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Financial Disclosure in Local Governments: A Comparative Study

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The views expressed in this note are entirely those of the author and should not be attributed to the Institutions with which she is associated.

Contents

| | | |
|--------|---|----|
| 1. | Introduction..... | 3 |
| 2. | International climate and accounting reforms..... | 3 |
| 3. | International accounting/reporting standards..... | 7 |
| 3.1. | United States | 7 |
| 3.2. | Canada..... | 9 |
| 3.3. | Australia/New Zealand | 10 |
| 3.4. | Europe – Germany, France, Spain, United Kingdom | 11 |
| 3.4.1. | United Kingdom..... | 12 |
| 3.4.2. | Germany | 13 |
| 3.4.3. | France | 15 |
| 3.4.4. | Spain..... | 16 |
| 4. | India | 16 |
| 5. | Conclusions..... | 19 |
| 6. | References..... | 22 |

1. Introduction

This paper attempts to map out the financial reporting and disclosure practices prevalent in the public sector across the world. A specific focus is given to the US because of its considerable history in developing and enforcing reporting standards that have continually evolved in response to mounting demands on transparency and accountability in the public sector. The paper also examines the accounting and financial reporting reforms that have taken place in the public sector of certain European and Asian countries. This paper also examines in comparative context the significant reforms being introduced in the public accounting system in India over the past decade.

2. International climate and accounting reforms

During the past couple of decades, the authority and autonomy of local governing bodies across the world have expanded to a remarkable extent. The increasing urbanization seen across the world has created a demand for faster and better delivery of services to the citizens that live in these urban communities. This growing demand has necessitated that federal governments of most countries step up their decentralization efforts so that the civic bodies that are closest to the citizen are in a position to address citizen issues in an effective manner. Local bodies are increasingly being granted more autonomy to make infrastructure and other investment choices to keep pace with the growing economic demands of their constituencies. With this growing autonomy has come a greater need to equip local officials with a framework that will help them better manage the resources under their control, at the same time help present government transactions in a more true and fair manner than was done traditionally in the past. Accounting reforms have been crucial in introducing more efficiency and transparency into public wealth management by government bodies.

A significant step in these public sector reforms aimed at modernizing government accounting is the transition to accrual based accounting. The public sectors in a number of countries across the world have taken concrete steps to move towards accrual accounting and reporting, which has long been the mandate in the private sector. The governments of developed countries are committed to this transition owing to the obvious merits of the accrual-based system.

Accrual versus Cash Accounting

| Accrual basis | Cash basis |
|---|--|
| Recognizes income as it is earned | Recognizes income only when cash is received |
| Recognizes expenses as they are incurred; as resources are consumed | Recognizes expenses only when cash payments are made |
| Expenses are matched with income earned in any specific year | Matching of income to expenses not possible |
| Comprehensive presentation of an entity's financial position (including assets and liabilities), helps in better financial management | Does not capture assets and liabilities; only cash flows are captured, rendering decision-making ineffective and inefficient |
| Depreciation is linked to each fixed asset owned by the entity | No concept of depreciation since asset is expensed entirely right at the time of purchase |
| Effective management of receivables and payables, assets and liabilities | No records of receivables, payables, assets, liabilities. Consequently, management of these items are problematic |
| Full cost of service delivery can be ascertained; costs and revenue can be matched | Not possible |
| Financial institutions, rating agencies and investors can easily assess financial performance and viability of entity | Assessment is difficult because the entity's financial position is not reflected in totality |

This movement has gained traction worldwide with the introduction of a public sector arm to the International Federation of Accountants (IFAC), a global body that sets disclosure and reporting standards and ethical guidelines for the accounting profession. These global accounting standards will strengthen the functioning of global capital markets by providing more consistent and comparable information to investors and other users of these financial statements, which in turn will likely lower cost of capital for these entities as well cut preparation and audit costs.

The public sector arm of the IFAC - International Public Sector Accounting Standards Board (IPSASB), located in New York - focuses on developing accounting and financial

reporting standards for local/regional/national governments around the world. It uses the International Accounting Standards for the private sector as a basis for developing standards for the public sector. Its members comprise of nominated representatives from several countries. The IPSASB has no formal power and its adoption by governments is completely voluntary. Support from international organizations such as the OECD, NATO, UN and EC have strengthened the role of IPSASB as a platform for providing sound financial accounting, auditing and reporting standards. Additionally, the International Organization of Supreme Audit Institutions promotes use of the IPSAS.

