic and international markets (Gebbsa, 2004).

Farmers generally sell *khat* to buyers or brokers who visit their farm in search of the produce. Some big and experienced farmers access the exporters of *khat* directly and negotiate for the best possible price, while others either sell their products either on site or approach brokers in their local market. Those brokers are known as *dalala* or *qaqabi* and they do not take title of the goods. Usually, *khat* traders and exporters

operate through a number of brokers involved in different markets. The brokers work on commission basis, which they receive from the seller of the product.

Most of the exporters to Somali deal at their own, by making an outright purchase in Ethiopia and its sale in Somalia (Hargessa, Mogadisho, Bosaso markets); Whereas the exporters of Djibouti deliver khat through the importers agent who are stationed in Ethiopia. (African Journal of Business Management Vol.5 p.3647).

The difference in the price of khat to different parts of the world can be attributed to the quality of khat that is consumed in these markets. When khat is sold even if quantity will be considered, what matter most is its quality. This depends on the nature of khat itself. Oromo people in Hararghe recognize three types/traditional "varieties" of *khat* plants classified physically based on the color of the young shoots of the plant. These identified types are *Dima*/red, *dalota* (*Dalacha*)/whitish and *Hamarcot*; the latter being in between *dima* and *dalota* in color.

The red/*dima* type has a reddish tinge, withstands harsh conditions, tolerates poor management, extensive harvest (exhaustion) and gives reasonable harvest even with less care compared with the other varieties. However, it is of inferior quality, is less preferred by consumers, and has low market value as compared to the other two varieties. *Hamarcot* has broad leaves and is less branched out; it is superior in quality and hence has better market value. *Dalota* is white or light in color, has narrow leaves and more branches compared to *hamarcot*. Unlike the other two varieties, *hamarcot* does not have clear distinguishing characteristics for easy identification. However, through experience it is possible to distinguish it easily. Some of the criteria farmers' use to grade the quality of khat are; exciting rate or narcotic effect, taste, physical appearance, demand and market value. According to farmers and *khat* users in Hararghe *hamarcot*, *dalacha* and *dima khat* are ranked as first, second and third, respectively, using the above criteria interims of the market value.

When it is sold in the market just like any other products, there are many intermediaries between the farmer and the end consumer. Sometimes the exporter may directly purchase from the farmer or they may purchase through *dalala*. After the products are purchased, since it is perishable, it should reach the market for end consumer immediately using different means of transport. In Harar when khat is prepared for sale, first the unnecessary part, called *garaba* will be removed by the farmers themselves and sold. In the past, if khat prepared for sale passes khat *kellas* it will be taxed. Khat *kellas* that are found in Awoday, Babile, Dhangago, Kombolcha, Chinaksen, Diredawa airport, Gursum, Bedesa, Hades, bordode, michata and others are responsible for the collection of khat tax.

The tax imposed on khat is unit tax. It does not consider the value and quality of khat. Quality and purchase price is not the issue. Only what is considered is its weight. The amount of tax will be determined based on the kilogram transported. Quality is considered only at the time of purchase and sale. When it reaches *kellas*, its weight is measured and the amount of tax to be paid will be determined based on that weight. The government has assigned the specific unit and the amount of the tax is computed by using that unit rate. However, what is surprising is, the government has assigned three (3) birr per kilogram for domestic consumption and six (6) birr per kilogram for export. This is not in line with the government's policy of export promotion. Undoubtedly, this will encourage domestic consumption.

Again, *Khat kellas* has loose internal control in which the employees and the tax authority have far relation. This opens a room for corruption. To avoid this and for export promotion the government closes all these *Khat kellas*, which is actually a base for government revenue in the past. At this time, except two khat *kellas* left in west Hararghe, all *khat kellas* are closed and the government has lost all the revenues from this source.

The closure of *khat kellas* makes the price of khat low, which in turn increases local consumption. In the past, khat has been the third largest exported items next to coffee and oil seeds. But starting from 2011, it changes its rank to fourth position. Export promotion by using tax does not mean that all taxes should be removed. For export promotion we should impose tax on one activity and remove for the other. Unless there is partial treatment we cannot say, we are using tax for export promotion. As it is clearly evidenced, the closure of khat *kellas* will decrease the price of khat and in turn increases local consumption; because it is easily available with low price. This will affect the working force of the country and the economy.

