

XVII. Accounts and Audit

19. *Having regard to the provisions of article 243Z of the Constitution which state that the Legislature of a State may, by law, make provisions with respect to the maintenance of accounts by the Municipalities and the audit of such accounts, the question is as to what provisions may be made in the law.*

- (1) Each State Government has to take a view in this regard considering that, presently, a cash-based system of accounting is used in most of the Municipalities across India. This system derives from the one that was developed and used during the colonial era. The procedures of accounting are out-of-date and are quite unable to deliver the information that a financially sound, i.e. a creditworthy organization would need in order to plan, budget and account for its development programmes and service delivery systems.

The methods of municipal accounting and audit thereof actually practiced in India make matters even worse. For example, in many States, Municipalities are years behind in the preparation of their audited accounts and the accounts reflect events long forgotten. Even when produced in a timely fashion, the accounts are inaccessible to the common person and are virtually ignored.

- (2) The Financial Institutions Reform and Expansion (FIRE) Project has supported the Institute of Chartered Accountants of India (ICAI) in developing a Technical Guide on Accounting and Financial Reporting by Urban Local Bodies.

In the technical guide published by ICAI, the *Financial Reporting Objectives* have been spelt out as follows :

- (a) to develop a comprehensive framework for financial reporting,
- (b) to provide the relevant information that the “users” or the various “interest groups” require
- (c) to enable the users to assess the performance of the local body on the basis of different yardsticks, as follows, so as to develop a comprehensive framework for financial reporting :
 - revenue generating capacity *vis-a-vis* the expenses incurred

- creation of non-revenue producing assets/infrastructural facilities in a particular period
 - non-financial parameters as may be defined, and
- (d) to provide relevant financial information in respect of each major but distinct activity separately.
- (3) The Technical Guide has also provided *Guidelines on the Formats of Financial Statements of Municipalities* as follows :

- (a) the financial statements of local bodies (viz. balance sheet and income and expenditure account) shall be prepared on accrual basis
- (b) accounting policies shall be applied consistently from one financial year to the next. Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods shall be disclosed.

In case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change shall also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact shall be indicated.

- (c) provision shall be made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.

Revenue shall not be recognized unless the related performance has been achieved and no significant uncertainty exists regarding the amount of the consideration; and it is not unreasonable to expect ultimate collection

- (d) the accounting treatment and presentation in the balance sheet and the income and expenditure account of transactions and events shall be governed by their substance and not merely by the legal form
- (e) in determining the accounting treatment and manner of disclosure of an item in the balance sheet and/or the income and expenditure account, due consideration shall be given to the materiality of the item

- (f) notes to the balance sheet and the income and expenditure account shall contain only the explanatory material pertaining to the items in the balance sheet and the income and expenditure account
 - (g) a statement of all significant accounting policies adopted in the preparation and presentation of the balance sheet and the income and expenditure account shall be included in the Municipality's balance sheet. Where any of the accounting policies is not in conformity with the accounting standards, and the effect of departures from accounting standards is material, the particulars of the departure shall be disclosed, together with the reasons therefor and the financial effect thereof except where such effect is not ascertainable
 - (h) if the information required to be given under any of the items or sub-items in this Form cannot be conveniently included in the balance sheet or the income and expenditure account itself, as the case may be, it may be furnished in a separate Schedule or Schedules to be annexed to and forming part of the balance sheet or the income and expenditure account. This is recommended where items are numerous
 - (i) in the Schedules referred to above, accounting policies and explanatory notes shall form an integral part of the balance sheet
 - (j) the corresponding amounts for the immediately preceding financial year for all items shown in the balance sheet and income and expenditure account shall also be given in the balance sheet or the income and expenditure account, as the case may be
 - (k) "provision" would mean any amount written off or retained by way of providing for depreciation, renewals, or diminution in value of assets, or retained by way of providing for any known liability the amount of which cannot be determined with substantial accuracy
 - (l) the figures in the balance sheet and the income and expenditure account, if rounded off, shall be rounded off corresponding to the various amounts involved, and
 - (m) a cash-flow statement may be annexed to the balance sheet showing cash flows during the period covered by the income and expenditure account and during the corresponding previous period.
- (4) Serious concern has been expressed by the Eleventh Finance Commission also, both about the municipal accounts and the audit practices.
- (5) Based on the recommendations of the Eleventh Finance Commission and the deliberations of a National Seminar on Municipal Accounting Reforms organized

by the Ministry of Urban Development and Poverty Alleviation, NIUA and FIRE-D project on January 9, 2002, the Comptroller and Auditor General (C&AG) constituted a Task Force to evolve appropriate accounting formats for the urban local bodies. The Task Force submitted its report on *Accounting and Budget Formats for Urban Local Bodies* to the Ministry of Urban Development and Poverty Alleviation in December 2002. The Report of the Task Force has been accepted by the Government of India and thereafter forwarded to the State Governments for implementation of the accounting and budget formats as specified by the Task Force, keeping in view the local requirements.

