

**CCS Series
on
NURM Reforms
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**MUNICIPAL ACCOUNTING SYSTEM:
*GETTING THE NUMBERS RIGHT***

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Municipal Accounting System

Getting the numbers right

Makarand Bakore¹

JNNURM Reform: Adoption of modern, accrual-based, double-entry system of accounting in Urban Local Bodies / Parastatals.

Accounting is the language of business. Accounting information is important for decision-making. Knowing the financial health of municipal corporations is important to the councillors, the commissioner, the state government and most importantly to the citizens. Information should be both accurate and timely. Borrowing and expenditure decisions can be made once the financial status of the municipalities is known. Many municipalities in the country are devoid of finances and they can raise money from markets by availing themselves of credit rating by a recognised rating agency. Maintaining proper accounts becomes mandatory to obtain credit rating.

CURRENT ACCOUNTING SYSTEM IN INDIA

Many municipalities in India follow the ‘cash-based’, ‘single-entry’ method of accounting.

Cash-based Accounting Systems

In cash-based accounting systems, a transaction is recorded only when there is movement of cash. Revenue is recognised when cash is received and expenses are recognised when payment is made. The information regarding future payments or receivables is not shown.

Revenues earned but not collected during the financial period, as well as expenses incurred but not yet paid, do not get recorded.

As the report of the Twelfth Finance Commission states:²

The cash-based system of accounting provides room for fiscal opportunism, as tax revenues can be collected in excess during a period followed by high incidence of refunds, payments can easily be

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² Report of the Twelfth Finance Commission, Para. 14.14

deferred and passed on to future periods, revenues due in the future could be compromised by providing for one time payments, etc. To quote some other examples, it takes no note of transformation of indebted government agencies into autonomous legal entities outside government through suitable state guarantees, and on the expenditure side, omit existing net liabilities of public enterprises and agencies outside the government, though the latter cannot escape such liabilities.

Single-Entry Bookkeeping

In a single-entry system, every transaction is recorded just once either as an income or expense, an asset or a liability. The system does not record assets, inventory and revenues, except in memorandum form. The advantage of the single-entry method of bookkeeping is that it is simple, easy to understand and requires little training. The disadvantage is that since all the assets and liabilities of the municipal corporation do not get recorded in the single-entry system, the government will never have the right figures to make the decisions. There is no way to check if the entries made are correct or not which may lead to errors or theft.

REFORMING ACCOUNTING SYSTEMS

To mitigate the disadvantages of the cash-based, single-entry system we need to move to an accrual-based, double-entry system.

Accrual-based Accounting Systems

An accrual-based accounting system records credit transactions also. Revenue is recognized for the period that it was realized and expenses incurred are recorded in the same period irrespective of actual cash flow.

Double-Entry Bookkeeping

In double-entry bookkeeping, each transaction is recorded twice. The same amount is credited to one account and debited from another. The advantage of a double-entry system is that common bookkeeping errors are avoided as the total debit has to match the total credit. It gives an accurate picture of the financial status of the organisation for a particular period as it includes dues payable and revenues accrued.

ACCOUNTING SYSTEMS IN INDIA

The accounts of the Central Government are on the single-entry system while the double-entry system is used to maintain the journal, ledger and trial balance sheet. Both Central and state governments use cash-based accounting systems.

Most local governments use the cash-based, single-entry accounting system even after two decades of experimenting. The World Bank initiated accounting reforms in India in the 1980s. In 1981, the Mumbai and Chennai Municipal Corporations initiated reforms. By 2003, less than 125 of the 4400 municipal bodies had attempted to adopt the new accounting system and only a few attained complete success.³

There is a gradual shift to the double-entry accounting system. In November 2001, the Supreme Court directed all municipal bodies to adopt the accrual-based accounting system. The 'National Municipal Accounts Manual' has been prepared by the Ministry of Urban Development and the Comptroller and Auditor General. The manual is a comprehensive guide to all accounting policies and guidelines in order to record municipal finances accurately. Financial reports can be prepared in a systematic and timely manner using the system set out by the manual. This will help in ensuring transparency in municipal finances and provide all stakeholders with reliable information about the finances of the Corporation. It will help in better assessment of the assets and liabilities of the organisation and determination of borrowing needs.

