

# **Municipal Accounting Reforms in Andhra Pradesh - Accrual Based Double Entry Accounting System**

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**Financial Management Resource Group,**  
Centre for Good Governance,  
Dr. MCR HRD IAP Campus,  
Road No:25, Jubilee Hills,  
Hyderabad, India.  
Web site: [www.cgg.gov.in](http://www.cgg.gov.in)

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## **Municipal Accounting Reforms in Andhra Pradesh – Accrual Based Double Entry Accounting System**

### **1. INTRODUCTION**

An account is a record of the financial transactions. Accounting system can be defined as ‘the series of tasks in an organisation/institution by which transactions are processed as a means of maintaining financial records.’ Such a system should recognise, calculate, classify, post, analyse, summarise and report transactions. It presents a true picture of the financial position, ensures adherence to the budgetary provisions, ensures utilisation of funds strictly in conformation with financial standards and would be useful for collection of revenues.

#### **1.1 Need for updating municipal accounts**

Accurate preparation of municipal accounts within the stipulated time is of vital importance in the overall functioning of urban local bodies (ULBs), among others, for the following reasons...

- i) To ensure collection of revenues due to urban local bodies.
- ii) To present true picture of the financial position of the urban local bodies
- iii) To ensure utilisation of funds strictly in conformation with financial standards.
- iv) To ensure adherence to the budgetary provisions in the utilisation of funds.
- v) To prepare Budget Estimates and Administration Report.
- vi) To detect misappropriation and misapplication of funds, frauds and errors
- vii) To ensure timely conduct of audit and to initiate appropriate measures on the audit reports, and ultimately
- viii) To ensure good governance

#### **1.2 Current scenario**

Currently, municipal accounts are prepared on cash based system. Under this system, receipts and expenses are recorded after they are actually received or paid in cash. It is a single entry system. All receipts and expenses are classified into various heads of account and the closing balance at the year-end is arrived. The classification of transactions in municipal accounts has a closer reference to the functions, programmes and activities of the municipality. The classification of each item of receipt and payment has to be made according to the head of the account to which it relates.

The adoption of cash basis owes its origin to the pre-eminence of budget as the principal means of financial control. A municipality, being a service oriented institution, needs to spend the monies received/raised only against planned expenditure. Further, its objective is not profit-oriented and therefore nothing is mentioned about the performance or better utilization of resources and/or savings.

The cash based accounting system cannot stand for arithmetical accuracy, since receipt and payment records only are maintained. It does not distinguish between asset, liability, income and expenditure. As a result, financial performance of the municipality for a period and status of financial position at a given point of time cannot be ascertained.

### **1.3 Advantages of cash basis of accounting**

- It is easy to maintain.
- Heads of account similar for receipts and payments.
- Classification of transactions (heads of account) has closer reference to functions, programmes and activities of municipality.

### **1.4 Disadvantages of cash basis of accounting**

- Only receipts actually received are reflected and receivables are not known.
- Only payments actually made are reflected and payables are not known.
- Represents only surplus/deficit in cash.
- Assets and liabilities are not reflected, and consequently, financial strength (net worthiness) not reflected.

### **1.5 Continuance of the system**

Since money transactions are done in cash, the single entry accounting system became the logical and accepted system of accounting. Simplicity is one of the main advantages of the cash-based single entry accounting system, and its wide appeal is also influenced by the prevailing institutional and operational conditions. Some of the factors promoting the continued use of the single entry system are the non-provision of actual transactions/liabilities/receivables in accounting, political apathy regarding fiscal and financial reporting and non-disclosure of financial status to the higher levels of government and the public.

## 2. ACCRUAL BASED DOUBLE ENTRY ACCOUNTING SYSTEM

### 2.1 74<sup>th</sup> Constitution Amendment

The municipal functional domain is radically changing from infrastructure provision to regulatory and then commercialisation. The 74<sup>th</sup> CAA has enhanced the functional domain and even made the municipality to prepare plans for economic development and social justice. Even, the government grants stipulate collection of user charges on the infrastructure created with those grants/funds. Added to it, the heavy cost of infrastructure made the municipality to go for commercial borrowing/capital market. These factors necessitate that the accounting system be converted to facilitate determination of financial performance as well as assessment of financial status.

