

Improved Financial Management

**Citylinks Partnership of Cuddalore &
Nagapattinam (Tamil Nadu, India)**

1. INTRODUCTION

A management study conducted by the CityLinks team the program in 2006 identified program and process improvement strategies for municipalities of Cuddalore and Nagapattinam. In response to the study, the ICMA team helped enact changes in municipal financial management procedures, updated financial records for the past three years, and issued outstanding tax notices to citizens. These measures led to the collection of more than \$537330 in increased revenues for both cities.

The ICMA team worked with municipalities of Cuddalore and Nagapattinam on the improvement of the overall financial system, leading to an increase of tax revenue collection and water user charges. ICMA also increased the collection of property tax revenue and water fees, improving the overall financial status of Cuddalore and Nagapattinam.

2. SITUATION BEFORE THE INITIATIVE

The municipalities of Cuddalore and Nagapattinam needed to strengthen institutional capacity through the improvement of the overall financial system.

3. THE PROCESS

Both Cuddalore and Nagapattinam municipalities faced problems in the provision of basic infrastructure and services to their existing populations prior to the tsunami, but the devastation added to this burden. Although immediate assistance from various quarters flowed to these cities, it was difficult to financially sustain infrastructure and utilities without undertaking systemic changes to improve their financial management.



ICMA's finance director visited the cities to undertake a detailed assessment and to devise a work plan for improving the financial management situation. The finance director recommended hiring accountants with appropriate skills and expertise, to help municipalities of Cuddalore and Nagapattinam reconcile financial statements, collect taxes more effectively and increase overall revenue generation.

Based on this work plan, the CityLinks team sought technical assistance from ICRA Management Consulting Services. The objectives of the technical support were to:

- Study the existing accounting systems
- Bring the accounts up to date
- Suggest process improvements to streamline financial management procedures
- Train the staff so that they can carry on these improvements after the exit of the consultants.

The project teams worked together to study the existing financial management systems in detail. Their main findings were:

3.1 Background of Accounting Issues in Cuddalore and Nagapattinam

Traditionally the accounting systems in the municipalities of Tamil Nadu were carried out on a cash basis. The municipalities used to prepare cash-based accounts and send a monthly receipt and payments account to the auditor, who cross-checked the figures, made necessary corrections and finalized the accounting books.



However, in 1999, the Government of Tamil Nadu decided to switch to a double-entry accruals-based accounting system. This activity was carried out under the aegis of World Bank funding where six ULBs were taken as the pilot case. Gradually, the double entry accounting system was introduced across all ULB's in Tamil Nadu. As a part of the accounting conversion, the municipalities of Cuddalore and Nagapattinam were also converted to double entry-based accrual accounting in 2000.

A CA firm was appointed at that time to prepare the opening balance sheet. The firm prepared the opening balance sheet, as well as the asset registers for these municipalities. As a part of the conversion, a detailed accounting manual, as prescribed by GoTN, was given to the accounting staff for future use. Initial training was organized by the GoTN, for the accounting staff on the concepts of double entry accounting system and the usage and maintenance of accounts.

During this period, the GoTN also developed integrated software, which covered 14 modules. However, due to only partial development of the software, municipalities adopted their own tax collection modules for their day to day work and have largely ignored the financial accounting module provided by the GoTN. Additionally, the transition of records from manual to computerized databases has been carried out by local staff and with less guidance. As a result, this has meant that the ultimate objective of transferring all records to the computerized system and phasing out the manual system has not occurred.

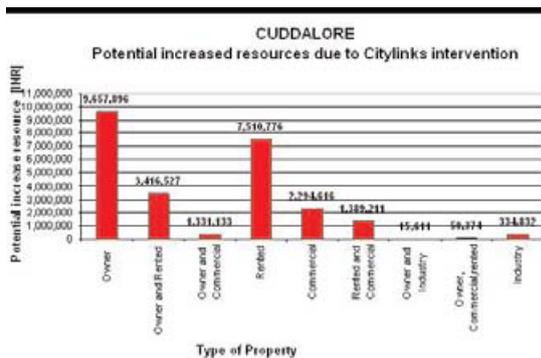
A combination of a limited grasp on the double entry accounting system and partial computerization has forced the accountants to resort to maintaining manual records in many cities, including Cuddalore and Nagapattinam. This approach of maintaining both the accounts partially in the computerized set-up and partially in the manual system, as well as maintaining some accounts on cash basis and some on accrual basis increased the work pressure and led to a delay in finalization of the accounts and updating of accurate accounts. Also, the fact that the accounts department was under-staffed and staffed with non-Commerce graduates further aggravated the problem of accounts finalization delay.

3.2 Preliminary Findings in Cuddalore

3.2.1 Issues in Property Tax

- Parallel maintenance of records – both manually and electronically.

