

Accrual Based Double Entry Accounting - A Revamp in the Financial Administration of Urban Local Bodies

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Abstract

The Cash Based Single Entry System of Accounting (CBSESA) was used by Urban Local Bodies (ULBs),

since their inception for the purpose of financial recording and reporting. Because of the system's inherent limitations, ULBs have failed to fulfil financial responsibility, transparency requirements, tapping new avenues of finance and efficient financial administration. The 11th National Finance Commission has made its apprehension on the accounting system followed in Local Self Governments (LSGs) and strongly recommended for a change in the accounting system as a good governance initiative. Time has proven that accrual-based double entry system of accounting is the most scientific method for financial recording and reporting, and the same has been in practice in commercial entities since 15th century. Unfortunately, the so-called scientific system could not be brought about in Government accounting or LSG accounting till the end of 20th century. As the first leap the Government of India suggested to adopt Accrual Based Double Entry System of Accounting (ABDESA) in ULBs in 2004. The state of Kerala adopted Municipal Accounts Manual and ABDESA in selected ULBs from 1st April 2007 (G.O. MS/8/2007/LSGD). Since, accounting information is largely used by stake holders for different purposes including financial administration and decisions, quality of such decisions (based on the published financial statements) rests largely on the shoulder of quality of information. The present paper is a detailed analysis of the quality of financial statements generated under ABDESA by the ULBs of Kerala, based on the primary data collected from five Municipal Corporations and 40 Municipalities.

Background

The Government of India (GoI) has initiated the 73rd and 74th amendments to the Indian Constitution, (Kerala Panchayat Guide) which made a remarkable change in local governance through decentralisation, in a concerted attempt to accomplish the long-cherished ambition of the Father of our Nation. In response to this, the Kerala Government (GoK) adopted two pieces of law in 1994, namely, Kerala

Municipality Act and Kerala Panchayat Raj Act. To support the development and welfare initiatives of the decentralised LSGs, the State made large budget allocations as well as the necessary power for its implementation. Following that, the amount of money to be managed and the challenges that come with the LSGs are multiplied many times. This has necessitated for a better and efficient financial administration.

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Accountability Concern

The Cash Based Single Entry System of Accounting was followed by Urban Local Bodies since its formation. This system had its inherent limitations in depicting the true financial result and financial position (CAG). This is mainly because of its incompleteness in recording accounting data as well as reporting based on the actual receipts and payments. Under the cash basis, the financial statements prepared by the ULBs do not provide a clear picture of the institutions' financial health, nor do they provide an effective reporting system to support financial planning and decision-making. The traditional accounting techniques used by ULBs proved inadequate in providing financial information to a variety of parties especially to decision makers. This necessitated the implementation of a comprehensive accounting system, potentially capable of overcoming the inherent limitations of the existing accounting practice (KILA).

Role of Accounting

Efficient mobilization of fund, its effective utilization, realistic budgeting, and systematic accounting are recognized as four pillars of modern financial management. The role of scientific accounting in financial administration is to provide timely, relevant, reliable, and complete financial information. Accounting is meant for keeping a systematic record of financial transactions whether of a public authority or of a private concern or an individual (Sharma M.P. 1962). Systematic accounting not only prevents omission and forgetfulness of demands but also avoids duplication of payments with the help of data provided by it (GoI, 1962). The system of accounting so adopted should be capable of providing complete, accurate and timely information highlighting the financial health of the institution concerned. The necessity to change the accounting system of LSGs arose from various sources, including the Controller & Auditor General (C&AG), 11th National Finance Commission, and the Supreme Court of India (Almitra H. Patel V. Union of India) due to the inherent limitations of the previous CBSESA.

Initiatives of Switchover

In this context, the Department of Expenditure of the Ministry of Finance, GoI, has entrusted the C&AG to prescribe formats for the preparation of the budget and keeping accounts of all ULBs in India. The C&AG had set up a Task Force in February 2002 to conduct study and report in this regard. The Task Force submitted its final report in December 2002, recommending that Municipalities must go for Accrual Based Double Entry System of Accounting system. As a result, the National Municipal Accounts Manual (NMAM) was developed and released in December 2004. In tune with NMAM, Kerala Municipal Accounts Manual (KMAM) was drafted for ULBs in 2007. The GoK developed an accounting software in technical consultation with Ferguson and Company for implementing ABDESA in computerized mode in ULBs. This was piloted in all the five Municipal Corporations and 3 Municipalities with effect from 1st April 2007. But the software was not comprehensive and faced difficulty to integrate with other software in practice for tax administration, planning, budgeting, and other public services. The Information Kerala Mission (IKM) has taken on the responsibility of developing alternative accounting software for ULBs in the face of ongoing technological challenges. SAANKHYA, an accounting software developed in 2008, was piloted in Kozhikode Corporation and Kannur Municipality. After this was completed successfully, the GoK made the following decision: the SAANKHYA will be introduced to all Municipalities on April 1, 2010.

