Training Module on
Functional Budgeting and Accrual System of Accounting

March 2015

Supported under
Comprehensive Capacity Building Programme (CCBP)

Ministry of Urban Development
Government of India
Prepared by: Municipal Finance Specialist Team

Module Preparation Team:

1. Team Leader
   - V.Ramakrushna

2. Editorial Advise, Guidance and Review
   - D.V.Rao
   - State Level Team

3. Content Contributions:
   - V.Ramakrushna
   - D.Mallikarjuna
# Outline of the Module

<table>
<thead>
<tr>
<th>COMPONENT BACKGOUND</th>
<th>DESCRIPTION</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><em>JnNURM is a reform-led urban governance strengthening and improvement at ULB parastatals and state government levels. Financial Management reforms, therefore, is the cornerstone and a necessary condition for investments in mission cities as well as across ULBs the states.</em></td>
</tr>
</tbody>
</table>

| INTENDED AUDIENCE(S) | The module addresses the training needs of all functionaries – elected as well as appointed - at ULBs, parastatals and other related urban governance institutions and state government departments who are directly or indirectly involved in urban management. |

| LEARNING OBJECTIVES | The primary aim of this module is to help the municipal functionaries to provide a larger understanding on financial management reforms including accounting, budgeting and resource mobilization so that, in turn they become enabled to sustain the investments being made through *JnNURM*. It is also intended to develop a basic understanding of key issues and their prospective solutions. |

| MODULE OVERVIEW / STRUCTURE/ CONTENTS | This module provides an overall understanding of the key aspects pertaining to municipal accounting and budgeting reforms, national municipal accounting manual, accrual based double entry accounting system, budget practices, means of resource mobilization and cost recovery and innovative illustrations through case studies. |

| MODULE DELIVERY OUTLINE | **Awareness**
Overview of
- Municipal Accounting Reforms
- Budgeting Practices

| **Knowledge**
- Step by Step approach of implementing Double Entry Accounting System.
- Overview of Municipal Budgeting Practices

| **Skills**
- Detailed understanding on Double Entry Accounting System to Accounts Professional and other municipal officials |

| MODULE ACTIVITIES | Presentations using power point, interaction, group discussion and peer learning to find out differences and issues pertaining to good urban management, site visits where necessary, exercises, etc. |

| SUPPORTING MATERIALS | Additional supporting material is given in a CD enclosed with this module. |

| MODULE FEEDBACK |

| MODULE DEVELOPER |
Contents of the Enclosed Compact Disc (CD)

1. Soft Copy of the Module in PDF Format
2. Power Point presentation of the Module
3. Reference Material for all Sub Modules
4. Other Related Documents
# Table of Contents

1. Municipal Accounts Reforms ......................................................................................... 8

1.1. Introduction .................................................................................................................. 8

1.1.1. Need for updating municipal accounts ................................................................. 8

1.1.2. Current System ...................................................................................................... 8

1.1.3. Advantages of cash basis of accounting .............................................................. 9

1.1.4. Disadvantages of cash basis of accounting ......................................................... 9

1.2. Accrual Based Double Entry Accounting System ..................................................... 9

1.2.1. The 74th Constitutional Amendment ..................................................................... 9

1.2.2. Advantages of double entry accounting system ................................................. 10

1.2.3. Accrual System of Accounting .......................................................................... 10

1.2.4. Benefits of Accrual System of Accounting ......................................................... 11

1.2.5. Cash basis Vs Accrual basis of accounting ......................................................... 12

1.2.6. Fund basis of Accounting .................................................................................. 13

1.2.7. Accounting Process ............................................................................................ 13

1.2.8. Source of Document ............................................................................................ 14

1.2.8.1. Vouchers ......................................................................................................... 14

1.2.8.2. Type of Vouchers .......................................................................................... 14

1.2.9. Main books of Accounts .................................................................................... 14

1.2.9.1. Cash Book ...................................................................................................... 14

1.2.9.2. Journal Book .................................................................................................. 15

1.2.9.3. Ledger ............................................................................................................. 16

1.2.10. Balancing of Accounts ....................................................................................... 16

1.2.11. Accounting Heads .............................................................................................. 16

1.2.12. Reconciliation ..................................................................................................... 16

1.2.13. Trial Balance ...................................................................................................... 18

1.2.14. Financial Statements .......................................................................................... 18

1.2.14.1. Income and Expenditure Statement ............................................................. 19

1.2.14.2. Balance Sheet .............................................................................................. 19

1.2.14.3. Receipt and Payment Account ...................................................................... 20


1.2.14.5. Schedules ...................................................................................................... 21

1.2.14.6. Notes to Account .......................................................................................... 21

1.2.15. Good Practices – Accounting Reforms: .............................................................. 21
1.3. Functional Budgeting ................................................................. 24

1.3.1. Introduction ........................................................................... 24
1.3.2. Functional Budget .................................................................. 24
1.3.3. Key principles for development of a good municipal budget .......... 25
1.3.4. Establishment of Objectives .................................................... 25
1.3.5. Municipal Budget ................................................................. 26
1.3.6. Types of Budget ................................................................. 26
1.3.7. Budget Classification ............................................................ 27
  1.3.7.1. Expenditure ................................................................. 27
  1.3.7.2. Receipts ........................................................................ 28
1.3.8. Planning and Budgeting ......................................................... 28
1.3.9. Budget Planning ................................................................. 29
1.3.10. Implementation ..................................................................... 29
1.3.11. Stages in the budget process ................................................. 29
1.3.12. Preparation of Budgets ........................................................ 30
1.3.13. Basis of Budgeting .............................................................. 30
1.3.14. Public Participation in Budget Preparation ............................... 30
1.3.15. Budget Sanction ............................................................... 30
1.3.16. Budget Execution ............................................................... 31
1.3.17. Budget Monitoring ............................................................. 31
1.3.18. Budget Calendar for Municipal Budget ................................... 31
  1.3.18.1. Budget Calendar for Municipal Corporations .................... 31
  1.3.18.2. Budget Calendar for Municipalities .................................. 32
1.3.19. Important Terms ............................................................... 33
1.3.20. Current Scenario in Municipal Budget .................................... 33
1.3.21. Budgeting in the New Accounting System .............................. 34
  1.3.21.1. Components of Budget in the New Accounting System ....... 35
1.3.22. Making Budgets Inclusive .................................................... 36
MUNICIPAL ACCOUNTS REFORMS
1. Municipal Accounts Reforms

1.1. 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 recognize, 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.

