
UNIT 1 DEVELOPMENT MANAGEMENT: AN OVERVIEW

Structure

- 1.1 Introduction
- 1.2 Meaning of Development Management
- 1.3 Aims of Development Management
- 1.4 Scope of Development Management
- 1.5 Elements of Development Management
- 1.6 Development Management Cycle
- 1.7 Pre-requisites of Good Development Management
- 1.8 Let Us Sum Up
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1.1 INTRODUCTION

After the Second World War 'development' becomes the buzz word for the developing country. As development is considered as a multi-dimensional concept, the management of various sectors of development became a challenging task before the managers of development. In a holistic sense, true development means not only high economic growth and per capita income but also enhancement of education, health, and living condition of the people. Balanced development calls for growth and development of all the sectors in the long run. Development management usually means management of development, management in development, and management for development. All of these are discussed in this unit. After reading this unit, you will be able to:

- Define development management
- Discuss the aim and scope of development management
- Identify various elements of development management
- Narrate the development management cycle
- Describe various pre-requisites for good development management

1.2 MEANING OF DEVELOPMENT MANAGEMENT

Development management is a growing and important area in development studies. It is used as an instrument for achieving smooth and faster development. Definitions given by various experts on development management are given below.

According to Paton, "Development management is contemplated with a realization of the importance of the expressive aspect of management in which values and ideas are promoted as part of, not just as one way, of getting things done".

According to Wuyt, “Development management aims at promoting values, in particular, what is to be regarded as development, in this way”.

According to Seers, “Development management means managing, as far as possible, in such a way as to enhance the potential of those one who is working with directly and development organizations that carry similar values, even if this is not the most straight forward way of getting a particular job done”.

In the words of Korten, “Development management can be thought of in terms of positive linkages between development, capacity building, and learning in individual, organizational, institutional and societal levels”.

Allan Thomas in his book on development and management has critically discussed development management. The three definitions of development management given by him are:

- i) Development management includes, firstly, the management of the specific tasks involved in development interventions called management of development;
- ii) Secondly the normative idea of management oriented towards development ideals called management for development; as well as the more straightforward notion of management in a development context, known as management in development.
- iii) Development management is not just a question of getting the task at hand completed by the best means available. It also means simultaneously building the capacity to undertake future tasks and learning how to be able to cope with what at present are unspecified task; and
- iv) Management for development implies a style of management in which any and every activity is undertaken in such a way as to enhance development.

According to Solaiman, “development management means evaluating change from the present situation into a better situation and it is a process of improving, building and innovating in order to ensure better quality of life for the present human beings without jeopardizing those of the future”. From these definitions it can be concluded that development management is a process of conducting development in a systematic way to improve the quality of life of the people.

1.3 AIMS OF DEVELOPMENT MANAGEMENT

Development management aims to improve the management of development projects or programmes in a systematic manner, in order to improve the quality of life of people at the grassroots level. The aim of development can be outlined as follows:

- i) It is aimed at promoting development through the best alternative ways and in a cost-effective manner.
- ii) It is aimed at improving the efficiency and effectiveness of the individuals as well as organizations for achieving development objectives.
- iii) It is aimed at synergizing the three important aspects of development management: management of development, management for development, and management in development.

- iv) Development management is more value-laden and aims at promoting present development without affecting the future. In other words, development management aims at sustainable development.
- v) Development management is a positive and proactive approach to formulating, considering, determining, and delivering development activities. It employs a participatory approach in development project and programme formulation, implementation, monitoring, and evaluation; instead of the one-sided, top down approach. In other words, it is undertaken in the spirit of partnership and inclusiveness.
- vi) The aim of development management is to improve the quality of life of the people through better management of development projects and programmes.
- vii) It is intended to build up both individual as well organization capacities in order to improve efficiency and effectiveness at all levels.
- viii) It aims at developing an alternative model of development, which is more efficient, effective, and productive compared to its existing counterparts.
- ix) Development management aims at effective management of funds, functions, and functionaries at various levels.
- x) It aims at just and equitable way of development.

The aims of development management can be presented in the form of figure below. Development management from the abovesaid discussions aims at management of manpower, finance, and process involved in the development. The other aspects which development management is aimed at, is the management of developmental values, principles, and ethics.