Problem Statement

The Technical Committee for the introduction of ABDESA and State Audit Department were raised certain apprehensions on the working of the system and defects in the financial statements generated from ABDESA. In this context it would be meaningful to see; How does the new system of accounting work? Whether the financial reports generated in new system satisfy the required quality? and What has the current system of accrual-based accounting contributed when compared to the

previous cash-based single entry accounting? Keeping this in view the paper addresses two specific objectives

Objectives of The Study

1. To examine the quality of financial reporting in ABDESA from the Stakeholders perspective, 2. To compare the accounting practices and financial reporting under CBSESA and ABDESA in ULBs of Kerala

Methodology

The study is both descriptive and analytical in nature. The sample for the study comprises of 45 ULBs in Kerala i.e., five Municipal Corporations and 40 Municipalities selected by adopting simple random sampling. Sample respondents being 157, constituting- Accounting Staff 88, Secretaires 45 and State

Auditors 24.

Results and Discussion

The annual financial statements of ULBs under ABDESA comprise of Balance Sheet, Income and Expenditure Statement, Statement of Cash Flows, Receipts and Payments Statement, Notes to Accounts and Financial Performance Indicators (CAG). The quality of financial statements is assessed in terms of accuracy, reliability, completeness, objectivity, promptness, relevance, brevity, under standability, and comparability. The quality assessment would be included only if it is made out of the insight of: 1. Accounting Staff- who works to generate financial statements, 2. Secretary of ULBs- the largest user of financial statements as financial administrator, 3. State Audit Officers- those who verify the accuracy and authenticity of books and accounts.

Table 1
Job Category and Quality of Financial Statements

Component	Job Category	N	AM	SD	t	df	p
Quality of Financial Statements	Accounting Clerks	45	3.34	0.31	2.48	86	0.015*
	Accounting Assistants	43	3.48	0.21			

*Significant at 5per cent (p<0.05)

N: Frequency, AM: Arithmetic Mean, SD: Standard Deviation

As per Table 1 the collected data shows a better and consistent opinion from operating staff as revealed by Arithmetic Mean more than the average in the 5-point scale and lower Standard Deviation as regards the quality of financial statements. In ULBs there are two groups of Accounting Staff, one is Accounting Clerks and the other is a supporting team [specially trained M. Com graduates working in a project for capacity building among Municipal Staff named Capacity Building for Urban Local Bodies (CBULB)] hereafter known as Accounting Assistants. There exists significant difference between the opinion of Accounting Clerks and Accounting Assistants as regards the quality of financial statements from ABDESA (t=2.48, p<0.05). The Accounting Assistants have better opinion (AM=3.48, SD=0.21) compared to Accounting Clerks (AM=3.34, SD=0.31) about the quality of financial statements. Being well trained and specialists in Double Entry and SAANKHYA they are the better choice for commenting on the quality of financial statements generated under ABDESA. The null hypothesis is rejected at 5 per cent level of significance.

Table 2
Type of ULB and Quality of Financial Statements

Component	Type of ULB	N	AM	SD	t	df	p
Quality of Financial Statements	Municipal	7	3.13	0.60	3.00	86	0.004*
	Corporation						
	Municipality	81	3.44	0.22			

Source: Primary data

*: Significant at 5per cent level (p<0.05)

N: Frequency, AM: Arithmetic Mean, SD: Standard Deviation

From Table 2, it is inferred that the quality of financial statements of Municipalities is found to be better (AM=3.44, SD=0.22) than the of Municipal Corporations (AM=3.13, SD=0.60). The observation is substantiated by the statistical t test that there exists significant difference between the opinion of Accounting Staffs of Municipal Corporations and Municipalities (t=3.00, p<0.05) on the quality of financial statements. Being a new initiative, size of the entity and volume benefit of transactions may have added further to the quality of financial statements of Municipalities as compared to large Municipal Corporations. Here the null hypothesis is rejected at 5 per cent level of significance.