The late Prime Minister Meles Zenawi, once discussing with the country's youth said that the government would take sever measures on houses that allow khat chewing and shisha smoking. Following the Prime minister's remark, officials of the city have taken measures on some places of the city sporadically. The city authority is also given written warning to khat retailers that the retailers should cease allowing chewing in their shop in the coming seven days.

However, still what is done is clear to all of us. All of these houses are on their function. Still they are serving the chewers. The possible solution for this is easy. Using tax as instrument, if unit tax let say six(6) birr per kilogram is levied on khat reaching the city, undoubtedly, the local khat consumption will decrease. Even, if we want to decrease local consumption of khat to the minimum level, only imposing a combination of tax on khat is enough and there is no need to take

coercive measure on the side of government. As khat has many social effects because of its direct relation with alcohol most of the time, it may harm the society from different angle. Even if, it is government's responsibility to keep the societies well being by taking measures; it is not expected on the side of government to use coercive action. What is expected is only the imposition of a combination of taxes on khat. On one side, this measure will increase government's revenue and employment creation and again decrease local consumption.

In the export market, the major problems witnessed are tax charged on the gross weight of khat that includes the packaging and other accessories, and lack of standard for the quality and type of khat for export, absence of tax refund policy. As it is perishable product, the government does not allow tax refund for the expired product. Khat exporters do not get any benefit as enjoyed by the exporters of other commodities.

It can be said that the internationalization of khat has not gained from the external factor such as export promotion program. However, the conducive

environment, demand for khat could be some external factors for its internationalization. While tobacco, bear and other products can be given recognition and support within the export policy on some pretext, treating khat half- heartedly for export marketing does not seem logical to the exporters and farmers. The Ethiopian government did not give any recognition for khat. As it is cash crop, it is helping itself by its own income. Even if Ethiopian government's main attention is development of agriculture in which different policies are made concerning agriculture, if there is one thing puzzling about the cultivation and trade of this plant; in Ethiopian history, no government has an extension policy for khat. Khat will support itself without any help from government. However, as one of the employees of Oromia revenue agency says, in this year (2014), the government has extension policy for khat. The assertion is, therefore, if extension policy is developed for khat, our country will become main foreign export earner.

In east and west Hararghe the amount of khat tax collected by those kellas are too large. Let see the amount of tax collected by each zone from khat per year:

Table 3.1 : Revenue collected in each year from khat tax in Hararghe

Kellas	2005/1997	2006/1998	2007/1999	2008/2000	2009/2001	2010/2002	2011
East Hararghe	106,816,811	97,127,604.5	99,662,807	77,176,720.4	14,862,412	0	0
West Hararghe	39,247,413.31	39,341,523	30,881,979	28,024,705	16,783,759	14,114,928	16,312,169
Total	146,064,224.3	136,469,127.5	130,544,786	105,201,425.4	31,646,171	14,114,928	16,312,169

Source:-Oromia revenue bureau

As you can see from the above table the amount of khat tax collected in each year is higher in east Hararghe than west Hararghe. Because, the number of kellas in east Hararghe is many in number than kellas in west Hararghe.

Again from the total cash collected starting from 2005-2009, the 2009 is small both in east Hararghe and west Hararghe. The reason is that, the khat kellas are operating only for two (2) months of the year 2009 i.e. for the month of *Hamle* and *Nehsie*.

The table shows that in west Hararghe the collection continues until now, even if the amount is small. Two kellas are functioning in west Hararghe i.e. *bordode* and *michata*. Before their closure, the kellas are contributing all those amounts of revenue to Oromia regional states; but not now. The reason is that there is no kellas at this time except the two kellas left in west Hararghe.

Currently, for export promotion, khat exported is not taxed even in these two kellas. But even if many of them are passing these kellas in the name of exporter, most of these traders do not export the product; they sale it locally. Nobody controls whether these products

are really exported or sold locally. This shows us there is loose coordination between the tax authority and khat kellas.

