

# **Preface to the Accounting Standards for Local Bodies**

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# Preface to the Accounting Standards for Local Bodies

*The following is the text of the Preface to the Accounting Standards for Local Bodies, issued by the Council of the Institute of Chartered Accountants of India.*

## 1. Introduction

1.1 This Preface to the Accounting Standards for Local Bodies (hereinafter referred to as ‘Accounting Standards’) sets out the objectives and operating procedures of the Committee on Accounting Standards for Local Bodies (CASLB) and explains the scope and authority of the Accounting Standards. The Preface should be used as a reference for interpreting invitations to comment, discussion documents, exposure drafts and standards formulated by the CASLB.

1.2 The 73<sup>rd</sup> and 74<sup>th</sup> Constitutional Amendment Acts envisage a key role for the Panchayati Raj Institutions (PRIs) and the Urban Local Bodies (ULBs) in respect of various functions such as education, health, rural housing and drinking water. The State Governments are required to devolve powers and responsibilities upon the PRIs and the ULBs with respect to preparation of plans for economic development and social justice, and for the implementation of development schemes as may be required to enable them to function as institutions of self-government. Due to such devolution of powers and responsibilities, the role of the ULBs varies across various States. Under the Urban Reforms Incentive Fund (URIF) which was launched a few years back, 28 States/Union Territories agreed to adopt the double entry system of accounting. Further, through the National Urban Renewal Mission, the Government requires Local Self Governments to adopt modern, accrual-based double entry system of accounting. The Government had also proposed Second Generation Reforms under Urban Reforms Incentive Fund (URIF-II) to further encourage adoption of accrual-based double entry system of accounting amongst Local Self Governments.

1.3 The term ‘Local Body’ may be defined as a local self-government at the third tier of governance in an administrative and geographical vicinity, e.g., a municipal corporation, a municipality or a panchayat. In many cases, the Local Bodies delegate their functions such as building of schools, city roads, parks, running transport services, providing water supply etc., to some other bodies that may or may not be controlled by the Local Bodies, e.g. development authorities, boards, parastatals. Such bodies may be constituted, in partnership with private sector or otherwise, directly or indirectly by or on behalf of a Local Body to promote or carry out some specific objective(s) or function(s) of the Local Bodies. Such bodies may be constituted under a statute. The term ‘Local Body’ would also encompass such bodies.

1.4 Of late, many Local Bodies in the country are shifting to accrual basis of accounting, particularly, after the issuance of the National Municipal Accounts Manual (NMAM) by the Ministry of Urban Development, Government of India, supported by the Comptroller & Auditor General of India, National Institute of Urban Affairs and Indo- USAID FIRE-D Project and the inputs provided by the Institute of Chartered Accountants of India. The

NMAM provides guidance to ULBs in preparation of their accounts on accrual basis. Another reason for ULBs adopting accrual basis is that these bodies are also approaching capital markets for raising funds. However, these bodies are following diverse accounting policies and practices in preparation of their financial statements. Hence, a need is felt for formulation of a single set of high quality financial reporting standards for Local Bodies which will set out recognition, measurement, presentation and disclosure requirements dealing with transactions and events in general purpose financial statements of Local Bodies. As a first step in this direction, Accounting Standards Board of the ICAI constituted a Sub-Committee for issuing accounting standards for government including urban local bodies in 1999, which issued a *Technical Guide on Accounting and Financial Reporting by Urban Local Bodies*. The Guide contains recommendations relating to application of accounting standards issued by the Institute of Chartered Accountants of India, to ULBs. Insofar as PRIs are concerned, a robust accounting system is also a need of the hour. Recognising the need to harmonise and improve accounting and financial reporting among Local Bodies, the Institute of Chartered Accountants of India (ICAI), constituted a full-fledged Committee on Accounting Standards for Local Bodies (CASLB) in March 2005.

1.5 The main function of the CASLB is, therefore, to formulate a single set of Accounting Standards applicable to Local Bodies.

1.6 The composition of the CASLB is fairly broad-based and ensures participation of all stakeholders in the standard-setting process. The following stakeholders, including members of the Council of the ICAI, are represented on the CASLB:

- (i) Representative of the Ministry of Urban Development
- (ii) Representative of the Comptroller and Auditor General of India
- (iii) Representative of the Controller General of Accounts
- (iv) Representative of the National Institute of Urban Affairs
- (v) Representative of the Ministry of Panchayati Raj
- (vi) Four representatives of Directorates of Local Bodies from various States by rotation
- (vii) Two representatives of Directorates of Local Fund Audit Department from various States by rotation
- (viii) Two representatives of Academic Institutions
- (ix) Eminent professionals co-opted by the ICAI (they may be in practice or in industry, government, education, etc.)
- (x) Representative(s) of any other body, as considered appropriate by the ICAI.

