

An Overview of Accounting Reforms in Indian Urban Local Bodies



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ABSTRACT: The Urban Local Bodies (ULBs) are considered as 'Growth Engines' for the development of the Nation. Different models have been adopted by ULBs in the rollout of accounting reforms, including centralized, decentralized, and independent approaches. In the case of ULBs that are independently managing their own accounts without any centralized supervision or monitoring by the department of urban affairs, there can be a risk of losing continuity with the transfer of staff, change in supervisor, etc. As ULBs are independent in their mode of self-governance, the methods adopted by the ULBs are bound to vary. Further, in the absence of a central monitoring body to supervise the accounting reform activities of the ULBs, there is lack of uniformity in the accounting modules being used and also in the reports created. The ultimate result is the absence of an efficient and sustainable effort to improve the financial performance of the ULBs. This leads to the conclusion that there is an urgent need to bring about greater uniformity and standardization in municipal accounting reforms at nationwide.

KEYWORDS: Urban Local Bodies; National Municipal Account Manual; Government Accounting Standards Board; National Municipal Accounts Training Manual; Accounting Standards for Local Bodies

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INTRODUCTION

The concept of Urban Local Bodies (ULBs) in India has a long history dating back to ancient times. In the olden days cities were often governed by councils or committees of local citizens responsible for maintaining order, regulating trade, and providing public services such as water and waste management etc. The British rulers introduced a system of local self-government in India, in which urban areas were governed by elected municipal councils. The first Municipal Corporation in India was established in Madras in 1688. The Indian Government continued the system of local self-government even after independence with some changes. Later, through a 74th Constitutional Amendment, 1992, the Indian Government recognized urban local bodies as a tier of government and provided for their establishment and functioning through laws enacted by the concerned State Governments. Today, urban local bodies in India are responsible for various functions, including planning and development, solid waste management, water supply, and transportation etc. They play a remarkable role in the development and growth of urban areas and in improving the quality of life for citizens.

Accounting System and Accounting Reforms

India is rapidly urbanizing. Over the past few years, urban development in India has received tremendous attention and greater investments than ever before. While cities are increasingly becoming responsible for instigating economic growth for the nation, they often face severe pressure to provide effective and efficient urban services to the increasing urban population. In such a scenario, strong fiscal management at the local level becomes very critical for optimal utilization of the available financial resources. One of the critical aspects of implementing strong fiscal management is the mode of accounting used for transactions

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at the municipal level. It is important to realize that the quality of information with regard to these transactions plays a critical role in enabling decision makers to take acquainted decisions.

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;

- Valuation of municipal services.
- Adequacy of the revenues to cover the cost of operating public services.
- Improvisation of services without raising taxes and charges.
- Effective and efficient utilization of assets.

A large number of urban local bodies still follow the cash based accounting system at the local level, whereas, worldwide the urban local bodies are shifting to "Accrual" based accounting system. Accrual based accounting system by virtue of its comprehensiveness provides a better understanding of finances for any organization. As cities grow to implement mega infrastructure development projects, the accrual accounting system would be more reliable to adopt.

A robust accrual based double entry accounting system should be followed in the urban local bodies. An accrual-based double entry system recognizes the occurrence of the transaction irrespective of its receipts and payments. The factors like reliability, objectivity, relevance, completeness, timeliness, and comparability of the books of accounts and financial statements are to be fulfilled. It also enables the preparation of annual financial reports as per the prevailing accounting framework and principles of National Municipal Account Manual (NMAM). Initially, ULBs were following diversified accounting practices 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 initiated the conversion of Cash Based Single Entry Accounting System into Accrual Based Double Entry Accounting System of ULBs by initiating different Accounting Reforms at the following different phases;

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 computerization were introduced in Tamil Nadu, Jaipur, Anand (Gujarat), Tumkur (Karnataka), Mirzapur (Uttar Pradesh), Andhra Pradesh and Haryana.

