

Accounting System of the Urban Local Bodies— Issues and Challenges

India ranks second in the population after China and contribute nearly 1/6 of the world's population. Since majorly, India is occupied by rural areas, substantial initiatives are required to enhance the economic growth and improve the living standards of its citizens. Urbanisation and digitalisation hold the key to this process. The urbanisation trends in the country indicate that by 2025, more than half of the country's population will be living in cities. Therefore, if urban agglomerations are to play an important role as engines of economic growth, it is imperative that the national and state governments catalyse a program of institutional, fiscal and financial reforms at the Urban Local Body (ULB) level. Read on...



CA. (Dr.) Pinky Agarwal

(The author is a member of the Institute. She can be reached at pinkyagarwalca@gmail.com and eboard@icai.in)

Administrative Structure of India

Indian Constitution follows a three-tier federal structure i.e. Union, State and Local Self- Government. The powers and responsibilities of all the tiers are well defined and they work in a cohesive manner for the urban infrastructural development of India. Local

self-government lies at the third tier of administrative structure of India. Local self-government is responsible to assist in the financial and administrative work of the government and enhance the development of the locality both economically and socially. It serves as an important pillar of the government in the developmental of the country.



Administrative structure of India

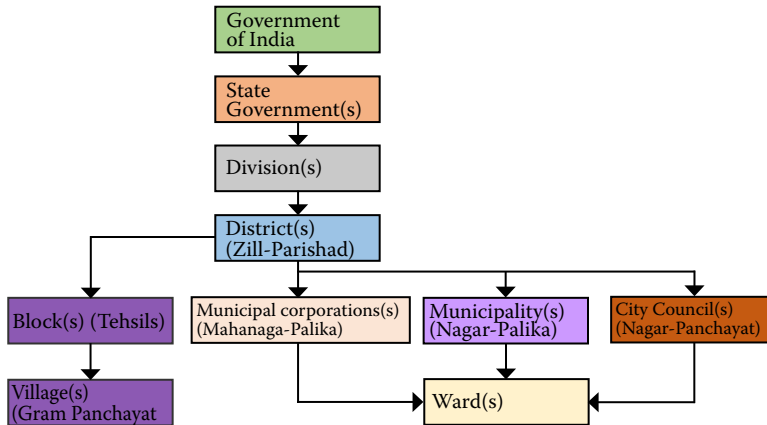


Figure 1: Administrative structure of India¹

Role of Urban Local Bodies

With the introduction of 73rd Constitutional Amendment Act 1992, Local self-government expanded further in rural areas with the name Panchayati Raj Institutions (PRIs) and they were entrusted with the powers and responsibilities for the economic development and social justice of the rural areas. Further, 74th Constitutional Amendment Act with the Article 243Q classified urban areas into three tier structure depending on the population of the area :

to enable them to function as effective institutions of self- government. In totality, eighteen areas of function were covered under the Twelfth Schedule of the Indian Constitution which primarily focussed on to create a democratic, effective, rational, and transparent local governance framework thereby promoting accountability and responsiveness. Overall objective of the Government of India was to strengthen the deliverability functions of the ULBs both economically and socially and ensure active participation of the local people

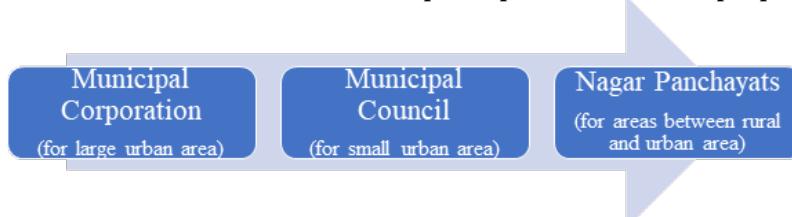


Figure 2 : Three tier structure of the ULBs

All the Urban Local bodies were conferred with such powers and responsibilities

in the governance of these bodies.

These ULBs are expected to play different roles in the economy such as:



Overall objective of the Government of India was to strengthen the deliverability functions of the ULBs both economically and socially and ensure active participation of the local people in the governance of these bodies.

Regulator

- to administer different acts, rules and regulations

Service Provider

- to provide effective and equitable services

Agent

- to ensure Infrastructural development
- to assist the government in delivering and distributing the equitable services to the local masses.

