

**Research Study Series
Number 96**

Municipal Accounting and Financial Reporting System

Sponsored by
United Nations Development Programme
Under the Economic Reform Programme of Government of India

National Institute of Urban Affairs
Core 4B, I & II Floor, India Habitat Centre, Lodhi Road
New Delhi – 110 003
March 2004

Municipal Accounting And Financial Reporting System

**Sponsored by the United Nations Development Programme
under the Economic Reform Programme of Government of India**

National Institute of Urban Affairs

Core 4-B, I & II Floor,
India Habitat Centre, Lodhi Road,
New Delhi-110 003.

March 2004

CONTENTS

	Page No.
Preface	ii
Abbreviations	iii
List of Symbols	v
Chapter 1 Introduction	1
Chapter 2 Accounting Principles, Systems and Financial Reporting	7
Chapter 3 Existing Municipal Accounting and Financial Reporting Practices	15
Chapter 4 Modern Municipal Accounting and Financial Reporting System	41
Chapter 5 Evaluating Municipal Accounting Reforms	52
Chapter 6 Conclusions and Suggestions on Statewide Accounting Reforms	79
Selected References	102
Annexure 1 A Critical Review and Analysis of the Report of the C&AG Task Force on Accounting and Budget Formats for ULBs	104
Annexure 2 Recent Development following the Report of the C&AG Task Force on Accounting and Budget Formats for ULBs	116

Preface


The reform of existing municipal accounting systems has to be viewed in the context of urbanization and urban growth. The rapid pace of urbanization in the country poses a demanding challenge on the capability of municipal bodies who have to meet the continuously increasing demand for urban infrastructure and civic services. Constraints on the availability of financial resources, to augment the level of urban infrastructure and services, have become a compelling reason to generate substantial funds by improving sources of own revenue, through effective municipal tax administration, and creating conditions for private sector involvement.

The accounting system that exists in existing municipalities in India is based on simple single entry cash accounting method. It does not remotely reflect either the financial performance of municipal governments or their innate financial strength. It does not reveal the expenditure liabilities postponed due to compelling fiscal reasons which is generally a rampant practice and which camouflages the financial status of municipalities. Further, it does not ensure the accuracy of information either. Even the cash based accounts are not updated regularly. Thus there is a need to introduce an improved accounting system, which could reflect the true financial status of municipalities on the one hand, and improve the efficiency of the municipal administration to manage civic resources and functions effectively on the other.

In recent years, a number of states/cities have introduced improved systems of municipal accounting and financial reporting. In this study, an attempt has been made to review the new systems in select states/cities and suggest measures to improve it further.

We gratefully acknowledge the support from the United Nations Development Programme (UNDP) for sponsoring this study under their programme of supporting the Economic Reforms of Government of India with a view to provide policy advice to the government to improve provisions of urban infrastructure. Dr. Ravi Kant Joshi, consultant to the study, undertook the responsibility of conducting the study. Dr. M.P. Mathur, Professor at the Institute, coordinated the study. He was supported by Mr. Satpal Singh, Research Analyst at the Institute. Valuable inputs were provided by a number of experts who participated in the two workshops organised at Jaipur and Bangalore as a part of the study.

March 2004

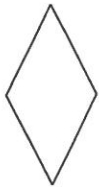

Vinod Tewari
Director, NIUA

Abbreviations

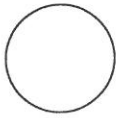
ADB	Asian Development Bank
AS	Accounting Standards
B/S	Balance Sheet
BATF	Bangalore Agenda Task Force
BCC	Bangalore City Corporation
BMP	Bangalore Mahanagar Palika
CAD	Central Accounts Department
C&AG	Comptroller and Auditor General of India
CAFR	Comprehensive Annual Financial Report
CAS	Central Accounting System
CBO	Community Based Organisation
CoA	Chart of Accounts
Cr	Credit
CUFR	Component Unit Financial Report
DOM	Directorate of Municipality
Dr	Debit
EDP	Electronic Data Processing
FABS	Fund Based Accounting System
FAS	Feeder Accounting System
FY	Financial Year
GAAP	Generally Accepted Accounting Practices
GAAP	Generally Accepted Accounting Principles
GASB	Government Accounting Standard Board
GMFB	Gujarat Municipal Finance Board
GO	Government Order
GOG	Government of Gujarat
GOI	Government of India
GOK	Government of Karnataka
GOTN	Government of Tamil Nadu
IAS	Independent Accounting System
IASC	International Accounting Standards Committee
ICAI	Institute of Chartered Accountants of India
IMC	Indore Municipal Corporation
JMC	Jai Municipal Corporation
JV	Journal Voucher
KUIDFC	Karnataka Urban Infrastructure Development Finance Corporation
LIC	Life Insurance Corporations
MA&FRS	Municipal Accounting and Financial Reporting System
MAS	Municipal Accounting System
MASB	Municipal Accounting Standard Board
MMFAS	Modern Municipal Financial Accounting System
NGO	Non-Government Organisation
NRI	Non Resident Indian
PAC	Public Affairs Centre
PAM	Payment Accounting Module
PAS	Peripheral Accounting System

RAM	Receipt Accounting Module
RUIDP	Rajasthan Urban Infrastructure Development Project
SEBI	Securities Exchange Board of India
TA	Technical Assistance
TCMC	Tumkur City Municipal Council
TCS	Tata Consultancy Services
TNUDF	Tamil Nadu Urban Development Fund
TNUDP-II	Tamil Nadu Urban Development Project II
ToR	Terms of Reference
UDD	Urban Development Departments
ULB	Urban Local Bodies
ULG	Urban Local Government

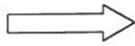
List of Symbols



Activity Related Department / Bank/ Party / Employee / Contractor / Tax Payer



Operation / Activity



Transportation



Inspection / Examination / Final Activity



Finalisation / End of Activity

CHAPTER 1

Introduction

Background

The reformation of existing municipal accounting systems has to be viewed in the context of urbanization and urban growth. The latter poses a demanding challenge on the capability of municipal bodies who have to meet the unprecedented growth in the demand for urban infrastructure and civic services. Constraints on the availability of financial resources to augment the level of urban infrastructure and services, has become a compelling reason to generate funds by improving municipal sources of own revenue, through effective municipal tax administration, and creating conditions for private sector involvement.

This calls for robust fiscal health on part of the municipal governments. Financial capabilities to raise funds from the private sector get reflected in their accounting and financial reporting systems. Municipal accounting systems would therefore need to contain information not only on financial transactions but also on the status of financial performance and, most essentially, on the financial position (strength or weakness) of the municipal governments. These two important aspects of an accounting system have assumed critical importance as the municipalities have just started turning to the capital market and financial institutions for raising of funds.

The accounting system that exists in existing municipalities in India is based on simple single entry cash accounting. This does not reflect the aforementioned vital information for investors. It does not even remotely reflect either the financial performance of municipal governments or their innate financial strength. It does not reveal even the expenditure liabilities postponed due to compelling fiscal reasons which is generally a rampant practice and which camouflages the financial status of municipalities. It does not ensure the accuracy of information either. Even the cash based accounts are not updated regularly. Moreover, the existing accounting financial reporting system is not amenable to credit rating required for assessing the municipality's position in the capital market, according to the regulations of the Security and Exchange Board of India.

Thus there was a need to introduce a new improved accounting system, which could reflect the true financial status of municipalities on the one hand, and improve the efficiency of the municipal administration to manage civic resources and functions effectively on the other. Attempts have been made in recent years in various parts of the country to introduce a new system of accounting and financial reporting, based on the double entry accrual system in municipal bodies. This could be cited as a beginning in this direction. Also the Institute of Chartered Accountants of India (ICAI) has developed a technical guide for accounting and financial reporting by urban local bodies.

There are certain issues associated with these attempts/experiments of Municipal Accounting Reforms, which need immediate attention, documentation and analysis.

1. Individuality/Heterogeneity – Each and every experiment of Municipal Accounting Reforms, at present, is unique. In the initial stage of the reform process it is bound to be so, but if this trend continues any longer, such practice will lead to non-compatibility of accounting data and performance measurement. The non-compatibility of accounting and financial data is the most important problem faced by higher governments (Central and state), research institutes, financial institutions and rating agencies regarding municipal accounting and financial data. A uniform accounting system with a built-in flexibility at the local level, should be the goal/objective of the entire gamut of municipal accounting reforms. In order to attain this objective, it is necessary that these experiments get properly documented and analysed. Such documentation will facilitate the design and development of a uniform accounting system for Urban Local Bodies in the country.
2. Slow pace/ Incomplete Attainment – Present municipal accounting reform experiments have taken too much time for implementation. In some cases it is more than five to seven years. In spite of such a long implementation period, only handful of local bodies have attained complete conversion to Accrual based double entry accounting system. One needs to address the question - Why is such slow pace and incompleteness associated with the municipal accounting reforms? A country having more than 300 cities with 0.1 million population cannot do with such a slow pace of accounting reforms if it wishes to make its local bodies competitive, and a partner in national development. We need to evolve a user friendly, simple accounting model, which can be implemented at reasonable pace and with complete attainment of objectives.
3. Modified Accrual base Accounting System – All municipal accounting system reforms have tried to replace and convert the age old single entry municipal accounting system into an accrual based double entry accounting system, as usually practiced in the corporate/commercial sector. But municipal bodies possess different characteristics and they exist for different purposes. Existing efforts directed towards implementation of accrual based accounting system without appropriate changes, have resulted in various implementation problems. Indian Municipal Bodies essentially require an accounting system, which brings in features of accrual based double entry accounting system, but at the same time, it should be suitable to their characteristics, activities and purposes. In other words municipal bodies required modified accrual base accounting system for speedy and complete implementation.
4. Non-replicability of reforms– One does not find replicability of innovations, reforms that have been successful in one or more ULBs. Another ULB starts similar reform from the scratch. There is no dissemination of reform experiments at the same time there is no enthusiasm to learn from other's reforms innovations.

The process of globalization, economic liberalization that we are witnessing in India since 1991 is bringing about unique and unprecedented change in the philosophy or role of the government and in the relationship between the state and its citizens. Citizens are thinking of themselves more as consumers in relation to the government. Governance is increasingly being seen as a participatory and contractual process in which citizens play a prominent part in designing, implementing and monitoring public policies. In this changing context, it has become increasingly necessary for the government to respond to the needs of its customers by measuring the citizen's responses to government initiatives. Also the government is now expected to pursue objectives of transparency and accountability in governance for attainment of ultimate objective of general welfare of citizens.

This changing context of the role or philosophy of the government rightly postulates that citizens in a democratic society deserve a fair account of how their government (in this case local) is doing financially, for much the same reason as investors in a company need fair accounts of the company's financial position and performance. The case for transparent systems of accounting and financial reporting by local governments is stronger, because their promises are enshrined in laws spelling out that a local government manages resources in public trust, for special purposes.

Thus, accountability and transparency are two basic objectives of an accounting system, which are becoming highly important for the government accounting system in the post liberalisation and globalisation era. These two objectives are not only philosophically relevant but have become a compelling necessity. A municipal body is a public institution concerned with community welfare, social justice and economic prosperity of its people, and as a component of the Government, it is accountable to the public on these issues by the Constitution. One of the effective ways of ensuring high levels of accountability and transparency is to introduce generally acceptable accounting practices and disclosure norms. These factors provide the basic rationale for improving the prevailing accounting and disclosure practices followed by the municipal bodies in India.

The other factors responsible for greater interest in improved accounting systems, are related to the new perspectives of urban governance and the paradigm shift in the urban development financing, particularly in the context of accessing market funds for long-term investments. In order to introduce and sustain market economy based financing, municipal bodies need appropriate accounting, auditing, budgeting and financial management systems that are transparent, comparable and accessible to the funding institutions and public for scrutiny. Present municipal accounting and annual financial reporting systems significantly fall short of these objectives.

Lastly, in order to tap capital market sources and also to improve overall urban governance we need to improve financial performance of the municipal bodies, that is, quality of expenditure and efficiency of the rupee spent or earned. For this, we need to improve the financial management in the decision-making process of municipal bodies. Lack of appropriate, scientific accounting system, at present, does not provide the information for efficient decision-making and it ultimately leads to wasteful expenditure.

Objectives and Scope of the Study

The main objective of the study is to review the new system of municipal accounting and financial reporting in the states/cities where it was introduced recently and suggest measures to improve it further. Thus, the more specific objectives of the study are:

- To review briefly the conventional practices of municipal accounting, budgeting and audit systems, and their relevance in the changing urban sector financial scenario;
- To review the initiatives taken recently by certain states/ municipalities to reform municipal accounts and financial reporting systems, and to analyse the drawbacks and advantages in traditional cash based accounting systems and also in the new accounting systems.
- To examine the replicability of the new accounting and financial reporting system in other states/cities. Problems faced by the states/ municipalities in implementing the reform measures will also be examined to suggest ways and means to overcome the difficulties.
- To analyse the guidelines proposed by the Institute of Chartered Accountants of India (ICAI), TCS and such other agencies on the New Accounting System. This will provide insights to such attempts and substantially help to suggest measures for further improvement in the accounting system, keeping in view the existing accounting codes, rules and regulations and also the procedures being practiced in various states/municipalities.
- On the basis of lessons learned from accounting reform initiatives, the NIUA will prepare guide points for further improvement in the municipal accounting system for use of states and institutions like ICAI.

In order to achieve the above objectives, the following tasks have been undertaken:

- Analysis of methods of recording revenue, expenditure, assets and liabilities, auditing of municipal accounts, budget preparation, etc. in the traditional cash based single entry accounting system as well as in the new accounting and financial reporting system based on double entry accrual accounting. Strengths and weaknesses of both the systems have been studied with a view to suggest measures for further improvement in the system, which should be flexible, user friendly and acceptable to state and municipal functionaries.
- Scrutiny of laws, rules and regulations on municipal accounts and financial reporting systems in the case study cities/states. This helped us to suggest changes needed in the legal, administrative and financial

framework to implement successfully the modified accounting system at the municipal level.

- Review of guidelines prepared by the ICAI, TCS and such other agencies on municipal accounting system keeping in view the existing municipal laws, rules and regulations and procedures being practiced in various states/municipalities.

Sample and Methodology

This study is a systematic analysis of accounting systems initiated in certain states/cities to improve the financial management of urban local bodies. As per the information available, there are four states where reforms have been initiated in the Municipal Accounting and Financial Reporting System (MA&FRS). They are Tamil Nadu, Gujarat, Rajasthan and Karnataka. Whereas in Tamil Nadu and Gujarat, a new accounting system was introduced a few years back, in case of Rajasthan and Karnataka not much has been done in this regard. In these two states, municipal accounting reforms were initiated very recently under the ADB Project.

As per the Terms of Reference of this study, three reports are to be submitted to the UNDP viz.: (i) Inception Report; (ii) Draft Final Report and (iii) the Final Report. The inception report was submitted to UNDP in January 2001. This Draft Final Report is prepared on the basis of collection of data/ information from the following municipal bodies of Tamil Nadu, Gujarat, Rajasthan and Karnataka.²

<u>State</u>	<u>Name of the Municipal Body</u>
Tamil Nadu	Alandur and Ambattur
Gujarat	Ahmedabad and Anand
Rajasthan	Jaipur
Karnataka	Bangalore and Tumkur

State level agencies such as TNUDP-II in Tamil Nadu and KUIDFC in Karnataka, responsible to carry out reforms in municipal accounting systems in the their respective states have also been consulted in the process of preparing this report.

With a view to include all the stake holders in preparing the guide points to improve the municipal accounting system further, workshop has been organized at Jaipur in July 2002 to discuss the initial draft of this report. Officials dealing with the municipal administration both at the city and state level as also the experts in the field have participated in the workshop. Suggestions obtained from the workshop have been incorporated in this report to make it more practical and user friendly.

² During the duration of this study Maharashtra State has made definite progress in this direction with the help from USAID-FIRE D Project. Also Indore and Hyderabad have introduced accounting reforms on their own. Though these experiments were not part of the study, these new development have been covered in brief to give updated accounts of accounting reform efforts.

This report is divided into Six Chapters. **Chapter I** provide introductory information about the study and relevance of accounting reform in the context of the changing socio-economic-political process in the country; whereas **Chapter II** explains various accounting concepts, principles and systems.

In **Chapter III** an attempt is made to explain existing municipal accounting and financial reporting system in its generic form. Drawbacks or defective characteristics of existing MA &FRS have also been discussed in this part of the study.

In **Chapter IV**, efforts have been made to evolve appropriate framework for modern municipal financial accounting system taking into account the characteristics, complexities associated with municipal bodies as a worldwide institution and peculiar characteristics associated with Indian Municipal Bodies.

Chapter V has evaluated municipal accounting reforms initiated in different parts of the country and has analyzed critically the process of reforms.

Chapter VI enlists conclusion and suggestions on statewide accounting reforms and guide points to improve the municipal accounting system further.

CHAPTER 2

Accounting Principles, Systems and Financial Reporting

The mounting pressure for public accountability has highlighted the need for reforms at the government accounting record keeping level. The proponents of municipal accounting reforms are advocating appropriate changes to current government accounting and financial reporting principles and formats. While there is recognition that government accounting is a specialized area, there is also a growing opinion that governments should be moving towards enterprise accounting principles, which are perceived to afford higher transparency and accountability.

In this Chapter various bases of accounting relevant to municipal bodies are presented in brief. The term 'basis of accounting' refers to the timing of recognition of revenues, expenses, assets and liabilities in accounts.

Cash Basis of Accounting

Presently, urban local bodies in India (like governments at other levels) generally follow the cash basis of accounting. Under this basis of accounting, transactions are recorded when the related cash receipts or cash payments take place. Thus, revenue (e.g., from property tax, water charges, etc.) is recognized when cash is collected. Similarly, expenditure on acquisition and maintenance of assets used in rendering services as well as on employee remuneration and other items is recorded when the related payments take place. The end product of cash basis of accounting is a statement of receipts and payments that classifies cash receipts and cash payments under different heads. A statement of assets and liabilities may or may not be prepared.

The adoption of cash basis of accounting by urban local bodies owes its origin to the pre-eminence of the budget as the principal means of financial control in the government. In the case of governments, the budget is a formal document setting forth the objects and purposes for which expenditures should be incurred during a period and the sources from which funds should be raised to meet such expenditures. Cash basis of accounting seeks to measure actual expenditures and receipts under various budget heads to facilitate a comparison of actual performance vis-à-vis budgeted targets.

Cash basis of accounting fails to meet most of the financial reporting objectives. It is obvious that the timings of cash receipts and cash payments may not coincide with earning of revenues or incurring of expenses. Furthermore, measures of performance based on cash basis of accounting are susceptible to alternation through a slight variation in the timings of cash receipts or payments. For example, merely postponing the payment of certain bills by a few days can conceal a budgetary deficit. Another major weakness of cash basis of accounting is that no distinction is made between receipts or payments on capital account and those on revenue account. Thus, under the cash basis of accounting, no distinction is made between expenditure on construction of infrastructural facilities such as roads, water distribution system,

bridges etc. and expenditure on routine items such as salaries, rents, etc. Similarly, a substantial expenditure on major changes to a building that result in an increase in its life is treated under the cash basis of accounting as no different from the revenue expenditure on normal repairs and maintenance. Similarly, refundable deposits are treated no differently from charges for service rendered.

The limitations of cash basis of accounting for proper measurement of performance and financial position have led to the adoption of accrual basis of accounting by the commercial world.

Accrual Basis of Accounting

Accrual basis of accounting attempts to record the financial effects of the transactions and other events of an enterprise in the period in which they occur rather than recording them in the period(s) in which cash is received or paid by the enterprise. Accrual basis recognizes that the buying, producing, selling and other economic events that affect an enterprise's performance often do not coincide with the cash receipts and payments. The goal of accrual basis of accounting is to relate the accomplishments (measured in the form of revenues) and the efforts (measured in terms of costs) so that the reported net income measures an enterprise's performance during a period rather than merely listing its cash receipts and payments. Apart from income measurement, accrual basis of accounting recognizes assets, liabilities or components of revenues and expenses for amounts received or paid in cash in past, and amounts expected to be received or paid in cash in future.

The major difference between accrual accounting and accounting based on cash receipts and payments is in the timing of recognition of revenues, expenses, gains and losses. It is possible that cash receipts during a particular period largely reflect the effects of activities of the enterprise in the earlier periods, while many of the cash payments may relate to activities and efforts expected in future periods. Thus, an account showing cash receipts and cash payments of an enterprise for a short period cannot indicate how much of the cash received is the return of investment and how much is the return on investment and thus cannot indicate whether or to what extent the enterprise is successful or unsuccessful. The essential features of accrual accounting are -

- Revenue is recognized as it is earned.
- Costs are matched either against revenues so recognized, or against the relevant time period to determine periodic income.
- Costs, which are not charged to income, are carried forward and are kept under continuous review. Any cost that appears to have lost its utility or its power to generate future revenue is written-off as a loss.

Modified Accrual Basis of Accounting

The cash basis and the accrual basis of accounting represent opposite ends of a spectrum. A compromise between these extremes, the one used by the governmental units for funds reporting spending activities, is the modified accrual basis. When accounting systems use this basis of recognition, revenues are recorded in the period

in which they are measurable and available. “Measurable” refers to ability to state the amount of revenues in terms of rupees. “Available” means collectible within the current period or soon enough to pay off the liability of the current period.” In other words, revenues are recognized either when they are received in cash (licenses, fines, and so on) or when collection of the amount can be reasonably estimated to be received in the near future (such as property taxes).

Expenditures in a modified accrual system generally are recognized in the period in which goods or services are received or a liability is incurred. A comparative picture of all the three basis of accounting is presented in Table 2.1.

Table 2.1

Distinction between Various Bases of Accounting

Element	Cash Basis	Accrual Basis	Modified Accrual Basis
Revenues	When cash is received Examples: <ul style="list-style-type: none"> ◆ On collection of PT ◆ On collection of fees and fines ◆ On transfer of grant money to the bank account 	When the revenues are earned Examples: <ul style="list-style-type: none"> ◆ On property taxes becoming payable – on issuance of demand note ◆ On receipt of sanction letter for grant from state government ◆ In case of revenue sharing agreement with other agencies as in case of utilities, when the other entity has earned the revenue of which a part is to be shared with the ULG 	When revenue becomes measurable and available to finance current period expenditures Examples: <ul style="list-style-type: none"> ◆ If property taxes were collected within 30 days of close of the FY, then these would be included in revenues for the FY, since they have been received within a relatively short period of FY end to be able to meet the FY liabilities.
Expenditures	When cash is paid out Examples: <ul style="list-style-type: none"> ◆ When salaries are paid ◆ When supplier bills are paid 	When the expense is incurred and a liability arises Examples: <ul style="list-style-type: none"> ◆ When at the month end, in consideration for 	When expenditure is incurred and a liability arises Examples: <ul style="list-style-type: none"> ◆ Same as in case of accrual basis Exceptions

Element	Cash Basis	Accrual Basis	Modified Accrual Basis
		services received, salaries become payable to employees ♦ When on receipt of supplies payment becomes due to supplier Exceptions: ♦ Inventory can be considered as an expenditure when purchased or when consumed	♦ Inventory can be considered as an expenditure when purchased or when consumed ♦ In case of debt service fund, (a separate fund created to service debt) both principal and interest are recognized as expenditures when they are paid.
Users	Present governments, small enterprises, professional firms	All medium and large enterprises, financial institutions	Governments, both in developed and developing countries

Single Entry Accounting System

Under the single entry accounting system the receipt and payment transactions are recorded on cash basis, that is, the receipts actually received and the payments actually made, irrespective of the period to which they belong. The annual account prepared reflects only cash in-flow and out-flow. Simplicity is one of the main advantages of the cash based single entry accounting system; its wide appeal is also influenced by the prevailing institutional and operational conditions. The salient features of the single entry accounting system are -

- Only the personal accounts (debtors and creditors) are reflected in this system.
- Since single entry accounting ignores the two-fold effects of the transactions, such as credit and debit. The preparation of trial balance is not possible in this system to test the arithmetical accuracy of the system.
- In the absence of “nominal accounts” no classified information is available regarding the gains or the losses and hence no income and expenditure account could be prepared, without a complete restructuring of the budget.
- In the absence of real or property accounts and opening and closing balances, no balance sheet can be prepared. At best, a statement of cash in-flow and cash out-flow can be prepared. Also, as assets accounts are not maintained, it is difficult to keep control over misappropriation of the assets.

- Single entry accounting system lacks self-balancing mechanism; accordingly this system is vulnerable to fraudulent activity and hence affects the credibility of financial statements.
- Since no demand is raised and accounted for by the Accounting Department, statements on tax demand, collection and balance (DCB) are not prepared. Coordination seldom exists, between the Revenue and Accounting Departments in reporting the DCB information in the municipal budgets.

Double-Entry Accounting System

Double entry accounting approach is based on principles that each financial transaction has a dual aspect, and for accurate presentation, both the aspects should be recorded in the account books.

Double entry accounting not only overcomes the shortcomings of the single entry system, but also allows systematic accounting of all aspects of an entity. It requires maintenance of records of assets, liabilities, revenues and expenditures of an entity and each financial transaction is recorded showing an impact on one or more of these. For example, if a loan is availed by a municipal body from any financial institution, then at present it is recorded in cashbook on receipt side and then put in income ledger against the budgetary head for this receipt. It is not recorded and carried forward as a liability of the entity as it should be in order to convey the correct financial position of the municipal body. Under the double entry accounting system, such an entry would be recorded with an impact on an asset account on one hand (cash balance showing an increase by the amount of loan) and on liability account (loan payable account of Financial Institution being the same amount as the cash received) on the other. In this system, the total assets of a firm are always equal to the total equities and liabilities of the firm. Equities and liabilities are the claims against the assets and indicate the source of the assets.

Table 2.2

Distinction between Double Entry & Single Entry System

Basis of Distinction	Double Entry System	Single Entry System
Two aspects	Under this system, both the aspects of a transaction are recorded.	Under this system, both the aspects of transaction are not recorded. In fact, for some transactions two aspects, for some others one aspect and yet for others no aspect is recorded at all
Accounts	Under this system, the accounts opened are personal, real , nominal, etc.	Under this system, only personal accounts and Cashbook are opened. Hence, it remains merely an incomplete record of accounts.
Trial Balance	Under this system, trial balance is prepared for checking the arithmetical accuracy of the books of accounts.	Under this system, trial balance cannot be prepared due to incomplete system of accounting. Therefore, arithmetic accuracy of the accounting cannot be checked.

Basis of Distinction	Double Entry System	Single Entry System
Profit or Loss	Under this system, after a certain period, net profit or net loss can be ascertained by preparing profit and loss account.	Under this system, after a certain period profit and loss account is not prepared to ascertain the net profit or loss. Method for ascertaining profit or loss is not sufficient.
Financial position	Under this system correct financial position of the business can be ascertained by preparing a Balance Sheet	Under this system, a balance sheet is not prepared. Only a statement of affairs is prepared. The reason is that the assets and liabilities do not stand at real figures but at estimated ones.
Adjustments	Under this system, adjustments (for closing stock, provisions for expenditure, receivable, depreciation entries, carry forward of miscellaneous expenses (assets) etc) are made at the time of preparing final accounts.	There is no provision to make adjustments (for closing stock, provisions for expenditure, receivable, depreciation entries, carry forward of miscellaneous expenses (assets) etc) mainly because of incompleteness of accounts.
Authenticity	This system is considered authentic by various statutory bodies, both nationally as well as internationally.	The statutory bodies do not consider this system as an authentic one.

Financial Reporting System

Financial reporting is a broad term that includes general -purpose financial statements as well as other types of financial reports. It should be recognised that while general-purpose financial statements (referred to hereafter simply as 'financial statements') are a principal means of information for most users, they may not (due to their very nature) provide all the information that the users, or some of them, may need. While developing a framework for financial reporting by urban local bodies, it would therefore be necessary to identify what information can best be communicated through financial statements and what information needs to be communicated through other financial reports.

User Groups and their Information Needs

There are principally three groups of users, namely the public, the legislature and the creditors of the financial statements of urban local bodies. Key users of governmental financial information and their information needs are described below.

(I) Citizens

The citizens include taxpayers, voters and service recipients and are usually represented by the media, advocacy groups, and public finance researchers. The citizens would be interested in information on the financial conditions and operational results, as indicators of increase or decrease in the level of services provided and impending tax burden in future.

(II) Elected Representatives

The elected representatives are interested in knowing how much money is available for providing services and how to optimize the services in given funds so as to keep the taxes low and citizens happy.

(III) Executive

The executive has the difficult task of managing financial resources while balancing the dictates of the legislative intent in the budget with political exigencies of the elected representatives, and the need for financial prudence required by creditors and investors.

(IV) Investors and Creditors

These stakeholders have the simplest and most easily understood objective of all, which is prudent management of resources to safeguard their interests in the entity.

(V) State Audit

State audit is a government department working with an objective of ensuring that the subject entities have complied with statutory requirements, contractual obligations, debt covenants and have conducted all their financial transactions within the specified rules and regulations. These users of financial information are also responsible for ensuring that financial reporting provides a true and fair view of financial performance and condition of the entity. Their information needs to have more to do with the accounting system underlying the financial information.

(VI) Urban Development Department (UDD)

UDD represents the state government, which is one of the key stakeholders since it provides, in some cases, nearly 90 percent of the local government resources through grants, both general purpose and special purpose. Therefore, UDD needs to know the financial position of a local government to assess its fund requirements for the coming years. Being one of the largest beneficiaries, the state government also needs to know whether the ULG conducts its affairs with financial prudence and within the limits defined by the state government's sanctioned budget.

Measurement of Performance

One of the principal objectives of financial reporting whether in the case of commercial enterprises or in the case of urban local bodies is to enable the users to assess the performance of the reporting entity. Performance is measured by relating the accomplishments (output) to efforts (inputs). In the case of commercial enterprises, accomplishments are measured in terms of revenues while efforts are measured in terms of expenses incurred to earn those revenues. 'Profit', the difference between revenues and expenses for a period provides the local measure of performance in the case of commercial enterprises. The nature of operations of urban local bodies and the environment, in which they operate, however, have certain distinctive features, which make 'profit' an inadequate measure of their performance.

The limitations of profit as the local measure of performance of urban local bodies call for devising appropriate parameters for measuring their performance. It would be appreciated that while the expenses and revenues would continue to be important measures of inputs and outputs respectively, more comprehensive measures are needed to report the efficiency and effectiveness of operations of urban local bodies. For example, apart from reporting financial measures of inputs (i.e., expenditure incurred on various services such as amount spent on schools and colleges, public transport, maintenance of roads, maintenance of law and order, etc.) it would also be necessary to report non-financial measures such as number of teachers in total or per thousand students, number of police personnel per thousand members of the public etc. Similarly, measures of outputs would also need to be reported in both financial and non-financial terms. Thus, apart from reporting financial revenues from various services, it would also be necessary to report the quantum of services provided, such as, the number of passenger kilometers provided by public transport, number of students graduated, etc.

Measurement and reporting of efforts (inputs) and accomplishments (output) in financial and quantitative terms as suggested above would need to be supplemented by information on (a) relationship of inputs to outputs (the 'efficiency') and (b) results of providing the outputs (the 'efficiency'). Example of measures to report the relationship between inputs and outputs are cost per student, cost per passenger kilometer, etc. Examples of measures to report the results of providing the outputs are percentage of population being served by public transport, percentage of crimes solved, etc.

There is now a growing recognition that where an enterprise provides a diverse range of products or services, which are subject to different risks or returns, provision of certain financial information (e.g. revenue, results of operations etc.) separately for each such product/ service enables the users of financial statements to better understand the performance of the enterprise. Accordingly, it is recommended that urban local bodies should provide (apart from aggregated information) the relevant financial information in respect of each major activity.

CHAPTER 3

Existing Municipal Accounting and Financial Reporting Practices

The existing accounting system followed by a majority of municipal bodies of the country is very rudimentary, non-transparent and fails to facilitate the purpose of accountability. This is one of the areas of municipal administration, which has been totally neglected over the years. A diagnostic assessment of the prevailing accounting system is called for before prescribing institutional and operational improvements in municipal accounting and financial reporting. Besides the hard-core accounting system, one will also have to take into account peculiar characteristics and issues associated with the existing municipal accounting practices and financial reporting system. Accordingly, existing municipal accounting and financial reporting practices have been discussed under two heads – one, the system and two, the salient characteristics and issues.

Owing to the heterogeneity¹ in all the aspects of the municipal accounting system, it is very difficult to generalize if one tries to compare the formats, books of accounts, and outputs of different municipal bodies. In the following pages an attempt has been made to provide a generic / generalized accounting system which exists in most of Indian Municipal Bodies.

The municipal accounting system in India is characterized by the 'cash-basis', that is, transactions are recognized in the Books of Accounts only when they manifest as cash-inflows or cash-outflows. It also entails that there is an absence of all types of 'Real Accounts' (as distinguished from personal and nominal Accounts).