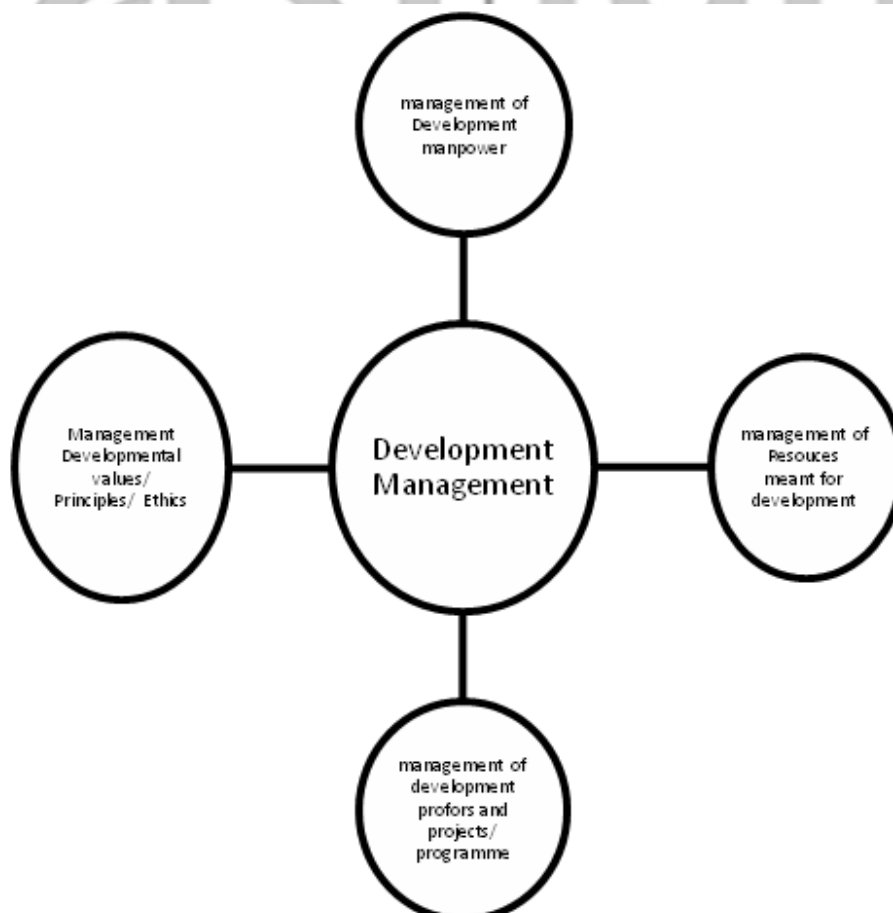


Fig. 1.1: Various aspects of Development Management

In this section, you have studied the meaning and the aims of development management. Now answer the questions given in Check Your Progress 1.

Check Your Progress 1

Note: a) Write your answer in about 50 words.

b) Check your answer with possible answers given at the end of the unit

1) What do you mean by Development Management?

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2) Narrate two important roles of development management.

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1.4 SCOPE OF DEVELOPMENT MANAGEMENT

Development management has a lot of scope in development studies. After the Second World War, most of the developing countries have adopted various development models, and development management is now regarded as an important tool of development. The scope of development management are follows:

- 1) **Hasten the process of development:** Development management helps to hasten the process of development. Development management intends to apply a systemic approach in the management of development programmes and projects. A well formulated project with proper need assessment will not only yield good results but also helps in the judicious use of resources and curtail wasteful expenditure.
- 2) **Facilitate empowerment:** Development management in general and participatory development management in particular lead to empowerment. Development management helps to achieve the goal of absolute, collaborative, adaptive, tacit, and cosmetic empowerment. It empowers the employed and people engaged in development projects and programmes.
- 3) **Proper utilization and allocation of funds:** Application of management principles in development projects and programmes could help the development management to achieve the project's goal and objectives with reduced cost. Proper manpower and resources management checks wastage of financial resources. Therefore, in recent years, most of the projects funding

agencies are using a logistics framework in project design. Proper balancing of expenditure on salary head and expenditure on service delivery is an important requirement of action research projects. It is observed that a large chunk of resources is consumed in paying salary to the service staff, while expenditure on actual services delivery is meagre. Development management helps the manager engaged in development process and activities to make their projects and programmes cost effective and promote judicious management of various aspects of development projects and programmes.