Table 3
Knowledge in Double Entry and Quality of Financial Statements

Components	Knowledge in	N	AM	SD	t	df	p
Quality of Financial Statements	SAANKHYA Good	42	3.48	0.22	2.40	86	0.018*
	Average	46	3.35	0.30			

Source: Primary data

*: Significant at 5per cent level (p<0.05)

N: Frequency, AM: Arithmetic Mean, SD: Standard Deviation

From Table 3, it is found that there exists significant difference between the opinion of Accounting Staff based on their level of knowledge in the accounting software, SAANKHYA regarding the quality of financial statements under ABDESA (t=2.40, p<0.05). Accounting Staff with good level of knowledge in SAANKHYA reported better opinion about the quality of financial statements under ABDESA (AM=3.48, SD=0.22) compared to Accounting Staff with average level of knowledge in SAANKHYA (AM=3.35, SD=0.30). Thus, it is explored that the null hypothesis is rejected at 5 per cent level of significance. It signifies that whose competency in the accounting software is good, hold high esteem about the quality of output. It indicates that the quality of financial statement also rests upon the mastery of the operating staff in their respective area of work. This calls for permanent accounting staff with specialisation in double entry accounting and well trained in SAANKHYA software for ensuring quality in recording and reporting.

Table 4

Quality of Financial Statements-Auditors' View

AM	SD	LCL	UCL	Moderate	High
3.12	0.37	2.96	3.27	20(83.3%)	4(16.7%)

Source: Primary Data AM: Arithmetic Mean, SD: Standard Deviation, LCL: Lower Confidence Limit, UCL:

From the point of view of State Audit Officers, who verify the authenticity, errors, omissions, completeness and lawfulness of books, accounts and annual financial statements as found in Table 4 that their overall perception on the quality of financial statements is only moderate (Mean=3.12, SD=0.37, LCL=2.96 and UCL=3.27). Majority of the respondents (83 per cent) of the opinion that the quality of Financial Statements is only moderate, while the rest expressed high opinion. It agrees with the assessment of Accounting Staffs about the quality of financial statements (See Table 1). Thus, almost similar opinion about the quality of financial statement is experienced from both the supply side and demand side. It shows that there are areas which need improvement especially at the recording stage (input) to make the output more accurate and reliable to decision makers and other stakeholders.

Table 5

Quality of Financial Statement- Secretaries View

AM	SD	LCL	UCL	Moderate	High
3.87	0.34	3.76	3.97	06 (13.3%)	39 (86.7%)

Source: Primary data

AM: Arithmetic Mean, SD: Standard Deviation, LCL: Lower Confidence Limit, UCL: Upper Confidence Limit

Being the administrative head, Secretary of ULB is responsible for the entire functioning including accounting. Th Secretary submit the annual financial statements to the Council for approval and submitted to the auditor. Table 5 signifies that from the Secretaries point of view, the overall quality of financial statements is high (Mean=3.87, SD=0.34, LCL=3.76 and UCL=3.97). Majority of the respondents (87 per cent) opined that the quality of Financial Statement is high whereas the rest has a moderate opinion. Being the executive head of the ULBs, Secretaries obviously hold high esteem about the system and its output. That may be the reason why majority have a good opinion about the quality of financial statements. This is contradictory to the opinion of Accounting Staffs and Audit Officials. Both have moderate opinion about the quality of financial statements-94 per cent and 83 per cent respectively against which 87 per cent of Secretaries hold a high opinion.

Comparison between the earlier and present systems of accounting from the user's point, in terms of recording and utility perspectives, is summarized in Table 6 and 7

Table 6
 CBSESA vs. ABDESA – Recording Perspective

Quality Practices	System	AM	SD	t	df	p
Database	CBSESA	3.08	0.41	3.391	23	0.003*
	ABDESA	3.58	0.58			
Keeping books and accounts up to date	CBSESA	3.00	0.51	3.635	23	0.001*
	ABDESA	3.71	0.75			
Completeness of books and accounts	CBSESA	2.92	0.50	5.376	23	<0.001*
	ABDESA	3.79	0.66			
Accuracy of books and accounts	CBSESA	3.42	0.58	1.479	23	0.153 ^{NS}
	ABDESA	3.00	0.88			
Up to date maintenance of Registers	CBSESA	3.33	0.76	4.184	23	<0.001*
	ABDESA	2.38	0.71			
Timely preparation of annual statements	CBSESA	2.71	0.55	5.369	23	<0.001*
	ABDESA	3.92	0.78			
Books and accounts in the Format	CBSESA	3.21	0.41	6.843	23	<0.001*
	ABDESA	4.29	0.55			
	ABDESA	3.50	0.93			

