

CHAPTER 2

DEFINITIONS, ACCOUNTING CONCEPTS, ACCOUNTING & GENERAL CONVENTIONS

2.1 The various terms used in this Accounting Manual, the Accounting Concepts and Accounting Conventions under the Accrual System of Accounting are defined in this chapter. The objective of this chapter is to ensure a common understanding of the terms often used in the Manual as well as to promote consistency and uniformity in their usage.

DEFINITIONS

2.2 The definitions of the terms used in this manual are those which are commonly understood and used. These have been taken, if available and appropriate, from:

- a. “A Dictionary for Accountants” by Eric L. Kohler; or
- b. “Guidance Note on Terms used in Financial Statements” issued by the Institute of Chartered Accountants of India (ICAI).
- c. In other cases, the description/definition used by AFF has been adopted.

2.3 The definitions/descriptions/meanings of the various terms used in this manual are as follows.

1. **Act** – A Act means the Himachal Pradesh Municipal Act,1994 and Himachal Pradesh Municipal Corporation Act,1994;
2. **Account** - A formal record of a particular type of transaction expressed in money or other unit of measurement and kept in a ledger. (*Kohler*)
3. **Accounting Entry** - A record of financial transaction in the books of account like journal, ledger, cash book, etc. (*AFF*)
4. **Account Payable** Amount owed by an enterprise on account of goods purchased or services received or in respect of contractual obligations. Also termed as trade creditor or sundry creditor. (*ICAI*)
5. **Accounting Period** The period of time for which an operating statement is customarily prepared. (*Kohler*)
6. **Accounting Principle** The general principles and procedures under which the accounts of an individual organisation are maintained; any one such principle or procedure. An accounting principle is an adaptation or special application of a principle necessary to meet the peculiarities of an organisation or the

needs of its management. Thus, principles are required for the computation of depreciation, the recognition of capital expenditures, and the disposal of retirements. *(Kohler)*

7. **Account Receivable** :- Person from whom amounts are due for goods sold or services rendered or in respect of contractual obligations. Also termed as debtor, trade debtor, sundry debtor. *(ICAI)* The words 'Receivables' and 'Debtors' are used interchangeably.
8. **Accounting Unit** :- An accounting unit shall be defined as a Zone, Circle, Divisional or Ward office identified by the ULB as an unit for maintenance of accounting records. *(AFF)*
9. **Accounting Year** :- The 'Official Year' or 'Year' means a year commencing on the first day of the Accounting period. *(AFF)*
10. **Accrual** :- Recognition of revenues and costs as they are earned or incurred (and not as money is received or paid). It includes recognition of transactions relating to assets and liabilities as they occur irrespective of the actual receipts or payments. *(ICAI)*
11. **Accrual Basis of Accounting** :- The method of accounting whereby revenues and expenses are identified with specific periods of time, such as a month or year, and are recorded as incurred, along with acquired assets, without regard to the date of receipt or payment of cash; distinguished from cash basis. *(Kohler)*
12. **Accrued & Due** :- In respect to an **asset** (or a **liability**) it means a claim which has become enforceable, which arises from the sale/rendering (purchase) of goods/services or otherwise and has become receivable (payable).

In respect to an **income** (or an **expense**) it means the amount earned (incurred) in an accounting period, for which a claim has become enforceable, and it arises from the sale/rendering (purchase) of goods/services or otherwise and has become receivable (payable). *(AFF)*
13. **Accrued But Not Due** :- In respect to an **asset** (or a **liability**) it means a claim which has not yet become enforceable, which accumulates with the passage of time or arises from the sale/rendering (purchase) of

goods/services which, on the date of period-end, have been partly performed and are not yet receivable

(payable).

In respect to an **income** (or an **expense**) it means the amount earned (incurred) in an accounting period, but for which no enforceable claim has become due in that period. It accumulates with the passage of time or arises from the sale/rendering (purchase) of goods/services goods which, at the date of accounting, have been partly performed and are not yet receivable (payable).(*AFF*)