At the generic level, the municipal accounting system comprises a Central Accounting System (CAS), Feeder Accounting Systems (FAS) and Independent Accounting System (IAS). The Feeder system and the Independent system constitute the periphery of the accounting systems of the municipal body. B & C grade municipalities comprise only the Central Accounting System. 'A' grade municipalities & small municipal corporations have accounting systems which are the mix of Central Accounting System and Feeder Accounting Systems. Larger municipal corporations have an elaborate accounting system covering all the three components. This is because of the higher level of departmentalization, decentralization, volume of operations etc. (Fig. 3.1 to 3.3). The Central Accounting System (CAS) is always looked after by the Central Accounts Department (CAD) of a municipal body. The Feeder Accounting Systems spread over various operative departments and carry out basic accounting functions in a municipality and provide raw or semi-processed data to the CAS. The independent accounting systems (IAS) pertain to the commercial undertakings or to the highly decentralized activity or fund of the municipal body, e.g. the city transport and electricity supply undertakings. The independent system may have its CAS and FAS. The final accounts produced by IAS are submitted to the

¹ Heterogeneity referred here arises because municipal bodies being State subject, each State has formulated separate law and account code under that for governing its municipal bodies. As result accounting policies, formats, procedures, accounting codes etc differ from State to State and sometime from municipal bodies to municipal bodies within the state

municipal body sometimes for the reporting purpose but most of the time for taking it into consolidated financial statements. (Fig. 3.1 to 3.3)

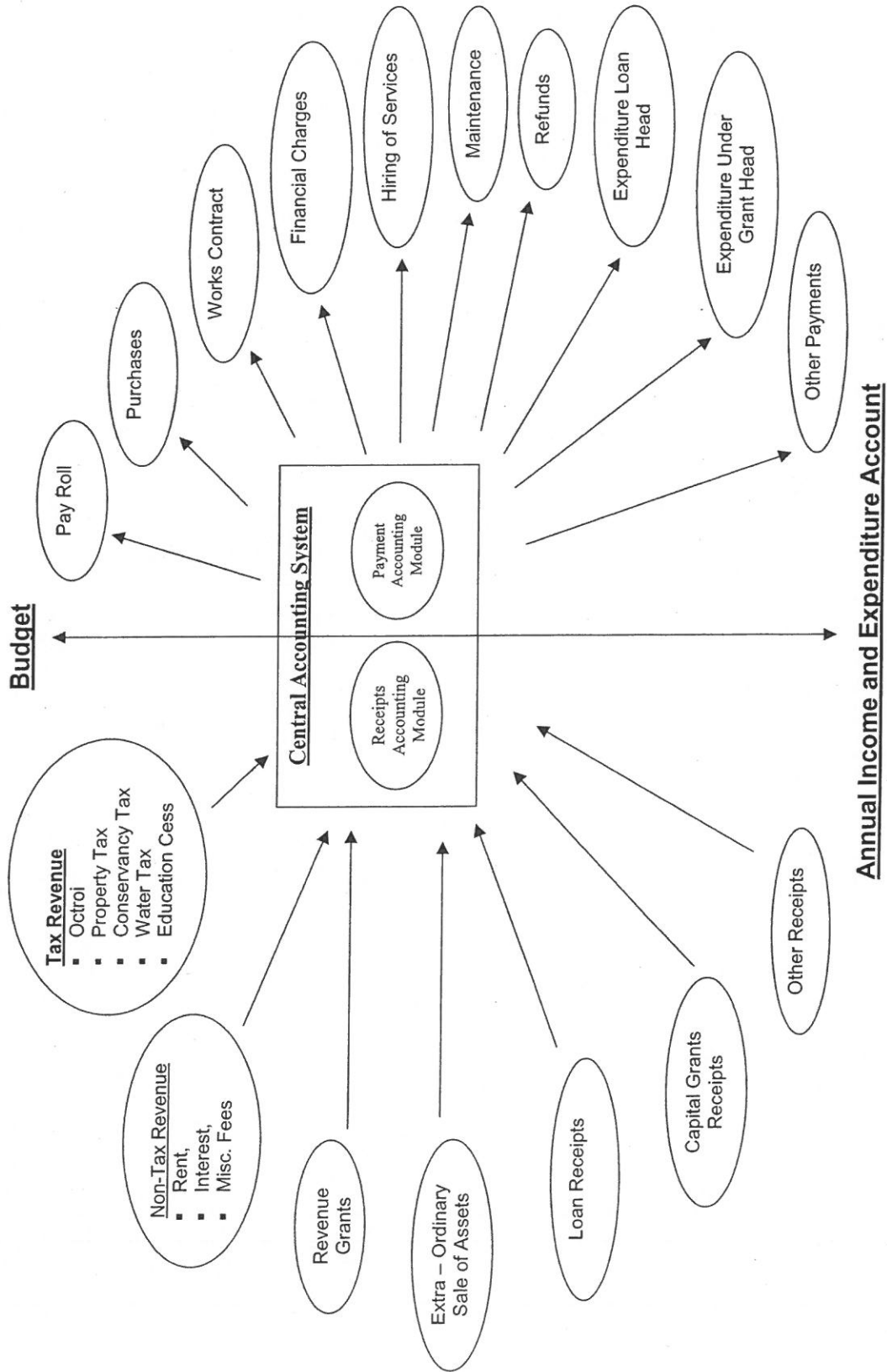
The study of the schematic models of accounting systems of various sizes of municipal bodies (Fig. 3.1 to 3.3.) clearly shows that it is confusing and ill structured. Only three basic structures have been discussed here, but in India, all probable combinations of the three structural components (CAS, FAS, IAS), exist in municipal accounting systems.

In **Figure 3.1**, one can observe a basic generic model of a municipal accounting system devoid of any distortion. This structure/model exists in all 'C' & "D" grade, sometimes in 'B' grade municipalities across the country. It is purely a single entry, cash -based accounting model. It draws heads/items of receipts and payments from the budget and is highly centralized with no peripheral accounting system. The central accounting system, which in other words is called Central Account Department (CAD) of a municipal body, receives all the receipts directly and carries out all the payments. A municipal body may have more than one bank account but maintains a consolidated fund system. The end result is the annual income and expenditure statement.

As one moves to a bigger municipality, the municipal accounting system/structure starts getting distorted and becomes complex (See **Figure 3.2**) With the increase in the size & volume of the municipality, at first instance peripheral accounting system on the receipts side starts getting added. The first FAS that come into existence are octroi and tax collection feeder (peripheral) accounting system. People/tax payers start paying their municipal dues in the departments other than accounts and in turn these departments start maintaining basic books of account. The receipts received (cash & cheques) are deposited into the central accounts department-wide challan on the same day or the next day. As the municipal body continues to grow, more and more revenue-receiving departments acquire feeder accounting system. Certain receipts still continue to get credited directly to CAS. Consequently the primary books of account for such receipts continue to get maintained in the CAS.

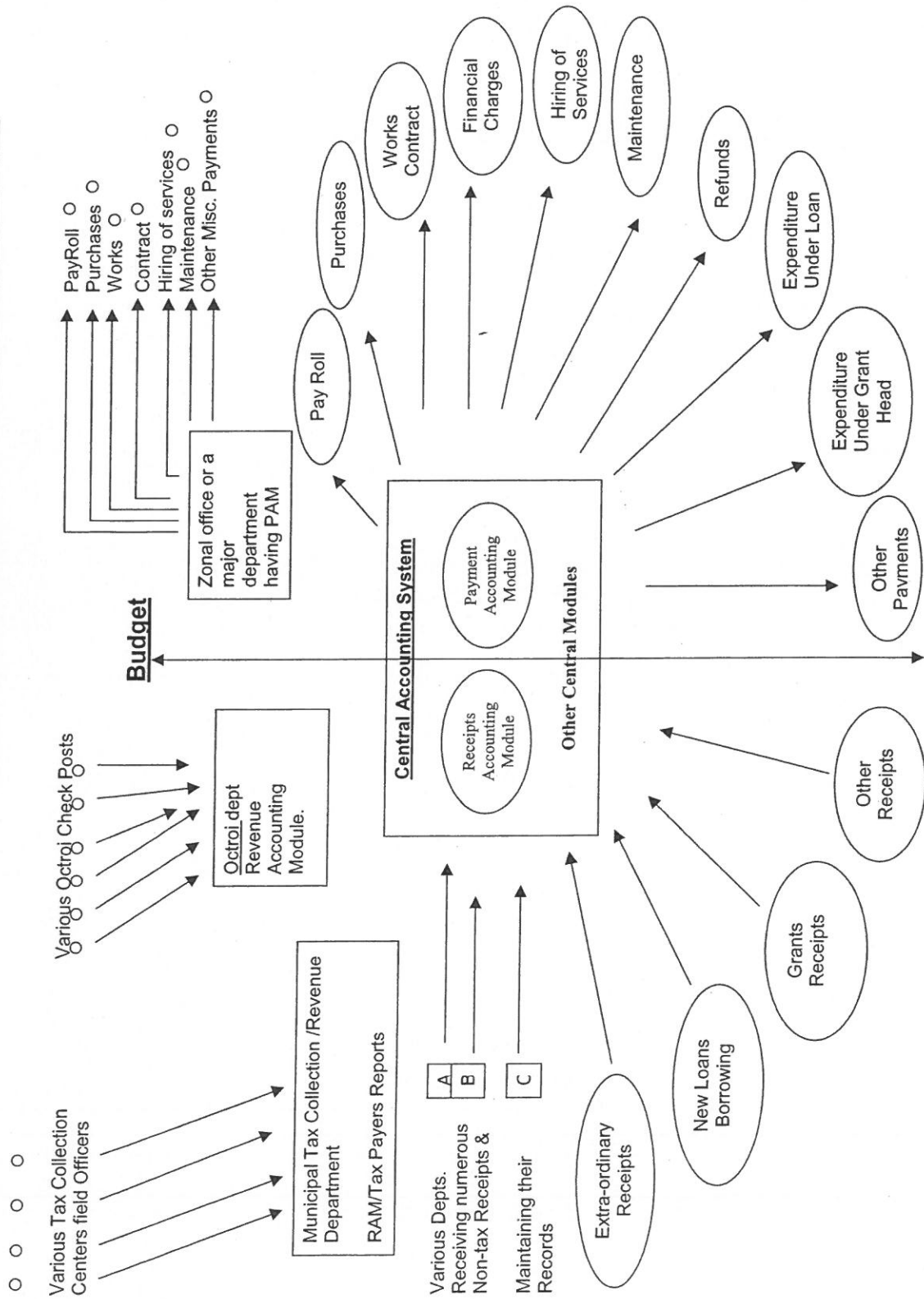
The peripheral or feeder system pertaining to payments does not come into operation along with the receipts. Even today most of the municipal corporations have not adopted the feeder accounting system for their payments. The FAS for payments are in existence in only some big municipal corporations, which have gone in for the decentralization of administration and have created zonal or circle offices. But here also not all types of payments are paid through these feeder systems. The payments like salaries to staff, financial charges and capital expenditure continue to get paid from the CAS. The CAS, burdened with excessive accounting and record keeping work, characterizes all the municipal bodies, which do not have a peripheral accounting system for payments.

Figure 3.1
Accounting Structure of Small Municipal Bodies



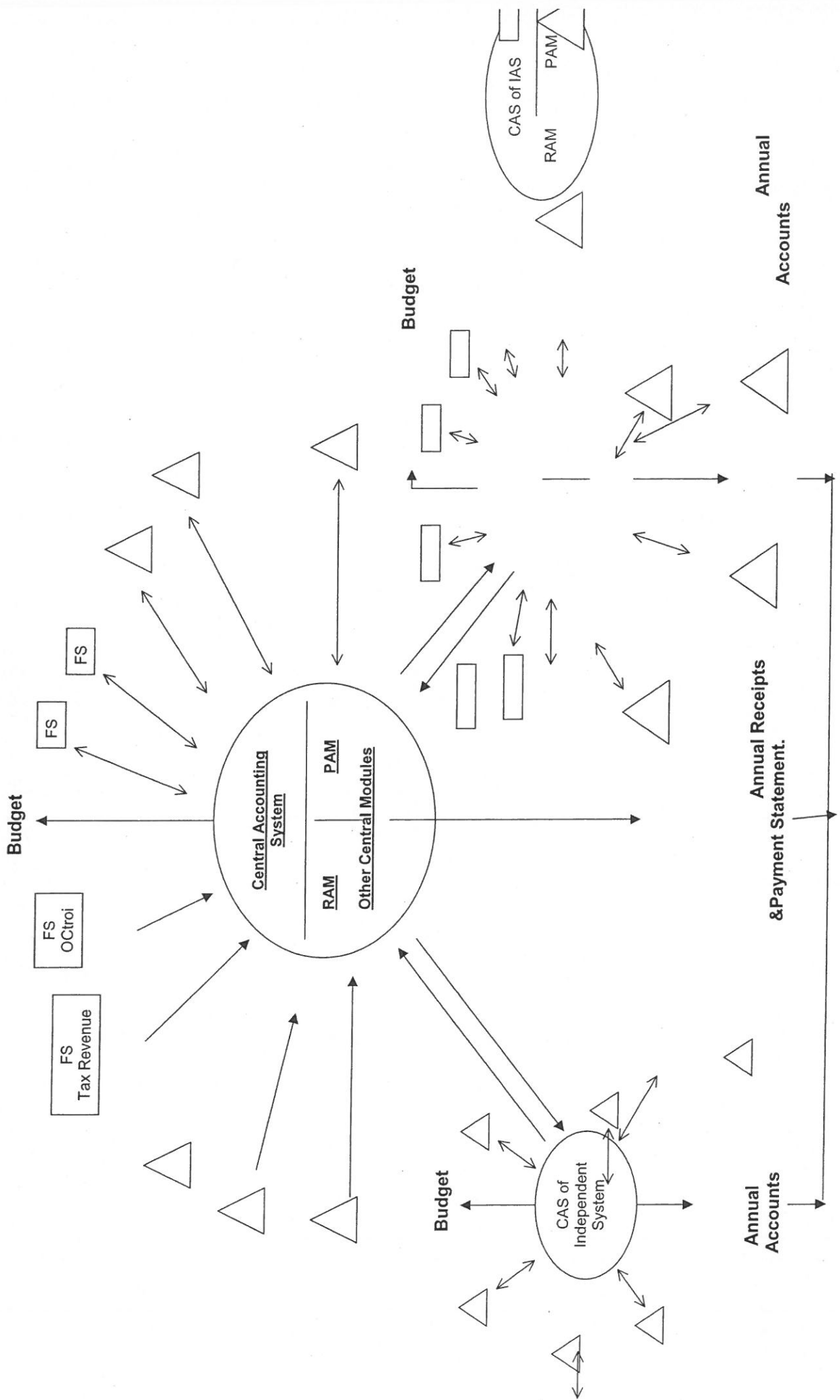
N.B. Budget comprises Annual I & E of Muni. Bodies

Figure 3.2
Accounting Structure of Medium to Large Municipal Bodies



* Budget = Annual I & E Statement

Figure 3.3
Accounting Structure of Municipal Corporations having Feeder & Independent Accounting System.



The structure of a municipal accounting system having all the three, CAS, FAS & IAS, (**Figure-3.3**) need not be associated only with larger municipal corporations. At many places bigger municipalities have an independent accounting system. Independent accounting systems have their own central accounting system and may or may not have feeder accounting systems. Usually independent accounting systems have their own budget document, which serves as the chart of accounts. Sometimes these independent accounting systems are self – sufficient and do not receive financial assistance from CAS. For example Natural Gas Supply Project of Vadodara Municipal Corporation runs on self sufficiency basis, thus requires no financial assistance. In some cases, IAS receives regular financial assistance from CAS for example city transport undertakings fall under IAS but invariably concerned municipal body is required to provide financial assistance from its main account to mitigate the deficit of its city transport undertaking. Also sometime IAS repays the CAS in the form of profits, refunds or charges for the services received for example gas project of Vadodara Municipal Corporation pays for the services like water, medical treatment etc received from VMC. The structural components of the existing accounting system are elaborated as below: -

- A. Central Accounting System (CAS). (Figure 3.4 A)
- B. Peripheral Accounting Systems (PAS). (Figure 3.4 B)
 - (1) Feeder Accounting System (FAS)
 - (2) Independent Accounting System (IAS)

A. Central Accounting System

The central Accounting system consists of following sub-systems/ modules in each and every municipal body irrespective of size, volume, scope etc. Some of them, which are uncommon, have been described in following pages.

- I. Receipts Accounting Module/Sub-System (Treasury section)
- II. Payments Accounting Module/Sub-system (Treasury section)
- III. Daily Receipts and payments Cross Verification (Daily Sheets) (Accounting Section).
- IV. Bank Reconciliation.
- V. Investment Module.
- VI. Liability module.
- VII. Suspense (Advances) Module.

Receipts Accounting Module (RAM)

The receipt of funds can be a highly centralized activity in small municipalities or it can be partially centralized/decentralized activity with varying degrees in the case of medium level municipalities to medium level municipal corporations. It can be totally decentralized in large municipal corporations. Where receipt activity has a decentralization element, money gets collected and receipts are issued at field level collection centers like the octroi check post, ward offices etc. The collection center, thereafter, deposits funds in central treasury by means of challans. The RAM covers the following major activities:

- Receipt of Funds (Treasury Section)
- Posting in Daily Sheets
- Consolidation into Classified Registers
- Cross Check with Collection Centers and Treasury Section
- Trial Balance (monthly & annually)

Payment Accounting Module (PAM)

It can be observed (**Fig. 3.1 to 3.3**) that payment is also a centralized activity in most of the municipal bodies in the sense that all payments are made only from the Central Accounts Department. The payees put up their requests by means of credit bill or Performa invoice to the department, which has placed an order for supplies or for the work or service provided. After due verification of the supplies received or the work done, the concerned department prepares 'payment-memo', debits it to the appropriate budget-head and then the head of that department or the person who has budget-drawing powers signs it. This payment-memo is then sent to the Central Accounts Department. The PAM covers the following major activities: -

- Payment Memo Approval
- Payment
- Daily-sheet preparation/posting
- Posting in Bills/Budget Ledgers
- Consolidation into Classified Register
- Trial Balance Preparation

Daily Receipts and Payments Cross-tally

Item-wise receipts and payment statements (Daily-Sheets) are prepared under RAM and PAM every day. These are prepared on the basis of paid vouchers and receipt challans, while bank- book (Journal) and cash-book (Journal) are written as and when challans are received along with cash or cheques or voucher is paid in cash or by cheque. The journal does not have item-wise bifurcation. It simply contains information about the party from whom money was received or to whom payment was made, the amount and the cheque number. In some municipal bodies, information about broad/main budget head such as revenue income/expenditure, and advances, deposits, receipts or refund, loan, grants is also entered into the journal. At some places a master journal is maintained which is prepared on the basis of cashbook and bankbook. In a way, it is a duplication of work.

In order to ensure correctness of daily accounts (receipts and payments) the cash and bankbooks (or main journal-rojmel) are cross-tallied with the sum of the budget item-wise daily statement. If the gross receipts & payments of the day (as per journals) tallies with the sum of the daily sheet, the accounts are presumed to be correct. (**See Figure 3.5**) Wherever peripheral accounting systems exist reconciliation between them is carried out between the book of accounts maintained by the CAS, and by the peripheral accounting system. (**See Figure 3.6**)

Figure – 3.4 A
Generic Structure of Receipt Accounting System having no Peripheral Systems

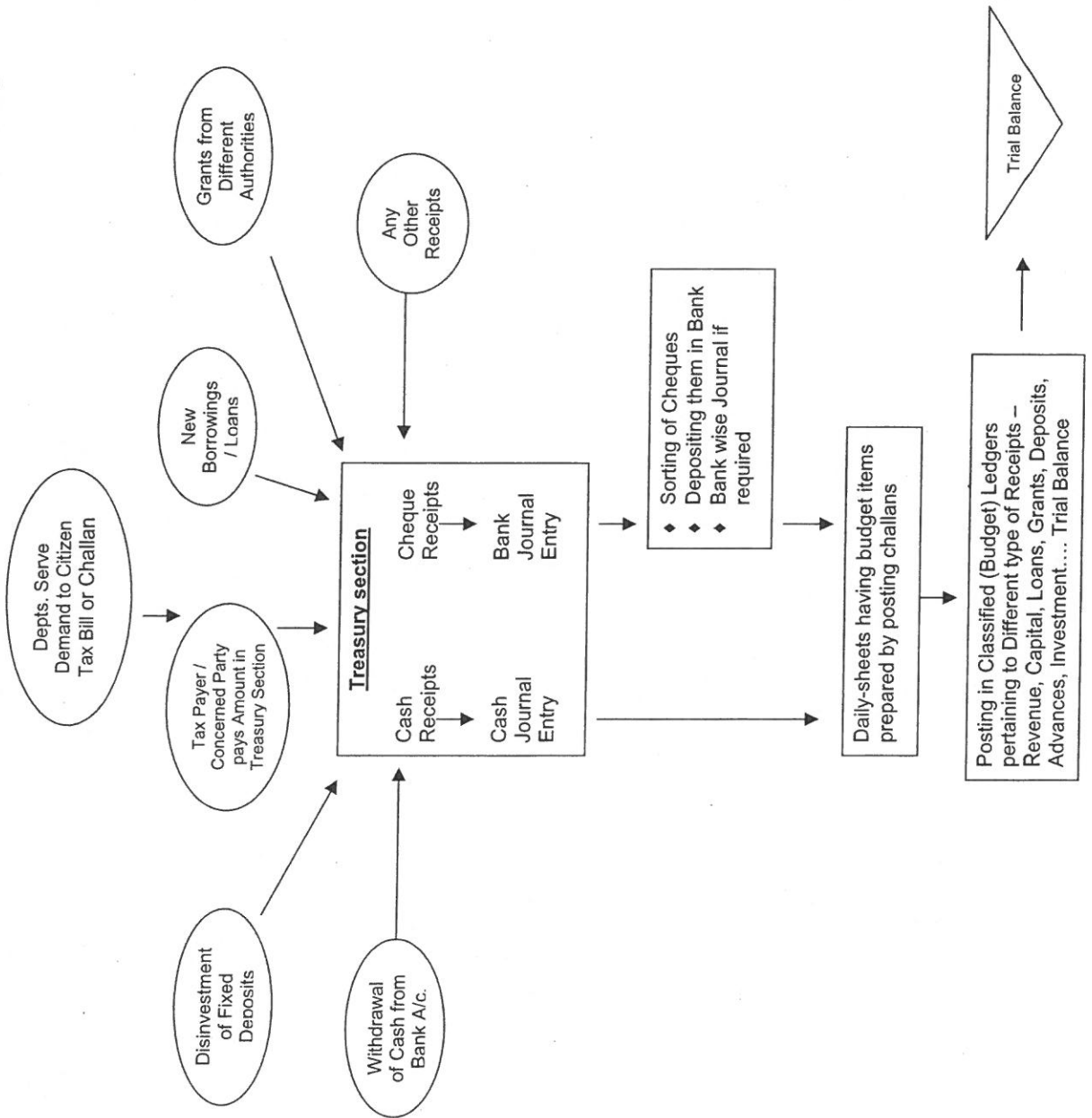


Figure – 3.4 B
Generic Structure of Payment Accounting System having no Peripheral Systems

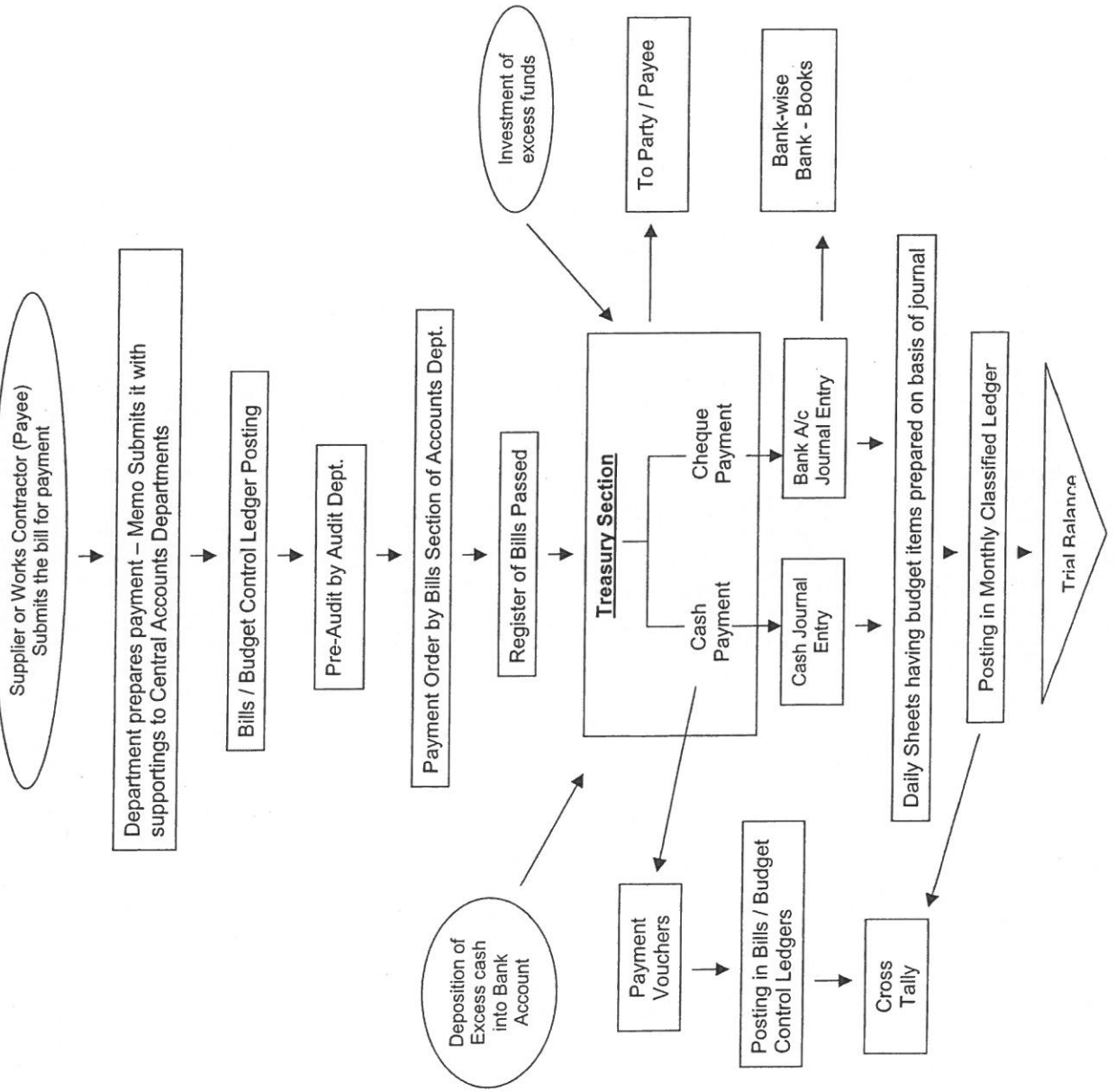


Figure – 3.5
Daily Receipts and Payments Cross Tally Process in Central Accounting System.

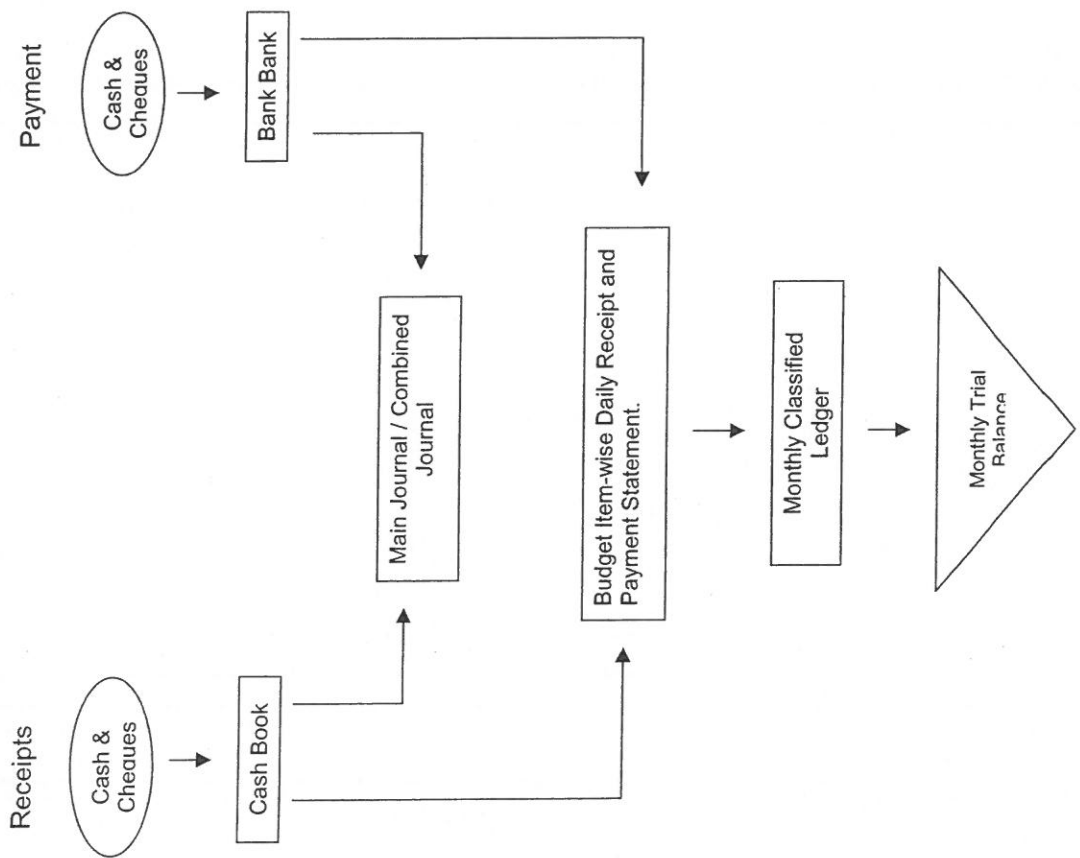
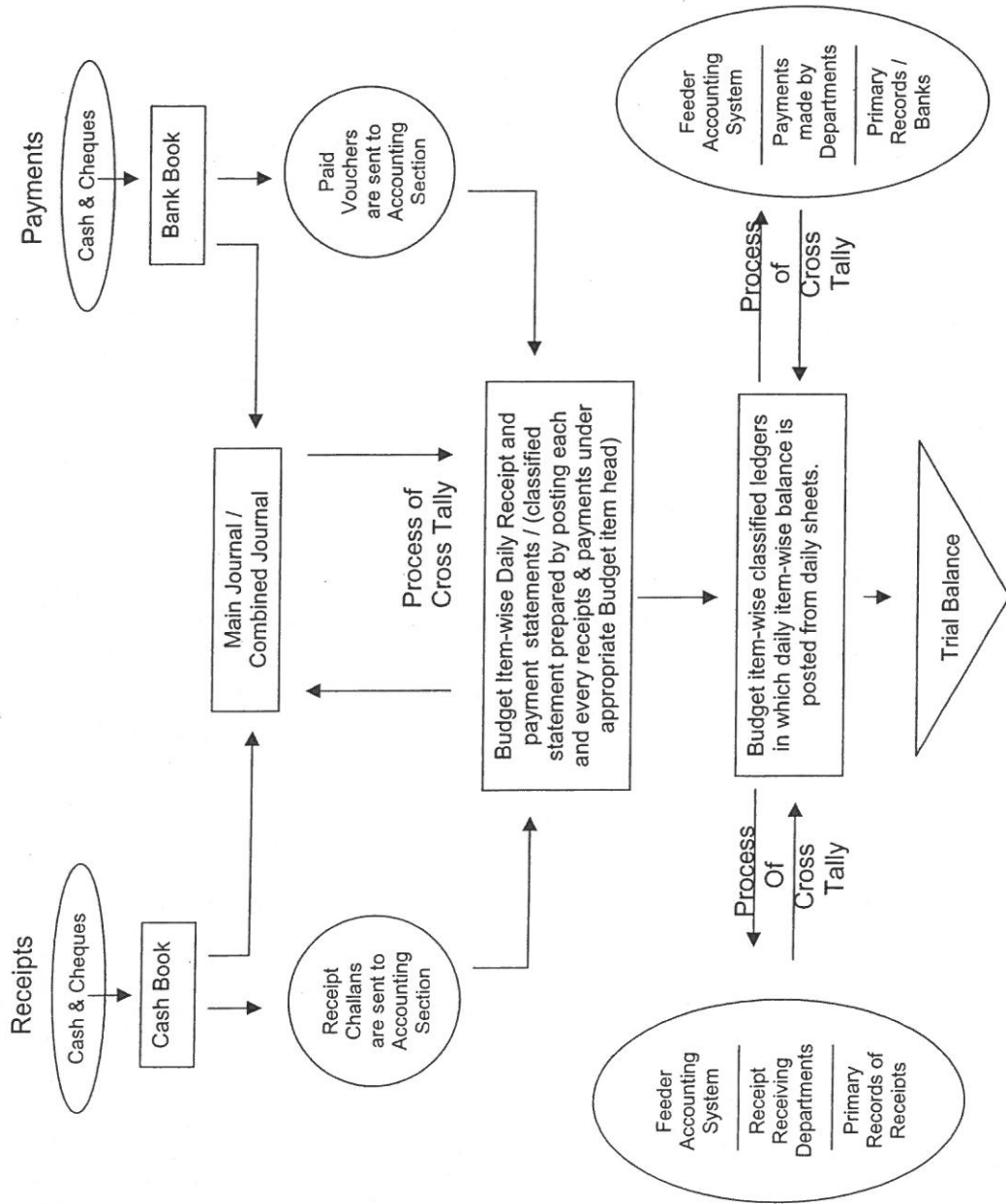


Figure – 3.6
Daily Receipts and Payments Cross Tally Process in CAS having FAS



In most of the municipal bodies, the unavoidable process of writing day-books (cash & bank) gets completed in any case. The next process of preparing daily budget-item-wise statements gets completed to some extent, but the process of reconciliation and consolidation and that of preparing monthly and annual accounts, remains pending in most of the municipal bodies, of course, in varying frequency and for different time periods.

Suspense (Advances) Accounting Module

This is a very peculiar feature of all local governments. The advance module is purely CAS sub-module in all-municipal bodies and therefore is handled by the CAD. The practice of incurring expenditure by drawing advance has played havoc with the municipal accounting, financing and budgeting in most of the municipal bodies. It has been observed that more than 10 percent of the total turnover of the municipal body gets routed through suspense account and every year unadjusted or outstanding advances go on increasing. Only Vadodara Municipal Corporation has solved this problem through its accounting reforms. The expenditure which cannot be appropriated to the respective budget item/items is paid from the advances account (suspense), for example purchase of pipes, material for road construction steel, cement etc. As per rules any payment made against pro-forma invoice or any amount deposited with an authority like the electricity board for erecting or shifting streetlight poles cannot be treated as budget or actual/final expenditure. Sometimes expenditure becomes necessary or urgent but there is no sufficient budget provision available. In such circumstances the advance mode of payment is resorted to and the payment is released from the suspense account. The accounting process of taking advance and its adjustment is hereby described.

The purchases of the stock items like Cement, Steel, C.I. Pipes, G.I Pipes, RCC Pipes, grit, metal bitumen, ferrules etc are purchased through the suspense (advances) account. Non-stock items are usually purchased under the credit facility, that is, payment after delivery and not by drawing advance. But when payment through the bank or against the delivery is to be made, advance is drawn, payment is made and then the adjustment entry is made debiting budget/ revenue account and crediting suspense account. All central store stock items are bought by taking advances in the name of the stores superintendent, while all non-stock purchases or payments are resorted through taking advances in the name of the budget-drawing officer.

In case of stock items, having supplied material to department, central store issues a bill for the stock/ material supplied. The department then, having consumed that material, books expenditure in the appropriate budget item and credits that amount to central store out-standing advances. In other cases, advances drawn in the name of departmental head (budget drawing officer) are adjusted by the department after material is received. Work is done or the job is accomplished by debiting expenditure to the respective budget item and crediting that amount to advances/ suspense account. The flow chart depicting the drawing of advances and then its adjustment is presented in the **figure 3.7 & 3.8**.

It can be observed from the figures that two sets of books of accounts are maintained for advances drawn; one, in the department, and second, in the CAS. In the CAS department-wise advances, a register is maintained for the advances given and adjusted. When advance is given to the department, the amount of advance gets debited to its account and when the department adjusts advance drawn, its budget provision/ item gets debited and the advances account of the department gets credited. At the end of the month department-wise sums are drawn and an outstanding advances statement is prepared. Similarly, on the other side, the department maintains the Advances Register and all the entries of the advances drawn and adjusted are entered into this, and at the end of month sums are drawn and are reconciled with CAS.

