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Assessment of selected Urban Local Bodies preparedness for Timely Preparation of Annual Financial Statements in line with 15th Finance Commission



Anuradha Goel
Academician

Finance commissions in the past have focused on the Financial Sustainability of Urban Local Bodies (ULBs) and grants have been linked to parameters that require Urban Local Bodies (ULBs) to have robust revenue like the 14th Finance Commission kept a provision of 20% as Performance Grant, 15th Finance Commission used carrot and stick approach for releasing grants; *carrot in terms of released grants if the State has migrated to the Capital Value method of Property Tax and its growth is commensurated with State Gross State Domestic Product (GSDP)*¹.



CA. Pankaj Goel
Member of the Institute

Government of India (GoI) Flagship Programs whether Smart City or Atal Mission for Rejuvenation and Urban Transformation (AMRUT), 14th Finance Commission (FC), and 15th Finance Commission (FC) advocate publishing of unaudited and audited Annual Financial Statement (AFS) of Urban Local Bodies (ULBs) within specified timelines. The Ministry of Housing and Urban Affairs (MoHUA)² has recently released guidelines for ranking cities financially. These guidelines, which are based on 15 parameters, utilize the Budget and Annual financial statements of Urban Local Bodies (ULBs) as the primary documents for assessing the financial ranking of cities. *This underlies the importance of timely financial reporting in coming years.*

This article aims to highlight the essential requirements that States and Urban Local Bodies (ULBs) must fulfill to adhere to the timelines set by the 15th FC. Establishing a robust Financial Ecosystem by the State/ULB is crucial for maintaining financial discipline. This ensures not only eligibility for grants but also the availability of documented Annual Financial Statements (AFS) for future city financial rankings and assessing the creditworthiness of ULBs for issuing Municipal Bonds.

¹ 15th Finance Commission and Para 8 of AMRUT 2.0

² Final Guidelines & Ranking Framework March, 2023, MoHUA

Public Finance

THE CHARTERED ACCOUNTANT

Introduction

India is one of the fastest-growing economies in the world, and its growth is propelled by its cities. Cities contribute 66% to the national GDP, and the number is expected to rise to 80% by 2050. The growth and sustainability of these cities would be dependent on what extent they can meet their expenses with their financial position. Their Financial Position is determined by their financial statements which are prepared by Urban Local Bodies as per the State Municipal Accounts Manual (SMAM) & National Municipal Accounts Manual (NMAM).

In line with the State Municipal Accounts Manual (SMAM) & National Municipal Accounts Manual (NMAM), Urban Local Bodies (ULBs) prepare their Annual Financial Statements (AFS) on an annual basis to depict their financial performance in the financial year. Para 31.4 of Chapter 31 of NMAM "Financial Statements states that the Annual Report/ financial statements" of the ULB shall include the following:

- i. Balance Sheet;
- ii. Income and Expenditure Statement;
- iii. Statement of Cash flows (a summary of an enterprise's cash flow over a given period);

- iv. Receipts and Payments Account (detailed as per the account heads);
- v. Notes to Accounts; and
- vi. Financial Performance Indicators.

More than 30 years have passed since autonomy was provided to Urban Local Bodies (ULBs) through the 74th Constitutional Amendment Act (CAA), still financial reporting is at a nascent stage restricting to the preparation and uploading of Annual Financial Statements (AFS). None of the Guidelines whether City Financing ranking or 15th FC specifies what financial statements shall cover to comply with condition of uploading of Annual Financial Statements. Most of the Urban Local Bodies (ULBs) fail to adhere to timelines required for preparing and publishing Annual Financial Statements (AFS) despite their dependence on third-party professionals for its preparation.