14. **Accumulated Depreciation** :-The total to date of the periodic depreciation charges on depreciable assets. (*ICAI*)
15. **Advance** :- Payment made on account of, but before completion of, a contract, or before acquisition of goods or receipt of services. (*ICAI*)
16. **Amortisation**:-The gradual and systematic writing off of an asset or an account over an appropriate period. The amount on which amortisation is provided is referred to as amortisable amount. Depreciation accounting is a form of amortisation applied to depreciable assets. Depletion accounting is another form of amortisation applied to wasting assets. Amortisation also refers to gradual extinction or provision for extinction of a debt by gradual redemption or sinking fund payments or the gradual writing off to revenue of miscellaneous expenditure carried forward. (*ICAI*)
17. **Annual Report**:-Any report prepared at yearly intervals.
A statement of the financial condition and operating results of an ULB, prepared yearly for submission to interested parties; summarising its operations for the preceding year and including a balance sheet, income & expenditure statement, often a receipts & payment statement, and the auditor' s report, together with comments by the Head of Council or the Municipal Commissioner of the ULB on the year' s operations(*Kohler*)
18. **Assets** :- Tangible objects or intangible rights owned by the ULBs and carrying probable future benefits. (*ICAI*)
19. **Assigned Revenues** :-Assigned revenues are revenues in the nature of a share in the revenues of the state government, to compensate for certain losses in revenue and arrangement of resources of the ULBs. The ratio of the share in revenues is determined on the basis of the revenues collected by ULBs and the recommendations of the State Finance Commissions and devolution of

funds to ULBs.(*AFF*)

20. **Asset Replacement Fund** :-A fund created for the purpose of replacement of an asset. The fund shall normally be equal to the amount of depreciation provided on the Fixed Assets and shall be utilised only for the purpose of replacement of those Fixed Assets or for any other purpose as resolved by the ULBs. (*AFF*)
21. **Bad Debts**:- Debts owed to the ULBs, which are considered to be irrecoverable, e.g., arrears of taxes, fees and other revenue left uncollected and considered to be irrecoverable. (*ICAI*)
22. **“Banker’s deposit-at-call Receipts”** means the acceptance in writing by a bank or banker of liability to pay on demand the amount specified on such receipt;
23. **Balancing** :- In order to balance an account, the two sides, namely Debit and Credit are totalled up separately and the difference is ascertained. This difference is put on the side that is lower to balance the two sides of an account.(*AFF*)
24. **Balance Sheet** :-A statement of the financial position of an ULB as at a given date, which exhibits its assets, liabilities, capital, reserve and other account balances at their respective book values. (*ICAI*)
25. **Bank Reconciliation Statement** :- A statement, which reflects the nature and amount of transaction not responded either by the ULB or the Bank as on a particular date. Such statement may also reflect errors/omission in the recording of transaction inter-se between the ULB and the Bank. (*ICAI*)
26. **Books of Original Entry**:- A record book, recognised by law or custom, in which transactions are successively recorded, and which is the source of postings to ledgers; a journal. Books of original entry include general and special journals, such as cash books. (*Kohler*)
27. **Budget** :- It means quantitative plan of activities and programs expressed in terms of money in respect of assets, liabilities, revenues and expenses. The budget expresses the ULB goals in terms of specific financial and operating objectives. (*ICAI*)
28. **Capitalisation** :-An expenditure for a fixed asset or addition thereto that has

the effect of enlarging physical dimensions, increasing productivity, lengthening future life, or lowering future costs. *(Kohler)*

29. **Capital Expenditure** :- An expenditure intended to benefit future period in contrast to a revenue expenditure, which benefits a 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. *(Kohler)*
30. **Capital Work in Progress** :- Expenditure on capital assets which are in the process of construction or completion. *(ICAI)*
31. **Cash Book** :- A book of original entry for cash receipts, disbursements, or both. *(Kohler)*
32. **Cash flow Statement** :- A financial statement prepared for an accounting period to depict the inflows and outflows of cash and cash equivalents of an enterprise. The cash flow statement reports cash flows classified by operating, investing and financing activities. *(ICAI)*
33. **Casting** :- It means totalling of the amounts in the books of account. *(AFF)*
34. **Chart of Accounts** :- A systematically arranged list of accounts applicable to a specific concern, giving account names and numbers, if any. *(Kohler)*
35. **Code of Account** :- A unique numeric or alphanumeric identification given to each Account to facilitate classification and ease of recording. *(AFF)*
36. **Competent Authority** means the Authority declared by the State Government from time to time.
37. **Commissioner** means Commissioner of Municipal Corporation appointed by the State Government.
38. **Contingent Liability** :- An obligation relating to an existing condition or situation which may arise in future depending on the occurrence or non- occurrence of one or more uncertain future events. *(ICAI)*
39. **Contra Entry** :- An item on one side of an account which offsets fully or in part one or more items on the opposite side of the same account. *(Kohler)*
40. **Control Account** :- Control account is an account in the general ledger that consists of related sub-accounts. The total of the related sub-accounts should total the balance in the related control account. *(AFF.)*