- The arrears details in the computer systems did not match with the manual registers in a number of cases.
- The property tax details of government properties entered into the computer systems stopped in 2002-2003 and did not include arrears demands.
- Monthly lists and mutation register details did not reach the accounting department on a regular basis.
- Postings of collections into the current demand register were not updated.
- Level of non-posting varied from one accounts clerk to the other.
- There was an increase in the number of wards in the year 1998-99 and at that time some new wards were carved out of the existing wards. New assessment numbers were assigned to all the wards, but there was confusion in the allocation of new assessment numbers and the accounting department was not able to correlate the old assessment numbers with the new assessment numbers in a number of cases.
- Some citizens who came forward to pay the dues left unsuccessfully due to non-availability of accounts/revenue staff or non-availability of details at the time of their visits.
- New building approvals were not informed of the revenue/accounts departments for effective follow-up.
- Arrears from Government properties, in a number of cases.
- There was no proper system of delivering the property tax dues demand notices. When served personally by bill collectors, an acknowledgement copy was received from the citizen. But these acknowledgement copies were not available for verification.
- There was a whopping 25% return of demand notices due to incorrect addresses. Accurate addresses are paramount for efficient collection.
- Collections continued to be poor due vacant position. One Revenue Inspector post and about 14 Bill Collectors posts were vacant and are yet to be filled.
- Commercial properties assessed at residential rates in a number of cases.



3.2.2 Other issues

- Registers were not maintained properly for two years (2002-03 and 2003-04) in the case of professional tax.
- Deducted sales tax from the contractors was not remitted in time.
- Provident Fund deductions from the employees and the employer's portion of provident fund contributions were not remitted in time to relevant authorities.
- Audit objections in the year 2003-04 ran as high as Rs.12.8 million.
- Local Fund Auditors carried out account compilation work also, but the auditors weren't fully comfortable with the computer-generated accounts.
- Accrual basis of accounting happened in a fractured manner only.
- The Financial Accounting System (FAS) - one of the about 18 modules available in the computerized systems - is used only for taking up the General Ledger Trial Balance. Even here, entries were not made for more than two months. It is also pertinent to note that a number of modules in the FAS did not work at all.
- All the subsidiary ledgers were maintained manually.

- Statutes to be amended for doing away with maintenance of some registers were redundant due to computer systems.
- Bank Reconciliation was pending from August 2005.
- Accounting entries had not been passed for more than four months.
- The accounts department was not aware of the adjustments carried out by the Local Fund Audit Team.
- Accounts department did not get key information regarding new assessments/ pulling down of old building, building plans approved etc.
- Routine daily Bank Receipt Vouchers were manually passed even though this could be automatically generated by the systems and checked for correctness by the accounting staff.
- Most of the entries in the Advances sub-ledgers were more than 20 years old. Retirement benefits were not accounted for on an accrual basis.
- Government departments deducted interest and principal sums out of the grants/devolution funds which were given to the municipality. In most of the cases, the details of deductions as to principal and interest were not available. In some of the cases, the accounts department did not know for which loan account deductions have been made.
- Even though property tax and water charges have been fully computerized, manual accounts were also maintained. Substantial parts of the account balances in the manual accounts did not match with the balances in the computerized systems.

3.3 Preliminary findings – Nagapattinam

3.3.1 Issues in Property Tax

- Classification of property into A, B and C categories was not been carried out properly.
- Monthly lists and mutation register details did not reach accounts department on a regular basis. New assessment details were not updated in manual registers.
- Postings of collections into the current demand register were not updated. Level of non-posting varied from one accounts clerk to the other.
- New building approvals were not distributed to the revenue/accounts departments for effective follow-up.
- Collections were poor.
- A complete survey of all the property units of the municipality was not carried out for more than 10 years.



3.3.2 Other issues

- The municipality did not have an Accountant or a Manager for a considerable period of time. The person who joined as an Accountant was looking after the duties of a 'Manager'. Even this Accountant retired by 28th February 2006.



- Trade Licences - Instances of demands were raised on shops that didn't exist and demands were not raised on shops that did exist.
- When there was a change in the trade conducted in a particular shop due to vacation of premises by the old trader and occupation by a new trader, such change, which might have involved financial implications in the form of different fees, was not taken into consideration.
- Deducted sales taxes from the contractors were not remitted in time.
- Provident fund deductions from the employees and the employer's portion of provident fund contributions were not remitted in time to relevant authorities.
- Local Fund Audit for the year 2003-04 was still in progress.
- The auditors were not fully comfortable with the computer-generated accounts.
- Accrual basis of accounting followed in a fractured manner only.
- The Financial Accounting System (FAS) - one of the about 18 modules available in the computerized systems - was used only for the General Ledger Trial Balance. Even there, entries were not made for more than two months.
- All the subsidiary ledgers were maintained manually.
- Accounts department did not get key information regarding new assessments/pulling down of old building, building plans approved etc.
- Routine daily Bank Receipt Vouchers were manually passed even though this could have been automatically generated by the systems and checked for correctness by the accounting staff.
- Retirement benefits were not accounted for on accrual basis. Actuarial valuations were not considered.
- Government departments deducted interest and principal sums out of the grants/devolution funds, which were given to the municipality. In most of the cases, the details of deductions as to principal and interest were not available. In some of the cases, the accounts department did not know for which loan account deductions were made.