### 2.2 Single entry Vs Double entry

Single entry system of accounting is defined as a method in which transactions are recorded on a single entry basis. Only a single line is entered in the book for each transaction. Each transaction is recorded in one column of an account as either a positive or a negative amount in order to represent the receipt or expense. This system is demonstrated in the following example.

**Single Entry System**

Date	Description	Amount (Rs.)
Jan 1	Opening Balance	1,000
Jan 2	Purchase of stationery	(150)
Jan 4	Water charges received	275
Jan 11	Shop room rent received	125
Jan 21	Street lighting electricity bill	(50)
Jan 31	Closing balance	1,200

The above system uses a single column, only the difference between receipts and expenses is totalled - not the individual values of each. Knowing the individual total amounts of receipts and expenses is important, for example, when formulating a budget. In the above example, the individual receipt and expense amounts can be determined only by sorting through the transactions and tabulating the receipts and expenses totals. This process can be designed into the system by using a separate column for receipts and expenses as demonstrated below:

Separating Receipt and Expenses		Amount (Rs.)	
Date	Description	Receipt	Expenses
Jan 1	Opening Balance	1,000	
Jan 2	Purchase of stationery		150
Jan 4	Water charges received	275	
Jan 11	Shop room rent received	125	
Jan 21	Street lighting electricity bill		50
Jan 31	Closing balance	1,200	

The above example uses two columns. It still is considered to be a single entry system, since only one line is used to record each transaction. This single-entry system often is expanded to provide more useful information. For example, additional columns can be added to classify the receipts as taxes, fees, user charges etc. Some single-entry systems may add dozens of columns for different types of receipts and expenses. Small enterprises can adopt such a system. It is not possible for a system which has large number of transactions.

On the other hand, under the double entry system of accounting, every transaction has two sides – debit and credit. For instance, if cash is paid for stationery, the transaction has resulted in depletion of cash (Cr) for the organisation due to expenditure on stationery (Dr). Likewise, if, for instance, a lessee pays shop room rent, the transaction has resulted in the increase in the cash balance (Dr) and generation of income (Cr) to the organisation. Thus, in double entry system of accounting, the two sides of a transaction are recorded in the account books.

In this system, two entries are made for each transaction - one entry as a debit in one account and the other entry as a credit in another account. The two entries keep the accounting equation in balance so that:

$$\text{Assets} = \text{Liabilities} + \text{Owners' Equity (Reserves)}$$

To illustrate, consider a transaction involving receipt of water charges on Jan 4 for Rs.275.

In a single-entry system, the transaction would be recorded as follows:

		Amount	
Date	Description	Receipt	Expenses
Jan 4	Water charges received	275	

In a double-entry system, the transaction would be recorded as follows:

Date	Accounts	Debit	Credit
Jan 4	Cash a/c Dr	275	
	To Water charges a/c		275

A narration may be added to this journal entry to indicate that the receipt is from water charges.

In this system, the double entries take the form of debits and credits, with debits in the left column and credits in the right. For each debit, there is an equal and opposite credit and the sum of all debits therefore must equal the sum of all credits.

### 2.3 Advantages of double entry accounting system

The following are the advantages of double entry accounting system over single entry accounting system:

- Recording of transactions in their entirety:  
Both the debit and credit aspects of a transaction are recorded to ensure the completeness of a transaction.
- Accuracy of financial statements:  
As the debit and credit elements of a transaction are recorded, the accuracy of the financial statements is established. Errors in recording of transactions can be detected and rectified with ease.
- Indicator of financial position:  
The Income and Expenditure Statement discloses the income earned or losses incurred during the financial year under report. The Balance Sheet discloses the financial health of the organisation on a given date. This is not possible in the case of single entry system of accounting.
- Reliability of MIS Reports:  
The reports generated from the books of account based on the double entry system of accounting give a reliable picture of the situation, as arithmetical accuracy is ensured. Thus, the status of the accounts of the customers, suppliers, assets and liabilities can be known with higher degree of reliability.

While double entry system of accounting ensures arithmetical accuracy, it does not, by itself, eliminate all the errors in the recording of transactions. The types of errors which are still possible in a double entry system of accounting are the errors of omission, errors of commission, errors of principles and compensating errors.

