Research Study on Accounting Reforms in Urban Local Bodies in India

The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

Research Study on Accounting Reforms in Urban Local Bodies in India

(Compilation of various readings available on Municipal Accounting Reforms in India)

Prepared by

Committee on Public Finance & Government Accounting

The Institute of Chartered Accountants of India

(Set up by an Act of Parliament)

New Delhi

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Foreword

Presence of an efficient and transparent Financial Reporting System has become extremely important for the government(s) as all stakeholders these days expect a fair account of how the government is expending its tax collections in public interest. This is on the same lines in which investors in a company expect details about the company's financial position and performance. An accounting system has to be fair in capturing the underlying transactions, transparent and user-friendly to facilitate understanding of the accounting statements to varied stakeholders. The same is true for Municipal Accounting Systems. Municipal Accounting Systems need to reflect not only financial transactions but also the 'financial performance' of the municipal governments, which includes its ability to achieve its developmental goals, meet its programme targets, its efficiency in the use of resources, its financial position including income, assets and liabilities as well as its foresight in dealing with the developmental and financial challenges of governing the city.

The Institute has always been the torch bearer of the virtues of transparency and integrity and as a partner in nation building, is making significant efforts to prescribe and support in implementation of reforms in Urban Local Bodies (ULBs). In this background, I am pleased to note that the Committee on Public Finance & Government Accounting (CPF&GA) of ICAI has come out with this publication "Research Study on Accounting Reforms in Urban Local Bodies in India". This Study is expected to apprise the readers with systematic and integrated approach to accounting reforms in Urban Local Bodies. The Study gives an insight on how improvements in accounting procedures will ensure better assessment of the financial position of the ULBs.

I congratulate CA. Atul Kumar Gupta, Chairman, Committee on Public Finance & Government Accounting (CPF&GA), CA. G. Sekar, Vice-Chairman, CPF&GA and other members of the Committee for bringing out this Study. I acknowledge the efforts put in by CA. Rohini Agarwal, Co-opted member, CPF&GA for her contribution in preparing the basic draft of the Study. I also wish to place on record my appreciation for the time and efforts put in by Ms. Anita Pattanayak, IA&AS, Deputy C&AG and Chairperson, Government Accounting Standards Advisory Board and Ms. Meenakshi Gupta, Additional Secretary, Government of India for reviewing and giving comments on the

Research Study.

I am sure that this Research Study would be useful to our members at large and other stakeholders.

CA. Naveen N. D. Gupta
President, ICAI

New Delhi
1st February, 2019

Preface

Transparent accounting and financial reporting is central to the fulfilment of new age governance. Municipal bodies or Urban Local Bodies (ULBs) in India, these days are facing unprecedented growth in demand for urban infrastructure and facilities. ULBs are accountable to society and Municipal Accounting Reforms (MAR) is the basic tool required for overall financial management reforms in ULBs.

A double entry accrual-based accounting system is the foundation of good management as it promises a superior method of tracking the resources of ULBs as compared to cash-based accounting and provides decision makers with a comprehensive financial picture. The Central Government has mandated each ULB to adopt double-entry accrual based accounting system in order to receive various performance grants.

This "Research Study on Accounting Reforms in Urban Local Bodies in India" being brought out by Committee on Public Finance & Government Accounting (CPF&GA) of ICAI attempts to cover various facets of accounting and financial reporting by ULBs and discusses the transitional issues, need for accounting reforms in ULBs, process of implementing accrual accounting, formats of financial statements of ULBs, way forward for municipal accounting reforms in India and so on.

I wish to place on record my sincere thanks to CA. G. Sekar, Central Council Member, ICAI and Vice-Chairman, CPF&GA for providing his constant support and guidance to the Committee. I would like to express my deep gratitude to CA. Rohini Agarwal, Co-opted member, CPF&GA for her dedication, perseverance, unstinted support in preparing the basic draft of the Study and personally steering the Study with great interest and zeal. I also gratefully acknowledge the efforts put in by Ms. Anita Pattanayak, IA&AS, Deputy C&AG and Chairperson, Government Accounting Standards Advisory Board and Ms. Meenakshi Gupta, Additional Secretary, Government of India for reviewing the Research Study. Further, I thank CA. Namrata Khandelwal, Sceretary, CPF&GA and entire team of the Committee in preparing the Study.

I believe that this Research Study would be found immensely useful by various stakeholders, members of the profession and other readers.

CA. Atul Kumar Gupta
Chairman,
Committee on Public Finance & Government Accounting

New Delhi
1st February, 2019

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Chapter I

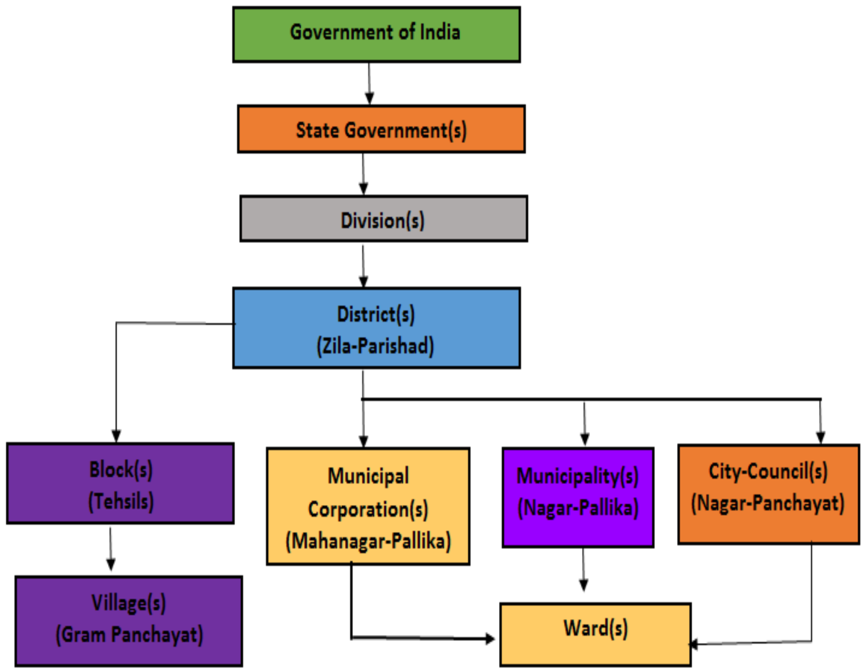
Introduction

LOCAL BODIES

Local bodies are institutions of the local self-governance, which look after the administration of an area or small community such as villages, towns, or cities. The local bodies in India are broadly classified into two categories. Those constituted for local planning, development and administration in the rural areas are referred as Rural Local Bodies (Panchayats - RLBs) and those constituted for the urban areas are referred as Urban Local Bodies (Municipalities - ULBs).

Local Government is a State subject figuring as item 5 in List II of the Seventh Schedule to the Constitution of India. Article 243 G and Article 243 W of the Indian Constitution enshrines the basic principle for devolution of power to the Local Bodies. In the nation's journey towards becoming an economic power, local bodies play an important part in enabling infrastructure availability to the citizens.

Figure I- Administrative Structure of India



RESPONSIBILITY OF LOCAL BODIES

Local bodies have responsibility to create effective, democratic, rational, transparent local governance framework that promotes responsiveness and accountability; to strengthen the legal, fiscal, economic and service delivery functions of municipalities; and to foster bigger citizen participation in the governance of local bodies.

Many roles that the local government is expected to play include:

- A Regulator to administer various acts and regulations.
- A Provider to provide basic services such as water, sanitation, education, health etc. efficiently.
- An Agent to execute/implement Central and the State Government schemes including promotion of schemes, facilitating its access to the masses and ensuring participation by the masses.
- A Welfare Agency to provide active assistance to higher level governments in the (equitable) distribution and delivery.

- An Agent of Development, who strives for improvement in the quality of life through the augmentation of infrastructure?

REQUIREMENT OF ACCOUNTING REFORMS IN LOCAL BODIES

While the physical planning and development measures will address the issue of spending the income earned and allocated funds judiciously, an appropriate accounting system for recording the transactions, including the establishment of a proper system for asset and liabilities accounting and revenue recognition are necessary. However, the traditional cash accounting system does not offer the said benefits whereas the accrual accounting system enables provision of the said financial information to various users such as, citizens, elected representatives, administrators, investors, creditors, executives, legislatures, State Audit Departments, and State Urban Development and Panchayati Raj Departments in a timely and organised manner. This necessitates the requirement of reforms in accounting at the local bodies.

Chapter II

History of ULBs in India

ULBs IN ANCIENT INDIA

The origin of local self-government has very deep roots in ancient India. On the basis of historical records, excavations and archaeological investigations, it is believed that some form of local self-government did exist in the ancient times. In the Vedas and in the writings of Manu, Kautilya and others, and also in the records of some travelers like Magasthnese, the origin of local self-government can be traced back to the Buddhist period. The Ramayana and the Mahabharata also point to the existence of several forms of local self-government such as Paura (guild), Nigama, Pauga and Gana, performing various administrative and legislative functions and raising levies from different sources. Local government continued during the succeeding period of “Gupta’s”, “Maurya’s”, etc. rule in the form of town committees, which were known as ‘Goshthis’ and ‘Mahajan Samitees’.

ULBs IN MODERN INDIA

In Modern India, the State is categorically divided into two types of habitation areas – rural local areas and urban local areas. At the initial stages, the rural part of population was dominant and urban areas were small. The distances were significant and local population used to resort to local governance for their day to day needs and resolution of disputes. Panchayats used to be all-powerful local government at the Rural level.

As the urban area started expanding, the concept of municipal governance started taking shape. Municipal Governance in India has been in existence since the year 1688 with the formation of Madras Municipal Corporation and then Calcutta and Bombay Municipal Corporation in 1726. In early part of the nineteenth century almost all towns in India had set up some form of municipal governance. In 1882 the then Viceroy of India, Lord Ripon's resolution of local self-government laid the democratic forms of municipal governance in India.

Government of India Act, 1999 incorporated the need of the resolution and the powers of democratically elected government were formulated.

Government of India Act, 1935 brought local government under the purview of the state or provincial government and specific powers were given to them.

Independence brought a new kind of activity in every sphere of public life. It opened a new chapter in the history of local government in India. The present Constitution came into force in 1950 and the local self-government entered a new phase.

Article 40 of the Constitution of India provides that – "The State shall take steps to organize village panchayats and endow them with such powers and authority as may be necessary to enable them to function as units of self-government". This Article constitutes one of the Directive principles of the State Policy of India which lays down_the fundamental principles of governance of the country and it is duty of the States to apply these principles in making laws, these are not enforceable by the court of law.

The point to note here is that at the time of making the Constitution of India, while the village panchayats as institutions of rural local governance were considered as the ones which should be developed as 'units of self-governance' by the law makers (though not with elaborate powers and functions), the same was not true with the urban local bodies. This could possibly be because of the fact that the Indian society has primarily been an agricultural society, and an inbuilt local system for informal governance like Panchayats had already been there since long past.

As for the urban local governance, Entry 5, List II of Seventh Schedule of the Constitution, categorically mentions 'local governance' as the state subject on which the State has exclusive powers to make laws, in the following words – "Local government, that is to say, the constitution and power of municipal corporations, improvement trusts, district boards, mining settlement authorities and other local authorities for the purpose of local self-government or village administration". Thus the urban governance though got recognised as an important state subject but the need was not felt to create self-governing institutions for urban local governance.

The Central Council of Local Self-Government constituted by the Central Government, also played a significant role in labouring on reforms needed in various aspects of municipal government and administration. The Rural-Urban Relationship Committee devoted itself to both functional and financial aspects and was largely microscopic in its approach. In 1985, the Central Government appointed the National Commission on Urbanization, which gave its report in 1988. This was the first commission to study and give suggestions on all aspects of urban management. Apart from the contributions made by the Central Government, committees were appointed in different States in order to improve the municipal organizations and administration there under. It was in the year 1993 that the urban local bodies were made the institutions of self-governance in terms of the 74^{th} Constitutional Amendment.

Chapter III

The Constitution (73rd & 74th Amendment) Act(s)

The Constitution of India has made detailed provisions for ensuring protection of democracy in Parliament and in State Legislatures. Hence, democracy in these institutions has survived and flourished. If democracy in Parliament and State Legislatures is to remain strong and stable, its roots must reach towns and villages and the cities where the people live and their involvement need to be ensured in the planning and implementation of the programmes at local level.

However, due to inadequate Constitutional provision for Local Self-Government, democracy in municipal governance was not stable. Though the respective municipal acts of the States provided for regular elections to municipal bodies, they were frequently suspended and superseded for indefinite periods of time. This eroded the very basis of local self-government and had a negative effect on democracy at the grassroot level. The general position with regard to financial resources of the municipal bodies was also not satisfactory. The weakened status of Urban Local Bodies crystallized public opinion in favour of need for a Constitutional guarantee to safeguard the interests of local bodies.

RURAL LOCAL BODIES IN INDIA: LEGISLATIVE BACKGROUND

The Central Government passed the 73rd Constitutional Amendment Act in 1992, which brought about major reform in local governance in the country. It contains provision for devolution of powers and responsibilities to the panchayats both for preparation of plans for economic development and social justice and for implementation in relation to twenty-nine subjects listed in the eleventh schedule of the Constitution.

The Ministry of Panchayati Raj was set up primarily to oversee the implementation of Part IX of the Constitution, inserted by the Constitution (73rd Amendment) Act, 1992, the Panchayats Extension to the Scheduled Areas Act, 1996, and Article 243ZD of Part IX-A relating to District Planning

Committees. Although the Panchayats have historically been an integral part of rural life in India, these Acts have institutionalised the Panchayati Raj Institutions (PRIs) at the village, intermediate, and district levels as the third tier of Government. The aim has been to combine social justice with effective local governance, with an emphasis on reservation of seats for the deprived classes of population, including of the leadership positions.

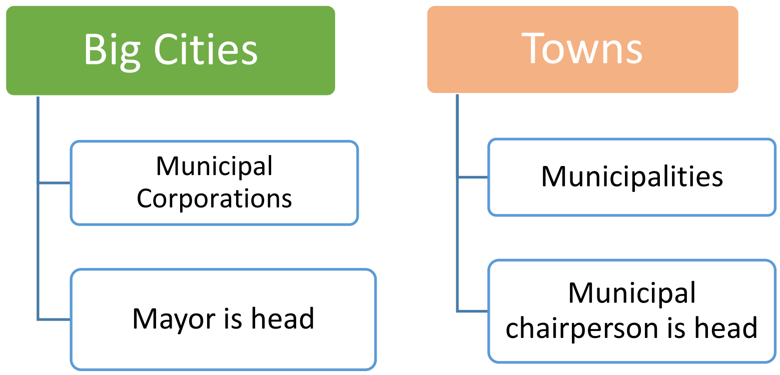
Articles 243 to 243 O contained in Chapter IX read with Eleventh Schedule of the Constitution provide:

- a broad framework of **constitution of Panchayati Raj** Institutions at the village, intermediate and district levels;
- **Gram Sabha** defined as body consisting of persons registered in electoral rolls of village;
- **composition** of panchayats with an objective to make these local bodies an independent system of self-governance at local level with a combination of elected representatives from society and administrative officials;
- **powers, authority and responsibility** of panchayats;
- with an elaborate list of **functions** that may be devolved to PRIs;
- power to impose **taxes** and provisions for **funds to them**; and
- empowering the State to establish appropriate **accounting and audit** mechanisms for these institutions.

Apart from this, a specific provision was made for constitution of **Finance Commission to review financial position of the PRIs.**

URBAN LOCAL BODIES IN INDIA: LEGISLATIVE BACKGROUND

FIGURE II- LOCAL GOVERNMENT (URBAN)



The Constitution (Seventy Fourth Amendment) Act, 1992 has introduced a new part namely, Part IXA in the Constitution, which deals with the issues relating to municipalities. **The main provisions introduced by the above Act are as under:-**

(i) **Constitution of Municipalities-**It provides for constitution of 3 types of municipalities depending upon the size and area namely (i) Nagar Panchayat for an area in transition from rural to urban area;(ii) Municipal Council for smaller urban area; and (iii)Municipal Corporation for larger urban area.

(ii) **Composition of Municipalities-** The seats shall be filled by direct elections. Besides the seats filled by direct elections, some seats may be filled by nomination of persons having special knowledge and experience in municipal administration. The manner of election of Chairpersons of municipalities has been left to be specified by the State Legislature.

(iii) **Constitution of Wards Committees-** This provides for constitution of Ward Committees in all municipalities with a population of 3 lakhs or more.

(iv) **Reservation of seats-** In order to provide for adequate representation of SC/ST and of women in the municipal bodies, provisions have been made for reservation of seats.

