

MUNICIPAL ACCOUNTING

Background

What is a Municipality?

A municipality is defined as “An urban district having corporate status and powers of self-government” or “People living in a town or city having local self-government”. Hence a municipality is basically a local self government in an urban area. The larger municipalities like those of Bangalore are called City Corporations. Like central and state governments, municipalities have various departments such as Revenue, Engineering, Finance, Health, Welfare, Education, Horticulture, etc.

What are the basic functions of a Municipality?

The essential function of a municipality is to govern the urban area under it. Taking the case of BMP, it needs to provide things such as good roads, street lighting, drainages, primary education, parks, playgrounds, hospitals, etc., and maintain all these in proper condition as required by the citizens of the City.

The basic functions of a municipality has been divided into 3 categories as per the Karnataka Municipalities Act, 1974 (refer Annex -1):

- The Obligatory Functions: Sec 87: The obligation to function arises from the statutory obligations – from the statute of being a (local) government. These are the functions for which the municipality came into existence, and they will vary from one municipality to another. For the BMP, obligatory functions include providing basic health and sanitation facilities (Clean and Green Bangalore), primary education, basic infrastructure like roads, street lights, drains, etc. BMP does build flyovers and subways and provides infrastructure for business like building markets.
- The Special Functions: Sec 88: These deal with various functions like special medical aid and providing relief measures in times of emergency;
- The Discretionary functions: Sec 91: These functions may be provided fully or in part as per the discretion of the municipal body. Providing public parks, plating maintaining road side trees, etc are some of the discretionary functions.

While these are functions statutorily provided, it would be worthwhile considering another way of classifying the functions of a Municipality based on the objectives of the organisation. The classification of functions in this way is called “funds classification”. This method of classification enables better planning and evaluation of achievement of objectives as compared to a departmental type of classification, in which the focus is on administrative departments rather than on the function performed. This scheme, when used in conjunction with a Fund Based Accounting System (to be discussed in a later section), allows the municipality’s accounts to be more easily understood and monitored.

How are the municipality’s functions executed?

The functions of the municipalities are executed by pooling the efforts of both appointed and elected officials. Appointed officials include functionaries who are trained to conduct technical and managerial functions; they work under the leadership of the Commissioner. Elected representatives i.e. the Councilors are grouped into various Standing Committees (e.g., Out of the eight standing committees provided by the

Karnataka Municipal Corporations Act, 1974 for BMP the Taxation and Finance Committee, Accounts Committee, are relevant to the subject of this Guide), each of which has a Chairman. Elected representatives work under the leadership of the mayor and are directly accountable to the citizens.

How does a municipality receive and spend its funds?

In order for a municipality to execute its various functions, employees have to be paid, infrastructure needs to be built and maintained, etc. How does the municipality get money to carry on its activities? Is the money continuously flowing? Are not the infrastructure investments huge – and how does the municipality manage to raise such funds? Every month salaries and rents have to be paid – where does the money come from?

Sources of Funds:

There are three basic sources of money (referred to as “funds”) for any municipality:

- Funds from own resources: a municipality raises funds through the following type of activities:
 - o By its taxation powers: By virtue of statute the Municipality is allowed to collect taxes from the public, like the Property Tax.
 - o By its ownership: The Municipality owns various properties like buildings which are let out on lease and rents collected.
 - o By collection of user / service charges: In certain cases certain user charges for water supply provision or for disposal of garbage are collected which is beyond the provision of infrastructure.
- Funds from borrowed sources: These are “loans” borrowed from financial institutions, banks, and governments; they are based on certain conditionality such as the number of installments in which the loan has to be repaid, the interest on these loans, and the security for providing the loan.
- Funds through Grants-in-aid: The term “grants” denote free or gift money from certain sources like higher levels of government or other institutions and bodies. The grants could be for creation of infrastructure like flyover (called “capital grants”) or for operational expenses like payment of salaries (called “revenue grants”).

All the funds of a municipality can be classified under one of these three categories. A good municipality should generate most of its funds from its own resources. Unfortunately this is not the reality.

Application of funds:

The application of funds of a municipality could be for any of four major activities:

- Developmental activities: These activities are those related to creation of various basic infrastructure. Typical examples are those activities related to ward works, or construction of additional classrooms in a corporation school, or the addition of a maternity ward in a corporation hospital. These are extremely essential to take care of the increasing needs of the citizens.
- Operational activities: these are related to carrying on day-to-day activities including maintenance of infrastructure. The salaries paid, the electricity and telephone bills paid, etc., come under this category.

- Repayment activities: The loans taken have to be repaid and the obligations in this regard need to be fulfilled meticulously. Municipalities generally have long-term commitments in this regard.
- Saving and reserves: The funds applied should be intelligently managed in such a way that some savings are available for taking up emergency works and innovative schemes without complete external funding.

