

## **Managing accounting reforms in local bodies – Key issues and approaches for Chartered Accountants**

### **Article Summary**

Chartered Accountants have been in the thick of action in the migration to accrual based double entry accounting in local bodies in India. Irrespective of the size of the local body in question, some unique characteristics distinguish such accounting reform projects from others.

This article identifies certain common issues encountered in such assignments and attempts to suggest approaches to avoid such issues or mitigate their impact. The issues identified broadly pertain to the mandate (within the local body) for reforms, training and capacity building, change management and sustainability.

These issues have drawn upon the numerous successful and unsuccessful attempts in introducing accounting reforms in local bodies across the country. The article concludes with a brief checklist for professionals in their capacity as implementation consultants to such reform projects. A run through the checklist can help present many a trouble that can arise during implementation and help in taking corrective steps when such issues arise.

### **Background**

One of the major reforms that are expected to significantly influence the quality of governance in local bodies is the transition from cash based system of accounting to accrual based double entry accounting. Mumbai, Tamil Nadu, Karnataka and Gujarat are the early movers in this regard. Even in these states, the accounting reforms were initially undertaken only in the major cities. The Model Municipal Law (Chapter XII) of 2003, National Municipal Accounting Manual (NMAM) and the JNNURM (which makes modern accounting system one of the prerequisites) are notable milestones in the effort to give these reforms a national character.

The ICAI has also been at the forefront in this regard by forming a Committee for Accounting Standards for Local Bodies that is spearheading the Institute's efforts in this area. The Committee has released a number of accounting standards on the lines of International Public Sector Accounting Standards (IPSAS). It is actively working with the Central and State ministries in conducting awareness and sensitization workshops on municipal accounting across the country.

Every India state has undertaken accounting reforms in its Urban Local Bodies (ULB). There are more than 3,700 urban local bodies in the country. The services of CAs have been utilised for accounting reforms in these ULBs. The Central and State governments have now turned their attention to accounting reforms in rural local bodies (Panchayat Raj Institutions) as well. The Model Panchayat Accounting System prescribed by the C&AG is a significant step in this direction. Once the ball gets rolling, the opportunities for accounting professionals are expected to grow immensely.

For implementing accounting reforms in ULBs, different states have tried different implementation models. One common characteristic among all the approaches is the simultaneous computerization of the accounting system along with migration to accrual based accounting. However, no state can claim that the reforms have been completely successful in terms of the expected benefits. This is because the approaches have failed to completely address all the implementation issues. This article examines certain implementation issues that are likely to come up at the local body level and attempts to suggest approaches to overcome these issues.

### **Sensitisation of the local body staff**

In many reform initiatives, the implementation is generally contracted out to an external consultant. This is good since the local body generally does not have the necessary expertise in-house. However, the mistake made here is that the involvement of the local body staff is deferred until the fag end of the project i.e., when training is taken up.

The staff are expected to run the new system after one round of training. In very few cases, a support arrangement with the external consultant is put in place to ensure smooth functioning. Only during training is when the local body staff get to voice their requirements and operational constraints. The local body finds it very difficult to ensure that these requirements are addressed since most of the concept and design work would have already been completed. It becomes difficult to hold the consultants and/or software vendors accountable and ensure delivery at this stage. There is also a lack of internal ownership in such cases and people try to avoid the system rather than adopt it.

This issue can be addressed by organizing a sensitization programme right at the beginning of the reform project. This programme will bring together all the key stakeholders namely the local body Management, the implementation consultants, the software vendors and most important the local body staff. At this programme, it is important to establish that the initiative

is ON and has the full backing of the local body Management. The broad phases of the reform project also need to be communicated to the stakeholders.

In addition to the sensitization programme, it is important to periodically circulate interim project outputs (chart of accounts, document formats etc.,) amongst the stakeholders and invite comments and suggestions. This will ensure that the reform project has a buy-in at all levels right from day one and there is stakeholder engagement throughout.

While this approach ensures better stakeholder engagement, it might extend the project duration. However, it is important to plan for sensitization at the project planning phase itself.

### **The chart of accounts**

It would not be wrong to state that the chart of accounts is the most important aspect in a transition from single entry cash based accounting to a double entry accrual based one. It is very important to get this right from day one. The chart of accounts drives the formats of most of the documents and reports forming part of the accounting system. It is also a key ingredient for the software requirement specifications. However, in many cases, the chart of accounts is viewed as just another master in the database and the finalization of the chart of accounts is not given due importance. It is an onerous task to revise the chart of accounts midway through the implementation. It not only affects the project timelines but also creates ambiguity for the local body staff.