Figure 3: Role of ULBs

The administrative freedom of the local bodies is affected by their finances which are further governed by their tactfulness in raising revenue and the independence in framing budgets. An improved quality of urban services and governance essentially mandates improved decision making by urban managers. It also assists in the efficient use of municipal resources and acts as a benchmark for comparison and evaluation of efficiency in civic services. Traditionally, capital investments in civic infrastructure by cities in

¹ Source: https://en.wikipedia.org/wiki/Municipal_governance_in_India

India are financed through inter-governmental transfers. This does not encourage performance, rather this model of financing urban infrastructure is not sustainable given the fiscal constraints faced by governments at all levels. For ensuring rapid and planned urban growth, urban infrastructure would necessarily require an element of market financing. However, market-based financing demands urban governance to be done on the principle of creditworthiness and financial information as per capital market requirements.

Again, as one of the representatives of the government entities, ULBs have the utmost responsibility to present to its stakeholders the necessary collated data in the form of government reports to many organisation and groups including various other units of the government, government officials, creditors, investors and most importantly, the citizens of the respective country.

Accounting System and Accounting Reforms

Accounting is an integral part of good governance and this can be achieved by providing timely, accurate financial information to the public. Proper accounting information helps in finding out the solution for the following considerations which are fundamental to municipal financial management i.e.

- Valuation of municipal services.
- Adequacy of the revenues to cover the cost of operating public services.

- Improvisation of services without raising taxes and charges.
- Efficient utilisation of assets.

Thus, in order to instil good and better financial management in the ULBs, a robust accrual-based double entry accounting system should be followed. An accrual-based double entry system recognises the occurrence of the transaction irrespective of its receipt/ payment, and factors like reliability, objectivity, relevance, completeness, timeliness, and comparability of the books of accounts and financial statements are fulfilled. It also enables the preparation of annual financial reports as per the prevailing accounting framework and principles i.e. National Municipal Account Manual (NMAM) to disseminate financial information to all the different stakeholders. ICAI has also issued Accounting Standards for Local Bodies (ASLBs) to assist

in the preparation of annual financial reports which are recommendatory in nature at present.

Initially, ULBs were following diverse accounting practises especially cash based single entry accounting system which depicted only the information related to cash inflow and cash outflow. They lack financial transparency, integrity and accountability as required by the International Financial Reporting System. In order to bring transparency and accountability in the financial reporting system, the Government of India is striving hard to convert the cash-based single-entry accounting system into accrual-based double entry accounting system of ULBs by initiating different Accounting Reforms.

The trends of the accounting reforms which were initiated by the joint collaboration of the World Bank and Asian Development Bank can be divided in three phases:

Phases	Period	Accounting Reforms
First phase	1981-1991	Implemented in Mumbai and Chennai but was restricted to only water supply and sewerage system. However, Chennai tried to improve the accounting operations but was not able to get the required result
Second phase	1991-1995	Under the banner of Gujarat Urban Development Project, accounting reforms were introduced in selected municipal local bodies of Gujarat
Third phase	1998 – till present	Several accounting reforms together with computerisation were introduced in Tamil Nadu, Jaipur, Anand (Gujarat), Tumkur (Karnataka), Mirzapur (Uttar Pradesh), Andhra Pradesh, Haryana and so on.



In order to bring transparency and accountability in the financial reporting system, the Government of India is striving hard to convert the cash-based single-entry accounting system into accrual-based double entry accounting system of ULBs by initiating different Accounting Reforms.

Table 1. Phases of Accounting Reforms

The third phase also witnessed one of the major and important accounting reforms i.e. introduction of Accrual based Double Entry Accounting System. The actual era of the accounting Reform started with the Supreme Court judgement *Union of India vs Almitra Patel* () (2001) which directed the Government of India to improvise the financial reporting system by developing guidelines for accrual based accounting system and ULBs were asked to take necessary steps for the conversion of prevailing cash based single entry accounting system to accrual based double entry accounting system. On the recommendation and direction of the Eleventh & Twelfth Finance Commission, the Government of India (Ministry of Housing and

Urban Affairs (MOHUA) earlier known as Ministry of Urban Development) in collaboration with the Comptroller and Auditor General of India (C&AG) appointed a Task Force in 2002 to implement a new system of accounting for ULBs which provides better and transparent financial reports to the stakeholders. The report of the Task Force suggested adoption of accrual basis of accounting and recommended different models and formats for books of accounts and budgets along with the adoption of Management Information System and computerisation in the accounting system of ULBs. On the basis of the report submitted by Task Force, Government of India (GOI) alongwith with C&AG constituted Government Accounting Standards Board (GASAB) through a notification dated 12th August 2002. GASAB prepared a “RoadMap for Accrual Accounting” and developed a detailed operational framework for accrual basis of accounting for both Central and State Government(s) through various accounting standards which were termed as Indian Government Financial Reporting Standards (IGFRS).

