



## Analysis of Municipalities Financial Management in India

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### ABSTRACT

The term 'Finance Function', as per modern approach, denotes procurement of funds and their effective utilization in the business. Under this, finance function covers financial planning, forecasting of cash receipts and disbursements, the realizing and recovering of funds, allocation of funds, and utilization of funds in the best possible manner, and financial control. This approach also entails a decision-making after analysing alternative uses and sources of funds. Thus, finance function deals with the three major decisions that any form of organization must make investment decision, financing decision, and dividend decision.

These decisions are interrelated and hence, their joint impact must be taken into account. Also, management has to evolve optimal combination (mix) of these decisions to maximize the wealth of the firm. This research on '*Analysis of Municipalities Financial Management in India*' was undertaken. For this research purpose, the researcher has made exhaustive use of earlier detailed review/research regarding financial management of 19 municipal corporations. The base on which all the conclusions have been drawn is very small, and therefore should be interpreted cautiously. Further urban development in India is managed by various urban development authorities and special purpose bodies. This study has focused on municipal financial management system and not that of other bodies. But it is utmost necessary that financial management stems of such development and special purpose bodies should be reviewed. The study has covered only three broad areas (1) Tools of financial analysis and forecasting, (2) short-term financial management, and (3) long-term financial management. This study has dealt with some micro aspects of municipal finance and it has not covered macro aspects or new challenged and opportunities of liberalized market oriented society.

## ***Introduction:***

The structural reforms or economic liberalization process initiated by the Government of India, since July 1991, has now consolidated its position and has stabilized the Indian economy to a great extent. It seems that there will be no reversal in this liberalization process and in coming years, the Indian economy will tune up with global economy. Though structural reforms process has very well set in, it has not yet percolated to the state or local government level. Similarly, other sectors of economy especially the urban infrastructure and basic urban services sector have lagged far behind in the liberalization process. In coming years, state or local governments will have to respond to it rather will have to adopt it. But this process, as far as the augmentation of urban infrastructure is concerned, cannot be left to natural course of adoption of reforms process. For the high industrial growth based economic revival program Indian Government is pursuing the augmentation of necessary urban infrastructure is must/essential for it. Perceiving this situation, though urban development is a state subject, the Indian Government has initiated the process of liberalization and reforms of urban infrastructure and urban services sector. As a first step, the Indian Government affected 74th Constitutional Amendment Act in 1992. Along with the implementation of this Constitutional Amendment the Central Council of Local Government resolved to bring out greater reforms and improvements in the functioning, performances and management of Urban Local Bodies. In order to implement the resolution of the Council, a Committee of State ministers and a Steering Committee under the chairmanship of Secretary (UA) have been set up. These decisions are interrelated and hence, their joint impact must be taken into account. Also, management has to evolve optimal combination (mix) of these decisions to maximize the wealth of the firm. This research on ` *Analysis of Municipalities Financial Management in India*’ was undertaken on behalf of this committee and the findings of the research are presented as follows.

### ***Why Municipal Financial Management?***

Urbanization is a truly global phenomenon. It is expected that urbanizations will continue to be rapid and the anti migration policies will not have a measurable effect on growth of urban population. For the rest of this century, the rate of urban population growth in developing countries is projected to be about 3.5 percent, some three times the rate of rural growth. Whereas in 1960, developing countries had an urban population of 460 million, by 1990 it rose to more than, 1.3 billion, and by 2000 it will rise to almost 2.0 billion. (U.N. Centre for Human

Settlements. 1987,23) The way urbanization is a global reality; urban India is also a stark reality. By turn of century, India's urban population is expected to cross 330 million marks in 2000 A.D. With Projected growth at such rates, the problems of urban growth and that of large cities are going to be highly complex, acute and of urgent nature. At the head of the list of problems will be that of how to finance adequate delivery (requirements) of urban services and municipal financial management.

In tune with the global shift towards reduction of tax rates, liberalization and reduction in government spending, the present government has successively reduced tax rates, liberalized economy and attempted to limit its spending. Not only this, the role of government itself is undergoing a complete change from its present role of a 'Provider' of all the things to that of a 'facilitator' and of a 'regulator'. The direct fallout of structural reforms program has been less government spending on infrastructure, and various demand creating activities, less transfer of funds to lower-level governments etc. Thus, even though there is huge backlog in infrastructure sector, and liberalization process will further accentuate urbanization process and demand for infrastructure services, it is less likely that budgetary allocation for urban sector will increase. But without necessary augmentation of urban infrastructure, it will not be possible to achieve high growth rate of industrial and economic development. Consequently, central government will have to take undertake non-budgetary, non-monetary measures such as –

- Structural improvement of urban local bodies in all respects - legislative, administrative, financial.
- Revamping of other special purpose urban local bodies.
- Liberalizing urban infrastructure sector for private participation providing adequate incentives and conducive competitive environment to them.