B1. Peripheral Accounting System – Feeder Accounting System

As the municipal body grows in size, volume and scope, some sort of decentralization takes place and the peripheral accounting system comes into existence. Receipts-related PAS is the first to come into operation. The payment side PAS may not be found in the small or even in the medium-size municipal corporations. Its evolution depends largely on the devolution and delegation of powers. In **Figures-3.9A & 3.9B** the final picture of CAS and fully developed PAS has been depicted but there exist various in-between accounting structures in municipal bodies. The evolution of PAS is also not similar in municipal bodies. A particular PAS may get developed in one municipal body while it may not be found in another municipal body. Any activity/ function, for which PAS has not been developed, remains with CAS. Usually the following PAS-FAS are found as providing inputs to the CAS in Indian municipal bodies.

Receipts Related Feeder Accounting Systems

- Octroi
- Property tax and other related taxes, levies.
- Department/ Activity related License/ Service Fees.
- Rents, Rates, Municipal Property Related Receipts.
- Sale of Assets

Payments Related Feeder Accounting Systems

- Purchase Accounting.
- Work Contract.

Figure – 3.7
Drawing and Adjustment of Advances Drawn For Stock Items

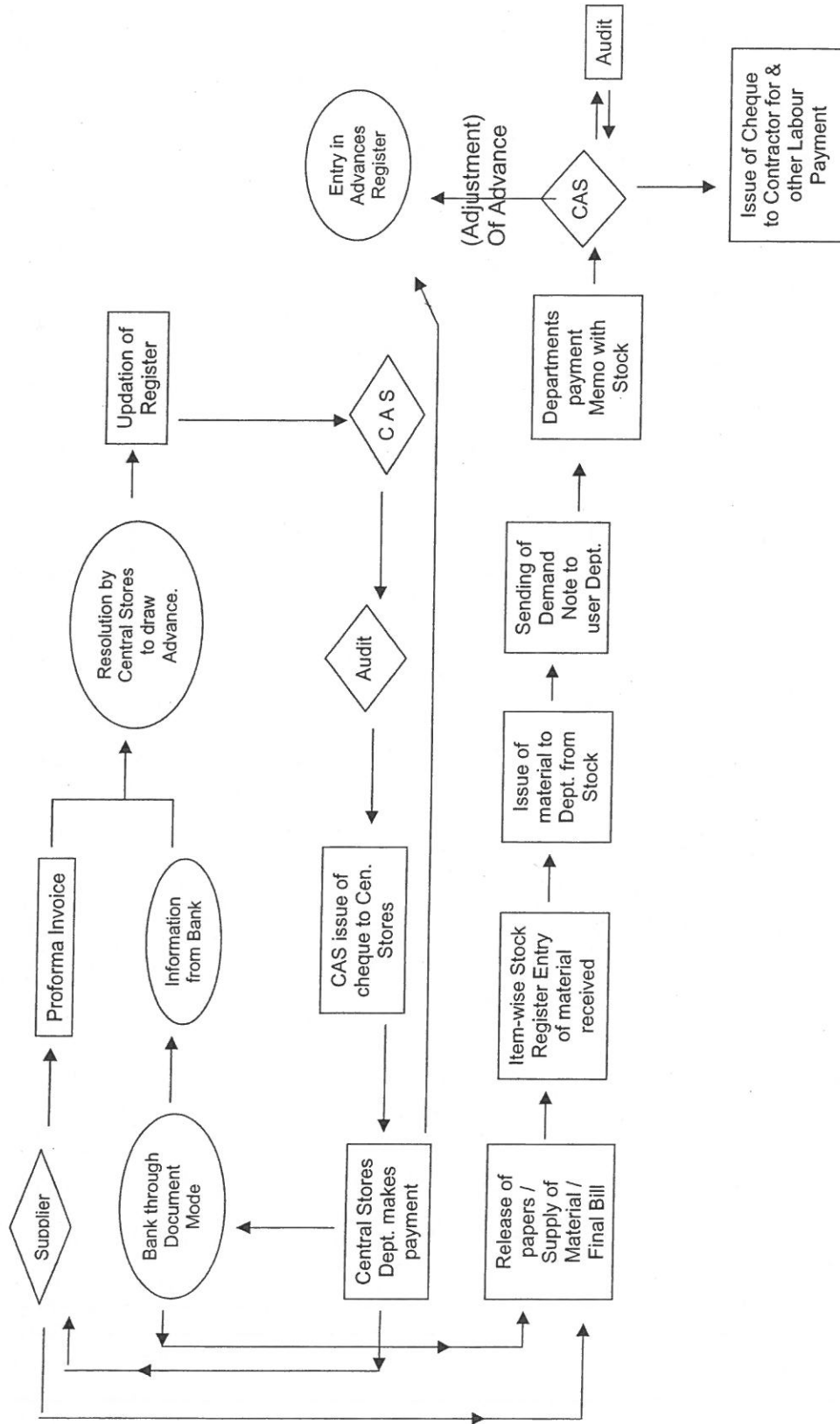


Figure – 3.8
Drawing & Adjustment of Advances in Case of Non-Stock Items

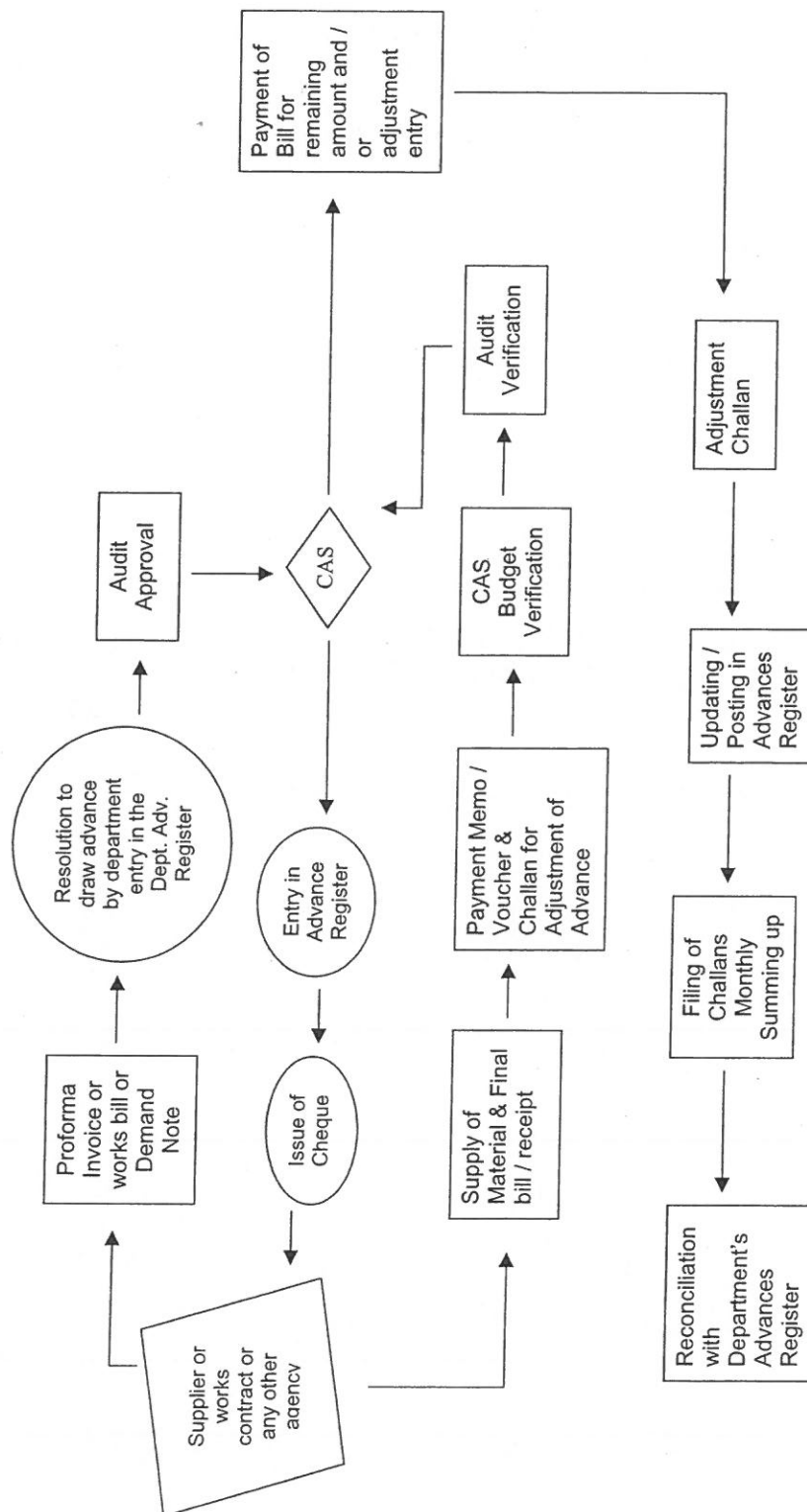


Figure – 3.9 A

Generic Structure of Receipt Accounting System having both CAS & Peripheral System

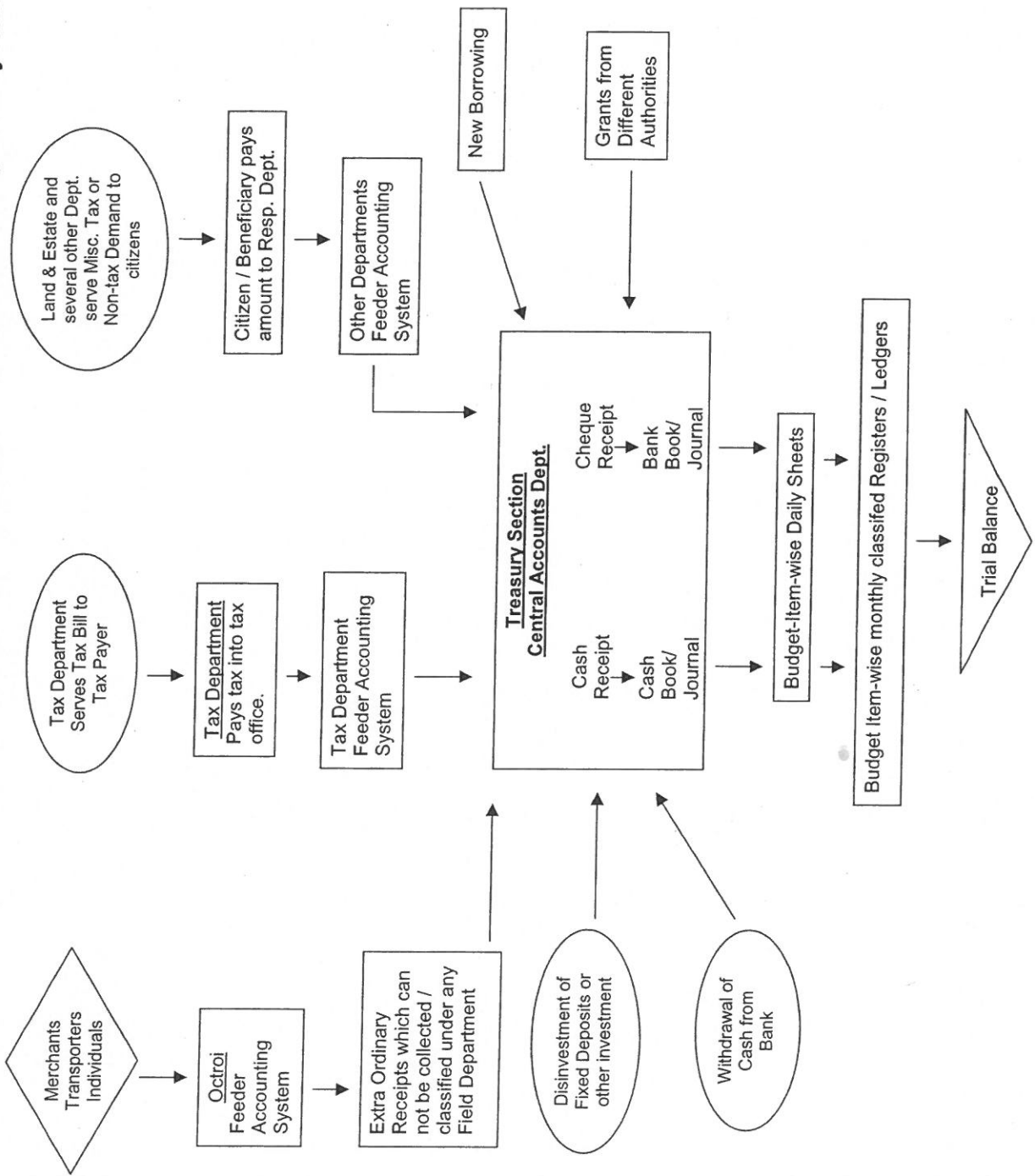
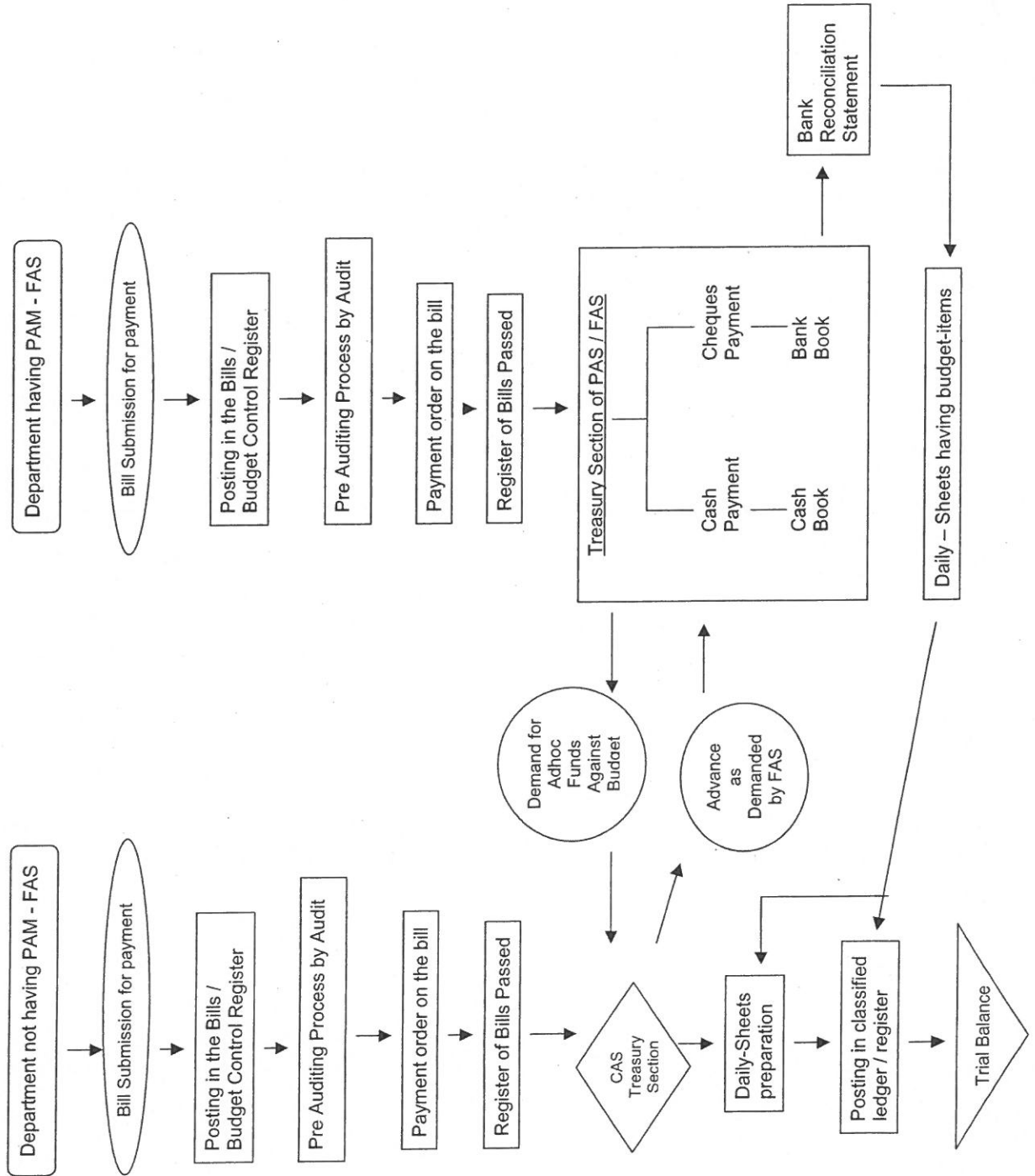


Figure 3.9 B

Generic Structure of Payment Accounting System having both CAS & Peripheral System



- Pay Roll.
- Deductions from Salaries and Payment Bills
- Refunds.
- Other Payments.

Dual Aspect Feeder Accounting System

- Education Cess (Amount received on other's behalf)
- Capital (Loan) Receipts and Expenditure System.
- Capital (Grants) Receipts and Expenditure System.
- Advances (Suspense A/c) Expenditure and Adjustment System.
- Deposits Receipts and Refunds

Receipts and payment related feeder accounting systems are common to any proprietary business or an organization having single entry cash based accounting system. The difference here is of nomenclature, so these feeder systems have not been discussed here. Certain FAS namely Loans, Grants, Deposits refund, Advances etc. are complete or dual-aspect FAS that is, they have both processes RAM and PAM. As their working is peculiar to municipal bodies, some of them have been discussed here.

Education Cess (collection of revenue on govt. behalf)

The municipal body collects education cess, on behalf of the government. Usually the demand for this tax is included in the property tax bill. Collection of the education cess, hence, takes place at ward offices along with municipal taxes. The ward office deposits the cess collected through a separate challan with CAS. CAD then deposits the cess in government treasury on a fortnightly basis. The ward offices maintain, the primary books of accounts and the tax demand, collection and recovery registers. CAS receives the day's consolidated figure, maintains a separate register for education cess receipt (from ward offices) and re-deposits in the government treasury. Usually education cess receipts are credited to a consolidated fund, which results in financial mismanagement and non-deposition of education cess into the government treasury. Nowadays, the government insists on a separate bank account and some municipal bodies like Vadodara have gone for separate fund accounting for this kind of receipt.

Capital (Loan) Receipts and Payment System

Though it is dual-aspect FAS it, for all practical purposes, belongs to CAS as it is handled only by CAS and not by any other department. As a municipal body becomes bigger and as its borrowings and capital expenditure out of its borrowings becomes sizeable, separate budgeting, accounting, FAS comes into existence, of course, within CAD. In some financially better-

managed municipal bodies a separate loan capital fund is created and is managed independently under this FAS.

Capital (Grants) Receipts and Payment System

Municipal bodies receive various grants and their volume also increases as the municipal body grows. Further, these grants are often given for specific projects, developmental works, and purposes. Moreover, nowadays state governments (granter) also ask for separate accounting and as a result, this FAS is used more often than loan account FAS. The accounting process and structure is similar to that of the loan account FAS, with a slight modification regarding the source of receipt.

Deposits Receipts and Refund Payment System

Municipal bodies receive numerous types of deposits. These receipts are a liability and are liable to refund. This source of deposits receipts provides much needed liquidity to municipal bodies, but as the single entry system fails to provide the sense of liability associated with this nature of receipt, municipal bodies end up spending more than their resources. Recently municipal bodies (Vadodara Municipal Corporation) have experimented with the creation of independent FAS for these receipts.

There are two types of refunds. One is against the money, which is paid to the municipal body in the form of deposits (earnest money deposit, security deposit or performance guarantee deposit etc.). The other is against the money, which has been paid to the municipal body under a revenue head – ocroi, various taxes or the service charge. Deposit refunds are out of budgetary purview in the sense that, specific budget provision is not required as a municipal body is repaying an amount received and held in the deposits.

The refunds against the revenue receipts require budgetary provisions. Such refunds, once budgetary allocation is in place, follow the normal Payment Accounting Module in which, the department upon receipt of refund application from a person, examines it and if found admissible, prepares the refund order. Such a refund bill moves to the audit department through the budgetary control section of CAS and having passed for payment by Audit department gets paid to the applicant from CAS.

Advances (Suspense A/c) Expenditure and Adjustment System

Usually the receipts and payments pertaining to advance heads belong to the CAS-Consolidated fund. Separate detailed books of accounts are maintained for this head under such a system. But it is possible and advisable to have independent FAS for the deposits and advances account. Vadodara Municipal Corporation under its accounting reforms has created separate fund, FAS, budgets for this extra ordinary receipts and payment.

There is a tendency to use this mode of payments more and more. As a result, FAS for advances through payments and their adjustment afterwards becomes necessary. In most of the municipal bodies, though FAS to take care of accounting process, volume, bills movement of advances mode comes into existence, it remains very much a part of CAS as cheques continue to be drawn from consolidated fund account and adjustment of advances drawn continue to be effected through challans (journal voucher) in CAS books of accounts.

B2. Peripheral Accounting System – Independent Accounting Systems

Usually there exist two Independent Accounting Systems, even in moderately small municipal bodies. They are Municipal School Boards, Municipal Transport Service. These two functions derive their independent accounting system status because of independent budgetary status and processes. Invariably municipal statutes provide for this separation and independent status. Though the General board (Assembly) is the final decision making body for these functions and approves their budgets and takes note of annual accounting results, the day to day operations are managed by School Board Committee and by Transport Committee respectively. Such independent accounting systems share and follow same accounting policies, strengths and weaknesses. Also, they have the same accounting structure and processes comprising CAS undoubtedly and may or may not have FAS as discussed earlier. In some municipal bodies, other IAS may be found pertaining to electrical undertaking, domestic Gas Supply undertaking. Again these IAS follow the model available in the form of school board or transport undertaking.

Municipal School Boards

Municipal School Boards are entrusted with the responsibility for primary education. The expenditure of this function is to be shared by the State Government and the municipal body. The main sources of receipts are government aid, matching contribution of the municipal body, and miscellaneous.

The grant received from the state government is not credited to the consolidated municipal fund but is taken into a separate account and a journal voucher is passed in CAS of the municipal body crediting primary education grant accounting and debiting contribution to school board account. For the contribution given to school board CAS maintains all books of accounts independently. The books of accounts maintained by school board are post-audited by the local fund examiner's office of the State Government and annual accounts prepared by school boards are incorporated in its annual accounts by the municipal body.

Municipal Transport Undertaking

Some municipal bodies run a city transport service. The character and the volume of this function call for an independent accounting system. The Municipal Statutes provide for separate budget and fund account. Thus, municipal transport undertaking comes to possess separate Central Accounting System comprising both Receipts and Payments Accounting Module and eventually as this undertaking becomes sizeable, various receipts and payments related Feeder Accounting Systems

come into existence. At the end of the year, annual accounts are integrated with municipal fund accounts.

MAS – Characteristics and Issues

The existing municipal accounting system as discussed is a cash - based, classical single – entry, government accounting system. Besides these three characteristics, it certainly has other characteristics, which are responsible for the present day status and form of municipal accounting. In following pages an attempt is made to enumerate and analyze the various accounting policies, characteristics and the issues associated with the existing municipal accounting system.

Objective of Municipal Bodies

Financial management systems are highly influenced by the institutional objectives. Municipal bodies, being the third tier of government, are mandated to provide services with larger social and economic objectives. Since the main objective of the government is not to maximize profit but social welfare, public services are often provided at long run average cost, rather than marginal cost. The cash based single entry accounting followed by these organizations, mirroring these institutional objectives, provides poor quality of information for any meaningful financial assessment.

Cash Basis of Accounting

Since the application of “profitability” criteria is not suitable for assessing the operational performance of municipal services and as there is absence of an alternative measure of performance efficiency, the accounting procedures in the municipal system moved unbridled. The main emphasis of municipal accounting was to record expenditure and the money received on various heads and hence, it was not structured to address the issue of service solvency. Sadly, the overall financial picture of a municipal entity was neither discussed nor reported. This has greatly influenced the structure of accounting. The budgeting process, which guides the accounting activity in government, always took note of the expenditures first and the generation of revenues next and for this purpose cash basis of accounting was found more suitable.

Single Entry Accounting System

Since money transactions are done in cash, single entry became the logical and accepted system of accounting. Even though, simplicity is one of the main advantages of the cash based single entry accounting system, its wide appeal is also influenced by the prevailing institutional and operational conditions.

Reasons for Perpetuation of Cash Based Single Entry Accounting

Some of the main reasons are the non-provision of actuarial transactions (valuation of employee retirement benefits as per AS 15) / liabilities / receivables in accounting, political apathy on the fiscal and financial performance of the organization and non-disclosure of financial status in a transparent manner by the

municipal body to the higher levels of government and public. Other reasons are detailed out as follows -

- a) Traditionally, accounting in a municipal context has not been considered as an important function. The general perception is that, an accountant's job is to make payments for work accomplished and to record receipts (bookkeeping) and at the year-end to consolidate figures and report against the budget. As a result, the organizational hierarchy of the Accountant within a municipality is not even at the rank of middle managers. This is largely responsible for the organizational apathy to redefine the functional authorities of the accounting department, and this limits the professional capacity to innovate alternate systems.
- b) The level of competence of current human resources is inadequate for introducing and maintaining a double-entry accrual-basis of accounts. Further, the employees are frequently transferred among departments inhibiting their ability to specialize in accounting.
- c) The municipal account codes (each state has separate municipal account code) are age old and provide only for cash based single entry accounting system. As per these municipal account codes, municipal bodies are required to record cash receipts and cash payments in accordance with budgetary heads, which are to be consolidated at the end of every fiscal year to facilitate preparation of budget. Except for the Government of Tamil Nadu and recently Maharashtra, no other state government has taken initiative to revise municipal account code to facilitate double-entry accrual based accounting system at the municipal level. Thus, there is no statutory / legal compulsion on municipal bodies to improve the accounting system.
- d) Double entry accrual based system requires an opening balance sheet. This requires valuation of fixed assets, determination of liabilities as on the date of the opening balance. Again, in the absence of any uniform guidelines to capitalize fixed assets, works in progress, assets financed through internal resources, etc, accounting reform initiatives undertaken in past remained as procedural improvements at individual level. This is the reason why the handful of cities which went for an improved accounting system around 1990 at the instance of the World Bank have not been able to produce appropriate financial statements or a full-fledged accrual based accounting system so far. Most of them are yet to account for their long-term assets and liabilities. These random experiences suggest that in the absence of generally accepted accounting principles, accounting reform initiatives undertaken at the level of individual municipal bodies will further increase the variability in accounting practices, making it all the more difficult to undertake comparative assessments.
- e) Another important factor is fear of penalty. The present non-transparent system and reporting policies allow a municipal body to hide its inefficiencies and therefore it suits everybody right from politicians to executives. In this context, greater transparency and performance visibility is not welcomed.

Budgeting and Accounting Conjuality

The functional conjuality with the budgeting system is one of the main features of the municipal accounting. Since the budgeting exercise is carried out in the beginning of the year, it is necessary to assign budgetary allocations into various account heads. The posting of receipts and payments (income and expenses) are made against these respective heads and the budgetary controls are exercised accordingly. In municipal bodies under existing single entry accounting system, the budget code itself forms the chart of accounts (CAO). This feature serves today a very important function of providing budget item-wise receipts and payments information and thus facilitates the legal aspect of budgetary control, authorization, preparation and updation.

Weak Core and Burdensome Peripheral System

The municipal accounting system is archaic. The accounting system, which exists today in municipal bodies, was designed in the pre-independence era for a pre-industrialized, colonized society and for a regulatory, maintenance agency called local / municipal body. Even many of the municipal accounts codes are more than fifty years old. But in the last 100 years the role of the local governments has undergone a paradigmatic change. The expansion of role and the functions of local government has taken place at invert level or informal level (among the peoples' perception) but lack of commensurate changes in formal status, powers, resources or at overt level. This has resulted in a 'weak core accounting system and burdensome peripheral accounting system' situation.

It can be observed from the various generic structures presented earlier that for a very small municipal body the basic accounting structure, although single entry cash based, is not that inappropriate, as it seems in case of big municipal bodies or municipal corporations. As the city expands/grows and becomes large, inevitably the municipal body of that city also grows. This ultimately results in the growth of accounting transaction, system and complexities. Over the years in order to meet growing accounting transactions, functions, processes of departmentation and decentralization, and other complexities, municipal bodies have created '*add on*' peripheral accounting system without strengthening '*core accounting system*' by modern accounting principles, techniques etc. The process was something like super imposing a heavy structure on the rudimentary foundation. The result is the present distorted municipal accounting system.

Fund Accounting

Funds are established and managed for the purpose of managing specific capital investments often with specific objectives. This includes the need to demonstrate the utilization of the funds for this specific purpose for which the funds are mobilized. Ironical situations arise sometimes when MCs may have to borrow funds for other activities at higher rates of interest while funds committed to specific purposes may remain locked up in savings accounts earning meager returns. This distorts the treasury function at the level of municipal entity. Intertwining the fund accounting with an accrual based accounting system along-with a supporting budgeting system would be a simple way of eliminating this problem.

Non-Capitalization

Since the cash based municipal accounting treats all receipts as income and all payments as expenses and there is no concept of capitalization of expenditure for amortization/ depreciation provisioned for the creation of assets. Thus the municipal bodies do not have the true picture of the properties owned by them.

Delay, Slow Pace and Incompleteness

One of the characteristics of the municipal system is the delay in processing and delivering demand for social services. The same work culture characterizes municipal accounting system in terms of bill passing and payment, finalization of accounts, auditing etc. In most of municipal bodies primary (first level) accounting processes are taken care of but secondary processes pertaining to ledger posting, reconciliation and third level accounting processes of finalising annual accounts remain pending for considerable period of time. The most important reason for delay and incompleteness is the absence of mandatory/statutory provision stipulating time limit for finalisation and auditing of accounts. Municipal Acts and Account Codes do not provide any such deadline.

Absence of System Documentation

There is a lack of overall systems approach. Systems and procedures evolved over a time period dictated by the functional requirements, often overlooking their internal consistency and overall municipal operational efficiency. Further, a total absence of documentation at the level of municipal administration deny the decision makers an overview of the entire accounting and budgeting positions to engage in midcourse corrections. As a result, the departmental heads either over-emphasize or under emphasize their functional areas overlooking the impacts of their decisions on the overall financial position of the municipality.

Procedural Inadequacy

The volume of accounting transactions is significantly high in the municipal bodies and in the absence of scientific assessment of workloads, it is common that either works are piled up or the municipal system comes under intense pressures to modify procedures as knee jerk reactions rather than as organizational strategies. The task of cross verification/reconciliation becomes a separate procedure in itself and is either taken up as a repetitive activity or altogether avoided. Municipal accounting system is characterized by inadequate, irrelevant procedures established as knee jerk reaction to situation.

Lack of Internal Checks

Conceptually, internal control system demands crosschecking of the works (accounting points) to be done by staff in the accounting department. This would be possible only if the system is well thought out and designed to take care of the same. In a system that has evolved incrementally over a period of time such internal checks are naturally found to be missing. On the contrary, due to apprehensions about account reconciliation, works are often intertwined

Imbalance & Unqualified Staffing

In practice, the departmental staffing pattern in a municipal entity is not structured according to the workloads. This is so because staffing in municipal bodies is not done on the basis of manpower planning or job and volume studies. Similarly staff is not recruited on the basis of educational qualification and merit requirements derived from job description and job requirement. As a result municipal staff lack necessary educational and professional qualifications. This kind of organizational culture, which does not give importance to proper recruitment and placement of employees naturally results in backlog in book writing and ultimately effects the reconciliation and finalization of accounts.

Short Term Perspectives

Since the accounting system in municipal bodies evolves, and is not planned, the accounting modules reflect the operational convenience rather than the long-term institutional objectives. The functional congruity for choosing the boundaries of a particular module is not maintained. Such a module does not take into account the incorporation of various checks and balances necessary in accounting.

The Existing Municipal Financial Reporting System

Financial reporting has for long been considered an important tool of accountability especially in the case of those private enterprises where there is a separation of ownership from management, e.g. companies. Similarly, managing public resources and operating in public trust requires that the governmental financial reporting support the twin objectives *accountability and transparency* at all times. Unfortunately at present, in most of municipal bodies, there does not exist proper FRS even for internal users. The Municipal Acts do not specifically compel a municipal body to publish and to disseminate financial results to the public at large. Similarly the municipal administration which has no perceived need for appropriate financial reporting system for its internal decision making process, has not made efforts to design FRS for external users or stake holders of the city.

The existing municipal FRS consists of three major documents – One, Annual Budget, Two, Annual Administrative Report and Three, Annual Audit Report. There is no provision or practice of preparing detailed annual accounts supplemented by appropriate explanations/footnotes etc. What is actually prepared is an annual cash in-flow and cash out-flow statement. The budget document usually contains the past years' data, the current year's original and revised estimates and the next year's budgeted estimates. In the case of some large municipal bodies, the budget document also contains some financial statements, but those statements cannot be called FRS.

The annual administrative report comprises department/function-wise information about the various events/activities undertaken, results achieved and other happenings which took place during the year. It is the annual administrative report, which formally comprises annual financial statements/reports. Preparation of the annual administrative report is mandatory under the municipal act/statute, but in most

of the cases these reports are not prepared and published in time and thus, lose much of their relevance.

The Audit Report of government agency basically contains information about the activities transactions, books audited, procedural or financial irregularities observed, various audit paras given to an agency and their compliance by the agency or department etc. Sometimes these audit reports contain summarised annual financial statements.

Thus there exists no system of preparation and dissemination of an exclusive Annual Financial Report. Annual Accounts form small insignificant part of both Administrative and Audit Report and the annual budgets are far away from accounting and financial data. Administrative and Audit Reports get published with inordinate delay while municipal budget at many places is in a highly summarized form and does not exist in a formal document format. Efforts to disseminate these documents to people at large are not mandatory under the Municipal Statutes and municipal bodies on their own do not make such efforts. Also these documents are not in user-friendly format or language. They are prepared merely to comply with statutory requirements and not as a part of FRS. At the micro level/internal level there is no perceived need for FRS as an essential ingredient of the decision-making process.

CHAPTER 4

Modern Municipal Accounting and Financial Reporting System

Municipal bodies are not business entities. They constitute the third tier of the government. Municipal bodies are miniature versions of the government, possessing various peculiar characteristics and complexities. Therefore it is not appropriate to design and implement accrual-based double entry accounting in its pure, business or corporate sector oriented form in municipal bodies. If due cognizance is not taken of these complexities, accounting reforms may lead to yet another messy situation. Designing an accounting system for municipal bodies in itself is an independent task; therefore it is not possible to present all the accounting reform aspects in this part or in this study. However, an attempt has been made to appraise the broad framework of various components of the proposed improved accounting system for the municipal bodies and the difficulties one may encounter while designing and introducing a modern system of accounting and financial reporting.

