

ASIAN DEVELOPMENT BANK

TAR: IND 37128

TECHNICAL ASSISTANCE

(Financed by the Government of the United Kingdom)

TO

INDIA

FOR

CAPACITY BUILDING FOR MUNICIPAL SERVICE DELIVERY IN KERALA

December 2004

CURRENCY EQUIVALENTS

(as of 6 December 2004)

Currency Unit	–	Indian rupee/s (Re/Rs)
Re1.00	=	\$0.022
\$1.00	=	Rs44.02

ABBREVIATIONS

ADB	–	Asian Development Bank
CAG	–	comptroller and auditor general
GoK	–	government of Kerala
IKM	--	Information Kerala Mission
LSG	–	local self-government
LSGUD	–	Local Self-Government (Urban) Department
TA	–	technical assistance

TECHNICAL ASSISTANCE CLASSIFICATION

Targeting Classification	–	General intervention
Sector	–	Multisector (transportation and communication; water supply, sanitation, and waste management)
Subsector	–	Water supply and sanitation, waste management, roads and highways
Theme	–	Governance
Subthemes	–	Financial and economic governance

NOTES

- (i) The fiscal year (FY) of the Government and its agencies ends on 31 March. FY before a calendar year denotes the year in which the fiscal year ends, e.g., FY2004 ends on 31 March 2004.
- (ii) In this report, "\$" refers to US dollars.

This report was prepared by M.T. Kho.

I. INTRODUCTION

1. During the 2002 Country Programming Mission, the Government of India confirmed its request for technical assistance (TA) from the Asian Development Bank (ADB) for the Urban Management Support Program in Kerala. Following further discussions, the Government and ADB agreed that a TA would be provided in 2004.¹ The Fact-Finding Mission was conducted in Trivandrum, India, 17–25 October 2004 to prepare the TA. The Mission held discussions with the Local Self-Government (Urban) Department (LSGUD) to reach understanding on the TA's objectives and scope. Costs and implementation arrangements were agreed on separately after the Fact-Finding Mission. The TA Framework is in Appendix 1.

II. ISSUES

2. Kerala is a relatively small state with 32 million inhabitants, but has the third highest population density in India (819 people per square kilometer), after West Bengal and Bihar. Kerala has 5 municipal corporations, 53 municipalities, and 991 bloc or village *panchayats*, which are all classified as local self-governments (LSGs). With the passage of the Kerala Municipalities Act (1994), the Kerala Panchayat Raj Act (1994), and the 73rd and 74th Constitution Amendment Acts, Kerala has implemented large-scale decentralization of both fiscal and administrative powers to the LSGs, making them responsible for the provision, operation, and maintenance of civic services. As part of the decentralization process, the government of Kerala (GoK) set up the State Performance Audit Authority, which was tasked with conducting performance audits of LSGs. However, the LSGs' financial and managerial performance have not made them attractive for bank borrowing or capital market issues. ADB is preparing the Kerala Sustainable Urban Development Project,² designed to help selected municipalities (i) promote good urban governance in municipal management and (ii) develop and expand urban infrastructure to increase the municipalities' economic opportunities and reduce their vulnerability to environmental degradation and urban poverty. The sustainability of the Project's investments can be ensured by improving the managerial and financial performance of the participating municipalities.

3. GoK has recognized the importance of promoting good urban governance. On 5 September 2003 the Government of India's Ministry of Urban Development and Poverty Alleviation and GoK signed a memorandum of agreement to confirm GoK's commitment to undertaking reforms in housing, urban infrastructure, and the municipal sector. The intent is to (i) improve urban governance and (ii) achieve viability and self-sustainability in the provision of various urban services. The reform measures to which GoK committed itself include introducing a double-entry (accrual) system of accounting in urban local bodies, namely, the 5 municipal corporations (Calicut, Cochin, Trissur, Trivandrum, and Quilon) and the 53 municipalities. The urban local bodies currently maintain their accounting records under a cash-based accounting system rather than a double-entry system of accounting, that is, revenues are recognized only when cash has been received, while expenditures are recorded only upon payment.