Apart from this macro/national level scenario, in coming days, urban local bodies will be under constant scrutiny/gaze from above (higher level governments) and from below (individual citizens, voluntary organizations, business groups etc.). They will lose monopolistic and protective advantage and will be exposed to stiff competition from private sector and market mechanism. The urban local bodies (municipal bodies) will be left with only two courses of action -

- To improve their own efficiency by improving all the aspects of management to generate maximum quantity of urban services. One of the major areas, which at present does not exist properly or is grossly unattended, is internal financial management.

- The great efforts by municipal bodies by improving their efficiency in all respects will yet fall short of desirable level of urban services. This is so, because urban infrastructure requirements are enormous.

Accordingly, municipal bodies will have to explore all the possibilities of alternative institutional arrangements (pub-pvt, pub-pub, pub-ngo, pvt-pvt etc..) to shoulder the responsibility of providing adequate urban services and infrastructure. As finance is an all-pervading activity, that is a thread running through all affairs. And as financial management is related to efficient augmentation and utilization of resources, it should be the first and foremost area of reforms in municipal management in order to improve its overall efficiency to cope with future challenges of urban sector.

### ***Finance Function:***

The term 'Finance Function', as per modern approach, denotes procurement of funds and their effective utilization in the business. Under this, finance function covers financial planning, forecasting of cash receipts and disbursements, the realizing and recovering of funds, allocation of funds, and utilization of funds in the best possible manner, and financial control. This approach also entails a decision-making after analysing alternative uses and sources of funds. Thus, finance function deals with the three major decisions that any form of organization must make investment decision, financing decision, and dividend decision.

These decisions are interrelated and hence, their joint impact must be taken into account. Also, management has to evolve optimal combination (mix) of these decisions to maximize the wealth of the firm.

### **The Investment Decision:**

The most important decision of all the three decision-making areas is the investment decision. Capital budgeting, a major aspect of this decision, is the allocation of capital to investment proposals whose benefits are to be realized in future. As the future benefits are not known with certainty, investment proposals necessarily involve risk. Consequently, they should be evaluated in relation to their expected return and the incremental risk they add to the firm as a whole. This area of decision-making also includes decision to reallocate capital when an asset no longer economically justifies the capital committed to it. Efficient management of current assets, liquidity etc. also forms part of this area.

### ***Financial Management:***

Financial management is essentially an attempt to provide the solution of the three areas of decision-making discussed above. In simple terms it means the entire gamut of managerial efforts devoted to the management of finance (both its sources and uses) of the enterprise. Traditionally, the basic objectives of Financial Management were the maintenance of liquid assets and maximization of the profitability of the organization. It has undergone a change. Today ultimate objective of financial management is maximization of wealth.

The objective of wealth maximization holds good for municipal financial management also. As we all know municipal bodies or any governmental form of organization exists not for 'profit maximization' but for 'wealth maximizations. In order to improve overall standard of living of people or society, government needs to maximize wealth and then to ensure equal distribution of wealth generated. Similarly municipal bodies are expected to attain objective of wealth maximization through judicious allocation and utilization of resources. In order to achieve this objective, municipal bodies must run their finance function as per modern financial management science as the discipline of financial management strives for 'wealth maximization'.

### ***Financial Management in Municipalities - Overall Scenario:***

The discussion above clearly indicates that municipal bodies must have efficient financial management process. The formal survey of 19 municipal corporations and informal survey of numerous municipalities reveals very dismal picture. In more than half of the municipal corporations and almost all of the municipalities there does not exist any finance function. The account or finance department is very low in administrative status or hierarchy and carries out mere bookkeeping job, that too inadequately, as accounting and auditing work remains pending for more than one year. The overall average picture about existence and application of various financial management concepts/techniques/systems is as follows -

- Only one-third municipal bodies have utilized one or more tools of financial analysis.
- Out of various techniques of financial forecasting only one technique is applied by half of the municipal bodies, while the municipal bodies have not applied other techniques.
- Concept of cost of capital is applied only in four municipalities (out of 19) while taking various important decisions.
- On an average only half of the municipal bodies utilize various short-term financial management technique like cash budgeting, Working Capital Budgeting, Inventory Controlling etc.

- Only one-fourth of the municipal bodies have the system of preparing long term development planning.
- In respect of having full-fledge formal project evaluation and selection process, only five municipal bodies have the practice of preparing project reports with all detailed analysis. But again, such exercise is regarding technical and administrative aspects or uses analytical techniques like - NPV, IRR etc., for project evaluation and selection.
- Financial and budgetary control over expenditure is very weak in case of more than half of the municipal bodies. Accounts department in these municipal bodies come to know about payments only at the time of payment.
- In most of the municipal bodies, overall recovery performance hovers around the 50 per mark and outstanding accounts receivables runs into millions of rupees.