(v) **Duration of Municipalities-**The municipality has a fixed term of 5 years from the date appointed for its first meeting. Elections to constitute a municipality are required to be completed before the expiration of the duration of the municipality. If the municipality is dissolved before the expiry of 5 years, the elections for constituting a new municipality are required to be completed within a period of 6 months from the date of its dissolution.

(vi) **Powers and Functions of the Municipalities-** All municipalities would be empowered with such powers and responsibilities as may be necessary to enable them to function as effective institutions of self-government. The State Legislature may, bylaw, specify what powers and responsibilities would be given to the municipalities in respect of preparation of plans for economic development and social justice and for implementation of schemes as may be entrusted to them. An illustrative list of functions that may be entrusted to the municipalities has been incorporated as the Twelfth Schedule of the Constitution.

LIST OF 18 ITEMS COVERED UNDER THE TWELFTH SCHEDULE OF THE INDIAN CONSTITUTION ARE AS FOLLOWS:

1. Regulation of land use and construction of land buildings.
2. Urban planning including the town planning.
3. Planning for economic and social development.
4. Urban poverty alleviation.
5. Water supply for domestic, industrial and commercial purposes.
6. Fire services.
7. Public health sanitation, conservancy and solid waste management.
8. Slum improvement and up-gradation.
9. Safeguarding the interests of the weaker sections of society, including the physically handicapped and mentally unsound.
10. Urban forestry, protection of environment and promotion of ecological aspects.
11. Construction of roads and bridges.

12. Provision of urban amenities and facilities such as parks, gardens and playgrounds.
13. Promotion of cultural, educational and aesthetic aspects.
14. Burials and burials grounds, cremation and cremation grounds and electric crematoriums.
15. Cattle ponds, prevention of cruelty to animals.
16. Regulation of slaughter houses and tanneries.
17. Public amenities including street lighting, parking spaces, bus stops and public conveniences.
18. Vital statistics including registration of births and deaths.

(vii) **Finances of Municipalities-** It has been left to the Legislature of a State to specify by law matters relating to imposition of taxes. ***Such law may specify:***

- Taxes, duties, fees, etc. which could be levied and collected by the Municipalities, as per the procedure to be laid down in the State law
- Taxes, duties, fees, etc. which would be levied and collected by the State Government and a share passed on to the Municipalities
- Grant-in-aid that would be given to the Municipalities from the State
- Constitution of funds for crediting and withdrawal of moneys by the Municipality.

(viii) **Finance Commission-**The Finance Commission constituted under Article 243-I to review the financial positions of Panchayati Raj Institutions shall also review the financial position of the municipalities and will make recommendations to the Governor***. The recommendations of the Finance Commission will cover the following:***

- Distribution between the State Government and Municipalities of the net proceeds of the taxes, duties, tolls and fees leviable by the State

- Allocation of share of such proceeds between the Municipalities at all levels in the State
- Determination of taxes, duties, tolls and fees to be assigned or appropriated by the Municipalities
- Grants-in-aid to Municipalities from the Consolidated Fund of the State
- Measures needed to improve the financial position of theMunicipalities.

(ix) **Elections to Municipalities-** The superintendence, direction and control of the preparation of the electoral rolls for, and the conduct of, all elections to the panchayats and municipalities shall be vested in the State Election Commissions.

(x) **Audit and Accounts-** The maintenance of the accounts of the municipalities and other audit shall be done in accordance with the provisions in the State law. The State Legislatures will be free to make appropriate provisions in this regard depending upon the local needs and institutional framework available for this purpose.

(xi) **Committee for District Planning-** Provision has been made for the constitution of a Planning Committee at the district level with a view to consolidate the plans prepared by the Panchayats and the Municipalities and prepare a development plan for the district as a whole.

(xii) **Metropolitan Planning Committees-** It is provided in the Act that in every Metropolitan area (with a population of 10 lakhs or more), a Metropolitan Planning Committee shall be constituted for preparing a draft development plan for the metropolitan area as a whole. ***The Metropolitan Planning Committee shall take into account the following for preparation of the Draft Development Plan:***

- Plan prepared by the Municipalities and the Panchayats in the metropolitan area.
- Matter of common interest between the Municipalities and Panchayats including coordinated spatial plans of the area.
- Sharing of water and other physical and natural resources.

- Integrated development of infrastructure and environmental conservation.
- Overall objectives and priorities set by the Government of India and the State Government.

Extent and nature of investments likely to be made in the metropolitan area by agencies of the Government.Other available resources, financial and otherwise.

Chapter IV

Impact of Supreme Court Judgement of 2001

The Supreme Court of India in the year 2001, while hearing a Public Interest Litigation (PIL) relating to the functioning of ULBs (Almitra H. Patel & ANR [Petitioner(s)] VERSUS Union of India & Others [Respondent(s)]: Writ Petition (Civil) No.888/1996), opined that urban local bodies in India should take immediate steps to get their accounts converted from cash basis to accrual basis. The Supreme Court of India directed the Government of India to develop guidelines for an accrual-based accounting system that could capture the full costs of services.

IMPACT OF THE JUDGEMENT AND OTHER EXTRANEOUS FACTORS:

1. Government of India established the Government Accounting Standards Advisory Board (GASAB) in 2002 under the Comptroller and Auditor General of India to formulate and recommend Indian Government Accounting Standards (IGASs) for cash system of accounting and **Indian Government Financial Reporting Standards (IGFRS) for accrual system of accounting** and entrusted it with the additional responsibility of creating a Roadmap and Operational Framework for transition to accrual accounting.

2. Pursuant to recommendation(s) of the Finance Commissions, the Central Government had made it mandatory for each ULB to adopt a double entry accrual-based accounting system in order to receive various development funds.

3. The Comptroller and Auditor General (C&AG) of India prescribed formats for budgets and accounts for ULBs, accounting policies, and costing of utilities and services.

4. Ministry of Urban Development (MoUD) began to prepare the National Municipal Accounts Manual (NMAM). Subsequently, C&AG oversaw

the development of the National Municipal Accounts Training Manual (NMATM) and the National Municipal Asset Valuation Methodology Manual (NMAVM). Based on these, state governments are required to prepare state-level accounting manuals and state-level training manuals according to their requirements.

Chapter V

Role of GASAB

Comptroller and Auditor General of India (C&AG) constituted Government Accounting Standards Advisory Board (GASAB) with the support of Government of India through a notification dated 12th August, 2002. The decision to set-up GASAB was taken in the backdrop of the new priorities emerging in the Public Finance Management and to keep pace with International trends. The new priorities focus on good governance, fiscal prudence, efficiency & transparency in public spending. The accounting systems, the world over, are being revisited with an emphasis on transition from rule to principle based standards and migration from cash to accrual based system of accounting. GASAB, as a nodal advisory body in India, is taking similar action to formulate and improve standards of government accounting and financial reporting and enhance accountability mechanisms.

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The mission of the Government Accounting Standards Advisory Board (GASAB) is to formulate and recommend Indian Government Accounting Standards (IGASs) for cash system of accounting and Indian Government Financial Reporting Standards (IGFRS) for accrual system of accounting, with a view to improving standards of Governmental accounting and financial reporting which will enhance the quality of decision-making and public accountability.

To facilitate the process of transition from cash to accrual system and as per the mandate entrusted by the Government, GASAB prepared a “Roadmap for Accrual Accounting” which has been accepted by the Government of India. The road map mentions the activities and milestones to be completed for migration to accrual accounting. GASAB has also developed a detailed “Operational Framework for Accrual Basis of Accounting in Governments in India” providing an overall architecture of the accounting model that would prevail in Government while conforming to constitutional reporting needs.

The transition would involve a great deal of preparation and may take a longer time. **The proposed transition could be envisaged in three stages, namely-**

(i) Short term activity involving value addition within the existing system by additional statements on salaries, subsidies, interest, pension, etc.

(ii) Medium term activity providing for value addition in the existing system with modifications to enable greater disclosures such as arrears in revenue, committed liabilities, etc. and

(iii) Long term activity for achieving the desired accounting system based on accrual basis. Important steps involved in this transition process would involve building up of adequate database essential for implementation of accrual accounting, identification of assets and liabilities, creation of asset registers, etc.

As indicated by GASAB, some important issues to be addressed at the time of transition to accrual accounting are given below:

(i) The decision on the format of financial statements on migration to accrual accounting and generation of first set of financial statements is of key importance in transition. The format has to facilitate transparent, accurate and complete depiction of financial position. Checks and balances have to be in place to ensure appropriate measurement and recording of accounting data. Issues like preparation of assets register and valuation of assets have to be addressed.

    Internationally the role of auditor has been significant in ensuring a smooth transition to accrual basis of accounting. Auditors may be helpful in framing the accounting policies on assets and liabilities, recognition of revenues and expenses, citizen’s net worth, reporting period, measurement basis etc.

(ii) Accurate information of revenues is essential for assessing the impact of taxation and other revenues on the Government's fiscal position, in assessing the need for borrowing in the long term and also to assess whether current revenues are sufficient to cover the costs of current programs and services. It is necessary to take a decision on the types of revenues that are capable of accruing with reasonable degree of certainty. In case there are few line items that are not suitable for accruing, they may be continued under cash basis accounting. The decision in this regard has to be taken by Government.

Accounting reforms and completion of tasks/ activities will involve costs for the Governments. Internationally, different countries have assessed costs involved differently based on their size of operations. Further, cost-benefit analysis of such a transition may not always be based on quantitative aspects, as many of the benefits of accounting reforms will be in qualitative terms, such as better financial information on assets and liabilities, costing of services and goods provided, satisfaction to users and other stakeholders, etc.

Chapter VI

Recommendations of the Central Finance Commissions

The 74th Constitutional Amendment Act actually set the stage for municipal accounting reforms by designating ULBs as an Institution of Self-Government. In this backdrop the issue of local bodies was referred to the Eleventh Finance Commission for the first time. The Commission identified maintenance of accounts and their audit as an area of concern. The report of the Commission highlighted the fact that though the states have been transferring funds to the local bodies under various heads of accounts, in absence of appropriate accounting systems, procedures and practices, meaningful information about financial status of ULB's is not readily available.

On recommendation of the **Eleventh Finance Commission**, Comptroller & Auditor General (C&AG) of India constituted a Task Force to recommend budget and accounting formats for ULBs. The Task Force constituted by C&AG noted that there was an urgent need for improved municipal accounting because it would serve as an effective management tool for financial status and activities of ULB, promote more effective and timely decision making, and facilitate greater accountability and transparency.

The report of the Task Force was considered in the Ministry of Urban Development and Poverty Alleviation (MOUD) and circulated to all States/UTs in April 2003 for implementation. MOUD has accorded high priority to the municipal accounting reforms to facilitate effective and efficient financial management. The States/UTs were, therefore, impressed upon to implement the Task Force Report by using the suggested accounting and budget formats. In this context, MOUD, Government of India organized a 'National Workshop on Municipal Accounting Reforms' in September, 2003 wherein it was agreed that the C&AG of India, with USAID Fire-D support, would prepare a model national accounts manual, and this will be provided by the MOUD to the State Governments. The State Governments in turn can prepare state-level accounting manual. Pursuant to these decisions, the C&AG of India constituted a committee under the Chairmanship of the Deputy Comptroller and Auditor General (Local Bodies), to monitor and provide guidance for the development of the model-accounting manual.

A National Municipal Accounts Manual (NMAM) has been prepared with the assistance of C&AG of India and was released by Ministry of Urban Development in December 2004 for dissemination among the states to enable them to develop state specific municipal accounts manual. Moreover, implementation of certain urban reforms including municipal accounting reforms was made conditional for availing central assistance under JNNURM.

The **Twelfth Finance Commission** acknowledged that the current system of cash based accounting does not provide a full picture of the government's financial position at any given point. It felt that the cash based system provides room for fiscal opportunism where taxes can be collected in advance and booked as receipts and current payments can be deferred and not booked as expenditure. The Twelfth Finance Commission, while recommending a changeover to accrual accounting in government had recognized that this should be a gradual and calibrated process. **In the interregnum, it had suggested that additional information be provided in the Government Accounts and listed eight statements, which could be usefully added to the accounts. These are:**

- Statement of explicit and implicit subsidies.
- Statement containing expenditure on salaries by various departments
- Detailed information on pensioners and expenditure on Government pensions.
- Data on committed liabilities in the future.
- Statement containing information on debt and other liabilities as well as repayment schedule.
- Accretion or erosion in financial assets held by Government including those arising out of changes in the manner of spending by Government.
- Implications of major policy decisions taken by Government during the year or new schemes proposed in the budget for future cash flows
- Statement on maintenance expenditure with segregation of salary and non-salary portions.

The Commission had further recommended transition to accrual accounting for the Union and the State Governments. The Twelfth Finance Commission in its Report elaborated on the limitations of the present cash based system and brought out some of the possible improvements in the accounting system once a shift to accrual takes place. These recommendations were accepted by the Central Government in principle.

The **Thirteenth Finance Commission** was asked to examine "the need to improve the quality of public expenditure to improve outputs and outcomes" in its Terms of Reference.

The Commission, also expressed its satisfaction with the attention accorded to the issue of transition to accrual accounting by the relevant authorities and the extant actions taken by the Central, State and local governments facilitating a 'bubble up' approach to this transition. Under such an approach, local bodies (and within local bodies – large municipal bodies and Panchayati Raj institution) would adopt accrual accounting first, given that the National Municipal Accounting Manual which incorporates the principles of accrual accounting stage was already finalised under the aegis of the CAG.

The **Fourteenth Finance Commission** observed that "it has been more than twenty years that municipalities and panchayats were sought to be empowered, through a constitutional amendment, to act as institutions of local self-governance and also to provide certain basic services to citizens. It is inconceivable, and certainly not desirable, that local bodies seek an ever increasing share of public moneys and yet continue to keep themselves beyond the ambit of accountability and responsibility for the public money placed with them.'' It stated that proper accounts are the starting point for financial accountability. Non-maintenance or delayed compilation of annual accounts means compromised accountability and implies that reliable financial data for determining the need for resource for local bodies is not available. It also noted that on account of the efforts of the past Finance Commissions, there has been progress in keeping of accounts and audit under the technical guidance and support of the C&AG but further progress in this regard is needed. Accordingly, it opined that it is necessary to continue the efforts initiated by past Finance Commissions for improving the maintenance of accounts, their audit and disclosure. The Performance Grants are designed to serve the purpose of ensuring reliable audited accounts and data of receipts and expenditure and improvement in own revenues. This will enable initiation of action at the grassroots level for compilation of data so that all stakeholders have access to reliable information for decision making and at the same time, it will enhance accountability of the local self-government institutions to the public.

Chapter VII

Contribution of NMAM

The Ministry of Urban Development (MoUD), Government of India took several initiatives to make urban local bodies self-sustaining viable entities of local self-government.

Based on the Eleventh Finance Commission recommendations and the Guidelines issued by the Ministry of Finance, Government of India, the Comptroller and Auditor General of India (CAG) constituted a Task Force to recommend budget and accounting formats for Urban Local Bodies (ULBs) in India. The CAG Task Force in its report, interalia, suggested adoption of accrual basis of accounting by ULBs.

To provide a generic framework of National Municipal Accounting and a simplified tool kit to the ULBs for recording the accounting entries, the MoUD, initiated the formulation of National Municipal Accounts Manual, based on the Task Force Report, facilitated by C&AG.

The Manual contains the required forms, formats, procedures, accounting entries, periodical statements, reconciliation procedures, etc. with respect to transactions of the ULB. The recommended principles for accounting have also been included. Accounting principles placed in the manual are primarily focussed on the concept of accrual basis of accounting.

As per the NMAM, the Annual Report of the ULB shall include the following:

(a) Financial Statements consisting of

- (i) Balance Sheet;
- (ii) Income and Expenditure Report;
- (iii) Statement of Cash Flows (a summary of an ULB's cash flow over a period of time);
- (iv) Receipts and Payments Account (detailed as per account heads);
- (v) Notes to Accounts; and

(vi) Financial Performance Indicators

(b) Report to the Municipal Chief Auditor

(c) Municipal Commissioner's Report on the Annual Financial Statements and the qualifications and comments made in the Report of the Municipal Chief Auditor; and

(d) Standing Committee's Action Taken Report on the qualifications and comments made in the Report of the Municipal Chief Auditor and the Report of the Municipal Commissioner.

In addition, the NMAM also provides for Budget Variance Report (BVR) and Management Information Systems Reports. It states that "Management Information System reports are necessary in ULBs for measuring its activities in a more meaningful and transparent manner. MIS not only provides information on accounting and financial aspects but also covers non-financial aspects/information in an integrated mode. The object of development of MIS reports is to provide the performance details/statistical data of the activities of the ULBs in various forms. MIS report serves as critical inputs for any decision making on any of the conducts of the ULBs."

As municipality is a state subject and the NMAM is expected to serve as a professional guide to the State, the responsibility of making the reforms a success depends on the initiative and interest taken by the State Government and the ULB.