1.1.1. 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.

1) To ensure collection of revenues due to ULBs.
2) To present true picture of the financial position of the ULBs
3) To ensure utilisation of funds strictly in conformity with financial standards.
4) To ensure adherence to the budgetary provisions.
5) To prepare Budget Estimates and Administration Report.
6) To detect misappropriation and misapplication of funds, frauds and errors
7) To ensure timely conduct of audit and to initiate appropriate measures on the audit reports, and ultimately
8) To ensure good governance

1.1.2. Current System

Currently, municipal accounts are prepared on cash based system. Under this system, receipts and payments are recorded after they are actually received or paid in cash. It is a single entry system. All receipts and payments 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.

1.1.3. 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.

1.1.4. Disadvantages of cash basis of accounting

The system has certain disadvantages. Some of them have been

- Only receipts actually received are reflected in accounts and receivables are not known in the accounts
- Only payments actually made are reflected in accounts and payables are not known in the accounts
- Assets and liabilities are not reflected; and consequently, financial strength (net worthiness) not reflected.
- Expenses not matched with revenues of the period making determination of surplus/deficit for the period a difficult task
- Certain capital expenditure treated as revenue items

1.2. Accrual Based Double Entry Accounting System

1.2.1. The 74th Constitutional Amendment

The municipal functional domain is radically changing from infrastructure provision to regulatory and then commercialization. The 74th 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.
In view of the above and as a measure of urban reforms and at the instance of Government of India directives, the State Government has taken a decision to introduce double entry accrual based accounting systems in ULBs (2011).

**1.2.2. 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 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 organization on a given date

**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.

**1.2.3. Accrual System of Accounting**

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 recognize, calculate, classify, post, analyze, summarize 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.

A good accounting system can provide confidence that the municipal resources are being used properly and that the funds have been spent according to adopted budgets and without misuse of public funds.

Account keeping is a system of recording the effect of each financial transaction under appropriate accounts, for purposes of easy comparison with past performance and for future development or improvement. The combined effect of all such transactions of a period is to arrive at the net result of the
activities or services rendered to the public by the municipality and to ascertain promptly the accurate financial position.

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:

<table>
<thead>
<tr>
<th>Financial Statement</th>
<th>Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Income and Expenditure Account</td>
<td>To determine the financial performance of the ULB</td>
</tr>
<tr>
<td>2. Balance Sheet, ie. Statement of Assets and Liabilities</td>
<td>To assess the financial status of the ULB</td>
</tr>
</tbody>
</table>

### 1.2.4. Benefits of Accrual System of Accounting

The main benefits of accrual based accounting system are

a. **Revenue** is recognized as it is earned and thus “income” constitutes both revenue received and receivable. The accrual basis not only records the actual income, but also highlights the level and efficacy of revenue collection, thereby assisting decision makers in taking financial decisions

b. **Expenditure** is recognized as and when the liability for payment arises and thus it constitutes both amount paid and payable. In accrual basis of accounting, expenditure incurred on repairs and maintenance shall be recognized as expense of the period in which they are incurred and, if not paid for during the year, shall be treated as a liability (payable) and be disclosed as such in the Balance Sheet

c. **Expenses** are matched with the income earned in the year. Thus, it provides an effective basis to understand the true performance of the organization for the operations that are conducted in the year.

d. A distinct difference is maintained between items of revenue nature and capital nature. This helps in correct presentation of financial statements, viz., the Income and Expenditure Account and the Balance Sheet.

e. The surplus or deficit in the Income and Expenditure Account represents the correct financial position of the municipality arising out of the various transactions during the year.
f. It helps in providing timely, right quality and nature of information for planning, decision-making and control at each level of management.

g. It assists in effective follow-up of receivables and proper ascertainment of payables by the municipal body.

h. Ease in financial appraisals by the financial institutions and facilitates credit rating through approved Credit Rating Agencies, which is a pre-requisite for mobilizing funds in the financial markets through debt instruments.

i. It presents a true picture of the financial position of the municipality and helps in better financial management.

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.

Thus, accrual basis of accounting results in recording of transactions and events on the basis of their substance, rather than merely when cash is received or disbursed, and thus, enhances their relevance, neutrality, timeliness, completeness and comparability.

1.2.5. Cash basis Vs Accrual basis of accounting

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

<table>
<thead>
<tr>
<th>S. No</th>
<th>Cash Basis of Accounting</th>
<th>Accrual basis of Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Statement of receipts and payments made based on entries recorded in the Cash Book</td>
<td>Income and expenditure account is prepared.</td>
</tr>
<tr>
<td>2</td>
<td>Only one entry is made for a transaction (either receipt or payment) in the books of accounts</td>
<td>Two entries are made for each transaction in the books of account</td>
</tr>
<tr>
<td>3</td>
<td>Receipts and payments represent the amounts actually received and payments actually made</td>
<td>Income includes revenues actually received and receivable and expenditure includes both payments made or payable</td>
</tr>
<tr>
<td>4</td>
<td>The receipts and payments statement commences with the opening balance – both cash on hand and cash at bank.</td>
<td>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</td>
</tr>
<tr>
<td>5</td>
<td>The difference between the two sides – receipt and payment will indicate the cash balance at the end of the period.</td>
<td>The difference between the two sides – debit and credit – will indicate the net surplus/deficit.</td>
</tr>
</tbody>
</table>
The statement need not necessarily be accompanied by a statement of assets and liabilities

The system shall, necessarily, have the Balance Sheet, i.e., statement of assets and liabilities.