The above-mentioned survey statistics about existence and application of various financial management concepts/techniques by municipal bodies project a very dissatisfactory picture. A one-to-one relationship between absence or weak financial management and bad financial health of a municipal body cannot be established; but wherever good financial discipline and financial management existed, those municipal bodies have performed much better compared to other municipal bodies of similar size and type. In megapolis category Bombay Municipal Corporation, in 10 to 15 lacs population category Baroda and Bhopal, and in below 10 lacs population category cities Rajkot Municipal Corporation can be pointed out as examples of this analysis. These municipal bodies faced identical problems as faced by the other municipal bodies of their size and type; still their performance (especially in the financial terms) is much better than others. This survey indicated that it is not important whether municipal bodies levy octroi or not, whether it has sufficient resources; or whether it is in surplus or deficit. What is really important is whether it has optimised utilization of and returns from its resources. There is no doubt that municipal bodies suffer from internal or macro factors like inadequate resources, inappropriate grant-in-aid or devolution of funds by higher level governments, various defective and outdated legislations etc., But this is a half truth, there is other side of coin also. Municipal bodies equally suffer from internal or micro factors like rudimentary administration, improper and wasteful utilization of scarce resources, non-augmentation or under-utilisation of resources, lack of technical know-how and professionalism etc. Unfortunately, these micro aspects or internal defects never received due attention. Municipal bodies by improving their internal/micro defects can improve their performance if not by 100 per cent but at least by 25%

to 30% of overall performance. The budgets of these municipal bodies run into millions of rupees and overall, 10 to 20 per cent improvement in efficiency through introduction of modern management and financial management systems/processes, can lead to additional resources mobilization worth millions of rupees. A case study-cum-success story regarding the various budgetary and financial control reforms carried out by Baroda Municipal Corporation clearly indicates and proves what benefits can accrue to a municipal body by adopting scientific financial management systems or be improving existing financial processes/systems. The case study is presented at the end of this paper. The various financial system reforms carried out by the Baroda Municipal Corporation are of micro/internal nature and can be easily replicated in other municipal bodies.

### ***Financial Management in Municipality - Detailed Scenario:***

The inquiry/survey about the basic areas of Financial Management that is conceptual frame work of this discipline and tools of financial analysis and forecasting showed that the awareness level is very low, even where the aware of the concepts and techniques existed, the authorities did not apply them. This is so because finance function has been given residual importance by all the functionaries. The non-professional people handle financial operations, accounting and auditing work in case of 90 per cent municipal bodies. Though the budgets of various municipal bodies run in to millions of rupees, and accounting transactions number more than lacs, these municipal bodies do not have separate accounting cadre or the subordinate personnel having adequate accounting background. There is no standardization of municipal accounting and financial processes, and wherever it exists it is based on single entry accounting (cash based) system. This makes inter-municipal comparison impossible. The survey findings regarding application/presence of various financial techniques/tool/concepts in municipal bodies are presented as follows.

### **Financial Analysis and Financial Forecasting:**

The various tools of financial analysis are useful to diagnose the financial condition of the organization and to suggest definite solutions to the financial problems, while tools of financial forecasting visages a systematic approach to planning. In municipal bodies application of both type of these very important tools is grossly lacking. The details are as follows.

### **Fund-flow Analysis:**

Annual Statement (Balance-sheet), which depicts financial status of an organization at a certain point of time, is not much useful as far as financial planning and analysis is concerned.

An organization to have effective financial management must constantly analyse its financial operations, changes, movements etc. Funds-flow analysis and Cash-flow analysis help management to analyse financial operations and movements of fund. Its utility is not limited only to analysis of past trends but it can be utilized to show how a firm should acquire and employ funds during some future period. Though at present not widely utilized in municipal bodies, it can be a very useful tool of financial analysis and planning for the municipal bodies.

|                                 | Awareness |   | Applicability Of technique |   | Actual Application |    |
|---------------------------------|-----------|---|----------------------------|---|--------------------|----|
|                                 | Y         | N | Y                          | N | Y                  | N  |
| <b>Cash-flow Analysis</b>       | 16        | 3 | 16                         | 3 | 14                 | 5  |
| <b>Funds-flow Analysis</b>      | 16        | 3 | 15                         | 4 | 7                  | 12 |
| <b>(Total Respondents - 19)</b> |           |   |                            |   |                    |    |

It can be observed from the data that there is considerable awareness and positive opinion about applicability of these techniques in municipal management. Compared to this the actual application is less. Another fact that emerges from the data is that 'cash-flow analysis' is utilized more compared to 'funds-flow analyses'. This is so because almost all the municipal bodies have cash-based (single-entry) accounting system. Because of this, they are not conversant with 'funds' concept. Still by creating necessary system 'funds flow analysis' can be prepared with cash-based accounting system.

### **Ratio-Analysis:**

Ratio analysis, the process of determining and interpreting numerical relationships based on financial statements, is very much applicable in municipal environment. This analytical tool suffers from various limitations; still, this is a very simple analytical tool, which helps one to locate/diagnose problematic area, and therefore municipal bodies should utilize it. The Survey of 19 municipal bodies indicates that in more than 74 per cent municipal bodies there is awareness about this tool of financial analysis and a feeling that this tool can be applied in municipal environment to carryout various kinds of financial and performance analysis. In spite of good awareness this tool is applied by only 7 (seven) municipal bodies out of 19 municipal bodies surveyed. The main reasons for non-application of ratio analysis in municipal administration are



1. Non-availability of knowledge/evolution of suitable tailor-made ratios to evaluate various aspects of municipal administration.
2. Absence of appropriate standards for comparison.
3. Inadequacy or absence of management information system and
4. Performance parameters.