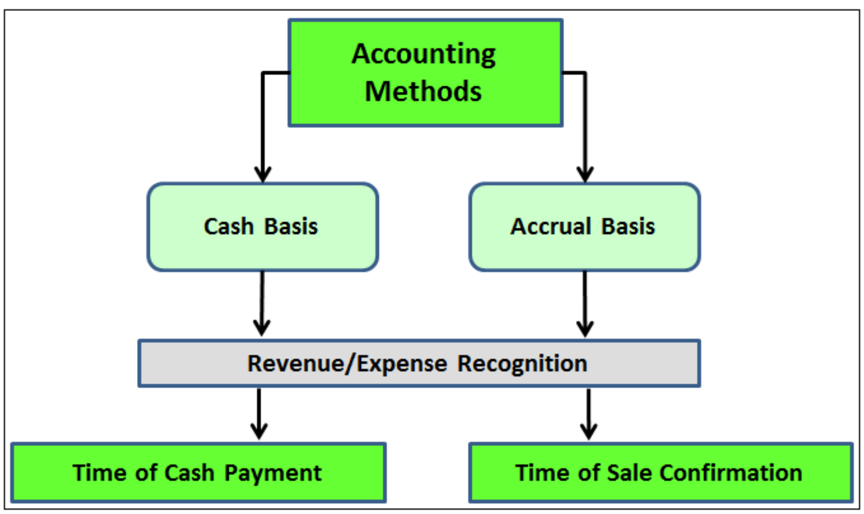
Chapter VIII

Need for Accounting Reforms in ULBs

ACCOUNTING SYSTEM PREVALENT IN ULBs

Most of the ULBs in India follow a cash basis of accounting wherein cognizance is not given to the timing of event and no distinction is made between revenue and capital items. Revenue items are recognized only when cash is actually received, irrespective of the timing when the revenue was accrued. As a result, accounting consideration is not given to the timing of the event of the transaction. Similarly, expenditure items are recognized only when cash is actually paid, irrespective of the timing when the expenditure is accrued. Resultantly, accounting consideration is again not given to the timing of the transaction. The whole focus is on cash management to comply with budgetary and legislative guidelines.

Figure III- Accounting Methods



Cash Accounting System

The method of recording transactions by which revenues and costs and assets and liabilities are reflected in the accounts in the period in which actual receipts or actual payments are made.

The cash basis of accounting is a method of recording transactions for revenue and expenses only when the corresponding cash is received, or payments are made. Thus, revenue is recorded only when a customer pays for a billed product or service, and a payable is recorded only when it is paid by the entity.

The cash method can yield inaccurate results, because revenues may be recognized in a different period than the period in which related expenses are recognized. Therefore, it is not acceptable under generally accepted accounting principles or international financial reporting standards. Thus, its limitations can be summarized as under:

- Complete picture of the financial position is not available which should inter-alia inform about
  - Capital work-in-progress like dams, power plants, roads & bridges etc.
  - Current assets e.g. accrued income like outstanding royalty, fees, service charges etc.
  - Comprehensive information about liabilities
  - Contingent assets and contingent liabilities
  - Accounting Policies on the basis of which Financial Statements are prepared
- Unit cost and total cost of services provided is not ascertainable.
- Ignores certain transactions by not recording expenditure already incurred but payment not made and also revenue earned but cash not received.
- Gives a wrong picture of income received, as advance tax receipts are recognised as income.
- No weightage is given to the concept of ‘matching’ i.e. expenses of a specific period should be set off against the revenue of the same period.

From the point of view of Government financial transparency, integrity, and accountability, pure cash accounting has a number of weaknesses.

Under cash accounting, transactions are recognized only when the associated cash is received or paid and economic events are not reported if there is no immediate exchange of cash. So, the Governments may be tempted to

- defer cash disbursements or bring forward cash receipts as a means of artificially inflating their financial balance.
- not maintain comprehensive and up-to-date records of the value of their assets and liabilities.
- Comprehensive information is not available about Government liabilities (pensionary commitments, interest due, bills payable, depreciation for replacement of assets etc.)
- transfer assets (such as land or mineral rights) or incur liabilities (such as pensions or public-private partnership contracts) to third-parties without disclosing their financial implications for the Government and taxpayer.
- Unit cost and total cost of services provided by the Government departments like health, education, water supply, transportation etc. is not ascertainable (as depreciation, interest etc. are not apportionable).
- No information is provided about existing net liabilities of public enterprises and agencies outside the Government, although the latter cannot escape such liabilities.
- No disclosures are made about Accounting Policies on the basis of which Financial Statements are prepared.
- It provides room for fiscal opportunism e.g. tax revenues can be collected in excess during a particular period followed by high incidence of refunds together with interest, payments can be easily deferred and passed on to the next financial year, revenue due in the future could be compromised by providing for one time payments.

Due to the above disadvantages, it is not possible to get the real picture of the Government financialperformance and position.

The benefits of accrual-based accounting promise a superior method of tracking the resources of ULBs as compared to cash-based accounting. The relevance, objectivity, timeliness, completeness, and comparability of the accounting records and statements are enhanced in an accrual-based accounting system because records of transactions and events takes place whenever a transaction occurs, even if no cash is received or disbursed.

Accrual Accounting System

Recognition of revenues and costs as they are earned or incurred (and not as money is received or paid). It includes recognition of transactions relating to assets and liabilities as they occur irrespective of the actual receipts or payments.

Accrual based system of accounting attempts to record financial effects of transactions in the period in which they accrue, rather than recording them in the period in which cash is received/paid. So, the transactions are recognised as soon as a right to receive revenue and/or an obligation to pay a liability is created i.e. incomes are recognized when earned and expenses are recognised when incurred.

Advantages of Accrual Accounting

- It gives comprehensive information on the Financial Position i.e. assets and liabilities of Government. In this system of accounting the financial decisions are not seen merely from the point of view of cash outgo or inflow but also from their impact on the asset- liability position of the government, future funding requirements of assets enabling planning of their timely maintenance and replacement.
- Liquidity position can be better assessed.
- It provides comprehensive information on expenses which enables comparison with alternative policies, which in turn assures optimal use of scarce resources.
- It helps in the assessment of financial performance by correctly reflecting surplus/deficit as all expenses whether paid or not and all incomes whether received or not are duly accounted for.
- It bridges the gap leftover by cash accounting by inclusion of accrued expenses and revenues (receivables and payables), physical assets, capital work-in-progress and depreciation, pension liabilities and provisions etc. in the accounting system.
- It gives information on whether income streams are adequate to meet short and long term liabilities so that their early payment keeping in view their payment period (short term and long term) and nature (cheap or costly loan) can be better managed.
- It provides comprehensive information on expenses which helps in

knowing the cost consequences of policies and enables comparison with alternative policies. Also, information about calculation of subsidy can be extracted from the accounts, which helps in its rationalisation. This ensures the adoption of best policy, which in turn assures optimal use of scarce resources. It also helps in ascertaining the future sustainability of programmes.

- It gives disclosures on account of contingent assets and contingent liabilities so that risk associated with the guarantees issued and letters of comfort given can be better assessed by the user of the financial statements.
- It discloses the Accounting Policies used in the preparation of Financial Statements for better understanding and appreciation of the Financial Statements.

The Accounting Reforms

The accounting reforms need to be understood in context of the stakeholders and their expectations of financial information. The major stakeholders for any ULB include:

(a) Citizens

(b) Legislature

(c) Executive

(d) Creditors

They require financial information for following purposes:

(a) determining compliance with laws rules and regulations

(b) evaluating efficiency and effectiveness

(c) facilitating decision making and monitoring

(d) assessing financial position

Advantages to an Economy/an Entity

The relevance of accrual accounting has to be looked at from the overall perspective of public financial management. It covers a broad spectrum of activities including budget preparation and execution, internal controls, accounting and financial reporting, internal audit, monitoring and reporting arrangements. Moreover, accrual accounting has to be assessed against the prevalent accounting practices, for improving the effectiveness of planning, policy making and budgeting process of public resources.

At the heart of the any fiscal management system is the accounting system, which maintains the basic records of Government transactions. A robust, comprehensive and transparent accounting system is a must for any Government

Advantages to an Economy

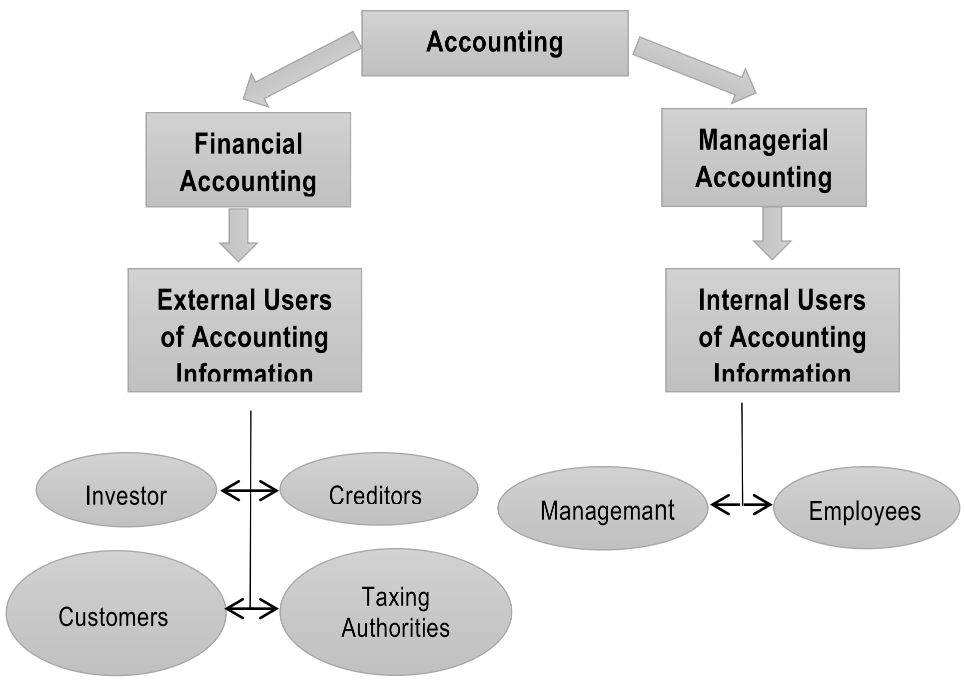
- Countries focusing on improving management of Government property may prioritize recognition of fixed assets over other constituents.
- Countries wanting to enhance surveillance of public enterprises may consolidate these entities in financial statements before bringing in local Governments.
- Leads to collection of additional data, reforms to business processes, modernization of IT systems, and capacity building both within and outside of Government.
- It is important to ensure an integrated set of financial data at each stage of the transition from cash to accrual accounting. This enables standard consistency checks and audit techniques to be applied.
- Implementing accrual accounting in the public sector takes a long time with continuous improvement in the quality, coverage, timeliness, and relevance of their financial data over a period of time.
- Recording of all stocks of assets and liabilities, in balance sheets. Governments that follow pure cash accounting typically account only for their cash holdings on the assets side and debt on the liability side of their balance sheets. These are often valued at “book value” or the value at which they were initially acquired or issued. Under accrual accounting, governments recognize all assets and liabilities including financial assets (such as equities), non-financial assets (such as land and buildings), and liabilities other than debt securities and bonds (such as payment arrears and pension obligations).
- Enhanced monitoring of liabilities and contingent liabilities. Liabilities such as employee entitlements, environmental obligations, insurance claim obligations, expected losses under guarantee schemes which are

not recognised in a cash based accounting receive requisite attention once recognised under accrual based accounting system.

- The consolidation of all entities under is Government control. Cash accounts typically only cover budgetary central government (central Government ministries and agencies). Accrual based international accounting standards call for financial statements which consolidate all entities under government control (such as extra-budgetary funds, arms-length agencies, and public corporations).

Accrual accounting therefore offers a number of benefits over traditional cash accounting from the point of view of government transparency, accountability, and financial management.

Figure IV- Types of Accounting & Users of Accounting Information



- By capturing both cash transactions and non-cash flows in financial statements, accrual-based fiscal reports provide a comprehensive view of the Government's financial performance and the cost of Government activities.

- Accrual accounting can help focus attention on the part of policymakers and the public on the acquisition, disposal, and management of Government assets, liabilities, and contingent liabilities.
- By reporting stocks and flows within an integrated accounting framework based on internationally-accepted standards, accrual accounting can improve the reliability and integrity of Government financial data.

Rationale for Moving from Cash Basis of Accounting to Accrual Basis of Accounting

The need for reforms in accounting originates from the realization of the limitations of the existing system. At the macro fiscal level, the importance of accrual accounting for macroeconomic policy arises from the fact that it measures assets and liabilities that are relevant to the overall stance of fiscal sustainability, but which are not measured by cash accounting. In particular, whereas cash accounting measures only conventional debt, accrual accounting measures other quasi-debt liabilities such as amount payable for the receipt of goods and services, and employed liabilities.

An accrual accounting framework is essential to systematically determine the full cost of Government's activities. Full cost information (including non-cash costs such as depreciation, accrued civil service pensions) is essential for assessing the efficiency of Government services and thus is a key element of any public sector performance management framework. More specifically, information about the full costs of Government services can be crucial when considering alternative service delivery options including outsourcing and cost recovery, as well as for purpose of international benchmarking (e.g. comparing the costs of health or education services).

Accounting Reforms as Engines of Good Governance

An integral part of the new expectations of governance is for Public Information – without which there cannot be meaningful participation or shared decision-making. The modern citizen expects a fair account of how the Government is faring in its job in much the same way as investors in a company expect fair accounts of the company's financial position and performance. Transparent accounting and financial reporting is central to the fulfillment of new age governance. The introduction of acceptable accounting practices and disclosure norms are not just technical practices but the foundations for the integrity and maturity of the government. For instance, municipal bodies in India today are facing an unprecedented growth in the demand for urban infrastructure and civic services. Municipal accounting systems would therefore need to reflect not only financial transactions but also the 'financial performance' of the municipal governments, which includes its ability to achieve its developmental goals, meet its programme targets, its efficiency in the use of resources, its financial position including income, assets and liabilities as well as its foresight in dealing with the developmental and financial challenges of governing the city.

It is necessary that accounting system has to satisfy the following basic objectives:

(i) be accurate in capturing the underlying transactions,

(ii) enhance transparency, and

(iii) be user-friendly to facilitate understanding of the accounting statements by most users. The prevailing cash-based accounting system in India is deficient on the dimensions of transparency and user-friendliness and therefore it becomes necessary to reform the accounting system.

The accrual based system is an improvement over the present cash based system. The appropriate accounting system provides all the information that is available in the present dispensation, besides providing such additional information which will make the accounting records more complete from a users' perspective. In a nutshell, the accrual accounting system supplements the cash accounting system. While cash accounts serve the purpose of legislative control over public finances, an accrual system is helpful in expanding the efficacy of fiscal management.

Chapter IX

Foundations of Municipal Accounting Reform

A municipal accounting reform (MAR) is the basic tool required for overall financial and management reforms in ULBs. The MAR primarily aims at three major fundamental financial reforms:

(i) improved asset–liability management;

(ii) improved expenditure management; and

(iii) maximization of revenue collections.

This can be achieved through a gradual process of activities that can be broadlycategorized into three major phases of financial management:

(i) Phase 1: Basic accounting and budgeting reforms;

(ii) Phase 2: Financial management reforms, through the introduction of management accounting techniques and tools; and

(iii) Phase 3: Implementation of e-governance and integration of all processes with the finance and accounting functions.

Table I - Municipal Accounting Reform Phases

Implementation Phases	**Activities**
Phase 1: Establish a double entry accrual-based accounting system	1. Assess ULB's readiness 2. Establish an institutional monitoring system 3. Finalize the required policies and legal requirements 4. Update accounts in arrears 5. Prepare opening balances 6. Design and migrate to a comprehensive IT system 7. Train and handhold ULB staff for one fiscal year

Phase 2: Establish a financial management improvement program	1. Prepare management information systems reports on all matters 2. Analyze the reports for various results 3. Establish parameters and benchmarks for efficiencies 4. Measure improvements
Phase 3: Establish an e-governance system	1. Create digital interface systems in the accounting process 2. Process transactions through electronic mode 3. Process tendering, bidding, etc. Electronically 4. Preparations and approvals of vouchers to be done electronically within the office system.

A. Supervision and Monitoring Structure for Municipal Accounting Reform

1. Institutional and Legal Arrangements

An appropriate institutional arrangement is the most crucial requirement for the rollout of a MAR. **The arrangements required for efficient implementation of a MAR include the following institutional setup prior to launching the MAR:**

(i) a state-level body to monitor and supervise the functioning of the accounting systems in the ULBs;

(ii) an information technology (IT) support system to run and maintain the accounting software;

(iii) a formal and regular training and capacity-building program for the accounting staff;

(iv) an effective audit system including arrangements with external accountants to conduct the balance sheet audit and review; and

(v) establishment of a municipal accounting cadre at the state level for continuous and sustainable capacity in the ULBs for accounting functions.