### 1.2.6. 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 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 group 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.

### 1.2.7. Accounting Process

The following steps are involved in the accounting process.

![Accounting Process Diagram](image-url)
Step 1: Preparation of Voucher

Step 2: Analysis of Transaction & Classification of Accounts

Step 3: Preparation of Cash Book & Journal Proper

Step 4: Ledger

Step 5: Balancing of Accounts

Step 6: Trial Balance

Step 7: Final statements (Income and Expenditure Account; and Balance Sheet)

1.2.8. Source of Document

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

1.2.8.1. Vouchers

- Is a written document that "vouches" the occurrence of a transaction
- Is not complete until all the requisite ‘Support / Source Documents’ are attached

1.2.8.2. Type of Vouchers.

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.

Payment Voucher A document prepared for recording payment entry in cash book.

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.

Journal Voucher A document prepared for recording entries in the journal book. These entries do not involve any cash/bank related transactions

1.2.9. Main books of Accounts

The main books of account under the double entry system are

- Cash book
- Journal book;
- Ledger.

1.2.9.1. 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’
1.2.9.2. 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.
1.2.9.3. **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.

![Format for Ledger](image)

1.2.10. **Balancing of Accounts**

The difference between the total debits and the total credits of an account need be balanced. There may be

- Debit Balance
- Credit Balance, or
- Nil Balance

1.2.11. **Accounting Heads**

The Account heads are defined -

1) Revenue Income  
2) Revenue Expenditure  
3) Capital Income  
4) Capital Expenditure

1.2.12. **Reconciliation**

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 un-realised 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

1.2.13. 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 Account, (3) Statement of Cash-flows and (4) Receipts and Payments Account.

Preparation of Trial Balance involves the following steps:

   a) All ledger accounts shall be closed at period-end and the debit and credit balances be totaled
   b) Debit balances to be posted in the debit column and the credit balances in the credit column of Trial Balance
   c) Posting of ledger accounts in the Trial Balance shall be in the same order as shown in the Chart of Accounts
   d) Cash books shall be closed and the balances posted in the Trial Balance
   e) Both debit and credit columns in the Trial Balance to be totaled

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 Account.

1.2.14. Financial Statements

After completing the above procedure and other reconciliation activities, the ULB shall prepare the Financial Statements.

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

1.2.14.1. Income and Expenditure Statement

- Discloses financial performance of ULB for an year
- Shows income and expenditure of ULB, and excess of income over expenditure or vice-versa
- Income means, income earned, i.e., actually received or not
- Expenditure incurred means, whether actually paid or not.
- Income and expenditure statement is drawn from Trial Balance.
- Various heads of income and expenditure are posted from Trial Balance to Income and Expenditure Statement.

### Income and Expenditure Statement

<table>
<thead>
<tr>
<th>HOA</th>
<th>Head of Account</th>
<th>Schedule</th>
<th>CY</th>
<th>PY</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>Income</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1-10</td>
<td>Tax Revenue</td>
<td></td>
<td>1-1</td>
<td></td>
</tr>
<tr>
<td>...</td>
<td>....</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1-80</td>
<td>Miscellaneous Income</td>
<td></td>
<td>1-9</td>
<td></td>
</tr>
<tr>
<td><strong>A</strong></td>
<td>Total Income</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2-10</td>
<td>Establishment Expenses</td>
<td></td>
<td>1-10</td>
<td></td>
</tr>
<tr>
<td>...</td>
<td>...</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2-72</td>
<td>Depreciation</td>
<td></td>
<td>1-17</td>
<td></td>
</tr>
<tr>
<td><strong>B</strong></td>
<td>Total Expenditure</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(A)–(B)</td>
<td>Gross surplus/deficit</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2-80</td>
<td>Add Prior-period items</td>
<td></td>
<td>1-18</td>
<td></td>
</tr>
<tr>
<td>2-90</td>
<td>Less Transfer to Reserve Funds</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Net balance surplus/deficit</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1.2.14.2. Balance Sheet

- A statement which reflects the financial position of ULB on a particular day
- It presents assets, liabilities and reserves on a particular day
- Balance Sheet is also drawn from Trial Balance
- Assets, Liabilities and Reserve Heads are posted from Trial Balance

### Balance Sheet

<table>
<thead>
<tr>
<th>Head of Account Code</th>
<th>Head of Account</th>
<th>Schedule (details)</th>
<th>Current Year amount (Rs.)</th>
<th>Previous Year amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>3-10</td>
<td>Municipal (General) Fund</td>
<td>B 1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>…</td>
<td>…</td>
<td>…</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3-60</td>
<td>Provisions</td>
<td>B 10</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4-10</td>
<td>Fixed Assets</td>
<td>B 11</td>
<td></td>
<td></td>
</tr>
<tr>
<td>…</td>
<td>…</td>
<td>…</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4-60</td>
<td>Loans, advances and deposits</td>
<td>B 18</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4-61</td>
<td>Less: accumulated provision against loans, advances and deposits</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total current assets, loans and advances</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4-70</td>
<td>Other assets</td>
<td>B 19</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4-80</td>
<td>Misc. expenditure (to the extent not written off)</td>
<td>B 20</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Receipt and Payment Account

- Shows sources of funds and application of funds
- Prepared from Balance Sheet, Income and Expenditure Statement, Ledgers and Cash Book