If these barriers are removed, ratio analysis can be successfully applied in municipal management.

### **Break-even Analysis:**

Break-even analysis is a very important tool of financial analysis, which deals with cost-volume relationship. The manager of any organization needs to know the behaviour of costs with change in volume so that he can plan out the activities in such a way that appropriate volume of activities is undertaken. Break- even analysis also helps in resource planning activities and capital budgeting by providing a rational and scientific approach. There can be no doubt about its utility for profit seeking organizations, but this tool is also very useful for non-profit seeking organizations like municipal bodies. This is so because knowledge of how costs fluctuate in response to change in volume is valuable regardless of whether profit is an objective or not. After all, no organization has unlimited resources. Thus, in case of municipal bodies this tool is specifically useful for allocation of limited resources to various competing activities and determining the financing needs to accommodate the changes in volume. Further, the knowledge of cost behaviour helps to minimize costs and maximize returns. These returns may not necessarily be only of financial nature, they can be of developmental or social nature also. This makes the application of break-even analysis very beneficial to non-profit seeking organizations like municipal bodies. Unfortunately, very few municipal bodies actually use this technique. The survey revealed that although eleven municipal bodies out of nineteen knew about this technique and also felt that it was applicable, only six municipal bodies actually used this technique.

### **Financial Forecasting:**

Financial forecasting is not a continuous and formal process in municipal bodies. Financial forecasting mostly forms a part of budgeting exercise carried out annually. In fact, municipal budgeting exercise itself takes form of 'Projected Income Statement' utilizing simple

incremental or thumb-rule approach. The survey about the application of various techniques of financial forecasting by the 19 municipal bodies revealed following picture.

|           | <b>Name of the technique</b> | <b>Awareness</b> | <b>Applicability</b> | <b>Actual Application</b> |
|-----------|------------------------------|------------------|----------------------|---------------------------|
| <b>1.</b> | Projected Income Statement   | 16               | 16                   | 13                        |
| <b>2.</b> | Projected Balance Sheet      | 14               | 14                   | 5                         |
| <b>3.</b> | Per cent of Sales/Activity   | 10               | 10                   | 0                         |
| <b>4.</b> | Scatter Diagram              | 9                | 9                    | 0                         |
| <b>5.</b> | Simple Regression            | 6                | 6                    | 0                         |
| <b>6.</b> | Curvilinear Regression       | 5                | 5                    | 0                         |

It can be observed from the above data that 'Projected Income Statement' is the most widely utilized technique of financial forecasting. But as pointed above, its application is limited to annual budgeting exercise. Compared to this technique, 'Projected Balance Sheet' technique is utilized scarcely. This is in spite of the fact that there exists an equally good awareness among the accounts and audit officers of the municipal bodies, yet, the main reason behind non-application of this forecasting is the present (cash-based) single entry accounting system. Accrual base double entry accounting system is necessary for the preparation of 'Projected Balance Sheet'. In coming years, as municipal bodies will switch over to (accrual base) mercantile accounting system, this forecasting technique will find more and more application in municipal managements far as the newer, statistical forecasting techniques are concerned, there is awareness to some extent, but these techniques are not applied in any of the municipal bodies reviewed under this study. Application of these newer techniques requires computerization of accounting and various other processes. Now-a-days, financial institutes ask for detailed forecasts about various aspects including financial forecasts, before sanctioning loans to the borrowing agencies (in this case, municipal bodies). As municipal bodies are on and often required to borrow for undertaking various urban development works, sooner or later municipal bodies will have to install formal and continuous forecasting processes.

#### **Short-term Financial Management:**

Short-term financial management essentially involves day-to-Day operations of every organization and thus forms a crucial part of overall financial management. The very existence of the organization depends on short-term financial aspects/decisions. The major areas of it are working capital management, cash/liquidity management, receivables management, and inventory management. The municipal scenario is very dismal. Most of municipal bodies suffer from defective short-term financial management, which results into poor recovery performance,

non-augmentation of resources, lack of expenditure control/wastage of scarce resources etc. The sample survey statistics about these aspects of municipal financial management are as follows.