## **2. Objectives and Functions of the Committee on Accounting Standards for Local Bodies**

2.1 The following are the objectives and functions of the CASLB:

- (i) To conceive of and suggest areas in which Accounting Standards for Local Bodies need to be developed.
- (ii) To formulate Accounting Standards for Local Bodies.
- (iii) To examine how far International Public Sector Accounting Standards (IPSASs) prepared by the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) can be integrated into national Accounting Standards for Local Bodies envisaged in paragraph (ii) above and to integrate the same to the extent possible with a view to facilitate global harmonisation.
- (iv) To review, at regular intervals, the Accounting Standards for Local Bodies from the point of view of acceptance or changed conditions, and, if necessary, revise the same.
- (v) To provide, from time to time, interpretations and guidance on Accounting Standards for Local Bodies.
- (vi) To respond to issues arising from implementation of Accounting Standards for Local Bodies.
- (vii) To take adequate steps for propagation and dissemination of the requirements contained in the Accounting Standards for Local Bodies, including appropriately addressing the training issues, with a view to ensure effective implementation of the standards.
- (viii) To take steps in facilitating improvement in accounting methodology and systems of Local Bodies, keeping abreast of the state of development of accounting systems in Local Bodies and to act as a forum to receive feedback from Local Bodies regarding problems faced by them in the adoption of accrual accounting and in application of the Accounting Standards.
- (ix) To create awareness amongst various stakeholders such as end users and citizens about the benefits of the accounting reform process in Government and Local Bodies.
- (x) To carry out such other work relating to Accounting Standards and other aspects of accounting and financial reporting by Local Bodies as may be entrusted to it by the Council.
- (xi) To formulate comments on the drafts of Accounting Standards for governmental bodies issued by various authorities including International

Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC).

- (xii) To perform such other functions as may be assigned by the Council such as, to provide support to Government(s) and regulators, e.g., the Technical Committee on Budget and Accounting Standards for ULBs constituted under the aegis of Ministry of Urban Development, in their endeavours towards various other aspects of financial reporting including preparation of asset registers, performance measurement, budgeting, costing, internal control and audit.

2.2 The main function of the CASLB is to formulate Accounting Standards for Local Bodies so that such standards may be established by the ICAI in India. While formulating the Accounting Standards, the CASLB will take into consideration the applicable laws, customs, usages and the economic environment prevailing in India.

2.3 The ICAI, being a full-fledged member of the International Federation of Accountants (IFAC), is expected, inter alia, to use its best endeavors to incorporate the requirements of International Public Sector Accounting Standards (IPSASs) issued by the International Public Sector Accounting Standards Board of IFAC into the national accounting requirements. Accordingly, while formulating the Accounting Standards, the CASLB will give due consideration to IPSASs, and try to integrate them, to the extent possible, in the light of the conditions and practices prevailing in India.

2.4 The Accounting Standards for Local Bodies are issued under the authority of the Council of the ICAI. The CASLB has also been entrusted with the responsibility of propagating the Accounting Standards and of persuading the concerned authorities to adopt them in the preparation and presentation of financial statements. The CASLB will provide interpretations and guidance on issues arising from Accounting Standards. The CASLB will also review the Accounting Standards at periodical intervals and, if necessary, revise the same.

### **3. General Purpose Financial Statements of Local Bodies**

3.1 For discharging its functions, the CASLB will keep in view the purposes and limitations of financial statements of local bodies and the attest function of the auditors. The CASLB will enumerate and describe the basic concepts to which accounting principles should be oriented and state the accounting principles to which the practices and procedures should conform.

3.2 The CASLB will clarify the terms commonly used in financial statements and suggest improvements in the terminology wherever necessary. The CASLB will examine the various current alternative practices in vogue and endeavour to eliminate or reduce alternatives within the bounds of rationality.

3.3 The term 'General Purpose Financial Statements' of Local Bodies includes balance sheet, income and expenditure account, a cash flow statement and other statements and explanatory notes which form part thereof, issued for the use of various stakeholders,

Governments and their agencies and the public. The State Governments may also require certain additional information by virtue of powers given to the legislatures of States in 73<sup>rd</sup> and 74<sup>th</sup> Constitutional Amendment Acts. If such information is required by a State Government, it would form part of the financial statements. References to financial statements in this Preface and in the standards issued from time to time will be construed to refer to general purpose financial statements. Accounting Standards for Local Bodies, therefore, are designed to apply to the general purpose financial statements and other financial reporting by Local Bodies.