## 2.4 Accrual based accounting system

Determination of financial performance as well as assessment of financial status can be accomplished through accrual based accounting system. Accrual based accounting is a method of recording financial transactions based on accrual, i.e. on occurrence of claims and obligations in respect of incomes or expenses, assets or liabilities based on happening of an event, passage of time, rendering of service, fulfillment (partially or fully) of contract, diminution in value etc., even though actual receipt or payment of money may not take place. In this system, there is a change in accounting of transactions and reporting of financial results, so as to provide the municipalities with the financial reports, in the form of two important financial statements for the purposes noted against each:

	Statement	Purpose
1	Income and Expenses Statement	To determine the financial performance of the ULB
2	Balance Sheet, ie., Statement of Assets and Liabilities	To assess the financial status of the ULB

## 2.5 Benefits of accrual based accounting system

- Revenue is recognized as it is earned and that 'income' constitutes both revenue received and receivable.
- Expenditure is recognized as and when the 'liability for payment' arises and thus it constitutes both amount paid and payable
- Expenses are matched with the income earned in the year
- A distinct difference is maintained between items of ordinary nature and capital nature
- Costs which are not charged are carried forward and kept under constant review
- Surplus or deficit as shown at the year-end represents the correct financial position.
- Presents true picture of financial position of the municipality and helps in better financial management
- Assists in effective follow-up of receivables and payables
- Facilitates the credit rating organizations to appraise the financial position of municipality

Accrual system has to be recorded through double entry system. In a double entry system of accounting, each transaction consists of two elements, a debit and a credit. Debits must always equal credits. Because debits equal credits, it prevents arithmetical inaccuracies. The dual effect of each transaction is balanced.

## 2.6 Cash basis Vs Accrual basis of accounting

Cash basis of accounting differs from accrual basis of accounting in terms of the following:

	Cash Basis of accounting	Accrual Basis of accounting
1	Statement of receipts and payments made based on entries recorded in the Cash Book	Income and expenditure account is prepared.
2	Only one entry is made for a transaction (either receipt or payment) in the books of accounts	Two entries are made for each transaction in the books of account
3	Receipts and payments represent the amounts actually received and payments actually made	Income includes revenues actually received and receivable and expenditure includes both payments made or payable
4	The receipts and payments statement commences with the opening balance – both cash on hand and cash at bank.	Income and expenditure account is confined to the year of accounting only and it will not include the items of income and expenditure relating to past or future years
5	The difference between the two sides – debit and credit – will indicate the cash balance at the end of the period.	The difference between the two sides – debit and credit – will indicate the net surplus/deficit.
6	This statement need not necessarily be accompanied by a statement of assets and liabilities	The system shall, necessarily, have the Balance Sheet, ie statement of assets and liabilities.

## 2.7 Fund basis of accounting

A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts, recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations.

It is postulated that the fund basis of accounting helps in taking managerial decisions in a more conducive accounting environment. This is simply because governmental operations are by their very nature diverse. The other major factor is the need to assure legal compliance at every step. As a single government entity is involved in multifarious activities, each with a specific purpose; some in the nature of business and others as a part of service activity, it implies that each activity-purpose must be accounted for separately. Therefore, including all the financial transactions in a single fund makes it difficult to

analyze the way government funds are being used or expended. The linked problem is that in Government, usually separate entities become responsible for particular groups of assets, unlike in the private sector where a single company will have all kinds of assets that are shown in its Balance Sheet. Therefore, governmental accounting system should necessarily be organized and operated on a fund basis.

### 3. NATIONAL MUNICIPAL ACCOUNTS MANUAL (NMAM)

#### 3.1 MoUD, GoI Initiative

During National Workshop on Municipal Accounting Reforms organised by Ministry of Urban Development (MoUD), Government of India (GoI) in September 2003, it was agreed that CAG with USAID - FIRE (D) support, would prepare National Municipal Accounts Manual and it would be provided to the State Governments by MoUD, based on which, States will develop State Municipal Accounting Manuals according to their specific requirements. Accordingly, CAG has developed National Municipal Accounts Manual (NMAM) and it was made available to all States in December 2004 for development of state specific Budget and Accounts Manuals conforming the provisions of NMAM to be used by all ULBs. Some States have developed state specific Manuals and revised the accounting rules.