The change of policies at the state level is generally outside the control of local governments, but is intrinsic to the decentralization process. For this reason, MoUD has advised all the states to revise their respective Municipal Acts in accordance with the Model Municipal Law. ULBs have the authority to make decisions about human resources, financial mobilization, private sector participation, and organizational restructuring, which can improve the chances of a successful MAR.

2. Staff Capacity

Overall, there is a major staff capacity constraint in most ULBs. This is mainly due to inadequacy of staff strength caused by state restrictions on recruitment to positions and due to inadequate qualifications and capacity of the staff. Also, in many ULBs, the staff is liable to be transferred to and from the accounts department without consideration for their qualifications and skills. In some ULBs, the staff is not transferable, which leads to continuity and provides long-term support if adequate capacity is built by providing appropriate training to the staff. States and ULBs, with help from the MoUD, should review their current staffing practices to build capacity of municipal staff through the creation of a state municipal cadre of accountants, introduction of a certification program for ULB accountants, and provision of continuing training programs.

3. Auditing Arrangements and Finalization of Accounts

Audits of ULBs' accounts are conducted on a regular basis by the local fund auditor, state auditor, and accountant general. The Comptroller and Auditor General (C&AG) is also involved and supports ULB audits in line with the recommendations of the Eleventh Finance Commission. The C&AG is entrusted with technical guidance and supervision for the maintenance of accounts and the audit of local bodies, including providing technical guidance to the Director of the Local Fund Audit. These audits highlight performance issues and the quality of decentralization. With the adoption of the double entry accounting system, the auditor's capacity also needs to be enhanced.In some cases, a separate external audit is carried out by an independent firm of chartered accountants to certify the true and fair view of the financial statements. This is usually insisted upon by financial institutions and development agencies for an independent professional opinion of the financial position and performance of the ULB. This external assistance was found to be very useful wherever this process has been adopted, as it supplements the ULB staff's capacity.

Many states have set up steering committees to oversee the transition from the existing cash-based accounting system to an accrual-based system. The steering committee is well positioned to take several actions to strengthen the audit system such as:

(i) reviewing the existing audit processes, methodology, roles, mandate, capacity constraints, and backlog of audits;

(ii) collaborating with the C&AG office to reinforce training efforts for the double entry accrual system, risk-based audit, use of computer-aided audit techniques, and sampling;

(iii) examining the scope of cost audits in selected areas;

(iv) assuming the role of Municipal Audit and Accounts Committees to ensure that audit reports are examined and there is accountability of the councillors for public funds; and

(v) examining the efficacy of independent attestation through a panel of professional auditors.

The audit recommendations should be implemented in a time-bound manner to strengthen the role and function of auditing in urban local bodies. Further, there should be a simultaneous effort to encourage public disclosure and improve public oversight of ULB's accounts.

B. Robust Accounting System Architecture

1. Comprehensive Accounting Modules

ULBs' accounting module should be comprehensive and include all aspects of the accounting functions. The accounting modules should also encompass sub-modules such as budgeting, fixed assets, current assets, inventory, payroll, projects under implementation, liabilities, etc. In addition, administrative modules, such as building permissions, project monitoring, a birth and death registration system, a marriage registration system, a grievance redressal mechanism, legal cases to follow up, a project/ program database, slum data management, a solid waste management system, a wastewater management system, a streetlight management system and an advertisement revenue system should also be included. The accounting modules should have sub-modules to provide more detailed information, wherever required. This would facilitate better analysis of accounting records and data. The revenue module of ULBs should function as an integral part of the accounting system and be connected to the accounting module to capture revenue collections on a real-time basis. **The revenue module should also provide for:**

(i) a database of the taxpayers under various revenue heads of the ULB;

(ii) generation of demand automatically on the due date;

(iii) collection of taxes and other user charges at multiple points with an option to upscale it to alternate methods of collecting such as credit cards;

(iv) provision for online printing of receipts;

(v) provision for the citizens to view their dues online or at payment counters; and

(vi) a facility to generate the revenue-related MIS reports.

2. Ring Fencing of Utilities and Services

The accounting system also should have modules to capture expenditures under various grant funds and for various services and utilities of the ULB, including the following: water supply, sewage, and drainage;

(i) solid waste management;

(ii) roads development and maintenance;

(iii) slum service;

(iv) commercial projects like hospitals and schools; and

(v) general administrative services.

The objective of service-based accounting is to arrive at the income and expenditures for services separately and to assess the service delivery viabilities. This is possible through the adoption of cost-accounting principles of direct expenses and the capturing of indirect and overhead expenses through allocation and apportionment procedures. As a result of the ringfenced accounting procedure adopted, the accounting system should be able to provide the overall cost of a service and revenue for a period and per unit of service.

3. Reports and Management Information Systems

The strength of any MAR lies in the quality and type of reports and information that can be generated from the accounting system, which can provide data for management and decision making by ULB management. The reports generated should be capable of capturing updated information with details for review and analysis to aid in decision making. Some of the important reports generated include:

(i) aging analysis of demand collection balances of revenue items;

(ii) categorized analysis of revenue arrears;

(iii) status reports on fixed assets, inventories, projects under implementation, cash, bank, and treasury; and

(iv) aging analysis of receivables and payables.

C. Computerization and Information Technology

An essential part of any MAR is the decision about the use of IT and the design and development of software. The scope of computerisation can range from a small system to an elaborate system. An ideal choice would be to decide on centrally managed computer software and IT infrastructure. The extent of centralization could be at the ULB level, district level, or State level. The decision about the extent of centralization or decentralization depends on the ULB's management and the extent of control exercisable by the state system based on the institutional infrastructure available to monitor and supervise the system. Data should be centralized at the ULB level, district level, or state level for greater supervision, monitoring, and maintenance.

The software should essentially include modules, which are required in a full-fledged accounting system of a ULB. The modules should be able to interface with each other and be able to produce required reports and analysis in a structured and streamlined manner.

Table II-Prior Actions Required For Implementation of Municipal Accounting Reform

Area	Activities
Institutional arrangements	• Constitute a state-level steering committee, which should be vested with the authority to manage the project and to promulgate accounting standards, formats for budgeting and costing, financial statements and audit reports; and • Establish a state-level project management unit under the guidance of the steering committee to oversee

	the implementation of the new system and conduct capacity building and training of the municipal officials.
Legal Notifications	• Issue necessary initial government official orders for the rollout of the MAR; • Review the legislative framework to identify the changes necessary to implement the improved financial management system. The implementation of the improved financial management system for all ULBs and urban civic services providers may require amendments to relevant legislation, bylaws, rules, regulations, etc.; • Amend the legislature governing the ULB to incorporate the provisions to enable accounting on the basis of double entry accrual-based accounting system. • Develop a state-level accrual-based accounting manual based on NMAM detailing the accounting system, policies and procedures, the records and documents to be maintained, and the form, contents and periodicity of various accounting reports; and • Based on NMAVM, devise accounting policies and valuation norms for assets and liabilities
Staffing and support arrangements	• Appoint a consultant for development of a state-level municipal financial accounting manual • Identify capable staff from the ULB and the state government who will enable smooth implementation of the accounting reforms; • Formulate appropriate policies for handholding assistance and get the internal audit done from chartered accounting firms; • Evolve a suitable recruitment and transfer policy for municipal officials to ensure reasonable stability of the tenure of finance personnel; and • Develop state-level policies and guidelines based on NMATM on training and handholding.

Chapter X

Process of Implementation-Grafting to Transaction Based

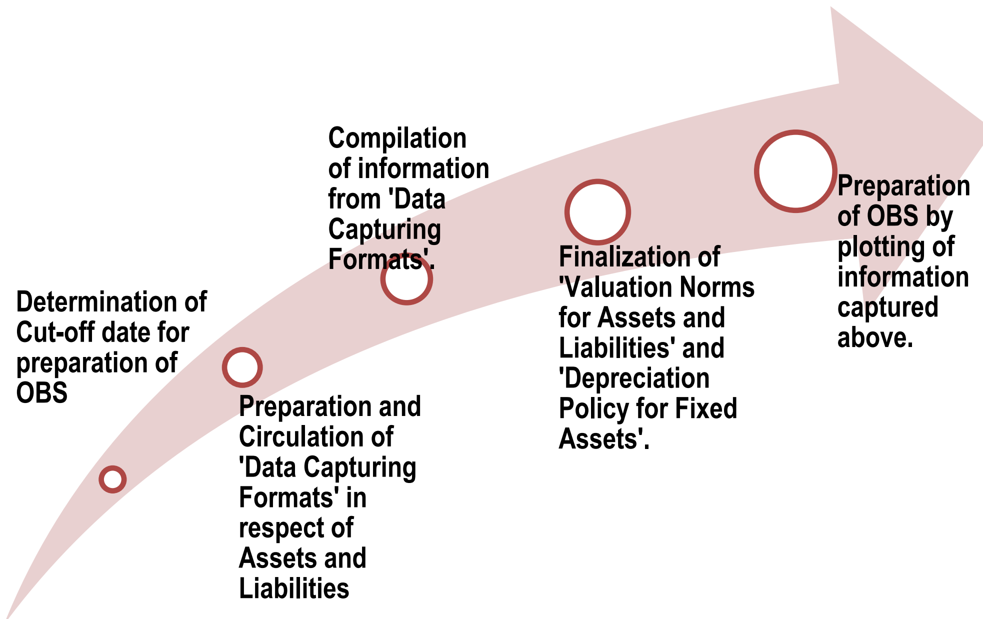
The conversion process of accounting from cash to accrual need to be undertaken with planning. As complete conversion may take longer time, it is suggested that to have early results, the existing financial statements prepared on cash basis can be converted into those on accrual based by including items having accrual impact in the final accounts like

- accounts payable
- accounts receivable,
- provisions required,
- income received in advance,
- recognition of fixed assets,
- depreciation/amortisation calculation,
- identification of contingent liabilities, etc.

This is also known as grafting method. This method uses the existing cash based data PLUS data having accrual impact collected separately. Introduction of these concepts in initial stage will enable the human resource involved to embrace the new concepts over a period of time. As and when the transaction level accrual accounting is introduced at the grass root level, this understanding will reduce resistance to change and ensure smooth transition.In comparison to transaction based accrual accounting, grafting method is easier and convenient as it uses existing data alongwith data having accrual impact. The first step towards accrual accounting is to identify account balances as on any cutoff date. So, an opening balance sheet is prepared to identify the account balances. ***Generally following process is followed for the compilation of Opening Balance Sheet:***

Process of Implementation-Grafting to Transaction Based

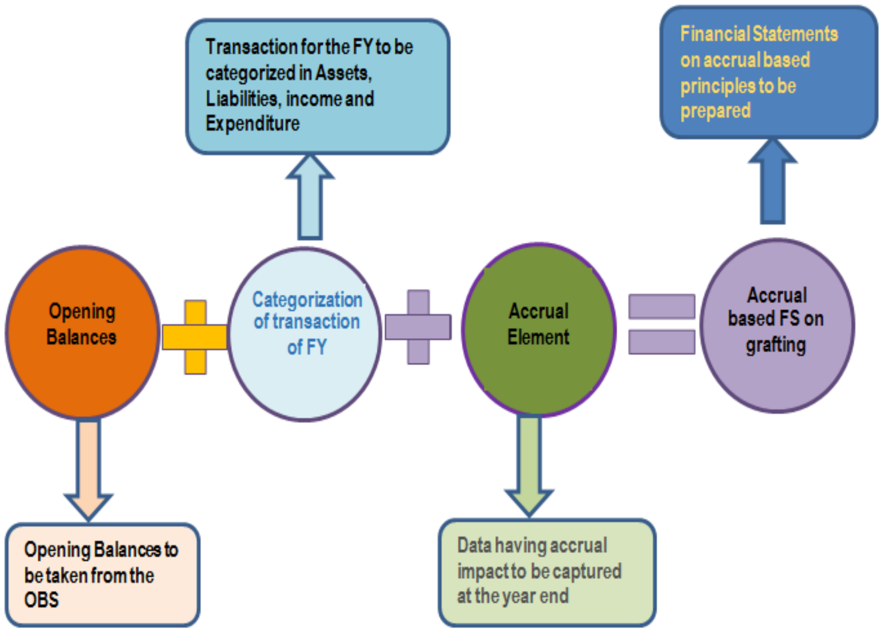
Figure V: Process for Compilation of Opening Balance Sheet



After preparation of Opening Balance Sheet, to sustain the accrual based accounting system, it is necessary to prepare financial statements for each financial year on grafting method till the system is developed for transactions based accrual accounting.

Figure VI: Process to Prepare Financial Statements on Grafting Method

Following process is carried out to prepare financial statements on grafting method subsequent to preparation of Opening Balance Sheet:



Conclusion

Accounting reforms or implementing new accounting system is not a one or two-day job. Therefore, it is required to be implemented in such a way so as to not to disturbance or with minimal disturbance to the existing system requirements/MIS. Grafting method for migrating to accrual accounting is the best way which does not disturb existing system of accounting instantaneously. Then system can be developed over a period of time to adopt transaction based accrual accounting.

Chapter XI

Process of Adoption

Issues in transition from cash based accounting to accrual accounting system can be categorized in two categories namely:

(a) Preparatory issues

(b) Implementation issues

Preparatory issues include:

I. Review of legislative framework by the State Government as ULBs are a state subject.

II. Development of Accounting Manual

III. Manpower and Training

Implementation issues include:

IV. Verification of assets and liabilities

V. Valuation of assets and liabilities

VI. Computerization

VII. Parallel Run

(I) Review of legislative framework

As ULBs are a state subject review of legislative framework is a necessary precondition for municipal accounting reforms. It is noticed that substantial work has been done in this respect. Model Municipal Law (MML) aims to strengthen current municipal laws and assist ULBs in areas of accounting reforms, resource mobilization and private sector participation. MML inter-alia aims at simplification of municipal byelaws, introducing specific provisions on financial management of ULBs, municipal revenue, urban environmental infrastructure and services and regulatory jurisdiction. MML was circulated to all the states in October 2003. The Ministry has been impressing States/Union territories the need for implementation of provisions of the MML as well as adoption of double entry accounting system by ULBs. While the twelfth report of Standing Committee on Urban Development (2005-2006) applauds measures taken by the Union Government in areas of municipal accounting reforms and enactment of the MML for strengthening ULBs in pursuance of Constitution (74th Amendment) Act, it also mentions that their proper implementation is also desired, otherwise such initiatives may remain sterile.

(II) Development of Accounting Manual

The Accounting Manual would bring about procedure to be followed in preparation of accounts statements, the accounts and documents required to be maintained and the form, contents and periodicity of various accounting reports to be generated. As already brought out in Section-II above the National Municipal Accounting Manual has been prepared and circulated to State Governments for adoption/implementation by MOUD.

(III) Manpower & Training

Success of the accounting reforms depends on skills and attitude of the accounting personnel. It is therefore, desirable that they are involved in the process of transition right from the beginning and are explained the necessity and importance of such transition. They need to be provided extensive training so that reform process is internalized and not hijacked by a select group. It may also be mentioned that NIUA has prepared National Municipal Accounting Training Manual 2007 as a follow up of the National Municipal Accounts Manual under INDO-USAID FIRE (D) Project.

(IV) Verification of assets and liabilities

The entire exercise about municipal accounting reforms described above would result in the most visible final product popularly known as “Balance Sheet”. Most crucial components of Balance Sheet are:

Assets

(a) Fixed Assets

(b) Current Assets

Liabilities

(a) Long term Liabilities

(b) Current Liabilities

Typically, a single entry, cash based system of accounting does not required preparation of Balance Sheet. Therefore, the first requirement for transition to accrual based double entry system of accounting is the mechanism for preparation of Balance Sheet. This obviously, translates into identification of Assets and Liabilities and their valuation.

Verification of assets and liabilities continues to be the most crucial and controversial area in the context of municipal accounting reforms. The Task Force has flagged this issue and very categorically stated that some of the assets/liabilities remain unrecorded. In case of fixed assets, documentary evidence of their cost, quantity etc. may not be readily available.

Experience shared at various forums across the country clearly highlighted the fact that historically no opening balances are maintained by ULBs. The Asset Registers/Stock Registers etc. giving details of assets, date of acquisition/construction, cost of acquisition/construction are simply not available. In absence of basic information, question of proper classification/grouping of fixed assets maintained does not arise. Thus the first challenge before the ULB is to identify the existing fixed assets.