This issue has been addressed to some extent by the introduction of the NMAM. Based on the NMAM, many states have brought out their own state level manuals that prescribe the chart of accounts. Still, there is a degree of customization required to be built into the chart of accounts at the local body level. This should be done after studying carefully the existing budget formats and annual accounts under the current system to identify the different types of possible transactions. The new chart of accounts should contain appropriate account heads to capture all types of transactions.

Once the chart of accounts is designed, it is important to circulate it among key stakeholders to obtain their comments. The chart of accounts should be suitably modified to incorporate suggestions received. It is important to map the chart of accounts structure to the reporting requirements and tweak it accordingly. This will ensure that the accounting system captures information to the required level of detail and facilitate reporting.

### **Importance of budgeting**

The budget as a document has much more significance in a local body setup than in a corporate setup. The need for development expenditure being very high across India, there is more often than not, a scarcity of financial resources. The budget has a pseudo legal authority in determining and regulating expenditure. The importance of budget is often undermined in the transition to modern accounting system. As a consequence, it is seen that though accrual accounting is established, all decision making is based on the budget that continues to be cash based. In certain other cases, there is a mismatch between the budget structure and the chart of accounts making budgetary comparison and control virtually a nightmare.

Budgeting needs to be seen as an integral part of accounting. The budgeting process and the budget formats need to be looked into and suitably modified to conform to the changes in the accounting system. The fact that in the initial years budgeting will remain cash based and may not be fully ingrained into accrual accounting, needs to be recognized. The budget format, the budget variance analysis and the software specifications must take care of this inconsistency.

Budget affects a larger group outside the local body that includes the elected representatives, the state government and the public. Hence, before bringing in accrual concepts into budgeting, these external agencies need to be sensitized on the meaning of a budget and how to read a budget that has been prepared applying accrual concepts.

### **Hardware and infrastructure**

Another important aspect that often fails to attract the necessary attention in the initial stages is the hardware and infrastructure arrangements. Although a good project plan is supposed to consider these aspects, in practice procurement & installation of hardware and the supporting infrastructure gets postponed until it becomes critical to procure. In many cases, the hardware procured might not be according to specifications. Typical examples would be lack of necessary servers, insufficient power backup arrangements, and low bandwidth connectivity. These bottlenecks could potentially become obstacles to the success of the initiative.

Hardware procurement and infrastructure arrangements should be done under competent guidance. It should not be left to the judgment of the local body staff or the implementation consultant unless he has the necessary competence. It is normal to encounter unexpected delays in procurement in such projects and hence the procurement process must be initiated well in advance.

### **Training**

Proper training is crucial to ensure that the local body staff are able to run the system once the external agents are out of the picture. While every such initiative has a training component, often it is observed that the training is more focused on the software aspects. Accounting reforms entail many changes in the way work is done and it is important to prepare the local body staff for it. Otherwise, they may not accept the new system and try to resist it. Such resistance comes more out of ignorance than intention.

Training should include training on procedural aspects, behavioral and attitudinal training. Training on computer basics to familiarize the staff with computers should precede the technical training. Training requirements must be sufficiently detailed in the Request for Proposals to include all these areas. This will ensure that sufficient time and cost are kept aside for such training. The preliminary training should necessarily be followed up with periodic refresher trainings so that the knowledge gained is retained.

### **Project ownership**

It is often observed that many initiatives fail because the person who started the initiative and championed it gets transferred. Since such reforms are long-term projects, non-continuance of key personnel may prove disastrous for the success of the project. A lot of capacity building and knowledge imparted to such persons also walks away when they get transferred.

It is very important that some key personnel are identified at the beginning of the reform project and they are not moved out until the project reaches a reasonable stage of completion. This may not always be possible in a practical setup. A project management group must be created consisting of local body staff, external consultants and other stakeholders. The project management group will ensure that even when individuals move, the knowledge within the group remains. This will ensure continuity of the project.

### **Support arrangements**

Arrangements for support after the implementation is complete need to be in place to ensure that the system runs smoothly in steady state. Many initiatives fail to sustain because of the lack of capacity within the local body staff to address post implementation issues. For example, when there is a failure of a printer or a network failure, arrangements need to be in place to **ensure that they are addressed immediately.**

Support arrangements need to be planned and budgeted for during the project planning stage itself. These support arrangements may be in the form of handholding for sometime by the implementation consultants, database and system maintenance, infrastructure maintenance etc. These arrangements may be put in place at the state level itself or at the individual local body level depending on the implementation model followed. These arrangements need to be properly documented and service levels monitored for their effectiveness.