41. **Cost**- The amount of expenditure incurred on or attributable to a specified article, product or activity. *(ICAI)*
42. **Cost of Acquisition**:-The cost of acquisition of a Fixed Asset comprises its purchase price and includes import duties and other non-refundable taxes or levies and any directly attributable cost of bringing the asset to its working condition for its intended use; any trade discounts and rebates are deducted in arriving at the purchase price. *(ICAI)*
43. **Cost of Investment** :-The amount of expenditure incurred on or attributable to the purchase/acquisition of an investment. The cost of an investment amongst others includes acquisition charges such as brokerage, fees and duties. *(AFF)*
44. **Credit** :-A book-keeping entry recording the reduction or elimination of an asset or an expense, or the creation of or addition to a liability or item of net worth or revenue; an entry on the right side of an account; the amount so recorded.*(Kohler)*
45. **Current Assets** :-Cash and other assets that are expected to be converted into cash or consumed in rendering of services in the normal course of operations of the ULBs. *(ICAI)*
46. **Current Liability**:- Liability including loans, deposits and bank overdrafts which fall due for payment in a relatively short period, normally not more than twelve months. *(ICAI)*
47. **Debenture** :-A formal document constituting acknowledgement of a debt by an ULB, usually given under its common seal and normally containing provisions regarding payment of interest, repayment of principal and security, if any. It is transferable in the appropriate manner. *(ICAI)*
48. **Debit**:-The goods or benefit received from a transaction; a book-keeping entry recording the creation of or addition to an asset or an expense, or the reduction or elimination of a liability, or item of net worth or revenue; an entry on the left side of an account; the amount so recorded. *(Kohler)*
49. **Deferred Revenue Expenditure**:- Expenditure for which payment has been made or a liability incurred but which is carried forward on the presumption that it will be of benefit over a subsequent period or periods. This is also referred to as Deferred Expenditure. *(ICAI)*

50. **Deficit** :- The excess of expenditure over income of the ULB for an Accounting Period under consideration. *(AFF)*
51. **Depreciable Amount** :-The historical cost, or other amount substituted for historical cost of a depreciable asset in the financial statements, less the estimated residual value. *(ICAI)*
52. **Depreciable Asset** :-An asset which is expected to be used during more than one accounting year, has a limited useful life, and is held by the ULBs for use in the supply of goods and services, for rental to others, or for administrative purposes and not for the purpose of sale in the ordinary course of operations of the ULB. *(ICAI)*
53. **Depreciation**:-A measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time or obsolescence through technology and market changes. It is allocated so as to charge a fair proportion in each accounting period during the useful life of the asset. It includes amortisation of assets whose useful life is predetermined and depletion of wasting assets. *(ICAI)*
54. **Depreciation Method** :-The arithmetic procedure followed in determining a provision for depreciation (an expense) and maintaining the accumulated balance. *(Kohler)*
55. **Depreciation Rate** :- A percentage which when applied to the depreciable amount will yield depreciation expense for a year. *(Kohler)*
56. **Dividend Income** :- An income received from investments by a ULB in shares/units. *(AFF)*
57. **Earmarked Funds** :- Funds representing Special Funds to be utilised for specific purposes. *(AFF)*
58. **Employee** means an officer or servant employed by the municipality and include a Government servant in foreign service under the Municipality, but does not include a Government servant doing work for the Municipality, under the control of his departmental superiors in Government service;
59. **Executive Officer** there shall be an Executive Officer in each Municipal Council who will be appointed by the State Government and shall govern by such conditions of service as may be prescribed by the State Government.
60. **Expenses** :-A cost relating to the operations of an accounting period or to

the revenue earned during the period or the benefits of which do not extend beyond that period. (ICAI)