Another international body is the International Accounting Standards Board, an independent standard-setting body of the International Accounting Standards Committee. The IASB works with national accounting standard setting bodies to promote convergence in accounting standards around the world. To this end, it offers the International Financial Reporting Standards, which are a single set of easily interpretable and high quality reporting standards for general purpose financial statements applicable to both the private and public sectors. Benefits such as ease in comparability and uniformity at a global level have increased the acceptance of these standards in many countries across the world.

Financial disclosure norms have historically been stronger for the private sector than the public sector, while budgetary disclosure is stronger in the public sector. This stems in part from the difference in emphasis on what each entity is accountable for. Private sector companies are created with the sole objective of generating a return on their investment and maximizing shareholder wealth. The competitive nature of the markets in which the different private sector stakeholders operate warrants stringent financial disclosure by an enterprise so that shareholder interests are safeguarded. Audited financial statements such as the Balance Sheet, Income & Expense Statements and Cash Flow statements are typically the reporting statements that served the external audience such as a shareholder, rating agency, or the capital markets. In contrast, the budget of a private sector entity is a management tool created and utilized for internal decision-making purposes only and is not shared in a public domain because of the proprietary nature of corporate activities.

On the other hand, as underscored in a recent report by IFAC¹, the sole purpose of the government/public sector is to provide citizen services. They achieve their objective by

¹ (International Federation of Accountants, 2006)

revenues generated from the taxes levied on the citizens whom they serve. Due to the involuntary and mandatory nature of taxes, citizens are entitled to hold governments to a very high degree of accountability. And governments are required to be transparent in their manner in which they spend public wealth. In most parts of the world, the annual budget of a government body has historically been its primary reporting tool for both internal and external audiences. The annual government budget was upheld as a document of special significance because it was the only public facing document that showcased a government's policy priorities. A citizen can hold a government accountable for non-compliance with this financial document. In fact, the document almost assumes law-of-the-land proportions in that it legally authorizes the government to spend public funds only as apportioned in the budget.

The differences in disclosure norms also stem from variation in the funding patterns. Companies have long been accessing the capital markets to finance their short- and long-term operations. Hence, there was a "felt need" for greater transparency in operations in order to secure the interests of a potential investor. Detailed financial statements were mandated by law to ensure that a company presents a true and fair position of its internal operations to the investing public. Governments, on the other hand, did not seek out capital markets for their financing needs until a few decades ago. Hence, the impetus from an investing public was clearly absent to improve their reporting and disclosure mechanisms. Even in the instances when a local government did raise debt externally, the debt was either state-guaranteed or as loans from banks and consequently considered risk-free. Above all, given an over-arching sentiment that governments cannot go defunct, government issues were largely viewed to be low risk and default-free. Consequently, regulation of government debt continues to be woefully inadequate in most parts of the world even today.

As a clear sign of changing times, governments are increasingly compelled to improve their disclosure and reporting norms. Watershed events such as the New York City default in the 1970s, Washington Public Power Supply System in the US in the 1980s drove some of the changes. The global financial meltdown of recent times has squarely brought to fore the need for more stringent regulations in financial reporting and disclosure even in the public sector. Governments worldwide are responding to this crisis by tightening regulations and mandating compliance with national and international accounting and financial reporting standards, as applicable.

Accurate and full disclosure of any material facts pertaining to a security is imperative for purposes of rational and informed decision-making by an investor. In other words, disclosure is an effective mechanism for investor protection. To quote a staff member of the Securities and Exchange Commission, USA, at a speech in Michigan to local governments in September 2000, “Disclosure defines the information age in municipal securities.”

3. International accounting/reporting standards

3.1. United States

Among developed countries, the US has some of the most transparent disclosure and reporting standards in place for both the public and private sectors. But even in this country, accounting and disclosure reforms have lagged in the public sector in comparison to the private sector. Because of the historical battle to preserve state’s rights (municipal securities are administered by states and cities that fall under the purview of states) and also because of the relatively lower risk associated with municipal securities, there exists very little federal regulation of municipal securities even today. However, the risks inherent in these securities became apparent in the 1970s and 1980s when a few municipalities began to default on their bond payments. As a consequence, accounting and reporting standard setting bodies for the public sector began to emerge in the US in these past two decades.