Complexities Associated with Municipal Bodies

Dual Character

The local government is unique in character. It has a two-fold character: public & private. As a miniature body polity local government is an organized entity. It has a governmental character, that is, the local people, to whom it must be accountable, elect it. It is also an agent of the state and, thus represents public interest. In this capacity it exercises sovereignty within its geographical boundaries. As a body corporate, local government has a private character. Its close proximity to the people provides it a platform to undertake market-based economic or business activities. Consequently it does carry out certain market-oriented activities. This second character makes the introduction of accounting & financial reforms relevant in the municipal body. At the same time, the duality of character makes designing and implementation of modern accounting system in the local government highly complex and difficult. Thus municipal bodies require an accounting system, which has a blending of both characters – governmental and commercial.

Diversity of Roles

The role of the local government is manifold and evolutionary. The changes taking place around us also bring out changes in the role of government. Recently the 74th Constitutional Amendment has broadened the role of the local government in a formal way but economic reforms have already altered its role informally. The manifold role of the local government comprises:

- The Regulatory Role: Administering various acts, regulations.
- The Provider Role: Providing urban services efficiently, and equitably.
- The Agency Role: Taking various schemes of higher-level governments to the people. It also includes promotion of popular participation.

- The Welfare Role: Active assistance to higher-level governments in an equitable distribution and delivery of wealth.
- The Developmental Role: To constantly pursue improvement in the quality of life through the augmentation of infrastructure.

Nature of Receipts

A typical local government's revenues are legally divided into a variety of sources. The nature of the municipal sources is diverse and quite different from the nature of private sector revenue sources. A large part of local government revenue comes from local taxes and grants, that is, more than $\frac{3}{4}$ of the revenue of the local bodies is not dependent on or governed by the market forces. Further these taxes are collected from a large number of taxpayers and this job is quite voluminous. The accrual concept of revenue recognition cannot be applied in its pure form to tax revenue. It needs appropriate modifications. Similarly local governments receive various types of specific-purpose (capital) grants, which need to be treated at the initial stage as a liability and not revenue. Such grants can be treated as revenue (addition to equity) only at the end, after specified objectives, tasks, purposes, and development are attained. A local government does deals with the services like water supply, sewerage, solid waste management etc., wherein market forces can play a leading role and accrual basis can be very important. But here again local government deals with services, which are inherently of a 'public-good' nature and this fact brings in limitations and complexities for which the accrual-basis accounting system is not fully prepared.

Nature of Functions

Local governments undertake diverse sets of functions ranging from purely the governmental, such as administration and regulation of various activities of the people under various acts, to agency function and welfare and development functions. This entails providing services without a direct charge or with a service charge. This may not cover the full cost of providing the service or charging a tax or fee without providing direct benefit against it (Quid pro quo). In addition, certain functions are linked with a specific source and governed by distinct policy guidelines for financing. In such a case, a part of the local government's activities is focussed on the development of infrastructure without bothering about economic feasibility or the rate of return. The pursuance of diverse financial activities involves recording receipts and use of specific funds separately, levying user charges for facilities operated on capital maintenance basis, adhering to legal requirements for setting aside funds and monitoring them for purposes such as amortization of debts.

Funds Management

Local government holds public resources for a specific purpose in a trustee capacity. This foundation again separates government accounting from business accounting. The management of several funds leads to complexities, which cannot be tackled by simple conversion of single-entry cash-based accounting system to the double-entry accrual-based accounting system. At present, the usual practice in municipal bodies for such funds is to open separate bank accounts but it falls short of

the requirement for distinct accounting for distinct resources earmarked for specific purpose. The current practice does not prevent the ULGs from spending the money of the fund 'X' on other activities. Thus ULGs need an accounting system, which can serve the following objectives simultaneously for different funds within a single governmental unit.

- Managing resources earmarked for specific purposes.
- Reflecting complexities of government operations encompassing activities ranging from commercial activities to normal governmental activities.
- Supporting accountability and transparency in governmental operations.

Government Environment

While designing an accounting system for the municipal bodies, the uniqueness of the government environment/system will have to be taken into account. The characteristics of the government accounting environment referred to are:

- Structure of government - various levels and branches of government create a system of checks and balances,
- Nature of Resource Providers - in the commercial sector there is a direct relationship between goods or services provided by a company and the price paid by the customer. However, in the government, this relationship does not exist for many transactions. In these instances, the taxpayer is in effect an involuntary resource provider. Also many times governments/municipal bodies receive assets at zero cost by way of its sovereign/public domain. Similarly, municipal bodies have to incur liability without a corresponding increase in the fixed assets (saleable) /capital outlays. For example the construction of roads by incurring liability
- Political Process - pressure on elected officials to provide the maximum amount of services at the lowest possible cost is unique to the government. This may lead to taxing the future generation for the services provided to the present generation.

Because of these characteristics of the government accounting environment, governments have established certain controls to maintain the integrity of budgeting, accounting and financial reporting. These controls include:

- Legally adopted budgets - budgets that are legally controlled and formulated in a democratic way by the elected representatives are unique to the government. For each receipt and payment there needs to be a budget item and it should get accounted for.
- Fund accounting - the reliance on the ability to segregate amounts for specific purposes has been reduced with the introduction of sophisticated accounting systems. It remains a primary element for demonstrating accountability.
- Internal control structure - encompasses those policies and procedures established by government to provide reasonable assurance that specific entity objective (e.g., compliance with legal requirements) will be achieved (referred to as accounting and administrative controls). It has three distinct elements: (1) control environment, (2) accounting system and, (3) control procedures.

Framework for Modern Municipal Accounting System

The foregone discussion has clearly indicated that the issue of municipal accounting reforms is not simplistic. It is not mere conversion of single entry cash based accounting into a commercial double-entry accrual based accounting system. The issue is much larger and more complex. No doubt Indian Municipal Bodies require accounting reforms and should be moving towards modern accounting techniques, principles to attain objectives of accountability and transparency, but municipal bodies, as miniature government, are 'not for profit' organisations. Thus, even after reforms municipal accounting system should not lose the government accounting character. Thus, we need an accounting system, which has a blend of government, and commercial (enterprise) accounting systems followed internationally. Such a system having a fine blend of government and enterprise (commercial) accounting system can be truly called a modern municipal financial accounting system (MMFAS).

The framework for modern municipal financial accounting system, presented below, comprises information regarding four constitutional factors. The Basis of accounting determines when a transaction will be recorded while measurement of focus determines which of the transactions need to be recorded. Fund accounting allows municipal bodies to appropriately record the operational and resource diversity, and thus facilitate conformance with prevailing laws and distinctive characteristic requirements of government finance. This framework is suggestive/indicative and is not exclusive or elaborate. It is an attempt to provide a theoretical and a practical framework within which a municipal body or the state government should develop its modern municipal financial accounting (MMFA) system. (The development of a detailed treatise on modern municipal financial accounting system is not within the scope of this study). The local governments (municipal bodies) of all developed countries and of many developing countries are utilizing this framework.

The framework of MMFA system presented in this report has drawn heavily from the US GAAP (generally accepted accounting practices), recently issued technical guide on accounting and financial reporting by urban local bodies by the Accounting Standards Board of the Institute of Chartered Accountants of India (ICAI) and a discussion paper – cum – training binder prepared by TATA Consultancy Services – India under ADB TA NO. 3209 – IND. The suggested MMFAS is no doubt based on the concepts, principles, which are similar to, but not the same as business accounting. The differences are due to the unique characteristics, purposes, activities of the local government institute (municipal body) and the profit motive associated with business enterprises. The common feature between the two is the double entry. The proposed MMFAS can be termed *the commercial pattern of government accounting*. The salient features of the framework for MMFAS are discussed as below.

Double Entry Accounting

The present day single entry accounting system of the municipal bodies must be changed as it suffers form various drawbacks and is an outdated, unscientific system of recording accounting transactions. Double entry accounting not only

overcomes the shortcomings of the single entry accounting system, but also allows systematic accounting of all aspects of an entity.

Conversion of municipal accounting system from single entry to double entry should be undertaken immediately as an intermediate step even if the basis of accounting is not changed from cash to accrual. This because if ULB has maintained its accounts perfectly on double entry accounting system then at the end of the year a qualified accounting professional (chartered accountant) can help ULB to pass various finalization entries to construe a perfect annual balance sheet acceptable to authorities. Of-course this not to advocate that ULB should not go for accrual-based accounting, this is to impress the criticality of double entry accounting system.

Measurement Focus and Basis of Accounting

The measurement focus and basis of accounting used to account for transactions are the driving force behind any accounting. It is these two factors (measurement focus and basis of accounting), which really make MMFAS different from commercial financial accounting system. Also most of the implementation problems are associated with these two factors. Measurement focus refers to what the financial statements are trying to present, and which resources are being measured to achieve that goal, while the basis of accounting refers to when revenues, expenditures, assets and liabilities and transfers are recognised and reported in the financial statement. There can be three types of measurement focus and three bases of accounting, which are used or can be used in governments or various types of government organizations.

<u>Measurement Focus</u>	<u>Basis of Accounting</u>
Flow of Current Financial Resources	Cash
Flow of Economic Resources	Accrual
Flow of Total Financial Resources	Modified Accrual

Out of these three models, in India the governments (both Central and States) use flow of current financial resources measurement focus and a cash basis of accounting. This model is based on the measurement of sources, uses and balances of financial resources that are received in cash within a specified period of time.

The most complex model used in current practice is the flow of economic resources measurement focus and accrual basis of accounting. Economic resources can be defined as all financial resources, as well as all assets of a fixed or permanent nature. This model measures the sources, uses and balances of economic resources regardless of when or if they will be received or disbursed in cash. To measure economic resources, the accrual basis of accounting must be used.

The model, which should be used by the governments and governmental organizations dealing with the public services/public goods, falls between the two models that were just discussed. This is so, because taking into account the peculiar characteristics and the ecological factors associated with the municipal bodies the accrual based commercial accounting system may not yield benefit as compared to the cost incurred. In this context, the two commonly observed disadvantages associated with the double entry accounting system are:

- Elaborate recording of transactions increases the volume of accounting work and consequently municipal expenses,
- A person without adequate knowledge cannot maintain accounts under this system, because it requires strict adherence to the principles.

It is these two factors (measurement focus and basis of accounting), which really make MMFAS different from commercial financial accounting system. Also most of the implementation problems are associated with these two factors. Municipal bodies being a government form of organisation and possessing various peculiar characteristics, require a different measurement focus and basis of accounting. Accordingly in the framework of MMFAS, a modified accrual basis of accounting, and flow of total financial resources as the measurement focus, has been recommended.

Fund Accounting

This is the third feature, which distinguishes MMFAS from business accounting system. This feature must form part of any framework of modern municipal accounting, as it effectively deals with complexities of financial reporting by governments or governmental form of organizations. Usually municipal bodies follow a consolidated fund accounting system, but fund accounting should be made part of the municipal accounting system to make municipal bodies fully accountable for various types special purpose public resources.

The fund theory is based on the equation: Assets = Restrictions on Assets (Liabilities). Assets represent prospective services to the fund and liabilities represent restrictions against the assets of the fund. For example, in case of a Library, the most commonly used specific funds are endowment funds, development funds etc. Each of these funds has its specific assets restricted for particular purpose. Under the fund theory, the balance sheet is considered as an inventory statement of assets and those restrictions applicable to the assets (liabilities). Revenues represent an increase in assets into the fund and expenses represent the release of services for designated purposes specified in the objective of the fund. Thus, the fund theory calls for fund based accounting rather than entity based accounting.

It may apparently resemble the present practice of keeping separate bank accounts, but it is not so. Along with separate bank accounts it ensures an integrated accounting for all resources within the statutory and budgetary mandates of public trust. Under fund accounting approach distinct resources within a single governmental unit are accounted for separately in what are called Funds. A fund has the following distinct features –

- It is a distinct fiscal and accounting entity.
- It has a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances and changes therein.
- It accounts for specific set of activities or has certain objectives in accordance with special regulations, restrictions or limitations.

Thus a fund may be defined as an accounting entity, “ with a self balancing set of accounts regarding cash and/or other resources together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations”. Fund accounting simultaneously facilitates diverse objectives of government accounting like

- Managing resources earmarked for specific purposes.
- Reflecting complexities of government operations encompassing activities ranging from those operated as commercial activities to normal governmental activities.
- Supporting the accountability and transparency dictums in governmental operations.

Chart of Accounts and Budget Code

Chart of Accounts (COA) defines the structure of an accounting system by delineating account heads for capturing transactions in an accounting system. Therefore, a CoA should be developed with a view to classifying transactions in conformance with the following –

- Accounting system design
- Users’ needs
- Ensuring true and fair view of accounts

As noted earlier municipal bodies or governments have various levels and they are required to carry out various types of activities, projects that have no parallel provisions or alternatives in the standard accounting heads/items, that is, chart of accounts. Only the major (1st level) accounting heads of the commercial accounting system are useful in the municipal environment. Sub-accounting heads (2nd level) and onwards classification of accounting heads is different in the case of municipal bodies. Accordingly, a tailor-made ‘chart of account’ needs to be structured covering all types of receipts, payments, assets, liabilities, funds and other extra-ordinary items.

In municipal bodies the budget itself forms the ‘Chart of Accounts’ of the present municipal accounting system. The budgetary framework of governments largely delimits the range of account heads for most transaction, in turn, determining the CoA. Throughout the country, state government departments require local governments to adhere to the budgetary formats. Also pre-eminence of the budget was one way responsible for the perpetuation of cash base accounting system. Present day cash based municipal accounting system follows ‘object-head-wise’ classification for recording receipts and transactions. If a municipal body switches over the ‘subject-head-wise’ classification or chart of accounts as postulated by the accrual based accounting system, then the data will not be available for the preparation of municipal budget. Or one will have to change budget to ‘subject-head-wise’ classification used by the accrual based accounting system. In that case budget will lose the object-head-wise classification. It will then cease to be a government budget and will not be able

to serve any purpose of government financial reporting. In light of this MMFAS suggest a 'chart of account', which has matrix of both object (budget) and subject (accounting) heads. This wedlock arrangement of budgetary (object heads) and accounting (subject heads) worlds, postulates the following three relationships between budget code and account code in the proposed 'matrix chart of accounts for MMFAS.

- There must be at-least one budget code for each and every account code.
- There can be several budget codes using the single accounting code. For example, electricity expenditure will have a single accounting code but it will cut across or will be used for different budget codes.
- But there cannot be more than one accounting code for the single budget code/item.

Though this wedlock of budgeting and accounting system should be the unique characteristic of the municipal bodies, this feature is highly defective at present. If proper policy and standardization is not adopted then 'chart of account' itself can be the main source of non-comparability of municipal data as the activity sphere of the municipal bodies differs from state to state and sometimes from municipal body to municipal body within the same state. A national level model 'chart of account', which can be applicable to all the municipal bodies of India should be prepared and municipal bodies should be left with the freedom to have their own classification from the 3rd level onwards.¹ This has to be prepared after an in-depth assessment of the accounting practices and systems in practice and its variability.

Comprehensive Annual Financial Reporting

A very important component/reform, which will have to be implemented along-with the improved accounting system in the municipal bodies, is the comprehensive annual financial report (CAFR). Most of the municipal bodies prepare only single page receipt and payment (cash in and out flow) statement as an annual accounts/ financial report. Sometimes, this receipt and payment statement is prepared according to accounting heads or as per budget heads or as per the different funds or sources of revenue. No explanatory notes or no disclosure statements are attached. These financial statements do not adhere to accounting standards. Thus the present financial reporting of municipal bodies is one of the weakest areas in which reform initiatives are required.

The preparation of a CAFR is recommended in this context. It should be based on generally accepted accounting principles and accounting standards. The information presented in CAFR should be in conformity with the accounting standards set by the country. Since accounting practices have evolved over a period of time with significant amount of variability, it is found necessary to introduce some standardized set of rules and accounting principles to reduce the CAFR/CUFR reporting variability. Such standardize set of accounting rules and principles are

¹ C&AG Task Force on Accounting and Budget Formats for ULBs (2002) has done such an attempt but both uniform budget code and account code provided by the C&AG Task Force require rationalization. For the discussion and analysis of C&AG Task Force report kindly, refer to appendix 1.

known as *accounting standards*. However, such accounting rules should have a reasonable degree of flexibility to accommodate the specific circumstances of an organization and align with the changes in the economic environment, social needs, legal requirements and technological development.

The International Accounting Standards Committee (IASC) based at London is responsible for developing International Accounting Standards (IASs). The IASC comprises the professional accountancy bodies of over 75 countries, and during the last two and half decades the IASC has issued more than 32 IASs. In India, the Council of the Institute of Chartered Accountants of India (ICAI) constituted the Accounting Standards Board (ASB) in April 1977. The board has set out 23 accounting standards as follows (Table 4.1).

Table 4.1
Accounting Standards as suggested by the ASB

<u>No.</u>	<u>Title</u>	<u>Mandatory from</u>
AS-1	Disclosure of Accounting Policies	1.4.1991
AS-2	Valuation of Inventories	1.4.1999
AS-3	Changes in Financial Position	1.4.2001
AS-4	(Revised) Contingencies and Events occurring After the Balance Sheet Date	1.4.1995
AS-5	Prior Period and Extraordinary Items And changes in Accounting Policies	1.1.1987
AS-6	(Revised) Depreciation Accounting	1.4.1995
AS-7	Accounting for Construction Contracts	1.4.1991
AS-8	Accounting for Research and Development	1.4.1991
AS-9	Revenue Recognition	1.4.1991
AS-10	Accounting for Fixed Assets	1.4.1991
AS-11	(Revised) Accounting for the Effect of Changes In Foreign Exchange Rates	1.4.1995
AS-12	Accounting for Government Grants	1.4.1994
AS-13	Accounting for Investments	1.4.1995
AS-14	Accounting for Amalgamations	1.4.1995
AS-15	Accounting for Retirement Benefits in the Financial Statements of Employers	1.4.1995
AS-16	Borrowing Costs	1.4.2000
AS-17	Segment Reporting	1.4.2001
AS-18	Related Party Disclosures	1.4.2001
AS-19	Lease	1.4.2001
AS-20	Earnings per Share	1.4.2001
AS-21	Consolidated Financial Statements	1.4.2001
AS-22	Accounting for Taxes on Income	1.4.2001
AS-23	Accounting for Investments in Associates in Consolidated Financial Statements	1.4.2002
AS-24	Discounting Operations	Recommen

AS-25 Interim Financial Reporting	1.4.2002
AS-26 Intangible Assets	1.4.2003
AS-27 Financial Reporting of Interest in Joint Ventures	1.4.2002
AS-28 Impairment of Assets	1.4.2005

Recently, the Institute of Chartered Accountants of India (ICAI) has brought out a technical guide on accounting and financial reporting by urban local bodies. This guide explains the applicability of each accounting standard to urban local bodies as follows. Annual accounts and CAFR of a municipal body should now have to adhere to these accounting standards. Though CAFR should to adhere to accounting standards completely, the CAFR exercise is not limited to the preparation of annual financial statement as per accounting standards. CAFR is something beyond annual accounting statements. The main characteristics of CAFR are:

- It should be comprehensive in detail, providing full disclosure beyond the requirements of GAAP and applicable legal requirements.
- It should cover specific information on all funds and account groups of the government.
- The CAFR is a general-purpose report in a sense that its contents should intend to meet the needs of a broad range of users.
- The CAFR should contain financial statements for each of the government's funds and account groups, combined statements, and should be organized into a financial reporting pyramid.
- It should also include supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, an extensive statistical section, and a letter of transmittal from the chief finance officer to the chief executive officer.

Structure of the Comprehensive Annual Financial Report

The CAFR/CUFR are prepared generally in three major sections: introductory, financial and statistical. The introductory section is intended to familiarize the reader with the organizational structure of the municipal body, the nature and scope of the service provided and the specifics of its legal operating environments within which it operates. In addition to giving a broad table of contents, the introductory section should provide the organization chart, details of the principal officers, and other information deemed important by the Chief Executive Officer and the Chief Finance Officer of the municipality.

The financial section, the most important part of the CAFR, should contain (a) Independent auditor's opinion, (b) Consolidated/individual fund statements, (c) Schedules demonstrating compliance with legal and contractual provisions, (d) Schedules consolidating information spread throughout the statements (e.g., investments, debt repayment schedule and cash receipts and disbursements, (e) Schedules on important information reported in the statements (e.g., additional revenue sources detail or object of expenditure data by departments).

The financial reporting pyramid method is the most efficient means of presenting basic financial statements within the financial section of the CAFR/CUFR. Under the pyramid approach, the front of the financial section (top of the pyramid) contains relatively narrowly focused fund type and account group data, and subsequent portions of the financial section (moving down the reporting pyramid) include increasing levels of reporting detail relating to individual funds.

The main objective of the statistical section of CAFR/CUFR is to provide users with broader and more complete understanding of the local government and the trends in its financial affairs derived from the financial statements and supporting schedules included in the financial section. It contains comprehensive financial trend information and non-financial data of the government. Such data relate to the physical, economic, social and political characteristics of the government. These shall include: (a) general governmental expenditures by function over the last five years, (b) general governmental revenues by source over the last five years, (c) external transfers over the last five years, (d) property tax demand collection balance for the last five years, (e) assessed and estimated actual value of properties, (f) revision in tax base and rates over the last five years, (g) principal taxpayers, (h) legal debt margin and amount drawn, (i) debt servicing profile over the last five years, (j) demographic statistics, and other legal and administrative covenants that have an impact on the financial performance of the municipality, etc.

Statistical tables usually cover more than two and up to ten fiscal years and often present data from outside the accounting system: physical, economic, social, demographic and geographic information intended to provide a more detailed financial picture than presented in the financial section. Financial section financial statements and supporting schedules, on the other hand, usually cover no more than two years and present data largely derived from the accounting system.

Summing Up

Municipal bodies will have to adopt improved accounting and financial reporting systems if they wish to cope with changing world. Looking to their peculiar characteristics, existing accounting and financial reporting systems and their modernisation requirement, a framework of modern municipal financial accounting and reporting system has been outlined in this part. As we know some municipal bodies have gone for accounting and financial reporting system reforms in past decade or so. In next part an attempt is made to document and analyze these efforts in the light of the frameworks discussed in this part.

CHAPTER 5

Evaluating Municipal Accounting Reforms

The story of municipal accounting reforms in India is barely two decades old. Even within that short time, the first decade (1981 to 1991) saw only two experiments – Mumbai and Chennai. At both these places the experiment of introduction of double entry accrual based accounting system was at the instance of the World Bank. In Mumbai this experiment was limited to the water supply and sewerage account/project and was not applied to all the accounting operations/funds of the municipal corporation. In Chennai an attempt was made to apply accounting reforms to all of its accounting operations.

The second series of the municipal accounting reforms was again at the behest of the World Bank. The World Bank as a part of its financial assistance to Gujarat Urban Development Project, in the year 1985 (IDA – Credit - 1643 – IN), insisted on the introduction of accrual based accounting in the recipient municipal corporations (six in number) and a municipal body (Anand). The work of municipal accounting reforms started in the 1990, after the World Bank finalized consultants for this job and the work of consultants continued till 1995 in the selected municipal bodies of Gujarat and met with varying degree of success.

The third episode of municipal accounting reforms belongs to the recent period, that is, after 1998. It includes TNUDF sponsored state-wide municipal accounting reforms programme in Tamil Nadu, introduction of improved accounting system in Anand (Gujarat), Jaipur (Rajasthan) and Tumkur (Karnataka) municipal bodies by TATA Consultancy Services-India under ADB TA No. 3209-IND, and various reforms in Mirzapur (Uttar Pradesh) under Ganga Action Plan. There are some individual experiments like the Bangalore Agenda Tasks Force initiated project of improving accounting system in Bangalore Municipal Corporation. Similarly Indore Municipal Corporation on its own has gone for various administrative and revenue mobilisation reforms including accounting reforms and computerisation efforts. Recently Maharashtra has received USAID technical assistance to introduce statewide municipal accounting reforms. A.F. Ferguson & Co. had been appointed as the consultants to prepare and to implement improved accounting system.

Reform Case: A Review

Indian municipal scenario is now full of various municipal accounting reform experiments. It is a very appropriate and opportunate time to evaluate various municipal accounting reforms which have taken place to formulate action plan for the introduction of nationwide municipal accounting reforms. In the following pages an attempt is made to review these experiments to understand their present status and to identify various problems faced while designing and implementing municipal accounting reforms and various innovations/strategies developed by implementing agencies to bring about these reforms.

The Gujarat Experiment

The Gujarat Experiment of introducing accounting reforms started at the insistence of the World Bank. Six municipal corporations and one municipality were part of it. The implementation process can be divided into three parts. Part one, comprises the beginning of the process, which started around 1990 and as the original term of TA was of three and half to four years, the original implementation process continued up to 1994. In part one, consultants designed financial accounting system for concerned municipal body, provided training to the staff of municipal bodies and tried to implement accounting reforms. Part two; can be called as an extended TA from the same accounting consultant but at the cost of municipal bodies, while part three comprises the running of a new accounting system on day-to-day basis. In part two, consultants and municipal bodies tried to complete unfinished agenda and by the end of this period anyhow they implemented accounting reforms. This part too varied from municipal body to body but around 1996 – 1998, except Anand Municipality, the other six municipal corporations commenced maintaining of their accounts on double – entry cash based system. Thus part three is marked by the running of a hybrid kind of municipal accounting system where day to day accounts are maintained on double entry cash based accounting system but fixed assets and depreciation module is not made fully operational.

Accounting Reforms in Ahmedabad Municipal Corporation

The Ahmedabad accounting reforms started under World Bank Technical Assistance in 1990 under its project C R 1643 - IN. World Bank selected S. R. Bataliboy & Co, a leading accounting firm in the country, to design and implement financial accounting system in the Ahmedabad Municipal Corporation within the period of three and half years.

The consulting firm S. R. Bataliboy & Co., in due course of time designed the financial accounting system, trained the staff of AMC but could not form opening balance sheet and implement the double entry accrual base accounting system on full fledged basis. As a result it could not produce first year (end period) balance sheet. The term of the consultant under World Bank TA ended in the middle of 1993. As the task of implementation of accounting reforms was incomplete AMC continued S. R. Bataliboy & Co. for additional period of six months. In this extended period also complete implementation was not achieved.

It was realised from preliminary implementation experience under S.R.Bataliboy & Co. in 1993-94 that it is not possible to adopt double entry accrual based accounting system on manual basis as it simply meant increase in work load and complexity. Consequently AMC thought of computerisation of accounting system. As usual an attempt was made to develop tailor made accounting software based on accounting system manual prepared by S.R.Bataliboy & Co. The contract was given to National Informatics Center (NIC). The accounting software prepared by NIC is written in Oracle language but is of very primary nature. In 1995 AMC commenced parallel run of double entry computerised accounting system using NIC software alongwith single entry cash based manual accounting system. The parallel run continued for two years and since in 1997 AMC switched over to computerised accounting system. In past years, after NIC's contract expired, in-house programming

staff has carried necessary changes to the accounting software as per requirement, but still this accounting software is not holistic or fully integrated like the present day ready made accounting software available in the market.

The present status of accrual based accounting system reforms in Ahmedabad Municipal Corporation is as follows.

- Ahmedabad Municipal Corporation maintains consolidated fund accounting system.
- The accounting reforms are incomplete and have not achieved desired objective even after 10 years of implementation. Complete conversion to the accrual base double entry accounting system has not been achieved. What exists, at present, is 'double entry cash basis accounting system'.
- By and large recording of accounting entries pertaining to income and expenditure has been converted to double entry from single entry accounting system. Transaction regarding assets and liabilities are not part on-line computerised accounting system.
- At present no accrual base entry is passed regarding revenue or capital expenditure. AMC is planning to introduce accrual base accounting for its revenue and capital expenditure. It is planning to introduce a system of entering payable entry of expenditure as soon as the work-order is issued to the contractor/supplier by the department.
- Balance Sheet module is yet not ready or is not available in the existing computer software; as a result though AMC has done valuation of its store items, it is not in position to add store items into current assets. AMC has computerised system of store accounting. Bin card, inward and outward movements of store etc. have been computerised.
- All types of fixed assets have not been valued and information about fixed assets is placed into accounting software as a result one is not in position to know assets position of the AMC. Fixed assets register is not maintained.
- Like assets, AMC has not entered the data regarding liabilities towards government or other loans in its accounting software. Consequently it not possible to have information about the outstanding loan liability on an 'on-line' basis. AMC does maintain database about its loan liabilities on 'Off-line' basis.
- The procedure regarding entering returned cheque accounting is adequate and the tax demand is raised immediately in the tax payer's account but as balance sheet module is not operational accounting system fails to reflect it in balance sheet.
- As a result of all the above drawbacks of present accounting system and its computer software, AMC's present accounting system can be termed as 'double entry cash based receipt and payment account system', and the existing computerised accounting system fails to generate Balance Sheet of AMC for the period automatically.

The reasons for the inadequate and incomplete implementation and for the present day status of accounting reforms in AMC are enumerated in detail in background paper under the title Gujarat Experiment. Similarly the suggestions to improve or to achieve full implementation of accounting reforms are enumerated in

background paper under the title 'Gujarat Experiment – Suggestions'. AMC should implement these suggestions to reap up full benefits of accounting system reforms.

Accounting Reforms in Anand Municipality

Anand, famous for its Dairy Industry (Amul) received TA under ADB. Tata Consultancy Services (TCS) provided technical assistance for introduction of double entry accounting system in the Anand Municipality. TCS has prepared operational or system document for the Anand Municipality provided training to the concerned staff and helped them to form an opening balance sheet and a provisional balance sheet for the period April to September 2000. As TOR of TCS assignment did not include actual implementation of the accounting system and as consultancy contract came to an end (around March 2001) TCS has to stop at this point of reform. Almost two years have passed since the beginning of accounting reforms exercise in Anand Municipality. The most important aspect of AM accounting reforms is its continuance in spite of the fact that no professional support is available for implementation, no adequate staff or resources have been provided and there is inadequate support from every quarter of AM including its top management. In whatever forms the accounting reform initiative is alive and functioning in Anand Municipality yet, is due to two operational level employees who have not allowed them to die. The factors responsible for this state of affairs are listed as follows.

- Monthly accounts are prepared regularly although on the basis of hybrid accounting system.
- The parallel run is still continuing even after two years, that is, the Anand Municipality is still maintaining its official accounts on manual single entry basis.
- In the parallel run of a new system the accounts are maintained in a double entry accounting system but on a cash basis.
- No further balance sheet is formulated as of 31st March 2001 or September 2002 and most likely at the end of 31st March 2002, the balance sheet will not be formulated. What gets prepared is operative or receipts and payment statement.
- There does not exist a matrix structure of the budget and account heads. At other place where accounting reforms have been implemented, it is the accounting heads, which replace budget heads. In AM ledgers are maintained as per budget heads/items. As a result accounting or subject head-wise data is not available. For example one can know the salary expenditure of a particular department but it is not possible to know the total salary expenditure of the municipality at a glance. One is required to total up department/section-wise salary expenditure or any accounting head-wise receipt or payment information.
- TCS has recommended Fund Based Accounting System but parallel run is conducted on consolidated fund basis.
- On the one hand fund based accounting system is not adopted, and on the other hand, in order to keep grant-wise separated accounting, almost 23 different bank accounts have been opened for managing accounts of grants

over and above two main bank accounts for a consolidated funds operations. It seems that having separate bank account is wrongly equated with fund accounting.

- The budget document is ill structured and unaugmented. Also the budgetary control system is almost absent, and as a result, bills of one budget head get booked in another head. Also in certain cases expenditure goes beyond budgetary allocations.
- Bills are pre-audited for payment but there is no system of post audit of books of accounts with vouchers.
- There is lot of duplication of work. Day to day receipts and payments are recorded in cash book/bank book and then in respective receipt and payment ledgers. Again the same data gets entered in budget head-wise ledgers (classifieds).

Over and above limitations the Anand Municipality, accounting reforms efforts are characterized by the various implementation issues and macro level shortcomings of Gujarat accounting reforms experiment.

Implementation Issues

The Gujarat experiment of introducing municipal accounting reforms has remained limited in the scope and has failed to achieve complete success. It has not made any qualitative difference in the municipal scenario of Gujarat. Though the whole experiment is more than a decade old, it has failed to motivate other municipal bodies to go for adoption of improved MA & FRS. Also, it has not solved the problem of quality/compatibility of data and Financial Reporting faced by agencies like GMFB & Director of Municipalities. Even after implementation of accrual based double entry accounting system in six municipal corporations; the Municipal Accounting code has not been amended/rewritten. It has been learnt that GMFB is getting a revised Municipal Account code prepared from retired IA & AS officers for the Government of Gujarat, but it has no concrete plans about how to implement it throughout the state/in all municipalities. Also, it has been observed that there is total absence of perceived need or felt need for municipal accounting reforms at all levels-GOG, its other organisations like GMFB, DOM or within a municipality itself. Why is this so? The answer to this question and to the present status of municipal accounting reforms in Gujarat lies in the implementation process narrated below.

Lack of Enough Support from Highest Government Level

The experimentation of introducing accrual based accounting systems in municipal bodies was undertaken at the behest/instance of the World Bank. There was absolutely no felt/perceived need (which is lacking even today) at all levels; even the consultants for this TA were finalised by the World Bank. The Government of Gujarat, the highest authority, merely participated in this exercise to ensure that the World Bank covenant/condition is fulfilled and loan instalments are released smoothly. There was no perceived/felt need for bringing out this reform in the GOG, Department of Urban Development and Urban Housing and in its other organs like the GMFB and DOM. As a result, the State Government never issued stern, formal orders in unambiguous terms regarding implementation of accounting reforms. In

governmental set up, until and unless firm orders (formal/informal) are issued, monitored and reaffirmed from the highest level again and again with penalty clause or negative incentives, things do not get implemented. Even after a decade, GOG has neither examined the implementation of municipal accounting reforms and tried to know the reasons for its partial success, nor it has made any efforts to implement them in other municipal bodies. This speaks clearly of a lack of support and interest from higher authority/level.

City Centred/Individualist Approach

There was lack of positive/active support from the GOG, but the World Bank, the funding agency, also never insisted on it. If the World Bank would have been firm enough, it could have forced the GOG to get involved in the process sufficiently. The World Bank in its periodical Aid memory did raise concerns about the slow progress of accounting reforms, but never took up an independent review of it. Another strange fact was that the World Bank selected five consultants for implementing municipal accounting reforms in six municipal bodies. In this way World Bank took city or individual municipal body centred approach for implementation of this reform and indirectly defeated the compatibility and standardisation aspect. It also allowed GoG to believe that it has no role in implementation on municipal accounting reforms.

The selection of a separate consultant for each municipal corporation essentially postulated city/municipal body specific approach. Compatibility of financial reporting systems was not the objective. The whole exercise was limited to the introduction of accrual based double-entry accounting system in a particular municipal body rather than developing a uniform/standard accounting system for the whole state of Gujarat. The result was the development of city specific accounting systems quite apart from each other. This city specific approach propagated the view among all the authorities and at all levels that this whole exercise is a baby-task with which a municipal body is supposed to deal with.

