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**Lecture – 28**  
**Municipal Accounts**

Welcome to lecture 28 in this lecture we are going to discuss the municipal accounts and its reform. In this week we have been discussing various aspects of municipal finance and possible sources of municipal finance. In this regard you can arrange many sources of finance but as long as the finance is maintained properly in the municipalities you can utilize or you can get maximum benefit of the finance.

But if it is not then you are not going to take the benefit therefore municipal accounting which is a basically a foundation of keeping all the finances and expenditure everything that was under question and that was assessed during last two decades. And I told earlier that in 2000 posts 2000 when a paradigm of reform linked urban developing came in India.

At that time municipal accounting reform was one of the major reform and it came as a mandatory reform. So, today we will just have an overview that what is the accounting system which was there in the beginning and few municipalities they are following that also that is a single entry based accounting system and what is the change or the reform expected and what is the benefit and what are the major concerns.

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# Contents

❖ Municipal Accounting Systems: Background

❖ Overview of Double entry Accounting

❖ NAM

So, let us start with the points like today we are going to discuss the municipal accounting system some of the background then overview of the double entry accounting system and also we will discuss few salient features of national accounting manuals given by the ministry. So, these also were going to demonstrate or show basic provisions. So, as a background I have already told you that in.

During jnnurm accounting reform has been considered as a mandatory reform in the municipalities. And it was given preference or the priority in the municipalities by the government of India and the state government. Basic reason was that if it is done in municipality then the productivity in terms of the financial transparency and the accountability will be more than municipalities will be in a better position to assess their assets and liabilities.

Both expenditures and income both and it will not only bring their transparency at the municipal level it will bring a transparency at all level and it will give a sound database in terms of accounting matters. So, that is the background and before falling that reform agenda most of the municipalities now have done that municipal accounting reform. But initially when it started in India there are lot of misconceptions, confusions and some myths which related to that.

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✓ When we can start?

✓  
—

✓ Whether the reform will minimize the job

✓ Whether it needs an additional degree/skill.

## Myths and Realities

✓ whether ULB needs any special preparation?

✓ fund requirement?

So, like some of the myths were there is like few questions which made people initially very much not sure about the program like whether the reform will minimize the job that is whether if the reform is there then whether it will take our job or not that whether it needs an additional degree or skillset that was the question also. Then whether the ULB needs any special preparation.

Then whether the fund requirement and not only that there was like questions like when we can start. So, there are a lot of questions like that but actual question actual response or the reality is that that this reform is not going to take away the job of the people who are working in the municipality. Rather in many municipalities the people they hired specialists and the other people who are working in the accounting system.

So, that the accounting system can run smoothly and perfectly then it the question was whether it needs an additional degree or skill no it is not required. What they did initially government gave some time to time some specialized training or orientation program and then they assessed the condition following that they could perform. Second was whether you will need any special preparation that is also no.

Because government notified the guidelines and the task wise checklist of the dos and don'ts so that municipality can perform can deliver those kinds of reform. Fund requirement the fund

requirement for getting initial software getting initial equipment computers everything was given by the government and also some amount of the manpower support also was given in some of these states.

And when we can start you can start anytime so it started during 2004-05 and they started slowly they took up within 2-3 years now they are going on with this kind of accounting reform.

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### ISSUES WITH THE SINGLE ENTRY SYSTEM OF ACCOUNTING

- Cash-based single entry accounting system followed by most Indian cities
- Financial Statements not finalized over the years, and not audited
- Non-capitalization of expenditure and incomplete information
- Inadequate asset management, valuation
- Poor financial management and weak MIS — *Manual*
- Inadequate internal control procedures
- Inadequate disclosure and audit mechanisms

So, basically the problem or the issues which was there associated with the single entry system of the accounting is that it is basically cash based. Whatever cash comes or goes out from the system that is the what used to be recorded in the traditional accounting system in our country. Then the financial statements not finalized over the year and not audited. So, auditing was not their non-capitalization or expenditure and incomplete information.

So, all the expenditures were that time used to be written in terms of the cash but the capitalization portion or capitalization dimension of an expenditure was not a recorded or system was not that there that somebody can record that particular information. Then asset management and valuation the municipality sometimes they do not know what is their assets and how to make their valuation in the current financial terms.

And how to record that in their whole accounting system that kind of practice was absent in municipality. Then poor financial management and information system was there because basically it was by and large based on manual system. Also it was lacking the control procedures for internal activities and internal processes. Inadequate disclosure and audit mechanism that I already told and because of this there was a few more issues like.