The NMAM has given detailed guidelines for preparation of opening balance sheet which inter-alia include classification of fixed assets into six categories namely Land, Building, Road-Streets-Lanes, Bridges-Culverts etc. and Furniture & Fixture etc. It also suggests that physical verification of assets may be carried out which should be cross verified with existing records. In real life it is not very uncommon to come across cases where physical verification is entrusted to very junior functionaries thereby defeating the very purpose, mismatch between existing records and physical verification, double counting of assets or total omission of some assets putting a question mark on reliability of information. This notwithstanding opening balance sheet must be prepared because a perfect opening balance sheet is a desirable but not essential precondition for reforms.

(V) Valuation of Assets

Valuation of fixed assets normally depends upon the cost of acquisition/ construction and cost of improvement, if any. NMAM provides that in case the cost of acquisition/construction is not available, an estimate of cost that would have been incurred for the acquisition/construction should be provided. In ULB the details regarding cost of acquisition are rarely available. Cash basis of accounting hardly contained information on cost of improvement of specific assets. Under such circumstances estimation of cost/value of fixed assets is a huge task. Some ULBs resorted to valuation of all such assets at nominal value of Rs.1 for opening balance sheet, thereby defeating the very purpose of accrual accounting i.e. transparency, reliability and accountability.

This also raised a fundamental issue i.e. valuation of infrastructure like roads, water and sewerage lines which strictly speaking are not tradable commodities. Further, the norms and rates for depreciation of fixed assets also need to be disclosed. The NMAM also mentions that a Task Force is being set up to prescribe life and ratio of depreciation for different types of assets of ULBs.

Current assets which inter-alia includes sundry debtors/receivables also need to be examined very carefully in context of ULBs. Given the socio-political milieu and nature of function of ULB, they have huge amounts of arrears on account of property tax, licence fee etc. Most of the ULBs are not maintaining year-wise/ age-wise break up of such arrears. Many of these arrears are also disputed and are pending in various courts of law or have been remanded back to the ULB. An exercise needs to be done to assess how much of these arrears are recoverable and accordingly reflected in the Balance Sheet. The Task Force has recommended that annually 50 percent will be provided on all outstanding beyond 3 years. The NMAM has also provided that in respect of the demand outstanding beyond specified years, provision shall be made to the extent of income of the ULB in the demand, based on the provisioning norms.

Treatments of current assets which include receivables on account of arrears of property tax, licence fee etc. are very crucial in context of ULBs for two reasons. Firstly, these are major sources of revenue for the ULB and secondly many times arrears are on account of dispute on interpretation of rules/regulations etc. Therefore, ULB needs to do a realistic assessment of what is actually recoverable. That assessment inter-alia may be based on age-wise analysis of arrears. However, other relevant factors also need to be looked at and arrears should be perhaps segregated with reference to amount under litigation, under stay and cases remanded back to ULB.

On the liability side the major issue which needs to be addressed is the pension fund. Most of the ULBs like government make provision for pension for their ex-employees in budget. There is a need to conduct actuarial studies to know the dimensions of pensionary liabilities of the ULB in the short term, medium term and long term.

(VI) Computerization

The Task Force recommended that after the accrual based accounting system stabilizes the ULB may go in for computerization. It is generally perceived that computerization is a necessary precondition for success of municipal accounting reforms. Many ULBs are trying to switch over to accrual based accounting in the computerized environment only.

(VII) Parallel Run

The Task Force recommended for a parallel run for smooth switch over from old system of single entry to accrual based accounting system. In practice the ULBs have resorted to shortcuts e.g. the new account being prepared by Consultants as a stand alone exercise. ULBs instead of preparing the accounts on accrual basis by compilation of vouchers have also resorted to convergence of accounts by simply using the convergence tables. The accounts so prepared actually neither reflect true and fair view of the entity nor do they highlight the issues that may actually be encountered while compiling the accounts on accrual basis from the vouchers.

Few other areas of concern in transition to accrual accounting are given below:

- **Formulating accounting policies**

Cash accounting is concerned mainly with the recording of cash receipts and payments, and is relatively simple to operate. This simplicity, however, comes at a cost-cash accounting fails to provide essential information about non-cash transactions and stocks of assets and liabilities. Accrual accounting, as discussed above, is a more comprehensive accounting system requiring the recording of flows and stocks within an integrated framework. The recognition and measurement or valuation of complex transactions, and assets and liabilities (e.g., finance leases, private-public partnerships (PPP), financial instruments, and intangible assets) often require the exercise of judgment and technical skill with attendant risks of errors and misstatements. It is partly to reduce such risks that national and international accounting standards are necessary. Accounting standards provide guidance on acceptable accounting treatment of specific items and define the minimum requirements that general purpose financial statements need to satisfy. One of the most important issues that governments need to address when contemplating a move to accrual accounting is the selection and application of appropriate accounting policies consistent with relevant accounting standards. Where existing standards do not deal with a particular issue, judgment has to be exercised to select accounting policies that would help generate relevant and reliable financial information.

- **Budget classification and the chart of accounts**

A budget classification sets out the manner in which the budgeted revenues, expenditures, and financing items would be categorized and presented in the budget. Under a cash budgeting system, the budget classification would not include stocks of assets or liabilities.

A chart of accounts (COA) is a logical coding framework that forms the basis of recording accounting transactions and balances (flows and stocks) in the general ledger, the principal accounting record of an entity.

In a well-designed system, the COA should incorporate the budget classification. This means that in addition to all the accounts specified in the budget classification, the COA will include other accounts required for accounting and reporting purposes. For example, a COA will have accounts for assets and liabilities that would not normally be included in a cash-based budget classification.

In addition, a COA would normally also include information about particular revenues and expenses at a more detailed level than required for the budget classification.

If a Local Body moves to accrual accounting and accrual budgeting simultaneously, then the COA and the budget classification can be expected to be unified, at the appropriate level of aggregation.

However, if the Local Body decides to adopt an accrual accounting regime, while continuing with cash budgets, there will be significant differences between the two classification systems.

The COA, in these circumstances, must maintain the capacity to generate both accrual-and- cash based reports. In addition, in these circumstances, the accrual system must provide necessary functionality to prevent breaches of legal expenditure limits, which may be based on cash or commitment concepts.

The design of the government's COA can have a critical impact on the efficacy of the accrual accounting framework. The COA occupies an important central place because it determines the classification of transactions and balances recorded in the government's general ledger and, therefore, determines the scope and content of financial reports that will be available from the government's central system. The COA must have the capacity to accommodate current data requirements and, to the extent practicable, anticipate future requirements. The COA must also be designed in such a way that it can support diverse reporting requirements of governments (e.g., management reports, budget reports, financial statements subject to audit, and reports in accordance with other applicable requirements (e.g., GFSM 2001, the European System of Accounts (ESA) 1995, and System of National Accounts (SNA), without the need for multiple data entry.

In order to meet the diverse requirements, COAs are often designed as a combination of segments (or dimensions) where each segment corresponds to a particular information element. Thus a COA may have separate segments for economic, functional, administrative, and regional classification.

In addition, separate segments may also be utilized to capture data about cost centers, programs, projects, outputs and outcomes. Transactions would be recorded, and reports generated, utilizing an appropriate combination of segment codes. In this way, a well- designed COA can facilitate the capture, classification, analysis, and reporting of a large quantity of data.

- **Opening balance sheet**

The systematic identification and valuation of assets and liabilities as at the date from which accrual accounting is to commence is an indispensable step in the move to accrual accounting. The opening balance sheet has to be supported by adequate information and explanation necessary for audit. This can be a very challenging and time-consuming process. The concept of materiality and prudence may be used to make judgments about assets and liabilities that should receive the most attention during this exercise.

- **Valuation Issues**

The traditional basis for valuation has been historic cost. There is, however, a growing movement to adopt more current approaches to valuation. Conceptually, current valuations are generally viewed as superior, but practical considerations have often led to the continuation / adoption of the historic cost approach. There are, however, problems regardless of which approach is adopted.

The historic approach is based on assets valued at their acquisition costs with subsequent depreciation. This can be viewed as a more objective approach as it is based on the amount actually paid for the asset. It is also easier to handle from a practical point of view.

Current valuations are meant to alleviate this problem. By their very nature, they are more relevant, i.e. the information is not out-of-date. As a result, they are viewed as a better indicator of the level of resources tied- up in an entity and a better basis to evaluate the performance of an entity. This is especially so when calculating the true cost of services provided (i.e. the flow-through from the balance sheet to the operating statement in the form of depreciation). Current valuation is also of much greater value for economic analysis.

The use of current valuation methodologies does, however, require many professional judgements to be made. There are a number of different methodologies for applying current valuations. These include depreciated replacement cost, value-in-use and net realisable value. Each of these has its own problems. Depreciated replacement cost assumes that one would purchase exactly the same asset in future, which most likely is not the case. Value- in- use methodologies are very dependent on management intent. Furthermore, when this approach is adopted in non -competitive environments, an entity can raise its charges and thereby the cash flows from an asset. As a result, the value of the asset would increase. This can therefore become a circular and rather meaningless exercise. The problem with the net realisable value approach centres on specialised assets, where markets may not exist or may not be reliable.

A further difficulty with current valuations is that they can fluctuate significantly from one year to another. This can create windfalls when values go up, but short -falls when values go down. This can have a great impact on the reported bottom line of governments. Will politicians be willing to accept that the government's bottom line can be determined by such fluctuations? Also, is there a danger that fiscal discipline may be undermined if the windfalls from such fluctuations are used to increase other expenditures. This again highlights the behavioural impact that the adoption of accruals can bring about.

- **Technical & IT Competency**

International experience suggests that a lack of adequate technical resources can be a major impediment to successful implementation of accrual accounting**.** It is essential that a government considering a move to accrual accounting has either a core of officials with required technical (accounting, IT, etc.) skills, or the capacity to recruit such people for its key positions. Outside consultants may be used to supplement in-house resources to develop the framework and the associated systems and procedures.

Although, in theory, cash or accrual accounting can be implemented with either a manual or an electronic system, in practice, it would be inadvisable for a government to attempt to implement full accrual accounting without the aid of a modern government financial management information system (GFMIS) with proven functionality in areas such as general ledger, accounts payable, purchases, assets management, etc. Implementation of such a system would be a major project, which would normally be a part of the accrual accounting project.

However, in order to ensure that the reforms are sustainable, consultants should be used mainly for capacity-building purposes and to assist officials with specific technical implementation issues (e.g., IT systems). The following institutional and professional arrangements would greatly facilitate a move to an accrual accounting framework:

- a well-established and regulated national professional accounting body;
- a well-functioning supreme audit institution;
- effective parliamentary public accounts committees;
- a national valuation office (or private sector valuation experts) to assist with valuation of assets; and
- an actuarial institution to assist with valuation of employee and social policy liabilities.

- **Social Insurance Programs**

The treatment of social insurance programs, such as general old-age pension programs, is a very contentious issue in an accrual environment. It is important to emphasize that this does not refer to the treatment of government employees' pension programs; these are contractual obligations and their treatment as a liability is clear-cut.

There are two schools of thought on this subject. Those who believe social insurance programs should be treated as a liability for the government, and those who do not. Social policy obligations at times may trigger liabilities upon government and for which accounting issues need to be considered whether to bring these obligations into the accounts or ignore on the grounds that the legislation affecting them can be changed and therefore the potential liabilities are not capable of measurement.

- **Fostering a "Cultural Change"**

Perhaps the overriding lesson is that implementing accruals cannot be seen as a technical accounting exercise. It needs to involve a "cultural change" in government and be linked with wider public management reforms. For accruals to be worthwhile and successful, the new information that accruals bring forth needs to be used to improve decision-making in government. This change will not necessarily happen automatically. It needs to be actively promoted, especially at the level of policy makers and senior officials.

- **Communication**

The countries that were first to move to accruals generally cite the need for more and better communication as the single overwhelming factor that was underestimated in the implementation of accruals. This includes promoting the "culture change" as noted above, but extends to all facets of the implementation cycle.

It is essential to have the specific new accounting policies available early so that line ministries and agencies can have adequate preparations. The use of task forces on specific issues composed of officials from a range of ministries and agencies serves to get buy-in from them more readily than otherwise.

Close communication with the audit office is also necessary if they are to reinforce the reform and attest to the accounts on an accrual basis. It allows the finance ministry to understand their concerns and the audit office to understand better the motives and rationale of the government for the decisions it takes as it implements accruals.

- **Impetus for Adopting Accrual Concepts Differently from Private Sector**

The private sector focuses on commercial viability whereas the government plays a developmental and social role. Therefore, the need for economic and rural development might necessitate governments to adopt accrual concepts differently from private sector. The concept of 'true and fair' is different in government from that of the private sector. Further the concept of net worth in government is not as important as in the private sector. The focus of accrual accounting in government is to ensure that the output and outcome of the spending are commensurate with the inputs and the long-term fiscal sustainability of government is captured appropriately.

- **Social Costs and Benefits of Government Accounting Reform**

It is not widely recognized that a sound government accounting system is an important part of a country's institutional infrastructure. Rather, government accounting is commonly perceived as a bureaucratic function. To make matters worse, like the foundation of a house or the sewer lines under the street, the accounting system as a critical institutional infrastructure is often invisible until it fails: when public money is lost and wasted, when taxes are not collected, or when employees are not paid on time. Better accounting systems can quite readily lead to improvements in a government's financial management. However, the accounting system's contribution to the achievement of higher-order goals, such as poverty reduction, is necessarily indirect and long-term. Hence, it is difficult to see its social benefits.

Furthermore, in economically poor countries, government accounting reform poses a moral dilemma. Because of its costs, such reforms compete with food for the hungry, medicine for the sick and clean water for urban slum dwellers. In such an environment, one can't justify spending money to improve the way a government keeps its accounts and produces annual financial reports.

This moral predicament is resolved by the social benefits of government accounting. Government accounting itself does not reduce poverty. Government accounting contributes to a country's socioeconomic development through its effect on public financial management and accountability. Effective government accounting makes it possible to manage the government's finances smoothly and provides audit trails to prevent and detect financial misconduct. In the light of the pervasiveness and severity of government corruption in many developing countries (Rose-Ackerman, 1999), financial integrity assurance is a critically important function of government accounting systems. Only an ethical and competent public management can efficiently and effectively implement programs to reduce poverty reduction and achieve other socioeconomic goals. Sachs declared: "No country should receive greater funding unless the money [for poverty reduction] can be audited."

It is important for accountants to educate the public and public officials about the social value of government accounting. The accounting system is in effect the "nerves of government" -to use Karl Deutsch's phrase (Deutsch,

1966) -because it is the core of a government's financial command and control centre. A government accounting system can be rudimentary or sophisticated. As in business (Simon, 1954), a good government accounting system at the minimum keeps accurate financial scores; a better government accounting system directs the attention of policy makers and managers to problem areas; and at its best, a government accounting system provides information useful for decision making.

Thus it takes a certain amount of foresight and insight to make investments in government accounting reform: the foresight to anticipate the consequences of bad or no accounting and the insight to link accounting to government performance and eventually the achievement of societal goals. Government accounting can contribute to a country's socio- economic development by providing information to public managers and those who hold them accountable to perform the fundamental functions of the state. As a support function, accounting does not have value of its own, and does not decide the allocation of resources. However, once these decisions are made, the accounting system performs the critical function of following the money. As such, accounting and its allied functions including information system design, internal control, pre-and post-audit, revenue administration, and public expenditure management -ensure that resources are used for their intended purposes. If the purpose is socio-economic development, accounting can help meet this goal by ensuring legal and contractual compliance, facilitating financial management, and promoting transparency and accountability.

Chapter XII

Chart of Accounts

Meaning of Chart of Accounts

A chart of accounts is a listing of all account heads. Each account is denoted by an account name and a reference number. The account name is known as the "account head ", and the reference number is known as the "account code". The chart of accounts varies from one organization to another depending on the nature of activity of the organization. The chart of accounts groups accounts of a similar nature into groups and sub-groups at different levels (major heads, minor heads and detailed heads with accompanying codes). The number of levels and the length of the account codes depend on the requirements of the organization.

Benefits of Chart of Accounts

The chart of accounts is of great help to the accountant in identifying the appropriate account heads for passing an entry for a financial transaction. It also provides uniformity of accounting and reporting financial transactions. A common understanding and usage of the account heads facilitates not only a comparison over different time periods, but also comparison across different ULBs.

Chart of Accounts (COA) defines the heads under which the income and expenditure of local bodies are classified and facilitates maintenance of accounts and preparation of financial statements. A well designed COA shall not only fulfill accounting requirements but also the Budgeting and MIS requirements and shall be flexible enough to consolidate and collapse to facilitate generation of various information reports.

A Chart of Accounts is a system of classification applied to financial transaction. Through the use of this system one can get answers to the following questions:-

1. What is the basic nature of this transaction? How is it linked to key parameters of financial operations?
2. Which aspect of the entities financial position does this transaction has an impact on?

3. Where the money for the transaction did comes from? And what was it used for?
4. Who was responsible, and who is accountable for this transaction?
5. If the transaction affected any particular geographical location than what was that location?
6. What is the link between this transaction and the basic tasks that the entity is supposed to perform?