Need for Financial Reforms

The 74th amendment to the Indian Constitution in 1992 brought in the concept of devolution of powers in the hands of the Urban Local Bodies (ULB). It aimed at bringing about the empowerment of the citizens and their active participation in the governance of the affairs of the ULBs.

Devolution of powers

A three-tier pyramid type structure or Subsidiarity exists for the governance of the affairs of the state in India.

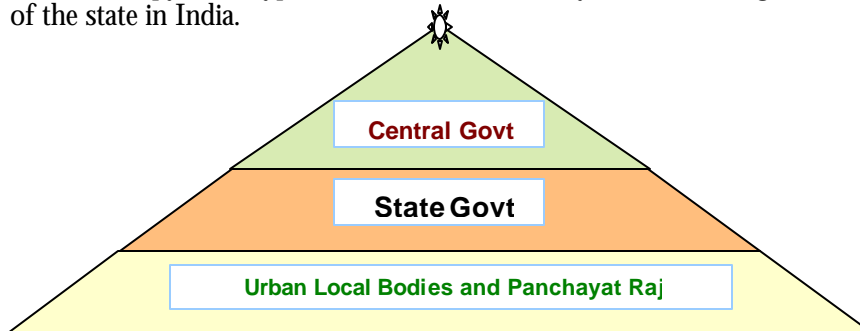


Figure 1.1 Three Tier Structure (Subsidiarity)

Although there exists, a hierarchy in the governance structure, the aforesaid amendment has brought in the concept of decentralization and wide powers as regards administration and finance have been given to the ULBs.

In the light of these powers, the role of the ULB has changed from a mere facilitator or executor to that of a Governing body. The ULB has now the responsibility of making suitable policies in addition to that of being an executive body. This has necessitated the ULB to function in a manner so as to attain self-sufficiency. To attain self-sufficiency, effective and prudent financial planning and management backed with an effective accounting system are essential. The other critical elements that would explain the need for a change in the method of functioning of the ULB are discussed in the subsequent paragraphs.

Citizen's needs

With the passing of the Karnataka Right to Information Act, 2000, and also the Transparency Act, there is a need to disclose adequate and appropriate information to the citizen about the functioning of the ULB. With the raising awareness level among the citizens, the ULB will have to be adequately equipped with information to meet the information needs of the citizen.

Absence of information and its flow

Prudent Financial Management presupposes the existence of an effective accounting system and an appropriate reporting structure.

“Financial Management begins where accounting ends”, the information from the accounting system forms the basic input for Financial Management.

The prevalent accounting system and practices do not give adequate information that enable financial management. The lapses in the existing accounting system need to be addressed immediately to ensure that there is no delay in flow of appropriate data which is converted into relevant information. This is discussed in detail later in this manual

Reducing Cash flows and need for ULB to raise funds from Unconventional Sources
Traditionally ULB generated revenue from the following two sources namely:

? Internal Sources: This consists of revenues from levy and collection of taxes, and revenues generated from various other activities of the ULB.

? External Sources: This includes loans and borrowings, and grant-in-aid from government and various other organisations.

With rapid changes in demographic situation, changing needs of the society and need for accountability and transparency on account of increased citizen participation, the overall role of the ULB has undergone a drastic change.

The ULBs in recent years are facing cash shortage and so is the government. This phenomenon requires the ULB, to generate funds through various other unexplored modes e.g. accessing the capital markets.

To meet the reporting requirements of the various institutions from which funds are to be generated through the unconventional mode, re-defining of the existing accounting policies, procedures, systems and financial statements is essential.

Control Needs

With the mounting requirements as enumerated above there is bound to be a manifold increase in the control needs of the ULB. To address this issue there has to be a redefining of the internal controls and the information flow structure to enable intelligent analysis and effective decision-making.

MUNICIPAL ACCOUNTING SYSTEMS

Cash System of Accounting in Practice

Under the current Cash system of Accounting in municipalities,

- Based on the transactions (Receipts & Payments), vouchers are prepared
- The voucher information is recorded in the cash book

Cash Book			
Date	Voucher No:	Details (Head of Account)	Amount

- From the Cash Book, classified abstract or classified Registers are prepared separately for Revenue & expenditure

Revenue Abstract							
Date	Voucher No:	Cash Book Ref #	Revenues				
			Property Tax	Rent

- The columnar totals, on a monthly basis, are carried over to a Receipts & Payments Statement
- Every month, similar statement is prepared
- The monthly balance in the classified register is not carried over from one month to another. Each month has a separate total. Hence, for cumulating, generally the Receipts & Payments statement is summarized.
- On the one side, Cash book balances are carried over, but the break-up provided by the classified abstracts are not carried over. So, overall self-balancing is not achieved.
- The limitations in physically maintaining too many columns in classified registers result in unscientific grouping of account heads.
- Though, Demand-Collection-Balance (DCB) Registers are mandatory, the cash book accounts only for accounting the “collection” portion (which is shown in Receipts & Payments Statement) and there is no financial statement for accounting demand and balance.