Financial disclosure of local governments is purely voluntary and there is an absence of any federal/state mandate or statute for disclosure. Full/any disclosure not required (by law) unless city is looking to raise public debt. So, disclosure is largely governed by demands of municipal market participants and antifraud requirements of the SEC. While it is recommended that local governments prepare comprehensive annual financial reports in addition to their annual budgets, it isn’t apparent if they are mandated to compile these statements and have them audited if they are not seeking debt in the public domain. On checking a few US city websites at random, most have their annual budgets on the website, not one had financial statements. Hence, it appears that budgets (estimate and actual) serve

as the internal and external reporting tool in most cases and not audited financial statements.

Municipal securities are not required to be registered with the SEC, unlike corporate securities. The SEC exerts very little authority over municipal issuers other than in instances of fraud. The anti-fraud provisions of Section 17 of the SEC Act of 1933 and Rule 10-5b under the 1934 SEC Act are applicable to municipal issuers. These are enforced via private lawsuits as well as SEC and federal prosecutors. That apart, Rule 15c2-12 under the 1934 SEC Act (created in 1989) requires primary and continuing disclosure of issuer information. However, this rule applies only to municipal dealers/brokers/underwriters, and not directly on the issuers. MSRB (Municipal Securities Rulemaking Board) is a self-regulatory organization created by the Congress/ SEC in 1975 to govern municipal broker-dealers. It provides professional guidelines for the municipal securities industry. But they again have authority only over dealers/brokers and not on issuers. In terms of issuer disclosure, MSRB requires the brokers/dealers to obtain adequate disclosure from the issuers. Continuing disclosure standard for purposes of secondary markets used to be 180 days but has recently been reduced to 120 days. Municipal issuers can file all financial statements at <http://emma.msrb.org/>, and anyone can access these statements.

GASB (Government Accounting Standards Board) is a professional organization that sets standards for financial reporting and formulates disclosure practices for state and local governments. They are similar to FASB and their guidelines are similar to GAAP (Generally Accepted Accounting Principles). Auditors of government financial statements look for compliance with these GAAP standards. GFOA (Government Finance Officers Association) issues recommended practices on important financial functions of state and local governments. This is to ensure better financial reporting quality.

The typical steps involved in raising external debt in the US are:

- Hire a financial advisor
- Iron out specifics of bond issue with advisor
- Secure credit rating for the bond issue (pay a fee to rating agency to get rated)
- Release Official Statement (equivalent to corporate prospectus)

- Comprises of audited comprehensive annual financial reports (Balance Sheet, Income/Expense, Cash Flows, Budget, Fund-wise financials, auditor summary, notes on statements, management analysis)
 - Purpose for issuing bonds
 - Revenue sources that will service the debt
 - Bond details – maturity date, payment, coupon rate, call price information etc
 - Credit rating of bond
 - Details related to bond insurance, state guarantees, other credit enhancements
- Advertise OS in the media to solicit bids/proposals from underwriters
 - Select winning bid with the help of the advisor. Bids are usually awarded on the basis of the lowest interest cost of the issue

3.2. Canada

Canada is the second largest issuer of municipal bonds outside of the United States and its disclosure practices and regulations mirror those in its neighbor. Federal intervention into state and local debt issues is restricted to merely upholding their investor protection and antifraud responsibilities. Canadian municipalities typically follow the Generally Accepted Accounting Principles recommended and maintained by the Canadian Institute of Chartered Accountants. The Board of the CICA has authorized the Public Sector Accounting Board to issue financial reporting standards as well as to provide guidance for financial and other performance information reported by the public sector. PSAB issues the GAAP for governments. It also issues guidance in performance reporting by issuing Statements of Recommended Practices.

Local governments prepare comprehensive annual financial reports and are required to make the audited financial statements as well as the auditor's report public by September 1 of the year subsequent to the financial year for which the statements are prepared. The auditors must be recognized on the basis of one of the Acts – The Management Accountants Act, The Certified General Accountants Act 1994, and The Chartered Accountants Act 1986. Canada, also a member of the GFOA, adheres to the GFOA's Disclosure Guidelines for State and Local Government Securities which outlines the recommended practices for new issues

and continuing disclosure practices for the secondary market. The typical annual financial statements prepared by local governments in Canada are:

- Statement of financial position (Balance Sheet)
- Statement of operations (Income & Expense Statement)
- Statement of changes in net debt
- Statement of Cash Flows

3.3. Australia/New Zealand

Like other developed countries, accounting reforms in the public sector in Australia picked up steam in the past two decades as a result of a growing demand for accountability and transparency in public sector operations. The public sector accounting standards board in Australia issued the first public sector accounting standard for local governments, AAS27, in the year 1990. This standard mandated that local governments should shift from cash based to accrual based accounting, and prepare financial reports, including Operating Statement, Statement of Financial Position, Statement of Changes in Equity and Statement of Cash Flows.