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#### ISSUES WITH CASH ACCOUNTING

- Full picture of assets & liabilities not available
- Budgetary control based on payments, ignores commitment
- Important items not recognized in cash-based reports:
  - Taxes billed but not yet received
  - Debts and loans owed by the municipality
  - Contracts completed, invoices received but not yet paid
- Difficult to determine surplus/deficit for the period
- Certain capital expenditures treated as revenue items, e.g., roads, bridges, drainage, etc.

You are never able to get a full picture of the assets and the liabilities basically the cash based systems you are writing either the expenditure or the income. But whatever the assets and liabilities you have in terms of the loan or the debt you are never able to get that idea then budgetary control based on payments, ignores commitment this type of information was not also possible to write.

Then important items not recognized in the cash based reports like tax bill but not yet received then debts and loans owned by the municipality owed by the municipality. Contracts completed, invoices received but not yet paid so that means any transaction during the transaction the status of the transaction was never possible to note in this kind of system. Then difficult to determine surplus or deficit in the earlier system.

Then expenditures were treated as revenue item for example roads, bridges, drainages etc but which is a capital expenditure you need to invest the capital for creation of the infrastructure.

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### **RATIONALE FOR MUNICIPAL ACCOUNTING REFORMS**

- Inadequate infrastructure in cities
- Cities unable to meet rising demand for services and unable to raise resources
- Cities lack financial viability and internal accruals are insufficient
- Though empowered by the Constitution, cities are not self reliant and depend upon central and state governments for fiscal support
- Resources available in the capital market and FIs
- Streamlining of financial analysis and accounting of ULBs as there is poor financial management
- Transparency/credit-worthiness shall help create interface between capital market and municipal finance

Now because of that those issues the reason was that we have the inadequate infrastructure in the cities then unable to meet rising demand of the services cities lack financial viability and internal accruals . Then empowered by the constitution but they were not able to perform. Resources available in the capital market and financial institutions. Streamlining of financial analysis and accounting as there is poor financial management.

And transparency and credit worthiness now if you follow this 8 9 points you will find that all the points were revolving around the strength of the municipality and the opportunities of the municipality which was not explored so far. Because municipalities they were not able to see the whole picture of their assets liabilities and the opportunities to create the new infrastructure. So, that was the reason that to bring the accounting reforms.

So, that they can understand in terms of the figures and the facts and the account that yes how much assets we have how much opportunities we have.

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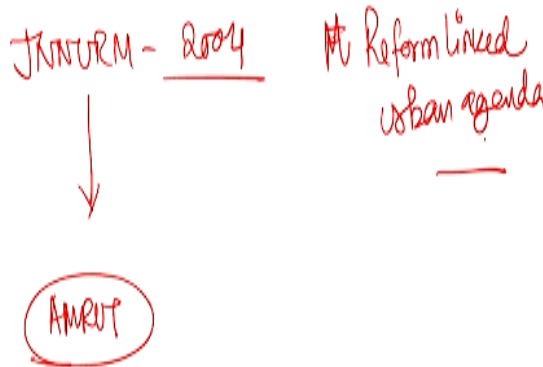
## REFORMS AGENDA

- Making Cities Creditworthy
- Municipal Accounting Reforms (bring in transparency, accountability & reliability)
- Better Financial Reporting & Disclosures lead to increased confidence in financial information by external lending agencies and auditors

So, therefore the reform agenda came to make the cities credit worthy. Municipal accounting reform to bring transparency accountability. Better financial reporting discloser lead to increased confidence in the information. Then credit rating and accessing capital markets then expenditure management costing etc.

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## ACCOUNTING REFORMS



So, therefore this accounting reform was part of JNNURM started in 2004 and then it continued during till this time when we are continuing the AMRUT mission. So, this mission linked so this reform linked like urban agenda that was kind of a catalytic effect on the accounting reform also.

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## IMPORTANCE OF MUNICIPAL ACCOUNTING REFORMS

- Inability of the present accounting system to provide information to assess the financial performance and position of ULBs → Ability to generate revenue, Assets
- Absence of asset accounts leads to fraud and misappropriations
- Income & Expenditure Account and Balance Sheet cannot be prepared
- Accrual-based system permits the preparation of reliable, detailed financial statements which provide appropriate information for decision-making — Liabilities, Expenditure

So, the importance of the municipal accounting reform is that inability of the present accounting system to provide information to assess the financial performance and position of the ULBs. When you say financial performance it is the ability to generate revenue, then assets and related to liabilities and rationalize the expenditure. These are the salient points which are there I mean which was considered for the benefit of the accounting reforms.