14th and 15th FC and other Guidelines issued by MoHUA requires Urban Local Bodies (ULBs) to prepare and publish Annual Financial Statements (AFS). (Table 1)

It is evident that the 15th Finance Commission has mandated timeline of 15th May of the year for publishing unaudited accounts of the previous year with the vision

Table 1: Conditions for Preparation and Publishing Annual Financial Statements by Finance Commissions and Centrally sponsored schemes guidelines

#	Finance Commission/ Centrally sponsored schemes guidelines	Conditions	Timelines
1	Smart City Mission	Audited Financial Statements need to be in place due to: <ul style="list-style-type: none"> ■ Credit Rating of Cities ■ Issuance of Municipal Bonds 	
2	AMRUT and AMRUT 2.0	Augmenting Accrual Based Double Entry Accounting System (ABDEAS) <ul style="list-style-type: none"> ■ Migration to ABDEAS & audit certificate from FY 2012-13 ■ Publication of annual financial statement on website ■ Appointment of internal auditor (IA) 	
3	City Financial Ranking guidelines, 2022	City financial ranking guidelines issued by MoHUA, Fiscal Governance Parameter - Point 10 requires a Timely Audit Closure & Publication of Audited Annual Accounts in the public domain for 3 years. The audit shall not be done beyond a period of 12 months since the end of FY else no marks will be awarded.	
4	14 th FC	As per 14 th FC, each ULB is required to submit audited accounts that relate to a year not earlier than two years preceding the year in which a ULB seeks to claim the performance grant. In addition to this mandatory condition, the following activities are to be undertaken by individual ULBs for accessing the grant for the remaining three years, i.e., 2017-18, 2018- 19, and 2019-20.	30 th Sept of FY

Public Finance

THE CHARTERED ACCOUNTANT

#	Finance Commission/ Centrally sponsored schemes guidelines	Conditions	Timelines
		<ul style="list-style-type: none"> For the Performance Grant of 2017-18, 2018-19, and 2019-20, audited accounts must be published on the ULB website for the years 2015-16, 2016-17, and 2017-18 respectively 	
5	15 th FC	<p>To claim a Grant for FY 2024-25; State to ensure online availability of:</p> <ul style="list-style-type: none"> Unaudited accounts i.e. Annual Financial Statements (AFS) for the previous year i.e. FY 2023-24, and Audited accounts i.e. Annual Financial Statements (AFS) of the year before the previous year i.e. FY 2022-23 	15 th May 2024

that accounts of local-self government are prepared well on time like that of listed companies. **This will further put financial discipline in place making it easier for ULBs to explore the bond market in the coming years.**

In today's era of Aatma Nirbhar visioned cities, punctuality in financial reporting needs to be addressed.

Scope of the Assessment

10 Cities of Two States i.e. Jharkhand and Assam, have been selected based on random sampling. Annual Financial Statements for the past three years i.e. FY 2019-20, 2020-21, & 2021-22 have been examined from the city financial portal³.

Methodology

A realistic study based on secondary sources was steered to find the measures adopted by the Government of India and State Governments for financial reporting through the preparation of annual financial statements. The data was collected from government reports, research articles, reports of research agencies, and other online resources. *The assessment of 10 cities is based on author's experience in the Municipal Finance field.*

Regulatory Framework for Accounting

Urban Local Bodies (ULBs) are governed by their respective State Municipal Act like Urban Local Bodies (ULBs) of Jharkhand are currently governed by the Jharkhand Municipal Act (JMA), 2011. Urban Local Bodies (ULBs) of Assam are currently governed by the Assam Municipal Act, 1956 (amended in 2022). Some States have made necessary amendments to their Municipal Acts regarding the method of accounting to

be followed by ULBs and other provisions related to realizing the importance of financial Statements.

- To illustrate: *The Jharkhand Municipal (Accounts & Finance) Rules, 2012 have been prepared in congruence with the Jharkhand Municipal Act, 2011.*

Part A – Jharkhand Municipal (Accounts & Finance) Rules, 2012: The Jharkhand Municipal (Accounts & Finance) Rules, 2012 have been presented with the rules containing Accounting and Financial matters and forms and registers related to the rules.

Part B – Jharkhand Municipal Accounts Preparation Guidelines: Jharkhand Municipal Accounts Preparation Guidelines have been prepared in pursuance to Rule no. 13 of Jharkhand Municipal Accounts & Finance Rules, 2012. The Guidelines in separate volumes consist of

- Accounting Principles under the double-entry accrual system of accounting;
- Chart of Accounts;
- Guidelines for the preparation of the Opening Balance Sheet;
- Formats and procedures to record the accounting entries.