As of January 1, 2005, the Australian government has adopted the IFRS for both the private and public sectors, rendering the AAS27 standard obsolete. Sector neutrality between the public and private sectors has long underscored the Australian accounting standard setting process². Even in the neighboring New Zealand, the role of financial reporting in discharging accountability is considered the same for both private and public sectors. Governments at all levels are required to comply with the disclosure and general purpose financial reporting requirements prescribed under the IFRS.

While the reforms of these past two decades have helped infuse more transparency and accountability into the public sector reporting process, there are also reservations about the recent transition to the IFRS. A recent study on the benefits of the shift to IFRS in the public sector indicates that the significant cost associated with transition does not justify the additional benefits derived from it, especially because the local governments are too busy complying with the increased reporting requirements rather than focusing on

² (Chalmers et al, 2007)

improving their operational efficiency. It is also felt that the adoption of standardized accounting policies and reporting standards allow significant room for interpretation by the account preparers and it is quite possible to choose accounting policies that will “dress-up” the financial position and performance of the entity.³

New Zealand shares a similar history in accounting reforms with its neighbor Australia. The 1990s saw an increasing convergence in the reporting standards and practices between the public and private sectors. The public sector accounting committee, which set standards for public sector accounting was disbanded and all levels of governments were required to adhere to the standards set by the Institute of Chartered Accountants of New Zealand, approved by the Accounting Standards Review Board. The Local Government Act requires that the financial statements produced include – Statement of Financial position, Overall Operating Statement, Statement of Cash Flows and any other statement that will represent the financial position of the local authority in a true and fair manner. Like Australia, New Zealand took the lead recently to shift to the reporting and disclosure practices proposed by the IFRS.

3.4. Europe – Germany, France, Spain, United Kingdom

Historically, the US and most European countries have represented two different accounting contexts in terms of public management – The Anglo American and European Continental. The Anglo-American countries (United States, Australia, Canada, New Zealand, and United Kingdom) have adopted territorial decentralization; with the local governments holding autonomy and authority independent of the centre.⁴ Local governments in these countries are free to approach capital markets to meet their investment needs with minimal to non-existent federal intervention. Such countries assume the public sector to be not very different from the private sector, and the citizen no different from a shareholder. Consequently, they are more likely to introduce market reforms and adapt private sectors experiences and reforms to the public sector as well. This in turn necessitates transparency in public sector operations and disclosure and reporting requirements that are comparable to the private sector. In most of these countries, the financial accounting system for

³ (Dr. Pilcher, 2008)

⁴ (Blidisel, 2008)

reporting purposes is independent of the budgetary system. Local governments and other public institutions that participate in the capital markets generate financial statements – Balance Sheet, Income & Expense Statement, Cash Flow Statement – similar to the private enterprise. These countries are early adopters of any reforms for modernizing their accounting and reporting systems.

On the other hand, accounting and public administration in the European Continental countries (Belgium, France, Germany, Greece, Portugal, Romania and Spain) are a legacy of bureaucratic and hierarchical structures with a strong basis on administrative law⁵. Most of these countries have interconnected financial accounting and budgetary systems. The budget holds a special significance since it showcases a government's public policy priorities. It is a formal document of government accountability. Consequently, the accounting systems in these countries are conditioned to monitor the budget. European System of Accounts (ESA 95) is the standard that European Union member countries must follow for preparation of government financial and forecast statements. Auditing in public sector is carried out by government-owned auditing firms, and not by independent professional audit firms. Standard setting bodies such as the GASB do not exist for the accounting profession. Hence, these countries need to rely on international standard setting bodies in financial accounting, reporting and auditing in order to carry out any improvements within their government accounting and audit.

