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RSMurali is a graduate in Applied Sciences from the Faculty of Engineering, University of Madras. He is a qualified Chartered Accountant, Cost Accountant and Company Secretary. He has also passed the Post Qualification Research Programme of the Institute of Chartered Accountants of India in Corporate Management, having stood ALL INDIA FIRST. His thesis was on Organisational Failures. Subsequently he was invited by London School of Economics, Department of Government, for a research work on "Restructuring of State Level Public Enterprises". He is an alumnus of University of Manchester, UK. He holds Japanese certification in Business Process Reengineering. He also has masters degree in Psychology. He is a Certified Management Consultant CMC of USA.

Murali has over 23 years of experience in the fields of Management Consultancy. He is Principal Consultant for various state governments in India including Tamil Nadu, Karnataka, Andhra Pradesh, Kerala, Orissa, Sikkim and Madhya Pradesh for various projects funded by the World Bank, Swiss Agency for Development and Cooperation, UNDP, ADB, Planning Commission, etc. He has also served as Advisor to Government of Kerala and created Public Sector Restructuring and Internal Audit Board (RIAB).

Murali has extensively done consulting assignments in the area of organizational improvement, finance, setting up of organizational systems including IT systems, process studies, control framework, audit of software, business process reengineering, feasibility studies, etc. He is a vivid trainer and has conducted programmes from students level to the level of senior management. He is also involved in active management research. In the area of Knowledge Management, Murali has been working on since 1999 and has undergone special training in the University of Manchester. He has presented exclusive papers and case studies on Knowledge and Change Management in international conferences.

Murali has published extensively in national and international professional journals in the areas of accounting, finance, audit, MIS and management. He has contributed chapters in two books and two of his booklets were published by National Productivity Council. Murali has published chapters on Arthasasthra in a book on HRD concepts and practices. He has made extensive discussions on Indian approach to management and self management according to Indian thinking which he advocates in all his assignments and discussions.

He is also an active trainer and has trained over 3,500 Government Officials at various levels.

He was a member of the Institute of Chartered Accountants of India's Accounting Standards Board's Committee on Accounting Standards for Local Bodies (CASLB), and has contributed for four accounting standards for Local Bodies.





Implementing Modern Accounting in Municipalities – Key Issues and Role of Chartered Accountants

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1 - GENESIS

Global

Across the globe, the governmental institutions have been following cash based accounting systems. This was due to the fact that these organisations had to simply account for the budgeted amount that was allocated to them. The focus was on “spending” the moneys rather than on “raising” moneys. With reducing allocations from the senior tier in the government and increasing requirements of the urban population, there is need for improved financial management. And “financial management begins where accounting ends” and this meant that the existing accounting system had to be taken a re-look by the policy makers.

Several countries across the globe have moved/are moving into accrual system of accounting based on various benefits of the accrual accounting (discussed elsewhere in this paper) from New Zealand to the Unites States of America. Few countries like New Zealand, Ireland, Botswana, etc. prepare country's balance sheet that is placed to the Parliament.

India

In India consequent to the 74th Amendment to the Constitution of India in 1992, much water has flown in this regard. To summarize on a national basic National Accounting Manual has been prepared and circulated to the State Governments for implementation, Model Municipal Law has been formulated to provide uniformity and to implement the same across the country with modifications for local requirements, under the Mission Mode Project the Government of India is designing e-governance modules for municipalities which incorporates accrual accounting, and the Institute of Chartered Accountants of India (ICAI) has constituted a

Committee under the Accounting Standards Board for formulating Accounting Standards for local bodies.

Some of the States in India have taken these seriously. Tamil Nadu has completely moved to double entry accounting on accrual basis since 2001-02, in Karnataka the Bangalore Corporation moved into accrual accounting since 2002-03 and it publishes its half-yearly accounts in newspapers, other municipalities in Karnataka are moving into accrual accounting in a phased manner. In Andhra Pradesh also the major Corporations have moved into accrual accounting, while the municipalities are in the process of changeover. Apart from this in large Corporations across the country like New Delhi, Kolkatta, Brihan Mumbai, etc. the implementation to modern system of accounting is in various stages. Some of the corporations in the states of Maharashtra, Gujarat, Madya Pradesh, Rajasthan have also taken initiatives in this regard.