Lack of Top Management Support

Within the municipal body, this whole exercise lacked much required support and leadership. Implementation process at every stage faced problems like –

- Inordinate delay in giving administrative clearance to different stages of implementation or to the different reports submitted by the consultants.
- Non-availability of the adequate staff required for the training and implementation of new accounting system.
- Frequent transfer of the trained staff.

The varying degrees of success in implementation of accounting reforms observed in different municipal bodies of Gujarat has a direct correlation with the level and kind of support received from its top management. Of-late in Ahmedabad and Surat Municipal Corporations these reforms have received good support both in terms of human resources and financial resources, in terms of continuing accounting consultants and hiring software consultants after expiry of their original World Bank TA term.

The main reason behind the lack of support from the top management of the municipal bodies was the absence of felt need for these reforms and also the absence of an adequate opinion building exercise. This whole exercise was looked upon as an alien or foreign body or something unwanted imposed upon by the lending agency. Also there were no strict orders from GOG or serious reviews by the GOG and World Bank. The implementation was not mandatory in the later and spirit, rather assumed character of discretionary exercise. With the lack of enough support from top management of the particular municipal body, this whole exercise got confined to the accounts department and received inadequate support from the other departments. As traditionally accounts' department and accounting function is very low in municipal organisational status or priority, the accounts department lacked necessary administrative strength to push these reforms through.

Inadequate Terms of References / Scope of the assignment

The TOR of accounting reform assignment / technical assistance lacked important components like audit function and computerization. One cannot have only accounting reforms and leave audit system / function unaugmented. Surprisingly TOR and the consultancy agreements completely overlooked this function. This has resulted in the situation of a mismatch in the municipal corporations in terms of accounting having shifted to Double Entry Accrual Basis, whereas the audit procedures, check lists, practices used for auditing changed accounting system are continuing as per the earlier Single Entry Cash Based System. Even today some of the municipal corporation having improved accounting system in place are continuing with the Auditing System that has lost relevance long ago. The matter of extension of TA to cover audit function and computerized system was brought to the notice of the World Bank and the GOG by the participating municipal bodies, but even today there is no guideline document or audit procedure manual for changed accounting system.

Municipal bodies are characterized by a highly centralized accounting system, which results into high volume of accounting data or transactions. Per employee accounting work in the Central Accounts Department is much more in most of the municipal bodies. Conversion of single entry cash based accounting system into double entry accrual based accounting system meant increasing accounting work by a more-than-double ratio. The computer technology can reduce this increased workload to a great extent, but this possibility was not given enough place/attention in the TOR of this assignment. The result was delay and extra cost in the implementation as municipal bodies first tried to implement accounting reforms manually, and having faced great resistance/ inertia looked for tailor made software computer solutions. Development of tailor made computer software (based on the accounting manual prepared by the consultants) took considerable time and money. Again as every municipal body tried to computerize its new accounting system on its own from different local consultant, the Gujarat experiment has produced five different computerized municipal accounting systems/models. The objective of comparability and standardization suffered a further below.

Absence of Opinion Building Exercise

Implementation of core reforms like introduction of modern financial accounting system in the municipal environment warranted opinion-building exercises

(for that matter in any organization any core level change requires such efforts), unfortunately this aspect of implementation received very inadequate attention. For introducing any major systemic/policy change in municipal administration, opinion building exercise should not only cover concerned officers/employees but others also like officers of other departments, top executives, politicians and finally government officers of the related departments of the State Government and of other governmental agencies. From the record and discussions with people, it seems that enough efforts have not been made to change the mindset of the people and to build opinion for the implementation accounting reforms. Due to the absence of such efforts the activity of introducing accounting reforms was relegated to minor importance and got confined to consultants and accounts departments of the municipal body.

New System lacked Blending of Government System/Experience and Professional Know-how in fact, topmost accounting firms of India worked on this project of introducing accounting reforms. There is no doubt about their professional know-how and input, but these firms lacked exposure and experience about governmental working and especially that of municipal government. The financial accounting system designed by these consulting firms was technically/theoretically correct but shows corporate overtone. They provided a modern enterprise accounting system but failed to provide the commercial form of government accounting system using fund accounting concepts and modified accrual accounting basis. The pure enterprise (commercial) accounting system envisaged by the consultants created a lot of inertia as municipal officers and staff could not accept new accounting system conceptually. They could not relate it to their working structure/processes of that time. In real terms the change process between two accounting systems was not too voluminous or complex, but the way it was presented it got magnified several times resulting in lack of confidence.

Premature Reforms

While analyzing Gujarat Experiment of municipal accounting reforms from a distance it seems that they were little premature. This is so because they were conceived and implemented before the economic and structural reforms. Changes have now taken place because of economic and structural reforms and forces of globalization, and also in government-citizen relationships, in the government's role in financing development, and in public-private relationships. These changes had not taken place at that time. The accounting reforms or even any other municipal reforms had not much relevance in the last decade. The mindset of everyone was not ready for the change and people's pressure groups were not there to demand efficient, transparent and accountable governance.

The Tamil Nadu Experiment

The Tamil Nadu' accounting reform is one of the most successful examples of the municipal reforms underway in India's urban sector. In contrast to other experiments of introducing double entry accrual based accounting system in the municipal bodies, the recent Tamil Nadu experiment is turning out to be a great success. As of today Tamil Nadu Government has achieved a rare feat of converting all the municipal bodies of the state (5 municipal corporations and 102 municipalities, that is, in all 107 municipal bodies) from single entry cash based accounting system to

the double entry accrual based accounting system. The whole conversion/ change process has been achieved within the short span of three years (1998-2001). The chronology/landmarks of this process and factors for its success are enumerated as follows.

The Tamil Nadu Urban Development Fund conceived and initiated the process/project of introduction of modern accounting system in the municipal bodies of Tamil Nadu by submitting a proposal to this effect to the GOTN in late 1997. The GOTN also wished for an introduction of a double entry accrual accounting system because it wanted to be able to present acceptable information to funding agencies on the financial position and performance of municipal bodies. The Tamil Nadu Municipal Accounting Reforms process formally started with the appointment of the three members committee to prepare an Accounting Manual in January 1998. The committee comprised Mr. K. Ishwaran – retired director of Local Fund Audit Department of Tamil Nadu Government, Mr. T. M. Kadriavelu retired joint director of Local Fund Department of GOTN and Mr. Narayanswami retired Regional Director of Municipal Administration, GOTN. The committee prepared Accounting Manual for introducing double entry accrual accounting system in the municipal bodies within six months and submitted its first draft to GOTN in June 1998. This draft was discussed in detail with the Commissioner of Municipal Administration, the Director of Local Fund Audit and the Chief Executive Officer of the Tamil Nadu Urban Infrastructure and Finance and Services Ltd. The Finance Department of the state also reviewed the draft. The accounting manual is divided in the three parts. The first part of the Accounting Manual deals with accounting procedures, the second part provides the chart of accounts and the third part presents the new forms and formats to be used in the new accounting system. Every procedure, account and form was specifically designed for the state's municipal bodies. The committee developed separate procedures for key municipal functions, including taxes and fees accounting, water supply and drainage fund accounting, suppliers/material accounting, contractors accounting, loans and grants accounting etc.

The Accounting Manual and the project to introduce accounting reforms in municipal bodies received government clearance (Department of Municipal Administration and Water Supply) in January 1999. Immediately TNUDF commenced training to the officers/employees of the selected municipal bodies. The opinion building workshops, conferences were conducted for all the key personnel, government officers. Training was provided even to the local fund auditors who audit accounts of the municipal bodies. In all 12 municipal bodies were selected (2 municipal corporations and 10 municipal bodies) as pilot or demonstration cities for introducing accounting reforms. New accounting system as per the revised accounting manual commenced in these 12 municipal bodies with effect from 1st April 1999.

TNUDF was entrusted with the responsibility of this project. In order to ensure smooth and effective implementation, a system of review at different levels was introduced. Secretary – Urban Development, GOTN reviewed the progress every month, over and above the reviews, discussions, meetings conducted by the TNUDF and by the Regional Directors of Municipal Administration with municipal officers/employees, local accounting consultants, members of accounting manual committee to sort out implementation problems. The Chief Secretary to the GOTN heads TNUDF and Secretary Municipal Administration – Urban Development is the member of the board. Thus through the review meetings of TNUDF the

implementation of the municipal accounting reforms got reviewed by the highest authority of the State Administration. Further TNUDF appointed local consultants in the form of Chartered Accountants/firms to help municipal bodies in the implementation process.

While implementation was going on TNUDF submitted accounting manual in June 1999 to the Institute of Chartered Accountant of India – New Delhi for review. In September 1999 a roundtable conference was organized by the INDO-US FIRE project and HUDCO to discuss various issues raised by ICAI committee. In this conference senior officials of the GOTN, consultants writing the manual, ICAI committee members and FIRE/USAID staff participated and reached unanimous decisions on several key issues. Having received suggestions from ICAI, necessary amendments (inclusion of a chapter on ‘Norms of Recognition of Municipal Assets and Revenue’ and other changes) were carried out in the Accounting Manual. The appropriate changes were also carried out based on the suggestions received from the municipal officers/employees, the local accounting consultants and the experience learned from the implementation process. Meanwhile Tamil Nadu Urban Development Project II started in November 1999 and the responsibility of implementation passed on to the TNUDF II Office. The first phase of accounting reforms was successfully completed by the end of March 2000 as all the 12 municipal bodies got fully converted to the double entry accrual based accounting system and produced a Balance Sheet in a proper manner.

While the first phase of implementation was coming to a successful end TNUDF II prepared itself and the remaining 95 municipal bodies for the implementation of improved accounting system. In January 2000 the state Department of Municipal Administration and Water Supply instructed all the municipal bodies about compulsory implementation of the new accounting system and with effect from 1st April 2000, introduced improved accounting system in all the remaining 95 municipal bodies of Tamil Nadu. TNUDF II Office again followed same review and updating process as narrated above and achieved complete success by the end of March 2001. In October 2000, computerization of the new accounting system was undertaken in Phase I 12 municipal bodies and it also met with a success. Propped up by the successful computerization of the new accounting system in the 12 demonstration municipal bodies and successful introduction of improved accounting system in remaining 95 municipal bodies; TNUDF II Office computerized new accounting system of all the municipal bodies with effect from 1st April 2001.

Another important feature of this reform process was the continuous updating and improvement of the accounting manual and system in the light of the experiences learned from the implementation process. TNUDF II Office has recently prepared an Accounting System User manual and has also restructured budget document in tune with the new accounting system. For speedy and efficient implementation of the accounting reforms TNUDF II Office also announced award scheme also in association with USAID – FIRE – D Project.

The foregoing discussion clearly outlines the success story of the Tamil Nadu experiment with municipal accounting reforms. GOTN, TNUDF, and all the municipal bodies of Tamil Nadu have achieved a stupendous task, which has no parallel in the history of Indian municipal system. Until now any sort of municipal

reform was considered an impossible task and repeated experiences from the municipal bodies throughout the country have confirmed this belief. Even the State of Gujarat and Maharashtra, which had a legacy of progressive and developed municipal system, have failed in recent years to bring about any substantial changes in the municipal administration. In the backdrop of such a hopeless situation of municipal reforms throughout the country, the success achieved by the State of Tamil Nadu in introducing accounting and other reforms is exemplary. It has proved that if there is administrative and political will, and appropriate methodology is adopted, it is quite possible to bring about municipal reforms not only in one or a handful of municipal bodies, but in all the municipal bodies of the state. It will be appropriate to look into various factors, which brought about such unparalleled success.

Presence of Strong Felt Need for Municipal Accounting Reforms

As mentioned above this whole exercise started at the behest of TNUDF. TNUDF is not a fully owned government organisation. It has equity participation from private and public sector as well as from leading financial institutions of India. One of the activities of TNUDF is to provide loan assistance to municipal bodies for urban infrastructure development. TNUDF wanted to know whether a municipal body would be in position to repay the loan given? Further it was also interested to know how municipal bodies have used the borrowed funds? And what is the emerging financial position? TNUDF realised that single entry cash based accounting system, which was prevalent in the municipal bodies, is incapable of providing such information in transparent manner. Thus TNUDF perceived and felt a pressing need for municipal accounting reforms, which culminated into the taking up of the project of introduction of double entry accrual, based accounting system in the municipal bodies.

In contrast to Gujarat Experience, the municipal accounting reform project in Tamil Nadu received unprecedented support from GoTN. As mentioned earlier the Chief Secretary to the GoTN heads TNUDF and the Secretary – Urban Development (municipal administration) are the members of the TNUDF Board. These two top most ranked officers of GoTN personally reviewed progress on a regular basis and sorted out bothersome implementation problems. Their positive and active involvement demonstrated the commitment of the State Government to this reform project/experiment and passed on the message in clear and unambiguous terms that government is serious about successful implementation of these reforms.

There was unprecedented involvement, support and commitment from the State Government and topmost bureaucrats. As the top management of each municipal body was made responsible to the government for the successful implementation of the accounting reforms, the implementation process received much needed support of the top management and of the other departments of the municipal body. Unlike Gujarat experiment, this exercise did not turn out to be the responsibility of the consultant and the accounts department of the municipal body only.

Presence of State level Professional Nodal Agency¹

State-wide implementation of any municipal reform would require presence of a competent, professional and dynamic nodal agency as urban development department of a state government cannot design and implement state-wide micro level municipal reform. This essential prerequisite was competently fulfilled by TNUDF. TNUDF as mentioned earlier conceived municipal accounting reforms, nurtured it, and made necessary arrangement of funds, human resources, and technical assistance for the implementation of the municipal accounting reforms. Thus presence of a state level professional nodal (state level) agency was one of the main factor responsible for the successful implementation of municipal accounting reforms. This feature was absent in Gujarat case and is absent in on-going reforms in Rajasthan (Jaipur), Madhya Pradesh (Indore), Uttar Pradesh (Mirzapur), Punjab (Ludhiana).

State-wide Unified Accounting System Approach

Right from inception stage GoTN and TNUDF has taken state-wide unified accounting system approach for introducing municipal accounting reforms in contrast to earlier city-specific approach observed in the case of Chennai, Mumbai and later on in the case of Gujarat. This is the only viable approach in India, which brings about commitment of the state government and other related government organizations / departments in the reform process. It also serves the objective of compatibility of financial reporting system / data besides accounting system improvement. It brings in unity and focus in the action.

Training and Opinion Building Exercise

TNUDF II Office carried out well thought out training and opinion-building exercise, which was absent in case of Gujarat Experiment. The training courses were conducted for all levels and for all types of officers/employees of the municipal bodies and of the other agencies, government offices and departments dealing with this reform process. Also opinion building exercise/ workshops were conducted for the politicians and top executives.

Involvement of Experienced Government Officers

This innovation has contributed greatly to the success of Tamil Nadu municipal accounting reforms. There is no doubt about the professional capabilities of Indian Accounting and Financial Consultancy Firms/personnel. But over the years they have not received much of the exposure about governmental working and opportunity of designing/implementing pure governmental system reforms. Involving knowledgeable retired government officers to design and implement reforms brought in first hand enrich

¹ These factors for successful Tamil Nadu experiment was suggested by Mr. Malaichamy of TNUDF and by Mr. Alok Shiromani of FIRE (D) in the Workshop held at Jaipur on 19th July 2002 to discuss this report.

knowledge of governmental system / working, deficiencies / shortcomings and reforms required etc. The involvement of experienced and knowledgeable officers also generated respect from the municipal officers/employees to the new system/reforms designed for implementation. Tamil Nadu thus achieved a confluence or blending of experience and professional knowledge.

Appropriate Implementation Methodology

In order to ensure a smooth changeover to the new system, TNUDP Office grouped all the 107 municipal bodies into 25 groups based on location and size. TNUDP – II funded by the World Bank to oversee implementation of the new accounting system, contracted with 25 Chartered Accountant firms to assist municipal bodies to introduce the new accounting manual. These firms are providing on-the-job training; trouble-shooting and helping to prepare financial statements based on the new system. This kind of implementation strategy was required for introducing accounting reforms in the municipal bodies. Because of years of neglect the present state of Indian municipal bodies is highly depleted and unaugmented. While introducing any reforms municipal bodies should be treated like a baby learning to walk for the first time. With this consideration municipal bodies should be provided localized, parental support over a considerable period of time. Only then reforms can really get implemented.

Committed, Motivated Participation by Municipal Bodies

With all the above-mentioned factors in the right order, the municipalities and their staff has worked with zeal and commitment to make introduction of the new accounting system a success story. Without their motivated and untiring efforts such a statewide comprehensive reform would not have been possible. Municipal bodies have meticulously collected information on assets and liabilities using the forms in the manual, and with the help of consultants, produced opening balance sheets. As per the guidance received from the TNUDP II Office, the core/main consultants, local consultants, and the municipal bodies have implemented this new system without bothering or making issue of increased workload. In this task the top management, heads of other departments and the accounts department of a municipal body have worked like a team.

The Tamil Nadu experiment empathetically proves that municipal accounting reforms can be successfully introduced on a state-wide scale if there is an effective political and administrative will and if various other factors like pragmatic leadership, recognition, respect and involvement of local/in-house talent, appropriate implementation strategy, creation of willingness among local officials through a motivating and helping approach, continuous support and review by state government/highest authority and last but not the least, technical/financial support by international/national donor agencies.

The Karnataka Experiment

Municipal Accounting and Financial Reporting System reforms in Karnataka, at present (August 2001), are half way through. Two Municipal Bodies namely Bangalore Municipal Corporation and Tumkur Municipal Body are undergoing accounting and financial reporting system reforms. The detailed accounts of the on-going reform process are as follow.

The story of Karnataka MA & FRS reforms started some two years ago, when Tumkur received technical assistance regarding introduction of improved accounting and financial reporting system under ADB T.A. No. 3209 – IND through Karnataka Urban Infrastructure Development Finance Corporation. TATA Consultancy Services – India prepared conceptual framework and guideline document about modern governmental financial accounting to be applied in the municipal bodies. TCS – India also provided conceptual training to the staff of Tumkur Municipal Body. As implementation of the modern (accrual based double entry) accounting system was not the part of TOR of TCS – India, it was left to KUIDFC to devise suitable implementation mechanism.

KUIDFC identified Public Affairs Center – a leading NGO of Bangalore for the implementation of Fund Based Accounting System (FABS) in the Tumkur City Municipal Council. In October 1999 KUIDFC and PAC signed TOR regarding this. PAC appointed Prof. R. S. Murali, NCR Consultants Limited, Chennai to head the team for design and implementation of FBAS. It also roped in two retired government officers from State Accounts Department, namely Mr. Shrinivasan Murthy and Mr. Nagaraja Gupta as consultants for this assignment in November 1999. In the first phase PAC and its consultants carried out system study of existing accounting practices and produced report entitled 'Revenue and Expenditure – Process Mapping. On the basis of first phase analysis a white paper regarding present state of municipal accounting system and what needs to be done was prepared and was submitted through KUIDFC to the Government of Karnataka in December 1999. On basis of this discussion paper formal orders were received from Government of Karnataka to introduce fund based accounting system in the Tumkur Municipal Body.

One special feature of the Karnataka experiment is not only the common team members who design and implement the reforms but also the focus, inspiration and impetus provided by Mr. Ramesh Ramanathan – the common force between the team, the BATF/PAC and the Government. Mr. Ramesh Ramanathan is finance professional, a NRI who came back to India after an excellent stint in one of the foreign banks with the sole objective of contributing something positive to his home state – Karnataka. He has been the sole motivator for all those concerned and the coordinator between organisations, governments and professionals for designing and implementing reform of this scale. His non-commercial commitment to this process of transformation of the state has added the required credibility to the entire exercise. He is a BATF member and part of PAC and is fully involved in these two experiments.

As a part of Phase I and basic background preparation, PAC team studied the Tamil Nadu municipal accounting system reforms initiative thoroughly. They also invited Mr. K. Easwaran and Mr. T. M. Kadirvelu, retired Tamil Nadu government local fund officers, who were instrumental in designing, implementing and the

success of Tamil Nadu experiment. PAC prepared manual for the proposed accounting system and submitted it to KUIDFC in February 2000 for approval. KUIDFC gave go ahead to the implementation of fund accounting system in the TCMC in April 2000. TCMC staff was provided training about accounting concepts, system and computer operation during the period May to July 2000.

By November 2000 PAC team prepared 'User Requirement Specification Document', which paved way for the preparation of tailor made software. Cross-Domain Solution Pvt. Ltd., a Bangalore based software company came forward and prepared tailor made software for implementation of proposed fund based accounting system in Tumkur City Municipal Council. During the period of January to March 2001 test run of this software were carried out. Finally PAC team prepared Fund Based Accounting System Workflow Manual in March 2001 and commenced parallel run in the TCMC with effect from 1st April 2001.

Since April 2001, parallel run of the manual single entry accounting system and fund based computerised accounting system is going on smoothly and results of both the systems are compared with each other. The software package is still under development; at present it takes care of all the necessary entries in to the FBAS. Also opening balances are yet to be introduced, as TCMC cannot give opening balances of various accounts, due to the single entry system of accounting and non-availability of balance sheet. In order to carry out parallel run of FBAS PAC has placed staff of three persons. These people carry out task of data entry and maintaining accounts as per FBAS.

In order to create opening balance sheet PAC has prepared list of assets as per municipal records and now it is being verified physically and is crosschecked with other records maintained by the Land Records department and Sub-Registrar's office. KUIDFC and PAC have planned to complete migration from existing accounting system to FBAS by the end of March 2002 and w.e.f. 1-4-2002 Tumkur City Municipal Council will switch over to FBAS completely and will handle new accounting system independently. This entire implementation of improved accounting system in TCMC is financed by ADB through KUIDFC.

The Municipal Accounting reforms in Bangalore City Corporation have almost same accounting model, software and chronology of events and stages, as same team has designed and implemented FBAS in the Bangalore City Corporation. However beyond this point comparison between Tumkur and Bangalore experiment cannot be made/stretched. Bangalore City Corporation is bigger than Tumkur by more than ten times (TCMC Budget Rs.20 Crores approximately, BCC Rs.900 Crores approximately). It is much more complex, voluminous and was in a real mess prior to accounting reforms. Its dynamics are totally different and driving forces behind the accounting reforms initiatives are different.

In 1999, the Chief Minister of Karnataka Shri. S. M. Krishna set up a high-level task force called Bangalore Agenda Task Force (BATF). The mandate for this task force is to "take Bangalore forward" by introduction of various reforms focusing on Bangalore city. It pioneered public private partnership with various organisations in Bangalore like the Bangalore City Corporation, Bangalore Development Authority, etc. with the sole objective of making this city the best destination in India for

investment and living. BATF has several members which includes the CEOs of several private sector giants like the Infosys, Principal Secretaries from the State Government and Public personalities committed to development of Bangalore, The private funding is made possible through a trust called Aadhar Trust.

BATF came forward with several initiatives to achieve its mission. Of the several tasks BATF came up with like improving the infrastructure, "clean Bangalore" campaign, introduction of accounting reforms in the City Corporation of Bangalore is an important one. It appointed the same consultants team (like PAC) to undertake the task of designing and implementing FBAS in Bangalore City Corporation. The Bangalore Agenda Task Force funds the entire operation of introducing accounting reforms (FBAS) in Bangalore Municipal Corporation. As a part of BATF's vision, the entire implementation process has been privatized to NCR Consultants Limited (NCRCL), Chennai.

In Bangalore City Corporation, the FBAS reforms have received very good support from three municipal commissioners. These reforms process was initially spearheaded by the then Commissioner of BMP, Mr. Jairaj, and IAS, who also decentralized the Accounting System to Zonal Accounting System. Mr. Shanthanu Consul, IAS, though he was in BMP for a brief period (Feb 01 to March 01), did not allow momentum to slow down. During his time a detailed Budget Exercise was done and the management focused on financial accounting and creation of financial information flow aspects. At present, Mr. Ashok Dalwai, IAS, is the Commissioner. He is extremely supportive and it is during his period that BMP Accounts Regulation, 2001 was passed and the MOU with Govt. of Karnataka was signed.

During the period October 1999 to May 2000 the implementation team concentrated on collection of information about assets of BMP from the municipal records. The document containing information about assets of BMP has been circulated to concerned departments for verification and for updation to include assets added during the period May 2000 to March 2001. PAC team is still awaiting revised information. Another problem associated with BMP was lack of basic information about number of works/expenditure in the pipeline and receipts in 300 plus bank accounts. So before implementing the improved accounting system it was necessary to set up the basic information flows system. Consequently in May 2000 Revenue department related information system was set up and in September 2000 engineering department related receipt and expenditure information system was created and placed in practice. Currently all the departments are covered for revenue and expenditure flows. Steps are being initiated to see that all revenue items are being tracked without exception.

BATF has undertaken physical verification of all the assets/properties listed by PAC team. Such verification will be done by using GIS technique and by verifying records with other government agencies like City/Land Survey Department, Income Tax Department etc.

The development and implementation of various accounting system documents for BMP has same chronology of time as mentioned above under TCMC case study. Theoretically and conceptually the same model has been implemented in the BMP, but the magnitude of the job is totally different. In BMP also the team

started parallel run with effect from 1-4-2001. Opening balance sheet has yet not been constructed but all the day-to-day entries are done on double entry accounting system using FBAS classification/structure. Tailor made software utilized for new accounting system is yet not fully operational but by the time accounting system reaches complete implementation, software will be made fully operational. The team has employed fifteen persons to manage day to day entry, report generation, trouble shooting during the parallel run, over and above core consultant's team. It is planned for complete migration by 1-4-2002. BMP would be switched over to FBAS completely and BMP's own staff will be able to manage it independently.

The discussion with the officials of the both TCMC and BMP revealed that they welcome these reforms and they are found supportive. They also expressed confidence that by the next year they will be able to handle the new system independently. The discussion with KUIDFC officials revealed satisfaction about progress of the implementation. Buoyed by success of the experiment/reform KUIDFC wish to put up plans to GoK about implementation of FBAS if not in all, but at least in bigger and important municipal bodies.

As implementation is half way through, it is not possible to evaluate it in totality, but on going experiment does indicate certain characteristics, features, and strong and weak aspects as follows –

Fund Based Accounting System, GAAP and Modified Accrual Base –

Compare to Gujarat and Tamil Nadu experiments/reforms, the Karnataka accounting reforms are based on sound conceptual footing. The theoretical and conceptual base of the on-going Karnataka Accounting Reforms are in line with the framework advocated by TCS report under its sub-head 'Framework for Modern Municipal Financial Accounting System (MMFAS)'. Gujarat experiment lacked all these elements; Tamil Nadu has applied Modified Accrual Base and GAAP but has not gone for FBAS, while Karnataka experiment hopes to employ all these three features. Discussion with the consultants revealed that they plan to incorporate fourth element discussed in this present report, that is, accounting and budget head conjugality or wedlock. The budget variance report has already been introduced and the functionality of the same will be enhanced during budget exercise 2002-03.

City Centred Vs State-wide Unified Accounting System Approach

Though at present accounting reforms are limited to Tumkur and Bangalore cities, this experiment is not falling into City Centered approach like Gujarat experiment. Same accounting model is used for both the bodies one at the higher end and the other at the lower end of the spectrum, making it possible to replicate the model irrespective of size. Also scalability becomes easy. The discussion with KUIDFC officials revealed that they plan to implement same model in all the municipal bodies of the Karnataka in phased manner. Thus it seems that Karnataka Municipal Accounting Reforms in the end will create state-wide-unified accounting system.

Involvement of Credible voluntary change agent, Experts and Experienced Government Officers

The credibility to the entire process has been brought by Mr. Ramesh Ramanathan who provides selfless committed financial / managerial expertise and his exclusive time for these experiments. The expert team involved in the process consists of persons who are experienced and involved in implementation of Government systems. Prof. Murali has been involved in development and implementation of projects relating to six different state governments and has clear understanding of the efficiencies and deficiencies of the governmental systems. Like Tamil Nadu, on-going Karnataka experiment has involvement of two retired experienced government officers of local fund cadre namely, Mr. Shrinivasa Murthy and Mr. Nagaraja Gupta. Their involvement is providing edge to this process, while understanding the government system of accounting and various implementation issues.

Active Participation by Municipal Bodies

The entire exercise is receiving active participation from concerned municipal bodies especially from the top executive (commissioner) and the accounting staff. In Bangalore City Corporation a special officer from Indian Revenue Service of Joint Commissioner rank is co-ordinating these reforms. Still the participation of entire municipal body/staff is not that committed and motivated as it is found in Tamil Nadu experiment. The way departments are taking too much time to provide information about assets and receipts and payments indicates that the mandate of inevitability of accounting reforms is not that loud and clear. As discussed earlier, in a government set up any message or any reform has to take the form of a mandate for its timely implementation by the line and staff subordinates / departments. This is something lacking in this experiment.

Peoples' Participation

This is the unique feature of Karnataka experiment. The agency (Bangalore Agenda Task Force), which is not only funding but also co-ordinating and providing required pressure Bangalore City Corporation Accounting reforms, and Public Affairs Centre, which is co-ordinating the reform process in Tumkur are platforms of citizens and industries, which are interested, in overall development of Karnataka. Bangalore Agenda Task Force is a powerful citizen's forum. The participation of such NGO/CBO combination has provided this on-going municipal reform an image, of which Chief Minister of Karnataka has taken note publicly. Thus compared to earlier experiments, this experiment is blessed with genuine peoples' participation. Gujarat experiment lacked top-level government as well as municipal level support and any sort of peoples' participation. Tamil Nadu experiment got excellent support from all the levels of government (State as well as municipal) (much more compare to Karnataka experiment) and from the equity stakeholders of TNUDF. General People's participation was not there but it did not matter as Tamil Nadu experiment was blessed with very strong and active government support. At present the Karnataka experiment lacks the

kind of government support, which Tamil Nadu experiment received, but it is most likely that after successful conversion of both the local bodies – TCMC and BMP, Government of Karnataka will extend similar kind of strong support.

Opinion Building Exercise

As there is involvement of a renowned NGO and a powerful citizens' forum not much opinion building exercise was required for the people at large, but opinion building exercise will be a must for the political masters and for other peer municipal heads of departments for the sustainability of reforms. Not much has been done, also it was not warranted in preliminary stages but now onwards BATF / PAC team will have carry to out such an exercise for full-fledged acceptance and sustenance of municipal accounting reforms.

Complex Operational System

The operative system of newly developed FBAS, which is being implemented in BMP and TCMC at present, seems complex at first instance. There is nothing wrong at the conceptual level but its operative system is being developed according to the existing clumsy system of accounting operations. This is bound to happen when one tries to develop new system without disturbing existing workflow system or legal provisions or other factors, which are not under the control of consultants, or implementing agencies. This is also done to avoid inertia reaction or undue reaction of human resources. One should not compromise, so that successful implementation can be achieved. Accounting and financial reporting system reforms constitute serious intervention and the objective is not only to convert the system from single entry to double entry, but also to improve existing accounting, financial and administrative procedures, and general workflow, information flow etc. Accordingly at present nothing is required to be done as far as the designing, implementation of FBAS is concerned as an attempt is made to achieve accounting system conversion smoothly. But once complete system conversion is attained by 1-4-2002, all the concerned agencies should take a fresh view of the entire system and should work to make it simple and independent from old cumbersome accounting and administrative procedures. This is necessary for preparing a standard model for replication in other municipal bodies of the state.

The Rajasthan Experiment

Accounting reforms in Jaipur Municipal Corporation started under the ADB TA around April 2000 along with Anand (Gujarat) and Tumkur (Karnataka). The TOR of concluded ADB TA (No. 3209 – IND) executed by the TATA Consultancy Services, India comprised only two components, designing of an accounting system and providing training to the municipal body and not the implementation of the accounting system in the municipal body. Accordingly Jaipur municipal body of the Rajasthan received an accounting system designing framework and training from the TATA Consultancy Services. It has started maintaining its accounts on double-entry accounting system on parallel basis since 1-4-2001. While compilation of information

is still under way, the Jaipur Municipal Body has prepared a provisional balance sheet upto February end (2001), with the help of an 'off-the shelf' accounting package. All available fixed assets owned by Jaipur Municipal Corporation have been listed and valued on the basis of market price and have been entered in separate accounting group. The 1st Balance Sheet as per new system was issued by 1st May 2001. The ongoing RUIDP is charged to carry remaining capacity building efforts of the ADB TA. Government orders have been issued in Rajasthan – for municipal corporations and other local governments in district headquarters to maintain accounts based on the double-entry system (parallel with their current accounting systems). The present status and the observations about the accounting reforms experiment in Jaipur Municipal Corporation are as follows:

The positive aspect of this experiment based on the TCS framework (under ADB TA) is that it has sustained its parallel run in spite of lack of adequate implementation support both external and internal. Out of three accounting reform experiments taken under ADB TA, the Tumkur (Karnataka) experiment received a lot of external support but still it has not achieved complete conversion, while Anand (Gujarat) did not receive any implementation support as a result it has failed to make any headway. The Jaipur experiment is also characterised by lack of support, still it has sustained its accounting reform process. If the Jaipur experiment gets due support as suggested in this report it can achieve full implementation of accounting reforms.

In order to take care of parallel run of improved accounting system Jaipur Municipal Corporation has hired one chartered accountant and one data-entry operator on a contractual basis. Also it has received the services of one computer programmer on deputation basis from state governments' computer department. It has adopted TCS – ex accounting software for maintaining its accounts on double entry accrual base accounting system.

JMC has entered opening balances pertaining to assets and liabilities as of 01/04/2001 in the computer software. These opening balances and the opening balance sheet as of 01/04/2001 has served very important purpose but needed to be verified before JMC adopts them as final for total switching over purpose.

On an average the accounting workload is 8000-10000 entries per month, that is, around 400 to 500 accounting entries per day. As there is only one data entry there is a need for extra manpower. As and when works gets piled up at present the bill clerks of the accounts department help to carry out data entry work.

TCS report suggested fund based accounting framework, but JMC's parallel run has adopted consolidated fund accounting system and the discussion with concerned officials did not indicate any intention of adopting fund based accounting system.

The on going parallel run at the best can be described as Double-entry cash base accounting system. Except one accrual entry pertaining to property tax receivables when the new-year tax demand was raised, all the entries about receipts are carried out on cash basis. Also in case of property tax, parallel run is not capturing increase and decrease in the demand, which is taking place during course of the year.

On payment side, the bills, which are prepared by the central accounts department, are recorded on accrual basis. The accrual entry is passed when the bill is raised and sent for pre-auditing. The bills which get prepared and paid in the zonal office (there are six zonal offices in JMC) are not entered on accrual basis but on the cash basis. Also expenditure bills undergo some revision during pre-auditing stage, but parallel run is not capturing these changes at present.