As in the US, the nineties have witnessed a number of government accounting reforms being introduced in Europe. However, the reforms being introduced are quite diverse across countries and the present situation of local government accounting in Europe is best characterized by considerable heterogeneity.⁶

3.4.1. United Kingdom

The United Kingdom was the bedrock of many developments in the accounting profession in the 19th Century. Owing to its considerable history, accounting and reporting practices in the UK have always been quite advanced in comparison to the rest of the world. The accounting practices of local governments have been on par with that of business

⁵ (Blidisel, 2008)

⁶ (Vela et al, 2000)

accounting practices. In fact, the UK government is now in the process of switching over from UK GAAP to the International Financial Reporting Standards (prescribed by the International Accounting Standards Board), in a move that is meant to bring public sector accounting practices more in line with the private sector. And by 2010/11, local authorities will prepare their annual accounts in accordance with the IFRS. Currently, local governments in the UK adhere to the Statement of Recommended Practice or the Code of Practice on Local Authority Accounting developed by the Chartered Institute of Public Finance and Accountancy, which is line with the UK GAAP for the private sector. The SORP recommends annual disclosures by all local governments in the form of:

- Balance Sheet
- Income& Expense Statement
- Statement of Total Recognized Gains and Losses
- Cash Flow Statements
- Detailed notes on accounting practices

While the National Audit Office (under the control of the Comptroller and Auditor General) audits central government accounts, the financial statements of local governments are audited by the Audit Commission for Local Authorities, a public corporation established under the Local Government Finance Act 1982. This commission is similar in its audit functions and responsibilities to the Local Fund Audit in India. However, unlike the LFA in India whose responsibilities are restricted to just auditing financial statements, the Commission in UK is empowered to inspect a local's authority's performance of its functions and also its compliance with this duty. Another independent standard setting body is the Financial Reporting Advisory Board, which plays an independent role in offering financial reporting guidelines to public sector entities, much like the GASB in the US. It shares a Memorandum of Understanding with public sector entities in providing its financial reporting guidance. Currently, it is in the process of reviewing whether the interpretations by the local governments of standard accounting practices or IFRS are accurate and applicable to the public sector.

3.4.2. Germany

In Germany, the mandate for government accounting, reporting and auditing is outlined in the Budgetary Principles Act and the Federal Budgetary Act. Government financial reports are audited by the Federal Court of Audit. The Minister of Finance who is responsible for the reports submits them to the parliament once the audit is complete. The government budgeting and accounting at all three levels of government (federal, state, local) is regulated by law and not by any governmental/external standard-setting body such as the SEC. Also, the Budgetary Principles Act provides the framework for unified accounting for all levels of government. The traditional accounting system is cash-based and the core objective of government reporting is to ensure compliance of actual receipts and disbursements to the budget. So, the traditional accounting system recorded only the transactions that impacted the budget. Accounting for assets and liabilities only included financial assets/debts, while physical assets, though recorded, were not valued.

The 1970s and 80s saw huge budget deficits due to German unification with a huge spike in public debt and interest expenditure. And the traditional accounting system was found to be highly inadequate to understand efficiencies in the public sector. Spurred on by a need for improved efficiency and increasing corporatization in the public sector, it is only in the past decade that there is a national debate to bring about governmental accounting and budgetary reforms⁷. In 2003, the legal framework to the Municipal Budget Act was laid out for the local governments, whereby they have the “option” to switch from their traditional cash based system to an output and accruals based budgeting and accounting system. Pilot projects have been undertaken in several cities with basic features such as:

- A defined chart of accounts
- Double entry book-keeping
- Accruals based financial accounting
- Accruals based financial reporting (consolidated balance sheets, operating statements and cash flow statements)
- Accrual based budgeting statements

Given that these reforms are not mandated, the transition for local governments is expected to span over several years. As for the state and federal governments, the

⁷ (Luder, 2003)

Budgetary Provisions Act still does not allow states to abandon their traditional accounting and budgetary practices (Luder, 2003). The pilot projects run at the state levels are fraught with issues such as poor preparation, insufficient coordination and software issues (Luder, 2003). The increasing international relevance and applicability of the IPSAS and accounting reforms in other EU member states and in the developed world at large are strengthening the cause of speeding up reforms within Germany (Luder, 2003).