It is also to be understood a pure accrual accounting similar to the one followed by the commercial organisations may not be applicable to governmental organisations. This is because the accrual accounting system per se does not take in to account the “social objectives” of governments. Hence while accrual aspects are needed, such a system has to have the capability of handling social objectives, which implies that any new accounting system should have a proper mix of Management Information System (MIS) embedded with it. Hence municipal bodies which are now “local governments”, as per the 74th Amendment Act to the Constitution of India, need to follow such a modern system of accounting that is meaningful and efficient.

With over 4,000 Urban Local Bodies (ULBs) in India, the responsibility of the massive task of migrating



to modern accounting system rests on the shoulders of policy makers, elected representatives, administrators and above all the accounting professionals who have the technical competence to understand and undertake such a massive task across the country.

This paper examines all these issues, and with the help of a case study provides the necessary inputs to the stakeholders concerned to handle such a task that will have a telescopic influence on the future of the country.

2- Why Modern Accounting Systems ?

The basis for consideration of a modern accounting system for local governments arises from the inability of the existing accounting system to cater to the needs of changing macro economic conditions, the transparency/accountability requirement of 74th Constitutional Amendment primarily and the Right to Information Act, 2005, and specially the decision requirements of the government, executives, and the elected representatives. The major reasons for introduction of modern accounting system are (and there could be many more):

- **Complete financial information currently absent:** The cash basis of accounting system followed by the Corporations, do not result in the production of Balance Sheet and Revenue Expenditure Account. These two financial statements provide information respectively about the financial position (strength/weakness) and the operational results (efficiency of day to day operation). The Receipt and Payments Accounts prepared only provide summary of cash receipts and payments, and does not enable any analysis.
 - **Enabling realistic financial information:** The Management of ULB should be in a position to understand where it stands. For instance if the liability on account of engineering works is Rs.22 Crores, the exiting accounting statements will not reveal, as they are maintained on cash basis. Similarly, if water charges receivables are Rs.26 Crores, such receivable information is not revealed by cash system financial statement – Receipt and
- Payment account. Hence a modern accounting system is required.
- **Providing correct planning instrument.** Budget which is the key planning instruments does not include payables. For instance pending bills to contractors (say Rs.20 Crores) is not considered while preparing the budget and the budget of Rs.30 Crores for the current year is used to settle previous years pending bills.
 - **Providing better decision tools:** The modern accounting system will be in a position to generate required reports on a continuous basis. For instance the revenue variance report can assist the management in providing information on the defaulters. This will enable better conduct of meetings with analytical information;
 - **Single data base for all purposes:** One of the major weaknesses in the Local Governments is multiple sources for the same data. Such an information asymmetry not only confuses the decision makers but also increases the inefficiency of the system. Hence an integrated data base using modern accounting system will enable providing reliable information from one data source. Also by linking service delivery parameters to the accounting information the productivity can be measured;
 - **Modern financial statements for resource generation:** Based on the financial statement and the strength of the Corporation innovative funding mechanisms are available in the market today. ULB need not depend on traditional high cost government funds that are delayed and come with extensive conditionalities. Based on the financial statements agencies can rate the performance of the Corporation to enable innovative financing possibilities;
 - **Increased accountability/transparency:** As discussed earlier a budget summary as available today does not provide information about the assets, liabilities, receivables; etc of the Corporation and hence limited information is





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only shared with citizens. Modern accounting system will provide the necessary information that is simple to understand and easy to interpret. This will promote the objectives of the 74th Amendment to the Indian Constitution, which discusses transparency and citizen participation in local governments.

Accounting and Budgeting

The accounting system followed by is similar to that of any government institution – Cash Basis of accounting. The cash basis of accounting has certain basic limitations that have been discussed exhaustively in various platforms across the globe. The system followed by ULB is “cash basis” of accounting as it just accounts for the monies entering and consumed by the system. Moreover, there is no financial statement that summarises all the transactions of the year. In any general commercial accounting system the following three aspects of functioning are easily understood:

- Operations during a period
- Financial position of a period
- The cash generation and utilisation

These are termed ‘Profit and loss account’, ‘Balance sheet’ and ‘Cash flow statement’ respectively for the purposes mentioned above are prepared. In the case of non profit organisations like governmental departments and municipal bodies instead of Profit and loss account, ‘Revenue and expenditure’ account is prepared. This is because in non profit organisations there is no concept of “income” or “profit”.