In modifying the Chart of Accounts (CoA), it must be noted that the CoA

- Should be definitive
- Should be logical
- Must be adaptable to the proposed accounting environment
- Should support changes as they may arise
- Must be easily understood yet comprehensive
- Compatible to Computer Systems as they may exist or as they are proposed to be installed
- Must reflect the nature of transactions or process

The issues that must be looked at and avoided at the time of revision of the chart of accounts can be briefly identified as

- Budget codes without predefined logic
- Misclassification of heads i.e. distinction not existing between reporting and accounting heads
- Codes created for functional data capture rather than capture under accounting.

The rationale of the chart of accounts needs to be specified by the consultant so that this is clearly understood and accepted by the urban local body. Particularly, it will help if the consultant can, through a separate presentation if necessary, explain to the top management how

- The logic of CoA is based on Functional Segmentation
- All major functional segments become discrete through the revision

process undertaken i.e. mutual relationship of activities become distinct

It must be noted that the purpose of all these revisions is to ultimately help the city government to achieve the major objective of the city government – the management of the activities relating to the city in a manner that is compatible with the statutory duties of the government. This means in effect that the overall objectives of the city government are above the functional targets of the separate departments. Therefore, the COA needs to be formulated by objectives rather than the functions of the departments and a hierarchy of budget heads and MIS heads to be established to meet the overall City Govt. Objectives.

Usually the current system of account coding is a cumulation of numeric and alpha sub codes. A normal structure in use in municipal bodies may be shown as follows:

TABLE III- STRUCTURE IN USE IN MUNICIPAL BODIES

	Main Head	**Sub 1 Head**	**Sub 2 Head**	**Sub 3 Head**	**Sub 4 Head**	**Sub 5 Head**	**Account Code**
	1	A	1	*(i)*	*(a)*	i	
1	General Taxes, Indirect Taxation and Miscellaneous Revenue						1
A		Domestic Taxes					1A
1			Obligatory Taxes				11
(i)				General Taxes from Urban Area			11(i)
(a)					Current		11(i)(a)
(b)						Arrears	11(i)(b)

Therefore, from the above illustration, it can be seen that the account code is alphanumeric. It is difficult to read and interpret. It is not possible to clearly identify the nature of account – asset, liability, income, expenditure of suspense heads. Therefore, to make it more easy and familiar the first step would be to identify each account head with its nature i.e., Asset, Liability, Income, Expenditure or Suspense. Once identified, each account code would have a prefix of the appropriate head e.g., say, all assets to start with code 1, all liabilities with code 2, all expenses with code 3, all incomes with code 4 and all suspense accounts with code 5. It would then be possible to identify the account head by merely looking at the account code. It is recommended that the accounting tree as being currently followed be reviewed.

The exercise begins by the identification of the following categories in the current chart of accounts:

- Assets
- Liabilities
- Income
- Expenditure

The identification of the various heads in the current chart of accounts is a crucial exercise. At the beginning, this needs to be commenced on a fund level basis. At first, there is a need to identify which funds are Proprietary in nature. Once identified, a Standardized Chart of Accounts would need to be prepared across Proprietary Funds distinguishing between Assets, Liabilities, Incomes, Expenditures and Suspense accounts. At the same time this needs to be identified for the Government Fund too.

It is apparent that this is a crucial exercise as the Chart of Accounts is the backbone of the accounting system, wherein once it is fixed and cleared, the accounting and MIS can be structured very easily. Fund level segregation is important from the perspective of GASB Pronouncements that make it very clear that Fund Level set of books must be maintained and segregation thereon between Funds be watertight.

To be able to obtain Zone and Ward Level information for each Fund there needs to be a unique code for each for each and every entry made in the books –a ward code which possibly links itself to its constituency, a Zonal code that identifies the Zone in question, and a Fund Code so that the entry is unique to that fund.

At the Zonal level the commutation would be Head of Account based at

Zonal level with individual entries having their corresponding links to their respective find. However, when cumulating at the Head Quarter level, the key field for the cumulation would be the requisite Fund.Therefore, at the headquarters, Fund Based Balance Sheet and Income and Expense Account would be statutorily maintained. However, it is possible to get MIS at the headquarters on individual wards, individual zones, certain expense /income reporting across wards / zones etc. Therefore, the efficiency reports could be generated across Funds, Zones, Wards, Constituencies or Account Groups. This flexibility would provide the Standing Committee the relevant information on how to assess expenditures /incomes versus budgets, collection efficiency in Zones / Wards, Ward performance, Zonal efficiency and Fund performance. These multifarious views would help councillors assess the efficiency of their constituency.

The next step of the exercise would be to review and suggest changes in current chart of accounts with respect to the following:

- **Removal of irrelevant heads**

  On review of the current Chart of Accounts of the Corporation is would be apparent that certain heads of accounts are superfluous i.e., accounting activity pertaining to that head has stopped or no budgetary support has been provided to that head for several years. Therefore, they exist as they are and add only volume not value to the Chart of Accounts. These heads appropriately need to be removed or else altered, if necessary or merged with some other head. Decisions on these are critical and require study and introspection keeping in view the how the Corporation would like to present their accounts in the future. Therefore, consensus and critical evaluation needs to be done before such heads of accounts are permanently removed or altered.

- **Creation of new heads with respect to Computerized Accrual Based Double Entry System of Accounting in the Corporation**

  The creation of new heads is also a very crucial activity – new heads represent new activities the ULB seeks to undertake. This again requires that new heads have to be thought through – one may have to consider their need and relevance, both in the current context and also the Corporation's future.

  In the case of a Double Entry System, accrual heads are to be included in the present Chart of Accounts. The accrual heads as seen in traditional double entry system, are not present in the Corporation's Chart of Accounts. They need to be first understood and thereafter included. This inclusion would be based on a) a needs assessment of the Corporation b) relevance of these heads in the current context of the Corporation c) their relevance in the Corporation's future.

- **Discussion and seek confirmation on proposed changes in the current Chart of Accounts**

  Once the changes, alterations and inclusions are identified and their rationale accepted, it is then proposed to formalize the process of creation of change with all the necessary formalities adhered to, so that this change takes effect.

  It is important to note that all changes that have been considered and effected have serious ramifications- once formal accounting commences, it would be very difficult to once again alter those codes that have already been approved for changes. Therefore, a consensus based approach in finally fixing the account code needs to be made. Thereafter formal entries need to be made in such account codes.

  The third step would be to recodify the Chart of Accounts giving due consideration to future computerized based Double Entry Accounting System. Once the Chart of Accounts has been fixed at each fund level, an efficient codification process would need to be initiated to ensure that that the new codes are in sync with the computerized double entry system put in place. This code would be specific to both the new computerized systems in place as also the specific needs of the Corporation's accounting system.

The C&AG in its "Report of Task Force on Accounting and Budget Formats for Urban Local Bodies" made the following recommendation regarding Budget and Accounting Formats. Budgets Heads had been divided into following three tier Codes:

(a) Major Head Code – 3 digit.

(b) Minor Head Code – 2 digit.

(c) Detailed Head Code -2 or 3 digit as per the requirement of Urban Local Bodies (ULBs).

The ULBs should identify the operative detailed heads, with the same description and code no. for accounting purposes. Further detailed heads commonly in use in ULBs within a particular State can be added at the State level and would apply uniformly in all ULBs within the State. Detailed Heads unique to a particular ULB can also be added with the approval of the State Government. All addition to detailed heads at the State level would however, be required to be intimated to Principal Director (Local Bodies), office of the C&AG of India, New Delhi.

- Major and Minor Head Codes given in the budget format would apply uniformly to all Urban Local Bodies in India
- Some Urban Local Bodies may have further break up in their activities requiring sub-heads above detailed heads ULBs can induct sub-heads under minor head and thereafter detailed heads may be suitably opened, with the approval of State Government

Major Head Code

- Three-digit code may be allotted to major Head, the first digit indicating whether Major Head Code is Revenue Receipt, Revenue Expenditure, Capital Receipt or Capital Expenditure
- If the first digit is "0", the head of account would represent Revenue Receipt
- If the first digit is "1", the head of account would represent Revenue Expenditure
- If the first digit is "2", the head of account would represent Capital Receipts
- If the first digit is "3", the head of account would represent Capital Expenditure
- Next two digit are running serial number of respective Major Head Code

Minor Head Code

- These may be allotted a two-digit code, the code starting from "01" under each Major Head Code
- For recording transactions relating to the 18 functions envisaged to be entrusted to the Urban Local Bodies {ULBs} as per 12th Schedule to the Constitution, minor heads of accounts have appropriately been provided in the budget and accounts, wherever applicable

Once the accounting heads and codes are in place, the accounting processes that need to be reworked considering the new accounting software proposed to be implemented has to be considered. Reworking of the accounting processes requires definition of the entries that need to be passed in a double entry scenario.

The General Ledger

The General Ledger ("GL") is the core system under which the accounting structure would inevitably rest. The GL would contain the Chart of Accounts, MIs formats as well as the GPFS formats from which the final balance sheet and profit and loss account of the corporation would be reported on.

If the GASB recommended fund based accounting system is being followed diligently, there would be a requirement to maintain at least two GLs –one exclusively for the governmental funds and the other for the proprietary funds. In case of proprietary funds, each fund would behave like separate company with its own GL – however, all residing in common physical GL. Some software systems allow for such accounting segregation without the need for a physical segregation of the GL. The consolidation of the accounting information between both the GLs would have to be in either of them (preferably in the governmental GL) from which accounting MIS would be derived.

Contractors Accounting System

This would track Contracts signed for, executable within the current year, tracking the long term liability of the contract, the cash liability towards executed projects, payments made against contracts to contractors, the Measurement Book, Encumbrances, etc. This is a suggestion from our side – a contractor's system is keenly required in the Corporation, as understood by us and to devise a tracking, MIS and accounting system for contractors that would link to the main accounting system. This is something that needs to be considered. This system would have a link to the Asset system when an asset is created and capitalized and the Purchase/Payable system for payments towards materials purchased and the contractors bills respectively. The Contractors Accounting System is similar to a Project Accounting System wherein each works contract is treated and accounted for like a separate project.

Revenue System

This would be a system that would enable the billing process in the municipal body. The Revenue System would have individual ledgers of all tax payers.

Inventory System

The inventory system would be a logical system. It would have to record all current assets of the municipal body. They would be assets in the form of stores and spares and parts of equipment of the Corporation. The inventory system would be linked to the Purchase System which would thereafter link itself to the Payable system.

Purchase System

A purchase system is required to look into the logistics of purchase. If an inventory system were designed, the purchase system would be linked into the inventory system. When the inventory system would trigger the need for an order based on stock levels etc, it would trigger a purchase action for the purchase system to take over.

Payable System

The payable system is the link between purchase / Inventory Systems to the GL. The payable system would contain all records relating to creditors as well as bank accounts that have to be used to effect payments. The cheque printing facility (if any) would be part of the payable system. The payable system works as a tool to track creditors, make payments, get MIS on payments to be made, create payable entries at year end that are passed through the GL.

Asset System

The Asset System in the GL records all the assets that are both in the governmental fund and in the proprietary fund. It would work as an asset register showing location, cost of purchase and asset identification codes. It would also be a grouping of assets wherein, based on depreciation rates on groups, such assets would be depreciated. In case of the governmental fund, it would only have proforma records of assets which would appear as a group for MIS purposes. However, it could allow tracking of the life of the asset for it to be replaced at some point of time. Depreciation would not be a financial entry but only a MIS entry. However, for the proprietary funds the

Asset System would track location of asset and also allow for the passing of depreciation entries, which is a financial entry to be reflected in the GL.

Payroll System

The payroll system actually exists in some parts of the Corporation and it would be wise to like the present to the new GL via the Payable System.

Budgetary Control System

The budgetary control system would be a part of all subsidiary systems as well as an integral part of General Ledger. The account- head wise budgets as followed in the Municipal Corporation would be reflected at first in the Chart of Accounts as being done currently. The same budgets would be reflected in the subsidiary books and as when they are required.

Reworking on the Accounting Process

In reworking of the accounting systems, there would be a number of sub-issues that would arise. One methodology that has been found to be useful is to create Department/Ward/ Borough Control Accounts. In most municipal bodies expenses statements are not forthcoming from the expending departments, although money is demanded and paid on specific heads. Therefore, for control purposes, monies given to the departments may be shown as advances and reconciled when detailed statements of expenditures are available. This is also important because in many instances, the money demanded for a specific purpose is not spent for that purpose. For instance, salaries may be paid from the money received to pay a contractor's bill. Similarly, expenses may be shown without bifurcation as to their nature, i.e., revenue or capital. Use of the Control Accounts helps in improving accountability.

Comments on usable software

A major question in managing transition arises from the identification of the accounting software. It may be noted that it is certainly not necessary to invest in expensive hardware or software at the initial stage. Formats for compilation of accounting data are to be designed by the advisor and circulated in the various departments of the municipal body. The formats can be filled in on simple Excel formatting and the data mailed to headquarters to be processed. That processing can also be done on a commonly used database. It is, in fact, not necessary to keep a single comprehensive database of all transactions together, if adequate backup of each set of data are kept. Customized accounting packages, which are variants of accounting packages available freely, can also be used. Thus major expenses on computerization can be saved as far as the municipal bodies are concerned, which, in any case are short of money most of the times.

Chapter XIII

Initiatives taken by Central Government

Jawaharlal Nehru Urban Renewal Mission (JNNURM)

The Jawaharlal Nehru Urban Renewal Mission (JNNURM) was a massive city-modernisation scheme launched by the Government of India under Ministry of Urban Development on 3rd December 2005 with the objective of creating 'economically productive, efficient, equitable and responsive Cities' by a strategy of upgrading the social and economic infrastructure in cities, provision of Basic Services to Urban Poor and wide-ranging urban sector reforms to strengthen municipal governance in accordance with the 74th Constitutional Amendment Act, 1992.

To reiterate the importance of municipal accounting reforms, Government of India under JNNURM made municipal accounting reforms a necessary precondition for grants-in-aid under the scheme.

JNNURM was a reform linked incentive scheme for providing assistance to state governments and urban local bodies in selected 63 cities, comprising all cities with over one million population, state capitals and few other cities of religious and tourist importance for the purpose of reforming urban governance, facilitating urban infrastructure and providing basic services to urban poor. This is the single largest initiative of the Central Government in urban sector with an outlay of Rs.50000 crores and after adding the contribution of states and municipalities the funding would be about Rs.126000 crores over a period of seven years. While the physical planning and development measures will address the issue of spending this amount judiciously, an appropriate accounting system for recording the transactions, including the establishment of a proper system for asset and liabilities accounting and revenue recognition was necessary.

In order to carry forward the reform agenda, JNNURM had called for implementing improved municipal accounting having a modern accounting system based on the double entry and accrual principal, which could lead to better financial management, transparency and self-reliant accounting system for the ULBs. GoI under JNNURM introduced Double Entry Accrual

Accounting System (DEAAS) in the ULBs of India to enhance the relevance, objectivity, timeliness, completeness and comparability of the accounting statements.

JNNURM was launched, scripting a comprehensive agenda for seven years to be implemented by States and urban local bodies (ULBs). But an evaluation of JNNURM in 2013 found States and ULBs unable to stick to reforms, delays in release of additional central assistance and manifold hindrances to project completion.

Atal Mission for Rejuvenation and Urban Transformation (AMRUT)

AMRUT is an improvement over Jawaharlal Nehru National Urban Renewal Mission (JNNURM). It conceptualized to replace JNNURM.

- The previous JNNURM scheme worked on components like treatment of sewage and garbage, augmentation of water supply, building roads and flyovers, but now, AMRUT will also include digitisation and wi- fi zones in the cities too.
- AMRUT is an increase from 65 cities covered under the erstwhile JNNURM
- In a significant departure from JNNURM, Central Government will not appraise individual projects. Earlier, the MoUD used to give project-by-project sanctions. In the AMRUT this has been replaced by approval of the State Annual Action Plan once in an year
- Under AMRUT the roles of State Government and ULBs have increased as active partners of programme implementation.

Atal Mission for Rejuvenation and Urban Transformation (AMRUT), launched in 2015 by the Ministry of Urban Development (MoUD), adopts a project approach to ensure basic infrastructure services.

The Key Result Areas (KRAs) of AMRUT are (i) improving access to municipal services and (ii) strengthening municipal functioning and revenue mobilization through reforms implementation. AMRUT seeks to achieve these KRAs by providing financial assistance to ULBs through three main components:

(i) municipal infrastructure investments in water supply, sewerage, storm water drainage, public transport, and green spaces;

(ii) incentive grants for the implementation of urban reforms to be used for eligible expenditures under AMRUT; and

(iii) capacity building activities.