Accrual system of accounting

Introduction

In order to have an **effective** System of Municipal Functions, an **efficient** Accounting System is a prerequisite. The efficient accounting system is the one that is able to provide updated, accurate and clear information for carrying on of the business of a Municipality. Accrual concept is one of the basic accounting concepts which need to be adhered to while accounting for both revenue and the expenditure.

Concept

The **accrual system** of accounting **goes beyond** the simple **cash system** of accounting. The accrual system takes in to account credit transactions also. For instance if an amount is receivable on the first of every month say rent, the accrual system of accounting is capable of saying that “this amount of receivable to day but is yet to be received or has been received”. Similarly if a particular expenditure say telephone bill is payable by 10th of every month the accrual accounting will provide information on the amount payable as a “liability” (the amount that remains payable) from such a due date onwards.

In contrast, in cash system of accounting, a transaction is recorded only when there is a movement of cash. Cash Book (where all cash transactions are recorder) is the main document. That is entries are passed in the cash book when expenditure is incurred or when a revenue or income is received. The Cash Book reflects various transactions taking place. This is the system the BMP has been working with so far.

Limitations of cash system of accounting

In cash accounting, such “receivable or payable information” is totally absent and to that extent limits the management from understanding the correct financial position of the organisation. Let us take the case of BMP: as per the traditional system the property tax due from various assesseees on 1st of April is not shown by the accounting records. Only when property tax dues are received they are accounted. Here again, the receipts may be out of dues of earlier years, which are not very important under cash system as it accounts only for the cash received, the year to which it relates to is not very important.

Financial Statements in Cash System of Accounting

Under cash system of accounting a periodic or annual statement called “Receipts and Payments Account” (RPA) is prepared. This statement is nothing but the summary of the cash book grouped as per head of accounts. The receipts will include all receipts: whether pertaining to current or previous periods, whether capital or revenue. The expenditure will include all expenditure: whether pertaining to current or previous periods, whether capital or revenue. The major drawback is that one does not get information about what should have been collected as per plans (budget) during the period and against that how much has been collected.

In general, a Balance Sheet is not prepared under cash system of accounting, though technically it is possible to prepare one. However, this Balance Sheet will be limited to the extent of lack of information on “receivables and payables” (or current assets and current liabilities respectively) as cash system of accounting is not capable of accounting such transactions.

Thus in the case of a Municipality if accounts are prepared on cash basis there is no way by which the receivables and payables are monitored. The Municipality may still have separate registers for the recording receivable and payable information. However, such records will remain de-linked from main accounting system, and the integrity of the information provided cannot be vouched.

Financial Statements in Accrual System of Accounting

Unlike the cash system of accounting, the accrual system of accounting generally produces the following three financial statements:

- Revenue and Expenditure Statement
- Balance Sheet
- Cash Flow Statement

Features of these statements are discussed later in the FBAS Chapter, in this manual

Features of Cash and Accrual systems of accounting

Sl No	Accrual System of Accounting	Cash System of Accounting
1	Complete system of accounting	Not a complete accounting system
2	Revenues and expenditure are accounted for as and when accrued	Revenues and expenditure are accounted for only on flow of cash.
3	Financial statements show accurate picture of the organization.	Financial statements do not show accurate picture
4	Information helps in a better financial management.	Financial planning is a tedious task.

Advantages of the Accrual System of Accounting

When the accounting is done on accrual system the organization will at any point of time be aware of the following:

- What are the incomes earned and what are the outstanding as income receivable
- What the organization has expended and the dues it needs to pay.
- Helps management of cash in an effective manner.
- Policy decisions can be taken with the available detailed information by the management.

Usefulness of Accrual accounting system for Municipalities

The financial statements, as provided by the accrual accounting system together provide various information required for the management, stakeholders, fund providers etc in a transparent manner. While the preparation of accrual accounting statements may involve certain technicalities, the analysis of the three statements provided by the accrual accounting system is very easy and does not require a lot of effort or training.

Accounting Concepts

The following are some of the terms that are often used in accounting and finance related discussions. These are often misused and confused. The objective is to provide clarity, as many of these terms are used in this paper and also in general in municipal accounting.

