URBAN INFRASTRUCTURE AND GOVERNANCE

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Accounting Reforms and Urban Governance: Necessary Conditions

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There was once a time, not so many years ago when accounting could be thought of as an essentially non-political subject

David Solomons, *Journal of Accountancy, 1978*

Governance reform context

One of the salient characteristics of the growth of emerging economies is the unprecedented expansion of urban centres. In India, urban centres and urban conglomerates are fast catching up with rural areas in terms of population. The growth of these centres has exposed the unpreparedness of urban centres in providing infrastructure and utilities, and establishing strong institutions and administration. The process of reform has to start from the engine of city management. Oft-mentioned handicaps of Urban Local Bodies (ULBs) are policy gaps, resource gaps and poor resource management, poor governance, poor leadership, etc. A key aspect of resource management is financial accounting; and Accounting Reforms (AR), the focus of this paper, is for most people an unlikely choice of topic when it comes to institutional and governance reform.

However, AR in ULBs as part of urban governance is now a well-received policy, and is part of the reform agenda of several countries. AR was implemented as part of administrative and governance reforms in New Zealand and Australia. USA brought a radical approach to government/municipal accounting through Statement No. 34 of the Government Accounting Standards Board (GASB). This has been a major departure from traditional government accounting that has been based on cash transactions.

In this paper, the AR in ULBs is discussed in the context of Urban Governance (UG). We have also highlighted the difference between Public Governance (PG) and Corporate Governance (CG); we have discussed how PG influences

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AR and is in turn influenced by it. In this context we also elaborate on aspects of Municipal AR, UG and PG. This helps in understanding the thrust of AR in the private sector and the public system, and explaining the different trajectories that these follow. For the purpose of illustration, we have taken the example of the Bangalore Municipal Corporation (BBMP).

Definitions of governance

The most common definition of CG is that it 'deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. How do the suppliers of finance get managers to return some of the profits to them? How do they make sure that managers do not steal the capital they supply or invest it in bad projects? How do suppliers of finance control managers?'[1] It is a narrow definition of CG and purely from the perspective of finance. A more common description is the oft-quoted one from the Cadbury Report, which defines CG as 'the way in which companies are directed and controlled'[2]. A broader definition of CG is given by the Organization for Economic Cooperation and Development (OECD): 'the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders, and other stakeholders, and spells out rules and procedures for making decisions on corporate affairs'[3]. This line of thinking comes closer to Public Governance because it talks about the balance of power, and distribution of rights and responsibilities among various stakeholders apart from shareholders. These definitions of CG are from Agency and Management Control perspective. Tricker defines CG as '…satisfying legitimate expectations of accountability and regulation by interests beyond the corporate boundaries'[4]. This definition makes two transitions—a shift from shareholder to stakeholder perspective, from organizational to beyond organizational boundaries, and also beyond financial perspective. This definition of CG is closer to PG, which considers the complexities of Public System in terms of defining organizational boundaries and stakeholders.

PG is more complex in scope and operation. There are these two definitions of governance at a macro level which are quite comprehensive:

> Governance is the exercise of political, economic and administrative authority to manage a nation's affairs. It is the complex mechanisms, processes and institutions through which citizens and groups articulate their interests, exercise their legal rights and obligations, and mediate their differences (UNDP).

> Governance is ... the traditions and institutions by which authority in a country is exercised for the common good. This includes (i) the process by which those in authority are selected, monitored and replaced, (ii) the capacity of the government to effectively manage its resources and implement sound policies, and (iii) the respect of citizens and the state for the institutions that govern economic and social interactions among them. (World Bank)

In recent times, the scope of CG has been broadened, and is closer to PG. According to Solomon, 'the basis for stakeholder theory is that companies are so large, and their impact on society so pervasive that they should discharge accountability to many more sectors of society than solely their shareholders'[5]. All these interpretations cover a range of stakeholders and emphasize accountability to these groups; recognize the conflicting nature of relationships and systems for the purpose of reconciliation; and also understand the power basis of relationships and the need for checks and balances.

These definitions lay stress on power and politics. In PG, it is about the relationship between the government and the agent, and the agent and the citizen. These definitions are esoteric and exist at a macro level; they are not useful as working definitions once we consider the micro level, i.e. organizational level. Ultimately, it is entities like municipal corporations, government hospitals and state-owned enterprises which are the front end organizations of the government, and it is in them that we are interested.

At another level, we will also explore the idea of Global Governance (GG) — the efforts to harmonize law globally. Global governance 'also implies ways of sharing responsibility between the public sector (regulation and supervision), the private sector (self-regulation), and civil society (democratic oversight)'[6]. So we have Global Governance, Public Governance, and Corporate Governance. The three vary in their focus: at the meso and inter-agency level (for example, regulatory agencies or public system); at the intermediary or inter organizational level (ULBs as organizations and as part of larger network systems); and at the micro or organizational level. State-owned organizations often operate as part of networks and at intermediate levels, and these are part of larger systems and integral to them. For policy makers, even a state-owned enterprise with profit objective is a microcosm of a larger system, and entity concepts are too subtle to matter. Here PG has more relevance than CG.

Aspects of corporate and public governance

Governance reforms in the corporate sector are about shareholder democracy, independent and professional board, compensation and agency issues, prudential norms and disclosure practices, etc. Recent reform initiatives have included conducting more formal audits of management performance, separating the positions of chief executive officer and chair, appointing lead outside directors, and making a company's board members more accountable to its outside shareholders[7]. OECD brought out revised principles covering the following areas: '(i) Ensuring the basis for an effective corporate governance frameworks; (ii) The rights of shareholders and key ownership functions; (iii) The equitable treatment of shareholders; (iv) The role of stakeholder; and (v) Disclosure and transparency, and (vi) The responsibilities of the board'[8]. The common themes are stakeholder rights, reporting and disclosures and role of boards as mentioned earlier. Shareholders dominate among stakeholders in the case of corporate governance whereas in the case of public system in the strict sense, the government is a shareholder only notionally speaking.

At the next level, there are principles of corporate governance. Ernst and Young lists out the following as principles of good corporate governance: 'Independent and effective Board of

Directors, Communications to Stakeholders, Internal Control & reporting, Risk management policies and procedures, internal audit function, and formal code of conduct'[9]. For Deloitte, key aspects of good governance include providing direction, establishing control, managing risk, maintaining integrity, sharing information, and focusing on results.

Once we shift the focus to public system, though governance is an issue, the related ones are about representative board, participative management, transparency, etc. In the context of Public Governance, the core characteristics of governance usually mentioned are[10]:

1. Participation
2. Rule of law
3. Transparency
4. Responsiveness
5. Equity
6. Accountability

The general tendency in PG is also towards prudential rather than regulatory norms like, Fiscal Responsibility Law, Right to Information, participatory budgeting, citizen-centric administration, etc.

OECD governance framework says that it should, 'clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities'. This provides a macro level definition, based on the principle of balance of power and division of responsibility. The capital market institutional structure works on this principle, which helps to handle the division of ownership and management. However, state-owned enterprises or public system organization often combine all these roles. For example, municipal departments at the state level are the policymaking and regulatory body apart from also being the implementing agencies. Increasingly, the trend in public system is towards correcting institutional imbalances through regulatory agencies and creation of autonomous corporations.