Eighty percent of the program funds have been earmarked for infrastructure investments, ten percent as incentive grants for the urban reforms, and ten percent for administrative and operational expenditures.

The focus of the Mission is on infrastructure creation that has a direct link to provision of better services to the citizens.

The Mission covers covering 500 cities that includes all cities and towns with a population of over one lakh with notified Municipalities.

Total outlay for AMRUT is Rs. 50,000 crores for five years from FY 2015-16 to FY 2019-20 and the Mission and is being operated as Central Sponsored Scheme. The project fund is divided among States/UTs in an equitable formula in which 50:50 weightages is being given to the urban population of each State/UT and number of statutory towns.

The Mission is encouraging and supporting the States in conducting reforms that will improve the financial health of the ULBs, delivery of citizen services, transparency and cut the cost of services.

Chapter XIV

Analysis of Existing Audit of ULBs being Undertaken

The Eleventh Finance Commission recommended that Comptroller & Auditor General of India (C&AG) should audit accounts of urban local bodies.

Accordingly, C&AG of India is regularly coming out with Report on Local Bodies of various States every year. A gist containing some of their comments which have come out in recent years is given hereunder:

State & For the year ended	Comment
Andhra Pradesh 31 March 2017 Page 35	The ULBs adopted the software developed by the Centre for Good Governance of Model Accounting System for maintenance of accounts. CDMA stated (September 2017) that the Double Entry Accrual Based Accounting System (DEABAS) was being adopted in all the 110 ULBs. The State Audit Department had audited the annual accounts of all the ULBs for the financial year upto 2015-16. Audit of annual accounts of 2016-17 was in progress.
Bihar: 31 March 2015 Page 54	The Ministry of Urban Development, GoI in consultation with the Comptroller and Auditor General of India (CAG) prepared (2004) the National Municipal Accounts Manual (NMAM) for maintenance of accounts on accrual basis by the ULBs. Section 87 of the BMA, 2007 stipulates that the State Government shall prepare a Bihar Municipal Accounting Manual (BMAM) for implementation of accrual based Double Entry Accounting System (DEAS) containing details of all financial matters and procedures relating to the Municipalities. The Special Secretary, UD&HD stated that the BMAM has not been finalised as on December 2015.

	Further, the UD&HD notified (January 2014) the 'Bihar Municipal Accounting Rules, 2014' for preparation and maintenance of financial statements36 on accrual based Double Entry System in the municipalities from 1 April 2014. The Department issued (February 2014) instruction to all ULBs regarding migration from Cash System of accounting to accrual based DEAS from 1 April 2014. The UD&HD stated (August 2015) that in 19 ULBs, first phase of implementation of DEAS including preparation of Fixed Assets Register (FAR), Opening Balance Sheet and Annual Financial Statement upto FY 2011-12 was completed and for other ULBs, appointment of competent Chartered Accountant firms for the purposes was underway.
Himanchal Pradesh Report of 2017 Chapter 4, Page 23	The ULBs were directed (April 2009) by the Director, Urban Development to adopt the double entry system of accounting. The ULBs test-checked during 2015-16 have maintained their accounts in double entry system.
Jammu & Kashmir 31 March 2015	Jammu and Kashmir Government prepared the J&K Municipal Accounting Manual, 2011 which inter alia provides for preparation of annual financial statements viz. Receipt and Payment Account and Income and Expenditure Statement on the transactions of ULB and a balance sheet depicting the status of assets and liabilities of the ULB at the end of the financial year. However, the manual was not fully adopted by all the ULBs and hence not fully implemented. Although, Srinagar Municipal Corporation (SMC) and Jammu Municipal Corporation (JMC) had prepared annual accounts on accrual basis, yet primary records were being maintained on single entry system by these corporations. Other ULBs, except Municipal Council Kathua, had not prepared annual accounts. Test-check of records of selected ULBs by the AG

	(Audit) revealed that internal control mechanism was very weak in the ULBs as neither audit wing nor monitoring wings existed in any ULB. Five ULBs had neither switched over to double entry/ accrual based accounting system nor prepared their annual accounts but had only prepared the monthly receipt and payment accounts. As a result, true and fair view of the financial affairs of these ULBs including position of assets and liabilities.
Jharkhand 31 March 2016 Page 49 and 50	The Municipal Commissioner or the EO shall prepare and maintain accounts of income and expenditure of the MC on Accrual Based Double Entry Accounting System. The UD&HD does not maintain consolidated information about finalisation of Annual Accounts of ULBs. Hence, status of preparation of Annual Accounts by all the ULBs in the State could not be commented upon. However, in 20 test-checked ULBs it was observed that only eight (Adityapur, Chas, Chatra, Gumla, Jamshedpur, Jugsalai, Mango and Pakur) had been preparing their Annual Accounts and of this, six ULBs had been preparing it on accrual basis while two had been preparing it on cash basis. Thus, in absence of annual accounts of 12 ULBs and failure in maintenance of accrual based accounts of two ULBs, financial position of those ULBs along with their Assets and Liabilities could not be verified.
Karnataka 31 March 2015 Page 57	On the recommendations of Eleventh Finance Commission, the Government of India (GoI) had entrusted the responsibility of prescribing appropriate accounting formats for the ULBs to the Comptroller and Auditor General of India (CAG). The Ministry of Urban Development, GoI has developed the National Municipal Accounts Manual (NMAM) as recommended by the CAG's Task Force. The State Government has brought out the KMABR based on the NMAM with effect from 1 April 2006. The KMABR was

	introduced in a phased manner in all the ULBs except BBMP. As of 31 March 2015, all the ULBs were preparing the fund-based accounts in double entry system. BBMP was maintaining FBAS based on the Bengaluru Mahanagara Palike (Accounts) Regulations, 2001.
Rajasthan 31 March 2016 Page 67	National Municipal Accounts Manual (NMAM) for ULBs in India developed by the Ministry of Urban Development, GoI was introduced in February 2005. On the lines of NMAM, Rajasthan Municipal Accounting Manual has been prepared. Accordingly, the Local Self Government Department (LSGD) directed (December 2009) all ULBs to maintain the accounts on Accrual Based (Double Entry) Accounting System from 1 April 2010. However, Director, Local Fund Audit Department (LFAD) intimated (July 2016) that only four ULBs are maintaining the accounts on above system. Absence of timely finalisation of accounts in the prescribed formats and lackadaisical approach in certification of accounts resulted in denial of correct accounting information to the stakeholders.
Tamil Nadu 31 March 2015	Accrual-based system of accounting is being followed in all the ULBs. Corporation of Chennai stated (July 2015) that in conformity with the National Municipal Accounting Manual, the chart of accounts was revised and accounts upto 2013-14 were finalised. CMA stated (January 2016) that at present the annual accounts of ULBs have not been compiled as per the newly updated Accounting Manual due to non-availability of software. CMA further stated that in order to implement a centralised web enabled software application for ULBs, a e-governance project has been taken up under Tamil Nadu Sustainable Urban Development Project (TNSUDP) at a cost of Rs. 18.31 crore and software for 29 modules (including accounting software) had been completed and validation process was in progress.

Telegana 31 March 2016 Page 51	The ULBs have adopted the software developed by the Centre for Good Governance of Model Accounting System for maintenance of Accounts. Commissioner and Director of Municipal Administration (CDMA) stated that maintenance of database format of the finances of ULBs was adopted in all 68 ULBs. On scrutiny of records of ten ULBs audit noticed that three ULBs were not maintaining accounts in Double Entry Accrual Based Accounting System (DEABAS). Double Entry Accrual Based Accounting System (DEABAS) was yet to be adopted by ULBs. Accountability framework and financial reporting in ULBs was inadequate.
Odisha 31st March 2016 Page- 49	• Accounts of ULBs are prepared by the respective ULBs. Accounts of ULBs are certified by the Director, Local Fund Audit as per Rule 20(h) of the Orissa Local Fund Audit Rules, 1951. • All the 102 Accounts of ULBs as per Audit Plan were certified by the DLFA, during 2015-16. • Adoption of modern accrual based double entry system of accounting was mandatory for ULB level reform set by the GoI. However, migration to double entry accounting system has been accomplished only in the mission cities since financial year 2012-13. In other ULBs, cash based manual accounting system was prevailing (March 2016).
Assam 31st March 2015 Page-71	The Government of Assam had accepted (March 2011) the National Municipal Accounting Manual (NMAM) which recommends introduction of accrual-based double entry system and improved financial management systems in all ULBs in India. As per para 5.1 of NMAM, the ULBs are required to maintain their accounts on accrual basis. However, the DMA stated that due to shortage of staff, the ULBs were unable to comply with the formats as prescribed in NMAM and only some of the ULBs were maintaining their accounts on accrual based double entry

	system but details of number of ULBs maintaining their account on accrual based double entry system was not provided by the DMA. Moreover, as per paragraph 31.6 of the National Municipal Accounting Manual (NMAM), the ULBs are required to prepare the financial statements like the Balance Sheet, Income and Expenditure Statement, Statement of Cash flows and Receipts and Payments Account, at the end of each quarter. Though the DMA stated that the accounts were updated till 2014-15, test check revealed that four ULBs did not maintain their Annual Accounts. As the Annual Accounts were not maintained, head wise receipt and expenditure; and the financial performance of ULBs could not be ascertained.
Chhattisgarh Annual Technical Inspection Report on ULBs and PRIs for the year ended 31st March 2013 Page -3	Consequent upon adoption of the budget and accounting format for ULBs as prescribed by the Task Force Constituted by government of India in associated with the comptroller & Auditor General of India (CAG), the Urban Administration and Development Department (UADD) Chhattisgarh initiated the process of actual accounting system. Department stated that all the Municipal Corporation, 28 out of the 32 Municipal Councils and 73 out of the 127 Nagar Panchayats have implemented the accrual system of accounting. In addition to this 20 administrative offices of the UADD have also implemented the accrual system of accounting. As per the decision taken in the National Seminar organized (September, 2003) by the Ministry of Urban Development, GOI, a Steering Committee was to be formed in all the States to oversee the implementation of budget and accounting formats as suggested by the Task Force. The formation of any such committee was not intimated by the department.
Maharashtra	Section 93 of the Maharashtra Municipal Corporation Act, 1949 and Section 123 of the MbMC Act, 1888 provide that the accounts of the Municipal Corporations

31st March, 2014 Page- 32, 33	should be maintained in the formats prescribed by the Standing Committees. In pursuance of the Eleventh Finance Commission recommendations, the Ministry of Urban Development, GoI in consultation with the Comptroller and Auditor General of India had finalised the National Municipal Accounts Manual (NMAM) for implementation of accrual based accounting system by ULBs in November 2004. The GoM adopted (July 2005) the NMAM for implementation from 2005-06. As per the NMAM guidelines, all Municipal Corporations were to maintain their accounts on accrual basis from 2005-06. The Steering Committee constituted by the GoM also recommended (January 2007) implementation of accrual system of accounting in the ULBs. However, the GoM published (January 2013) the Maharashtra Municipal Account Code, 2013 prescribing the procedure for maintenance of accounts of receipts and disbursements only for the Municipal Councils. The notification for the implementation of Maharashtra Municipal Account Code, 2013 was issued by GoM in November 2014 i.e. after a delay of nearly two years.

An analysis of above observations prove that implementation of Double Entry Accounting System though carried out in several States has failed to yield desired results as it is yet to be implemented in true spirit. Though requiring unflinching support of top management, deployment of inadequate resources (both human and financial), and their misallocation has delayed its progree to achieve their full potential.

Moreover, same recommendations are being reiterated by successive Finance Commissions over aperiod of time. Therefore, though there is some development on the ground, aggressiove support is required to compel government officials to implement these reforms within a given time frame.

Chapter XV

Way Forward for Municipal Accounting Reforms in India

Municipal Accounting Reforms is a necessary tool for improving urban finances and governance. Reforming the present accounting system in favour of accrual based is a step in the correct direction that is in line with what users would want, and in conformance with best practice. The path of implementation is arduous and would take time for a wide scale implementation. The success of the reform depends on the planning ability and the inclusion of a comprehensive computer software module that is capable of meeting all the data requirements, satisfying analytical needs, and providing adequate reports and information to enable the municipal management to make informed decisions.

Development institutions could play a great role in partnering with the government to provide support for the process through standardization of computer software modules and the implementation processes. Further, they could also develop and implement capacity-building programs in municipal accounting reform both for the municipal staff as well for private sector aspirants in order to build external capacity, which is required on a large scale considering the large number of Indian towns. This partnership would make a huge improvement in the startup stage as well as in the implementation process in terms of quality, cost, and sustainability. An urban body with a strong accounting base would be able to provide better governance for its citizens.

ULBs in case following accrual accounting can get themselves rated by an authorized/approved credit rating agency which can enable them to raise resources on the basis of a specific prospective revenue stream. A reference in this regard can be made to ICAI publication “Municipal Bonds for Financing Infrastructure in India: An Overview”.

As the latest spate of financing of infrastructure assets in urban areas is being undertaken by incorporating a company therefore, ICAI’s Accounting Standards or Ind-AS, as the case may be, are applicable on them. This all the more emphasizes importance of accrual accounting in the context of ULBs.

Role of Chartered Accountants in Municipal Accounting Reforms:-

1. Scope of accounting services which can be rendered by Chartered Accountants – To enable a ULB to take benefit of accounting, first of all, proper accounting, then accrual accounting is mandatory as the outside commercial world understands accrual based financial statements only. So, a CA can help a ULB to make its books of accounts' standards compliant.
2. Scope of Auditing services which can be rendered by Chartered Accountants: Proper audit ensures that the underlying financial statements depict true and fair view of the affairs of the ULB.
3. Empanelment Criteria of Chartered Accountants can be mutually discussed and decided: ICAI can help ULBs in approaching the right kind of professionals as Professional Development Committee of ICAI prepares a Multipurpose Panel wherein multifarious experience of Chartered Accountants are recorded which enables t to provide criteria specific panel to all requisitioners.
4. ICAI as a partner in Nation Building has recognised the need for creating awareness amongst various stakeholders about the benefits of the accounting reform process in local bodies and is making significant efforts to prescribe and support in implementation of high quality Accrual Accounting Framework for Local Bodies that is at par with the internationally accepted accounting and financial reporting standards for application by Government at all levels through its Committee on Accounting Standards for Local Bodies.

   (*https://resource.cdn.icai.org/49031caslb32852.pdf)*

Contribution of ICAI ARF in Accounting Reforms of Urban Local Bodies:

Institute of Chartered Accountants of India has got a research arm, ICAI Accounting Research Foundation (ICAI ARF - A Section 8 company under the Companies Act, 2013), which undertakes consultancy assignments in areas like accounting, fiscal discipline, etc. on nomination basis. ***Some of the relevant assignments undertaken by it includes:***

(i) Validation of Accounting Reforms Report and Related Pilot Study Project on Migration to Accrual Based Accounting System at North

Western Railway head quartered at Jaipur of **Indian Railways** (2015-16).

(ii) **Municipal Corporation of Delhi Project (2002-2006):** The project related to conversion of accounts of Municipal Corporation of Delhi to accrual basis of accounting. During this period, ICAI ARF assisted in preparation and presentation of financial statements for the year ended 31st March 2006, ICAI ARF also advised in restructuring and refining of various budgeted heads, accounting process, setting up of Asset Information System and introduction of accrual system of accounting in the various zones of MCD.

(iii) **Kolkata Municipal Corporation Project (2004-2007)**: The project from Kolkata Municipal Corporation (KMC) was taken up for application of advance concept in financial monitoring reforms in KMC. ICAI ARF assisted KMC in the preparation and presentation of its final accounts, conducted various studies on business processes and training programme for capacity building etc.

Currently, ICAI ARF is engaged in **Roll out of Accrual Accounting across all offices of Indian Railways**.

Chapter XVI

Terminology used in Accrual Based Accounting System

- ***Account -*** A formal record of a particular type of transaction expressed in money or other unit of measurement and kept in a recorded form. In accounting separate record of each individual, asset, liability, expenses or income is kept. The place where such a record is maintained is termed as 'Account'.

  All accounts are divided into two sides.

  The left side of an account is called Debit side and the right side of, an account is called Credit side.

  In the abbreviated form, Debit is indicated as Dr. and Credit is written as Cr.

- ***Accounting Entry*** - A record of financial transactions in the books of account like journal, ledger, cash book, etc.

- ***Account Payable* -** Amount owed by an organisation on account of goods purchased or services received or in respect of contractual obligations. Also termed as creditor.

- ***Accounting Period* -** The period of time for which financial statements are customarily prepared.

- ***Accounting Principle* -** The principles and procedures under which the accounts of an organization are maintained/ to be maintained are called accounting principles. An accounting principle is an adaptation or special application of a principle necessary to meet the peculiarities of an organization or the needs of its management. Thus, principles are required for the computation of depreciation, the recognition of capital expenditures etc.