#### 3.2 National Municipal Accounts Manual – Chart of Accounts

The first step in the Accounts Manual is Codification Structure. A Chart of Accounts (COA) has been designed. It defines the heads under which the transactions are classified and facilitates maintenance of accounts and preparation of financial statements. It not only fulfills the accounting requirements, but also the budgeting and MIS requirements; and will be flexible to consolidate and facilitate generation of various information reports.

The Account Code primarily represents the subject of income, expenditure, liability or asset. It is a numeric and consists of 7 digits. The 7 digit code is structured as (i) Major Head Code, (ii) Minor Head Code and (iii) Detailed Head Code. The first three digits represent Major Head Code, the next two, the Minor Head Code and the last two, the Detailed Head Code. All the 7 digits are linked together and one is subset of the other.

#### 3.3 Major Head Code

The financial statements of an ULB are drawn at Major Head Codes of Account and hence this is a mandatory level of information. Keeping in view of ULB requirements, all Major Head Codes are incorporated.

The *first digit* of the Major Head Code shall indicate the nature or type of the account. The first digit shall be assigned one of the following numbers depending on the nature of the account:

- '1' shall denote an account relating to 'Revenue Income'
- '2' shall denote an account relating to 'Revenue Expenditures'
- '3' shall denote an account relating to 'Capital Receipts & Liabilities'
- '4' shall denote an account relating to 'Capital Expenditures & Assets'

The *next 2 digits* of the Major Head Code shall denote the group codes for the various heads of accounts. For example,

- Code 1-10 shall denote 'Tax Revenue' related accounts
- Code 2-10 shall denote 'Establishment Expenses' related accounts
- Code 3-50 shall denote 'Other Liabilities' related accounts
- Code 4-10 shall denote 'Fixed Assets' related accounts

### **3.4 Minor Head Code**

The Minor Head Code shall be of 2 digits. An item covered by a Minor Head Code is a subset of the Major Head Code. Thus, it shall be necessary to refer the Minor Head Code in conjunction with the associated Major Head Code.

The Minor Head Code provides further details of transactions in respect of the Major Head Code it is associated with. For example,

- Under the Major Head Code 110 relating to 'Tax Revenue', the Minor Head Code 01 shall denote 'Property Tax'
- Under the Major Head Code 210 relating to 'Establishment Expenses', the Minor Head Code 10 shall denote 'Salaries, Wages and Bonus'
- Under the Major Head Code 350 relating to 'Other Liabilities', the Minor Head Code 10 shall denote 'Creditors'
- Under the Major Head Code 410 relating to 'Fixed Assets', the Minor Head Code 20 shall denote 'Buildings'.

The schedules to financial statements of an ULB are drawn at Minor Head Codes of Account and hence this is a mandatory level of information. Minor Codes provided in the Manual are mandatory.

### **3.5 Detailed Head Code**

The Detailed Head Code shall be of 2 digits. An item covered by a Detailed Head Code is a subset of the Minor Head Code. Thus, it shall be necessary to refer the Detailed Head Code in conjunction with the associated Minor Head Code.

The Detailed Head Code provides further details of transactions in respect of the Minor Head Code it is associated with. For example,

- Under the Minor Head Code of Account 110-01 covering Property Tax, the Detailed Head Code 01 shall denote 'Property Tax - General'. Thus, the Account Code for this will be 110-01-01.
- Under the Minor Head Code of Account 210-10 covering Establishment Expenses under Salaries, Wages and Bonus, the Detailed Head Code 04 shall denote 'City Compensatory Allowance'. Thus, the Account Code for this will be 210-10-04.

- Under the Minor Head Code of Account 350-10 covering Creditors, the Detailed Head Code 01 shall denote ‘Suppliers’. Thus, the Account Code for this will be 350-10-01.
- Under the Minor Head Code of Account 410-20 covering Buildings, the Detailed Head Code 01 shall denote ‘Office Building’. Thus, the Account code for this will be 410-20-01

The detailed heads are to be identified by State Government. They can also give flexibility to the ULBs to add new heads. List of detailed heads are also provided in the Chart of Accounts.