61. **Financial Statement** :- A balance sheet, income statement (income and expenditure), receipts & payment statement or any other supporting statement or other presentation of financial data derived from accounting records. (ICAI)
62. **Finished Goods** :-Goods held for sale in the ordinary course of business. (ICAI)
63. **Fixed Asset** :-Asset held for the purpose of providing services and that is not held for resale in the normal course of operations of the ULB. (ICAI)
64. **Fixed Deposit** :-Deposit for a specified period and at specified rate of interest.(ICAI)
65. **Fund** :- The term fund refers to amount set aside for a general or specific purpose, whether represented by specifically earmarked assets or not. (ICAI)
66. **Folio reference** :-A page number or voucher or other number in a book or document of original or final entry, which refers to the disposition or source of an entry or posting. (Kohler)
67. **Goods** includes animals;
68. **Grants** :-Grants are assistance by government in cash or kind to an enterprise for past or future compliance with certain conditions. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the enterprise. (ICAI)
69. **Gross Block** :-The total cost of acquisition/purchase of all the Fixed Assets of the ULB. (AFF)
70. **Hire Purchase** :- Hire purchase agreement is a contract (more fully called contract of hire with an option of purchase) in which a person hires goods for a specified period and at a fixed rent, with the added condition that if he shall retain the goods for the full period and pay all the installments of rent as they become due the contract shall determine and the title vest absolutely in him.(AFF)
71. **Head of Department** means the Director Urban Development Department;
72. **Income** :-Money or money equivalent earned or accrued during an accounting period, increasing the total of previously existing net assets, and arising from provision of any type of services and rentals. (Kohler)
73. **Income and Expenditure Statement** :-A financial statement, often prepared

by non-profit making entities like clubs, associations, ULBs, etc., to present their revenues and expenses for an accounting period and to show the excess of revenues over expenses (or vice-versa) for that period. It is similar to profit and loss statement and is also called revenue and expense statement. (ICAI)

74. **Interest:-** The service charge for the use of money or capital, paid at agreed intervals by the user, and commonly expressed as an annual percentage of outstanding principal. (Kohler)
75. **Investments :-** Assets held not for operational purposes or for rendering services, i.e., assets other than fixed assets or current assets (e.g. securities, shares, debentures, immovable properties). (ICAI)
76. **Inter unit transactions :-** Transactions between one or more accounting units of the Urban Local bodies. (AFF)
77. **Infrastructure Assets:-** Those assets with the characteristics of being, a part of a system or network, specialised in nature and do not have alternative uses, immovable, and subject to constraints on disposal. (AFF)
78. **Journal Book :-** The book of original entry in which are recorded transactions not provided for in specialised journals. (Kohler)
79. **Joint Venture :-** Joint Venture is a contractual arrangement whereby two or more parties undertake an economic activity to share expertise in a single defined project, which is subject to joint control. (AFF)
80. **Lapsed Deposits :-** Deposits unclaimed for more than such period or periods as defined in the act or provisions governing the ULBs. (AFF)
81. **Ledger:-** A compilation of all accounts used for accounting purposes. (AFF)
82. **Lease: -** A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period. A lease agreement also includes a Hire Purchase agreement. A lease is classified as a finance lease if it transfers substantially the entire risks and rewards incident to ownership. All other leases are classified as operating leases. (ICAI)
83. **Liability :-** An amount owing by one person to another, payable in money, or in goods or services: the consequence of an asset or service received or a loss incurred or accrued; particularly, any debt (a) due or past due (current liability),

- (b) due at a specified time in the future (e.g. funded debt, accrued liability),
or
(c) due only on failure to perform a future act (contingent liability). (*Kohler*)
84. **Long term investments :-** Any investment falling outside the ambit of current investments are treated as long-term investments. (*ICAI*)
85. **Member** means a member of the Municipality;
86. **Mortgage :-** A lien on land, buildings, machinery, equipment, and other property, fixed or movable, given by a borrower to the lender as security for his loan; sometimes called a deed of trust. (*Kohler*)
87. **Municipality** means a Municipal Council or Nagar Panchayat or a Municipal Corporation.
88. **Municipal Engineer** means the officer appointed by the State Govt. in charge of the Municipal Works;
89. **Municipal fund :-** The municipal or general fund is the general operating fund of an ULB. It is used to account for all financial resources except those related to any special or trust funds. (*AFF*)
90. **Narration :-** A brief description written below an Accounting Entry. It is normally written in brackets and starts with the word "Being". It explains as to why the entry has been recorded and other related aspects of the entry. (*AFF*)
91. **Net Assets :-** The excess of the book value of the assets of an accounting unit over its liabilities to outsiders. (*Kohler*)
92. **Net Block :-** Gross Block less Accumulated Depreciation of all the Fixed Assets of the ULB. (*AFF*)
93. **Period End :-** the last day of any Accounting Period, e.g., quarter, half-year, year-end. (*AFF*)
94. **Pooling of interest method -** Pooling of interests is a method of accounting for amalgamations the object of which is to account for the amalgamation as if the separate operations of the amalgamating entities were intended to be continued by the transferee entity. Accordingly, only minimal changes are made in aggregating the individual financial statements of the amalgamating entities. (*ICAI*)
95. **Posting :-** An act of entering separately the debit and credit aspect of transactions from the books of original entry in respective accounts

maintained in the ledger. (ICAI)