The present data-entry under parallel run suffers from a serious flaw. The data entry is based on the secondary records or the cashbook; that is, it is carried on the basis of entries made in the cash or chequebook instead of on the basis of original receipt challans or payment voucher.

Another serious lacuna of the parallel run is absence of verification or validation process. The results of the parallel run are tallied with results of existing single entry system on a gross/summarised basis and not on individual receipt or payment basis. Thus the data entry is made on the basis of cash/cheque book and it is again compared with cash/cheque book on a gross basis. This is a very serious lacuna and must be abandoned immediately. The parallel run has failed to design and test the verification and validation process.

There is inadequacy of manpower to manage parallel run properly. Though the data-entry work is not lagging behind, the verification, reconciliation and finalisation of monthly accounts; under parallel run, is lagging behind substantially. The accounts, at present, stands finalized up to Sept. 2001 under parallel run. Similarly the bank reconciliation work is getting inadequately attended under both the systems (manual cash based and computerised accrual based).

The Chart of Accounts entered in the computer software is highly defective. The accounting (subject) heads and the budget (object) heads have got mixed up with each other. The tree structure or hierarchical structure of various accounting heads/sub-heads does not exist. What exists is unaugmented, mixed up, ill-structured Chart of Accounts.

The budget of JMC is a highly unaugmented document. It also lacks logical tree or hierachial structure. The new accounting system is not using budget codes. The TCS software does have a scope for entering budget codes (cost centers) but this is not made operational. Thus there does not exist wedlock or matrix of accounting & budgeting heads and is not entered in the computer. Also there does not exist pure chart of accounts associated with double entry accrual base accounting system. As a result parallel run data is not in position to give budget code wise data.

The capital nature expenditure is shown as Development Expenditure (work-in-progress) if a running bill is received. If final payment bill is received with work completion certificate then that expenditure is debited directly to fixed assets head. The fixed assets module and the process of converting WIP to fixed assets is still underdeveloped, unattended. The schedule of fixed assets, opening and maintaining individual asset ledgers is not attempted. Only a gross figure of the fixed assets is taken in to the accounting system.

The parallel run exercise has remained confined to the group of three people only (hired on contractual basis). The regular or mainstream staff of the JMC has not become an integral part of this process. The staff of the JMC trained for the implementation of these accounting reforms has got transferred long ago and the new staffs have not been able to identify itself with these accounting reforms. Thus as of today, the regular JMC staff lacks the necessary capability to take over operation of the new system from the implementation team.

The entire exercise of introducing an improved accounting system has remained confined to the implementation cell, formed of contracted people and to some extent CAD. The rest of the corporation, officers and even the zonal accounting section are not involved or motivated in this important exercise. The top management of JMC is also not taking adequate measures and reviews to implement the improved accounting system.

The Government of Rajasthan has issued recommendatory or enabling order stating that municipal corporations can maintain their accounts on a double-entry accrual basis. Besides that nothing has followed. There are no regular high level reviews or efforts like Tamil Nadu experiment to introduce accounting reforms in JMC and in other municipal bodies of the state.

To sum up it can be said that Jaipur Accounting reforms experiment requires urgent support as outlined in this report under the suggestions section before it is too late.

The Indore Experiment

In recent years Indore Municipal Corporation (IMC) has been in news for various reforms initiatives and in past three years in real terms it has implemented various reforms with varying degree of success. Infact the entire reform process of Indore Municipal Corporation started when in 1999 IMC was required to prepare and submit Balance Sheet for international funding. The exercise of formulating Balance Sheet of IMC, exposed various gray areas and need for reforms to decision-makers of IMC. Naturally alongwith other reforms IMC undertook accounting reforms since 1999.

Shortcomings of the Previous System

The accounts were maintained on manual and cash basis on a single entry system. As a result IMC suffered from the classical shortcomings cash based single entry accounting system. The shortcomings of the previous accounting system of IMC were as follows -

- Prior to 1998-99, the accounts did not effectively differentiate between revenue and capital receipts and payments. The classification used was confusing even to IMC personnel.
- The cash book was not prepared for years, the cash position was not ascertainable and back accounts were not reconciled for years;
- Errors and omissions were commonplace;
- It took months to finalize accounts and that too inadequately;

- Up-to-date information on finances was seldom available;
- The asset-liability position could not be known;
- Maintaining accounts was time-consuming and man-power intensive;
- The budget was the only financial document prepared by the Corporation. It was not possible to prepare an income-expenditure statement or a balance sheet for the Corporation.

Specific Steps Initiated

In light of the above IMC initiated accounting system reforms. The changes with respect to accounting and budgeting systems can be broadly grouped in three heads:

- Computerization of accounting system and process;
- Conversion of accounting system from single-entry cash-based to double-entry accrual-based system of accounting; and
- Separation of the capital account from the revenue account.

IMC, with its technical partner, developed a new tailor made accounting software package in order to computerize its accounting processes. IMC has assigned account codes to each item in its budget and has created cost centers for effective cost analysis.

The tailor made computer accounting software automatically facilitated conversion to double entry accounting system. Alongwith this IMC adopted a revised format for the budget, containing separate budgets for the capital and revenue receipts and payments.

Initially Oswal Data Processors-Indore, IMC's technical partner, handled high volume transactions such as payroll accounting and maintenance for records for taxes like Property Tax and Water Charges. In the second stage of computerization, all these functions have been shifted to IMC's premises. Personnel of IMC are being trained in the use of the computer systems. In addition, the technical partner will continue to provide technical assistance to IMC for a period of five years to ensure a smooth transition and adequate training of the Corporation's personnel.

Key Impact Areas and Success Achieved

IMC claims that, till date, it has achieved following improvements in the accounting system as a result of its accounting reform efforts.

- The entire accounting system has been computerised.
- Separate cash and bank books are maintained;
- Various ledgers are being maintained on a double-entry basis;
- Bank reconciliation is done regularly;
- An accounts statement is prepared every month;
- A trial balance and balance sheet are prepared;

- The accounting work has got professionalised as IMC is now utilizing the services of a Chartered Accountant on full time bases to take care and to improve the accounting and budgeting processes.
- Various allied functions like payroll accounting, Provident Fund, employee loans and employee attendance has become computerised.
- Better quality and timely information on the financial position of the Corporation is available. The corporation can now prepare cost-center-wise reports, budget variance reports and other types of MIS reports; and
- The computerized system has brought in flexibility as it can easily accommodate growth in the volume and nature of financial transactions over a period of time.

IMC Accounting Reforms – Observations

The accounting system reforms efforts of IMC are laudable, as they have been conceived initiated and carried out by the IMC on its own. IMC neither received any technical or financial assistance from any organization nor it was compelled or dictated by higher-level government. The review of IMC accounting reforms efforts has revealed following observations, which are not intended as criticism or faultfinding exercise. The following observations are intended to provide constructive suggestion to an exercise, which is at first place very commendable.

- The implementation of accounting system reforms is largely incomplete and patchy; IMC needs to give it a holistic framework.
- IMC consultants have adopted chart of accounts as per the schedule of Companies Act, but IMC is not a corporate body and therefore should carry out appropriate changes to suit its structure, uniqueness and accounting need.
- The latest version of the accounting software developed for the IMC by their technical partner is much-improved one and provides for cost center-wise analysis. But budget coding itself needs rationalisation.
- There does not exist symbiotic or matrix relationship/structure between chart of accounts and budget code.
- The bifurcation between revenue and capital nature of receipts and payments needs further rationalisation.
- The extra-ordinary receipts and payments (the receipts and payments other than revenue and capital nature) need to be separated and there should be separate budget regarding such items.
- Advances given for purchase goods or for any sort of payment and adjustments or returns made against the advances given are not accounted properly.
- Currently payment bills directly go to the audit department from the departments concerned. This current practice leads to lack of budgetary and financial control, beside it results into shifting of accrual incidence of expenditure to inappropriate time.
- The conversion of single entry cash base accounting system to double entry accrual base system has not resulted into rationalization and simplification of the system. Still there exists more than 56 bank accounts which were opened under single entry cash base accounting system to ensure accountability. Similarly as IMC is suffering from the cash crunch for many years, it evolved

a unique system of releasing payment to contractors. Under this system once payment bill gets audited and reaches to accounts department for payment, it is disposed of by passing payable entry into party ledger. Later on when IMC gets some funds for releasing payment, it distributes funds partly and equitably to all the contractors by preparing separate payment bill. In this system, thus, each payment bill-wise entry is not effected as a result it is difficult to know which payment bill got paid. This system was evolved for single entry cash base accounting system. IMC has continued with it even after the conversion. It should have rationalized it; rather it has attempted to add age analysis of pending bills in the accounting software.

- Though day-to-day accounting entries are made on double entry basis, finalisation of accounts on accrual basis is not taking place appropriately. There are several problems and IMC could not finalise balance sheet of 2000-01 and 2001-02.
- Bank reconciliation feature is available in software but it has not been operationalised, consequently bank reconciliation is not done adequately.
- The present computer software and accounting system is not having fixed assets or capitalisation module working on 'day-to-day' or on 'on-line' basis. Also the present accounting software does not updates Balance Sheet of the IMC on 'on-line' basis.

The Maharashtra Experiment

Maharashtra is one of the leading states in India in terms of its commitment to urban sector reforms. The Government of Maharashtra (GOM) decided to take up accounting reforms in municipal corporations and municipal councils. The Director of Municipal Administration (DMA), Government of Maharashtra, is responsible for supervising the 230 municipal councils in the state. The DMA assessed the accounting systems in the state's municipal councils and on seeing the need for accounting reforms requested the FIRE project in the beginning of the year 2001, to support the development of an improved accounting system for the state's municipal councils and municipal corporations. The activity was launched in two municipal councils (Islampur and Navghar Manekpur) and three municipal corporations (Navi Mumbai, Mira-Bhayander and Sangli), to serve as pilot cities for implementation of the new accounting manuals.

Objectives

The major objective of this reform project is to develop an improved accounting and financial reporting system that will be able to:

- Determine ULB compliance with laws, rules and statutory regulations;
- Evaluate efficiency of performance and effectiveness of controls in ULBs;
- Assess financial position of ULBs;
- Prescribe parameters for measurement of ULB performance; and
- Assess ULB budgetary planning and control over resources.

The Chronology of Maharashtra Municipal Accounting Reform Project

Exposure Trip: During March 1-5, 2001, FIRE project organized an exposure trip to Tamil Nadu for four officials from the State of Maharashtra to have an overview of the level of the efforts, energy and commitment required to undertake municipal accounting reforms.

Launch Workshop: The activity was launched in the State with two kick-off workshops organized at Sangli and Navi Mumbai on July 24, 2001 and August 3, 2001, respectively.

Hiring of Consultant - In June 2001, GOM, with USAID FIRE project support, hired A.F. Ferguson & Co. as consultants to review the existing ULB accounting systems in the state and develop accounting manuals for municipal councils and corporations.

Inception Report: AFF commenced the consultancy and submitted its "Inception Report" on August 14, 2001.

Analysis of Existing Situation: Subsequent to carrying out a study of the existing system of financial accounting and reporting of the municipal corporations and municipal councils of the State, AFF submitted four ULB-specific reports on "Review of Existing Systems" and a "Consolidated Report on Review of Accounting Systems at Municipal Bodies in Maharashtra" on February 9, 2002.

Workshop I: On February 5, 2002, a workshop was organized for the Commissioners, Chief Officers, Accountants and Auditors of the pilot ULBs. The salient features of the draft manuals and the opening balance sheet formats were discussed at the workshop.

Draft Manuals: On February 5, 2002, AFF submitted two draft municipal account manuals, one each for municipal councils and municipal corporations of the State.

Visit to ULBs: DMA, FIRE and AFF visited the pilot ULBs during March 5-25, 2002 to obtain their comments, understand their problems and help them comprehend the new system.

Launch of pilot workshop II: The 18-month pilot phase/activity was launched in the five pilot ULBs in August 2002, with two three-day intensive training workshops for the municipal employees.

Review and revision of draft manuals: The draft manuals were sent by FIRE to ICAI for a peer review. The Review Report submitted by ICAI was deliberated on by FIRE with AFF, DMA and pilot ULBs. Based on the Review Report and comments received from the ULBs, AFF incorporated the necessary changes in the manuals and submitted the revised manuals on August 9, 2002. FIRE has reviewed the manuals to ensure that all comments have been incorporated and prepared a note on the same.

A.F. Ferguson & Co. and local associates are currently assisting the municipal staff to understand and implement the new accounting system and manuals. They are providing on-the-job training as well as formal training programs on specific elements of the new accounts manuals and on the new double entry accrual accounting transactions. The GOM decided that municipal staff would use the new system in parallel with the old cash-based system until they are proficient in the new system. The municipal staff and consultants also worked to identify and value municipal assets and liabilities so they prepare opening balance sheets, which has been on the verge of finalisation. Encouraged by the results of the pilot, the GOM decided to expand the new accrual accounting system to 40 large cities of the state on April 1, 2003.

Recognizing the critical importance of training municipal staff in new accounting principles and practices, the GOM, with USAID FIRE project support, organized *training for trainers* for 80 chartered accountants from the 40 selected cities (* to 11 March 2003). The training module, developed by YASHADA in association with FIRE project and ICAI, focused on implementation of the new accounting manuals and the conversion from cash-based to accrual-based accounting. The GOM, with FIRE project support, also organized several orientation and training programs for elected representatives, municipal officials, and auditors on “Municipal Accounting and Financial Management” at YASHADA, Pune. The GOM plans to use the services of the local chartered accountants for on-going support to the ULBs.

Development of accounting software for the new accounting system and training accounting staff to use it is also essential for better financial management. The GOM is exploring the possibility of using the software developed by the State of Tamil Nadu for the state’s ULBs, after incorporating necessary modifications.

The GOM has set up a state-level steering committee, chaired by the Secretary of the Urban Development Department, and a dedicated project management unit directly under the Director of Municipal Administration, to provide guidance to scale up the activity statewide. The committee will coordinate with the State Finance Department, ICAI and the ULBs. The members of the Steering Committee include Secretary Accounts and Treasuries, GOM, DMA, Commissioners and Chief Officers of the pilot ULBs, Chief Auditor, Local Fund Accounts, Representative of Accountant General, Maharashtra, Representative of Indo-USAID FIRE project, Representative of ICAI and Representative of A.F. Ferguson & Co.

CHAPTER 6

Conclusions and Suggestions on State-wide Accounting Reforms

No reform efforts can be 100 per cent perfect; also we all are going through an era of phenomenal change. In order to cope with the ever-changing world around us we need to update and improve ourselves. Even a reform or a new system introduced sometime before, perfect at that point of time, may appear wanting or inadequate at present. Keeping in mind the objective of constructive criticism and appreciation towards these pioneering municipal accounting efforts and the reformers that the following suggestions are made. It is hoped that these suggestions will complement these reform initiatives.

Gujarat

Though the State of Gujarat took the lead in municipal accounting reforms, during the last decade it has not been able to build upon the initial lead due to various reasons narrated above. Implementation of Modern Municipal Financial Accounting System will not be very difficult if GOG undertakes the following suggested action plan:

Policy Decision

Government of Gujarat should take a formal policy decision to introduce Modern Accounting System in all municipal bodies. Such a decision should be made known to all. The message of this policy decision should be loud and clear about GOG's commitment to municipal accounting reforms. Introduction of improved accounting system should be made mandatory to all municipal bodies.

Time Bound Implementation Plan

Contrary to earlier approach of city specific or individual municipal body specific accounting reforms, GOG should follow the Tamilnadu model of municipal accounting reforms. A time bound implementation plan covering all the municipal bodies in a phased manner should be formed to actualize municipal accounting reforms. The minimum time frame for such implementation plan could be two years and the maximum could be four years.

Nodal Agency

There is no need for creating any new nodal agency to spearhead the task of implementation. Gujarat Municipal Finance Board (GMFB), Director of Municipality (DoM) or Gujarat Urban Development Corporation (GUDCOL) can handle the task of implementing improved accounting system. It is true that these agencies as of now do not have expertise in the field of Municipal Accounting but can provide excellent basic infrastructure. The nodal agency should hire one or two experts of this field on a full-time but contractual basis to spearhead the implementation.

State-wide Unified Accounting Approach

As mentioned earlier GOG should do away with earlier city specific/individualistic approach. The whole process should start with the preparation of a common municipal account code (the way Tamilnadu did) which will replace the age-old Municipal Account Code. The Revised Municipal Account Code should be made applicable to all the municipal bodies. For a long time new the municipal account code is getting prepared. It should get finalized at the earliest and should be circulated to different stakeholders for scrutiny and evaluation such process should be made as participative as possible. Also before promulgating new municipal account code it should be put to the test in at least 10 demonstrations municipal bodies of different size, type and capabilities. The Account Code should be then updated as per suggestions of experts and on the basis of actual implementation problems & experience.

Opinion Building Exercise

The First phase of municipal accounting reforms of Gujarat lacked this aspect completely. The lack of an opinion building exercise was partly responsible for the lack of top management involvement and support to accounting reforms in the earlier phase. The opinion building exercise should not create awareness and support only but it should also create strong felt need among decision-makers and opinion makers for municipal accounting reforms. The nodal agency charged with the implementation of accounting reforms should carry out opinion-building exercise through well-structured workshops, seminars, tailor-made for different groups like municipal executives, officers, employees, municipal councilors, government officers, officers of other agencies dealing with municipal bodies etc. This whole exercise should be treated separately from the actual training programmes.

Training Methodology

The training to the officers/employees who will be actually implementing the accounting reforms should be on-the-job, and should be carried out at their workplace as part of implementation. Training should be given at every stage of implementation. Obviously it will have to be need based and user friendly.

Appropriate Terms of References / Scope of Assignment

The ToR of an Accounting reforms assignment should cover all the aspects like design, implementation, training, documentation, user-friendly literature, reporting & information system, auditing, computerization and final updation of all these aspects. Over and above the main consulting / implementation agency to take care of above ToR, local accounting firms/ chartered accountants should be hired to provide technical assistance on 'live wire' basis to cluster of municipal bodies. This arrangement/ innovation was one of the main reasons behind the success of the Tamilnadu Experiment. This arrangement of linking local accounting firms to municipal bodies can be stipulated in ToR of the main consultant or the nodal agency can select and appoint such local technical consultants directly under separate ToR.

Judicious mix of Government Experience & Professional Know-how

Designing and implementing an accounting system for the municipal bodies warrant blending of insider view, actual working experience and professional know-how. The core-team responsible for designing & implementing constituted by the Nodal Agency should have members drawn from the government's accounts & audit cadre, from the municipal bodies who have implemented accounting reforms in the first phase, independent accounting experts and consultants. This feature helped Tamilnadu to make their municipal accounting reforms closer to ground realities and to smoothen the implementation process.

Unification of Phase I Accounting Reforms

Under World Bank TA six municipal corporations of Gujarat has undergone accounting reforms during 1990 to 1999. As mentioned earlier a separate consulting firm was appointed for each of these municipal corporations, consequently today one finds six different accounting models in Gujarat. The accounting systems of these six municipal corporations will have to be unified first among themselves and later on with statewide uniform accounting code & accounting system.

Computerisation

It has been observed that introduction & implementation of accrual based accounting system in a municipal body becomes much easier and faster if computerization is sought right from the beginning. This was the feature, which was absent in the accounting reforms carried, in six municipal corporations of Gujarat. As a result these municipal corporation were forced to find computer solutions after the new system was introduced on a manual basis and were required to carry out restructuring, training etc. again. This resulted in loss of time, energy and money. Accordingly while introducing accounting reforms in its municipal bodies, Gujarat should rope in computer technology right from the beginning. It can use ready-made accounting software available in the market or it can get tailor-made software developed by a suitable agency. The issue is application of common accounting software to all municipal bodies right from inception stage along with the application of unified accounting code.

Participatory Approach

The entire exercise of municipal accounting reforms should be made as participatory as possible. In municipal body it should involve along with a managerial, and political leadership, other non-accounting (technical & administrative) officers as accounting system cut across all the departments and sections. Outside municipal body, it should involve local academic experts, local consultant appointed as a part of implementation and the government officers of related departments/agencies. (Local fund audit, GMFB, DoM, Dept. of Urban Development etc.)

Regular Monitoring and Updation of Implementation Plan

The statewide implementation of municipal accounting reforms will require regular monitoring at different levels besides all the above steps/suggestions. There should be weekly review by the local implementation team of a municipal body. The state level core implementation team attached to nodal agency should review progress every fortnightly. Secretary – Urban Development and Urban Housing GOG should review once in a month and chief secretary of GOG should review implementation progress quarterly. On the basis of the review, the implementation plan should be updated so that its completion can be attained within a time schedule.

Tamilnadu

As described earlier, the Tamil Nadu municipal accounting reform experiment is the most successful, complete and large-scale experiment. It is quite flawless and worth replicating by other states. So, not many suggestions can be made to improve Tamilnadu experiment. Of course there is always room for constructive suggestions and improvement. Accordingly if the following improvements are carried out to Tamilnadu Municipal Accounting Reforms model then the model can become applicable to all the states; that is, it can become a national model. The suggested improvements are as follows:

Fund Based Accounting System

Tamilnadu has rightly adopted the modified accrual based double entry accounting system but with the consolidated fund format. As sequel to this they should now convert it to fund based accounting system. This conversion will not be difficult, as they have placed a sound accounting system in their municipal bodies. Fund based accounting system as described earlier in the report, is the most appropriate system for the governments or the government form of organizations, as they have to deal with various purposes and have to manage various special funds.

Budgeting and Accounting System Wedlock

The budget is not merely a tool of financial management for the government. It is a legal authorization, an operational guide, a structure of financial reporting, and much more. The budget represents 'object-head wise' classification. Entire government reporting, monitoring and resource allocation system is based on 'object-head classification'. Single entry accounting system has served this requirement over the years and hence it has perpetuated over the years. Accrual base accounting system will provide 'subject (Accounting) head-wise information only, if it is not properly integrated with budget (object) heads.

The Tamilnadu improved accounting system does provides correlation between budget code and account code, but this correlation is at the macro or very broad level. Detailed accounting code is correlated with broad budget heads and not with individual budget items. The detailing and wedlocking (one to one matching) of the budget or object code with accounting code items will facilitate cost analysis and control at micro level over and above avoidance of maintaining a separate accounting

and budgeting database. It is therefore suggested that Tamilnadu should deepen integration of accounting and budget code by following three principles.

- There must be at least one budget item code for each and every account code item.
- There can be several budget codes/items using the single accounting code/item e.g. petrol or electricity. Used by each budget or cost center.
- There should not be more than one accounting code/item for the single budget code or item.

Improvement in the Computer Software

Tamilnadu municipal bodies, at present, are using tailor-made software developed by the Electronic Corporation of India – Hyderabad. This software needs various improvements. It should be made more user friendly and should have open environment technology. It should provide varied outputs useful for financial analysis and performance even beyond stipulated accounting formats. If Tamilnadu accepts suggestion of introducing fund-based accounting system then the software should be updated to accommodate this feature. Similarly it should take care of matrix structure of budgeting and accounting as suggested above. It should be web-enabled so that direct connectivity can be created between various state level supervising agencies like Dept. of Urban Development of GoTN, Director of Municipal Administration, TNUDF etc and a municipal body. In short, the software tailor-made for municipal body should not be limited to the accounting system. It must serve its budgeting, financial analysis and financial reporting needs. Over and above it should be even more user friendly in taking into account human resources of municipal bodies.

Continuous Sustainability and Updating of the System

In last four years or so, each and every concerned person or organization has contributed towards the successful implementation of the Tamilnadu accounting reforms. It is necessary now to sustain this commitment and sincerity of all concerned by creating a platform for exchange and dissemination of knowledge and experience and also by providing refresher training, financial incentives, vertical and horizontal motivation etc. Rationalization of staff structure, change in recruitment rules and job specification etc., will be quite useful.

Karnataka

The Karnataka municipal accounting reform experiment going on in two municipal bodies – Bangalore and Tumkur is nearing completion. Therefore it is difficult to give suggestions for improvement at this point of time. Still, the following aspects need attention of the GoK and concerned agencies (KUIDFC) to make these accounting reforms sustainable and broad based

State-wide Implementation

The Karnataka experiment in one way resembles the Gujarat experiment, in the sense that it is confined to one or two municipal bodies in an individualistic way. Of course it is conceptually much improved and it is more technology savvy. It is also

backed by people's participation as well as political leadership. It is now high time that GOK formulates an appropriate policy and an implementation plan to introduce accounting reforms in all the municipal bodies of Karnataka. If this is not done then it is feared that Karnataka will go the Gujarat way. As we know, after initiating accounting reforms a decade ago in six municipal corporations, Gujarat has failed to replicate accounting reforms in a single additional municipal body. The accounting reforms/experiments in Bangalore and Tumkur have proved the point beyond doubt, and concerned people have gained enough experience about all the aspects of implementing accounting reforms in the municipal environment. What is now required is state-wide implementation or replication of municipal accounting reforms.

GOK should now follow the Tamilnadu experiment as far as implementation methodology is concerned. It should draft a common municipal accounting code and accounting system model to be implemented in all the municipal bodies. The Tumkur model can be applied in most of the municipal bodies of Karnataka with some modifications. The Bangalore model is complex, extra sophisticated and over specific (tailor-made) as it was prepared to take care of unique requirements of Bangalore Municipal Corporation. GoK may simplify the Bangalore model and may use it for bigger municipal corporations.

Government Support

A policy decision, implementation plan and setting up of other aspects like nodal agency, core team, consultants will not be sufficient, if it is not backed by strong, active and demanding support. GOK will have to make it clear by its decisions and actions to all the parties, concerned that implementation of accounting reforms must be carried out and that too within the time limit and the manner it prescribes.

Simplify Operational Aspects of New Accounting Model

The present form of Bangalore or Tumkur accounting system has become quite complex and high tech. As mentioned earlier, while designing FBAS for Bangalore and Tumkur, an attempt has been made not to disturb the existing cumbersome illogical accounting and administrative procedures and practices to avoid problems of inertia. Such a strategy may be termed right so as to achieve targeted results against the odds in demonstration or case study City. The objective of accounting reforms is not only to convert the system from single entry to double entry but also to take the opportunity to improve archaic illogical accounting & other administrative procedures. If GOK wishes to apply this model on a mass basis throughout the state then a fresh view of it should be taken to make it simple and free of old accounting and administrative procedures.

Make it Cost Effective

The accounting reforms experiments going on in Bangalore and Tumkur have become possible initially due to ADBIA and later on Bangalore Agenda Task Force T.A. The amount of resources committed is on higher side. For its mass application, the municipal accounting reform model will have to be cost effective and economical. GoK should also finalize the financing plan for implementation of accounting reforms in all the municipal bodies.

These were certain state-wise suggestions to improve their on-going municipal accounting reform efforts and also to the other states and municipal bodies who will be attempting accounting reforms in future. For example, recently Maharashtra State has also initiated the process of municipal accounting reforms under USAID T.A. A.F. Ferguson and company have been appointed as the implementing consulting agency. There are individual cities like Indore; Mirzapur, which have attempted accounting, reforms on their own. It is hoped they will also be benefited by these case studies.

Rajasthan

The suggestions offered are in two sets, the first set of suggestions is regarding on-going accounting reforms in Jaipur Municipal Corporation (JMC). The other set of suggestions is regarding how the Government of Rajasthan can help on-going JMC reforms and replicates these accounting reforms in other municipal bodies of the state. The specific suggestions to improve on-going accounting reforms exercise in JMC are as follows –

Carry out Pending TCS Recommendations about Accounting Reforms

Before JMC moves ahead with the implementation of various suggestions made in this report, first of all it should complete the tasks, which TCS report has identified under “Way Forward” section of its report. Almost all of them are still pending and must be carried out as early as possible, so that one logical stage will come to an end.

Role of Top Management of JMC

There is passive support of JMC’s top management to the accounting reform efforts but only support is not sufficient. Accounting reform is one of the major reforms, which cut cross all the departments, and sections of the organisations. Consequently accounting reforms in order to become successful needs to involve the entire organisation. Top management’s overt and openly pronounced commitment to reforms, necessary administrative orders and review of implementation efforts at regular intervals etc, are important steps which must be undertaken to make proposed accounting reforms successful. Such an active support is lacking at present in JMC. The top management of JMC will have to take keen interest in the implementation of accounting reforms. It will have to remove administrative stumbling blocks coming in the way of reforms and last but not least it will have to make it clear to all the people of JMC that accounting reforms are going to stay forever.

An opinion Building Exercise

It is very necessary that other officers and key functionaries of JMC should know about the on going accounting reforms of JMC, their relevance and what is expected of them to make these reforms successful. The accounting reforms should become an activity of the whole organisation (JMC). To achieve this purpose suitable opinion building exercise should be undertaken by the JMC.

Total Involvement of Accounts Department

At present new accounting system exercise is confined to the three-member implementation team. The central accounting department is not involved in the implementation. Each and every person of central accounts department should get accustomed and involved in this process and at the earliest; the central accounts department should take it over its implementation.

Prepare an Accounting Manual

The TCS has given an implementation guideline book, but it is not a complete municipal account code or an accounting manual. JMC should get prepared a detailed municipal account code or an accounting manual based on the theoretical framework and guidelines provided by the TCS, and on the basis of experiences of parallel run.

Revise Chart of Accounts and Chart of Budget

The chart of Accounts and chart of budget are highly unaugmented and at some places even illogical. Both these documents constitute the skeleton or backbone of the accounting and budgeting system respectively. JMC should get both the charts redrafted and should also get them wedlocked to each other to form a matrix chart. Feeding this matrix structure of chart of accounts and budget in the computer software will lay sound foundations for a new accounting system.

Adopt Fund-Based Accounting System

TCS report has provided the fund-based accounting system framework. JMC should adopt it in place of existing consolidated fund accounting system. Applying FBAS JMC should get prepared its accounting manual, the chart of accounts & the chart of budget as mentioned above. JMC should carry out necessary changes in the computer master and operational system of the new accounting system.

Consistency in Application of Accrual Concept

At present certain entries are made on an accrual basis and that too in an inconsistent way. JMC should lay down clearly data entry rules and accounting treatment to the transaction.

Recheck Opening Balances

Recheck opening balances of assets and maintain asset records. JMC has prepared opening balance sheet but the state of historical data and past accounting records was not up to mark. So the provisional opening balances regarding assets should be rechecked. More importantly JMC should start maintaining assets records on a regular and scientific basis.

Data Entry on Basis of Primary Records

Making data-entry on the basis of cashbook (secondary records) must stop. This can be achieved by converting parallel run into full run that is completely switching over to new accounting system. For whatever period JMC continues with

parallel run the data entry should be made on the basis of original receipt challans & payment vouchers.

Strengthen Validation Process

The parallel run lacked appropriate validation process JMC should fine-tune it by putting more staff for this process before it converts itself to new accounting system fully.

Fixed Assets and Other Modules

JMC has tested up till now cash and bank entry module or receipt and payment module only. Other modules pertaining to fixed assets, bank reconciliation, material accounting, depreciation etc have not been fully tested.

The above recommendations about JMC accounting reforms essentially center around or hinge on one thing that is full-fledged commitment by the organisation (JMC and its officers) to implement accounting reforms, which is lacking at present. Once it is ensured, most of the above technical problems, shortcomings can be set right. The positive gain of the Jaipur parallel run is the operational experience and confidence that accounting reforms are possible in municipal environment. This fact should give confidence to GOR to go ahead with accounting reforms in other municipal bodies. Following could be the suggested course of action.

Successful Completion of JMC Accounting Reforms

First of all GOR should see that JMC accounting reforms attain successful completion, by adopting above mention specific suggestions and any other steps which GOR may find necessary during the process.

Constitution of Implementation Team

Simultaneously GOR should constitute a core implementation team made up of experienced officers from its account cadre, municipal officers, external experts and professionals under a suitable nodal agency to implement accounting system reforms in all the municipal bodies of Rajasthan in a step by step manner.

Allocating Necessary Funds

State-wide implementation of municipal accounting reforms will involve sizeable cost, some of which participating municipal bodies will be able to bear but GOR will have to arrange funds for preparation of municipal account code, giving training to concerned people, provision of computer hardware and software to municipal bodies etc. For this GOR may approach international agencies like USAID, DIFD, and UNDP for technical and financial assistance.

Hiring of Professional Help

The core implementation committee should select professional consultant / consulting firm for drafting new municipal account code and for implementation of new accounting system in municipal bodies. The assignment should also include training component.

Implementation in Municipal Body

After selection of professional consultant the next step will be to prepare a model municipal account code based on the review of new municipal accounts code adopted by other states and on the basis of implementation insight gained from the Jaipur accounting reforms. A time bound implementation plan should be prepared to implement municipal accounting reforms throughout the state of Rajasthan. The Tamil Nadu experiment can serve as best model for statewide implementation.

GOR will have to adopt policy of non-transfer regarding the key account officers and subordinate personnel who are involved with the implementation of municipal accounting reforms.

The implementation process should be linked to positive and negative incentives.

GOR will have to decide about computer software for the municipal accounting system. There should be tailor made software made applicable to all municipal bodies, or municipal bodies should be allowed to select any ready-made accounting software.

Along with accounting reforms GOR should carry municipal budgetary reforms. The budget documents of Rajasthan municipal bodies are highly underdeveloped.

For implementation it should follow Tamil Nadu model that was characterised by following characteristics

- Time bound implementation plan.
- Constant review and direction by high-level authority.
- Mandatory implementation
- Well-structured opinion building exercise covering all the exhaustive stakeholders.
- Training with more emphasis on on-the-job training.
- Linking local professional accounting consultant with group of municipal bodies for implementation.
- Implementation linked with positive and negative incentives to municipal bodies.

These were certain state-wise suggestions to improve their on-going municipal accounting reform efforts and also to the other states and municipal bodies who will be attempting accounting reforms in future. For example, recently Maharashtra State has also initiated the process of municipal accounting reforms under USAID T.A. A.F. Ferguson and company have been appointed as the implementing consulting agency. There are individual cities like Indore; Mirzapur, which have attempted accounting, reforms on their own. It is hoped they will also get benefit from these case studies.

Indore

In addition to the significant steps already undertaken by the IMC, the following improvements could also be considered to overcome above mentioned shortcomings or problem areas associated with its accounting reforms.