### 3.6 Main books of account

The main books of account under the double entry system are (1) Cash book (2) Journal book; and (3) Ledger.

1.	Cash book	It is a book of original entry recording transactions involving cash and/or bank. It has two sides, ‘receipt’ and ‘payment’. All collections shall be recorded on the ‘receipt’ side and all payments on the ‘payment’ side. Separate cash books shall be maintained in respect of each bank account. Similarly, separate books be maintained for separate Fund Accounts.
2.	Journal book	It is a book of original entry for recording all transactions other than those involving cash and/or bank. A non-cash/bank transaction is first recorded in the journal book by dividing into its debit and credit aspects, from which a posting is made in the relevant ledger account. Recording of income in respect of property tax bills raised; or recording of liability on receipt of suppliers’ bills are examples of transactions, which shall be first recorded in the journal book
3.	Ledger	It is a book containing all the accounts in the Chart of Accounts. The ledger has two sides, viz., ‘Debit’ (Dr.) and ‘Credit (Cr.)’. The head of account which is ‘debited’ while recording an accounting entry in the Journal book or which is recorded on ‘payment’ side of the cash book shall be posted on the ‘debit’ side of the Ledger. Similarly, the head of account which is ‘credited’ while recording an accounting entry in the journal book or which is recorded in the ‘receipt’ side of the cash book shall be posted on the ‘credit’ side of the Ledger. Each entry in the cash book and the journal book shall have a posting in the Ledger.

### 3.7 Accounting documents

Vouchers prepared at the ULBs shall form the base documents for recording the transactions in the books of original entry. Four accounting documents are prescribed in the Manual.

1.	Cash/Bank Receipt Voucher	A document prepared for recording receipt entries in the cash book. A cash receipt voucher shall be prepared for receipts in cash; and a bank receipt voucher for receipts by cheques, drafts or pay orders, which need to be deposited in banks for realization.
2.	Cash/Bank Payment Voucher	A document prepared for recording payment entry in cash book.
3.	Contra Voucher	A document prepared for recording transactions involving deposit of cash into bank, withdrawal of cash from bank or transfer of amount from one bank to another.
4.	Journal Voucher	A document prepared for recording entries in the journal book. These entries do not involve any cash/bank related transactions

Some more registers, forms and documents are also prescribed.

## **4. MUNICIPAL FINANCIAL MANAGEMENT**

### **4.1 Revenue Income**

The following 9 (nine) major heads of revenue have been identified and the accounting procedure in respect of all the revenue items have been explained in the Manual.

- 1) Tax Revenue
- 2) Assigned revenues and compensation
- 3) Rental income from municipal properties
- 4) Fees and user charges
- 5) Sale and hire charges
- 6) Revenue grants, contributions and subsidies
- 7) Income from investments
- 8) Interest earned, and
- 9) Other income.

All details regarding accounting principles, scheme of accounting the entries, accounting records and procedure, provisioning for doubtful recoveries, period-end procedure, writes-off and internal controls have been explained.

### **4.2 Revenue Expenditure**

Revenue expenditure is classified into the following 11 heads of account.

- 1) Establishment expenditure
- 2) Administrative expenditure
- 3) Operation & maintenance
- 4) Interest & finance charges
- 5) Programme expenditure
- 6) Revenue grants, contributions and subsidies
- 7) Provisions and write off
- 8) Miscellaneous expenditure
- 9) Depreciation
- 10) Prior-period items
- 11) Transfer to reserve funds.

Details regarding accounting records and procedure, accrued expenditure, treatment of pre-paid expenditure and internal controls have been explained.

### **4.3 Liabilities**

Liabilities are classified into the following 10 heads of account.

- 1) Municipal Fund
- 2) Earmarked Funds
- 3) Reserves
- 4) Grants, contributions for specific purposes
- 5) Secured Loans

- 6) Unsecured Loans
- 7) Deposits received
- 8) Deposit works
- 9) Other liabilities
- 10) Provisions

As regards earmarked funds, ULBs have to create various funds for which separate provisions are to be allocated from general funds or earmarking of certain share from specific receipts. All monies collected for specific purpose shall be transferred to respective special fund account. Similarly, all expenditure incurred for specific purpose shall be debited to the respective fund account. The funds cover development-related like Water Supply Fund, City Development Fund, Road Fund; employee related like General Provident Fund, Pension Fund, Welfare Fund; or sinking funds like Asset Replacement Fund, Escrow Account etc.