So, this I have already told the asset accounts was added I mean it was possible to take the account of the assets. Then income and expenditure account and balance sheet cannot be prepared without the current. This thing current system the accrual based system permits the preparation of the reliable detailed financial statement which provides appropriate information for decision making.

There are some element which is accrual in nature for example every year in the municipalities they get the tax from the property tax from the various sources. We have discussed the sources of the revenue from the tax revenue and the non-tax revenue. So, those kind of accrual flow of money that was not recorded properly because of the single entry system. In the double entry accounting system it is possible to see that how the flows of the money.

Or the flows of the revenues are accrued in your account. So, that was the basic intent of the accounting system.

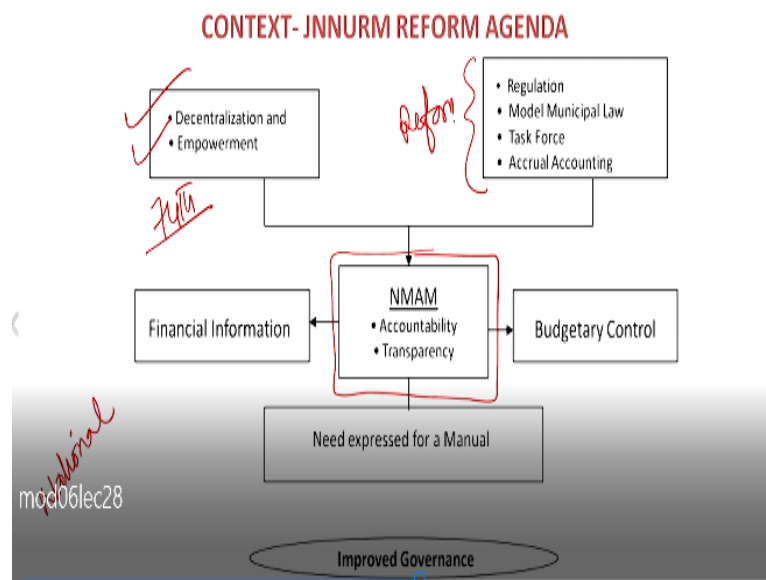


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# Benefits of Accrual- Based Accounting

Then so therefore after doing this there are some benefits you must have a look of the benefits.

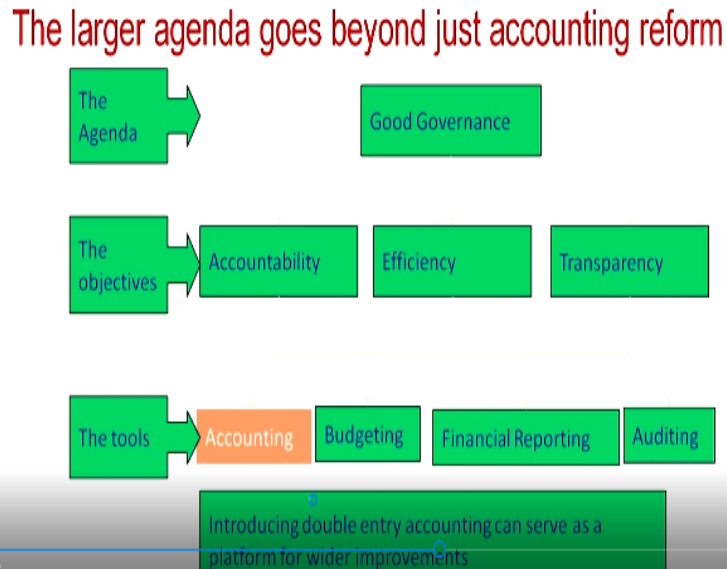
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So, basically in JNNURM agenda we got the decentralization and empowerment after the 74th amendment. So, after this reform agenda this reform agenda then government tried to prepare a national municipal accounting manual. Objective of this manual was to bring a procedural coherence procedural infirmity in the practice accounting practice of all the municipalities in the country.

But definitely there will be some contextual variations which the state government can do. So, this national municipal accounting manual was mandated to make the budgetary control, financial information was available and this need expressed for a manual this was expressed by the ULBs and state government. So, the ultimate objectivity improved local governance.

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Next you can see that how the accounting manual will help the improving the good governance. Now the agenda is the good governance the objective under the good governance is the accountability, efficiency, transparency. So, accountability basically refers to fulfilling responsibility because you are not going away from your responsibility, efficiency refers to your ability and quality.