- A new system for allotting codes to individual accounts that is more structured and user friendly would also generate MIS reports with greater ease. For example, at present, IMC's establishment expenses are allotted account/budget codes in the range 943000 to 943999. Establishment expenditure is a fairly large and heterogeneous category comprising pay, allowances, pension, etc. a better way of allotting account numbers to individual items could be to allot, say, the code '301' to 'pay', '302' to allowances and so on. 'Basic pay' which is a component of 'pay' could then be given the code '30101', 'special pay' would '30102' and so on. Thus, creating the computer software program for summing all 'pay' or all 'allowances' would become simpler. The essential difference is that this method gives us an almost unlimited number of ways in which to analyse account groupings and sub-groupings.
- IMC should detailed out its budget code (cost centers) and more importantly it should integrate its chart of accounts and budget code completely. The accounting software should be modified to have matrix relationship of accounting and budgeting heads/sub-heads/items.
- The accounting software presently being used is a quantum jump over the manual system of account keeping. It has reduced errors, omissions and effort, while at the same time improved the quality and variety of available information. However, the software system cannot generate important financial statements such as the balance sheet and profit-loss statement on a real-time or on-line basis. IMC, with its technical partner is continuously implementing modifications to the accounting system and is already aware of these shortcomings. Accounting software should be upgraded at earliest.
- At present, IMC receives funds from a variety of sources such as its own sources, grants from the Central and State Governments, deposits, advances, loans and borrowings. To introduce greater fiscal discipline, it is prudent to separate these into individual funds and accurately record all movements of resources between these funds. The same should also be reflected in the annual budget and financial statements.
- IMC should adopt fund based accounting system to deal with the problem of heterogeneity of receipts, payments and purposes.
- All the payment bills should be routed through accounts department before sending it to audit department for pre-auditing. Payable entry on accrual basis

should be passed at this time only after verifying budget availability. If budget is not sufficient neither financial sanction nor forwarding of bill to audit should be done. Payment should be released against the each passed bill and not lump-sum amount against the total payable amount to a particular party/contractor.

- Number of existing bank accounts should go down by rationalisation of system.
- Separate accounting system and revolving fund system should be created for giving all sorts of advances and for their adjustments. Advances should be brought under budgetary control.
- The organisation structure of the accounts department and its linkages with other departments should be streamlined and strengthened.
- IMC should develop financial reporting system as per accounting standards and disclosure norms and should start publishing annual accounts in it.

Maharashtra

To ensure sustainability of the municipal accounting reforms following the completion of the piloting phase and to permit scaling-up of the activity on a statewide basis, the following steps are required to be taken by the GOM:

- Mandatory adoption of new accounting manuals: As a first step in adopting the new accounting manuals statewide, GOM's cabinet approved the implementation of accrual based accounting in municipal corporations and municipal councils of the State, and GOM issued a Government Resolution (GR) on September 27, 2000 to that effect. The GOM, however, must make the necessary legal changes, specifically regarding the mandatory adoption of the new accounting manuals by the ULBs.

Since the municipal corporations are set up and governed by the Bombay Provincial Municipal Corporations (BPMC) Act, 1949, which empowers the standing committees of the municipal corporations to decide on the method of accounting to be followed, the GOM shall issue a second GR directing the municipal corporations to adopt the new accounting manual. Consequently, the municipal corporations shall have their standing committees pass a resolution adopting the new manual, which shall become the basis of accounting.

As the Maharashtra Municipal Accounting Code (MMAC), 1971, issued as a part of the rules under the Maharashtra Municipal Council, Nagar Panchayats and Industrial Townships Act (MMCNPITA), 1965, governs the accounting rules and formats of municipal councils, GOM shall issue a Notification to the effect that the new accounts manual shall replace all the existing provisions relating to accounting in the MAMC. However, the provisions for administration and financial management in the MMAC may continue.

- State Level Project Management Unit: A sustainable institutional framework is required, at the state level, for scaling up the activity in all the State's ULBs. In order to achieve this objective, GOM shall initiate steps to set up a

dedicated project management unit, at the DMA's office, on the lines of the Project Management Unit (PMU) of Tamil Nadu Urban Development Project (TNUDP). In addition to the Director of the PMU, one Deputy Director, one financial specialist and one assistant are the minimum full-time positions required for the PMU. GOM should earmark sufficient funds for the PMU and the Steering Committee to provide the necessary guidance and support to it.

- Software Development: Development of accounting software for the new accounting system and training thereon for accounting staff is essential for its implementation and better financial management.
- Consultants: To ensure a smooth changeover to the new system in all the State's ULBs, assistance from an appropriate number of Chartered Accountants firms will be required. Each firm, based on its location and size, should be entrusted to oversee the implementation of the new accounting system in a certain number of ULBs of the State. Periodic review of the performance of the CA's should be done at the ULB and at the State level.
- Training: Training of the key municipal stakeholders constitutes an important aspect of the implementation and sustainability strategy. PMU should undertake this activity in association and support from the Institute of Chartered Accountants of India (ICAI). PMU should organize the orientation and training programs for elected representatives, municipal officials, auditors and chartered accountants. The training module for accountants, auditors and chartered accountants should focus on the details of the implementation of the new accounting manuals and the intricacies of the conversion process from cash based accounting to accrual based accounting system and the audit procedures. NIUA, YASHDA and its training network should be used as venues for conducting the training modules and for developing the content of the training modules and training materials.
- Audit: To improve the discipline in the accounting system and introduce more efficiency in the auditing system, GOM shall issue Notifications under the MMAC and MPMCA to introduce audits of ULBs by independent chartered accountants.

Modern Municipal Financial Accounting System – Way Ahead¹

Professionalisation and modernisation of the municipal accounting system is the need of the hour. The question is how to bring about this change. In the previous pages we have discussed various issues associated with the existing municipal accounting system, and designing improved accounting system for the municipal bodies to ensure accountability, transparency, comparability and to improve financial performance of the municipal bodies. We have also discussed various case studies pertaining to municipal accounting reforms. From all this discussion, one point has become very clear that the road ahead for improved accounting system in municipal

¹ In September 2003 MOUD&PA and C&AG organized 'National Workshop on Municipal Accounting Reforms' which was attended by representatives of all State Governments. An action plan to implement accounting reforms in municipal bodies was drafted and agreed which is presented in the Annexure 2 of the report.

bodies cannot be a linear one. One will have to start efforts simultaneously from all the corners and on all fronts. Also the process of introducing municipal accounting reforms will vary from state to state. Still there are certain lessons, which can be learned from the various experiments of municipal accounting reforms, which have taken place in the last two decades. There are points, which one will have to keep in mind to create a unified system of modern municipal accounting system throughout the India.

Though here we are contemplating a framework for nation wide implementation of modified accrual based fund accounting system for municipal bodies; it cannot be drawn for a single set of municipal bodies. The framework has to address a plethora of municipal bodies having different stages of reforms / development. India has around 4500 urban local governments out of which more than 300 municipal bodies have to manage above 0.1 million population, while 50 municipal bodies have to manage a city with more than 1.0 million population. At present less than 5 per cent urban local governments have undertaken some sort of accounting reforms, the remaining urban local governments will have to undergo accounting reforms due to various compelling external and internal factors during this decade. The point of concern is that if the right kind of framework / policy model is not framed regarding municipal accounting system reforms then these urban local bodies are likely to adopt different kind of accounting models in a sequential manner or in a disjointed manner before reaching the ideal accounting system/model. This will result in wastage of time, energy, and money, which we cannot afford. Also it will result in to non-compatibility of accounting and financial data. India is faced with a dual challenge. It must design an appropriate accounting policies and accounting model which will take care of the nation wide unity, compatibility and homogeneity of accounting policy, system, standards, reporting etc; at the same time India should design an accounting system which possesses enough flexibility to take care of diversity, heterogeneity with which our municipal systems are characterised. In the light of these ground realities the following framework is outlined.

Role of Central Government

The Government of India will have to play a role of an able navigator taking diverse agencies towards unified nation-wide municipal accounting system while maintaining identity and diversity at local level. The ministry of urban development, GOI has got prepared a set of accounting policies and standards by bringing together C&AG, ICAI, representatives of state governments, representatives of municipal bodies. The ministry of urban development has recently taken an initiative in this direction by calling a meeting of urban secretaries regarding adoption of C&AG Task Force Report. It is necessary that necessary rationalisation, updation should be carried to C&AG Task Force report by making it open for the review and debate. Then a model municipal accounting manual and account code, which will comprise chart of Accounts, Budget code, system description and operational guidance should be prepared on basis of agreed accounting policies and standards for municipal bodies. GOI should then place this model municipal account code in force with some legal sanction. A state government can adopt it in full or can develop own separate municipal account code but in such circumstances it will have to follow charts of accounts, budget code up to second level of the model municipal account code and all the major accounting policies and standards in totality. This is so because if every

state government goes ahead and formulates its own account and budget codes, accounting policies differently than that may correct the ills of existing accounting system at micro or individual municipal body level or at the most state level but still there will remain the problem of comparable data. State level (accrual based double-entry accounting system) improved account codes will improve accounting system of municipal bodies, but will not solve the problem of non-comparable data, which we all (national government, various research organisations, institutions, individuals) face today.

Earlier such kind of duplication of efforts has taken place. Around 1985 – 1990 when the World Bank provided loans to selected municipal corporations of India; it also provided institutional strengthening funds for accounting reforms. In order to prepare improved accounting system for these selected municipal corporations World Bank appointed different consulting firms for different municipal corporations! The result was obvious, non-compatibility of the accounting systems. A model municipal accounting code (manual) by ministry of urban development (GOI) will serve as a common / linking thread running through the state level municipal accounting codes and will bring about much desired comparability of municipal data.

Government of India should give consideration to modified accrual basis of accounting coupled with fund accounting. (As discussed in this paper to little extent and as practised in U.S.A.) GoI may even consider setting up of Government or Municipal Accounting Standard Board (GASB or MASB). This board should look after for development, standardisation and regulation of municipal accounting system. It should also work for promotion of professionalism in municipal bodies.

Formation of or necessary help to form Association of Municipal Accountants and Auditors of India will create much-desired platform to share experiences and to inculcate professionalism among the municipal accountants and auditors. The municipal Chief Accountants and Auditors of Gujarat have formed such an association way back in 1993. This association is registered under Indian Societies Registration Act and Public Trust Act. This association has remained dormant and limited to Gujarat due to lack of support. It is necessary to revitalise such an association.

The Role of State Governments

It has become very clear from the case study discussion that it is the State Government, which has to play the crucial and leading role if municipal accounting reforms are to come through. The different degree of success between Gujarat and Tamil Nadu experiment has proved this point.

The State Governments should also undertake the task of revising municipal account code (on the lines of Tamil Nadu State Government) using the national level model municipal accounting manual at least up to 2nd level. State Municipal Accounts codes should develop Budget and Account Codes up to third level, that is, group account code or sub-budget heads. The fourth level, that is, accounting ledger or budget items can be provided in the account code but municipal bodies should be allowed to finalise the fourth level coding / classification (accounting ledgers & budget items) structure / items. It must be noted that the state governments should

place modified accrual based double entry account code in place because it only can provide legal mandate and compulsion to municipal bodies to implement improved accounting system. The account code should also provide stipulations regarding the disclosure norms and financial statement (taking into account ICAI guidelines), which are required, by the SEBI & stock exchanges in order to access the capital market.

Putting revised municipal account code in place will not be sufficient. The state governments will have to undertake a massive programme of upgrading accounting systems of municipal bodies. It will have to take initiative to provide adequate institution strengthening (capacity building) services to municipal bodies. Such an initiative will require lot of funds. The lending agencies like World Bank, ADB; HUDCO, L.I.C. etc. should be roped in to share the cost of institutional strengthening. Municipal bodies will have to be motivated to improve through appropriate scheme of positive and negative incentives. For timely implementation of the new accounting system/reforms State Government should adopt following strategies.

- Setting a time frame spanning two to three years for implementation of double entry accounting systems in the ULGs.
- Indicating the incentives for compliance with specified time frames for upgradation and punitive measures on non-achievement.
- Demanding financial statements produced by improved accounting systems at defined periodicity.

Other Concurrent Level Issues

One area that will need special attention is incorporation of budgetary systems and reports in MMFAS. Therefore, it is important to incorporate in the initial stages of implementation plan the reformatting of budgetary statements in consonance with the accounting system and financial statement presentation. Lack of synergy between the two can act as a major hurdle in upgrading the accounting system. Central and State Governments should address this issue while framing model accounting system for the municipal bodies. A municipal body should take care of its operational part.

Although there is widespread agreement about the desirability of development of an Indian GAAP for local governments, there is an equally widespread recognition that this will neither be implemented easily, nor in a few years time. Basic skills of the accounting professionals employed by local governments, record-keeping systems at the local level, on which all financial reporting depends, and several transitional issues about specific principles in the Indian GAAP are some of the issues which need to be addressed. Skills and record keeping systems at the ULG level need to be upgraded. All the levels of Government, ICAI, CA & AG will have jointly address this issue.

The key implementation issue remains as to how an earnest, honest, and basically competent, but typically untrained employee, who prepares a municipality's financial statements can make the transition most effective – from single-entry accounts (incomplete because of past neglect in record-keeping), to a system based on the standard model and emerging Indian GAAP (based on double-entry book-keeping

and the special principles and accounting standards for governments). An appropriate programme of human resource development of municipal bodies will have to be undertaken by the respective state governments.

The most important thing, which should happen at the local municipal level, is change in the perception of all concerned (the elected members, bureaucratic executive head, and the fellow municipal officers) towards accounting functions. For this specially tailored structured opinion building workshops need to be conducted.

Only a change in the perception will not be sufficient, induction of professionally qualified accounting personnel in the municipal bodies will be a must. In order to attract such personnel municipal bodies will have to suitably upgrade organisational status of municipal accountants, auditors. Also, working conditions and recurrent training facilities.

The hardest issues are technical ones, such as valuation of general fixed assets, and fundamental questions of law (like, who actually owns the road or a particular public land, or who is actually liable for the unpaid electricity, bills from the state government's Electricity Board, for the electricity provided to a ULG under previous administration). Clearly, such issues cannot be resolved by accounting, especially by a typical municipal accountant, or even a typical municipal commissioner. At the same time, such issues need to be resolved before most of the Indian local governments fully implement a modern system for governmental financial reporting and accounting conforming to government objectives.

Last but not least important is civic education. Municipal bodies have continued with rudimentary outdated accounting system and without any meaningful financial disclosure because our society at large including NGO's / CBO's or media or interest groups never compelled them for improvement, transparency, accountability. As discussed, at present, neither municipal body present comprehensive annual financial report (CAFR) nor society demands it. For healthy democracy it is necessary that people should come forward for meaningful participation and should press government for accountability, transparency and information in user-friendly manner. For this, higher-level government should hold workshops for NGO's / CBO's, other related organisations, individuals regarding municipal accounting system, information disclosure norms, performance indicators etc.

Accounting Reform's Implementation Plan for a Municipal Body

The process of implementing municipal accounting reforms on a nation or state-wide scale outlined above will take considerable time as it involves various macro level policy and operational issues. They will come through during course of time. Interested municipal bodies should not wait for the introduction of accounting reforms. As our country is very vast and the number of municipal bodies which should undergo accounting reforms are more than 4000 in number from the top that is Central or State Government. It is from this point of sheer volume that it becomes necessary that the capable and enthusiastic municipal bodies should go for accounting reforms on their own. Such an initiative is not now difficult as we have various

successful examples to follow and sufficient experience about implementing accounting reforms in a municipal body. A municipal body can source these experiences and can go for accounting reforms. Such an initiative will complement the efforts of central and state government. Accordingly an action plan based on municipal accounting reforms, which have taken place at various places is outlined below. A municipal body can pursue this action plan while introducing accounting reforms.

A municipal body can go for full fledged consultancy assignment where the consulting agency will be responsible for designing the system, implementation of the system, training, taking inventory of assets and liability, formulation of opening balance sheet and undertaking parallel run. This will of-course involve sizeable cost which an average municipal body cannot afford if no external aid is forthcoming. A municipal body can opt for self-help option in which it utilises in-house capabilities and hires external professional support only for technical advice. This option is now quite feasible as a municipal body can study earlier experiments and literature (including this report), which is increasingly becoming available. The action plan suggested below for accounting reforms is to facilitate the municipal bodies, which adopts self-help approach.

Study Earlier Successful Municipal Accounting Reforms

It will be very worthwhile to study about the municipal accounting reforms initiatives/case studies, which have take place in different parts of India by a municipal body before going for accounting reforms. By far Tamil Nadu experiment for state-wide unified accounting system application, Bangalore (Karnataka) experiment for its FABS concept, holistic design and people's participation and Vadodara (Gujarat) experiment for its self reliant, cost effective, in-house efforts, coupled with application of ready made accounting software, unique fund based accounting design and matrix structure of accounting and budgeting codes, are successful experiments which a municipal body should study before going for accounting reforms.

Resolution for adopting improved accounting system

It is necessary that general council of municipal body formally adopt a resolution regarding introduction of improved accounting system. Usually municipal corporations draw powers from the act itself to decide their accounting system, procedures, policies and formats. Municipal councils do not have such independent powers. For them such a resolution becomes necessary to seek permission from the State Government. Such a resolution should specify a phased program for implementation and may also list the following:

- Identify a key person, either the municipal commissioner or the mayor or any other officer for spearheading the implementation.
- Identify a core group for supervising the implementation exercise.
- Outline strategies to ensure initiation and sustainability of improved accounting system, for example incentive policy for the staff and key personnel involved in this exercise.

- Delegation of administrative powers to undertake decisions measures steps necessary for the implementation of improved accounting system.

Approval from the state government

Municipal corporations are simply required to inform state government about their resolution, while municipal council/municipalities are required to take approval of state government. Accordingly a municipality should obtain necessary approval to introduce accounting reforms. Earlier such an approval would have difficult one but now the state government will grant such an approval readily.

Identify and retain professional support

As a next step municipal body should identify an external expert agency or individual consultant who would design appropriate accounting system and would provide technical guidance during the implementation period.

Conformance with Accounting Period

A municipal body can commence the transformation or implementation of improved accounting system at any point of time, but care should be taken to organise the accounting information in the new accounting system from the beginning of the relevant financial year. This implies that a municipal body may decide to start with the new system at any point of time between financial year (April to March), but they should maintain the accounting records for the whole accounting year period under new system from April to March. A municipal body should time the implementation of new system closer to the starting of the accounting period that is April so that it will have to take care of less accounting works backlog.

Process Mapping

Process mapping means preparation and documentation of existing accounting system using flow chart technique. This is an important stage as this exercise provides information about what is wrong with existing flow of work, documents, and communication. It also provides information about items, which will have undergone a change under new system.

Resolve Accounting Policies and Disclosure Issues

Before proceeding on to prepare a revised accounting system manual a municipal body should resolve various accounting policies and disclosure issues. Especially in this respect the external professional support is essential. Basically under this head a municipal body need to resolve accounting policies about two areas

- Valuation of fixed assets
- Determination of liabilities

Application of most of the accounting standards issued by ICAI is possible in case of municipal bodies; some standards pertaining to asset valuation and depreciation will need more clarifications about their application to municipal bodies.

Accordingly a municipal body with the help of external professional help should finalise documents regarding various accounting policies to be adopted. It may circulate it to various experts, government departments, especially to A.G. and Local Fund Audit etc., and to the ICAI for their comments. The process of finalisation of accounting policy document may take some time; meanwhile a municipal body should not halt the implementation process and should go ahead with the preparation of accounting manual.

Accounting Manual

The preparation of accounting manual is very important stage of the implementation process. It serves as the foundation on which the entire edifice of improved accounting system is going to stand so utmost care should be taken while preparing it. The accounting manual should be as exhaustive as possible. The manual should be cognisant of various internal processes mapped earlier as part of this exercise, statutory and regulatory environment and stipulations to be complied with, the organisational and budgetary structure and system etc. The accounting manual should ideally content following –

- General overview of the organisation
- Statutory and Regulatory Stipulations to be adhered
- The Accounting Policies and Disclosure norms
- The Chart of Accounts
- The Budget Code and its Conjugality with Accounting Heads/Items
- The System Description
- The Procedures and Processes to be followed
- The Books of Accounts to be maintained and various forms & formats
- The Glossary of Terms

From the above two important contents have been described as follows:

Preparation of Chart of Accounts - Chart of Accounts defines the structure of an accounting system by delineating account heads for capturing transactions in an accounting system. It is essentially a comprehensive list of account heads, which are required for recording accounting transaction of the accounting entity. The Chart of Accounts is not a mere listing, the accounts heads are grouped logically under a tree format of main heads, sub-heads and sub-sub heads. The computerisation of the accounting system greatly depends on the local structuring of the chart of accounts. The Chart of Accounts should be designed with a view to classifying transaction in conformance with the following –

- Accounting System Design
- User Needs
- Legal and Statutory Requirements
- Ensuring true and fair view of accounts.

The accounting heads in Chart of Accounts are classified into five basic categories --

- Revenue – means flow of funds
- Expenditure
- Assets
- Liabilities
- Funds

The Budget Code and Chart of Accounts Conjugality - A Municipal body as an organisation is substantially different from corporate sector organisation. Budget is the source of power, a legal authorization, central operational guide and base of data management as well as reporting. It is therefore necessary that the chart of accounts be synchronised with the budget code by carrying out one to one mapping of budget items and accounting heads. A municipal body should take special care of this aspect to avoid the situation wherein two sets of database (one accounting and another as per budget) are required to be maintained on conversion to accrual base double entry accounting system. Vadodara Municipal Corporation (Gujarat State) has developed very good matrix of budget and accounting code; a municipal body can source that while framing its accounting manual.

Computerisation of the Proposed Accounting System

Right from the inception municipal body should go for computerisation of the new system. The introduction of accrual base double entry accounting system gets immensely benefited if it is aided by the application of computer technology. A proactive decision to go for computerised accounting system not only smoothens the implementation but it also avoids duplication of efforts. Now days-readymade user-friendly accounting softwares are available. Such software programmes are very economical if compared to the expenditure of developing tailor-made accounting software. Individual municipal body should not go for tailor-made software for implementing its accounting reforms. Accordingly a municipal body should select suitable accounting software available in the market at the inception of accounting reforms and then should design its accounting system, manual in accordance with the software selected. Advise of external professional support will be quite useful to finalise accounting software. Vadodara (Gujarat) and Mirzapur(Uttar Pradesh) have convincingly demonstrated that accounting system of a municipal body can be converted into computerised accrual base double entry accounting system at least possible cost by selecting readymade accounting software.

Setting of Opening Balances of Assets and Liabilities

One of the important steps in the implementation of accrual base double entry accounting system is formulation of opening balance sheet. For preparation of opening balance sheet, an inventory of various assets (fixed as well as current) possessed by the municipal body on a particular date need to be made. Similarly the liabilities on account of various activities need to be calculated. If municipal body has funds then unspent balances of the funds amount to be liability, so these balances need to be accounted as liability. The difference between the value of assets and liabilities will constitute equity of the municipal body. The preparation of inventory of the liabilities does not pose much of the problem as most of the municipal bodies

traditionally have their liability data more or less accurate and available. It is the inventory of the assets and later on their valuation applying accounting norms, which pose the greatest challenge for a municipal body. This exercise can be done in-house if opinion building exercise creates enough support among the other officers and departments for the accounting reforms. In Tamil Nadu as other officers, especially engineering wing and land and estate officers, got committed to the accounting reforms, the process of assets inventory become very smooth and timely. External professional support come very handy for doing inventory of assets as observed in case of Bangalore, Ludhiana and Indore. As mentioned earlier valuation of assets as per accounting standards is a contentious issue but there is no harm to get them valued as per prescribed accounting standards from the external professional support.

Training Programmes and Workshops

Training constitutes the backbone of any system reforms. Given the present capacities and capabilities of municipal human resources, training becomes the crucial precondition. The training programmes should cover not only the staff of the accounts department of a municipal body but it should cover all the people who in one or another way are connected with the accounting system and procedure. The training programmes should be structured as per the training needs of the trainees.

Opinion Building Exercise

Changing the accounting system is a very serious intervention in the life of any organisation, as accounting system cut across all the aspects of organisation. It impacts not only people directly associated with accounting system but almost all the people of the organisation and to some extent outside people dealing with the organisation. Moreover a municipal body is a political body having elected element in its management. The normal organisational communication, training programmes etc., cannot manage such kind of change. A well structured opinion building exercise explaining various aspects of accounting reforms need to be conducted. Such an exercise not only should familiarise these groups about the benefits of the reforms but also should acquaint them with the outputs, which the improved system, can generate. It should also encourage them to use these outputs.

Set Up Books of Accounts

The type of books required as spelled out in the accounting manual should be set up and on going training exercise should provide on job training to concerned people about their maintenance.

Parallel Run

Once accounting manual and various books of accounts are put into place and necessary training has been provided to the workforce a municipal body should start parallel run with or without preparation of opening balance sheet. Without undertaking a parallel run a municipal body should not directly switch over to the new accounting system. Parallel run means maintaining books of account under both the systems that is cash based single entry as well as accrual base double entry and comparing results of both the systems. The parallel run is an acid test of the new

system. It serves as the best on the job training exercise. It can be of a longer period, but in any case it should not be of less than three months.

Revisions and Refining of System Design & Work-Flows

The parallel run provides extremely important information about the revisions and refinements, which should be carried out to the new accounting system. Moreover it also provides information about the changes, which should be carried out to the organisational structure and work/information flow linkages between various departments. With the help of external professional support a municipal body should carry out revisions and refinements to the new accounting system as well as to other non-accounting systems of the organisation.

Full Implementation or Switching Over to New System

After successful completion of the parallel run and refinement of the new system and associated workflow, a municipal body should switch over to the new system completely. Even though full implementation or conversion is achieved successfully it should retain external professional support at least for one-year of-course under revised agreement. Also the municipal body should not dismantle the core team or special task force created to implement the new system for the same period. Such a measure will help in nurturing the infancy stage of new system.

Post Switching over New System Problems/Issues

Even if enough care is taken there arise certain problems after successful implementation of new system. A municipal body should address them immediately, so that they do not lead to the breaking down of the new system.

Beside such exigencies, certain reforms or issues required to be or can be undertaken only after the successful conversion of the accounting system from single to double entry. They are as follows –

- Reforming Budgetary System
- Performance Based Auditing (Efficiency Auditing)
- Cost Accounting and Auditing
- Financial Analysis and Reporting System

Thus successful conversion or full implementation of the accrual base double entry accounting system is not an end in itself, but rather a beginning of the process of reforms for a change for the better.

Selected References

A.F. Ferguson & Co. (1991), 'Financial Accounting System for Vadodara Municipal Corporation' Vadodara, August.

Alandur Municipal Body (1999), 'Annual Accounts for the year 1999 – 00', Tamil Nadu.

Amol Datt and Associates (undated), 'FAS for Jamnagar Municipal Corporation, Ahmedabad.

Ambattur Municipal Body (undated), Restructured Budget Document, Tamil Nadu.

Ambattur Municipal Body (2000), 'Annual Accounts for the Year 2000 – 01', Tamil Nadu.

Comptroller and Auditor General of India – New Delhi, 'Report of the Task Force on Accounting and Budget Formats for Urban Local Bodies', (2002)

Corporation of Chennai (1997-98), 'Simplified Accounting Manual', Corporation of Chennai.

Electronics Corporation of India Limited (undated), 'Financial Accounting System For TNULBs – Software User Manual', Hyderabad.

Government of Tamil Nadu (undated), Information Submitted by Ambattur Municipal Body to Second State Finance Commission, Tamil Nadu.

Health and Industries Department (1962), 'Municipal Account Code', Government of Gujarat.

Infrastructure Professional Enterprise (undated), 'Accounting Manual For Ludhiana Municipal Corporation (Draft Report), New Delhi.

Manubhai and Company (undated), 'FAS for Bhavnagar, Ahmedabad.

Ministry of Urban Development (2001), 'A manual to improve The Fiscal And Financial Performance of Municipal Corporation'– A study Commissioned by the Ministry of Urban Development – Narayanan Edadan and Atual Sharma – REALM – New Delhi.

Municipal Administration and Water Supply Department, Government of Tamil Nadu, (undated), 'Accounting Manual For Urban Local Bodies in Tamil Nadu', Government of Tamil Nadu.

NIUA / USAID / TCS (1996), 'Elements of Accounting', October.

ORG (1993), 'Study on Implementation Assistance to Anand Municipality for Accounting and Financial Management System', Baroda, June.

Pacific Islands Training Initiative (undated), 'Governmental Accounting' a Course book, USDA Graduate School.

Price Waterhouse Management (1991), 'FAS for Surat Municipal Corporation', Kolkutta.

S. Chand & Company Ltd (1999), 'Advanced Accounts' by M.C. Shukla, T.S. Grewal, S.C. Gupta, New Delhi.

S.R. Batliboy Consultants Private Limited. (1991), 'FAS for Ahmedabad Municipal Corporation', Bombay, February.

TATA Consultancy Services (undated), 'Modern Government Financial Accounting Framework and Guidelines for Urban Local Governments', a Discussion Paper - prepared Under a technical assistance project of ADB, India.

The Institute of Chartered Accountants of India (2000), 'Technical Guide on Accounting and Financial Reporting by Urban Local Bodies', Accounting Standards Board, New Delhi, October.

TATA Consultancy Services (undated), 'Training Material-Modern Government Financial Accounting System', under LADB TA No. 3209 IND, India.

USAID, FIRE – D Project (1996) 'Accounting and Financial Management System Review – Ahmedabad Municipal Corporation', Charles D. Francis, New Delhi, December.

USAID, FIRE – D Project (1997), 'Accounting case Studies of Baroda Municipal Corporation and the Water Supply and Sewerage Division of Mumbai Municipal Corporation', Jeanine Kleimo, New Delhi, April.

A Critical Review & Analysis of the Report of the C&AG Task Force on Accounting and Budget Formats for ULBs

Introduction

Pursuant to the recommendation of Eleventh Finance Commission, Government of India, Ministry of Finance, Department of Expenditure issued 'guidelines for the utilisation of local bodies grants' in June 2001. In terms of paragraphs 6.5 of these guidelines, the Comptroller & Auditor General of India has to prescribe the format of budget and accounts for Panchayati Raj Institutions and urban Local Bodies. The Honourable Supreme Court of India has also been hearing a Public Interest Litigation (PIL) relating to the functioning of ULBs wherein one of the issues raised was regarding appropriate accounting system for ULBs. Accordingly, C & AG of India constituted a Task Force in February 2002 to evolve appropriate accounting formats for ULBs after taking into account their requirements and expertise of accounts staff available with them. The Task Force on Accounting and Budget Formats for ULBs constituted by C&AG submitted its report on 16th December 2002 in which it has devised model budget formats along with accounting formats and its recommendations about introduction of cost accounting, MIS and Computerization etc. in ULBs.

The Task force was constituted with the following objectives (TOR) –

- To suggest budget and accounting formats drawing out of the positive features of the existing system as well as the commercial system of accounting for which 'Technical Guide on accounting and Financial Reporting of Urban Local Bodies' prepared by the Institute of Chartered Accountants of India will be referred to.
- To suggest format for determining the cost of important utilities and services like water supply etc. to enable the accounting system to focus of managerial issues as well.
- To ensure that the format provide for appropriate codification and classification so that it is possible to network the data on computer for the purpose of comparison and aggregating any information at State and Central levels, as recommended by the Eleventh Finance Commission (Para 8.21) and as mentioned in the Finance Ministry's guidelines (Para 2.2).
- To recommend improving/strengthening the present management information, which may not be an integral part of accounting data but are essential for enhancing the financial health and managerial performance of the ULBs.
- To visit places like Bangalore, Chennai, Mumbai etc. to study the changes being suggested in the existing system of accounting by various consultant to the State Government so as to make a comparative study to draw out the most suitable and easily implementable combination.
- To hold discussions with representatives of any State Governments or Institutes like ICAI, ICWAI, ICRA etc.

Out of the various aspects covered by the Task Force, the accounting policies and the model budget formats suggested by it need reconsideration. Their finalisation and adoption in their present form by the GOI, State Governments, C&AG and ULBs will result into serious problems.

The Drawbacks of Existing Municipal Budgeting System

The C&AG Task force has designed model budget formats to address following three drawbacks of existing municipal budgeting system –

- Defective Structure and Improper Classification of Budget
- Improper distinction between various natures of expenditure
- No Scope for Cost-reduction

Before examining the model budget formats devised by the C&AG Task Force on ULBs, it is necessary to take look at the principals of budget structuring.

Basis of the Budget Structure

While budgets across cities may differ in appearance, volume, structure and content, they need to be based on a common logical structure. A municipal body can choose to prepare separate (multi-budget) or unified (single budget) capital and revenue budgets. Within this overall structure (unified or separate), there can be further classification, namely

Subject-based classification

Object-based classification

Function-based classification

Subject and Object based budget structure

The commercial accounting system of small establishments is based on a system of classifying receipt and expenditure primarily under subject (accounting) heads. For instance receipts may be categorized as ‘sales receipt’, ‘income-accrued but not received’, ‘income on investment’, ‘sale of assets’, whereas expenditure is classified as ‘establishment’, ‘operation and maintenance’, and ‘loan repayment’.

A larger establishment, which has operations spread over various geographical locations or has various products or processes (i.e., cost centres) introduce a further break-up of the subject heads into object-heads. Consequently the formation of the budget is based on the evolution of a matrix of subject and object heads.

Such a matrix may be based on two principles,

- 1) A budget with subject heads as the major category, followed by *sub-subject heads* and finally by *object heads and sub-object heads*.
- 2) A budget classified at first instance under major object heads, followed by sub-object heads (cost centres) and finally by subject heads or sub subject heads.

The key pre-requisite of a logical, well-structured budget is consistency in applying subject or object heads for classifying various types of receipts and payments in a matrix or symbiotic manner. In other words budget is like weaving the design cloth with the help of vertical and horizontal threads of different colours or types. If there is any mistake in use of the vertical and horizontal threads then desired design will not emerge. The absence of conceptual clarity about what forms subject and object heads and the resultant inconsistency in classification results in a hybrid, and illogical budget, which is unfortunately the characteristic of most municipal budgets in our country. Failure to create logical matrix

relationship of subject (accounting) and object (budget) heads has made existing municipal budgets mystical, non-transparent and incomprehensible.

Function based budget structure

It is also possible to structure the budget around the basic functions of a municipal body. This type of structure is a variant of the object based budget structuring. For instance, a municipal body may structure its budget according to its functions like water supply, transport etc. The function-based budget is not a new concept to municipal bodies; it is there right from pre-independence era unfortunately no body is aware of that. Most of the municipal acts provide for separate budget for the transport undertaking of municipal body. Municipal Corporation act in Maharashtra provides for separate budget for Water Supply and Sewerage Service. Also a municipal body may structure its budget according to the geographical dispersion of its activities, such as the formation of zonal budgets in Surat or Divisional budget in Mumbai Municipal Corporation. The municipal bodies implementing concept of ward and circle committees envisaged by 74th Constitutional Amendment will have to incorporate this geographical dimension into their budget structure.

In general, the subject-based budget structure is found to be suitable to commercial for of organizations while the budgets of governments are characterized by a large number of cost-centres/objects for which the most suitable structure is the object-based classification. For any government object (budget or cost centre) wise classification of its receipts and expenditure is more important than the subject (accounting) wise classification utilised by the corporate world. Accordingly throughout the world, budget (object or cost centres) heads form the chart of account or base of accounting in every form of the government.