- ***Account Receivable* -** Persons from whom amounts are due for goods sold or services rendered or in respect of contractual obligations. Also termed as debtor. The words 'Receivables' and 'Debtors' are used interchangeably.

- ***Accounting Standards* -** The Accounting Standards as laid down by the Institute of Chartered Accountants of India are a set of neutral principles for drawing up the financial statements so that there is minimum possible ambiguity and uncertainty about the figures contained in those statements. The objective of Accounting Standards is, to reduce the accounting alternatives in the preparation of financial statements within the bounds of rationality, thereby ensuring comparability of financial statements of different organisations/departments with a view to provide meaningful information to various users of financial statements to enable them to make informed economic decisions.
- ***Accounting Unit* -** An accounting unit shall be defined as a unit for maintenance of accounting records.
- ***Accounting Year* -** Accounting year means a year commencing on the first day of the accounting period. It generally refers to the period from 1st April of a year to 31st March of next year.
- ***Accrual* -** Recognition of revenues and costs as they are earned or incurred (and not as money is received or paid). It includes recognition of transactions relating to assets and liabilities as they occur irrespective of the actual receipts or payments.
- ***Accrual Basis of Accounting* -** The method of recording transactions by which revenues, costs, assets and liabilities are reflected in the accounts in the period in which they accrue. The 'accrual basis of accounting' includes considerations relating to deferrals, allocations, depreciation and amortisation. This basis is also referred to as mercantile basis of accounting.
- ***Accrued and Due* -** In respect of an asset (or a liability) it means a claim which has become enforceable, which arises from the sale/ rendering (purchase) of goods/ services or otherwise and has become receivable (payable). In respect of an income (or an expense) it means the amount earned (incurred) in an accounting period, for which a claim has become enforceable, and it arises from the sale/rendering (purchase) of goods/services or otherwise and has become receivable (payable).
- ***Accrued but Not Due* -** In respect of an asset (or a liability) it means a claim which has not yet become enforceable, which accumulates

with the passage of time or arises from the sale/ rendering (purchase) of goods/ services which, on the date of period-end, have been partly performed and are not yet receivable (payable). In respect of an income (or an expense) it means the amount earned (incurred) in an accounting period, but for which no enforceable claim has become due in that period. It accumulates with the passage of time or arises from the sale/ rendering (purchase) of goods/services goods which, at the date of accounting, have been partly performed and are not yet receivable (payable).

- ***Accumulated Depreciation*** - The total to date of the periodic depreciation charges on depreciable assets.
- ***Advance*** - Payment made on account of, but before completion of a contract, or before acquisition of goods or receipt of services.
- ***Amortisation*** - The gradual and systematic writing off of an asset or an account over an appropriate period. The amount on which amortisation is provided is referred to as amortisable amount. Depreciation accounting is a form of amortisation applied to depreciable assets. Depletion accounting is another form of amortisation applied to wasting assets. Amortisation also refers to gradual extinction or provision for extinction of a debt by gradual redemption or sinking fund payments or the gradual writing off to revenue of miscellaneous expenditure carried forward.
- ***Annual Report*** - The information provided annually by the management of an organisation to the owners and other interested persons concerning its operations and financial position. It includes the information statutorily required, e.g., in the case of a company, the balance sheet, profit and loss statement and notes on accounts, the auditor's report thereon, and the report of the Board of Directors. It also includes other information voluntarily provided e.g., value added statement, graphs, charts, etc.
- ***Assets* -** Assets are tangible objects or intangible rights owned by an Institution and carrying probable future benefits. Assets are resources controlled by an Institution as a result of past events and from which future economic benefits or service potential expected to flow to the Institution. Assets provide the means to achieve their objectives. Assets that are used to deliver goods and services in accordance with

an institution's objectives but which do not directly generate net cash inflows are often described as embodying “service potential”. Assets that are used to generate net cash inflows are often described as embodying “future economic benefits”.

- ***Bad Debts*** **-** Debts owed to an enterprise which is considered to be irrecoverable.
- ***Balancing*-** It means writing of the difference that exists between the amount columns of the two sides, namely debit and credit in the smaller side so that the totals of the two sides are equalized.
- ***Balance Sheet*** **-** A statement of the financial position as at a given date, which exhibits its assets, liabilities, capital, reserve and other account balances at their respective book values.
- ***Bank Reconciliation Statement*** - A statement, which reflects the nature and amount of transaction (s) not responded either by the entity or the bank as on a particular date. Such statement may also reflect errors/ omission in the recording of transaction inter-se between the entity and the Bank.
- ***Books of Original Entry*** - A record book, recognised by law in which transactions are successively recorded, and which is the source of postings to ledgers; a journal. Books of original entry include general and special journals, such as cash books.
- ***Budget*** - Budget is a financial plan, an expression of financial intent. It sets forth the expenditures that bodies are expected to incur during the year on various programmes and the means of financing them. A budget thus provides both, the authorization of, and limitations on, the amounts that may be spent for particular purposes.
- ***Capitalisation*** **-** An expenditure for a fixed asset or addition thereto that has the effect of enlarging physical dimensions, increasing productivity, lengthening future life, or lowering future costs.
- ***Capital Expenditure*** **-** An expenditure intended to benefit future period in contrast to a revenue expenditure, which benefits a current period. The term is generally restricted to expenditure that adds fixed asset units or that has the effect of improving the capacity, efficiency, life span or economy of operations of an existing asset.

- ***Capital Work in Progress* -** Expenditure on capital assets which are in the process of construction or completion.
- ***Cash Book* -** A book of original entry maintained on daily basis for cash receipts and disbursement in its chronological order.
- ***Cash flow Statement* -** A financial statement prepared for an accounting period to depict the inflows and outflows of cash and cash equivalents of an enterprise. The cash flow statement reports cash flows classified by operating, investing and financing activities.
- ***Chart of Accounts* -** A systematically arranged list of accounts applicable to a specific concern, giving account names and numbers, if any.
- **Contingent Liability -** An obligation relating to an existing condition or situation which may arise in future depending on the occurrence or non-occurrence of one or more uncertain future events. No accounting entry needs to be passed for a contingent liability. However, disclosure is required in the Balance Sheet.
- ***Contra Entry* -** An item on one side of an account which offsets fully or in part one or more items on the opposite side of the same account.
- ***Cost* -** The amount of expenditure incurred on or attributable to a specified article, product or activity.
- ***Cost of Acquisition* -** The cost of acquisition of a fixed asset comprises of its purchase price and includes import duties and other non-refundable taxes or levies and any directly attributable cost of bringing the asset to its working condition for its intended use; any trade discounts and rebates are deducted in arriving at the purchase price.
- ***Credit* -** A book-keeping entry recording the reduction or elimination of an asset or an expense, or the creation of or addition to a liability or item of net worth or revenue; the amount so recorded.
- ***Current Assets* -** Cash and other assets that are expected to be converted into cash or consumed in rendering of services in the normal course of operations of the entity.

- ***Current Liability* -** Liability including loans, deposits, expenses and bank overdrafts which fall due for payment in a relatively short period, normally not more than twelve months.
- ***Debit* -** The goods or benefit received from a transaction; a book-keeping entry recording the creation of or addition to an asset or an expense, or the reduction or elimination of a liability, or item of net worth or revenue; the amount so recorded.
- ***Deferred Revenue Expenditure* -** Expenditure for which payment has been made or a liability incurred but which is carried forward on the presumption that it will be of benefit over a subsequent period or periods. This is also referred to as deferred expenditure.
- ***Deficit* -** The debit balance in the profit and loss statement.
- ***Depreciable Amount* -** The historical cost or other amount substituted for historical cost of a depreciable asset in the financial statements, less the estimated residual value.
- ***Depreciation* -** A measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time or obsolescence through technology and market changes. It is allocated so as to charge a fair proportion in each accounting period during the useful life of the asset. It includes amortisation of assets whose useful life is predetermined and depletion of wasting assets.
- ***Depreciation Method* -** Any method of calculating depreciation for an accounting period.
- ***Depreciation Rate* -** A percentage applied to the historical cost or the substituted amount of a depreciable asset (or in case of diminishing balance method, the historical cost or the substituted amount less accumulated depreciation).
- ***Disclosure* -** Process of divulging accounting information so that the content of Financial Statements is understood.
- ***Double-Entry Book keeping* -** It is a system of accounting in which both debit and credit aspects of each transaction is recorded. It affects at least two accounts. You've probably heard the saying, "Money doesn't grow on trees." It means that money must come from somewhere-it doesn't just "appear." Double-entry accounting is a

method of record-keeping that lets you track just where your money comes from and where it goes. Using double-entry means that money is neither gained nor lost-it is always transferred from somewhere (a source account) to somewhere else (a destination account). This transfer is known as a transaction, and each transaction requires at least two accounts.

- ***Earmarked Funds*** **-** Funds representing special funds to be utilised for specific purposes.
- ***Expenses*** **-** A cost relating to the operations of an accounting period or to the revenue earned during the period or the benefits of which do not extend beyond that period.
- ***Fair Market Value*** **-** The price that would be agreed to in an open and unrestricted market between knowledgeable and willing parties dealing at arm's length who are fully informed and not under any compulsion to transact. Arm's length is a term applied to any transaction on the assumption that the parties to the transaction would act without being influenced by each other or by any other person.
- ***Financial Statement*** **-** A balance sheet, income statement (income and expenditure), receipts & payment statement or any other supporting statement or other presentation of financial data derived from accounting records.
- ***Fixed Asset*** **-** Asset held for the purpose of providing services and that is not held for resale in the normal course.
- ***Fund*** **-** The term fund refers to the amount set aside for a general or specific purpose, whether represented by specifically earmarked assets or not.
- ***Generally Accepted Accounting Principles (GAAP)*** **-** Conventions, rules, and procedures necessary to define accepted accounting practice at a particular time. In India, these principles are set by the Accounting Standards Board (ASB) established by the Council of the Institute of Chartered Accountants of India.
- ***Grants*** **-** Grants are assistance by Central Government and/ or State Government in cash or kind to an Institution for past or future compliance with certain conditions.

- ***Gross Block*** **-** The total cost of acquisition/ purchase of all the fixed assets of the entity.
- ***Income*** **-** Money or money equivalent earned or accrued during an accounting period, increasing the total of previously existing net assets, and arising from provision of any type of services and rentals.
- ***Income and Expenditure Statement*** **-** A financial statement, prepared by an entity in double entry accounting system on accrual basis to present their revenues and expenses for an accounting period and to show the excess of revenues over expenses (or vice-versa) for that period. It is similar to Profit and Loss Statement and is also called revenue and expense statement.
- ***Interest*** **-** The service charge for the use of money or capital, paid at agreed intervals by the user, and commonly expressed as an annual percentage of outstanding principal.
- ***Internal Control*** **-** The entire system of controls, financial and otherwise, established by the management in order to carry on the business of the enterprise in an orderly and efficient manner, ensure adherence to management policies, safeguard the assets and secure as far as possible the accuracy and completeness of the records.
- ***Investments -*** Assets held not for operational purposes or for rendering services, i.e., assets other than fixed assets or current assets (e.g. securities, shares, debentures, immovable properties).
- ***Inter unit transactions*** **-** Transactions between accounting units of the bodies.
- ***Infrastructure Assets*** **-** Those assets with the characteristics of being, a part of a system or network, specialised in nature and do not have alternative uses, immovable, and subject to constraints on disposal.
- ***Journal Book*** **-** The book of original entry in which the 'dual aspect' of transactions other than those involving cash and/ or bank, along with explanations, is recorded in their chronological order, from which a posting is done in the relevant ledger.
- ***Journal Entry*** **-** Recording of transaction other than those involving cash and/ or bank by dividing into its debit and credit aspects.

- ***Lapsed Deposits* -** Deposits unclaimed for more than such period or periods as defined in the Act or provisions governing the entity.
- ***Ledger* -** A compilation of all accounts used for accounting purposes.
- ***Lease* -** A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period. A lease agreement also includes a hire purchase agreement. A lease is classified as a finance lease if it transfers substantially the entire risks and rewards incident to ownership. All other leases are classified as operating leases.
- ***Liability* -** An amount owed by one person to another, payable in money, or in goods or services: the consequence of an asset or service received or a loss incurred or accrued; particularly, any debt (a) due or past due (current liability), (b) due at a specified time in the future (e.g. funded debt, accrued liability), or (c) due only on failure to perform a future act (contingent liability).
- ***Long Term Investments* -** Any investment falling outside the ambit of current investments are treated as long term investments.
- ***Mortgage* -** A lien on land, buildings, machinery, equipment, and other property, fixed or movable, given by a borrower to the lender as security for his loan; sometimes called a deed of trust.
- ***Narration* -** A brief description written below an accounting entry. It explains as to why the entry has been recorded and other related aspects of the entry.
- ***Net Assets*** - The excess of the book value of the assets of a body over its external liabilities.
- ***Net Block* -** Gross block less accumulated depreciation of all the fixed assets
- ***Period End* -** The last day of any accounting period, e.g., quarter, half-year or year-end.
- ***Prepaid Expense* -** Payment for expenses in an accounting period, the benefit for which will accrue in the subsequent accounting period(s).

- ***Ratio Analysis* -** Analysis of relationship worked out among various accounting data which are mutually interdependent and which influence each other in a significant manner, arises from the fact that often absolute figures standing alone convey no meaning. They become significant only when considered with other figures. It also helps in comparing the actual or projected data for a particular entity to the data of that entity or any other entity in order to analyse trends or relationship.
- ***Receipt* -** A written acknowledgement of something acquired; hence, an accounting document recording the physical receipt of cash /cheques.
- ***Receipts & Payments Statement* -** A financial statement prepared for an accounting period to depict the changes in the financial position and to present the cash received in and paid out in whatever form (cash, cheques, etc.) under certain headings. All non-cash related transactions are ignored while preparing this Statement.
- ***Reconciliation* -** It means identifying the difference between two items (i.e. amounts, balances, accounts or statements) so that the figures agree.
- ***Revenue Expenditure* -** It means outlay benefiting only the current year. It is treated as an expense to be matched against revenue.
- ***Special Fund* -** An amount set aside for a specific purpose represented by specifically earmarked assets.
- ***Straight Line Method (SLM)* -** The method under which the periodic charge for depreciation is computed by dividing the depreciable amount of a depreciable asset by the estimated number of years of its useful life.
- ***Surplus -*** The excess of income over expenditure of the entity for an accounting period under consideration.
- ***Trial Balance* -** A list or abstract of the balances or of total debits and total credits of the accounts in a ledger, the purpose being to determine the equality of posted debits and credits and to establish a basic summary for financial statements.

- ***Useful Life -*** The period over which a depreciable asset is expected to be used by the enterprise; or (ii) the number of production or similar units expected to be obtained from the use of the asset by the enterprise.
- ***Voucher* -** A document which serves as an authorisation for any financial transaction and forms the basis for recording the accounting entry for the transaction in the books of original entry, e.g., Cash Receipt Voucher, Bank Receipt Voucher, Journal Voucher, Payment Voucher, etc.
- ***Written Down Value (WDV)* -** Written down value in respect of an asset, means its cost of acquisition or substituted value less accumulated depreciation.
- ***Written Down Value (WDV) Method* -** A method under which the periodic charge for depreciation of an asset is computed by applying a fixed percentage to its historical cost or substituted amount less accumulated depreciation (net book value). This is also referred to as "Diminishing Balance Method".

Abbreviations

ADB	:	Asian Development Bank
AMRUT	:	Atal Mission for Rejuvenation and Urban Transformation
BSUP	:	Basic Services to Urban Poor
BVR	:	Budget Variance Report
C&AG	:	Comptroller & Auditor General of India
CMAG	:	City Managers' Association Gujarat
DEAAS	:	Double Entry Accrual Accounting System
DoM	:	Directorate of Municipalities
GASAB	:	overnment Accounting Standards Advisory Board
GMARP	:	Gujarat Municipal Accounting Reform Project
GMFB	:	Gujarat Municipal Finance Board
GoI	:	Government of India
JNNURM	:	Jawahar Lal Nehru National Urban Renewal Mission
KRAs	:	Key Result Areas
LGD	:	Local Government Directory
MIS	:	Management Information System
MMP	:	Mission Mode Project
MML	:	Model Municipal Laws
MoPR	:	Ministry of Panchayati Raj
MoUD	:	Ministry of Urban Development
NAD	:	National Asset Directory
NMAM	:	National Municipal Accounts Manual
NMATM	:	National Municipal Accounts Training Manual
NMAVM	:	National Municipal Asset Valuation Methodology Manual

PES	:	Panchayat Enterprise Suite
PIL	:	Public Interest Litigation
PRIs	:	Panchayati Raj Institutions
PRIASoft	:	Panchayati Raj Institutions Accounting Software
RLBs	:	Rural Local Bodies
ULBs	:	Urban Local Bodies
TAC	:	Technical Advisory Committee

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