- 4) **Strengthen Development Organization:** The application of management principles in development organization helps to strength development organization. Customarily, the five important functions of management are planning, organizing, staffing, directing, and controlling.

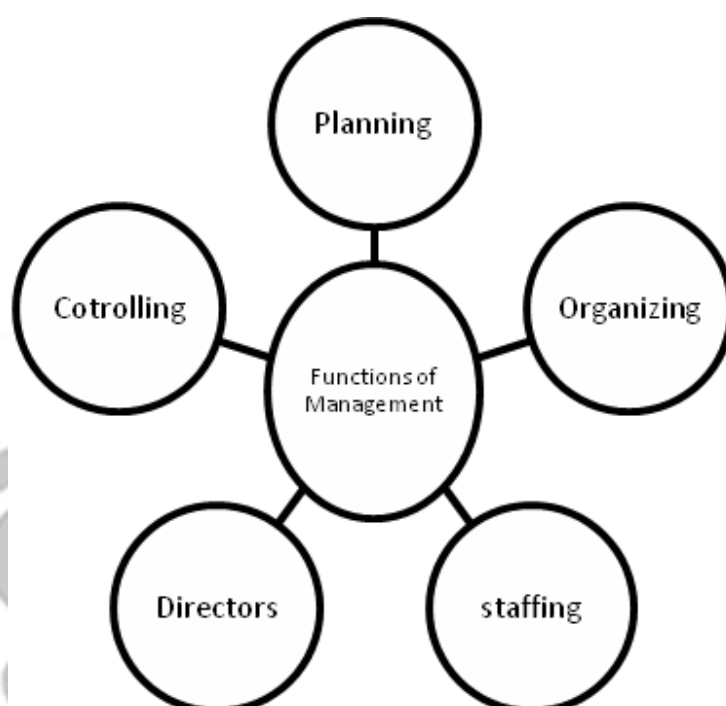


Fig. 1.2: Functions of Management

The planning of development activities in advance with a future course of action helps to effectively achieve pre-determined developmental goals. Organizing is a process of bringing together physical and financial human resources and developing effective relationship among them to achieve developmental goals. Staffing helps in putting the right person in the right job. Directing aims at influencing, guiding, supervising, and motivating the developmental functionaries and actors for the achieving of development goals. Controlling is a way of applying measurement and correcting the course of action in case of any deviation for the achievement of development goals.

These management principles should not only be applied to organizational development but also for effective implementation of projects and programmes by any organization. Therefore, the scope of development management is immense in development.

- 5) **Human Resource Development and Capacity Building:** The goal of human resource development is to improve the performance of the organization by maximizing the efficiency and performance of its people. Human resource development is a system of developing continuously, and, in a planned way, the competencies of individual employees, didactic groups, teams and the entire organization to achieve organizational objectives. According to Tadaro, it is human resources which ultimately determine the character and pace of economic and social development.

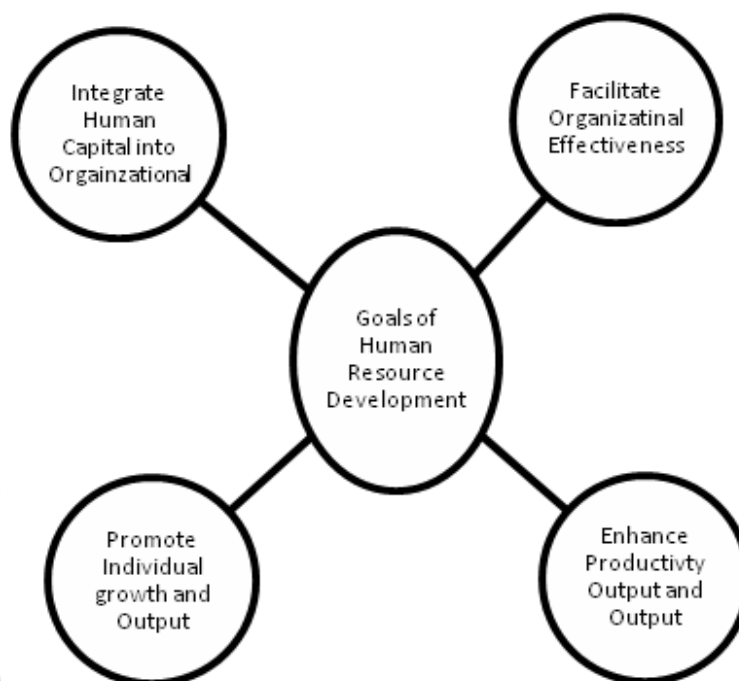


Fig. 1.3: Various Aspects of Human Resources Management

Human resource management principles help to promote human capital, and human capital is the most vital capital required for faster development. Development management promotes human capital. Human capital is generally defined as the skill formation of employee through training and capacity building which increases an individual's contribution to total productivity and development. Thus, human resource development is one the important areas of development management.