Single-Entry accounting system: This refers to recording of one side of transactions. For instance, when Rs.10/- is paid for purchasing a pen, there are two activities taking place: (1) the cash of Rs.10/- goes out and (2) the item called pen comes in. In single entry accounting system, only the cash going out is supposed to be recorded. In reality, single entry systems do not exist. For e.g., in a Municipality which follows Cash Basis of accounting, an entry is made in the cash book recording the purchase of the pen under "Stationery account". Here, the information, that stationery called "pen" has been bought and "cash" has gone out (as it is recorded in Cash Book) are available. Only fact is that unlike double entry accounting system the entries are not transferred into any Ledger (which has information on account head wise transactions). Hence the benefits of double entry are not realised – though the double entry information exists. *Generally, the system of accounting followed by municipalities is referred to as 'single entry'. In fact it is actually cash basis of accounting which has all the features of double entry accounting; the only problem is that, as mentioned, the double entry data is available but not used. So it could called as 'incomplete double entry'.*

- **Double-Entry accounting system** This is different from single entry system and accounts for both sides of transactions (generally referred to as 'debit' and 'credit').

Golden rules for accounting a transaction on Double Entry System

- Rule 1 Personal Accounts: Debit the receiver; credit the giver
Rule 2 Real Accounts: Debit what comes in; credit what goes out.
Rule 3 Nominal Accounts: Debit all losses or expenditure; credit all gains or incomes.

This means that every entry made in the books of accounts should specifically indicate as to: which account is debited and which account is credited. (As discussed elsewhere in this Manual even cash basis of accounts can be written-up using double entry accounting system. Only feature is that such books will not provide information on receivables and payables). The double entry book keeping, due to its dual nature of accounting is often referred to as "self balancing system of accounting".

- **Revenue:** refers to any income that is received or certainly receivable and is also capable of being measured. In the case of Municipalities, the property taxes, rents receivable, grants receivable are considered as revenue.
- **Expense / Expenditure:** **Expense** refers to those operating items like salary, rent etc that are related to periodic consumption of a resource. These are of short term or operational nature or include only "revenue items" and do not include "capital items". **Expenditure** includes these "expenses" and includes capital items also. Thus "purchase of land" is expenditure and not an expense, while "salary" is both an expense and expenditure. Expenditure includes expenses also. In case of any expenditure, the same needs to be accounted for in the books when they are incurred, that is payment in cash may be made immediately or at a later point of time.

- **Capital items** Capital items are items that are of long term nature. For e.g.: Building is a long term item, Loan from Bank that is to be repaid in 10 years is also a long term item. Both of these are referred to as 'capital items' though Building is an "asset" and the loan is a "liability".
- **Revenue items:** Revenue items are of short term existence. For example: Salary (say for January) paid to staff is a short term item, Property tax received is also a revenue item. Both of these are referred to as 'revenue items' though salary is "expense" and the property tax received is "income".
- **Relationship between capital and revenue:** In general revenue expenditure (salary or power) is incurred to maintain and help the capital expenditure (building or machine) earn revenue. The capital items are shown in **Balance Sheet** and revenue items are summarised in **Revenue & Expenditure Statement**. In the case of budgeting, both on Receipts and Payments side "capital" and "revenue" items are separately grouped.

GAPS IN EXISTING ACCOUNTING SYSTEM

Introduction

The existing system of accounting is on cash basis i.e. transactions are accounted when there is a movement of cash. The major limitation in a cash based accounting system is that transactions, which do not involve movement of cash, are not accounted immediately and accounting takes place much later. Due to this, the information available is not complete. This results in incomplete information being furnished to various users. For example, the existing financial statements (Receipts & Payments Statement) does not provide information about Property Taxes due that were not collected during the period, as it gives information only about the collections made during the period. Also there is no information, generally provided, about whether the collections made were in respect of dues for the earlier period or current period. This is because under the Cash system of accounting, only Receipts & payments Statement is prepared. Since transactions are not accounted in the period in which they arise, performance related to a given period cannot be measured.