Source: Primary data

*: Significant at 5Per cent level ($P < 0.05$), NS: Not Significant ($P > 0.05$)

When we look at the table 6, it can be realized that the adoption of ABDESA is successful to a large extent in many respects by resolving the pitfalls of the earlier accounting system raised and experienced by National Finance Commission, Hon. Supreme Court, Funding Agencies and the ULBs in particular. Significant improvement is found under the new system in terms of strong database, keeping books and accounts up to date, completeness of books and accounts, up to date maintenance of registers, timely preparation of AFS and preparation of books and accounts in the format. As regards accuracy of books of accounts no significant difference is found from the earlier system. It is the most serious issue raised by the users of financial statements, especially auditors regarding the inaccuracy of books of accounts. When the books and accounts are inaccurate (due to errors or omissions), the reliability and usefulness of financial statements will be lost.

Table 7
 CBSESA vs. ABDESA in Financial Administration

Components	System	Mean	SD	t	df	P
Cash Management	CBSESA	2.84	0.37	2.940	23	0.007*
	ABDESA	3.20	0.71			
Tax Management	CBSESA	3.21	0.51	3.158	23	0.004*
	ABDESA	3.83	0.82			
Managing Arrear Collection	CBSESA	2.58	0.78	1.000	23	0.328 ^{NS}
	ABDESA	2.75	0.85			
Control over Expense	CBSESA	2.46	0.72	1.225	23	0.233 ^{NS}
	ABDESA	2.67	0.87			
Support in Budgeting	CBSESA	2.88	0.61	1.664	23	0.110 ^{NS}
	ABDESA	3.17	1.09			
	ABDESA	2.92	1.06			
Management of Liabilities	CBSESA	2.96	0.69	1.904	23	0.070 ^{NS}
	ABDESA	3.25	1.03			
	ABDESA	3.04	0.95			
Project Monitoring	CBSESA	2.83	0.64	3.444	23	0.002*
	ABDESA	3.42	0.72			
Assets Management	CBSESA	3.08	0.41	2.840	23	0.009*
	ABDESA	3.46	0.72			
Stores Management	CBSESA	2.71	0.46	3.391	23	0.003*
	ABDESA	3.21	0.83			
General Administration	CBSESA	3.00	0.42	3.680	23	0.001*
	ABDESA	3.54	0.88			

Source: Primary data

*: Significant at 5Per cent level (P<0.05), NS: Not Significant (P>0.05)

When we look at the support of accounting system in the financial administration as disclosed in table 7 that by the introduction of ABDESA, remarkable change has been noted in cash management, tax administration, asset management, stores management and general administration of ULBs. At the same time deficiency in integration of other software for tax collection, planning, budgeting, and other public services with SAANKHYA is badly affecting the areas like arrear management, budgeting, and expenses control.

Conclusion

Being a form of Government, ULBs are functioning with the public fund and public accountability. The 11th National Finance Commission envisaged transparency, accountability and good governance are as the thrust areas of Local Governance. In the financial administration, transparency and accountability can be materialized only through an efficient system of accounting and auditing. Recognizing this reality that the Government has moved to replace CBSESA with ABDESA in ULBs. At the initial stage as any other system faces, ABDESA also encounters several hurdles including policy issues, software issues, need for capacity building among Municipal Staff etc. The present paper reveals that the new system of accounting could overcome these issues to a large extent and acts as a strong database for financial administration of ULBs. However, State Audit Officers have expressed their apprehension on the accuracy of accounts mainly due to the reason for errors and omissions at the entry level. In ULBs, the recording element of accounting is performed in a decentralized way starting from front office and spreading over different departments including purchase, health, construction, revenue, planning, education etc. Being this is as the fact; it is quite impossible to get verified and ensure accuracy of each transaction through a single qualified Double Entry Accountant. The one and only solution is to have a permanent and continuous system for capacity building among Municipal Staff on Municipal Accounts Manual and SAANKHYA. So, let's hope for a transparent, accountable, and good governed ULBs with a foolproof accounting practice, resolving all its shortcomings.

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