4. Improved account record keeping and maintenance, complemented by higher capacity of personnel, will help enhance the governance and transparency of the urban local bodies. Urban local bodies need assistance to convert to the double-entry accounting system not only to meet GoK's requirements, but also to improve financial governance in their respective units. Proper accounting of assets and liabilities will enable lenders to urban local bodies to accurately

¹ The TA first appeared in the *ADB Business Opportunities* (Internet edition) on 14 July 2004.

² ADB. 2003. *Technical Assistance to India for Preparing the Kerala Sustainable Urban Development Project*. Manila.

determine the financial position and capacity of municipal corporations and municipalities before undertaking new investments and will ensure accurate reporting, will protect the urban local bodies' assets, and will provide baseline information to facilitate efficient allocation of financial resources.

5. India's comptroller and auditor general (CAG) has set up a task force to establish the accounting and budgeting formats to be used by Indian states. The task force has also prepared a timetable for the implementation of these formats. The Government of India will be supplying guidelines that apply to Kerala.

6. GoK set up a state-level monitoring committee in March 2003. In September 2003, GoK's Cabinet decided to implement double-entry accounting at the level of urban local bodies, which are required to implement the system by April 2006. To support these efforts, GoK created a steering committee in January 2004 whose members include the secretary of GoK's Finance Department, the secretary of LSGUD, the state's general auditor, the accountant general for accounts and entitlements, the examiner/director of Local Fund Audit, the chief executive officer of one of the municipal corporations, the state performance auditor, and the director of Information Kerala Mission (IKM).

7. IKM is an agency that reports to Kerala's LSGUD. Its objectives are to (i) computerize and network the 1,215 LSGs, (ii) establish reliable technical support systems, and (iii) train those involved. IKM has developed software to enable urban local bodies to implement the double-entry accounting system. Sankhya³ was scheduled for deployment in the five municipal corporations by November 2004. LSGUD is implementing its comprehensive computerization program through a build-transfer-maintain model for a 5-year period. The build-transfer-maintain operator will (i) supply, deliver, install, commission, and maintain hardware in the 1,249 LSGs and related institutions; (ii) maintain the applications developed by IKM; (iii) provide training and support services; and (iv) handle relevant data entry. However, the transfer to double-entry accounting necessitates increased capacity building, independent verification of assets, and an asset valuation exercise at the level of urban local bodies.

8. Subject to GoK initiating the reform process, the Government of India will provide funds from the Urban Reforms Incentive Fund; however, the amount will be insufficient to undertake the accounting reform. Thus to achieve conversion of its accounts to double-entry accounting, GoK has requested ADB TA.

III. THE TECHNICAL ASSISTANCE

A. Purpose and Output

9. The objective of the TA is to help urban local bodies prepare and implement a carefully coordinated package of capacity-building activities required to enhance the efficiency and autonomy of LSGs. The TA will assist the municipal corporations and selected municipalities to (i) improve their capacity to organize, record, update, and manage financial and other information on a routine basis; (ii) increase the efficiency and integrity of the data being collected; and (iii) promote good governance in relation to financial management. This initiative will help ensure the sustainability of the investments under the proposed Kerala Sustainable Urban Development Project.

³ Sankhya is the module designed to handle accounting and finance functions in the urban local bodies (receipts and payments, generation of necessary registers, reports, budgets, and financial statements).

B. Methodology and Key Activities

10. The TA will cover pilot implementation of double-entry accounting in the five municipal corporations and in two of the municipalities in Kerala. The experience of and lessons learned from the pilot towns can be used to promote long-term training and hands-on capacity building of the staff of other urban local bodies that will be switching over to double-entry accounting.

11. The TA is expected to include the following:

- (i) **Part A: study tour.** Two representatives from each municipal corporation and pilot municipalities will undertake an 8day study tour of three cities in other states that have successfully implemented a double-entry accounting system (e.g., Bangalore, Chennai, and Hyderabad). The objective is for the representatives to directly observe the implementation of a double-entry accounting system in these cities and to learn from their experience of converting to the system.
- (ii) **Part B: confirmation of compliance of the IKM software with the requirements of the CAG's task force.** Sankhya (para. 7) supposedly incorporates the recommendations of the CAG Task Force on Accounting in Urban Local Bodies, but this needs to be verified. IKM will make any changes necessary to comply with the CAG task force's requirements.