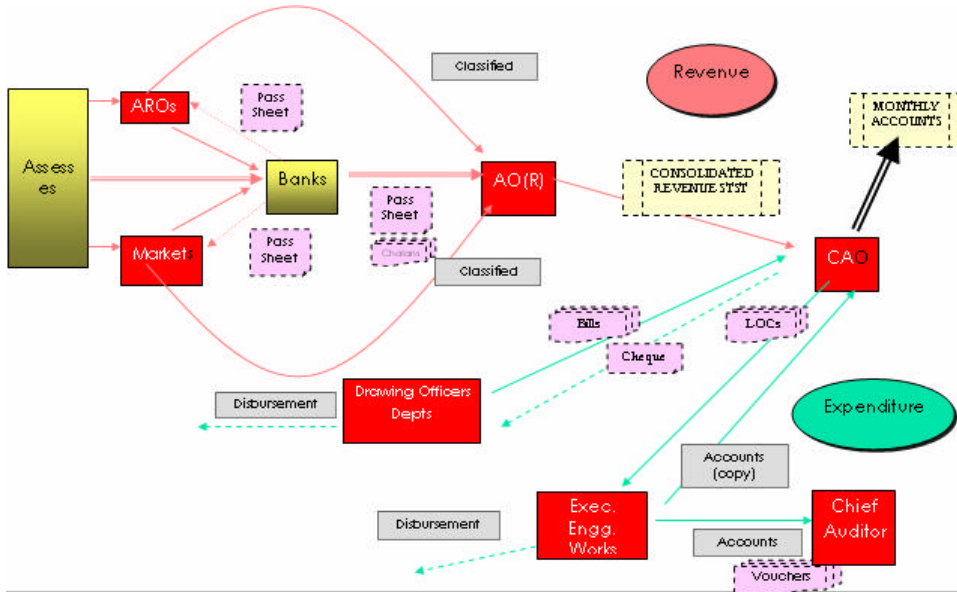
Major Gaps

Apart from the fact that the information provided is inadequate, there are also certain other drawbacks:

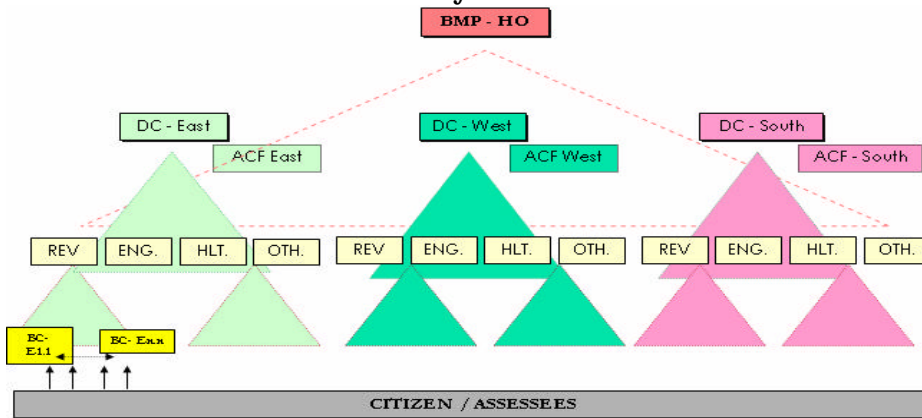
1. Non-Existence of a single database for information.
2. Non-availability of information on a timely basis to all levels of management because of considerable delay in compiling information from various sources (Registers and records maintained at various offices).
3. There exists only a vertical movement of information within the department. Parallel movement of information i.e. across departments at the same level does not exist.

The above is basically due to the fact that there is no “demand for information”. Also, even if there is information, the credibility of the information could be questioned as the Cash Basis of accounting followed currently, does not have checks and balances.

Info Flow in BMP: Earlier System



Info Flow in BMP: Decentralized System



Impact

The Gaps in information flow has an impact on:

- Internal Users
- External Users

1. Impact on Internal Users at various Management Levels

The information required at the three levels of management may be classified as given below:

Sl No	Management level	Information required for
1	Top Management	Policy changes, Decision making and Control
2	Middle Management	Decision making and Operational Control
3	Supervisory cadre	Operational Control

The existing information flow pattern caters to the needs of the Supervisory cadre only, as the information required is for controlling the routine affairs in the working of any department. However at the other two levels of management, the information required

is of a varying degree, for an effective control over expenses, revenue and assets, plugging revenue leakage if any and also for decision-making.

For instance, the Municipal Accounting Rules specify that Cash Book is to be closed once in a month and Accounts compiled on a monthly basis, generally because of the huge volumes, the information would reach from various capture points after considerable delay when the data cannot be used effectively.

The present system does not provide a base for reviewing the past decisions taken by the Management. There does not exist a base for capturing the Business Intelligence developed and applying the same to future decisions. In turn there is no facility for monitoring the decisions taken and feedback to the decision makers as to the true results of their decisions.

2. Impact on External Users

The main external users comprise of the following namely

- Government
- Financial Institutions
- Citizens

These may be analysed as follows:

a. Government

With the increasing importance of the Right to information and for achieving the goals of democracy, the government needs to account for the movement in its funds. Increasing accountability and transparency in the Government's functioning requires it to furnish accurate and reliable information to various users. As regards the ULBs, the Government would need the following information.

It would need to know manner of utilization of the

- Loans advanced by it to the ULBs and
- Grants provided by it to the ULBs

In addition, the Government would also need to know the amounts collected on its behalf by the ULBs (e.g. Cesses) and whether such amount is remitted to the Government or not. Similarly, information on the guarantee commission due to Govt for various loans guaranteed by Govt, is needed.