Basically local bodies are non profit organisations which have certain distinct features different from profit oriented organisations. Some of these features are:

- Receipts of significant amounts of resources from resource providers (government, donors) who do not expect to receive either repayment or economic benefit proportional to resources provided;
- Operating purposes other than to provide goods or services at a profit or profit equivalent (for welfare of the general public);

- Absence of defined ownership interests that can be sold, transferred, or redeemed or that convey entitlement to a share of a residual distribution of resources in the event of liquidation of the organisation. In the case of commercial organisations, the net worth of the organisation gets distributed to the owners in case the organisation is wound up. In the case of local bodies, the net worth is represented by the Fund balance and indicates the financial strength of the local body.

In the erstwhile scenario, as per the legal requirements the Budget is the main financial document along with various subsidiary summaries. But these do not provide the information required for effectively running the organisation, though they give necessary information to the administrative and control authorities. But with the increasing autonomy of the local bodies, as per the 74th Amendment Act to the Constitution of India, they are expected to ensure transparency and accountability, in respect of financial transactions. This can be achieved by introducing a modern accounting system, which can generate the above mentioned three statements.

Gap Analysis – the Accrual Accounting solution

In order to evolve a financial accounting system that is commensurate with the needs of ULB and in accordance with accepted accounting principles, the ‘gaps’ in the current system need to be recognized. This is not only for the purpose of development/ implementation of a new system, but also to understand the impact of such changes on the linkages inherent in any well-entrenched process. The following are some of the major gaps that exist in the system:

- **ULB does not know what it owns (assets):** Though ULB maintains a List/Register of immovable properties, the updated information of the assets owned by ULB need not be incorporated in the financial statements currently used – the Budget document and the annual accounts. This implies that the accounting system



should tie up the updated assets of the ULB in its annual financial statement. *Having a Balance Sheet for ULB only would enable this;*

- **ULB does not know what it owes (liability):** There is no liability accounting by ULB as a system. This is because, there is no accounting record to show that a particular amount needs to be paid by the due date, as accrual accounting is absent. Though register of loans is available, the information from it is not incorporated in the final statement. *This is taken care by the Balance Sheet in the proposed accounting system;*
- **No distinction between capital and revenue:** The Capital (long term items like grant which create fixed assets enable the ULB earn revenue and remain in the ULB for long term) is treated the same way as revenue items (short term items like salary that are used for earning the revenue for that year). Both are shown as consumed in the same year. A very high value asset is shown to have been consumed or expended during the year and this does not show the real picture. In the case of double entry accounting the Balance Sheet shows the value of the asset carried over while the revenue and expenditure account shows the value of the asset consumed during the year by means of depreciation. *In the modern accounting system these issues are scientifically and realistically addressed;*
- **No statement is available where all aspects of ULB's activities are summarized:** In the cash system of accounting, all aspects of long term and long term receivables, payables, assets etc are not tied up in one statement. In double entry accounting the surplus/deficit of the revenue and expenditure accounts is transferred to the balance sheet. *Thus all transactions of a particular year's account are tied up in the financial statements;*
- **Required information cannot be generated quickly:** The current system does not provide for easy generation of reports, as it is not computerized. This results in two problems. One,

the difficult/complicated process of preparation of the reports and secondly, not all offices prepare the required reports. *While in the proposed system, the record maintenance itself makes it convenient for preparation of the required statements. Plus the computerized Accounting enabled MIS makes it possible for the decision makers to look at their reports as and when they want;*

- **The erstwhile system was not in line with any accounting standards, GAAP (Generally Accepted Accounting Principles):** World over, accounting standards and policies are governed by GAAP. These deal with various aspects such as accounting principles, standards, rules, etc. They provide directions for treatment, recording, disclosure and presentation of accounts. The current system does not take in *cognizance* many of these aspects. *The accrual accounting once implemented will take care of the key elements of GAAP.*

Chartered Accountants need to play a key role in this regard. In general there is a feeling the CA community has not understood the governmental accounting from the perspective of governance, and that the approach of CAs has been too much oriented towards the commercial angle. These two issues are true and need to be addressed by the members of the ICAI. There is a need for the ICAI and the chapters to sensitize the government institutions and the local bodies in matters relating to 'complete and correct' accounting from the perspectives of Information, Control, and hence Governance.

3- The Approach

Implementation is the crux of the entire exercise of introduction of modern accounting system. It is not just the introduction, it also means a change in the attitudes and approaches of the persons within the system to understand appreciate and are part of the process. Also the focus should be on making accounting the core function (enterprise approach) from being terminal function (departmental approach).