### Receipt and Payment Account

<table>
<thead>
<tr>
<th>Account Code</th>
<th>Head of Account</th>
<th>Current period amount (Rs.)</th>
<th>Corresponding Previous period amount (Rs.)</th>
<th>Account Code</th>
<th>Head of Account</th>
<th>Current period amount (Rs.)</th>
<th>Corresponding Previous period amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-10</td>
<td>Tax Revenue</td>
<td></td>
<td></td>
<td>2-10</td>
<td>Establishment Expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>…</td>
<td>…</td>
<td></td>
<td></td>
<td>…</td>
<td>…</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1-80</td>
<td>Other income</td>
<td></td>
<td></td>
<td>2.60</td>
<td>Revenue grants, contributions and subsidies</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>4-30</td>
<td>Purchase of stores</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Non Operating receipts</strong></td>
<td></td>
<td></td>
<td></td>
<td><strong>Non operating payments</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3-30</td>
<td>Loans received</td>
<td></td>
<td></td>
<td>…</td>
<td>…</td>
<td></td>
<td></td>
</tr>
<tr>
<td>…</td>
<td>…</td>
<td></td>
<td></td>
<td>4-10</td>
<td>Acquisition &amp; purchase of fixed assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3-50</td>
<td>Revenue collected in advance</td>
<td></td>
<td></td>
<td>…</td>
<td>…</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other receipts</td>
<td></td>
<td></td>
<td></td>
<td>4-60</td>
<td>Other loans &amp; advances</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Grand Total</strong></td>
<td></td>
<td></td>
<td></td>
<td><strong>Grand Total</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### 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 other
financial statements to provide information to evaluate the changes in assets and liabilities of a ULB, its financial status, and the actual performance in terms of cash inflows and outflows.

1.2.14.5. Schedules

- Various schedules to support the financial statements will be prepared.

1.2.14.6. Notes to Account

- Disclosure of significant accounting principles.
  - Basis of accounting
  - Recognition of revenue
  - Recognition of expenditure
  - Fixed assets
  - Borrowing cost
  - Inventories
  - Grants
  - Employee benefits
  - Investments

1.2.15. Good Practices – Accounting Reforms:

The Gujarat Accounting Initiative

While Tamil Nadu is the best known and cited example of accounting reforms initiative, there are a few other city level initiatives as well. In 1990, as part of its financial assistance to Gujarat Urban Development Project in 1985, World Bank had insisted on the introduction of accrual based accounting in the recipient municipal corporations (six in number) and also in Anand which had the status of a municipality. The process began in 1990 with the design of a financial accounting system for the municipal bodies by consultants, paid for by the World Bank.

Later, after 1994, the same continued, with the municipalities paying. Finally, from 1998 onwards, the new system was operationalized. However, due to a number of reasons this effort could not be sustained. Chief among these were lack of involvement of consultants in the implementation stage, lack of interest of the State Government to carry forward the work after World Bank assistance got over, lack of insistence on part of the Bank, inadequate scope of reforms which completely overlooked reforms in audit areas, lack of contextualization of the system to local requirements, among others.
Karnataka Municipal Accounting Initiative:

Karnataka is presently in the process of implementing fund based accounting system (FBAS) in all ULBs, the first state to do so in accordance to requirements of the NMAM. The grounds for shifting to fund based accounting was set by the Bangalore Agenda Task Force (BATF) which initially implemented this system in Tumkur (budget of around Rs.20 crores) and Bangalore (budget of around Rs.1000 crores). Both these ULBs shifted to FBAS in 2002. In 2003, based on learning’s from this exercise BATF advised shifting of all ULBs to FBAS; this was undertaken by KUIDFC through ADB support.

Karnataka has prepared uniform accounting and budget manual based on NMAM for implementation across 43 ULBs in the state in the first phase. Uniform software and training manuals have also been developed. Fresh commerce graduates have been recruited in most ULBs who are also being trained.

Local firms of Chartered Accountants are being appointed as Field Level Consultants (FLCs) to prepare the opening balance sheet and implement the system. The entire initiative is being run under the Additional Secretary (Reforms), a special senior level position created to implement this. He is being assisted by a nodal firm (IPE) responsible for drafting the manual, budget rules, training and providing handholding support for implementation. The reports and MIS would also have the provision to be integrated and analyzed at the state level. This would allow benchmarks and detailed analysis through the software (developed by e Governments foundation). This is being implemented from 2005-06.

Other Accounting Initiatives at City Level – Importance of State Role:

Apart from Tamil Nadu, Gujarat and Karnataka, there have been incidences where individual cities have wanted to shift to double entry accounting. Ludhiana is the best example which undertook all necessary groundwork to shift to double entry accrual system of accounting under dynamic leadership. However, once the leadership changed this initiative was given a cold treatment since the State Laws did not require ULBs to move to the more complex form of accounting. Agra is another such example which also undertook necessary ground work to shift to double entry accrual system of accounting but was thwarted in this initiative as they received no support from the State Government. Apart from these, metros like Chennai and Mumbai also shifted to double entry accounting system of accounting, but these reforms were not reflected at the state level till much later.
FUNCTIONAL BUDGETING
1.3. Functional Budgeting

1.3.1. Introduction

A budget is a statement of the estimated receipts and expenditure of an institution for a financial year. It is prepared before the commencement of the year with the object of enabling the authorities to watch that the revenue anticipated is fully realised and to exercise control over the expenditure to ensure that it is kept within the authorised allotment. It is a forecast to show what will be received and what will have to be paid during a financial year and whether the receipts would be sufficient to meet the expenditure. From the perspective of a public institution, it is a summary of anticipated expenditure along with proposals as to how to meet them for a financial year.

Budget is prepared not only by public and private (corporate) institutions, but also by individuals. While the budget of public institutions is service-oriented, the corporate budget is profit-oriented. However, the personal (individual) budget is basically savings-oriented.

1.3.2. Functional Budget

A functional budget is a statement of income and/or expenditure applicable to a particular function, department or process.

By functional budgets, we mean budgets that relate to an area of an organization that produces, or does, something. This is not necessarily to say that we are talking about manufacturing alone. We can have functional budgets in manufacturing, in commerce, in government. We can have functional budgeting in non-profit making organizations too.