The Task Force has suggested the formats of Receipts and Payments Accounts, Income & Expenditure Accounts and Balance Sheets. It also suggested a model of significant accounting policies regarding revenue recognition and treatment of expenditure during construction period. The Task Force has further suggested three-tier codification and classification of the budget, accounting and costing formats. It has further recommended that the costing formats should also bear the same code for the purpose of uniformity and for proper management information system.

- (6) The Task Force report has also made the following recommendations:
- a) *the urban local bodies should uniformly follow the suggested formats for presentation of annual financial statements;*
 - b) *the budget formats, codification and classification of the budget heads given in the report of the Task Force need to be uniformly adopted by all urban local bodies;*
 - c) *the suggested formats for determining the cost of important utilities and services like Water Supply, Primary Schools and Hospitals be adopted by the ULBs for overall effective financial administration and given as supplementary information to the accounts;*
 - d) *significant accounting policies to be followed by the ULBs as per model accounting policies need to be disclosed in a separate schedule forming part of the accounts; and*
 - e) *the urban local bodies need to initiate steps for smooth switch over to the new system of accounting.*

- (6) The following major transitional issues have also been discussed in the Report that need to be addressed while switching over from the existing cash based accounting system to accrual based accounting system in urban local bodies:
- a) policy decisions by the State Governments on adoption of the Task Force Report on accrual system of municipal accounting;
 - b) constitution of State Level Steering Committees;
 - c) review of legislative framework;
 - d) development of accounting manual;
 - e) manpower, training and implementation support;
 - f) verification and valuation of assets and liabilities;
 - g) parallel run of old and new accounting system; and
 - h) computerization of budget and accounts.
- (8) It may be noted that in respect of accounts and audit, while the principal law would incorporate the “substantive enabling provisions only”, the detailed aspects would be covered by the Schedule(s) to the Acts or the rules framed by the State Government which may be amended easily.

Provisions Made in the Municipal Law

23. *The Municipal Law has provided for the following :*

- (1) *Clause 88 provides that the Chief Municipal Officer shall prepare and maintain accounts of receipts and expenditures of the Municipality in such form, and in such manner, as may be prescribed.*
- (2) *Under clause 89, it is provided, that the State Government shall prepare and maintain a “Municipal Accounting Manual” containing details of all financial matters and procedures relating thereto in respect of any Municipality.*

- (3) *Clause 90, provides that the Chief Municipal Officer shall, within four months of the close of a year, cause to be prepared a financial statement containing an income and expenditure account and a receipts and payments account for the preceding year as also cause to be prepared, under clause 91, a balance sheet of the assets and the liabilities of the Municipality for the preceding year.*
- (4) *Under clause 92, the financial statement as prepared under clause 90, and the balance sheet of the assets and liabilities as prepared under clause 91, shall be placed by the Chief Municipal Officer before the Empowered Standing Committee for its adoption and forwarding to the Auditor appointed by the State Government in this behalf.*
- (5) *Under clause 93, the State Government shall appoint an Auditor from a panel of professional chartered accountants prepared in that behalf by it, and such Auditor shall examine the financial statement and the balance sheet.*
- (6) *The Auditor, or an officer subordinate to him, may report any item of accounts contrary to the provisions of the Act to the Empowered Standing Committee which shall consider the same and take prompt action thereon. If necessary, any person responsible for any illegal payment would be surcharged.*
- (7) *Under clause 94, the Auditor shall prepare a Report of the accounts audited and examined and such Report shall be sent to the Chief Municipal Officer not later than the 30th day of September each year.*

In such a Report, the Auditor shall include a statement showing every payment which appears to the Auditor to be contrary to the law; the account of any deficiency or loss which appears to have been caused by gross negligence or misconduct of any person; the account of any sum received which ought to have been, but has not been, brought into account by any person; and any other material impropriety or irregularity which may be observed in the accounts.

- (8) *Under clause 95, the audited financial statement, the balance sheet and the Report of the Auditor and his comments thereon shall be placed, successively, before the Empowered Standing Committee and the Municipality.*
- (9) *Provisions have also been made, under clause 98, for a special audit, and clause 99, for the internal audit.*
- (10) *The Municipal Law has, under clause 100, also made provisions for appointment of a Municipal Accounts Committee, for the levels of Municipalities as specified by the State Government, The composition of this Committee and its functions have also been defined under this clause.*