

FINANCIAL ACCOUNTING AND REPORTING PRACTICES OF MUNICIPALITIES IN WEST BENGAL: A STUDY OF THE LEVEL OF COMPLIANCE WITH NEW REGULATORY REQUIREMENTS

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Abstract:

The regulatory system governing the preparation and presentation of financial accounting reports by municipal organizations in West Bengal has undergone massive changes in the recent years. These changes have been underpinned by the need for appropriate planning, quality budgeting, the execution and monitoring of plans and budgets, transparent and user-friendly financial reporting that will assist decision makers and the public to measure performance and service quality. One of the major changes made in the regulatory requirements relating to municipal accounts relates to the replacement of the old cash-basis single entry system of accounting by the accrual-basis double entry system. The West Bengal Municipal (Financial and Accounting) Rules, 1999 has been amended suitably in order to bring about the matching changes in the layout and presentation of the financial statements. The implementation of the new system requires the preparation of an opening balance sheet, which is a complex and challenging job. The preparation of opening balance sheet requires the collection of information on fixed assets, including their location, service levels and value, and determination of liabilities as of the date the fiscal year begins. Guidelines have been formulated as to how the various issues involved in the preparation of the opening balance sheet should be addressed. The reformed municipal accounting system has been brought into force for the municipalities in Kolkata Metropolitan Area (KMA) from the financial year 2006-2007. Other municipalities have been given one year's extra time for the transition. Under the new regime, municipal organizations are required to generate the following financial statements: Trial Balance; Income Expenditure Statement; Receipts and Payments Account; Cash Flow Statement; and Balance sheet.

KEYWORDS:

Municipalities , organizations , Kolkata Metropolitan Area .

INTRODUCTION

Initiatives to reform municipal accounting systems have started not only in West Bengal but also in several other states. During the National Workshop on Municipal Accounting Reforms organized by Ministry of Urban Development (MoUD), Government of India in September 2003, it was agreed that the Comptroller and Auditor General of India (CAG) would prepare a National Municipal Accounts Manual (NMAM) based on which the states would develop their own Municipal Accounting Manuals according to their specific requirements. The Manual was duly prepared by a CAG Task Force and made the same available to the states in December 2004. The CAG Manual comprehensively details the accounting policies, procedures and practices designed to ensure correct, complete and timely recording of municipal transactions and produce relevant, reliable and understandable financial reports. The Union Government has made arrangements for providing financial assistance to the states for carrying out the reforms. In West Bengal, the Change Management Unit under the Kolkata Urban Services for the Poor (KUSP) developed a Manual for Urban Local Bodies (ULBs) in January, 2006. Accounting software has also been

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developed in accordance with codification structure and chart of accounts as prescribed in the ULB Accounting Manual Part 4. This has greatly facilitated the process of preparation and presentation of municipal accounts. The ICAI Technical Guide on Accounts and Financial Reporting System for ULBs has also been quite useful in this regard. Till date the ICAI issued seven Accounting Standards for Local Bodies in addition to the [Preface to the Accounting Standards for Local Bodies](#) and one Exposure draft of Accounting Standards for Local Bodies (ASLB 8), 'Construction Contract'. According to the information available, the process of migration to the new accounting system is well under way. The functional domain of municipalities is now changing fairly rapidly. The 74th Constitution Amendment Act has made the stipulation that municipalities would function as institutions of self-government, prepare plans for economic development and social justice, and perform functions and implement schemes as entrusted to them by the state governments. It even stipulates collection of user charges on the infrastructure created and to go for commercial borrowing/capital market. Changes in the functional domain of municipalities make it imperative that the accounting system be revamped to facilitate generation of supporting financial information. The introduction of the new system of preparation and presentation of the municipal accounting reports is a challenging job. Our primary investigation has revealed that municipalities in West Bengal are experiencing considerable difficulty in implementing the system. There are several constraints that need to be overcome if the system is to be implemented in a proper way. At present all 40 ULBs in KMA are making day-to-day accounting with the help of an Accounting Software developed strictly as per codification structure and Chart of Accounts as Prescribed in the ULB Accounting Manual Part 4 and 86 ULBs in the Non-KMA have started day to day accounting with the help of Accounting Software. Out of this 86, 82 ULBs have already completed the preparation of opening Balance Sheet but certification is due in case of 4 them, 36 ULBs already migrated to accrual - based double entry accounting system .

PRIOR LITERATURE AND OBJECTIVE

The literature on the subject of municipal accounting and reporting practices in West Bengal is extremely scanty. And much of the scanty literature that exists consists of official manuals, rules and authoritative pronouncements. Bhattacharyya (2005) is probably the most comprehensive study which covers various aspects of the preparation and presentation of municipal accounting reports in West Bengal. This study was conducted when the old cash-basis single entry system of accounting was prevailing in the state. More recently, some studies have been conducted on the current status of municipal accounting systems (eg, Ramesh and Murali, 2006; Financial Management Resource Group of the Center for Good Governance, Hyderabad, 2008; National Institute of Urban Affairs, 2010), but these are based on data pertaining to urban local bodies in other states. The developments that have taken place in West Bengal in the post-reform period have not been researched. The objective of this paper is to highlight the major deviations of the state manual (2006) from the national manual (2004) on accounting of ULBs. The present paper seeks to understand the extent of progress in implementing the accrual-basis double entry system in the state.

METHODOLOGY, SURVEY AND FINDINGS

This paper is predominantly descriptive in nature. Both primary and secondary data have been used in this endeavour. Primary data for this research were collected through interactions with preparers, auditors of ULBs and users of municipal accounts. The secondary data have been collected from official pronouncements, published municipal annual reports of ULBs, unpublished audit reports, books, journals, and study reports. The study used online sources to a certain extent. The paper did not involve testing any formal hypothesis. But it had a definitive research question that it sought to resolve. For the purpose of this paper, to analyze accounting reports, 5 municipalities of North 24-Parganas over a period of 2 years starting with the 2006-07 have been considered. The municipalities, namely Bidhannagar, Kamarhati, Taki, Barasat and Madhyamgram were selected using an accepted sample technique.