The third phase also witnessed one of the major and important accounting reforms for the introduction of Accrual Based Double Entry Accounting System. The actual era of the accounting reforms started with the Supreme Court Judgment in the case of 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 recommendations and directions of the 11th & 12th Finance Commissions, 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 (CAG) of India 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 Computerization in the accounting system of ULBs. On the basis of the report submitted by

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Task Force, Government of India (GOI) along with CAG constituted Government Accounting Standards Board (GASAB) through a notification dated 12th August 2002. The GASAB prepared a “Road Map for Accrual Accounting” and developed a detailed operational framework for accrual basis of accounting for both Central and State Governments through various accounting standards which were termed as Indian Government Financial Reporting Standards (IGFRS).

The 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 Accounting Manuals according to their specific requirements. Accordingly, a National Municipal Accounts Manual (NMAM) was prepared under the guidance of CAG and GOI and was made available to all States in December, 2004. Later, the GOI also introduced the National Municipal Accounts Training Manual (NMATM) and the National Municipal Asset Valuation Methodology Manual (NMAVM).

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 Annual Financial Statements;

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

Along with the above financial statements, the ULBs were asked to prepare an opening balance sheet and different charts of accounts to facilitate financial statements in a well-structured and reformed manner.

Apart from the introduction of NMAM, the 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 focused mainly on:

- Improvement in the municipal finances through the recommendations of Sustainable Furnishing Councils.
- Mandatory framing of ULB Debt Limitation Policy.
- Development of a State-wide Municipal Accounting Manual.
- Formation of a committee for preparation of the accounts and the Financial Statements of the Municipalities.
- Mandatory for ULBs to maintain Inventory Accounts for all Municipal Assets.
- Encouragement for ULBs to implement their own development plans and framework for private sector participation in the construction, financing and delivery of services.

The Right to Information Act (RTI), 2005, was 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, it 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 ULBs 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 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 replaced by **Atal Mission for Rejuvenation and Urban Transformation (AMRUT) in 2015**. The basic objective of AMRUT is to channelize 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 in the delivery of services to the local people, it also strives to reduce the cost of the services, augment resources and enhance transparency through digitalization. It aims at migrating completely to accrual based double entry accounting system with regular audits of books of accounts by appointing both internal and statutory auditors. Publication of Annual Financial Statements 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.

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The Fourteenth Finance Commission under the supervision of Ministry of Housing and Urban Affairs (MOHUA) has also introduced Performance Grant Scheme to ensure reliable audited accounts, data of receipts and expenditure and maximization of revenue to expedite 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, the following Accounting Standards were issued by the Institute of Chartered Accountants of India (ICAI);

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

Issues and Challenges in the Implementation of New Accounting System

The implementation of Accrual Based Double Entry Accounting System in ULBs is not a smooth process. Though many ULBs have successfully adopted the new accounting system still some Local Bodies are reluctant to adopt the Accrual Based Double Entry Accounting System. A survey of selected ULBs has highlighted the following problems faced in the implementation of Accrual Based Double Entry Accounting System by the ULBs;

- 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 tailor made software specially designed for recording the cash transactions only.
- Irregular and non- continuous training on the new accounting system.
- Centralized work culture and absence of autonomy in the middle and lower levels.
- Dearth of the computer system and limited licensed version of the accounting software.
- Improper Data Backup System.

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The absence of a proper internal control system is also a major challenge for implementing the new accounting system.

In order to overcome the various notified issues and challenges faced by the Urban Local Bodies in the implementation of the new accounting system the following measures can be adopted;

- Complete Digital Transformation of both Accounting and Administrative System which can be done by setting up of specific digital targets and promoting IT investments.
- Redesigning E-government services as per the demand of end users.
- Recruiting skilled staff especially from IT sector imbibing data and analytics together with cyber security strategies.

CONCLUSION

The proper and systematic adoption of the new accounting system and reforms will prove beneficial to both the ULBs and the Government in preparation and finalization of the financial statements and reports as per the prevailing NMAM and ASLBs issued by ICAI. The new accounting system and reforms will lead to the path of more Accountability and Transparency in the Financial Reporting in the Local Bodies and will boost the confidence of all the stakeholders. It will also comfort the process of exploring alternative avenues of funds especially the possibility for floatation of Municipal Bonds which will augment the profitability of the Local Bodies. This leads to the conclusion that there is an urgent need to bring about greater uniformity and standardization in Municipal Accounting Reforms at nationwide.

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