Structuring Municipal Budget Formats

Budgets can be classified according to a range of factors such as the nature of receipts and expenditure, functions, concepts, time period and contingency, among others. Accordingly, a municipal budget may be classified in a number of ways. The structure of a budget depends on the interplay or dynamics of classification patterns, budgeting techniques, accounting system, size of municipal body. Different types of generic budget structures are possible under different combinations. However all budgets involve a three-dimensional base, i.e., the appropriate incorporation of the logical matrix of object (budget), functional and subject (accounting) heads.

Municipal body is a local government and not a corporate entity. The various purposes, activities, various types of receipt and expenses characterize them. Keeping these peculiarities the way fund based accounting system is most appropriate for municipal bodies, the object based or function based budget structure is equally the most appropriate budget structure for the municipal bodies.

If the municipal government were to continue with the single entry accounting system then the issue of structuring matrix of object and subject heads would not have arisen. Rationalisation of the logic and structure of the existing object head-wise municipal budgeting system would have been sufficient. But as municipal bodies are required to adopt double entry accrual accounting system it became necessary to devise uniform accounting and budgeting system. The constitution of the Task Force on ULBs was the inevitable result of these efforts across the India and need for uniformity of policies, systems and formats.

When a municipal body adopts double entry accrual based accounting system, then it can no longer continue to have budget or object heads as the base of accounting or chart of accounts. Now in order to make its budget coterminous to double entry accounting system (which is based on subject or accounting head based chart of account), if a municipal body transforms its budget to subject (accounting) head based structure then its budget will cease to be a government budget. The object or budget or cost centre wise analysis, monitoring and reporting which is the hallmark of any government system will not be possible. Thus a situation has arisen in which if a municipal body adopts and moulds its budget to new accounting system then its budget loses its governmental character and if its governmental character is to be retained then either municipal body can not adopt double entry accounting system or it will have to maintain two separate data base systems.

There is solution to this problem. An attempt to keep object (budget) head wise structure of municipal budget in tact along-with subject (accounting) head wise structure of double entry accrual system by developing unique matrix of object and subject heads would have facilitated both way information that is object/services/function wise (cost-centre-wise) information from the budget and subject or accounting head wise (Income & Expenditure, Balance Sheet wise) information from accounting system.¹ This would have also served municipal MIS in a better way. Precisely this solution was expected from the model budget formats devised by the C&AG task force. Unfortunately C&AG Task Force adopted uni-dimensional policy for structuring budget code, which is clear from following statement taken from the Para 3.6 of the report.

“Budget heads have been so codified that these can be easily used for corresponding accounting items. As such, the codes provided for budget heads and accounts heads are the same at Major and Minor heads levels.”

Analysing Model Budget Formats Recommended by C&AG Task Force

- The Task Force has gone for multi-budget Subject–Sub-subject head based format. It is termed as subject head based budget format as up to first two levels (main heads & major heads) it is classified by the accounting or subject heads (Figure 1). Not only this even at the minor heads level its overtone is subject or accounting heads. The finalization of detailed heads is left to ULBs, which is a good feature, but illustrative structure should have been provided for the detailed heads.
- Figure 2 depicts budget coding structure and relationship between various heads envisaged by the Task Force budget format. It can be observed from the figure 2 that it is envisaging seven to eight digit budget coding, which can be termed little long. Ideally it should be five to six digits. Further in spite of it is of eight digits, it does not have scope for zonal or circle budgeting (geographical dimension).
- Task Force report has envisaged two types of the budgets - Revenue and Capital. (See figure 3) It has not provided for the third of type of budget for extraordinary receipts and expenses. The receipts and expenses of extraordinary nature for example pertaining to various earmarked funds (sinking fund, pension fund, depreciation), deposits account, employee related liabilities, recovery of loan and advances, realizations of investments etc. have been included in the Capital budget. From accounting point of view it is not wrong but the concepts/words revenue budget and capital budget utilised in public finance

¹ Such kind of matrix relationship between budgeting and accounting system has been successfully implemented by the Vadodara Municipal Corporation since 1998.

theory or budgeting are not equivalent of the words operational account and capital account in the accounting terminology. The term capital budget includes capital receipts resulting from own sources, new loans or contributions or donations, grants, raised, received or transferred in order to carry capital formation or development expenditure of capital nature and not the receipts and payments we may be of assets and liability nature like granting of loans and advance and their recoveries, or deposit or fund receipts and expenses. If municipal bodies adopt this two way or category classification (Revenue & Capital which unfortunately exists in many of the municipal bodies) then like today no one will be able to determine capital expenditure (development expenditure or capital formation) of a municipal body. Any sort of structure one may devise for municipal bodies will have to have third category of extraordinary receipts and payment budgets to make it user-friendly.

Figure 1
Relationship of different Levels of Heads

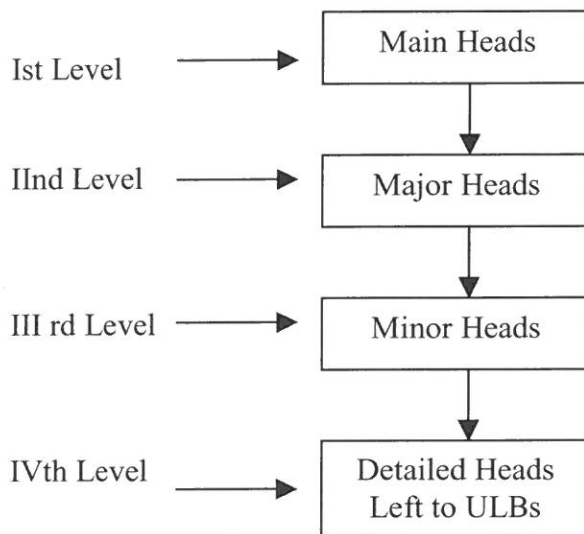


Figure 2
Budget Coding Structure Envisaged In Model Budget Format

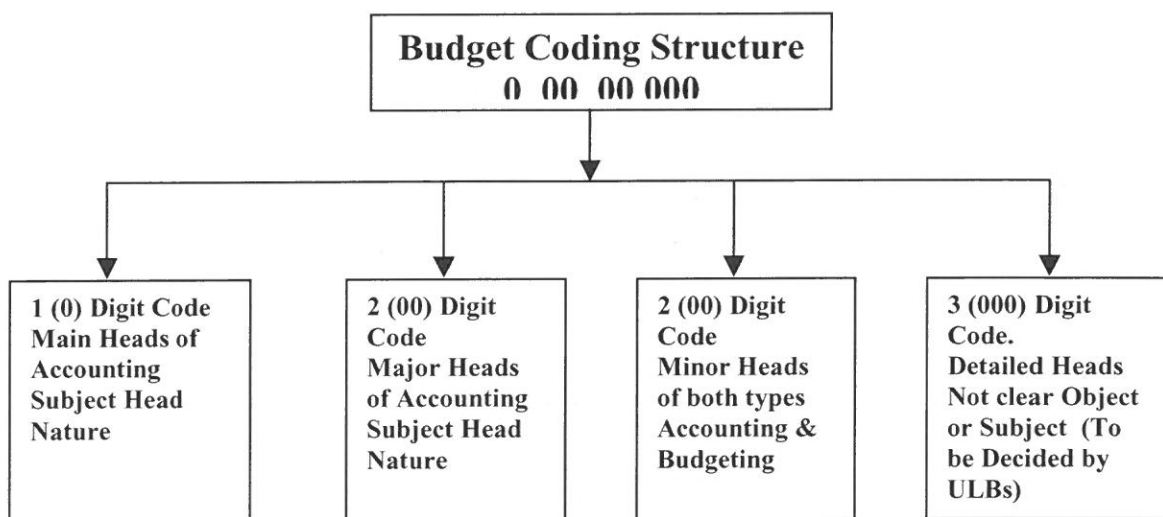
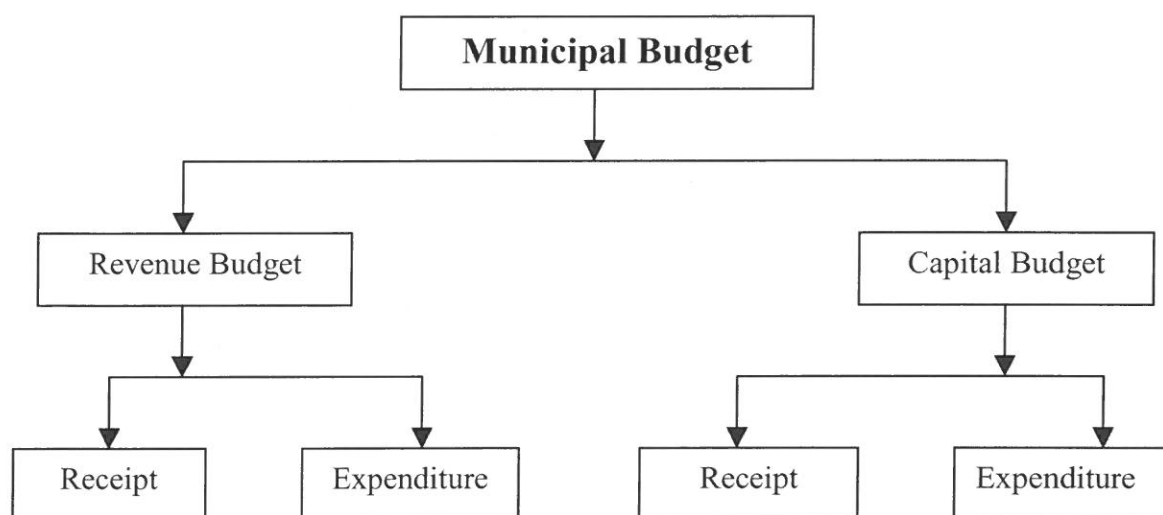


Figure 3
C&AG Task Force On ULBs
Budget Structure Envisaged Under Model Budget Format



- The next level of budget structure is of bifurcating revenue and capital budget into receipt and expenditure parts is obvious and logical. Then we reach to the level of major heads and for that we will have to look at four figures one by one (Figures 4 to 7). It can be observed from the figure 4 that task force has suggested at the moment 9 major heads of revenue receipts. As mentioned earlier these major heads are of accounting nature that is they follow subject head-wise classification and not of object or purpose nature. The list is unnecessarily long in a sense these nine major heads can be group into three classical revenue group heads namely Tax Revenue, Non-tax Revenue and Revenue Grants.

We notice real distortion as move one step further and take a close look at Minor heads pertaining to revenue envisaged by the model budget format. It can be observed from the figure 4 that there is no thematic homogeneity when we compare minor heads under different major heads of revenue. For example major heads like Tax Revenue, Assigned Revenue and Rental Income from Municipal Properties are followed by the subject (accounting) nature minor heads, while other major revenue heads like Fees and User Charges, Sales and Hire Charges are succeeded by the object (budget) nature minor heads. Here minor object heads are in term of various services or departments of municipal bodies but under next major head of Revenue Grants, Contributions and Subsidies the minor heads are of object nature but in terms of Grant Source. Again other two major heads namely Interest Earned and Other Income are followed by mixture of subject and object nature minor heads. Strangely under the major head of Other Income we notice minor head titled Pension and Leave Salary Contribution. It is difficult to understand by which accounting or budgeting standard this minor budget head can have place under revenue receipts. The nomenclature does not make it clear what kind of receipt it is supposed to hold. If it is meant to reflect amount deducted from the salary of an employee or received from other agency then it should form part of the fund maintained for this purpose and not of a revenue receipt.

Similarly we notice serious distortion under a major group entitled Income from Investments. Income from investment is a legitimate revenue income head but why one should have this as a major head when one is going to have another group Interest Earned. The real problem is with the list of minor heads it is suggested to house. It can be observed from the figure that the list includes interest from General Provident Fund or Pension Fund or Gratuity Fund investment. A fund is not merely a separate bank account or budget head but an independent accounting and budgeting entity consequently income from the investments of such earmarked fund not be taken as revenue income of a municipal body. It is at the most revenue income for the fund to which it belongs.

We can conclude discussion of revenue receipt budget format that it includes various items, which does not classify as revenue receipt. Using this format no one will be able to know easily the real total revenue income of a municipal body as one will have to deduct various non-income but receipt nature figures. Similarly it will not be easy to know function-wise or activity wise total income data.

- The examination of revenue expenditure budget format and structure (Figure 5) reveals us same story of breaking down of logic, lack of symbiotic relationship between object and subject heads. It can be observed from the Figure 5 that model budget format has envisaged 10 major heads. Again this list is very long and should have been restricted to five generic major heads of revenue expenditure namely Establishment, Administrative, Repairs and Maintenance, Interest and Financial Charges, Provisions and Transfers. The major heads entitled Programme Expenses and Revenue Grants are illogical or out of place. Once an option of having major heads of accounting or generic subject nature has been selected then there cannot be object heads like programme expenditure or revenue grant expenditure. Any such expenditure should get classified under one or all the above five generic major heads of expenditure. Further revenue grant cannot be expenditure head as nowhere an organisation is required to give account of expenditure against revenue grant received. If it indicates revenue grant given by municipal body to others then it should go under generic accounting head of Transfers.

Coming to the minor revenue expenditure heads one finds maximum intermingling of object and subject nature heads and that too in an illogical way. We can observe from the Figure 5 that first three Major expenditure heads namely Establishment, Administrative and Repairs & Maintenance are bifurcated by 33 minor object heads of functional or departmental nature. Other major heads Programme Expenses, Revenue Grants – Contributions, Transfer of Funds are followed by the minor object heads but of different order. The source-wise object heads follows some while the fund-wise object heads follows others. Rest of the major heads like Interest and Finance Charges, Depreciation, Provisions and Write-off have minor subject head bifurcation.

- Figure 6 shows capital receipt budget structure in graphical forms. Again so many major heads (in all 12) and as discussed earlier most of them belonging to increase or decrease in assets and liabilities rather than capital receipts raised for carrying out municipal infrastructure development or capital expenditure. These major heads are correct from accounting definition of capital account rather than budgeting definition of capital budget. Further these major capital receipt heads are followed by variety of minor object and subject heads. For example Reserves and Surplus and Realization of Investments major heads are bifurcated in the minor object heads comprising various funds while secured and unsecured loans' major heads are bifurcated by minor object heads comprising

various sources of loans. Similarly Grants for Specific Purpose and Deposits Received heads are classified into minor object heads pertaining to sources of grants or deposits received. Minor subject heads succeeds other two major heads Recoveries of Loans and Advances from staff and Sale Proceeds of Assets. Thus it can be observed that there is no homogeneity at the minor level of heads. Using this capital receipts budget format and structure no municipal body will be able to provide data about capital receipt under different activity or functional heads. In other words it will not possible to know how much capital receipt is likely to be received under water supply service from municipal body's own resources or from transfers or from loan source or from grant sources. It will also be not possible to know how much capital receipt was received for a particular service or activity in the past years and from which source to finance capital expenditure of that service. Naturally one will not be able to access how much capital resource were available with a municipal body under different object or services heads to compare it with the actual developmental expenditure to know developmental efficiency or capital absorption capacity of a municipal body. One may claim that it will be possible by going through and summing up detailed heads and by doing permutation and combination of various heads. Yes it may be possible but the budget structure should be such that reasonably educated person should be able to derive this data without doing loads of calculations and cross referencing.

- The model budget format of capital expenditure budget is depicted in the figure 7. It again reveals similar distortions regarding major and minor heads application. In order to avoid duplication those points have not been discussion again. The capital expenditure budget format because of all these structural are classification limitations will not able to provide a municipal body or to a analyst net capital (development) expenditure service, function or cost centre wise. As it involves various items which are of capital nature from accounting point of view but are not capital expenditure from public finance or government point of view at summary level it will give wrong impression about the capital expenditure of a municipal body. The capital expenditure budget format includes many major heads (311 to 321 which are of extraordinary nature and should not have been part of capital budget.

General Comments

The budget formats designed and suggested by C&AG Task Force can be examined in the context of the three drawbacks of existing municipal budgeting system which these formats were suppose to address. as follows.

Defective Structure and Improper Classification of Budget – the entire above discussion clearly indicate that model budget formats envisaged by the C&AG Task Force are structurally defective and classification of various major and minor heads is not proper. The model budget formats and various major & minor heads of revenue and capital nature give an impression that there is no clarity regarding basic concepts of receipt and payment and income and expenditure while devising these budget formats. As a result we find many items of receipt or payment nature in these budget formats which do not result into income or expenditure. When we think of pure receipts and payment statement the entries like return of the cheque and its clearing at second attempt or investing in or encashing funds from bank deposits, or any entry of turnover nature etc can become part of it but such receipts and payment entries cannot be part of Income and Expenditure Statement. Similarly Budget is not a receipt and payment but it is an income and expenditure statement presented in an object or cost centre (budget) wise structure.

Improper distinction between various natures of expenditure – The model budget formats have completely blurred the distinction between various natures of expenditure.

No Scope for Cost Accounting and for Cost-reduction - C&AG Task Force in the chapter 4 (Para 4.2 & 4.3) has rightly observed need for introduction of cost accounting in ULBs for the purpose of cost analysis and cost reduction. It has recommended (Para 4.4) cost sheet for each major activity and has provided specimen of cost sheets for primary schools, water supply and hospital in Annexure F, G, and H to the report. But as the model budget formats lack object-wise budget structure they are not in position to allocate various cost to each object or service or function, it will not be possible to know real full cost for any of the municipal service. Among various things budget should provide cost centre wise data, which is not possible with these model budget formats. Thus C&AG budget formats defeat one of the basic purposes of the budgeting that is cost control and cost reduction. In fact if C&AG Task Force had adopted object based budget structure then there would not have been need for designing of separate system of cost sheets.

There are other drawbacks of Indian municipal budgeting system regarding which Task Force's model budget formats are silent and have not offered any guidelines or solutions. The other drawbacks are as follows –

- **Excessive reliance on the incremental approach** – The trends of the past do form an important reference point for budgetary planning, excessive reliance on the incremental approach poses the danger of being unrealistic and unresponsive to the needs of the city.
- **Absence of physical/performance indicators** - As the model budget formats lack object (cost or budget) head wise structure almost completely, modern budgeting techniques like performance or planning and programme budgeting can not be applied. Similarly physical or performance indicators cannot be developed and measured.
- **In-house services are not charged** - The model budget formats have not provided object or activity wise structure for allocating in-house services charges so it will not be possible to know full cost of any activity easily.
- **Non-allocation of loan charges to respective services** - Similarly it will not be feasible to allocate loan/finance charges to respective services. The result is obvious non-availability of full cost data for each function or service.
- **Budgeting of 'how much' rather than 'how best'** –
- **Absence of proper mechanisms for resource allocation** – The budget is also an instrument for the socio-economic development of the city. Governments should embody their development policies through appropriate resource allocations in the budget. Most ULBs lack a well thought out and efficient system of resource allocation.
- **Excessive Reliance on Deficit Financing** – According to law, all ULBs are required to formulate a budget with a positive closing balance (surplus). ULBs adhere to this provision numerically, that is they inflate revenue projections to match expenditure projections and to have a 'balanced budget'. The result is disastrous since at the end of year the receipts fall short of projections the expenditure resulting in a deficit.
- **Absence of a Subsidiary Budget that provides the detailed computation underlying an budget estimate** –
- **Expenditure is not conditional on resource realization** – In governmental set up the budget being legal the authorisation; the operating departments get a free hand to utilize their allocation irrespective of revenue realized or availability of money.

- **Budgetary lapses and the psychology of spending –**
- **Irrelevance of Revised Budget Estimates –** Urban local statutes provide for the preparation of a revised budget in the budgetary process. Unfortunately its purpose is defeated by the intent to increase budget allocation at this period. In some cases the revised budget is not even discussed within the deliberative wing.
- **Absence of a long-term perspective –** The ULBs should ideally have a long term development plan based on holistic vision, and divided into periodic plans for the long, medium and short terms respectively. The annual budget should be an integral part of such a plan. ULB budgets lack such kind of long-term perspective
- **Absence of Centralized Budgetary Control –**
- **Exclusion of advances from budgetary control -** Taking Advances is an accepted accounting practice and is used across the organizations but in ULBs payments made through advances are excluded from budgetary control unlike other forms of expenditure. The unfortunate absence of such a system allows departments to spend more, intentionally or unintentionally, than what is budgeted for.

Summing Up

The model budget formats are a mirror image of Chart of Accounts. It means we are simply reversing existing situation. As explained earlier in present system Budget heads form the Chart of Accounts (COA) thus negating accounting (subject) head based classification or structure. Under proposed model budget formats as the Chart of Accounts is going to serve as base for budget format, thus completely negating budget or object or cost centre heads based classification or structure along with many other limitations explained above. Thus we will be moving from one kind of one-dimensional, inadequate system to another sort of equally one dimensional, illogical system under the pretext of reforms. If one has to choose from two one-dimensional, inadequate and illogical system then municipal bodies being the third tier of government one should opt for existing object head base budget structure with appropriate modifications.

We need not go backward, as it is not necessary that in order to have one structure you have to loose another one. It is completely possible to design budget structure having symbiotic or matrix relationship and interplay of object and subject heads to achieve benefits of both the worlds that modern accounting and budgeting practices.

\$

Figure - 4
Report of C&AG Task Force on Accounting and Budget for ULBs

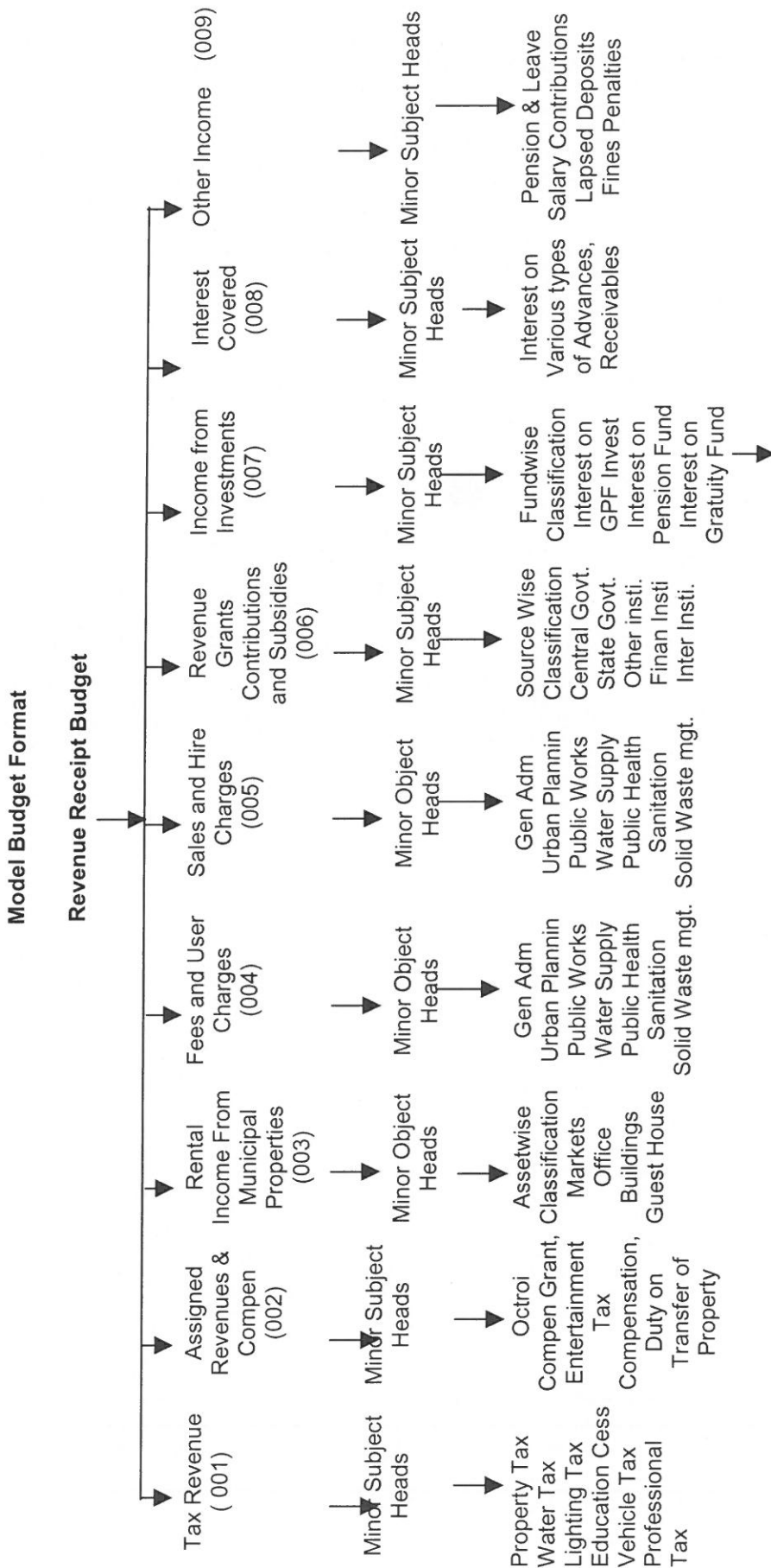
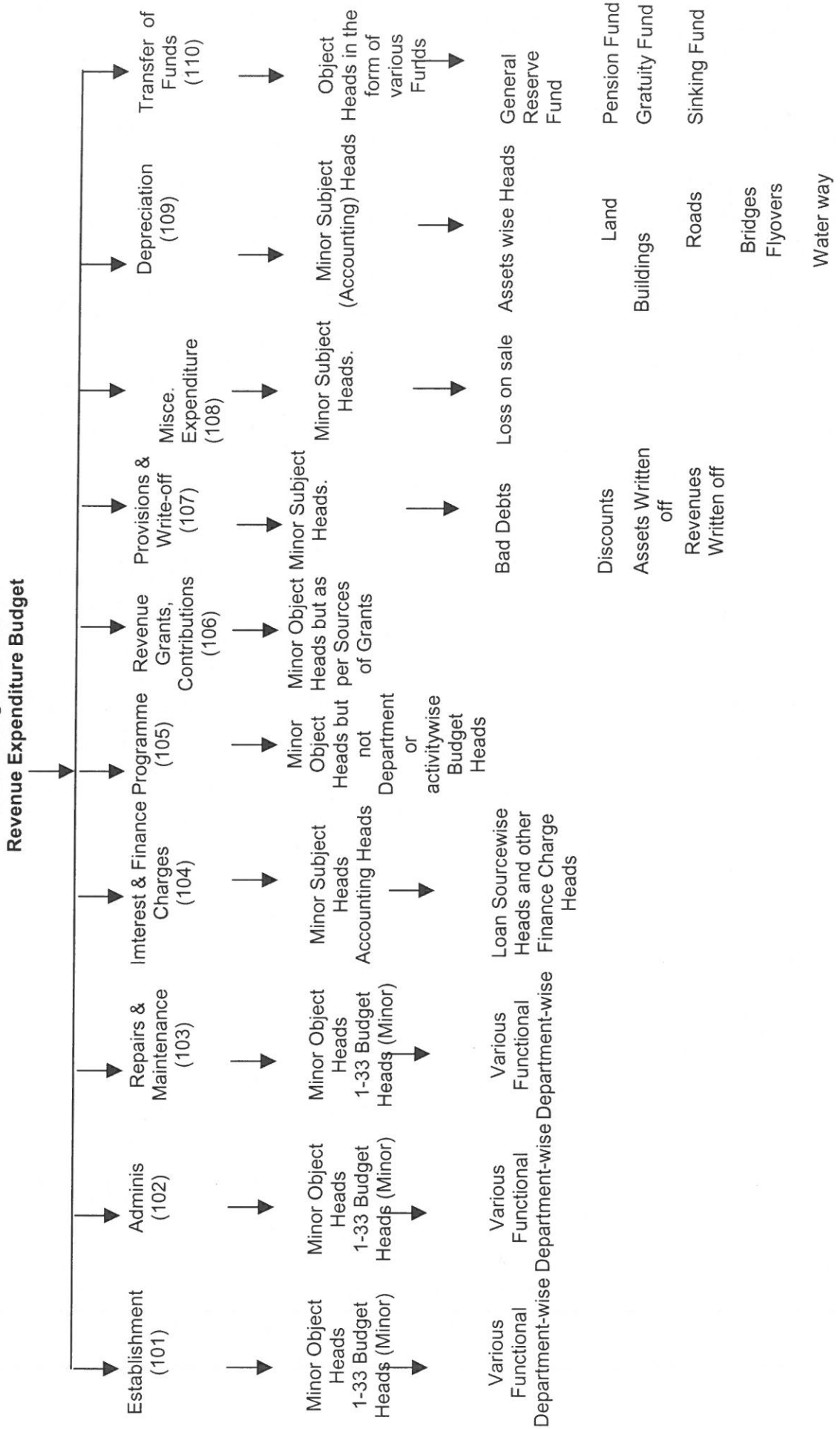


Figure -5
Report of C & AG Task Force on Accounting and Budget Formats for ULBs
Model Budget Format



Recent Development following the Report of the C&AG Task Force on Accounting and Budget Formats for ULBs

Introduction

Pursuant to the recommendation of Eleventh Finance Commission, C & AG of India constituted a Task Force in February 2002 to evolve appropriate accounting formats for ULBs after taking into account their requirements and expertise of accounts staff available with them. The Task Force on Accounting and Budget Formats for ULBs constituted by C&AG submitted its report on 16th December 2002 in which it has devised model budget formats along with accounting formats and its recommendations about introduction of cost accounting, MIS and Computerization etc. in ULBs.

The report of the Task Force was accepted by the Government of India and thereafter forwarded to State Governments in April 2003 for implementation of the accounting and budget formats as prescribed by the Task Force, keeping in view the local requirements.

In this context a 'National Workshop on Municipal Accounting Reforms', was held on September 26,2003 at Hotel Imperial, New Delhi, to review the progress made by the various State Governments in the area of municipal accounting reforms and to finalise a countrywide time bound programme for implementation of accounting reforms and the recommendations of the Task Force on Accounting and Budgeting Formats for Urban Local Bodies, constituted by the C&AG of India.

Based on the recommendations of the C&AG Task Force, an agenda was circulated by the MOUD&PA in advance and the following relevant decisions were taken at the workshop –

Agenda 1 – Policy decision by the State Governments on adoption of the Task Force report on accrual system of accounting by ULB's.

Decision – All the State Government's representatives agree in principle with the recommendations of the Task Force report in adopting accrual system of accounting by ULBs.

Agenda 2 – Constitution of State Level Steering Committees

Decision – All the State Governments agree to constitute State Level Steering Committees. It was also agreed that though the Task Force suggests the composition of these committees, however, the State Government may have different composition, based on their respective requirements.

Agenda 3 – Review of Legislative Framework of State for implementation of recommendations of the Task Force

Decision – All the State Governments agreed to look into their respective State Act/Rules for necessary amendments, in order to incorporate the recommendations of the Task Force. However, there was reservation as to the time allowed for such a review.

Agenda 4 – Development of Accounting Manual

Decision – It was agreed that the C&AG, with USAID FIRE support, would prepare a Model Accounting Manual by February 2004 and its draft should be circulated to the States for comments. The final Model Accounting Manual will be provided to the State Governments and based on the same the State Governments can prepare their respective State specific accounting manuals according to their own requirements.

Agenda 5 – Manpower, Training and Implementation Support

Decision – It was decided that C&AG team will, with USAID FIRE support, prepare a model training module by April 2004, which would be circulated amongst the States. State Governments can use the model training module according to their requirements and prepare state level training modules.

It was emphasized that training of municipal officials is required to be a continuous process and it was agreed that the training modules should be in two phases. The first phase of training may be before the finalisation of State specific accounting manuals and the second phase after the finalisation of such manuals. The training module should also consider the type of training to be imparted to official at different levels. It was also agreed that training-of-trainers is an integral part of training municipal officials and that consultants should also be provided adequate training. The representative of Yashwantrao Chavan Academy of Development Administration (YASHADA) Pune, a state level apex training institute of the Government of Maharashtra, offered his institute's support to the C&AG's office in the development of the model training module and in providing training to the municipal staff.

Agenda 6 – Verification and Valuation of Assets and Liabilities

Decision – It was agreed that the municipal officials should start the process of identifying ULB's assets at the earliest. However, since the asset valuation requires specialised expertise, outside professionals may be appointed by ULBs for the purpose.

Agenda 7 – Parallel run of the old and new accounting system

Decision – It was agreed that the parallel run of old and new accounting systems should continue at least for one year till the new system stabilises.

Agenda 8 – Computerisation of Budget and Accounts

Decision – It was decided for the purpose of uniformity, a uniform software for computerisation of budget and accounts will be developed by the MOUD & PA, which will be given to all the States and the States may on their part make necessary changes in the software according to their requirements.

On the issue of timetable for implementation of accounting reforms, barring some minor suggestions, it was agreed by the participants that the time schedule circulated is achievable by the States.

Steps taken for Timely Development of the Model Accounting Manual

To ensure timely development of the Model Accounting Manual the following steps were taken by the Comptroller and Auditor General of India.

The C&AG of India constituted a committee under the Chairmanship of the Dy. C&AG to monitor and provide directions for the development of the Model Accounting Manual. Further, the committee shall coordinate with the MOUD&PA and State Governments. The committee evaluated the revised Maharashtra Municipal Accounting Manual, which can be the starting point for the development of the Model Accounting Manual.

- The following are the function of the committee
- Appointment of a consultant to develop the Model Accounting Manual
- Provide directions to the consultant on specific technical issues
- Circulate the draft manual to State Governments for their comments
- Authorise/arrange for the consultant's interaction with the State Governments
- Organise a workshop to discuss the issues raised/suggestions made by the State Governments. The participants shall include the Director Municipal Administration of at least five major states, Chief Accountant and Chief Auditors of Municipal Corporations of the at least five States, professionals working in the area of municipal accounting, representatives of ICAI.
- Provide directions to the consultant on issues raised/suggestions made by the State Governments.

Steps taken for Timely Development of the Model Training Module

Training of the key municipal stakeholders constitutes an important aspect of the implementation and sustainability strategy. The training module shall be in two phases; the first phase of training shall focus on the sensitization and orientation of the municipal officials, elected representatives, auditors and chartered accountants before the finalisation of State specific accounting manuals and the second phase after the finalisation of such accounting manuals. The training module for accountants, auditors and chartered accountants shall focus on the details of the implementation of the new accounting manuals and the intricacies of the conversion process from cash based accounting to accrual based accounting system and the audit procedures. NIUA will be used for developing the content of the training modules and training materials and its training network will be used as venues for conducting the training. The training modules shall also consider the type of training to be imparted at different levels and shall also provide training points for the trainers i.e. training of trainers.

For the development of the National Accounting Manual, NIUA has already appointed a consultant who will soon proceed on the development of the manual.