Municipal Corporation of Delhi was the first local body in the country to switch to the accrual-based, double-entry accounting system in 2003. Municipal Corporation of Hyderabad will become the first urban local body to introduce 'Oracle Financials', a sophisticated software application programme for computerising its double-entry accounting system. Bangalore Municipal Corporation has an advanced system of accounting, called the Fund based Accounting System. It uses multiple systems of account to report finances accurately. Municipal Corporation of Greater Mumbai has brought out an outcome-based budget for the year 2006-07. It focuses on the relationship between government resources (finances, personnel, etc) and instruments

³ Joshi, Ravikant. The Myths and Realities of Municipal Accounting Reforms, CRISIL Infrastructure Advisory

(subsidies, legislation, etc) on one hand between outputs, and the final outcome on the other.

STEPS IN IMPLEMENTATION

Adopting an accrual-based double-entry system is an elaborate process that may take upto three to four years. The following needs to be done:

1. Modification of existing laws and rules to introduce double-entry accounting system
2. Appointment of consultants for development of state manual (either based on National Model Accounting Manual or otherwise)
3. Completion and adoption of the manual
4. Personnel Training
5. Business process re-engineering (if required)
6. Valuation of assets and liabilities
7. Production of financial statements (income-expenditure statement and balance sheet)
8. Audit of financial statements

The change will place considerable demand on the lower and middle layers of the accountancy hierarchy. Although some of them have formal education in finance and accounts, majority of them have not been through it. There is an absence of professional accounting personnel in the Indian public sector.⁴

ACCOUNTING REFORMS A MUST

It is evident that the accrual-based double-entry accounting system is more complex than the simple cash-based, single-entry system most urban bodies are used to. The shift to the new system will require more resources and training of personnel. But the fruits of labour will be worth the effort for the organisation, the government, and most importantly, for the citizens.

⁴ Report of the Twelfth Finance Commission, Para. 14.18

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Optional Reforms (Common to state and local bodies)

1. Revision of bye-laws to streamline the approval process for construction of buildings, development of sites, etc
2. Simplification of legal and procedural frameworks for conversion of agricultural land for non-agricultural purposes
3. Introduction of Property Title Certification System in ULBs
4. Earmarking at least 20-25% of developed land in all housing projects (both Public and Private Agencies) for EWS/LIG category with a system of cross subsidization
5. Introduction of computerized process of registration of land and property
6. Revision of bye-laws to make rain water harvesting mandatory in all buildings to come up in future and for adoption of water conservation measures
7. Bye-laws on reuse of recycled water
8. Administrative reforms, i.e., reduction in establishment by bringing out voluntary retirement schemes, non-filling up of posts falling vacant due to retirement etc., and achieving specified milestones in this regard*
9. Structural reforms
10. Encouraging public-private partnership*

The National Urban Renewal Mission (NURM) is a project of the central government. Through this project, the central government will fund 63 cities for developing urban infrastructure and services. The cities will have to carry out mandated reforms in return. The mission will last for a period of seven years starting December 2005. The total central government funding will be Rs. 50,000 crores. Adding the contribution of states and municipalities, the amount will go up to Rs. 1,25,000 crores over the seven year period.

REFORMS UNDER NURM

CCS research papers are available for the starred reforms.

State Level Mandatory Reforms

1. Effective implementation of decentralization initiatives as envisaged in the Constitution (Seventy-fourth) Amendment Act, 1992 *
2. Repeal of Urban Land (Ceiling and Regulation) Act, 1976 *
3. Reform of Rent Control laws, by balancing the interests of landlords and tenants *
4. Rationalisation of stamp duty to bring it down to no more than 5 per cent within seven years
5. Enactment of public disclosure law *
6. Enactment of a community participation law, so as to institutionalise citizens' participation in local decision making *
7. Association of elected municipalities with the city planning function

Municipal Level Mandatory Reforms

1. Adoption of a modern, accrual-based, double entry system of accounting*
2. Introduction of a system of e-governance using IT applications, GIS and MIS for various urban services
3. Reform of property with GIS, and arrangements for its effective implementation so as raise collection efficiency to 85 per cent
4. Levy of reasonable user charges, with the objective that full cost of operation and maintenance is collected within seven years *
5. Internal earmarking of budgets for basic services to the urban poor
6. Provision of basic services to the urban poor, including security of tenure at affordable prices

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