1. Government of India in joint collaboration with C&AG, initiated the formulation of National Municipal Accounts Manual (NMAM) to be provided to the State Governments for the development of state-specific Budget and Accounts Manuals according to their specific requirements.

Accordingly, a National Municipal Accounts Manual (NMAM) was prepared under the guidance of C&AG and GOI and was made available to all States in December 2004. The basic aim of NMAM is to improvise the financial management and internal government operations for stimulating good governance. As per NMAM, municipal accounts have to be prepared on accrual-based double entry accounting system and the process results in preparation of the following 4 annual financial statements.

- Income and Expenditure Statement - Balance Sheet,
- Receipt and Payment Account, and
- Cash-flow Statement.

ULBs were asked to prepare an opening balance sheet and prepare different chart of accounts to



GASAB prepared a “RoadMap for Accrual Accounting” and developed a detailed operational framework for accrual basis of accounting for both Central and State Government(s) through various accounting standards which were termed as Indian Government Financial Reporting Standards (IGFRS).

facilitate financial statements in a well-structured and reformed manner. NMAM was later followed by the introduction of the National Municipal Accounts Training Manual (NMATM) and the National Municipal Asset Valuation Methodology Manual (NMAVM).

Apart from the introduction of NMAM, following other initiatives, are also considered to be the most important Accounting Reforms:

Model Municipal Law, 2003 facilitated by Indo-USAID FIRE –D (Financial Institutions Reform and Expansion–Debt and Infrastructure) project in order to assist the state governments in revising municipal legal and administrative framework as per their requirement. The law focussed mainly on :

- a. Improvement in the municipal finances through the recommendations of Sustainable Furnishing councils;
- b. Mandatory framing of ULB debt limitation policy;
- c. Development of a state-wide municipal accounting manual;
- d. Formation of a committee for the preparation accounts of municipalities and the financial statements;
- e. Mandatory requirement for ULBs to prepare an inventory of all municipal assets;
- f. Encouragement for ULBs to implement their own development plans;

- g. Framework for private sector participation in the construction, financing and delivery of services.

The above provisions would have a great impact on Public Finance Management Act and had they been implemented by the municipalities. However, the Model Municipal law was not readily welcomed by the councils and it has not been adopted completely by several states.

The Right to Information Act (RTI), 2005, introduced to ensure transparency in the governance and financial management of the public bodies. It requires government bodies to provide operational information and disclose it publicly in order to maintain transparency and accountability. The RTI Act, though not directly related to Municipal Accounting Reforms, gave much needed impetus to promote transparency and accountability in the working of the Public Bodies.

Jawaharlal Nehru National Urban renewal Mission (JNNURM), 2006 was launched to aid the Urban Local Bodies and the state governments to build proper infrastructural facilities and improvise their capacity building and governance by providing requisite financial assistance. It also aimed at the implementation of the accrual-based double entry accounting system to bring transparency and reliability in the financial reporting system by making

the new accounting system as the mandate condition for the sanction of the grants.

JNNURM was later on replaced by **Atal Mission for Rejuvenation and Urban Transformation (AMRUT)** in 2015. The basic objective of AMRUT is to channelise the activities of ULBs not only towards infrastructural facilities but also on the achievement of Accounting Reforms and capacity building of the ULBs. Besides improvisation of the deliverability of services to the local people, it strives to reduce the cost of the services, augment resources and enhance transparency through digitalisation. It aims at migrating completely to accrual based double entry accounting system with regular audits of the books of accounts by appointing both internal and statutory auditors. Publication of annual financial statement on the government website has been mandated under the AMRUT mission.

Public Disclosure Law (PDL), 2008, aimed at disclosing necessary financial and operational information of the variety of governmental services and generating a uniform and consistent structure of financial statements to the citizens of India. The PDL also set a precedent to the ULBs for maintaining transparency and accountability in the accounting system.

The Fourteenth Finance Commission under the

supervision of MOHUA has also introduced **Performance Grant Scheme** to ensure reliable audited accounts, data of receipts and expenditure and maximisation of revenue by improvisation of the deliverability of services to expediate the implementation process of the Municipal Accounting Reforms,.