96. **President** includes an Administrator.
97. **Prepaid Expense** :-Payment for expense in an accounting period, the benefit for which will accrue in the subsequent accounting period(s). (ICAI)
98. **Provision for Expense** :-An amount written off or retained by way of providing for depreciation or diminution in value of assets or retained by way of providing for any known liability the amount of which cannot be determined with substantial accuracy. (ICAI)
99. **Provision for Unrealised Revenue** :-A provision made for revenue considered doubtful of recovery. (ICAI)
100. **Qualifying Fixed Asset** :-A Qualifying Fixed Asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Ordinarily a period of twelve months is considered as substantial period unless a shorter or longer period can be justified on the basis of facts and circumstances of the case. In estimating the period, the time which an asset takes, technologically and commercially, to get it ready for its intended use or sale should be considered. (ICAI)
101. **Receipt** :- A written acknowledgement of something acquired; hence, an accounting document recording the physical receipt of cash/cheques. (Kohler)
102. **Receipts & Payments Statement** :- A financial statement prepared for an accounting period to depict the changes in the financial position and to present the cash received in and paid out in whatever form (cash, cheques, etc.) under certain headings. All non-cash related transactions are ignored while preparing this Statement.(AFF)
103. **Reconciliation** :- It means adjusting the difference between two items (i.e. amounts, balances, accounts or statements) so that the figures agree. (ICAI)
104. **Report of the Municipal Chief Auditor** :-The formal expression of opinion by the Municipal Chief Auditor on the Financial Statements, books of accounts and transactions of the ULB. (AFF)
105. **Revenue Expenditure** :-It means outlay benefiting only the current year. It is treated as an expense to be matched against revenue. (ICAI)
106. **Secretary** there shall be an Secretary in each Nagar Panchayat who will be appointed by the State Government and shall govern by such conditions of service as may be prescribed by the State Government.

107. **Sinking Fund :-** A fund created for the repayment of a liability or for the replacement of an asset. *(ICAI)*
108. **Special Fund :-**An amount set aside for a specific purpose represented by specifically earmarked assets. *(ICAI)*
109. **State Government** or Government means the Government of Himachal Pradesh.
110. **Straight Line Method (SLM) :-** The method under which the periodic charge for depreciation is computed by dividing the depreciable amount of a depreciable asset by the estimated number of years of its useful life. *(ICAI)*
111. **Sub-Account :-** One or more accounts that make up the Control Account. These sub-accounts are related to the control account and provide more detail of the Control Account. The total of the related sub-accounts will equal the related Control Account.*(AFF)*
112. **Surplus :-**The excess of income over expenditure of the ULB for an Accounting Period under consideration. *(AFF)*
113. **Short term investments :-** Those investments which are readily realisable, and are intended to be held for not more than twelve months from the date of investment *(ICAI)*
114. **Treasury** means a Government treasury or Sub-treasury or a Post office bank to which the Government treasury business has been made over, and includes the officer of the banker or person acting as a banker with whom the municipal fund is deposited under the provisions of Sub-Section(2) of section 55 of the Act; and
115. **Treasury officer** means the officer in charge of a treasury, and includes a banker or person acting as a banker with whom the municipal fund is deposited under the provisions of sub-section (2) of section 55 of the Act.
116. **Trial Balance :-**A list or abstract of the balances or of total debits and total credits of the accounts in a ledger, the purpose being to determine the equality of posted debits and credits and to establish a basic summary for financial statements. *(Kohler)*
117. **Useful Life :-** The period over which a depreciable asset is expected to be used by the enterprise; or (ii) the number of production or similar units expected to be obtained from the use of the asset by the enterprise.*(ICAI)*
118. **Voucher:-**A document which serves as an authorisation for any financial transaction and forms the basis for recording the accounting entry for

the transaction in the books of original entry, e.g., Cash Receipt Voucher, Bank Receipt Voucher, Journal Voucher, Payment Voucher, etc. (AFF)

119. **Work in progress :-** Goods in the process of production for their sales or usage. (ICAI)
120. **Written Down Value (WDV) :-** In respect of a fixed asset means its cost of acquisition or substituted value less accumulated depreciation. (ICAI)
121. **Written Down Value (WDV) Method :-** A method under which the periodic charge for depreciation of an asset is computed by applying a fixed percentage to its historical cost or substituted amount less accumulated depreciation (net book value). This is also referred to as 'Diminishing Balance Method'. (ICAI)
122. **Other words and expression used,** but not defined, in these rules shall have the meanings assigned to them in the Act.