We need to understand what we're budgeting for if we're going to be successful. We will work through an accounting examination question to demonstrate the nature of functional budgets.

Functional budget preparation is not a difficult affair: The key principles of functional budget preparation are

- Understand the function, processor and system you are budgeting
- Find all of the data you need
- Separate the values from the volumes
- Check for interrelationships, understand and use them
- Check your arithmetic once you have prepared each budget

A functional budget is one, which relate to a function of the unit. All the functional budgets are summarized into what is known as a “master budget”. These functional budgets are subsidiary bright of the master budget.
A functional budget is actually one which relates to some function of the unit. You can find many types of functional budgets.

### 1.3.3. Key principles for development of a good municipal budget

There are certain key principles that can guide the development of a good municipal budget:

A. **Budget realism** is a very important. If a budget is unrealistic, it will be impossible to execute it as passed. An unrealistic budget undermines the credibility of the budget process, muddles rules for compliance and makes it difficult to hold responsible people accountable for its execution.

B. **Ownership of budget** is a prerequisite for a quality budget and to ensure that the executing units can be held accountable for execution of their budgets.

C. **Budget comprehensiveness** is the key to ensure that all public spending is subject to consistency and the ULBs can be held accountable for the use of public funds. In the absence of budget comprehensiveness, budgetary funds are likely to be diverted to off budget activities, reducing transparency and accountability.

D. **Clarity and timeliness in budget preparation** are critical to financial accountability. This enables both the ULB and civil society to hold the executive accountable for executing the budget as planned.

### 1.3.4. Establishment of Objectives

The first step in budget preparation is establishing the objectives for the next fiscal or the budgeting period. The objectives can be derived from the City Development Plan (CDP), if any prepared. The following are the examples of questions that need to be addressed at this stage. Please note that the questions below are only illustrative and not exhaustive.

a. What is the Vision of the Municipality and what activities the Municipality needs to take during the year to progress to the same?

b. What new assets are required?

c. Would certain citizen service be improved like providing web based payment options?

d. Would any additional recruitments be required to fill vacancies to enable citizen services?

e. Where will financial resources come from to meet commitments (Mix of revenues, grants, scheme funds and borrowings)?

f. Are any specific steps required to enhance income like assessing un assessed properties?

g. Should tax rates be raised?

h. Should certain charges like rent be increased?

i. Will any of the assets require any major improvement?

j. Is there any major capital expenditure planned as part of any programme?
k. What needs to done to manage the Solid Waste?. Is the existing procedure adequate or should that be strengthened?. If so, how that can be done? (this question needs to be raised for all functions)
l. Would the town hall require any refurbishment?
m. What requires immediate attention and what can wait?

This stage is the most important stage in the budget preparation process. This stage shall include all the key players involved in preparation of Budget including the Mayor / Chairperson, the Deputy Mayor / Deputy Chairperson and the Chairpersons of the Standing Committees concerned. The meeting shall be convened by the Mayor / Chairperson.

As of now, the citizens are not involved in the preparation of budgets. However, as this being the local government budget, it is suggested that the citizens are also involved at this stage of preparation of budget. Involving the public brings about transparency and improved governance.

### 1.3.5. Municipal Budget

A municipal budget is a traditional and conventional exercise emphasizing accountability of the Executive to the Municipal Council. It plays an important role in planning and controlling operations of the municipalities/urban local bodies (ULBs). It reflects the principles, policies, priorities and programmes of the ULBs. Budget is a tool for optimal deployment of limited resources for the best possible utility and achievement of its felt needs. It communicates the financial objectives and resource requirements to its officers, administrators, elected representatives and the public in order to secure their support for planned allocation of resources and for performance of objectives. The budget is viewed as a transparent show piece of the objectives and targets of the ULB in achieving the goals set by itself. Above all, it is a legal authorization for expenditure during the budgetary period.

A realistic budget acts not only as a tool for financial planning and control, but also as a most significant instrument to steer the development of the ULB for achieving the aspirations of the people. The budget of a ULB can be used as an effective management tool for promotion of accountability in service delivery and provision of infrastructure.

### 1.3.6. Types of Budget

Budgets are several types including: i) Line Item Budget; ii) Performance Budget; iii) Program Budget, iv) Zero-based Budget and v) Outcome Budget.

Normally, government budgets are planned and approved on a detailed line-item basis. However, actual spending may be controlled and managed on a broader and less detailed level. Each type of operating
budget, however, differs in the way in which funds are allocated for expenditures and in the orientation of the budget: control, management efficiency, or planning.

<table>
<thead>
<tr>
<th>Budget Type</th>
<th>Characteristics</th>
<th>Criteria</th>
</tr>
</thead>
<tbody>
<tr>
<td>Line Item</td>
<td>Expenditures and revenues related to commodities</td>
<td>Control</td>
</tr>
<tr>
<td>Performance</td>
<td>Expenditures and revenues related to workload</td>
<td>Management Efficiency</td>
</tr>
<tr>
<td>Program</td>
<td>Expenditures and revenues related to public goals</td>
<td>Planning/Impact</td>
</tr>
<tr>
<td>Zero-Based</td>
<td>Budget starts from scratch or as if it were for a new operation</td>
<td>Cost-effective delivery of public services</td>
</tr>
<tr>
<td>Outcome</td>
<td>Related outcome with reference to input</td>
<td>Outcome to input</td>
</tr>
</tbody>
</table>

1.3.7. Budget Classification

Budget classification is based on the objective of enforcement of accountability on the part of various functionaries. The following are the broad heads under which the Municipal Budget estimate is prepared:

<table>
<thead>
<tr>
<th>Receipts</th>
<th>Expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ordinary/Revenue Receipts</td>
<td>Ordinary/Revenue Expenditure</td>
</tr>
<tr>
<td>Capital Receipts</td>
<td>Capital Expenditure</td>
</tr>
</tbody>
</table>

1.3.7.1. Expenditure

The expenditure incurred by a Municipality can be broadly classified into (a) Revenue Expenditure and (b) Capital Expenditure.