**Working Capital Management:**

In Municipal Corporations, the control of working capital requires an analysis of operating cycle as in case of business firms. The operating cycle of a municipal body begins with the delivery of municipal services and ends with the collection of tax. The duration of the operating cycle depends on the time required at each stage. The control of working capital is possible by efficient planning and adhering to the budget as far as possible. For short-term funds requirements also, planning is essential in terms of a cash budget, which will ensure a control over the movement of cash. This aspect is explained in the following chapter. The main point to emphasize is that working capital estimation needs to be carried out in advance and accordingly, a control system should ensure a smooth operating cycle. As a part of short-term financial control, an inquiry about the stage/time of financial and budgetary scrutiny of project works was done in the survey, which revealed the following picture: (data out of 19 municipal bodies)

|          | <b>Stage</b>                             | <b>Responses</b> |
|----------|--|------------------|
| <b>1</b> | Tender Approval                          | 2                |
| <b>2</b> | At the time of principle approval        | 6                |
| <b>3</b> | Before issuing work-order                | -                |
| <b>4</b> | After work order, at the time of payment | 5                |
| <b>5</b> | At all stages mentioned above            | 5                |
| <b>6</b> | No such scrutiny at all                  | 1                |

From the findings, it can be observed that a sound financial and budgetary scrutiny at all the stages of project sanctioning is done only in five municipal bodies out of 19 municipal bodies. This kind of an elaborate financial and budgetary scrutiny is very necessary for the financial health of a municipal in a much better condition compared to other municipal bodies. On the other end, there are six municipal bodies, which do not have a formal financial, and budgetary control system. In these bodies, the accounts department comes to know about payments to be made for purchases/works carried out only when the payments are due or overdue. Consequently, these municipal bodies have to face a liquidity crisis some times. Also, the problem of over-spending (spending beyond the budgetary limits and even beyond the resources also) exists in these bodies. This causes accumulated deficits and dues to various agencies, due to which the financial health of these corporations becomes very poor. In certain cases, the scrutiny is done at the time of principle approval which is theoretically good, but many

problems like liquidity crisis, time lapse between the conception and implementation of the project, loss of budgetary authorization, loss of relevance, priority, etc. may occur.

### **Cash\liquidity Management:**

These five corporations where such system exists, are financially Cash management is very crucial for every form of organization because it represents day-to-day solvency aspect and protects organization against uncertainties characterizing its cash flows. While cash serves these functions, it is an idle resource which has an opportunity cost. The nature of municipal financial transactions is highly cash based. This is because most of the municipal bodies receive receipts in the form of numerous tax receipts and most of municipal services require resources in the form of cash. In most of the municipal bodies cash is viewed to serve solvency purpose, accordingly most of the municipal bodies are characterized by the huge holding of cash. But the liquidity provided by cash holding is at the expense of profits sacrificed by foregoing alternative investment opportunities. There is a lack of awareness about this 'profitability aspect of cash' in most of the municipal bodies. It has been observed that 13 out of 19 municipal corporations use cash budgeting technique for management of cash. But here again cash budgeting is not done in a formal systematic manner.

### **Receivables Management:**

The nature of municipal resources is such that the receivable of the municipal bodies is very large in number and in this context, that receivables management assumes great significance. The receivable management in the municipal bodies has not kept pace with increasing volume and complexities, and is weak in most of the municipal bodies. This is evident from the fact that out of 19 municipal corporations surveyed only 5 municipal bodies have posted recovery performance over 70 per cent, while 8 municipal corporations have registered recovery performance between 50 to 70 per cent. While 6 municipal bodies registered recovery performance below 50 percent. Numerous committees and researches have clearly indicated that the recovery and receivables management is not satisfactory in almost all the municipal bodies. The simpler techniques of receivables management such as average age of receivables', 'aging schedule', 'payment pattern approach', etc., are not applied. The study of the researcher shows that in case of municipal bodies, additional techniques such as Network Analysis, PERT/CPM, A B C Analysis etc, can be successfully applied to improve their receivable management. A marked improvement in recovery and receivables management will relieve many hard pressed municipal bodies from liquidity crises.

### **Inventory Management:**

The inventory in municipal bodies represents a significant proportion of total assets - store purchasing generally average around 20 per cent of total expenditure. As we know the assets of municipal corporations run into millions of rupees, and taking 20 percent thumb rule one can visualize the quantum of inventory management in average municipal body. In spite of this inventory management has not received enough consideration and is usually overlooked. This area is significant enough to lay emphasis as improvement upon the stores and inventory items can lead to savings of millions of rupees. This will reduce material handling procedures; costs associated with it and also can affect a considerable amount of savings. In the survey, it was found that out of five inventory control techniques- ABC analysis, mini-max system, two bin system, order cycling system and statistical inventory control systems, only the first two techniques were known. In case of ABC analysis, twelve out of nineteen respondents were aware about it and said it was applicable while only six of them actually used it in their corporations. In case of mini-max system, nine out of nineteen were aware and the same respondents replied in positive about its applicability in municipal situations, but not a single corporation uses it actually. This dismal picture shows the lack of proper concern towards proper inventory management. In the chapter, it has been attempted to show how certain inventory management techniques can be used in municipal situations and what impact it can have on the short-term financial management. The savings generated as a result of efficient inventory management can make available considerable funds for other important purposes.