ACCOUNTING CONCEPTS & CONVENTIONS

2.4 The Accounting Concepts and Accounting Conventions have been developed over the years from experience, reason, usage and necessity and are generally accepted for accounting of transactions and preparation of Financial Statements.

2.5 Accounting Concepts are the necessary assumptions, conditions or postulates upon which the accounting is based. They are developed to facilitate communication of the accounting and financial information to all the readers of the Financial Statements, so that all readers interpret the statements in the same meaning and context.

2.6 The Accounting Concepts are as follows:

- a. Entity Concept;
- b. Dual Aspect or Accounting Equivalence Concept;
- c. Going Concern Concept;
- d. Money Measurement Concept;
- e. Cost Concept;
- f. Accounting Period Concept;
- g. Accrual Concept;
- h. Periodic Matching of Cost and Revenue Concept; and
- i. Realisation Concept.

2.7 Accounting conventions are the customs or traditions guiding the preparation of accounts. They are adopted to make financial statements clear and meaningful. The Accounting Conventions are as follows:

- a. Convention of Disclosure;
- b. Convention of Materiality;
- c. Convention of Consistency; and
- d. Convention of Conservatism.

ACCOUNTING CONCEPTS

2.8 Each of the Accounting Concepts is discussed below:

Entity Concept

2.9 For accounting purposes, an “organisation” is treated as a separate entity from the “owners” or “stakeholders”. This concept helps in keeping private affairs of the owners and stakeholders separate from the business affairs. For example, a ULB is a separate, independent and autonomous entity and is governed by a separate legislation and the regulations formed by it. The various stakeholders of the ULBs, including citizens, State Government, environmentalists, etc., do not own the ULBs. Thus, a separate Balance Sheet and Income & Expenditure Statement is prepared in respect of the operations of the ULB. This concept is applicable to all forms of organisations.

Dual Aspect or Accounting Equivalence Concept

2.10 This concept follows from the Entity Concept. All entities own certain assets. Such assets are acquired through contributions of those who have provided the funds for the purpose. Funds are made available either through the surpluses of the entity or loans or payables. In a sense, such providers of funds are claimants to the assets. At any point in time, the assets will be equal to the claims. Since the claims on the assets could be those of “outsiders” (i.e. liabilities) or “owners” (i.e. capital, reserves, etc.), it results in the accounting equation:

$$\text{Assets} = \text{Own Funds} + \text{Liabilities}$$

Going Concern Concept

2.11 It is assumed that the organisation will continue for a long time, unless and until it has entered into a state of liquidation. It is as per this concept, that the accountant does not take into consideration the market value of the assets while valuing them, irrespective of whether the market value is higher or lower than the book value. Similarly, depreciation on fixed assets is provided on the basis of expected lives of the assets rather than on their market values. Also, the financial statements are prepared at

defined period-end to measure the performance of the entity during that period and not only on the closure or liquidation of the entity.

Money Measurement Concept

2.12 In accounting, every transaction is recorded in terms of money. Events or transactions that cannot be expressed in terms of money are not recorded in the books of accounts. Receipt of income, payment of expenses, purchase and sale of assets, etc., are monetary transactions that are recorded in the books of accounts. For example, the event of a machinery breakdown is not recorded as it does not have a monetary value. However, the expenditure incurred for the repair of the machinery can be measured in monetary value and hence is recorded.

Cost Concept

2.13 As per this concept, an asset is ordinarily recorded at the price paid to acquire it, i.e., at its cost and this cost is the basis for all subsequent accounting for the asset. The cost concept does not mean that the asset will always be shown at cost. This basically signifies that each time the financial statements are prepared, the fixed assets need not be revised and recorded at its realisable or replacement or market value. The assets recorded at cost at the time of purchase may systematically be reduced through depreciation.