(a) Revenue Expenditure: Revenue expenditure can be defined as the outlay benefiting only the current year. It is treated as expenditure to be matched against revenue. The following are the broad categories of revenue expenditure.

1. Establishment Expenses
2. Administrative Expenses
3. Operations and Maintenance
4. Interest and Finance Expenditure
5. Programme Expenses
(b). **Capital Expenditure**: Capital expenditure can be defined as the expenditure intended to benefit future period in contrast to a revenue expenditure, which benefits the current period. The term is generally restricted to expenditure that adds fixed asset units or that has the effect of improving the capacity, efficiency, life span or economy of operations of an existing asset.

The objectives laid down for the municipality drive the capital expenditure budget. The capital expenditure incurred during the year can be either on account of the ongoing works, the expenditure for which is expected to be recognized during the year and the new development works that may start during the year. In addition to the public works, the department heads shall also estimate the capital expenditure that may be incurred on other assets, movable or immovable.

The department head shall however note that the budget proposals for capital expenditure are not be based on what will be paid out during the year but will be estimated on what will be incurred during the year.

1.3.7.2. **Receipts**

The Receipts of a Municipality can be classified into (a) Revenue Receipts and (b) Capital Receipts.

a) **Revenue Receipts**: The revenues drive the municipality’s operations. It generates the cash flow for the running the municipality and for the development works of the Municipality. The Municipality derives its revenue mainly from the following sources—(i) tax revenues, (ii) non tax revenues, and (iii) grants.

b) **Capital Receipts/Grants**: Capital receipts include transfers from Municipal General Revenues for the execution of developmental works, grants released by the State Government and Government of India for specific works/schemes, Loans from Market, HUDCO and other sources.

1.3.8. **Planning and Budgeting**

Sound planning and effective use of resources is perhaps the central tool for improved PFMA in ULBs. Currently planning is limited to the annual budget which is essentially a financial balancing exercise and a sanction tool to authorize spend by the council. Poor planning poses three types of risks to a sound PFMA environment:

i. Formulation Risk in that it does not assess and provide for correct and efficient allocations;

ii. Policy Risk in that the ULB fails to execute the budget passed, and

iii. Fiduciary Risk in that funds are not spent for the purposes mentioned in the budget.

This section deals with the use of budget as a planning tool by the ULBs.
1.3.9. Budget Planning

It is desirable that the process for budget planning is realistic, comprehensive, orderly and participatory and reflects then ULB’s priorities and policies. This would imply the budget to be need based, prioritized and have a multi-year time horizon. Further, the budget process should ensure that the projections made are realistic, achievable and developed in a participatory manner. Further, the focus of budgets should be on results achieved and not merely money spent by the ULB.

1.3.10. Implementation

Successful implementation of the budget prepared by the ULB involves a number of processes. It needs to be used as a tool for planning, procurement and expenditure control. Linkages with the accounting, MIS and treasury operations are also critical. It also requires strong internal control and audit, assets and liabilities management and related systems in place for effective and efficient implementation.

1.3.11. Stages in the budget process
1.3.12. Preparation of Budgets.

Budgets are prepared by the accounts department based on estimates of revenue and expenditures of the previous financial year. Due to lack of relevant information, most revenue estimates are based on *ad hoc* or percentage increases over the previous year’s budget, without taking into account the actual potential or requirement. These result in large variations between budget and actual, even in places like Bangalore where budgeting systems are comparatively better developed.

Expenditure estimates are also not backed by detailed workings or breakdown such as the exact Projects that are planned, estimated costs etc. This leads to a focus on the ‘input’ i.e. the amount of money to be spent rather than ‘output’ i.e. the result of the spend.

Estimates would be made for each of the accounting subject under every budgeting centre. Hence a budget code is defined as a combination of budget centre and account code. The codification structure for this is defined in Andhra Pradesh Municipal Accounts Manual (APMAM).

Budget would reflect estimated revenue income and expenditure, revenue surplus/deficit, inflows and outflows and opening and closing balances for capital heads.

1.3.13. Basis of Budgeting

Current budgets as tools for financial discipline are prepared on cash basis. This means that only those expenses and revenues which are actually expected to be paid are included in the budget. As a result, it does not consider ‘full cost’ method of planning, excluding several items of non-cash revenues and expenses (including depreciation).

1.3.14. Public Participation in Budget Preparation.

One of the most important tenets of effective PFMA is ensuring effective participation of concerned stakeholders in the planning process. Generally in Indian ULBs, there are no public debates on the budgeting process. Ward Committees, although prescribed, have either not been formed or are not active in most states (West Bengal and Kerala being notable exceptions). However, since budgets continue to be ‘input’ based, these documents are only of limited use and understandability for the common person.

1.3.15. Budget Sanction.

In the Municipalities, the Commissioner prepares the annual budget and places before the Municipal Council for approval. If it is not approved in the Council meeting, it would be referred...
again to the Council for approval. In case the budget is not approved even in the second meeting, the Chairperson would forward the budget to the Government for approval.

The budget sanctioned by the Corporation/Council will authorise the Commissioner to strictly adhere to the realization of revenue and controlling the expenditure as per the budgetary allocations.

1.3.16. **Budget Execution**

To enable the budget document to be used as an effective tool for planning, procurement and expenditure control. It is essential for the budget to be linked to accounting systems and MIS. Periodic budget analysis reports need to be prepared and disseminated. Dissemination is necessary to ensure transparency in the budget execution process leading to public pressure and accountability.

1.3.17. **Budget Monitoring**

Budget monitoring practices differ across States. In general, the Department of Municipal Administration is required to monitor the budgets externally while internally the responsibility of ensuring that the budgets are adhered to lies on the standing committee/council. However, internal monitoring is generally not mandated in the Rules.