And transparency refers to trust worthiness of the government and which is accessed by people right. So, we discussed earlier accountability and transparency now accounting as a tool it is helping the accountability because it is giving the account of the assets liability, accrual, accrued incomes and all those elements and also it is giving additional transparency and efficiency both. And with this accounting tool there is increased I mean better budgeting procedure.

Financial reporting is better and auditing is possible in a much efficient manner because all the information out there within easy reach in a better platform. Now better system now so

introducing double entry accounting can serve as a platform for wider improvement of the system of the accounting and as a whole for the good governance.

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### **BENEFITS OF ACCRUAL-BASED ACCOUNTING**

- Revenue is recognized as and when earned
- Costs are matched against revenues so recognized
- Distinction is maintained between revenue and capital items
- Assists in effective follow-up of receivables & ascertainment of payables
- The surplus/deficit shown at the end of the year represents the net surplus/deficit for that year
- Presents a true picture of the financial position of an ULB
- Helps in better financial management and decision-making

So, these are the other benefits revenue is recognized as an when earned. Costs are matched against the revenues so recognized. Distinction is maintained between the revenue and the capital items you can see the points they can follow up with receivables and ascertainment of payables because you are also able to track the possible payments, possible expenditures during the transaction period also.

And you can also track the surplus or the deficit amount in the account. Presents a true picture of the financial position so whether in a urban local bodies if having the strength in terms of revenue and their rationalization of the expenditure that true picture will give in terms of the assets and the liability and it will give whether the healthy in terms of the financial matter or not so this will help to give that picture.

Then it also helps a better decision making a leader or an executive which is taking day to day decision in the municipalities they can see the facts and figures from the accounting system and they can take a decision. Because this accounting system is accurate it is taking the earlier records and it is taking record not only the expenditure and the cash based system it is taking record for assets, liabilities, expenditure or income both.

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### **BENEFITS OF ACCRUAL-BASED ACCOUNTING (contd.) ....**

- Facilitates credit rating, one of the pre-requisites for mobilizing funds through debt instruments
- Leads to increased confidence in financial information by:
  - External lending agencies thus improving infrastructure availability and better urbanization
  - External Auditors thus helps in obtaining unqualified opinion
- Assists in policy formulation, e.g. , tax rates, service charges, etc.
- Accrual-based system permits:
  - Preparation of reliable, detailed financial statements

So, again the few more benefits so credit rating will be increased if you can do this because banking institution they will give more credit rating. In one lecture we have discussed the credit rating requirement where because the bankable projects for the infrastructure development is very much important. And for those projects where they can also take money from the financial institution.

So, financial institutions will give money municipalities they can earn any credit rating. So, this accrual based system will enable the credit rating then confidence will be increased also so that they can also get more confidence to do more other jobs. So, external lending is possible external auditing also possible assist in policy formulation tax rates and service charges. In the last two lectures we discussed about the conventional and the non-conventional financial revenue sources.

Out of that you have seen that tax rates and the service charges those are there. So, from this accounting system with a transparent way with a systematic way you can track that what are the major revenues from the tax base and non-tax base service charges etc. Accrual based system that we have already told you that it is reliable system and it gives information for decision making transparency, accountability I told.

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## INITIATIVES TAKEN BY MOUD, GOI

Post 74<sup>th</sup> Constitutional Amendment

- Model Municipal Law ✓
- Tax-Free Municipal Bonds ✓
- Urban Reform Incentive Fund ✓
- Pooled Finance Development Fund, PPP Guidelines, National Urban Information Scheme ✓
- E-Governance ✓
- **JN National Urban Renewable Mission (JNNURM)**

- accounting reforms mandatory

Okay now so far the government of India they have taken some steps like they have taken model municipal law tax free municipal bonds they have started some enabling mechanisms. So, that they can do that urban reform in terms of incentive fund pool finance I discussed earlier lectures. E governance also that we have discussed so and in the JNNURM they have started the accounting reform as a mandatory and now it is being continuing in AMRUT also.

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## INITIATIVES TAKEN BY MOUD, GOI (contd.)....

- Put in place a model National Municipal Accounts & Financial Reporting Manual (NMAM), with C&AG and USAID support
- Develop a Training Manual and Generic Software, linked with eGovernance
- Valuation Committee for fair valuation, useful life and depreciation rates of assets
- Support State Governments in preparing State-specific manuals
- Initiated the formation of a professional association of Municipal Finance Officers - MFOA

So, after that the national accounting, municipal accounting manual which I told that they have started that. Then training manuals training manual is important you can understand that being a big country about 5000 municipalities and the urban centres. How difficult it could be to give

training to each and every urban areas. Then the valuation committee for fair valuation and transparent valuation that is also possible with this.