Details regarding creation of special funds, accounting principles, accounting records and procedure, investment of special funds, period-end procedures and internal controls have been detailed.

#### **4.4 Assets**

Assets are classified into the following 14 heads of account

- 1) Fixed assets
- 2) Accumulated depreciation
- 3) Capital works-in-progress
- 4) Investments – general fund
- 5) Investments – other funds
- 6) Stock-in-hand
- 7) Sundry debtors (receivables)
- 8) Accumulated provisions against debtors (receivables)
- 9) Pre-paid expenses
- 10) Cash and bank balance
- 11) Loans, advances and deposits
- 12) Accumulated provisions against loans, advances and deposits
- 13) Other assets
- 14) Miscellaneous expenditure to be written-off

Fixed assets represent those assets, which are meant for use over an extended period. These are the assets held for providing services and are not held for resale in the normal course of operations of the ULBs. Fixed assets may be constructed or acquired by or may be gifted or donated to the ULBs either for its own use or for public benefit.

Details regarding the accounting procedure in respect of purchase/acquisition (including acquisition by way of gift/donation) and disposal of fixed assets are explained. Accounting for revaluation of the assets and depreciation on the fixed assets are also explained. The accounting principles, accounting records and procedures, period-end procedures and internal controls are also explained. Similarly, the details about investments, stores, leases and hire purchases are also explained.

## 4.5 Reconciliations

The ULB has to prepare periodic accounts at quarterly basis and this shall be in addition to the annual accounts. To facilitate the preparation of these accounts, it is necessary to carry out daily and monthly reconciliations and other accounting procedures. The procedures to be followed on daily, monthly, quarterly and annual basis are detailed.

The daily procedures cover,

- (a) Closing of Cash book
- (b) Physical verification of cash balance
- (c) Deposit of collections (both cash and cheques) in the bank
- (d) Checking ledger accounts with the books of original entries, i.e., Cash Book and Journal Book
- (e) Verification of number of receipts issued as reported by the collection office with the Collection Register, and
- (f) Updation of Subsidiary Ledgers.

The monthly procedures cover

- (a) Bank reconciliation
- (b) Recording of expenditures incurred against permanent advance
- (c) Payment of statutory deductions and remittances
- (d) Payment of provident fund dues and pension contribution in respect of employees on deputation
- (e) Reconciliation of Function wise - Income/Expenditure Subsidiary Ledgers with respective Trial Balance totals
- (f) Compilation of details of closing stock for recording the consumption of stores at the end of the month, and
- (g) Closing of ledger accounts.

The quarterly procedures cover

- (a) Reconciliation of deposits, advances, receivables and incomes
- (b) Provision for period-end expenses
- (c) Transfer of revenue grant received in advance for specific purpose to grant income
- (d) Recognition of grant income for revenue expenditure incurred in respect of grant receivable as reimbursement
- (e) Accrual of interest on borrowings
- (f) Recording of provision for bills remaining unpaid in respect of Special Fund expenditure
- (g) Accrual of interest on investments
- (h) Accrual of interest on loans to employees
- (i) Reconciliation of Capital Work in Progress
- (j) Reconciliation of Inter Unit Balances

- (k) Passing of adjustment entries, and
- (l) Closing of ledger accounts.

The annual procedures cover

- (a) Physical verification of stores
- (b) Physical verification of fixed assets
- (c) Transfer of funds from Special Funds to Special Funds (Utilised)
- (d) Confirmation of all categories of advances
- (e) Provision for unrealised revenue
- (f) Accounting of pre-paid expenses
- (g) Contribution of difference in interest to the Provident Fund
- (h) Expenditure for the benefit of SC/ST/BC or similar other welfare schemes
- (i) Confirmation from Government/Quasi-government and Government owned agencies, and
- (j) Closing of ledger accounts.