Currently, just like any businesses, khat exporters are paying income tax. But, the problem is, these exporters does not maintain accounting records and difficult to determine the amount of tax. Federal government of Ethiopia has tried to search solution for this. The exported amount will be taken from letter of credit/LC/ which is issued by bank. Depending on this letter of credit, they will calculate the amount of export and then the amount of tax that should be paid.

Again, another problem arises on the side of Oromia regional state. First, some of the exporters are private limited companies (plc) and as per the Ethiopian government law, PLCs are federal tax payers. Nevertheless, now they agree to share the revenue on 50-50 basis. Still the problem is not solved for Oromia regional state as from the total 50% remitted, the federal government will not specifically state that this amount is from khat exporters and this amount is from other sources. The federal government will determine the amount by itself and will share 50% to Oromia regional

states. Second, some of the exporters are in other regions like Somali. From the exporters, only two of them are Oromia tax payers. Oromia regional state does not know whether these tax payers are even really paying tax to their respective regions or not. Nobody knows. As there is no coordination between Oromia regional state and other regions on this issue, the information is not clear for those regions. Even Oromia regional state, where products are transported from, does not have any information about what amount is transported by those traders. Again, this closure of khat

kellas has opened a road for illegal trade, as there is no control. By this, large amount of khat is exported to Djibouti and Somalia illegally.

The total amount of cash collected by other kellas like Jimma, Shashamane, Guji, Wondogenet, Borena and Finfinne surrounding special zone are far less than the amount collected by the two (east and west hararghe). Let see the following table which shows the total amount of khat tax collected by khat kellas in hararghe and others.

Table 3.2 : Total revenue collected from khat tax of all kellas

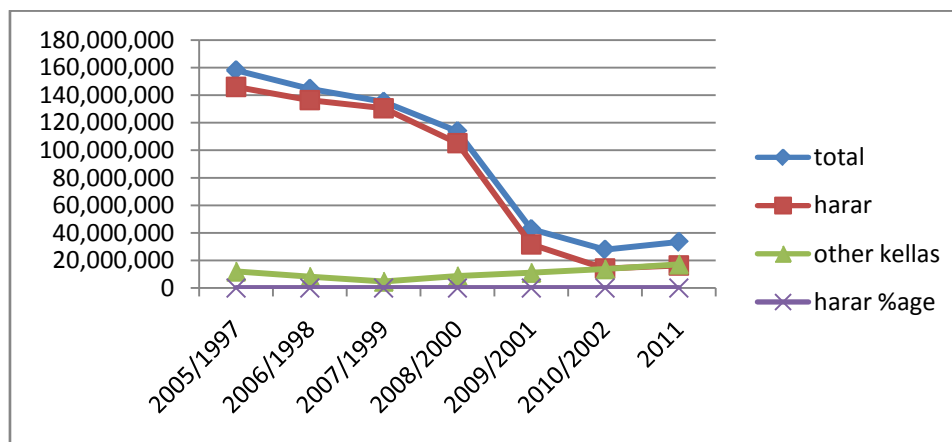
Year	2005/1997	2006/1998	2007/1999	2008/2000	2009/2001	2010/2002	2011/2003
Total	158,090,701	144,672,475	135,240,214	113,844,953	42,790,277	27,873,674	33,505,597
Minus hararghe	146,064,224.3	136,469,127.5	130,544,786	105,201,425.4	31,646,171	14,114,928	16,312,169
Other kellas	12,026,476.70	8,203,347.50	265,785,000	8,643,527.60	11,144,106	13,758,746	17,193,428
%age of Harar kellas	0.923926729	0.94329711	0.96528083	0.924076322	0.739564528	0.506389219	0.486849078

Source: - computed using data gained from Oromia revenue bureau

As one can see from the above table, the total tax collected from all other kellas are very much less than that of Harar. The rest only contribute small amount to the total revenue. This shows that, the closure of those kellas erodes the revenue obtained from this source as the largest part of revenue come from them. So if these kellas are closed, we can say that the revenue obtained from this source will decrease by more than 90 % (More than 90% of khat tax revenue is collected from Harar khat kellas and only small amount

is collected from other sources). Even after its closure, the two khat kellas left to function in west hararghe contribute around 50% of khat tax revenue. The main reason is that, khat production is larger in Harar than any other place in Ethiopia. In Harar khat is the livelihood for many people. Not only farmers but also, many others get their daily income from this source. So to change the economic standard of these people, government should give attention to this crop.