The information about the solvency position of the ULBs is necessary for providing additional funds for improvements and approving of certain major projects in which the State Government also would have a stake.

b. Financial Institutions

The Financial Institutions (FIs) need information for determining the financial strength and weakness of the ULB for advancing funds, rescheduling of loans etc. The Credit Rating of the ULB would not be easily possible under the existing system as there are no financial statements that would enable a critical analysis of the performance or financial position of the ULBs. ULBs in turn would find it extremely difficult to mobilize funds for its operational and expansion plans.

c. Citizens

The information needs of the citizens are manifold. To cater to these needs, the Gaps in the existing system need to be overcome.

Citizens would need information for the following purposes:

- To participate in the affairs of the local government
- To participate in the discussions relating to their ward
- To participate in the budgeting of items relating to their ward
- To supervise in providing support to certain implementation activities
- To fulfill their social aspirations
- To correlate the taxes paid against the services rendered
- To justify the levy of service charges for additional amenities being provided to them by the ULBs.
- To give their assent to a change in the tax structure (manner of levy and collection).

Conclusion

To overcome the gaps listed above and to remove the hardships imposed on the users of the information of the ULBs, it is essential to move from the existing system to a modern system of accounting and administration, which would provide accurate and reliable information to meet the needs of the various users on a timely basis.

FBAS- AN INTRODUCTION

The Concept

Fund Based Accounting System is a concept that is new to Indian Governmental accounting system. In the West, Governments follow fund accounting in order to provide them with better information and hence possibility of better control. Fund Based Accounting System (FBAS) has been suggested due to following reasons:

- It is “Objective” oriented
- It provides basis for better control of various activities
- It provides information trail enabling better auditability
- It provides the base for computing cost of goods and services which the units are providing
- It provides better information for external funding and donor agencies in assessing the performance of the unit
- It provides flexibility in accounting by enabling accrual and modified accrual methods of accounting (depending on the type of the fund and its purpose)
- It is in line with General Accepted Accounting Principles (GAAP) which is becoming the global standard for accounting
- It provides basis for evaluation of achievement of objectives

What is a Fund?

The basic characteristics of a Fund are:

- Fund is a separate “entity” for the purpose of Accounting;
- Fund has very clear objectives, purpose for which they operate;
- Funds are generally defined in legal terms in constitution / Acts / Rules / Regulations by the authority (Government / Council) that regulates the municipal body;

- Funds are self-balancing and follow double-entry accounting system. This also means that balance in a fund at any point of time can be known.

Fund categories

Funds are generally classified into three types. This is based on the premise that there are basically three broad categories of municipal operations. These categories are based on the activities, purpose, operations and their nature.

Governmental types – spending activities:

Governmental Fund Types form the main category in FBAS. In these funds the focus is on spending. This does not mean that all the budget funds are pooled here and spent for any purpose. In this fund most of the activities of the municipal body can be categorised as obligatory. Obligatory functions include activities like provision of basic infrastructure, sanitation, health, primary education, etc. “Public assets” like roads, bridges, sewage lines, all belonging to general category are required to provide various obligatory services. Hence the focus of this fund is stated to be on spending. This means that the government cannot plan to collect or recover the entire operational costs by “user charges”. This implies that there has to be, naturally, some grant-in-aid element, donation, etc in this fund. In general, the following are covered in this fund:

- Obligatory Functions
- General operations of the municipal body;
- Legally earmarked activities;
- Major (general) assets.

Proprietary types – capital maintenance:

In these funds, creating and maintenance of productive assets are the focus. The maintenance of assets is normally done by levy of “user charges”. The activity in this type of fund is similar to activities of a commercial business and hence called “proprietary”. The assets created in this category, belong to municipal body and the municipal body uses it to collect rent or other user charges similar to business. The main features of this fund are:

- User charges
- Full ownership

Fiduciary type – agency/trust relation:

In these funds, moneys are held in trust for a group of persons (employees) or for an agency. The focus is maintaining moneys as per trust deed or arrangement. The main types of such funds are:

- Pension fund
- Executing works as agency for someone else

Basis of accounting

The most important feature of FBAS is the multiple basis of accounting it uses in order to achieve the objectives of accounting control. It incorporates all the three types of accounting stated below:

- a. Almost all the Governmental units including municipal bodies currently follow cash basis of accounting. Also generally, there is no classification between “capital” and “revenue” and as and when cash “comes in” and “goes out”, recording is made in accounting. The features are:
 - i. Revenue recorded when cash is received

- ii. Expenditure recorded when cash is paid
 - b. Accrual system refers to the normal double-entry accounting system that is being followed by all commercial organisations including public sector units. Clear classification of accounting period, capital / revenue classification are important. The features are:
 - i. Revenue recorded when revenue is earned
 - ii. Expenditure recorded when expense is incurred
 - c. Modified accrual system has features of both cash and accrual basis. Many financial institutions follow this method of accounting. For e.g. Revenue is recorded on cash basis, while expenditure is recorded on accrual basis. However there are several exceptions to this general form. The general features are:
 - i. Revenue recorded when measurable & available
 - ii. Expenditure recorded when expenditure is incurred
- FBAS makes use of accrual system of accounting for Proprietary funds and Trust funds; while for the other types of funds, modified accrual system is resorted to.