In order to formulate a single set of uniform, consistent and high-quality financial reporting standards for Local Bodies, a Technical Guide on Accounting and Financial Reporting by Urban Local Bodies was issued by ICAI for ULBs. A Committee was also constituted by the Council of ICAI known as, Committee on Accounting Standards for Local Bodies (CASLB) in 2005. The primary responsibility of the committee was to develop and formulate Accounting Standard for Local Bodies (ASLBs) and assist the Local Bodies in adoption of the accrual based double entry accounting system. ASLBs are modified to the extent possible in line with the International Public Sector Accounting Standard (IPSAS) after giving due consideration to the conditions prevailing in Local Bodies of India. Later, another committee, Committee on Public Finance and Government Accounting (CPF&GA) was constituted to facilitate the transition process of Accounting Reforms. During the Council year 2019-20, a new committee was formed, Committee on Public

and Government Financial Management (CP&GFM) to carry forward functions of both the erstwhile committees, i.e., CASLB and CPF&GA. The new committee CP&GFM of ICAI strives to assist Central and State Government and Local Bodies in the successful implementation of the accounting reforms and public financial management. The primary objective of the Committee is to formulate Accounting Standards for Local Bodies and capacity building of the Government finance officials through workshops and developing e-learning lectures etc. ICAI has also

formed ICAI Accounting Research Foundation (ICAI ARF). The ICAI ARF has undertaken and completed many projects in the past involving basic and applied research which help in drawing out learning lessons for future similar assignments for the guidance of ICAI members and other stakeholders. Some of such prestigious projects include accounting reforms at Indian Railways, Municipal Corporation of Delhi, Kolkata Municipal Corporation.

ICAI, through its committee has issued following Accounting Standards for Local Bodies so far:

List of Accounting Standards for Local Bodies

Accounting Standards	Title
ASLB 1	Presentation of Financial Statements
ASLB 2	Cash Flow Statements
ASLB 3	Accounting Policies, Changes in Accounting Estimates & Errors
ASLB 4	The Effect of Changes in the Foreign Exchange Rates
ASLB 5	Borrowing costs
ASLB 9	Revenue from Exchange transactions
ASLB 11	Construction contracts
ASLB 12	Inventories
ASLB 13	Leases
ASLB 14	Events after the Reporting Date
ASLB 16	Investment Property
ASLB 17	Property, Plants & Equipment
ASLB 18	Segment Reporting
ASLB 19	Provision, Contingent Liabilities & Contingent Assets
ASLB 20	Related Party Disclosures
ASLB 21	Impairment of Non-Cash Generating Assets
ASLB 23	Revenue from Non-Exchange Transactions (Taxes and Transfer)

ASLB 24	Presentation of Budget Information in Financial Statements
ASLB 31	Intangible Assets
ASLB 32	Service Concession Arrangements : Grantor
ASLB 33	First Time Adoption of Accrual Basis ASLBs
ASLB 34	Separate Financial Statements
ASLB 36	Investment in Associates and Joint Ventures
ASLB 39	Employee Benefits
ASLB 42	Social Benefits
Cash Basis ASLB	Financial Reporting under Cash Basis of Accounting

Table 2. List of Accounting Standards for Local Bodies



The new committee CP&GFM of ICAI strives to assist Central and State Government and Local Bodies in the successful implementation of the accounting reforms and public financial management.

Issues and challenges in the implementation of the new accounting system

But the implementation of the accrual based double entry accounting system in ULBs is not a smooth process and is facing lot of issues and challenges on its path. Though many ULBs have successfully adopted the new accounting system still some Local Bodies are reluctant or struggling to adopt the accrual based double entry accounting system.

A survey of the selected ULBs has highlighted the

following issues and challenges confronted by them in the implementation of the Accrual based Double entry accounting system:

Accounting department and accounting staff

- Non-existence of Accounts department.
- Non-qualified and non-commerce graduate accounting staff.
- Most of the accounting staff are computer illiterate and are not well versed with the basic computer operations. They are trained to operate a tailor made software specially designed for recording only the cash transactions.
- Irregular and non-continuous training for the new accounting system
- Centralised work culture and absence of autonomy in the middle and lower layer

Infrastructural facilities

- Paucity of the continuous and regular electricity

supply and lack of proper arrangement of inverter/ generators

- Dearth of the computer system and limited licensed version of the accounting software.
- Irregular and non-continuous internet facilities
- Improper data backup system

Accounting System

There are several lacunas in the areas of assets and liabilities management. Even there are discrepancies in the disclosure of the income and expenses of the local bodies. The main problem areas are:

Liabilities management

- Lag in recognising outstanding expenses. This results in overdue payables like contractors thereby affecting the creditability of the ULBs.
- Non availability of proper documentation of the loan statements. This leads to misleading information related to interest and principal of the outstanding loan.
- Non-disclosure of the contingent liability

Asset management

- Lack of proper system of recognising Receivables/ arrear income.
- Non-maintenance and irregular updation of the assets register.