Graph 3.1 : Total revenue collected in each year from Harar, other kellas and its total



Source:-calculated from data of Oromia revenue bureau

As one can see from the above graph, the total revenue collected from both Harar and other khat kellas is decreasing from time to time. This is because of less attention given from government and the increase in corruption on this activity. Due to less coordination between regional tax authority and these employees, it is open for corruption. In Harar it is known that if somebody works in Harar khat kellas, he/she has to be rich. Everybody knows and it is common in that area.

Diredawa has also one khat kella to the entrance of the town at the place called Manafasha. It is still there. Diredawa imposes tax for the purpose of cleaning the town from khat leaf (Garaba). The municipality imposes one birr per kg on khat that to pass the location specified. But the intention is not to earn revenue to use for other purpose or to decrease khat consumption; it is for cleaning the town from garaba/by product/. The researcher doesn't know clearly the amount of khat tax collected from Diredawa khat kella. I have seen when considerable amount of revenue is generated from this tax. I did my practical attachment in Diredawa finance bureau. During that time, the investigator witnessed that large amount of money were remitted to the office. What should be known here is that the intention is not to decrease khat consumption through tax but, to clean garaba from the city.

V. CONCLUSION AND RECOMMENDATION

It is not expected to be prophet to know the problem of Ethiopian tax system which is evidenced by small tax bases. Based on the analysis of the information obtained from the study, the following findings were obtained.

Even if the efficiency of the countries tax system is increasing from time to time, still it needs a resistive effort from the government and all stake holders to make the system all inclusive, because for efficient collection of tax, the tax base should be increased. Khat kellas was used to be a valuable portion of government revenue. But the government has closed these kellas found in east and west hararghe with the intention of export promotion and to increase foreign currency. Khat kellas are considered as a tackle when exporters are stopped on all khat kellas they face. As a result khat kellas are removed for the intention of promoting export.

A unit rate of 3 birr per kilogram for local consumption and 6 birr per kilogram on exports has been used in the past. As the tax imposed on khat is unit tax it lacks some consideration which have direct effect on khat export i.e. quality and type. The unit tax does not consider khat quality as there is no standard. So it is imposed irrespective of the quality and type of khat even if these things have direct effect on profit.

Even if the government takes those measures with the intension of export promotion, it cannot hit its intended objectives that khat ranked on the fourth

places in foreign exchange earnings. This is as a result of misinterpretation of export promotion by the government. Export promotion does not mean the removal of all taxes from the item in all conditions. There should be partial treatment for the item in order to call it as export promotion by using tax. If there is no tax for both khat locally consumed and exported, we cannot say it is export promotion. Khat kellas not only decrease local consumption, and sources of revenue but also used for employment creation.

As a result of removal of khat kellas, the government has imposed business profit taxes on the exporter of khat just like any other businesses. But it is complicated by less record keeping habit of khat exporters in which government use letter of credit as a solution to this problem.

Oromia regional states has also the authority to collect khat tax, but ordered by federal government to close these kellas. As a result of this closure Oromia lost all the revenue from these sources and couldn't even get business profit taxes collected by others. Because some of the exporter are private limited companies which are federal tax payers where as some of them are other region tax payers like Somali. As there is no coordination between Oromia and other tax authority, they cannot know what amount those tax payers should pay. Even not only the amount they should pay, nobody knows whether they are really paying tax or not.

West and east hararghe comprises the largest portion of khat tax revenue. They comprise more than 90% of khat tax revenue. Even after their closure, the two khat kellas left in west hararghe i.e. michata and bordode comprise almost 50% of khat tax revenue.

a) Recommendation

Based on the finding summarized, the study provides the following possible suggestion to recommendable findings.

✚ The removal of khat kellas increase local consumption and decrease export earnings from khat. For these reason tax should be imposed on khat consumed locally. As the prevalence of local consumption open road for other illegal activities, it should be decreased by using tax, not coercive measures as the government is doing. Just impose a combination of taxes on khat consumed locally and make export free. This will increase export and discourage local consumption.