Accounting Period Concept

2.14 An accounting period is the interval of time at the end of which the financial statements are prepared to ascertain the financial performance of the organisation. Although the “going concern” concept stresses the continuing nature of the entity, it is necessary for an organisation (e.g. ULB) to review how it is performing. The preparation of financial statements at periodic intervals helps in taking timely corrective action and developing appropriate strategies. The accounting period is normally considered to be of twelve months.

Accrual Concept

2.15 Under the cash system of accounting, the revenues and expenses are recorded only if they are actually received or paid in cash, irrespective of the accounting period to which they belong. But under the accrual concept, occurrence of claims and obligations in respect of incomes or expenditures, assets or liabilities based on happening of any event, passage of time, rendering of services, fulfillment (partially or fully) of contracts, diminution in values, etc., are recorded even though actual receipts or payments of money may not have taken place. In respect of an accounting period, the outstanding expenses and the prepaid expenses and similarly the income receivable and the income received in advance are shown separately in the books of accounts under the accrual method.

Periodic Matching of Cost and Revenue Concept

2.16 To ascertain the surplus or deficit made by the entity during an accounting period, it is necessary that the costs incurred are matched with the revenue earned by the entity during that accounting period. The matching concept is a corollary drawn from the accrual concept. To ascertain the correct surplus or deficit, it is necessary to make adjustments for all outstanding expenses, prepaid expenses, income receivable and income received in advance to correctly depict and match the income and expenditure relating to that accounting period.

Realisation Concept

2.17 According to this concept, revenue should be accounted for only when it is actually realised or it has become certain that the revenue will be realised. This signifies that revenue should be recognised only when the services are rendered or the sale is effected. However, in order to recognise revenue, actual receipt of cash is not necessary. What is important is that the organisation should be legally entitled to receive the amount for the services rendered or the sale effected.

ACCOUNTING CONVENTIONS

2.18 Each of the accounting conventions are discussed below.

Convention of Disclosure

2.19 The term “disclosure” implies that there must be a sufficient revelation of information which is of material interest to owners, creditors, lenders, investors, citizen and other stakeholders. The accounts and the financial statements of an entity should disclose full and fair information to the beneficiaries in order to enable them to form a correct opinion on the performance of such entity, which in turn would allow them to take correct decisions. For example, the Accounting Principles that have been followed for preparation of the Financial Statements should be disclosed along with the Financial Statements for proper understanding and interpretation of the same.

Convention of Materiality

2.20 An item should be regarded as material, if there is a sufficient reason to believe that knowledge of it would influence the decision of informed creditors, lenders, investors, citizen and other stakeholders. The accounts and the financial statements should impart importance to all material information so that true and fair view of the state of affairs of the entity is given to its beneficiaries. Hence, keeping the convention of materiality in view, unimportant items are not disclosed separately and are merged with other items. For example, the expenditure incurred on repairs and maintenance of a certain asset of the ULBs, which are small, may not be disclosed separately in respect of each such small item but may be grouped together and shown as a single item of expenditure.

Convention of Consistency

2.21 The convention of consistency facilitates comparison of financial performance of an entity from one accounting period to another. This means that the accounting principles followed by an entity should be consistently applied by it over the years. For example, an organisation should not change its method of depreciation every year, i.e., from Straight Line Method to Written Down Value Method or vice-versa. Similarly, the method adopted for valuation of stocks, viz., First In First Out (FIFO) or Weighted Average should be consistently followed. In case a change is made, it should be disclosed.

Convention of Conservatism

2.22 As per this convention, the anticipated profits should be ignored but all anticipated losses should be provided for in the books of accounts of an entity. This means that all prospective losses are taken into consideration, however, no doubtful income is taken into consideration in recording of transactions by an entity. For example, while provision for doubtful debts and discount is made on debtors or Accounts Receivable, no provision is made for likely discount receivable from creditors or Accounts Payable. Similarly, provision is made for diminution in value of investments, however, no provision is made for any appreciation in value of investments.

ACCRUAL SYSTEM OF ACCOUNTING

2.23 Accrual system of accounting means a method of recording financial transactions based on accrual, i.e., on occurrence of claims and obligations in respect of incomes or expenditures, assets or liabilities based on happening of any event, passage of time, rendering of services, fulfillment (partially or fully) of contracts, diminution in values, etc., even though actual receipts or payments of money may not have taken place.