### **Long-term Financial Management:**

The continuity of the organization depends on short-term financial management whereas the growth of the organization depends on long-term financial management. Accordingly, every organization has to develop long-term financial management strategies, systems. An organization of non-governmental nature may decide not to grow but organization of governmental nature and in particular, municipal nature has to grow in order to cater to the ever-increasing population. Any form of government organization, by definition, must always try to provide more and more service of better and better quality to the people. Urbanization is never ending process; consequently scope, jobs, challenges, complexities and workload of municipal bodies will continue to increase. Municipal bodies will have adequate, efficient, tailor-made long-term financial management. Long-term financial management in municipal context involves four broad areas - long- term planning and controlling, augmentation of resources, allocation of

resources (budgeting), capital budgeting. In spite of such a dire need of long-term financial management, it was found in the survey that the long-term planning process is lacking in most of the municipal bodies.

### **Long-term Planning and Controlling:**

Unprecedented population growth and other developments have taken place in our cities and towns during the past decades. There prevails unanimity about one logical way/instrument to solve the chaotic situation prevailing in our cities that is 'Planning'. Unfortunately, in most of our cities, planning has been a corrective or remedial process rather than a pro-active or preventive one. Similarly urban planning authority has very rarely got the opportunity to plan a city or part of city from its inception. Planning has usually begun after much of the physical layout has been set and after the pattern of land use has been affected by uncontrolled developments. Thus, the operation of planning is greatly circumscribed by costly mistakes of the past. Planning when it relates to urban area or situation cannot confine itself only to the municipal body or to the area within the arbitrary and quite often illogical city limits. Whatever happens or what is likely to happen in the city depends not alone on what has happened or likely to happen in the city, but also on what is likely to happen in the region or in the state. Planning in the context of urban development and management must also look far beyond the city or agency limits for the forces, trends and government policies which condition the City's future. Thus, planning in terms of city development must integrate itself with the plans of the region, state and the nation itself. As government policies and plans have long-term perspective and impact, long-term planning becomes inevitable for the municipal bodies or other bodies responsible for urban management and development. Keeping in mind this necessity & inevitability of planning in municipal administration, the Planning Commission of India had written to the State Governments, as early as in 1962, about the urgent need to draw the urban areas into the scheme of national planning in an organic manner and suggested that cities and towns with a population of one lac or more should prepare development plans of long-term perspective and period. The memorandum on the fourth five-year plan observed about planning that, "in no other way will it be possible to solve the pressing problems thrown up by rapid urbanization, development of industry and migration from rural areas and small towns." In spite of acknowledgment of importance of planning from every quarter it is still very much lacking in municipal bodies and right from Government to municipal authority, everybody is responsible for today's sorry state of Urban affairs. Most of the municipal bodies lack much needed long-term planning. Small municipal bodies cannot afford it,

but big municipal corporations also lack it, which is very unfortunate. The survey of 19 municipal corporations indicates that 73 percent that is 14 municipal corporations lacked formal long-term planning process. This data suggests indirectly an even more dismal picture about small municipal corporations and municipal bodies. The detailed study of Baroda Municipal Corporation shows that it lacked formal and continuous long-term planning process, but one remarkable feature is, it got prepared from time-to-time master plans for various services from renowned consultancy firms. Recently Baroda Municipal Corporation has taken various steps to create formal long-term planning machinery. As a part of it, corporation carried out in 1991 an exhaustive exercise of listing all the ongoing and proposed work to know the pending development work and the resource gap, that is, how much funds it requires to carry out all the works and how much funds it has or it can augment. On the basis of this information the corporation, in 1991, prepared a 10-year (1991-2001) long-term development plan. The plan was broken down in annual plans. In this exercise, the corporation worked out what physical development will be required to be undertaken under each urban service head and how much funds it will require to undertake such planned physical development. This planning exercise also worked out long-term financial plan wherein it assessed how much funds will be available from external (loan subsidy etc.) as well as internal (savings/surplus) financial sources it also contained resource augmentation plan, that is, increase in tax rates, and other measures, to bridge the resource gap. The preparation of such a ten-year development plan has helped Baroda Municipal Corporation to know exactly where it stands and what it needs to do to achieve desired objectives. It has brought focus and prioritisation in its development planning and expenditure. It has also facilitated controlling in a sense that corporation could slash down discretionary and non-essential expenditure, thus making funds available for other priority works/activities. In the last two years corporation has not only followed this plan, but has also revised it in the lights of the physical developments made, financial position of corporation and development priorities. Finally, from April-1994 corporation has created a formal 'Planning and Estimates Cell', which is headed by Executive Engineer, and co-supported by Chief Accountant. The cell is under direct control of & reporting to the Municipal Commissioner. The cell's created to undertake activities such as preparation of long-term development plans for each services and their revision every year preparation of estimates of each development work pertaining to basic urban services scrutiny and verification of all the works from point of estimate, tender, procedures, etc. scrutiny of budget, financial outlay required etc. creation of data-base about all

the urban services review of all the works in progress preparation and submission of loan proposals to outside agencies etc. The creation of formal planning cell is a really progressive step of Baroda Municipal Corporation and given the time and conducive environment to grow, it will help the corporation immensely to improve its overall management and performance.