✚ The existence of kellas does not only decrease local consumption and increase government revenue, but also it promotes employment. On this regard just like a VAT department in tax authority, khat tax department should be there in order to directly monitor the activities of khat kellas so as to decrease corruption. Even it should be administered by federal revenue authority. The qualified

employees should be employed and directly administered by large tax payer organization.

✚ Again government should give attention to this crop. Extension policies should be implemented in an extensive manner. It is good that in 2014/15 the government has developed extension policies for khat even if it is not yet implemented. Agricultural atomization policy of the government should also include khat plant too.

✚ When locally consumed khat is taxed and that exported is free of tax, there should be coordination between federal and regional tax authorities. As has been noted, export should be kept free of tax. During this, some of the traders pass khat kellas as it is for export and sale it locally. This fraudulent activity should be avoided by the coordination of federal and regional government. The trader should bring verification to khat kellas that shows whether the specific amount and quality of khat that is expected to be exported was really exported. Otherwise, it is impossible to control if there is unequal treatment between what is locally consumed and exported. This coordination should be not only between federal and regional government but also between regions in order to prevent tax evasion.

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Note :

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- In future, if the board feels the necessity to change any board member, the same can be done with the consent of the chairperson along with anyone board member without our approval.
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4. Manuscript's Category,
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Final Points:

A purpose of organizing a research paper is to let people to interpret your effort selectively. The journal requires the following sections, submitted in the order listed, each section to start on a new page.

The introduction will be compiled from reference matter and will reflect the design processes or outline of basis that direct you to make study. As you will carry out the process of study, the method and process section will be constructed as like that. The result segment will show related statistics in nearly sequential order and will direct the reviewers next to the similar intellectual paths throughout the data that you took to carry out your study. The discussion section will provide understanding of the data and projections as to the implication of the results. The use of good quality references all through the paper will give the effort trustworthiness by representing an alertness of prior workings.



Writing a research paper is not an easy job no matter how trouble-free the actual research or concept. Practice, excellent preparation, and controlled record keeping are the only means to make straightforward the progression.

General style:

Specific editorial column necessities for compliance of a manuscript will always take over from directions in these general guidelines.

To make a paper clear

- Adhere to recommended page limits

Mistakes to evade

- Insertion a title at the foot of a page with the subsequent text on the next page
- Separating a table/chart or figure - impound each figure/table to a single page
- Submitting a manuscript with pages out of sequence

In every sections of your document

- Use standard writing style including articles ("a", "the," etc.)
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- Align the primary line of each section
- Present your points in sound order
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- Use past tense to describe specific results
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Abstract:

The summary should be two hundred words or less. It should briefly and clearly explain the key findings reported in the manuscript-- must have precise statistics. It should not have abnormal acronyms or abbreviations. It should be logical in itself. Shun citing references at this point.

An abstract is a brief distinct paragraph summary of finished work or work in development. In a minute or less a reviewer can be taught the foundation behind the study, common approach to the problem, relevant results, and significant conclusions or new questions.

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- Fundamental goal
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- Consequences, including definite statistics - if the consequences are quantitative in nature, account quantitative data; results of any numerical analysis should be reported
- Significant conclusions or questions that track from the research(es)

Approach:

- Single section, and succinct
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- A conceptual should situate on its own, and not submit to any other part of the paper such as a form or table
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Introduction:

The **Introduction** should "introduce" the manuscript. The reviewer should be presented with sufficient background information to be capable to comprehend and calculate the purpose of your study without having to submit to other works. The basis for the study should be offered. Give most important references but shun difficult to make a comprehensive appraisal of the topic. In the introduction, describe the problem visibly. If the problem is not acknowledged in a logical, reasonable way, the reviewer will have no attention in your result. Speak in common terms about techniques used to explain the problem, if needed, but do not present any particulars about the protocols here. Following approach can create a valuable beginning:

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- Present a justification. Status your particular theory (es) or aim(s), and describe the logic that led you to choose them.
- Very for a short time explain the tentative propose and how it skilled the declared objectives.