#### **4.6 Financial Statements**

After completing the annual procedure and other reconciliation activities, the ULB shall prepare the Financial Statements. The Financial Statements consists of:

- 1) Balance Sheet
- 2) Income and Expenditure Statement
- 3) Statement of Cash Flows
- 4) Receipts and Payments Account
- 5) Notes to Account
- 6) Financial Performance Indicators

#### **4.7 Trial Balance**

The process of preparation of financial statements shall be preceded by preparation of Trial Balance. The Trial Balance is a list of closing balances in all the accounts in the ledger and the cash books. The objective of preparation of Trial Balance is to determine the equality of the (posted) debits and credits, and to generate a basic summary of accounts for facilitating preparation of the financial statements like (1) Balance Sheet, (2) Income and Expenditure Statement, (3) Statement of Cash-flows and (4) Receipts and Payments Account.

Preparation of Trial Balance involves the following steps:

- all ledger accounts shall be closed at period-end and the debit and credit balances be totalled
- debit balances to be posted in the debit column of Trial Balance and the credit balances in the credit column

- posting of ledger accounts in the Trial Balance shall be in the same order as shown in the Chart of Accounts
- cash books shall be closed and the balances be posted in the Trial Balance
- both debit and credit columns in the Trial Balance to be totalled

Since every debit entry has a corresponding credit entry, the sum-total of debit balances in various account heads shall be equal to the sum-total of credit balances in other account heads. From the Trial Balance prepared, the ULB shall prepare Balance Sheet and Income and Expenditure Statement.

#### **4.8 Income and Expenditure Statement**

The statement details the income earned and the expenses incurred, and the excess of income over expenditure or vice-versa for that period. Since the financial statements are prepared under accrual basis, the Income and Expenditure Statement shall include all the incomes earned during the year, whether actually received or not; and all the expenditure incurred whether actually paid or not.

#### **4.9 Balance Sheet**

Balance Sheet is prepared at the end of each accounting period to know the financial status as on that date. It presents the assets, liabilities and reserves of the ULB as on a specified date. Thus, the excess of the assets over the internal liabilities and borrowings indicates the net-worth of the organisation. Higher the net-worth, higher will be the credit-worthiness of the organization. The details of various Balance Sheet items should be provided through separate schedules and attached to the Balance Sheet.

#### **4.10 Statement of Cash Flows**

The statement is prepared to assess the ability of the ULB to generate cash and cash equivalents and the needs of the ULB to utilise those cash flows. Cash flow statement is used in conjunction with the other financial statements to provide information to evaluate the changes in assets and liabilities of an ULB, its financial status, and the actual performance in terms of cash inflows and outflows.

#### **4.11 Receipts and Payments Account**

It shows the sources of funds and the applications of funds during the accounting period. The Receipts and Payments Account shall be prepared from the Balance Sheet, Income and Expenditure Statement, Ledgers and Cash Book.

#### **4.12 Notes to Accounts**

It shall comprise of statement of significant accounting principles, statement on contingent liabilities, subsidy report and other disclosures. The statement of significant accounting principles shall state important accounting principles followed by the ULB in respect of accounting of transactions and in the preparation and presentation of the financial statements. The statement of contingent liabilities represents an obligation relating to a past transaction or event or condition, that may arise in consequence of a future event now deemed possible but not probable. It represents a claim against the ULB which is contingent on the happening of a future uncertain event, the financial implications of which may or may not be ascertainable at the end of the accounting period. Subsidy report is one wherein general funds are provided to make good of the deficiency in respect of water supply, sewerage, lighting, solid waste management etc funds. Other disclosures mean other important financial information about the ULB, which have not been disclosed in the financial statements.

#### **4.13 Financial Performance Indicators**

A ratio is an arithmetical relationship between two figures. Some ratios have to be worked out to indicate the performance of the ULB. Financial ratio analysis is a study of ratios between various items or group of items in the financial statements of the ULB.

The financial performance indicators to be worked out are:

- i) Income Ratios
- ii) Expense Ratios
- iii) Net Income Ratios
- iv) Efficiency Ratios
- v) Leverage Ratios
- vi) Investment Ratios
- vii) Liquidity Ratio
- viii) Asset Ratios, and
- ix) Performance Ratios.