*However, there are no Assam Municipal (Account & Finance) Rules, unlike The Jharkhand Municipal (Accounts & Finance) Rules, 2012 which are based on the National Municipal Accounts Manual (NMAM). Thus, there is inconsistency among states regarding the adoption of State Municipal Accounting manuals to empower ULBs through the power of Governance with the weapon of *Municipal (Account & Finance) Rules.**

³ <https://cityfinance.in/home>

Public Finance

THE CHARTERED ACCOUNTANT

- A brief comparison of 2 States among 10 Urban Local Bodies (ULBs) showing the inconsistency of robust governance has been presented in Table 2:

15TH Finance Commission Timelines: Assessment

Timely financial reporting ensures meeting of statutory deadlines and availability of information to decision-makers promptly. The relevance of financial information tends to be lost if it is delayed so it is important to provide up-to-date and current data for decision-making.

- Seeing the importance of timelines of financial reporting, Section 137 of the Companies Act, 2013 has given a statutory timeline of filing Annual Financial Statements within 30 days of the Annual General Meeting of the Company.
- The Ministry of Housing and Urban Affairs (MoHUA) in its city financial ranking, 2023 has also given a timeline of Timely Audit Closure & Publication of Audited Annual Accounts in the public domain -i.e. within 12 months of ending the financial year, else zero marks will be awarded out of 25 marks.
- 15th Finance Commission has given a timeline of 15th May of 2024 for ULBs to become eligible for 2022-23 grants.

However, once these Urban Local Bodies (ULBs) are listed for municipal bonds, they need to get annual accounts prepared and audited within the timeline of SEBI for listed companies. The Ministry of Housing and Urban Affairs (MoHUA) (earlier known as MoUD) has

also established a national portal of ULB finances, i.e., <http://www.cityfinance.in> that is a repository of municipal financial information where all urban Local Bodies need to publish annual accounts audited and unaudited for verification by Project Management Unit (PMU), MoHUA. Each state has its system of preparing annual financial statements (AFS) and getting its audit done. Some illustrative examples of State of Assam, Jharkhand, Chhattisgarh, and Tamil Nadu have been given below:

- Like in Jharkhand, each ULB has an accountant as an employee who prepares Annual Financial Statements (AFS) reviewed by the State Project Management Unit (PMU).
- In Assam, most ULBs except in Guwahati, day-to-day accounting is done on a cash basis by a ULB accountant on a manual basis. For the preparation of Annual Financial Statements, external parties are hired by ULB themselves. In Guwahati Municipal Corporation, a professional CA has been hired for the maintenance of day-to-day accounting and preparation of the Annual Financial Statements.
- In Chhattisgarh, tenders have been floated by the State Urban Development Agency (SUDA) for the preparation of annual financial statements (AFS) on an accrual-based double-entry system by external parties.
- In Tamil Nadu, the ULB accounting Department prepares annual financial statements (AFS) through their Centralized Software Urban Tree (UTIS) and accounts are audited by a Local Fund auditor.

Table 2: Table showing the status of the State Municipal Accounting Manual (SMAM) and amendment in the Municipal Act for selected ULBs

#	Cities	State	SMAM prepared Yes/No	SMAM approved Yes/No	Municipal Act amendment Done Yes/No
1	Dhanbad Municipal Corporation	Jharkhand	Y	Y	Y
2	Giridih Nagar Nigam		Y	Y	Y
3	Godda Nagar Panchayat		Y	Y	Y
4	Latehar Nagar Panchayat		Y	Y	Y
5	Ranchi Municipal Corporation		Y	Y	Y
6	Guwahati Municipal Corporation	Assam	Y	Y	No
7	Tejpur Municipal Board		Y	No	No
8	Nagaon Municipal Board		Y	No	No
9	Nalbari Municipal Board		Y	No	No
10	Digboi Municipal Board		Y	No	No

Source: Annual Financial Statements and State Municipal Acts

Public Finance

THE CHARTERED ACCOUNTANT

Brief assessment of 2 States among 10 Urban Local Bodies (ULBs) regarding the timelines followed for past financial years have been presented in Table 3.