### **Audit**

In many states, it is found that although modern accounting systems have been implemented and are running well, the old system continues to run in parallel. This is because in these places while accounting has transitioned, the auditors are yet to migrate to the new system. This not only creates duplication of work but also defeats the very objective of transparency and accountability that the modern accounting system is expected to achieve.

The training part of the project must necessarily include training of auditors. Training must be given on the accounting system, financial statements and audit in a computerized setup. In addition to training, necessary legislative changes must be introduced to ensure that the audit of accounts maintained in the new system happens. The audit manual needs to be thoroughly revised to address aspects of auditing accounts under double entry and auditing in a computerized environment.

### **Sustainability of the new accounting system**

Introduction of the accrual based double entry accounting system is often taken up by the local body as a necessary evil thrust down by the state government than out of a genuine desire to reform. Therefore, many such initiatives fail once the initial momentum is gone. This is because people do not attempt to make use of the new system due to lack of awareness and an inherent resistance to change. Lack of usage of outputs of the new system results in the old system creeping in slowly from the back door. In other cases, the new system is run parallel but for all decision making, the outputs of the old system are relied upon.

The reporting module of the new accounting system assumes a major role in establishing its acceptability amongst the local body Management and staff. Reports should be developed taking into account the actual decision making and operational needs of day-to-day local body administration. People at various levels need to be sensitized on the content of the reports and their usage. Once people develop an inclination to make use of the reports for their day-to-day

information needs, the focus will be on ensuring that the new system runs smoothly and that accurate data is entered. This becomes the key to sustainability of the new accounting system.

### **Preliminary checks**

The impact of most of the issues discussed above can be mitigated if certain preliminary checks are performed at the project planning stage itself. The following checklist must be run through by the person in-charge of the implementation before embarking upon the reform project. The checklist is only indicative and specific checklists need to be developed by the professional suited for the specific scope of work.

1	Is there a clear mandate from the top for implementation of the reforms?
2	If yes, has it been properly documented and communicated to all the players involved?
3	Are the local body staff aware of the project objectives, project outcomes and their role in it at least at a macro level?
4	Is there a project management team in place (working committee, project management cell etc.)?
5	Is there a project governance structure in place with project review mechanism?
6	Does the project plan include clearly defined deliverables for the various stakeholders and project milestones to assess the outcome of the project?
7	Have all the project stakeholders been identified and sensitized about the project and what it means for them?
8	Does the project in-charge have the required mandate and sufficient time and resources at his disposal to undertake the project?
9	Is there a proper hardware procurement plan in place with sufficient lead times built in and does this plan fit into the overall project plan?
10	Is there a proper software development and deployment plan in place and is it consistent with the milestones identified in the overall implementation?
11	Whether in addition to migration of the accounting system, aspects relating to audit under the new system have been considered?
12	Whether suitable post-project support arrangements have been thought of and budgeted for?
13	Whether the project plan carries sufficient provision for unforeseen contingencies?
14	Does the implementation agency have sufficient and experienced manpower to implement reforms of this nature with multiple skills such as subject expertise, domain knowledge, and software knowledge?
15	Is there a proper mechanism for acceptance of the project outputs and definition of who is authorized to accept the same?
16	Whether the proposed training is adequate in terms of coverage, number of rounds and the trainees proposed to be covered?

### **Role of CAs**

The CA community has been actively involved in this local bodies accounting reform process right from the beginning. The Chartered Accountant has been called upon to play multiple roles ranging from conceptualization, implementation, internalization and audit. The technical expertise and skill sets of the CA to undertake such assignments are unquestionable. In addition to accounting knowledge, it is important to build the necessary domain expertise and management skills to execute such reform initiatives successfully. In this article, certain non-technical aspects of the implementation have been discussed. Taking into consideration the issues discussed in this article and planning for the same will go a long way in making the implementation easier.

### **Conclusion**

Accounting reform projects encounter one or more of the issues discussed in this article in varied forms. The approaches suggested herein will have to be adopted based on the actual peculiarities of each implementation. It is important to take these issues into cognizance and formulate approaches to deal with them at the project planning stage itself to avoid surprises later.

The initial implementation exercises in India did not have the benefit of this knowledge and had to address these roadblocks as and when they surfaced. With a number of accounting reform initiatives in local bodies across the country now completed or nearing completion, every project provides insights so that future implementation strategies can be formulated better. There is a need to create a knowledge base of all such initiatives. This knowledge base will act as a valuable resource for subsequent reform initiatives.