Fund accounting process & elements

The fund accounting is oriented towards following specific objectives:

- a. To get a comprehensive picture of what is happening in the municipal body: As a distinctive departure from the common Government Financial statements, the FBAS statements, through the classification under fund columns, provide required objective information to the users;
- b. To get a picture of what happened in the past: FBAS gives the local body a clear picture of what had happened in the past by providing a Balance Sheet. Also the cumulative financial position is depicted;
- c. To understand the performance under each of the objectives: The Revenue & Expenditure statement shows the performance during the current period and the relative performance under various fund categories.
- d. To plan for the future: FBAS system is so designed that it gives a very clear picture of what has been achieved (actuals) vis-à-vis what was planned (budget). This feature gives a very clear idea about the what needs to be done;
- e. To observe certain legal considerations: FBAS is also a legal requirement as necessitated by the Government, Acts, Rules and Regulations governing the municipal body.

Accounting Cycle:

Various steps involved in FBAS process are as follows:

- b. Record the Opening Balances: The basic principle underlying FBAS is control and hence the closing balances from the previous year's Balance Sheet (Books of Accounts) are carried over as Opening balances of the current year's Books;
- c. Record transactions for the period: as per the accounting convention of each of the funds, various transactions are recorded;
- d. Prepare closing entries: closing entries are prepared in order to draw the accounts for the year or the period. The closing entries are made as per

accounting conventions (GAAP) and features of specific fund accounting practices;

e. Prepare financial statements: There are basically two very important financial statements: the Balance Sheet and Revenue & Expenditure statement. Apart from these the two other important ancillary statements are Cash Flow statement and Budget variance statement:

- i. **Balance Sheet** gives what the local body owns (assets) and owes (liabilities). This statement gives the overall situation of the local body as on the date of preparation of the accounts; normally this is the last day of the accounting year or accounting period. Various assets and liability accounts are carried over from one year / period to the next;
- ii. **Revenue & Expenditure statement** shows the summary of all the revenues earned during the period and also the related expenses. Depending on the type of accounting (full accrual or modified accrual) the expenses are accounted whether incurred or not. The result of the statement is surplus / deficit which is carried over to the Balance Sheet. *This is similar to Income and Expenditure statement popularly used in India. However, since the local bodies do not basically earn "income" it has been named such;*
- iii. **Cash Flow statement** gives the summary of all the cash inflows and outflows as per prescribed groupings.
- iv. **Budget Variance statement** is basically a control statement that enlists all the planned (budget) and actual figures for the period along with the deviations. This serves as the basis for evaluation apart from being used for planning for the next period.

Note: - All the above statements are made for each of the funds;
- Normally a combined Balance Sheet and Revenue & Expenditure statement is prepared to get an over all picture.

FREQUENTLY ASKED QUESTIONS

What is FBAS?

Fund Based Accounting System (FBAS) is a system of accounting that enables governmental organizations like BMP (Bangalore Mahanagara Palike) maintain the accounting records in an objective manner. All the accounting transactions are classified into Governmental, Proprietary or Fiduciary types. One transaction cannot be classified in to more than one type.

Governmental type transactions relate to those activities that BMP needs to perform as a local government (or a mini government) and these functions are obligatory functions like health, education, basic infrastructure, and so on.

Proprietary type transactions are similar to those of running a business. For instance BMP builds various markets. These markets are competitors to private markets.

Fiduciary type transactions relate to agency or representative transactions, where BMP gets funds from funding agencies like World Bank and implement their programme as per specific arrangements.

Under the FBAS, the financial statements are prepared on accrual or modified accrual basis depending on the fund type enabling “true and fair” representation of actual transactions. The performance evaluation of the BMP becomes structured, simple and usable.

Why FBAS?

There are several reasons why FBAS is the most suitable accounting system for a local body. Some of the main reasons are:

- FBAS is objective (as explained in what is FBAS) and hence achievement of objectives can be evaluated;
- FBAS ties up various loose ends that are present in the current system and provides a comprehensive financial position of BMP;
- FBAS links all the functional areas of BMP and the overall financial position can be easily understood and evaluated;
- FBAS statements are easily and scientifically analyzable and depending on the performance better / more suitable financial resources can be tapped;
- FBAS analysis provides direction to the management and government about the direction in which the BMP has to plan and focus in the future;
- FBAS enables information to all types of users from citizens to policy makers, which can be arranged in a fashion that the users can easily understand and interpret.