Preparation of the methodology for valuing assets and liabilities. As the urban local bodies may not use a consistent methodology to value their assets and liabilities, the consulting firm needs to establish a methodology that all the pilot towns will use (e.g., historic cost or current cost).

- (iii) **Part C: independent verification and valuation of asset and liability accounts.** To ascertain the opening balances of the pilot municipalities' accounts, an independent verification of assets and confirmation of liabilities is needed, and this will be done by valuers deployed in the pilot towns. Following the verification of assets, an independent valuer will determine the value of the assets for accounting purposes. This exercise will require a sign-off by the independent chartered accountants engaged for the TA.

Actual conversion of pilot towns' accounting records to double-entry accounting. Following the valuation and updating of their account balances, the pilot towns can then implement the double-entry accounting system for recording their financial transactions. The chartered accountants will design a process for providing on-the-job support to finance personnel in the pilot towns during the conversion to help ensure that transactions are recorded accurately, that data integrity is maintained, and that accounting processes that support double-entry bookkeeping are defined.

- (iv) **Part D: preparation of an accounts audit manual in collaboration with the State Performance Audit Office.** Following the conversion to double-entry accounting, an accounts audit manual will have to be prepared to provide guidelines for recording and updating transactions in the system, thereby ensuring data integrity. A budgeting manual will be prepared under the

Modernizing Government Program⁴ that will complement the accounts audit manual. It can also help instill financial discipline in the urban local bodies, as it could be used as a financial planning tool for balancing revenues against planned expenditures. A training manual and module that captures the main points of the accounts audit manual and lessons learned during the conversion exercise will also be prepared.

12. The TA will be implemented by municipal staff with on-the-job support from consultants. Additional activities to be undertaken during the TA will include (i) conducting workshops and (ii) preparing required reports. Upon completion of the TA, the pilot towns are expected to have improved information linking revenues and expenditures, thereby enabling effective financial management and planning for the delivery of municipal services.

C. Cost and Financing

13. The total cost of the TA is estimated at \$1,058,000 equivalent, comprising foreign exchange costs of \$7,000 and local currency costs of \$1,051,000 equivalent. The entire foreign exchange costs and \$793,000 equivalent in local currency costs, totaling \$800,000, will be financed on a grant basis by the Department for International Development funded by the Government of the United Kingdom, and the TA will be administered by ADB. GoK will contribute the remaining local currency costs of \$258,000 for office accommodation, counterpart staff support, and other administrative expenses. GoK will also provide all the information required for the TA activities. A cost estimate and financing plan is provided in Appendix 2.

D. Implementation Arrangements

14. LSGUD will be the executing agency for the TA and will be responsible for overall coordination with ADB. The Directorate of Urban Affairs is a key implementing agency and the State Performance Audit Office will monitor TA activities. LSGUD will also provide the TA consultants with administrative and technical support and will coordinate all activities under the TA with other government agencies. The consultants will report to the project director of the Kerala Sustainable Urban Development Project,⁵ who will track the TA's overall progress. GoK will provide adequate office space for the consultants along with sufficient means of communication.

15. The steering committee (para. 6) will be set up prior to the commencement of the TA, comprised of (i) the secretary of GoK's Finance Department, (ii) the secretary of LSGUD, (iii) the state's general auditor, (iv) the accountant general for accounts and entitlements, (v) the examiner/director of Local Fund Audit, (vi) the chief executive officer of one of the municipal corporations, (vii) the state performance auditor, (viii) the director of Information Kerala Mission (IKM), and (ix) a representative from the Institute of Chartered Accountants, India; and (x) a representative from the Institute of Public Auditors of India. The secretary of LSGUD will chair the steering committee and will be assisted by the team leader and deputy team leader engaged under the TA. The steering committee will meet at least once every 2 months during implementation of the TA to discuss the consultants' progress (after the inception, midterm, and

⁴ ADB. 2002. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to India for Modernizing Government and Fiscal Reform in Kerala Program*. Manila (Loan 1974-IND, for \$200 million, approved on 18 December 2002).