The program supported accountants to work in municipalities of Cuddalore and Nagapattinam for 6 months to ensure that financial numbers and information was collected and accurately reported for the past two years. The assistance allowed the municipalities to reconcile balance sheets, clear outstanding audit adjustments educate top management staff in their current loan position and do an analysis of the loan repayment schedule. The accountants also prepared a list of the top 100 defaulters in the area of property tax, water tax etc and facilitated issuing of demand notices to them. A personal survey was carried out by the consultants and in most of the cases; the consultants met the citizens in person to understand the reason for arrears. A sample of the list is shown below:



Assmnt. No	Name	Ward	Year	Amt (INR)	Remarks of Municipality	Our Remarks	Action by Municipality
41531	A. Subramaniyan	41	1993-94	71,180.00	The said assessment is a marriage hall. Notice has been issued.	The said assessment is under a bank mortgage. Rent amount has been adjusted against the loan amount due to the lender. Party	The case is to be perused by the municipality.

						assured us that it would clear the arrears before end of April 06.	
22185	Andalammal	22	1997-98	1,30,292.00	This building being locked for years	It is difficult to accept this reason	The case is to be perused by the municipality.
18390	Aravindhan Laxmanaswamy	18	1994-95	68,603.00	Party is not in the town. Notice pasted on the door	Party residing in Bangalore. Assured to pay the tax before May 06	The case is to be perused by the municipality.

The accountants also facilitated collection of these taxes by working with the municipality to do rigorous follow up with defaulters.

During the study of the financial management systems in Cuddalore and Nagapattinam, the CityLinks team identified several properties missed in the existing property tax net. Moreover there were several existing properties whose land-use was incorrect and hence led to lower property tax assessment. The CityLinks team, therefore, conducted extensive property tax survey for Cuddalore in all 45 wards so as to show the problems in the current property tax demand registration system. The survey identified buildings, per ward, that were either new or not listed in the government records, had uses that were improperly identified, and/or were incorrectly assessed.

Existing Assessments	No. of Assessments	Potential Increase in half year tax (INR)
Owner	10, 037	38,61,236
Owner & Rented	814	30,19,903
Owner & Commercial	131	6,65,369
Rented	1,777	63,65,369
Commercial	1,109	32,29,315
Rented & Commercial	615	22,01,209
Owner & Industry	-	-
Owner, Commercial & Rented	19	87,047
Industry	19	4,03,532
Total	14,521	1,98,32,617

Tax collection information (property tax, water tax, professional tax and rental taxes) was documented by ward and by street to identify payers and non-payers. From this information, tax collection gaps were identified and recommendations/specific action points were provided to the municipalities for improvement.

- New assessments to be taken on priority basis and to be completed in two months time.
- Existing assessments where potential increase in tax is high to be covered in a month's time.
- Conducting a month long special camps/trainings on property tax.
- Cross-checking of new connections and transfers/registrations from the Electricity board and sub-registrar offices.
- Declaration from bill collectors and revenue inspectors every month
- Surprise checks by the manager.
- Preparation of lists of top 100/200 defaulters.

The detailed action plan has been presented in Annexure 2

4. RESULTS

As an end result, Cuddalore and Nagapattinam are more financially sound. Over \$800,000 in back taxes was identified, with more than \$500,000 collected in both municipalities. This additional revenue has been used to pay for improved services, cover municipal loans and improve the financial standing of both cities.

A total of 19,217 properties were surveyed. More than 10,000 properties were newly identified which was a 75% increase over the earlier total number of properties. These properties were brought under the tax net. These additional properties can fetch an annual property tax income of almost Rs. 94 lakhs (equivalent to \$235,000 USD).

Moreover, if the existing 14,521 properties were rightly assessed as per the land use, area and ownership status, the total property tax could be increased by Rs. 40 million (equivalent to 10 million USD) Municipal management has been improved with an output of institutionalized financial management procedures and updated financial records. Improved accrual based accounting systems have been established, in addition to the MIS format.

An assessment report, outlining the financial management systems and procedures within Cuddalore and Nagapattinam, including a timeline for implementation of financial management assistance, collection of financial data and dates for training was completed. Training kits for financial management capacity building workshops were used to train local government staff in Cuddalore and Nagapattinam on financial systems. Training on the interpretation of financial data for Commissioners and top management staff was completed. MIS/Final report on the financial data, synopsis of financial status for Cuddalore and Nagapattinam and analysis of the financial position of Cuddalore and Nagapattinam with baseline indicators and financial ratios was completed.

5. SUSTAINABILITY

ICMA submitted the findings of the property tax survey to the collector in Cuddalore, who plans to use the summary reports to begin collecting outstanding property taxes from citizens and businesses. The ICMA team has also worked with and trained municipal staff to ensure post project sustainability.