3.4.3. France

France is traditionally a centralized state, with the central government holding primary control over legislation and taxation. However, the past two decades have seen a definite shift towards decentralization, with a transfer of authority from central to local governments. This decentralization has provided an impetus to bring about reforms in governmental accounting and budgeting practices. The Budget Act governs the government accounting system in France, which had until quite recently followed a cash based accounting system. The Constitutional Bylaw on Budget Acts was passed in 2001, requiring centre and local governments to transition to accrual accounting a reporting framework over a multi-year time period. From the most recently available literature, it doesn't appear that these reforms have been completed yet. Under the cash based system, when local governments in France raise public debt, the presale disclosure requirements to prospective buyers of the public issue are:

- Local government financial health; budget features over a 2-3 year period, details of all outstanding liabilities and debt, details of off-budget items
- Information pertaining to the quality of security being issued
- Local economy structure and performance characteristics that will shed light on the risks and repayment capability
- Tax and fee collection efficiency

Continuing disclosure regarding the budget is mandated; and the borrower is also obligated to inform investors about any material events affecting the repayment ability of the public issue. All local governments are also required to file a detailed description of any

outstanding debt as an annex to the annual budget, which is filed with the central government.

3.4.4. Spain

Following in the tradition of European-Continental countries, accounting and budgeting standards in Spain are set by law and compliance of financial reporting to legal and administrative rules is of paramount importance. Until the 1980s, the budget and cash based single-entry accounting were the key tools of public finance management and reporting. The political transition to democracy in the 1970s, bringing about a favorable political and administrative approach, was the precursor for significant reforms within government budgeting and accounting in the following decade. As can be seen in other European countries such as France, Sweden, Switzerland and Belgium, business accounting practices had a significant influence on the development of accounting for municipalities in Spain. Even the chart of accounts that municipalities use is based on the chart of accounts developed for business entities in 1973.⁸ It is noteworthy that the role of capital markets in the reform process was very marginal compared to other countries because issuance of bonds was not a common practice in Spain. The financial reports of Spanish local governments comprise of⁹:

- Balance Sheet
- Operations Statement
- Statement of Budgetary Execution
- Notes that contain other financial statements such as statements of cash flow and statement of public borrowing

4. India

In India, as in most countries around the world, local governments are decentralized entities, with their activities falling under the purview of the states in which they are located. Each municipality is governed by its own Municipal Act, which details all the roles, responsibilities and in certain cases, even disclosure requirements for the municipality.

⁸ (Vela et al, 2000)

⁹ (Torres, 2003)

However, the municipal act provisions are typically not very specific in addressing issues such as accounting methodology, type of financial statements, the timelines for preparing these statements and releasing them for audit, and later to the public and the importance of internal and external audit.

The past decade has seen a number of accounting reforms being introduced in the public sector in India. As in other parts of the world, these reforms are driven by the increasing financial and investment needs of growing cities. It is quite reasonable for a lender – be it the government, financial institutions or individual investor – to demand full and fair disclosure of a municipality's operations in order to assess the viability of the investment. One of the consequences is the growing thrust on local governments to shift from cash to accrual based accounting and financial reporting. A recent report from ICRA highlights some of the drivers as:¹⁰

- Institute of Chartered Accountants of India (ICAI) Technical Guide on ULB Accounting and Financial Reporting, 1999
- Recommendation of the Eleventh Finance Commission, 2001
- Directive by the Supreme Court, 2001
- Pre-requisite for funding under the Urban Reform Initiative Fund
- Recommendation of the Task Force Report, 2002, of the Comptroller & Auditor General (C&AG)
- Release of National Accounting Manual by the C&AG and the Ministry of Urban Development, Government of India, 2005
- ICAI Committee for Local Body Accounting Standards, 2005
- ICAI Exposure Draft, 2006
- Pre-requisite for funding under the National Urban Reform Mission, 2006

The Ministry of Urban Development has collaborated with the C&AG and ICAI to propose a detailed chart of accounts, accounting standards and recommended financial statement formats for local governments. Also available are in-depth training manuals that provide a thorough understanding of and assistance in developing these standards and statements for any municipality. While the annual budget still appears to be the governing

¹⁰ (ICRA Limited, 2006)

tool in any municipal body in India, municipalities that seek financial assistance from external entities must prepare detailed financial statements. These financial statements include:

- Statement of Financial Position (Balance Sheet)
- Statement of Income and Expenses
- Statement of Cash Flows (Receipts and Payments)
- Detailed notes on accounting and reporting practices

As mentioned earlier, the municipal acts in India do not mandate the provision of financial statements in a standard format. It appears that any reform that is proposed at the centre or state is communicated to local governments in the form of government orders and not as an amendment to the Municipal Act itself. Again, it is unclear whether such intimation of government orders happens uniformly across the board. Compliance and enforcement appear to be huge issues as revealed from discussions with municipal corporations in Tamil Nadu and the Local Fund Audit.