⁵ ADB. 2003. *Technical Assistance to India for Preparing the Kerala Sustainable Urban Development Project*. Manila (TA 4106-IND, for \$1 million, approved on May 2003).

final workshops) or upon the achievement of key milestones. GoK will identify a core team of staff from among the pilot municipalities who can serve as resource persons at a later time.

16. The TA will be implemented over 11 months from August 2005 to July 2006. The consulting services for the TA will total 124 person-months of domestic consulting services. A domestic firm will be engaged to organize the TA activities and prepare the intermediate and final outputs for review and approval by LSGUD and ADB. The consultants will be engaged by ADB in accordance with its *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB for engaging domestic consultants. The experts to be provided by the firm will include chartered accountants, asset valuers, and information technology support personnel. The outline terms of reference for consultants are in Appendix 3.

17. The TA will provide equipment such as computers and other office equipment that the consultants will purchase in accordance with ADB's *Guidelines for Procurement*. The equipment will be handed over to LSGUD upon completion of the TA. The TA will also provide funds for workshops to be conducted by the consultants in accordance with arrangements acceptable to ADB.

18. The consulting firm will be chosen using a full technical proposal that employs the quality- and cost-based method of selection. The consultants will be required to prepare (i) an inception report within 1 month of TA commencement, (ii) an interim report within 6 months of TA commencement, (iii) a draft final report within 10 months of TA commencement, and (iv) a final report upon completion of the TA. During implementation, the consultants will organize three workshops in Trivandrum, India, to discuss the inception, interim, and draft final reports. The consultants will also organize participatory meetings throughout the implementation of the TA to disseminate information about the TA and incorporate feedback from local stakeholders into the TA. Tripartite meetings will be held immediately after the workshops on the inception, interim, and draft final reports.

IV. THE PRESIDENT'S DECISION

19. The President, acting under the authority delegated by the Board, has approved ADB administering technical assistance not exceeding the equivalent of \$800,000 to the Government of India to be financed on a grant basis by the Government of the United Kingdom for Capacity Building for Municipal Service Delivery in Kerala, and hereby reports this action to the Board.

TECHNICAL ASSISTANCE FRAMEWORK

Design Summary	Performance Indicators and Targets	Monitoring Mechanisms	Assumptions and Risks
<p>Goal Increase the transparency and improve the financial governance of urban local bodies in Kerala</p>	<p>Reduced number of urban local bodies employing cash accounting</p> <p>Urban local bodies converted to double-entry accounting by the end of FY 2007</p>	<p>Periodic monitoring by the State Performance Audit Office of entities that have converted to double-entry accounting</p>	
<p>Purpose To help five municipal corporations and two municipalities organize, record, update, and manage financial information on a routine basis using double-entry accounting</p>	<p>Compliance with the requirements of the comptroller and auditor general's task force</p> <p>Assets valued using standard methodology employed in Kerala</p> <p>Five municipal corporations and two selected municipalities fully converted to double-entry accounting by the end of FY 2006</p>	<p>Certification of financial records by auditors following conversion to double-entry accounting</p> <p>Annual financial statements of five municipal corporations and two selected municipalities</p>	<p>Assumptions</p> <ul style="list-style-type: none"> • Timely implementation of the advisory TA with sufficient support from the government and counterpart staff • Readiness of five municipal corporations and two selected municipalities to implement double-entry accounting <p>Risks</p> <ul style="list-style-type: none"> • Delay in issuing the Accounting, Budgeting and Auditing Manual by the Government of India
<p>Outputs Following the implementation of double-entry accounting, the financial statements of five municipal corporations and two municipalities use a consistent methodology for valuing assets and liabilities</p> <p>Staff in five municipal corporations and two municipalities are trained in double-entry accounting</p>	<p>Financial statements of five municipal corporations and two municipalities certified by independent auditors following their full conversion to double-entry accounting</p> <p>Key finance staff in five municipal corporations and two municipalities trained in double-entry accounting by the end of FY 2006</p>	<p>Inception, interim, and final reports</p> <p>TA review missions</p> <p>Confirmations from the State Performance Audit Office</p>	<p>Assumptions</p> <ul style="list-style-type: none"> • Timely recruitment and participation of counterpart staff <p>Risks</p> <ul style="list-style-type: none"> • Insufficient capacity of five municipal corporations and two municipalities to absorb the change of accounting system • Inadequate staff skills and too few staff • Delays in obtaining confirmations of the valuation methodology from the State Performance Audit Office