So, those kinds of training is also given then support the state government then professional association of municipal finance officers it is also possible so that financing mechanism in the municipality that also was given a formal mechanisms so that they also can be recognized for this kind of job.

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# Accounting Manual

So, let us have some screenshots of the accounting manual.

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## FEATURES OF NMAM

- Common Manual for large and small cities
- Double - entry, Accrual – based
- Prescribed formats for Financial Statements
- Provision for Fund Accounting
- Integrated with Budgeting system
- Addresses the MIS and budgeting needs of ULBs
- Conservative, provides flexibility to States and Cities

So, accounting manuals basically they provide the information regarding the large and small cities accounting system double entry of course we have discussed. Then formats for financial statements then provision for fund accounting then budgetary system then municipal information system then also it is conservative provides flexibility to states and cities.

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## CONTENTS & COVERAGE OF NMAM

### • Part 1 – General

- Introduction
- Definitions
- Significant Accounting Principals
- Codification Structure & Chart of Accounts
- General Accounting Procedures

And now please see the contents what is the contents of the national municipal accounting manual. Part one is the basically general just have a look I do not need to explain each and everything.

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## CONTENTS & COVERAGE OF NMAM

### Part-II Accounting for Transactions

- |                                 |                                   |
|---------------------------------|-----------------------------------|
| • Octroi                        | • Borrowings by ULBs              |
| • Property & Other Taxes        | • Special Funds                   |
| • Cess                          | • Investments                     |
| • Water Supply                  | • Fixed Assets                    |
| • Assigned Revenues             | • Lease & Hire Purchase           |
| • Rental, Fees & Other Income   | • Loans & Advances                |
| • Public Works, Stores          | • Special Transactions            |
| • Employee Related Transactions | • Addition/Merger of Local Bodies |
| • Health & Sanitation           | • Inter-unit Transactions         |
| • Other Revenue Expenditure     | • Municipal School Boards         |
| • Grants                        | • Transport Undertakings          |

Part one sorry and the part two you can see the basically the details of the how you maintain your accounts. The type of the sources is given various sources and for every source how you are going to maintain your accounting that is also given.

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### CONTENTS & COVERAGE OF NMAM

- **Part III- Period – end Requirements**

- Period – end Procedures
- Reconciliation Procedures
- Financial Statements
- Audit Report

- **Part IV – Others**

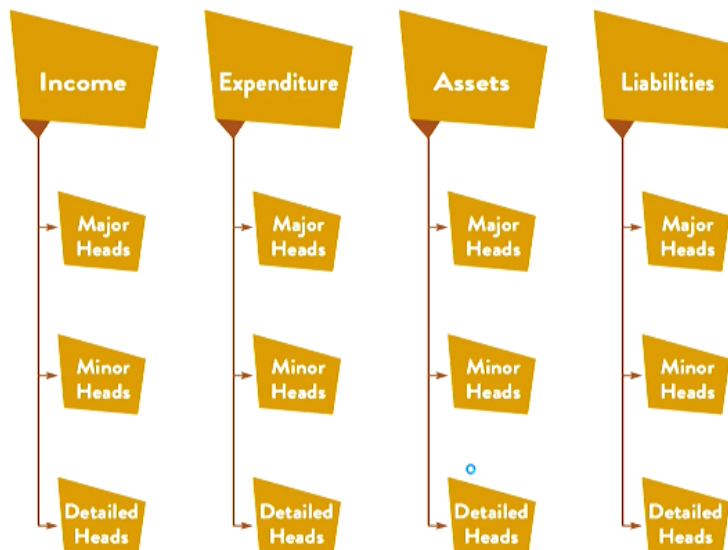
- Budgeting & MIS reports
- Guidelines for preparation of Balance Sheet

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Opening

In part three basically your procedures are given procedures statements audited report and in the part for the budgeting and the MIS report is given and how to make the balance sheet.