3.4 Responsibility for the preparation of financial statements and for adequate disclosure is that of the management of the Local Bodies.

#### **4. Scope of Accounting Standards for Local Bodies**

4.1 The CASLB is developing a set of standards which will be based on the accrual basis of accounting. Efforts will be made to issue Accounting Standards for Local Bodies after giving due consideration to the provisions of the applicable customs, laws, usages and economic environment in India. Accounting Standards formulated by the CASLB do not override the statute/law that govern the issue of general purpose financial statements of a particular Local Body. Accounting Standards (ASs) already issued by Institute of Chartered Accountants of India apply to those enterprises as stated in paragraph 3.3 of the 'Preface to the Statements of Accounting Standards'. These Accounting Standards are not designed to apply to Local Bodies. However, since these Accounting Standards lay down wholesome principles of accounting, Local Bodies may follow these Standards during the transitional period, until the Accounting Standards for Local Bodies (ASLB) are issued by this Committee. Thus, once an ASLB is issued, the Local Bodies should follow the ASLB and not the corresponding Accounting Standard issued by the ICAI.

4.2 The Accounting Standards for Local Bodies are intended to apply only to items which are material. Any limitations with regard to the applicability of a specific Accounting Standard will be made clear by the ICAI from time to time.

4.3 The CASLB believes that the adoption of the Accounting Standards for Local Bodies, together with disclosure of compliance with them will lead to a significant improvement in the quality of general purpose financial reporting by Local Bodies. This, in turn, is likely to lead to better informed assessments of the resource allocation decisions, thereby increasing transparency and accountability.

4.4 In the formulation of Accounting Standards for Local Bodies, the emphasis would be on laying down accounting principles and not detailed rules for application and implementation thereof.

4.5 The Standards formulated by the CASLB include paragraphs in bold italic type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. An individual standard should be read in the context of the objective stated in that standard and this Preface.

4.6 The CASLB may consider any issue requiring interpretation on any Accounting Standard for Local Bodies. Interpretations will be issued under the authority of the Council. The authority of Interpretations is the same as that of the Accounting Standard to which it relates.

## **5. Moving from the Cash Basis to the Accrual Basis**

5.1 A Local Body in the process of moving from cash basis of accounting to accrual basis of accounting may wish to include particular accrual-based disclosures during this process. Such accrual-based disclosures may or may not be audited. The location of such additional information (for example, in the notes to the financial statements or in a separate supplementary section of the financial statements) will depend on the characteristics of the information (for example, reliability and completeness).

5.2 The CASLB also attempts to facilitate compliance with the Accounting Standards for Local Bodies (ASLBs) through the use of transitional provisions in certain standards. Where transitional provisions exist, they may allow a Local Body additional time to meet the full requirements of a specific Accounting Standard or provide relief from certain requirements when initially applying an Accounting Standard. A Local Body may at any time elect to adopt the accrual basis of accounting in accordance with the Accounting Standards. At this point, the Local Body should apply all the Accounting Standards including the transitional provisions in an individual Accounting Standard.

5.3 Having decided to adopt accrual accounting in accordance with the Accounting Standards, the transitional provisions would govern the length of time available to make the transition. On the expiry of the transitional provisions, the Local Body should report in full in accordance with all the Accounting Standards.

## **6. Procedure for Issuing an Accounting Standard for Local Bodies**

Broadly, the following procedure is adopted for formulating Accounting Standards for Local Bodies:

6.1 Determine the broad areas in which Accounting Standards need to be formulated and the priority in regard to the selection thereof.

6.2 For the preparation of the Accounting Standards, the CASLB will be assisted by Study Groups constituted to consider specific subjects. In the formation of Study Groups, provision will be made for wide participation by various interest groups.

6.3 The draft of the proposed standard will normally include the following:

- (a) Objective of the Standard,
- (b) Scope of the Standard,
- (c) Definitions of the terms used in the Standard,

- (d) Recognition and measurement principles, wherever applicable,
- (e) Presentation and disclosure requirements,
- (f) Deviations, if any, from the corresponding International Public Sector Accounting Standard (IPSAS), as an Appendix to the Standard.

6.4 The CASLB will consider the preliminary draft prepared by the Study Group and if any revision of the draft is required on the basis of deliberations, the CASLB will make the same or refer the same to the Study Group.

6.5 The procedure for issuance of an Interpretation on any Accounting Standard for Local Bodies will be the same as that for issuance of an Accounting Standard since the authority of an Interpretation is the same as that of Accounting Standard for Local Bodies to which it relates.