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Design Summary	Performance Indicators and Targets	Monitoring Mechanisms	Assumptions and Risks
<p>Accounts audit manual prepared</p> <p>Training manual and module for rollout to municipalities</p> <p>Synopsis of study tour prepared highlighting lessons learned from the implementation of double-entry accounting in other cities</p>	<p>Audit manual prepared for rollout to other urban local bodies undergoing conversion by the end of 2006</p>		<ul style="list-style-type: none"> • Delay in organizing the study tour
<p>Activities</p> <p>Recruit a team of consultants</p> <p>Organize a study tour to three cities that have successfully converted to double-entry accounting</p> <p>Confirm compliance of Information Kerala Mission software with the requirements of the comptroller and auditor general's task force</p> <p>Prepare a methodology for valuing assets</p> <p>Convert cash-based accounting systems into accrual-based accounting systems on a pilot basis in selected urban local bodies</p> <p>Prepare an accounts audit manual</p> <p>Prepare a training manual and module for roll-out to municipalities</p> <p>Organize and facilitate three workshops with relevant stakeholders</p>	<p>Delivery of TA within the budget</p>	<p>TA steering committee minutes</p> <p>TA reports</p> <p>Feedback received during the workshops</p>	<p>Assumptions</p> <ul style="list-style-type: none"> • High level of cooperation and participation by government counterpart staff and government officials

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Design Summary	Performance Indicators and Targets	Monitoring Mechanisms	Assumptions and Risks
Inputs 124 months of Domestic Consultants 336 months of Government Counterpart Staff Study Tour Workshops and Consultations Equipment, Report Preparation, Communications, Transportation, etc. Contingencies	\$624,000 \$105,000 \$30,000 \$13,000 \$210,000 \$76,000		

FY = fiscal year, TA = technical assistance.

COST ESTIMATES AND FINANCING PLAN
(\$'000)

Item	Foreign Exchange	Local Currency	Total Cost
A. Government of the United Kingdom Financing^a			
1. Consultants			
a. Remuneration and Per Diem for Domestic Consultants	0	624	624
b. Reports and Communications	0	12	12
2. Office Equipment ^b	0	15	15
3. Study Tour	0	30	30
4. Workshops	0	3	3
5. Local Transport	0	26	26
6. Secretarial Support and Office Services	0	7	7
7. Representative for Contract Negotiations	7	0	7
8. Contingencies	0	76	76
Subtotal (A)	7	793	800
B. Government of Kerala Financing			
1. Office Accommodation and Utilities	0	28	28
2. Remuneration and Per Diem of Counterpart Staff	0	105	105
3. Local Travel and Transport	0	37	37
4. Computer Equipment ^c	0	58	58
5. Workshop Venues	0	10	10
6. Other	0	20	20
Subtotal (B)	0	258	258
Total	7	1,051	1,058

^a Financed by the Department for International Development, funded by the Government of the United Kingdom and administered by the Asian Development Bank.

^b Includes five desktop computers, uninterrupted power supply, software, five printers, seven desktop telephones, and seven mobile telephones will be purchased by the consultants in accordance with ADB's Guidelines for Procurement. The equipment will be handed over to Local Self Government (Urban) Department upon completion of the technical assistance.

^c Personal computers for counterpart staff, server, and hubs/switches for networking.

Source: Asian Development Bank estimates.

OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

A. Background

1. The output of the technical assistance will be broken down into four parts and the associated activities will be organized by the team leader. The consultants will draft an implementation plan during inception.
2. The team leader will report directly to the Project Director of the Project Management Office of Kerala Sustainable Urban Development Project. The consultants' reporting requirements will comprise of (i) an inception report, due within 1 month of TA commencement; (ii) an interim report, due within 6 months of TA commencement; (iii) a draft final report, due within 10 months of TA commencement; and (iv) a final report, upon completion of the TA study. During implementation, the consultants will organize three workshops in Trivandrum, India for discuss the inception, interim, and draft final reports. The consultants will also organize participatory meetings throughout TA implementation, to disseminate information on the technical assistance and incorporate feedback from local stakeholders into the technical assistance. Tripartite meetings will be held immediately after the workshops for the inception, interim, and draft final reports.

B. Scope

1. Part A: Study Tour

3. The consultants will undertake the following activities:
 - (i) Organize a study tour to three cities in other states that have successfully implemented a double-entry accounting system. The cities will be chosen in consultation and close coordination with the government of Kerala.
 - (ii) Work with the partner cities to develop a 2-3 day program for each city to provide participants with an opportunity to see different types of accounting systems, discuss the recording and reconciliation processes followed by the partner cities in implementing double-entry accounting, and share the lessons they learned during the conversion of their accounting systems.
 - (iii) Report on the outcome of the study tour.

2. Part B: Confirmation of Compliance of the Information Kerala Mission Software with the Requirements of the Comptroller and Auditor General's Task Force

4. The consultant will perform the following tasks:
 - (i) Review the requirements of the task force.
 - (ii) Examine the accounting modules prepared by Information Kerala Mission to ascertain that they meet the task force's requirements.
 - (iii) Recommend changes, if any, to the system to meet the task force's requirements.
 - (iv) Submit a proposed action plan to the steering committee if any changes are to be made.

5. **Preparation of the Methodology for Valuing Assets.** The consultant will undertake the following activities:

- (i) Review the various methodologies used to value assets and recommend a valuation methodology for Kerala for approval by the State Performance Audit Office.
- (ii) Document and disseminate the methodology to be used for valuation.

3. Part C: Independent Verification and Valuation of Assets and Confirmation of Liability Accounts.

6. The consultant will take on the following tasks:

- (i) Establish teams of counterpart staff in each pilot town.
- (ii) Carry out an inventory of assets in the pilot towns and reconcile it with the towns' accounting records.
- (iii) Value the assets and help the pilot towns adjust their general ledger accounts to reflect the valuations.
- (iv) Confirm the balance of liabilities and help the pilot towns adjust their general ledger accounts accordingly.

7. **Actual Conversion of Pilot Towns' Accounting Records to Double-Entry Accounting.** The consultant will carry out the following tasks:

- (i) Conduct an initial workshop to explain the difference between the two accounting systems.
- (ii) Help the pilot towns implement a double-entry accounting system.
- (iii) Help the pilot towns establish procedures for accrual and reconciliation of accounting records to ensure data integrity.
- (iv) Provide on-the-job support to ensure that problems related to the conversion are addressed and resolved promptly.
- (v) Introduce and document procedures for recording and maintaining the accounting system to further ensure data integrity.

4. Part D. Preparation of an Accounts Audit Manual in Collaboration with the State Performance Audit Office

8. The consultant will undertake the following activities:

- (i) Prepare a manual that establishes accounting policies and procedures for recording transactions and for maintaining the various general ledger accounts.
- (ii) Obtain approval of the manual from the State Performance Audit Office.
- (iii) Prepare a roll-out plan to disseminate the accounts audit manual to those municipalities set to convert from cash accounting to double-entry accounting.
- (iv) Prepare a report that summarizes the activities during the technical assistance and recommendations made to the steering committee to facilitate the conversion from cash accounting to double-entry accounting in other municipalities. Recommendations should include human resource and financing requirements for undertaking reforms in other municipalities.
- (v) Develop a training manual and module that captures the main points contained in the accounts audit manual and lessons learned during the conversion exercise.

C. Expertise

9. The experts to be provided by the firm will include the team leader (11 person-months), a senior chartered accountant (11 person-months), 4 chartered accountants (44 person-months), a senior valuer (9 person-months), 7 valuers (21 person-months), and 7 project managers for management information systems and accounting (28 person-months).