### **Budgeting and Controlling:**

Of all the municipal management processes, those of planning and budgeting are the most pervasive. Lying at the heart of municipal financial management, they enter into both policy-making and control. They are all pervasive in a sense that they affect the whole management and use most of the management techniques. The way planning serves the purpose of controlling; budgeting serves the purpose of planning. Planning and budgeting (controlling) are complementary and responsible for success of each other. Planning gets operationalised through the medium of budgeting while budgeting draws its basis or existence from planning. Thus, like planning, budgeting is a primary function of municipal management. At the micro level of municipal scenario these are two areas, which are really responsible for dismal performance of our municipal bodies. The most popular and widely applied budgeting technique or system is 'line-item budgeting technique.' It is applied in almost all the municipal bodies. Only 3 municipal bodies have tried to apply 'performance budgeting technique' while the other three budgeting techniques have not been applied in any of the municipal bodies surveyed under this study. In all these municipal bodies, budget is prepared by applying 'incremental approach' that is, on the basis of past figures, average annual growth rate is calculated and budget figures are formulated by adding increment at predetermined rate (say 10 percent) in the previous year Budget figures. Such an approach though rich in practical experience suffers from adhocism and rigidity. One solution to remove adhocism from budgetary process is introduction of the system of preparing subsidiary budgets. Under this, departments are required to justify their budget demands with detailed calculations based on quantity, per unit cost, replacement ratio, default ratio, etc. Adoption of subsidiary departmental budgeting system brings exactness in budget demands or forecasts. The survey of 19 municipal bodies indicated that only half of the municipal bodies have the system of preparing detailed subsidiary budgets by all the departments. The budgetary control over expenditure is weak in most of the municipal bodies. The survey about the stage or time when financial and budgetary scrutiny of project works/expenditure is carried out reveals following picture.



A sound financial and budgetary control comprises of scrutiny of control at all the stages of project selection and approval process. Out of 19 municipal bodies only 5(five) have such elaborate financial and budgetary control system. The municipal bodies that have such elaborate control system, are functionally good municipal bodies among the 19 municipal bodies surveyed. These 5(five) municipal bodies may or do have other problems/limitations but their finance function is working much better compared to other municipal bodies. On the other extreme of continuum there are six municipal bodies, which virtually do not have any financial and budgetary control system.

|           | <b>Stage</b>                             | <b>Response Data</b> |
|-----------|--|----------------------|
| <b>1.</b> | At the time of in-principal Approval     | 6                    |
| <b>2.</b> | At the time of Tender Approval           | 2                    |
| <b>3.</b> | Before issuing work-order                | -                    |
| <b>4.</b> | After Work-order, at the time of payment | 5                    |
| <b>5.</b> | At all stages mentioned above            | 5                    |
| <b>6.</b> | No scrutiny at all                       | 1                    |
|           | Total                                    | 19                   |

In these municipal bodies, finance or accounts department comes to know about the payments arising out of purchases made of works completed, when the payments become due or overdue. As a result of this, these municipal bodies many times face acute liquidity crisis. They also suffer from the problems of overspending (spending beyond the budgetary limits and resources), accumulated deficit and default in paying various dues to government or financial agencies. This shows that these bodies have comparatively weak financial health. Besides these two extreme cases there are municipal bodies, which do have budgetary control system, but not the elaborate one. It can be observed from the data that 2 (two) municipal bodies undertake scrutiny and control exercise at the time of tender approval while 6 (six) municipal bodies carry it out at the time of in-principal approval to project works or expenditure. It means that in case of these municipal bodies such scrutiny is carried out in initial stages. Theoretically this is a good control system, but in case municipal projects or develop-mint works there lapses a considerable time period between in-principal' approval and the actual commencement or completion of work. It is possible that there may arise a situation where the particular work loses its relevance or

priority or it loses budget authorization. It is because of these considerations that the 'end-point' or 'multi-stage' financial and budgetary control system is necessary. The municipal bodies which have 'initial stage' control system, may face the problem of liquidity at the time of payment, accordingly such municipal bodies should reinforce their financial budgetary control by adding or introducing control systems at various stages of project sanctioning and financing process.

### **Capital Investment Decision and Controlling:**

The decisions regarding expenditure have far-reaching effects on the finances of a municipal body. Once acquired, capital assets cannot be disposed off except at a substantial loss, and this is more so with municipal bodies. Most of the capital expenditure of municipal bodies is in the form of urban infra-structure i.e., laying water supply or sewerage lines, construction of roads, bridges foot-paths, storm-water drainage, etc. Thus, capital expenditure of municipal bodies does result in creation of assets to municipal bodies but these assets are not of commercial nature (rather of social service nature) and hence once created, they cannot be disposed off in any circumstances. Further, if increased earnings do not result from the purchase of the additional capital assets, the ability of the organization to discharge its financial obligations gets affected adversely. This is also very true with municipal bodies. There does not exist one-to-one relationship between creation of additional capital assets (urban infrastructure) and increased earnings (revenue) in case of municipal bodies. Accordingly municipal bodies are required to undertake special resource augmentation efforts along with capital expenditure to become capable of discharging resultant financial obligations. The municipal bodies, which fail to augment their resources, cannot sustain capital (development) expenditure over the years. The balancing of capital (development) expenditure against estimated resources augmentation and resource saving in future requires careful analysis of both the engineering and financial aspects of the projects which are undertaken by the municipal body. A careful planning of all the related activities at each stage of urban infrastructure development project is essential for selection of right project to avoid cost overruns and delay in providing services to the targeted group and to optimise returns. In the wake of situations like urban explosion, all municipal bodies are facing the problem of widening gap between demand and supply of urban services. There is acute scarcity of re-sources. Looking to the characteristics of urban infrastructure projects like their volume, complexity, capital intensiveness and having long gestation period, capital investment decisions and their control should achieve great significance in municipal administration. It is clearly evident from the discussion above that the capital investment decision and controlling is