Table 2 indicates that due to the requirement of 15th FC and City Financial ranking, pending audit of various past years was done lately like some ULBs of Assam, audit for 2019-20 annual accounts has been done in FY 2023-24. The prime reason for the delay in auditing Annual Financial Statements (AFS) is the delay in the preparation of annual accounts due to a lack of real-time updating of Tally accounting software by Urban Local Bodies (ULBs). *This is a clear indication that the time has come to link reform to Grants so that timeliness in financial reporting can be adhered.*

Annual Financial Statements Assessment

Annual accounts prepared by ULB either themselves or with external support have to be in line with the SMAM & NMAM. Furthermore, it shall also meet the qualitative characteristics of financial statements for effective financial reporting. Assessment against these parameters has been done in Table 4 and Table 5:

Conclusion

Preliminary assessments of Annual Financial Statements (AFS) of sample cities indicate that lately due to the 15th FC condition for claiming Grants and City Financial Ranking requirements, cities have started preparation and auditing of financial statements seriously. Sample assessment of 10 cities indicates that delay significantly reduced in 2021-22 as compared to 2019-20 as even earlier years' financial statements have been audited in the years 2021-22 and 2022-23. *The challenge is that all cities of India where accounts are not updated in real-time will face*

difficulty in meeting the deadline of 15th May from FY 2024-25 onwards.

This article attempts throw light on areas where States and ULBs need to gear up well on time by getting their all tools in place like getting all accounting entries updated, all reconciliations done, and appointing a Statutory auditor well on time else the timeline of 15th May of Financial Year may become the dream for certain ULBs leading to their failure to claim Grants for FY 2024-25.

Some of the key tools/suggestions that the State and ULB can place in their baggage of complying with 15th FC conditions well before the close of 31st March of FY have been presented below:

- a. **Appointment of Firm of Chartered Accountants:** State/ULB needs to appoint a Firm of Chartered Accountants through a valid tendering process for the preparation of Annual Financial Statements and/or for carrying out Statutory Audit to meet 15th FC conditions.
- b. **Resolving Accounting Staff shortage issues:** Staff shortage in municipalities can pose significant challenges in the timely preparation of financial statements. Adequate staffing is crucial for ensuring compliance with legal and regulatory requirements. States shall create a Municipal Cadre of accounting Staff and it shall be ensured that staff appointed shall be of commerce background to give justice to day-to-day bookkeeping and they shall be given regular training, both off the job and on the job. A Municipal Accounts Service cadre was proposed in one of report of MoHUA⁴.
- c. **Creation of State Mission Monitoring Team (SMMT):** *The State Mission Monitoring Team (SMMT) needs to be set up under the leadership of any senior*

Table 3: Status of Audited Annual Financial Statements in Sample ULBs

Sl.No	Name of ULB	FY		
		2019-20	2020-21	2021-22
1	Dhanbad Municipal Corporation	23.07.2021	10.11.2021	14.12.2022
2	Giridih Nagar Nigam	01.07.2021	10.11.2021	14.12.2022
3	Godda Nagar Panchayat	09.08.2021	30.01.2022	12.11.2022
4	Latehar Nagar Panchayat	24.07.2021	31.12.2021	30.11.2022
5	Ranchi Municipal Corporation	09.12.2020	16.12.2021	27.01.2023
6	Guwahati Municipal Corporation	08.02.2022	15.02.2022	30.06.2023
7	Tejpur Municipal Board	19.05.2023	20.01.2023	30.06.2022
8	Nagaon Municipal Board	26.06.2023	26.06.2023	09.05.2023
9	Nalbari Municipal Board	12.05.2022	12.05.2022	03.04.2023
10	Digboi Municipal Board	05.05.2022	20.05.2022	03.04.2023

Source: City Financial Ranking (<https://cityfinance.in/login>)