- Irregularity in the maintenance of the database of rental properties.
- Absence of a proper record of advance money disbursed for a particular project,
- Recording and maintenance of accounting data in handwritten book wherein the details of only cash receipts and payments are recorded.
- Irregular reconciliation of the bank book with the cash book.
- Improper system of recognising interest accrued on unutilised earmarked funds.
- Absence of a proper system for reconciling the actuals with the budgeted amount.
- Irregular and non-periodic statutory audit of the books of accounts
- Improper and non-systematic reporting system of the status of the ongoing project and unutilised grants for the said project.
- Absence of a proper system of MIS report for the collection and expenditure of the councils.
- Non availability of published financial information/ reports at the local level.

Financial statements and other relevant reports

- Non availability of the requisite data for the timely preparation of the financial statements.

Improper internal control system

- Absence of a proper internal control system

Suggestions to overcome the issues and challenges

In order to overcome the issues and challenges faced by the Urban Local Bodies in the implementation of the new accounting system, the following steps can be adopted

- Complete digital transformation of both the accounting and administrative system. This can be done by
 - setting up of specific digital targets and promoting IT investments
 - redesigning the e-government services as per demand of the end users
 - recruiting skilled staffs especially from IT sector
 - imbibing big data and analytics together with cybersecurity strategies
- Capacity building of the staff by
 - forming a separate municipal cadre of accountants
 - introducing a certification program for ULB accountants
 - imparting regular training of the new system to the existing staffs
- Development of Institutional and Infrastructural arrangements by



- i. appointing a state level body to monitor and supervise the functioning of the accounting system of the ULBs,
- ii. delegating the power at all levels so that responsibility and authority can be entrusted to all the concerned persons involved in accounting and administrative work,
- iii. installing adequate computer systems and updated latest version of the accounting software with continuous internet facility,
- iv. arranging continuous and regular flow of electricity with proper arrangement of inverters, if required,
- v. availing a proper data backup system with special emphasis to Clouds or other digital platforms, and by
- vi. Implementing a proper and effective internal control system.
 - Improvising the data/information collection facility by formulating a proper Management Information System (MIS) with proper communication among the different departments
 - Reporting of unutilised grants to the DMA office at periodic intervals in a prescribed format
 - Embracing a comprehensive accounting



This will augment the profitability of the Local Bodies and ultimately, both the Central and State governments will reap the benefits of the enhanced profitability of the ULBs.

module for the adoption of the new accrual based double entry system of accounting for both recording and finalisation of the books of accounts. In order to facilitate this, the accounting modules should consist of sub modules for fixed assets, current assets, payroll, inventory, liabilities, etc.

- Preparation of both long term and short-term budgets as per the scheduled timeliness fixed by the DMA along with the implementation of a proper system of reconciliation of the actual amount with the budgeted amount periodically.
- Appointment of both statutory and internal auditors for the verification and authentication of the correctness and fairness of the financial statements and ensuring audit within the due date.

Conclusion

A Chartered Accountant can play a very important role

in assisting and executing the above suggestions and recommendations thereby smoothening the implementation process of the new accounting reforms and system initiated by the government. The proper and systematic adoption of the new accounting system and reforms will prove beneficial to both the ULBs and the Government in many ways like:

- Preparation and finalisation of the financial statements and reports as per the prevailing NMAM and ASLBs issued by ICAI
- Timely submission of the financial statements to the DMA office
- Easy accessibility and availability of the latest financial reports in a published form
- In short, it will lead to the path of more accountability and transparency in the Financial Reporting in the Local Bodies and will boost the confidence of the stakeholders. It will also ease the process of exploring alternative avenues of funds especially the possibility of floatation of municipal bonds. This will augment the profitability of the Local Bodies and ultimately, both the Central and State governments will reap the benefits of the enhanced profitability of the ULBs. ■■■