By scrutinising the state and national manual it could be commented that the state manual is very close to NMAM with respect to most of the areas, but there are some vital issues that have not been incorporated or otherwise left untouched as before. Some of the revenue items are recognised as cash basis like Trade License Fees instead of due basis, most of the income items are recognised on accrual basis, but there is no mechanism for provision on arrear of incomes in respect of taxes, water taxes and other incomes. In that scenario the Income & Expenditure A/c cannot disclose the true & fair view of periodical financial result of ULBs and also their performance. Only age- wise analysis of receivables up to 15 years with any mechanism for provisioning is a flaw of the state manual and ultimately the goal of generating quality information to be frustrated. In conclusion one word could be said that if Balance Sheet bears receivables

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accrued for up to last 15 years the dependability, reliability and effectiveness of the information would be at stake.

The transformation to accrual based accounting system in ULBs in West Bengal is almost complete according to the statistics available (Government of West Bengal, Kolkata Urban Services for the Poor). The study aims to find out whether there are any problem areas in recording transaction as per the state manual in generating true & fair view of financial statement. To fulfill this objective, the accountants of some municipalities were interviewed; the audit reports of the Accountant General, W.B. on ULBS have been consulted in addition to a limited scrutiny of accounts of these five ULBs and their audit reports (unpublished reports collected under RTI Act by the author). The interactions with the accountants of the municipalities have also been useful to have idea about the mode of preparing financial statements and related disclosures. The major findings have been enumerated below in nutshell:

1. The problem of classifying and codifying transactions according to function wise and head wise while entering them into the accounting software at the ground level leads to incorrect disclosures of accounting information. That happens due to the lack of proper orientation of the employees at micro level.
2. The problem of function wise classification and codification of expenses is also a problem when the primary accounting document like one Bank Payment Voucher or Cash Payment Voucher includes expenses relating to more than two functions as well as heads. As for example, sometimes the electricity bills for street light, office and water supply is generated in a single voucher. At that time proper care is needed to classify them function wise and head wise.
3. Due importance required to be given while preparing the age-wise classification of receivables for arrear taxes is not seen, as it is required as in notes to accounts. At ground level such age-wise classification is not done.
4. In all municipalities it has been noticed in the audit report in the form of audit observations that the incomes and expenditures figure differ from the actual. As for example, in case of Kamarhati Municipalities for the year 2007-08, there were understatement of expenditure of Rs. 1586.45 lakh and overstatement of incomes by Rs. 120.67 lakh.
5. But the internal audit system is not adequate and effective. The audit reports in all cases mentioned that a good number of transactions are entered against generation of vouchers that are supported by primary documents. It indicates poor internal control in system in practice. The physical cash balances are not regularly verified with that of books of accounts (p. 19). In one case it is noticed that the books of accounts have been prepared without preparation of Bank Reconciliation Statement where the difference between the two is around Rs. 8 crore. Every municipality is required to form Municipal Accounts Committee according to the section 92 of the Municipal Act, 1993 to examine accounts, physical verification report, audit report. But no such committee was formed in case of Bidhannagar Municipality.
6. The assets registers are not maintained, only for the assets created in the current period a register is prepared. The physical verification and valuation of assets are not done. So, the balance sheet cannot disclose the true & fair view of the financial position. This has been noticed in all municipalities. As for example Madhyamgram Municipality did not maintain any record showing quantitative details of and status / situation of fixed assets.
7. In many cases schedules of various items relating to financial statements are not prepared according to the format as laid down in the manual. It happens due to involvement of more than one head in an expenditure / income voucher or lack of clarity of an item among the preparers of vouchers and accounts.
8. Cash Flow Statement is not prepared in practice by any ULB as it is required.
9. The audit of books of accounts lagging behind for more than three years in most cases.
10. Audit comments on information asked under sub rule 22 of the West Bengal Municipal (Financial & Accounting) Rules, 1999 as amended in January 2007 have been found to be similar with minimum deviations. Only negative comments are enumerated below:
 - a) Excess expenditures in 90% cases have not been approved by supplementary budget.
 - b) Only in one case proper classification of assets/ expenditures/ incomes have been made and in other cases due to non availability of primary documents it could not be ascertained.
 - c) It is noticed that no physical verification of assets and stores were made in the sample study.
 - d) Internal control with respect to procurement of assets and other items was either nonexistent or ineffective.
 - e) The audit reports in 75% cases state that the books of accounts are not properly maintained and financial statements do not give true and fair view. In rest cases the reports are full of audit observations.
11. Follow up action on audit report submitted to the government is not taken by not organising any meeting

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of the State level Committee. Only one such meeting was held on 24th April, 2008 from May 2005, p. 7.

From the appraisal of the above points it could be easily summarized that the municipal accounting practices in our state are not able to meet the expectations of all stakeholders. The study has been done covering only five municipalities and accounting records of only two years. The compliance study has not been quantified. More emphasis has been given auditor's report. In spite of these limitations it is believed, the paper will also assist users of municipal accounting reports in developing a deep insight into the content and quality of the information provided in municipal financial reports.

CONCLUSION

In conclusion, the accrual based accounting system has legal backing and made compulsory. In the initial years there may be some deficiencies in implementing the principles because the employees involved at the micro level are not familiar with the new principles and their applications. We have started the journey from scratch. Subsequently, the ULBs will be forced to comply with all the accounting principles and generate qualitative information for ensuring their survival.

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