⁴ Approach towards Establishing Municipal Cadres in India, 2014, MoHUA

Public Finance

THE CHARTERED ACCOUNTANT

Table 4: Assessment of Audited Annual Financial Statements of FY 2021-22 in selected ULBs against Chapter 31 of NMAM/JMAM

Sl.No.	Name of ULB	Chapter 31				Notes to Accounts	Financial Performance Indicators
		Balance Sheet	Income and Expenditure Statement	Statement of Cash Flows	Receipts and Payments Account		
1	Dhanbad Municipal Corporation	Yes	Yes	Yes	Yes	Yes	Yes
2	Giridih Nagar Nigam	Yes	Yes	Yes	Yes	Yes	Yes
3	Godda Nagar Panchayat	Yes	Yes	Yes	Yes	Yes	Yes
4	Latehar Nagar Panchayat	Yes	Yes	Yes	Yes	Yes	Yes
5	Ranchi Municipal Corporation	Yes	Yes	Yes	Yes	Yes	Yes
6	Guwahati Municipal Corporation	Yes	Yes	No	Yes	No	No
7	Tejpur Municipal Board	Yes	Yes	No	Yes	No	No
8	Nagaon Municipal Board	Yes	Yes	No	Yes	No	No
9	Nalbari Municipal Board	Yes	Yes	No	Yes	No	No
10	Digboi Municipal Board	Yes	Yes	No	Yes	No	No

Source: City Financial Ranking (<https://cityfinance.in/login>)

Table 5:

Proposed Municipal Functional Groups	Municipal Services under the Municipal Cadre
Municipal Administrative Service [MAS]	<ul style="list-style-type: none"> ■ Municipal Executive Service ■ Municipal Social Development Service ■ Municipal Staff Services
Municipal Technical Service [MTS]	<ul style="list-style-type: none"> ■ Municipal Engineering Service ■ Municipal Sanitation Service ■ Urban Planning & Transportation Service ■ Municipal Fire Service ■ Municipal E-Governance Service
Municipal Finance Service [MFS]	<ul style="list-style-type: none"> ■ Municipal Accounts Service ■ Municipal Revenue & Financial Service

official of the Urban Department, primarily from a finance background State Mission Monitoring Team at the State Level consisting of Senior Chartered Accountants with experience in Municipal Finance and implementation of accrual-based double entry in ULBs and IT staff shall be formed to act as surveillance unit to monitor and guide ULB

for completion of work of preparation of Annual Financial Statements and its auditing.

- d. **Completion of Preliminary work of bookkeeping:** The prime reason that audit work is delayed in ULBs is due to the delay in preparation of Annual Financial Statements which is due to a lack of real-time accounting and reconciliations. State/ULB

Public Finance

THE CHARTERED ACCOUNTANT

Table 6: Indicative Checklist for Readiness of System

#	Checkpoints	Yes/No
1	Whether previous year's opening balance from the approved Balance sheet have been entered?	
2	Whether journal has been prepared for all receivable income such as tax, charges and lease income?	
3	Whether journal has been prepared for all pending/outstanding payments?	
4	Whether periodic reconciliation of various sub registers including Bank reconciliation is done?	
5	Whether capital work in progress completed during the year have been capitalized and depreciated during the year?	

shall ensure with strict instruction to the accounts department to update all accounting entries in real-time so that financial statements can be prepared without any significant delay once the financial year FY 2023-24 is closed.

Indicative checklist in Table 6 may be used by the State/ULB to assess the readiness of the system and completeness of AFS:

- e. **Accounting precedes Auditing:** Auditing is known as post mortem of books of accounts and thus timeliness of the audit is dependent on the timely preparation of accounts. Thus, ULB accounts staff shall ensure that day to day accounting is done on real time with periodic reconciliation. This would ensure to prepare of annual financial statements on time to be available for audit.
- f. **Capacity Building Initiatives:** Nothing can be achieved without effective Training in terms of troubleshooting guide. Thus State/ULB shall ensure regular training, especially on-the-job training is provided so that queries can be resolved without any delay. State/ may get a small video solution to queries of ULB developed that ULB accountants may face while entering transactions and generating reports as part of training material.

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Authors may be reached at
eboard@icai.in