## **5. GUIDELINES FOR PREPARATION OF OPENING BALANCE SHEET**

### **5.1 Assets and Liabilities**

Under accrual system of accounting, opening balance of assets and liabilities is a prerequisite. Detailed guidelines are issued in the Manual for preparation of opening balance sheet. The ULB shall bring to book all its assets and liabilities. This exercise can be taken up in three phases:

- List and value all fixed assets;
- List and value all other assets (receivables i.e. monies/claims receivable by the ULB, be they taxes due or deposits); and
- List and value all liabilities ( Payables i.e. monies/claims that others have on the ULB)

### **5.2 Listing and valuing all fixed assets**

The first exercise of listing and valuing fixed assets is making an inventory of all assets. All assets must be grouped under various categories, like land, buildings, vehicles, roads, etc. as identified in the Accounts Manual. Separate teams should be formed for collecting particulars for each category/class of assets (land, for instance). The Manual provides 29 formats for collecting the information. The designated team should collect particulars such as identification number (survey no. in case of land, registration no. in case of a vehicle, name of a building), location of the asset, its acquisition date, value, and so on. In the first instance, assets should be listed based on physical verification. Further details such as date of acquisition and value should be obtained, if available, from records.

After having completed listing and collecting the particulars of all assets that can be 'seen', expenditure (sanctions) records should be examined to (a) list the assets that might have been missed in the first round, and (ii) capitalize expenditure incurred on refurbishing/renovating/strengthening buildings, roads, parks, etc

There would be cases, where particulars of acquisition date or value may not be readily available. In such cases, depending upon the kind of asset, a value has to be worked out that would correctly represent its economic worth. This exercise could be undertaken, if the relevant records are not traced.

### **5.3 Depreciation of Fixed Assets**

As regards depreciation in the value of assets, there are two models:

- i) **Straight Line Method (SLM):** The method under which the periodic change for depreciation is computed by dividing the depreciable amount of a depreciable asset by estimating the number of years of its useful life. In other words, it means that 100 % depreciation will be proportionately written off over the estimated life of depreciable assets.
- ii) **Written Down Value (WDV):** WDV in respect of a fixed asset means its cost of acquisition or substituted value less accumulated depreciation. In this case, the depreciation value of an year is deducted from the value of asset every year and depreciable amount is accordingly worked out.

Thus, the depreciation of an asset is worked out with reference to the estimated number of years of useful life of the asset. Further, the last year's proportionate amount of depreciation should be reduced by rupee one, which shall remain in the books of account as 'residual value' of the asset. The method and rates of depreciation on each class of fixed asset will be prescribed by Government.

The depreciation amount should be deducted from the value of the fixed asset for the purpose of calculating opening balance of the assets.

### **5.4 Listing and valuing other assets and liabilities**

Similarly, the other assets and liabilities have to be listed and valued. Assets include current assets, receivables and deposits given to various institutions and individuals. The liabilities include various payments due for which claims are received, salary arrears, amounts due to other agencies.

It is advisable that the whole exercise is supervised and guided by a steering committee chaired by the Commissioner or Examiner of Accounts.

Secondly, when the opening balance sheet is prepared for the first time, it may be possible that it is not correctly made. Even otherwise, it may become necessary to revise the Opening Balance in subsequent years. Guidelines for revision of Opening Balance sheet have also been provided in the Manual.

## **6. STATE-SPECIFIC MUNICIPAL MANUALS**

### **1. AP Manuals**

Few State Governments like West Bengal, Karnataka and Andhra Pradesh have developed state-specific accounts and budget Manuals keeping the NMAM guidelines in view. Andhra Pradesh have developed the following state-specific accounts and budget Manuals.

- 1) Andhra Pradesh Municipal Accounts Manual
- 2) Andhra Pradesh Municipal budget manual
- 3) Andhra Pradesh Municipal Audit manual
- 4) Andhra Pradesh Municipal Asset Management Manual
- 5) Andhra Pradesh Uniform Budget and Accounts Codes
- 6) Handbook on Municipal Financial Accountability
- 7) Andhra Pradesh Municipal Asset Valuation Methodology Manual