2.24 In this system, there is a change in accounting for transactions and reporting the financial results so as to provide the ULBs and the Government with the Financial Reports, in the form of two important financial statements for the purposes noted against each:

Statement	Purpose
Income & Expenditure Statement	To determine the financial performance of the ULBs
Balance Sheet	To assess the financial status of the ULBs

BENEFITS OF ACCRUAL SYSTEM OF ACCOUNTING

2.25 The accrual basis of accounting helps in determination of correct income and expenditure of the municipal bodies. The main benefits of accrual based accounting system are enumerated below:

- Ø Revenue is recognised 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.
- Ø Expenditure is recognised 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 recognised 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.
- Ø Expenses are matched with the income earned in that year. Thus, it provides a very effective basis to understand the true performance of the organisation for the operations that is conducted in that year.
- Ø 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 Statement and the Balance Sheet.
- Ø Costs which are not charged to Income & Expenditure Account are carried forward and kept under continuous review. Any cost that appears to have lost its utility or its power to generate future revenue is written-off.
- Ø The surplus or deficit as shown at the year-end represents the correct financial position of the organisation arising out of the various transactions during that year.
- Ø It facilitates proper financial analysis and reporting.
- Ø It captures “full” cost of servicing and helps in identifying financial viability of rendering services.
- Ø It helps in providing timely, right quality and nature of information for planning, decision-making and control at each level of management.
- Ø It assists in effective follow-up of receivables by the municipal body and proper ascertainment of payables by the municipal body.

- Ø One of the distinct advantages of adopting accrual accounting system is ease in financial appraisals by the financial institutions. It also facilitates credit rating through approved Credit Rating Agencies, which is a pre-requisite for mobilising funds in the financial markets through debt instruments.
- Ø It presents a true picture of the financial position of an organisation and helps in better financial management.

2.26 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.

RULES OF ACCOUNTING

2.27 The basic rules of accounting flow from the accounting equation: $Assets = Own\ Funds + Liabilities$

2.28 An increase in the asset, e.g., Vehicle can be brought about by:

- a. Decrease in another asset, e.g., Bank Account, or
- b. Increase in liability, e.g., Loans or Payables.

2.29 An decrease in the asset, e.g., Cash may result in:

- a. Increase in another asset, e.g., Medical Equipment
- b. Decrease in liability, e.g., Payment of Loans or payment of suppliers outstanding
- c. Decrease in own funds through expenditure.

2.30 It is customary to use the term “*Debit*” and “*Credit*” to communicate the above phenomenon. The rules of debits and credits are as follows:

Type of Account	Debit Signifies	Credit Signifies
Asset Accounts	Increases	Decreases
Liability Accounts	Decreases	Increases
Own Funds	Decreases	Increases

2.31 An Accounting Entry would be a combination of a single debit and a single credit or a set of debits and a set of credits, as may be appropriate. Following the accounting equation of Assets = Claims, the debits will always equal credits.

2.32 If we were to expand on the above, the following will be the rules applicable to incomes, expenditures, grants, etc.

Type of Account	Debit Signifies	Credit Signifies
Income (which will increase Own Funds)	Decreases	Increases
Expenditure(which	Increases	Decreases
Grants Received	Decreases	Increases

GENERAL

2.33 **Extension of time when the office is closed ---** Whenever in this manual any act or proceeding is directed or allowed to be done or taken on a certain day, then, if the office is closed on that day the act or proceeding shall be considered as done or taken in due time if it is done or taken on the next day on which the office is open.

2.34 **Power of Inspector may be exercised by members and other Specified officers.---** The powers conferred by this manual on an inspector may be exercised by the E.O./Secretary or by an Audit Officer and by any other officer authorized by the municipality.

2.35 **Instructions of the Director Urban Development Department to be complied with in respect of details.---** In the matter of details connected with accounts not provided for in this manual, the municipality shall comply with the instructions of the Director, Urban Development Department, Himachal Pradesh.

2.36 **Unauthorized forms not to be used---** No forms other than those prescribed in this manual shall be used by the municipality except with the sanction of the Director, Urban Development Department.

2.37 **Destruction of records etc. to be done in accordance with the schedule.---** Vouchers, registers and other forms prescribed in this manual shall not be weeded out or destroyed otherwise than in accordance with the directions as to the disposal of records contained in the Annexure- I of this manual.

Provided that the relevant records donot contain any Audit observations.

Note.--- Records should not be auctioned but should be destroyed.