Approach:

- Use past tense except for when referring to recognized facts. After all, the manuscript will be submitted after the entire job is done.
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Materials:

- Explain materials individually only if the study is so complex that it saves liberty this way.
- Embrace particular materials, and any tools or provisions that are not frequently found in laboratories.
- Do not take in frequently found.
- If use of a definite type of tools.
- Materials may be reported in a part section or else they may be recognized along with your measures.

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- Report the method (not particulars of each process that engaged the same methodology)
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- Simplify - details how procedures were completed not how they were exclusively performed on a particular day.
- If well known procedures were used, account the procedure by name, possibly with reference, and that's all.

Approach:

- It is embarrassed or not possible to use vigorous voice when documenting methods with no using first person, which would focus the reviewer's interest on the researcher rather than the job. As a result when script up the methods most authors use third person passive voice.
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What to keep away from

- Resources and methods are not a set of information.
- Skip all descriptive information and surroundings - save it for the argument.
- Leave out information that is immaterial to a third party.

Results:

The principle of a results segment is to present and demonstrate your conclusion. Create this part a entirely objective details of the outcome, and save all understanding for the discussion.

The page length of this segment is set by the sum and types of data to be reported. Carry on to be to the point, by means of statistics and tables, if suitable, to present consequences most efficiently. You must obviously differentiate material that would usually be incorporated in a study editorial from any unprocessed data or additional appendix matter that would not be available. In fact, such matter should not be submitted at all except requested by the instructor.



Content

- Sum up your conclusion in text and demonstrate them, if suitable, with figures and tables.
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- Present a background, such as by describing the question that was addressed by creation an exacting study.
- Explain results of control experiments and comprise remarks that are not accessible in a prescribed figure or table, if appropriate.
- Examine your data, then prepare the analyzed (transformed) data in the form of a figure (graph), table, or in manuscript form.

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- Do not present the similar data more than once.
- Manuscript should complement any figures or tables, not duplicate the identical information.
- Never confuse figures with tables - there is a difference.

Approach

- As forever, use past tense when you submit to your results, and put the whole thing in a reasonable order.
- Put figures and tables, appropriately numbered, in order at the end of the report
- If you desire, you may place your figures and tables properly within the text of your results part.

Figures and tables

- If you put figures and tables at the end of the details, make certain that they are visibly distinguished from any attach appendix materials, such as raw facts
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- You may propose future guidelines, such as how the experiment might be personalized to accomplish a new idea.
- Give details all of your remarks as much as possible, focus on mechanisms.
- Make a decision if the tentative design sufficiently addressed the theory, and whether or not it was correctly restricted.
- Try to present substitute explanations if sensible alternatives be present.
- One research will not counter an overall question, so maintain the large picture in mind, where do you go next? The best studies unlock new avenues of study. What questions remain?
- Recommendations for detailed papers will offer supplementary suggestions.

Approach:

- When you refer to information, differentiate data generated by your own studies from available information
- Submit to work done by specific persons (including you) in past tense.
- Submit to generally acknowledged facts and main beliefs in present tense.



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Methods and Procedures	Clear and to the point with well arranged paragraph, precision and accuracy of facts and figures, well organized subheads	Difficult to comprehend with embarrassed text, too much explanation but completed	Incorrect and unorganized structure with hazy meaning
Result	Well organized, Clear and specific, Correct units with precision, correct data, well structuring of paragraph, no grammar and spelling mistake	Complete and embarrassed text, difficult to comprehend	Irregular format with wrong facts and figures
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References	Complete and correct format, well organized	Beside the point, Incomplete	Wrong format and structuring



INDEX

B

Baldvinsdottir · 15
Biddle · 2, 5

D

Dengego · 25
Diredawa · 25, 29, 30, 33

H

Hararghe · 23, 25, 27, 28, 30, 31, 35

I

Imipenem · 3

K

Kyriazis · 3, 5

L

Lefkowitz · 2, 5

M

Machuga · 2, 5, 6
Michata · 25
Mirqana · 28
Misrepresentation · 11

O

Oromiffaa · 26

S

Symposiums · 9

W

Weygandt · 8, 12



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