Several municipalities in states such as Tamil Nadu, Karnataka, Andhra Pradesh and Gujarat are already preparing annual statements on an accrual basis but reform does not appear to be uniform across the country. Even in these municipalities, issues such as non-maintenance of asset ledgers, lack of valuation of capital assets, lack of adequate internal controls and quality control monitoring, absence of internal audit, highly unreliable data quality caused by manual maintenance of asset and liability records or inadequate to non-existent e-governance systems, lack of controls or integration in e-governance systems, and limited training affect the workings of the system. While some of these issues are prevalent in other countries as well (capital asset valuation in the public sector is a highly debated issue as is software integration), training, quality control, and accountability appear to be additional overarching issues in the Indian context.

It is also not clear whether there is a common mandate for all municipalities to file these statements within a specific time period every year. For example, talks with the Corporation of Chennai indicate that these statements have to be filed by June 30 of every year to the Local Fund Audit (a local government audit body created under central government mandate in all states and falls under the control of the state government). It is

however very rare that the municipalities file these statements for audit within the stipulated time period. Very often, extensions for filing are sought and these extensions might even extend to several years. This maybe attributed in part to absence of any formal enforcement mechanism.

It is also important to bear in mind that imposing timeliness mandates for reporting on local governments in India might be somewhat premature because the municipal finance market is not developed well enough to warrant that. In developed municipal bond markets such as the US, timeliness in providing financial information is imperative because market players' decisions will be influenced by the information disclosed in these statements. More importantly, timeliness mandates in India might have an adverse impact on data quality. Under pressure to meet a government imposed deadline, local governments might be forced to compromise on the data that gets reflected in their statements. Hence, any reforms mandating timeliness in financial disclosure must carefully weigh the relative merits of timeliness against the reliability of data quality.

The reforms proposed under the 74th Constitutional Amendment include adoption of accrual based accounting and passage of a Public Disclosure Law to facilitate quarterly performance information of municipalities to all stakeholders. These reforms as well as the efforts taken by the MoUD, CA&G & ICAI in achieving these reforms are clearly steps in the right direction to address the multitude of issues that afflict local government affairs in India.

5. Conclusions

The preliminary findings from this comparative study indicate that accounting reforms in the public sector across the world have taken center-stage only in the past two decades. While countries such as the United States, United Kingdom, Canada, Australia and New Zealand have comparatively better and more transparent disclosure practices, other countries, including India, are fast catching up in introducing reforms that will revamp their public sector reporting and disclosure. Cash accounting has been the norm even in developed countries such as France and Germany and these countries are still in various stages of transition to the accrual accounting system. While there appears to be limited

correlation between the stability of capital markets and the degree of financial disclosure, as evidenced by the recent financial crisis, governments are recognizing that disclosure is a key component of good governance. The Indian government has taken a number of steps in this past decade to introduce more transparency into local government operations. Key reforms include e-governance, accrual accounting, model financial statements and training manuals that can be used by all local governments. The failure appears to be more in the implementation of these reforms. Most states are yet to comply with the accounting and e-governance requirements. And those that have complied are ridden with other, equally serious operational issues.

Comparison of worldwide disclosure practices:

| Country | Accrual Accounting/Reporting | Disclosure (Mandatory/Voluntary) | Financial Statement Standard |
|----------------|---|---|------------------------------|
| UNITED STATES | Yes | Voluntary, but mandatory for cities accessing capital markets | GASB |
| CANADA | Yes | Mandatory | PSAB |
| AUSTRALIA | Yes | Mandatory | IFRS |
| NEW ZEALAND | Yes | Mandatory | IFRS |
| UNITED KINGDOM | Yes, since 2000 | Mandatory | IFRS |
| GERMANY | Some, cash statements being supplemented with accrual information | Mandatory budget statements | ESA 95 (#) ¹¹ |
| FRANCE | Some, being introduced | Mandatory budget statements | ESA 95 (#) |
| SPAIN | Modified accrual | Mandatory (#) | ESA 95 (#) |
| ITALY | Yes | Mandatory (#) | ESA 95 (#) |
| SWEDEN | Yes, since 1994 | Mandatory (#) | ESA 95 (#) |
| INDIA | Some, being introduced | Mandatory (#) | NMAM |

¹¹ (#) Literature review being done to re-confirm that the data are current.

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