Further, Indian ULB legislations fail to specify fiscal management responsibilities for ULB officials; thus, most ULB officials are unsure of their roles and responsibilities in budget execution. As a result there is no internal performance measurement within the ULBs as to the actual budget and its execution. The recent recommendation of the 12th CFC for state enactment of fiscal responsibility legislation is likely to improve budget preparation, execution and monitoring situation in ULBs.

1.3.18. **Budget Calendar for Municipal Budget**

The budget preparation and monitoring process follows a budget calendar. The budget calendar provides milestones by which officials in the ULB need to prepare the budget and place before the concerned authorities. Various stages of budget preparation and approval should be within the time limits stipulated in this regard by the relevant Acts/Rules.

1.3.18.1. **Budget Calendar for Municipal Corporations**

<table>
<thead>
<tr>
<th>Budget Activity</th>
<th>Not later than</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commissioner to convene section heads meeting to initiate budget process</td>
<td>25th September</td>
</tr>
</tbody>
</table>
Circular from the Commissioner to section heads to prepare budget estimates | 1st October
---|---
Preparation of budget estimates for sections by the section heads (functionaries) | 10th October
Compilation of budget at accounts section | 25th October
Budget finalisation by the Commissioner and placing before the Standing Committee | 10th November
Review and approval of budget by the Standing Committee to be placed before the Corporation | 10th December
Circulation of budget booklets to the ward members/corporators | 15th December
Sanction of budget by the Corporation | 20th February
Submission of approved budget to the State Government for information | 1st March
Budget copy to Examiner of Accounts and Auditors | Within 15 days of sanction
Re-appropriation to the Corporation by the Commissioner | As and when necessary
Additional allotment information to Corporation by the Commissioner | As and when necessary

**1.3.18.2. Budget Calendar for Municipalities**

<table>
<thead>
<tr>
<th>Budget Activity</th>
<th>Not later than</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commissioner to convene section heads meeting to initiate budget process</td>
<td>25th September</td>
</tr>
<tr>
<td>Circular from the Commissioner to section heads to prepare budget estimates</td>
<td>1st October</td>
</tr>
<tr>
<td>Preparation of budget for sections by section heads (functionaries)</td>
<td>10th October</td>
</tr>
<tr>
<td>Compilation of budget at accounts section</td>
<td>25th October</td>
</tr>
<tr>
<td>Budget finalisation by Commissioner to place before the Council</td>
<td>7th November</td>
</tr>
<tr>
<td>Circulation of budget booklets to the ward members/councillors (at least seven days before the budget meeting of the Council)</td>
<td>8th November</td>
</tr>
<tr>
<td>Budget approval in the Council</td>
<td>15th November</td>
</tr>
<tr>
<td>Budget approval (again by the Council), if the Council fails to approve the budget with or without modification in the first meeting</td>
<td>22nd November</td>
</tr>
</tbody>
</table>

In case budget is not approved by the Council in two meetings, it would be forwarded by the Chairperson to Government for approval
Submission of approved budget to the State Government for information through the Collector and Commissioner & Director of Municipal Administration (CDMA)

<table>
<thead>
<tr>
<th>Event</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Submission to Collector (by municipality)</td>
<td>31st December</td>
</tr>
<tr>
<td>Forwarding of budget by Collector to CDMA</td>
<td>15th January</td>
</tr>
<tr>
<td>Forwarding of budget by CDMA to State Government</td>
<td>5th February</td>
</tr>
<tr>
<td>Copy of approved budget to Auditors</td>
<td>31st December</td>
</tr>
<tr>
<td>Observations if any made by Government to be placed before Council</td>
<td>After receipt from the Government</td>
</tr>
<tr>
<td>Budget additional allocation / re-appropriation to Council by Commissioner</td>
<td>As and when necessary</td>
</tr>
</tbody>
</table>

Any expenditure during the course of a year shall be regulated in accordance with the allotments made in the budget for the year, as sanctioned by the Corporation/ Council. Additional budget needs, if necessary, would be made by additional allotment or re-appropriation. The Budget calendar facilitates the ULB to complete the budgeting process before commencement of financial year and smooth roll over to the new financial year.

1.3.19. Important Terms

In this connection, it is necessary to understand some of the important terms in budget preparation.

Budget Estimate

It is a statement of the estimated receipts and expenditure of an ULB for a financial year. It is prepared before the commencement of the year with the object of enabling the authorities to ensure that the revenue anticipated is fully realized and to exercise control over the expenditure.

Revised Estimate

A revised estimate is an estimate of the probable receipts and disbursements for a year framed in the course of the year with reference to the transactions already recorded. The revised estimate for the current year and budget estimate for the ensuing year have to be framed simultaneously.

Appropriation

Appropriation means the amount provided in the budget estimate under a regular head of account.

Re-appropriation

Re-appropriation means transfer of funds from the appropriation made in one budget head to that of another budget head. It becomes necessary when the allotment made in a budget head is exhausted and additional amount is required; or an allotment made in a budget head has become unspent and can be made use in another budget head.

1.3.20. Current Scenario in Municipal Budget

The current budgeting practices in most municipalities in the country suffer from the following drawbacks...
a. Though budget is a forecast, in reality the forecasting is done on an ad hoc basis and not on scientific lines
b. Budget heads or categorization is not rational and is not fully useful for expenditure planning and control
c. Budget formats do not focus on the goals and programmes as a result of which it is not possible to hold municipal functionaries accountable for their functions
d. Feedback mechanisms from operational to decision-making levels and accountability mechanisms are generally weak;
e. Information systems linking budget, accounts and performance management functions are not developed;
f. The distinction between recurrent and capital expenditures is often not clear; capital budgets are either not prepared or are prepared on unscientific lines;
g. Even the existing budgets are not compiled and presented on time;
h. The budget execution, management and monitoring processes are not effective, as a result the management role of the budget is diluted;
i. Budget, accounting, municipal management information system, annual reporting and audit systems are not integrated.