6.6 The CASLB will circulate the draft of the Accounting Standard/Accounting Standards Interpretation for Local Bodies to the Council members of the ICAI and the following specified bodies for their comments\*:

- (i) Comptroller and Auditor General of India (C&AG)
- (ii) Ministry of Urban Development
- (iii) Controller General of Accounts
- (iv) Ministry of Panchayati Raj
- (v) National Institute of Urban Affairs
- (vi) Directorates of Local Bodies of the State Governments
- (vii) Directorates of Local Fund Audit Department of the State Governments
- (viii) Major Local Bodies
- (ix) National Institute of Financial Management
- (x) Securities and Exchange Board of India
- (xi) Any governmental Committee(s) or other similar body, e.g., the Technical Committee on Budget and Accounting Standards for ULBs constituted by the Ministry of Urban Development.
- (xii) The All India Council of Mayors
- (xiii) All India Institute of Local Self Government

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\* The Council of ICAI, at its 375th meeting held on May 24 - 26, 2018 decided that the procedures mentioned in paragraphs 6.6 and 6.7 need not be followed in respect of Accounting Standards for Local Bodies issued hitherto fore.



- (xiv) Donors of funds to Local Bodies such as US AID, World Bank, etc.
- (xv) The Institute of Cost and Works Accountants of India
- (xvi) The Institute of Company Secretaries of India
- (xvii) All the Indian Institutes of Management (IIMs)
- (xviii) Any other body considered relevant by the CASLB keeping in view the nature of the Accounting Standard.

6.7 The CASLB will hold a meeting with the representatives of the selected specified bodies to ascertain their views on the draft of the proposed Accounting Standard/Accounting Standards Interpretation for Local Bodies. On the basis of comments received and discussion with the representatives of specified bodies, the CASLB will finalise the Exposure Draft of the proposed Accounting Standard/Accounting Standards Interpretation for Local Bodies\*.

6.8 The Exposure Draft of the proposed Standard/Interpretation will be issued for comments by the members of the Institute and the public. The Exposure Draft will be sent to the specified bodies (as listed above), and other interest groups, as appropriate.

6.9 The Exposure Draft will be sent to any governmental Committee(s) or other similar body, e.g., the Technical Committee on Budget and Accounting Standards for ULBs constituted by the Ministry of Urban Development for sending comments on the Exposure Drafts of the proposed Standard/Interpretation.

6.10 After taking into consideration the comments received, the draft of the proposed Accounting Standard/Accounting Standards Interpretation for Local Bodies will be finalised by the CASLB and submitted to the Council.

6.11 The Council of the ICAI will consider the final draft of the proposed Standard/Interpretation, and if found necessary, modify the same in consultation with the CASLB. The Accounting Standard/Accounting Standards Interpretation on the relevant subject will then be issued by the ICAI.

6.12 The ICAI will send the Accounting Standards so formulated to the governmental Committee(s) or other similar body, e.g., the Technical Committee on Budget and Accounting Standards for ULBs constituted by the Ministry of Urban Development for recommending the same for implementation by the State Governments to achieve uniformity in preparation and presentation of financial statements by complying with the requirements of the Accounting Standards for Local Bodies.

6.13 For a substantive revision of an Accounting Standard/Accounting Standards Interpretation for Local Bodies, the procedure followed for formulation of a new Accounting Standard/Accounting Standards Interpretation for Local Bodies, as detailed above, will be followed.

6.14 Subsequent to issuance of an Accounting Standard/Accounting Standards Interpretation for Local Bodies, some aspect(s) may require revision which are not substantive in nature. For this purpose, the ICAI may make limited revision to an

Accounting Standard/Accounting Standards Interpretation for Local Bodies. The procedure followed for the limited revision will substantially be the same as that to be followed for formulation of an Accounting Standard/Accounting Standards Interpretation for Local Bodies, ensuring that sufficient opportunity is given to various interest groups and general public to react to the proposal for limited revision.

## **7. Compliance with the Accounting Standards for Local Bodies**

7.1 Ensuring compliance with the Accounting Standards for Local Bodies is the responsibility of the appropriate authority which approves the financial statements of the Local Body for the purpose of issuance thereof. Having issued the Accounting Standard for Local Bodies, various State Governments may require Local Bodies to follow the Accounting Standards for Local Bodies issued by the Institute of Chartered Accountants of India. Thus, an Accounting Standard for Local Bodies becomes mandatory for Local Bodies in a State from the date specified in this regard by the State Government concerned.

7.2 Financial statements cannot be described as complying with the Accounting Standards for Local Bodies unless they comply with all the requirements of each applicable Standard.