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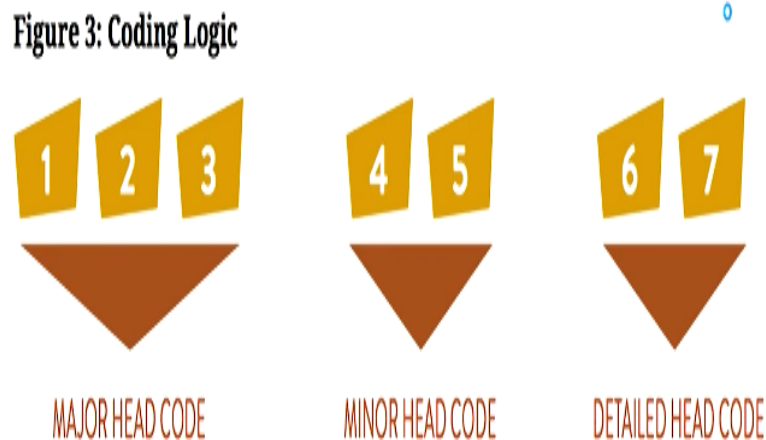


So, this is in short the provisions of the national municipal accounting manual and in this manual it is mentioned that all the entries will be either in terms of income expenditure assets and liabilities and out of every entry there will be major head minor head and detailed heads. So,



these are the major structure of the accounting manual which all the municipalities are subject to follow this format.

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These are the coding logic I am not going into this details you can go through the manual and you can understand.

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a. **Accruable income**

Income in respect of which the ULB's right to receive arises in regular period and for which **DCB Registers (MAM 14)** have to be maintained are the items that have to be accounted on **accrual basis**. Some examples of acc incomes are:

- Property Tax
- Water Supply & Drainage Tax
- Elementary Education Tax
- Advertisement Tax
- Profession tax
- Tax on carriages and animals
- Tax on carts
- Trade Licence fees

So, these are the accruable incomes as per the national accounting manual you can see we have told earlier also property tax, the user charge ,and the drainage tax, the education advertisement, profession, carriage on the animals, carts, trade license.

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- Licence fees under PFA Act
- Metered/Tap Rate Water Charges, Drainage fees etc of WS&DF
- UGD monthly charges
- Rent on lease of lands`
- Rent on buildings
- Rent on shopping complexes
- Rent on Bunk Stalls
- Market fees – Daily markets
- Market fees – Weekly markets
- Advertisement fees
- Fees for Bays and other receipts in the Bus Stand
- Fees for Slaughter Houses

Then license fee under PFA act then there are so many actually so many you can go through and you can relate with your context that how many can be utilized. So, most of them I mean municipalities some of this items could be relevant some of the items may not be relevant so it is up to you. How much you can utilize?

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## Accruable income

- Cart Stand/Cycle Stand/Lorry Stand/Taxi Stand Fees
- Fees for fishery rights
- Parking fees
- Fees on Pay & Use Toilets
- Income from Cinema Theatre

Then some accruable incomes are there like many municipalities have their provision of the parking fees or the stand fees they can take fees for fishery rights . For example there are rivers there are canals and where there are paid services are there parking fees also there fees on pay and use toilets income from the cinema theatre. So, these are all accruable income which is there for I mean the accrued every month every year.

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## Accruable income

- Cart Stand/Cycle Stand/Lorry Stand/Taxi Stand Fees
- Fees for fishery rights
- Parking fees
- Fees on Pay & Use Toilets
- Income from Cinema Theatre

Non-accruable incomes are basically the revenues which is coming from the other sources. Okay so that is all with a brief overview of the accounting situation and the accounting reform of the municipality. I just quickly summarize that after 2000 when the government of India started bringing reform leading to urban development JNNURM program that time there was two sets of reform.

What was the first was the mandatory reform and the second was the optional reform. Out of the mandatory from the accounting reform was measured. The objective of the accounting reform was that if the accounting reform accounting system is not a full proof and the modern system the accounting or the financial status of the municipality cannot be assessed. And the earlier system was basically cash based not the transaction based.

Now the double entry accounting system which is introduced now it is basically a transaction based and as a result it takes care of the account of the assets of the municipality liability of the municipality the expenditure and the income of the municipality and as a result it gives the true picture of the financial health of the municipality and that has been being carried out in most of the municipalities.

This I can tell you that this is one of the major reform and this will give a longstanding effect and the benefit of the municipality and these the service delivery of the urban in the urban areas.

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Next LECTURE ◦

## 29. Value Capture Financing

Next day well discuss the value capture financing in this week we have been discussing the finance aspect of the municipalities. So, out of that the tax I mean the conventional sources non-conventional sources. And today we have discussed the accounting system next day we will discuss value capture financing we will show that from various assets like land property and other assets

How municipality can earn revenues for creating new infrastructure and better service. So, thank you very much for attending.