Most of the ULBs’ budget is on an ”incremental” basis, which means that costs up to date serve as the basis for addition of cost increases or higher budgets during each successive year. Such an approach simply accepts historical costs and financial experience. It does not examine costs, facts and financial innovations.

Traditionally, the budgeting processes in the ULBs have been undertaken with the following:

1. Income head-wise classification for receipts into ULBs, and
2. Department-wise classification for payments out of ULBs

Although these have lent the needed flexibility in tracking and controlling the expenses / revenues overall and under a budgetary head, the budget is not, however, used as a tool for measuring and promoting accountability on part of service functionaries.

1.3.21. Budgeting in the New Accounting System

Generally accepted principles of budgeting require budgeting system to be integrated with the accounting system. Traditionally, the Municipalities were maintaining the accounts on cash based single entry system of accounting. The budget was also prepared on the same lines. As Municipalities transition to Accrual based Double Entry System of Accounting, the Budget prepared should also reflect the accounting system
followed. Therefore, the Municipalities that have transitioned to Accrual Based Double Entry System of Accounting shall prepare their budget based on the new system.

Following details gives an overview of Budgeting in the new system focusing on the components of the budget in the new system, the coding structure and the budget reports generated in the new system.

1.3.21.1. Components of Budget in the New Accounting System

Budget in the new system is built around five components – Fund, Function, Functionary, Field and Account Heads. These components are briefly described below.

**Fund**

1) A “Fund” is defined as an activity for which separate books of accounts and financial statements are required to be maintained and prepared, as per the orders of the state government. The general municipal activities will come under “General Fund”.

2) The Municipalities shall prepare separate budget for each type of fund and the same shall be passed separately by the council. Further, the Municipalities shall consolidate all the FUNDS for which separate budget has been prepared. Such consolidated budget shall be an integral part of the Budget placed before the Council.

**Function**

The next important component of a budget is the “Function”. A Function represents the services offered or specific functions performed by the Municipality. Solid Waste Management, Mosquito Eradication Programme, Immunization, Accounts, Administration are examples of Functions of a Municipality. The list of function groups are given in National Municipal Accounts Manual (NMAM).

**Functionary**

Functionary represents the department / position which performs the various functions of the Municipalities. This includes the Implementing Officers of Transferred Institutions. Engineering Department, Health Department, General Section are some of the examples of Functionaries. Some of the Functions undertaken by these Functionaries would include Public Works by Engineering Department, Immunization by Health Department and Administration by the General Section. Every Functionary would prepare budget proposals for each of the function it undertakes.

**Field**

Field represents the geographic distribution of the Municipalities. A ‘Field’ represents the geographic area to which the income or expenditure relates. An electoral ward is an example of a “Field”. The functionaries shall prepare a function-wise budget for each Field.
Account Heads

The Account Heads are defined for the Assets, Liabilities, Income or Revenue and the Expenditure. The Budget proposals shall be prepared using the Account Codes as recommended in the NMAM.

a) Assets  
b) Liabilities  
c) Income  
d) Revenue Expenditure

The above components of the budget have been codified and the same has been incorporated in the National Municipal Accounts Manual.

1.3.22. Making Budgets Inclusive

Internal earmarking, within local body budgets, for basic services to the urban poor, is an important reform required for the attainment of the following larger objectives envisaged under JNNURM:

- Scale-up delivery of civic amenities and services with emphasis on universal access to the urban poor.
- Provision of basic services to the urban poor including security of tenure at affordable prices, improved housing, water supply and sanitation, and ensuring delivery of other existing universal services of the government for education, health and social security.
- Integrated development of slums through projects for providing shelter, basic services and other related civic amenities with a view to providing services to the urban poor.

There are two main aspects of this reform – one, adoption of clear, affirmative policy of earmarking (allocating) certain quantum (%) of funds for urban poor and two, creation and operation of appropriate budgetary mechanism to ensure that funds allocated for urban poor get spent on urban poor.

In response to this reform conditionality, states and ULBs have initiated processes (policy adoption) aimed at earmarking a certain percentage of the budget exclusively for the urban poor. For example, Gujarat state has adopted a policy for earmarking 20 percent of its budget for urban poor and has made it mandatory for ULBs in the state to earmark the same proportion of their budgets for provision of services to the urban poor. Andhra Pradesh State has given policy direction to municipal bodies to allocate 40% of total budget for provision of services to the urban poor. Though this is a step in the right direction it will be effective only when a appropriate budget restructuring is undertaken for actualizing policy of internal earmarking of specific budget for providing services to urban poor.
Summary of the Module

The National Municipal Accounts Manual comprehensively details the accounting policies, procedures, guidelines designed to ensure correct, complete and timely recording of municipal transactions and produce accurate and relevant financial reports. The manual is to be adopted and followed by the various State Governments while drafting their state specific municipal accounts manuals. Accounting principles placed in the manual are primarily focused on the concept of accrual basis of accounting. The accounting principles adopted for preparation of the Financial Statements of the Municipalities shall be followed uniformly unless stated otherwise in the manual. The manual provides for integrating the budgeting and accounting systems to enable better control.

It is felt desirable to have a Training Module which could be used across all Municipalities to whom the National Municipal Accounts Manual with or without modifications are made applicable. The Training module can be used at all Municipalities. This material is intended for the trainers for use as a background material for training the accounting staff on day to day accounting of transactions. The training manual does not replace the national municipal accounts manual nor is it intended to be a substitute for the same. For details reference must be made to the NMAM.

For information or queries, please contact,

**Under Secretary, NURM IV**

JnNURM Directorate

Ministry of Urban Development

Government of India

E mail: usjnnurm4@gmail.com

Or

Visit www.jnnurm.nic.in