one of the most important aspects of financial management and long-term planning aspects. The survey about the status of capital budgeting in municipal bodies indicates that there exists separate capital budget for capital works in 12 out of 19 municipal bodies. This data projects some what satisfactory picture, but as there does not exist concept of capital rationing, long-term planning, formal project evaluation and selection process and project monitoring/controlling, the capital budgeting in these municipal bodies has become more or less meaningless. The project evaluation and selection techniques help out weed out or drop put inappropriate non-priority and unsuitable projects. These techniques also help management to rank suitable and appropriate projects in order of priority. This greatly facilitates preparation of capital budget.

Following table provides data about the applicability and actual application of various project evaluation and selection techniques in municipal administration.

|           | <b>Name of technique</b>  | <b>Awareness</b> | <b>Applicability</b> | <b>Actual Application</b> |
|-----------|---------------------------|------------------|----------------------|---------------------------|
| <b>1.</b> | Payback Approach          | 13               | 13                   | 2                         |
| <b>2.</b> | Accounting Rate of Return | 13               | 13                   | -                         |
| <b>3.</b> | Time adjusted Rate        | 11               | 11                   | -                         |
| <b>4.</b> | Net Present Value Method  | 11               | 11                   | -                         |
| <b>5.</b> | Internal Rate of Return   | 11               | 11                   | -                         |

It can be observed from the above that though there is awareness and feeling that these techniques can be applied, the actual implementation is almost nil or zero. Project selection decision is still essentially a political one. Concept of capital rationing which deals with problems of allocation of limited capital resources to numerous conflicting development projects, is an important part of process of capital budgeting. As in municipal bodies, project evaluation and selection processes are weak or missing, this concept assumes greater importance. Unfortunately, concept of capital rationing is applied in only 3 municipal bodies. Long-term planning, which forms base of capital budgeting process, is lacking in most of the municipal bodies. Only 5 municipal bodies undertake long-term planning of city development. Again, in some of these municipal bodies, long-term planning process is not undertaken on a continuous and formal basis. Another prerequisite of capital budgeting, which is missing or very weak, is monitoring/controlling of progress of capital projects/works. Various new project monitoring and management techniques are either not known to officers of municipal bodies or even they are known in actual practice not applied. The survey data about three of widely known techniques of project management is as follows.

|           | <b>Name of technique</b> | <b>Awareness</b> | <b>Applicability</b> | <b>Actual Application</b> |
|-----------|--------------------------|------------------|----------------------|---------------------------|
| <b>1.</b> | PERT                     | 11               | 11                   | 2                         |
| <b>2.</b> | CPM                      | 11               | 11                   | 2                         |
| <b>3.</b> | Network Analysis         | 11               | 11                   | 2                         |

The result of absence of appropriate project management technique is delay in project completion that is heavy cost overruns. Thus, in most of the municipal bodies project evaluation, long-term planning, project management systems are either absent or weak, capital budgeting is also weak in its operation.

***Concluions:***

This research study has various limitations. It is purely of preliminary nature and addressed only to one point that is present status of financial management in municipalities. The scope of this research is very vast but looking to various constrains of time, resources, data etc., in it an attempt has been made to review financial management systems prevalent in the municipalities. For this research purpose, the researcher has made exhaustive use of earlier detailed review/research regarding financial management of 19 municipal corporations. The base on which all the conclusions have been drawn is very small, and therefore should be interpreted cautiously. Further urban development in India is managed by various urban development authorities and special purpose bodies. This study has focused on municipal financial management system and not that of other bodies. But it is utmost necessary that financial management stems of such development and special purpose bodies should be reviewed. This research is also limited in terms of text coverage of financial management. The study has covered only three broad areas (1) Tools of financial analysis and forecasting, (2) short-term financial management, and (3) long-term financial management. This study has dealt with some micro aspects of municipal finance and it has not covered macro aspects or new challenged and opportunities of liberalized market orient-ed society. In this respect too, this study is limited. Though this preliminary research/survey about financial management in municipalities suffered from various limitations and constraints, it has clearly indicated that there does not exist finance function at all. What exists at present is bookkeeping of financial transactions. The observation may sound very curt and unfortunate, but it is stark reality. As we all know, finance is an all-pervading activity. It is not a specialist’s monopoly. It is a thread running through all affairs, and therefore there is no reason why financial management cannot be applied in municipal environment.

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