Whom and How does it benefit?

Due to the structured and analytical information that the FBAS can provide with proper integration to various functions, it benefits:

- **Citizens** in getting information about the revenue planning, actual collection, budgeted works details and the status, etc at ward level;

- **Employees** by providing status of various financial records they update and manage; with the use of computers the FBAS enables increase the quality of work of the BMP employees reducing their workload on routine items;
- **Decision makers** within BMP by providing them with analytical and timely information; also the computerization helps in generation of various reports needed for various decision needs;
- **Policy makers** in the government to understand the performance of BMP and also needs of Corporation in implementation various programmes on behalf of the State;
- **Funding agencies** including bankers in order to provide required finance based on the performance evaluation of BMP made possible by the FBAS statements;
- **Others** like general public, media, researchers, students, and so on by providing authentic, structured information in internationally accepted format.

Is it mandatory that BMP will have to follow FBAS?

Yes! During March 2001 the BMP Council passed the BMP Accounting Regulations, 2001 and according to these Regulations, the BMP shall follow FBAS.

What is the accounting system in other Municipal Corporations in other parts of India?

Most of the municipal corporations in India follow the single entry cash basis of accounting. Since this type of accounting does not satisfy the requirements of the management, the government, the funding agencies and importantly the tax payers / citizens, they are slowly shifting the focus to modern methods of accounting.

Outside Karnataka, there are examples of some of the states like Tamil Nadu where the focus has been on accrual system of accounting. Tamil Nadu has introduced accrual accounting to all the local bodies from the accounting year 2000-01. Some of the Municipal Corporations like Hyderabad are in the process of computerizing the accounts and contemplating on the accrual system of accounting. In all these cases, there has been no thinking of FBAS, which is more appropriate for the local bodies.

In the case of Anand (Gujarat) and Jaipur (Rajasthan) preparations are underway to introduce FBAS with the assistance of Asian Development Bank. However, BMP is the first organization in India to introduce FBAS from 1st April 2001, with duly passed Regulations.

Does it make life simpler? And how?

The computerized FBAS that is currently being introduced in BMP makes the life of all stakeholders simple. For instance:

- ✓ The employees do not have to maintain manual registers;
- ✓ Currently the employees take a lot of time to prepare reports manually and these reports sometimes are incorrect due to the volume. This will not be so in future as reports will be generated by the computer as soon as the transactions are entered;
- ✓ There is delay in receipt of information to various accounting centers, as the information has to be transferred manually. In the new system the data will

- be transferred electronically and this will reduce the time and cost of data transfer and improve the integrity;
- ✓ In the existing system structured reports are not available and so every time report preparation is a burden. In the proposed system structured reports are generated by computers instantly at any time needed. This simplifies work;
 - ✓ Policy makers can get analytical reports very easily and this can be generated at request;

While the above are indicative, in reality many other procedures that are complicated will be rendered simpler.

Why they did not follow this system all these years?

India has been gradually improving its governance in various ways. With the 74th amendment to the Constitution of India the governance is being taken more and more to people. Hence the guiding principle is decentralization.

Until now, the focus has been only on centralized system. The local bodies existed, as a part of the government and all the operations were centralized. Under the centralized system, the local body was maintaining accounts for the moneys taken from the government. In fact, the moneys are collected through various levies like property tax collected from people and the accounting system needed to go through a change. This is slowly being recognized and hence the amendment.

As a part of decentralization process BMP has three zonal offices: East, West and South today. Currently through the Zonal Accounting System (ZONACS) the accounting process has also been decentralized.

Do you think the employees will be able to handle the same?

The BMP employees have been part of the FBAS, even from Conceptualization stage. The implementation has designed in such a way that the existing system flow is not affected. The employees have been provided sensitization training in both accounting and computers to enable smooth switchover of the system.

In the implementation training that is starting now, the employees will be trained in the usage of the software and in trouble shoot. In order to increase the comfort level of operation, Accounting manual and Operations manual will be provided.

The accounting staff of BMP is currently fully involved in the day to day functioning of the FBAS.

Is there a role for technology in this system?

Any good organizational solution today has to be technology driven, more so in the area where huge data is involved. In the case of BMP where huge data is involved, the FBAS is being operated using specific software designed and developed for the purpose.

The information flow today from various unit offices of the BMP happens manually. The ultimate system is proposed to be web-enabled so that data from various offices can be transferred to the data centre on a cost / time effective basis.

Will this be helpful for a long time to come?

Yes. The FBAS solution is not only long term but also a pioneer solution. In time to come various aspects of accounting in government is changing. The modernization of accounting is a contextual necessity in today's fast changing world. Not only from the point of view of local governance, also from the view point of state finances, this system will be of perennial use.

Whom should we contact in this regard? Can we come and have a look at what is happening?

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