1.5 ELEMENTS OF DEVELOPMENT MANAGEMENT

It is more important to discuss various elements of development management. The four important elements of development management enhancement strategies are:

- i) Capacity building training
- ii) Technical assistance and
- iii) Leadership and participation
- iv) Decentralization and empowerment.

All four elements are directly focused on people. It is pertinent to mention here that individuals alone cannot define management. Management takes place within organizational settings. Therefore, both individuals as well as an organization are central to development management.

Development management needs to focus on four main areas:

- i) Contextual factors related to management which include the impact on local, physical, environmental, political and cultural factors, as well as on external factors such as economic and political conditions on the projects and programmes.
- ii) Management strategy, which includes organizational structure and institutional arrangements, encompasses both formally established and informally constituted working relationships among affected organizations and people. Secondly, the resources control encompassing financial, commodity, and logistic management. Thirdly, the approach includes getting things done in an effective and efficient manner.
- iii) Management enhancement strategy, involves attempts to change administrative processes, such as ways of carrying out development programmes in the local setting and efforts to increase consideration of human resources management and behavioural factors, such as skills, performance, and management capacity of the people who are part of, or, who will benefit from the project.
- iv) Fourth, the important elements of development management are decentralization and empowerment. The development goal can be effectively and efficiently achieved if it is decentralized. The decentralization principles thrust responsibility at all levels, thereby promoting accountability and transparency. The decentralization of political, economic, and administrative decision making would ensure better and effective implementation of developmental projects and programmes. The capacity building of grassroots functionaries will be helpful to effectively deal with decentralization and development.

The first area of emphasis is to assess the impact of the local environment on the project. The second area of concern is how the project was designed and managed to encounter the change, and; the third area relates to activities that strengthen the management and institutional capacity of those who will sustain the project after donor funding ends.

Effective management strategies for development must take care of following aspects.

- i) Setting goals and benefits
- ii) Discussion with the stakeholders
- iii) Time horizon
- iv) Resource management
- v) Managerial leadership
- vi) Training and technical assistance.

At the outset, the development manager must set the goals of development and articulate the benefits of the development projects and programmes. After setting goals, the development manager must initiate discussion with the stakeholders. For example, in case of a rural development projects and programmes, the village panchayat is the main stakeholder. The development manager has to initiate discussion with the village panchayat before launching the development project. This will make the development participatory.

The management of time is critical to any development initiative. The project and programme has a certain time period limit. The development manager has to stick to the time limit. It is better, if the development managers prepare a *Gantt Chart* of various projects and programmes activities and move accordingly.

Management of both physical and financial resources of the project is very important. The development manager must have adequate training on how to manage fiscal and financial resources. The managerial leadership and training of development managers, from time to time, is important for development management.

In this section you studied the scope and elements of development management. Now, answer the questions given in Check Your Progress-2.

Check Your Progress 2

Note: a) Write your answer in about 50 words.

b) Check your answer with possible answers given at the end of the unit

1) Briefly, write about the scope of development management.

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2) What are the three key elements of development management?

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1.6 DEVELOPMENT MANAGEMENT CYCLE

Development management intends to set out a detailed and wide variety of policies to guide the decision making process for future planning. Customarily development management as an instrument is largely used in: (i) Management of development sectors such as a agriculture, industry, rural development, etc.

and (ii) Management of development projects and programmes. For example in India context, management of Mahatma Gandhi National Rural Employment Guarantee scheme (MGNREGS); Sarva Shiksha Abhiyan (SSA); National Rural Health Mission (NRHM), etc. are the example of management of development programmes.

The development management cycle begins with the formulation of development goals and objectives and ends after the dissemination of development impact. The steps involved in development management cycle are mentioned in Figure 14.

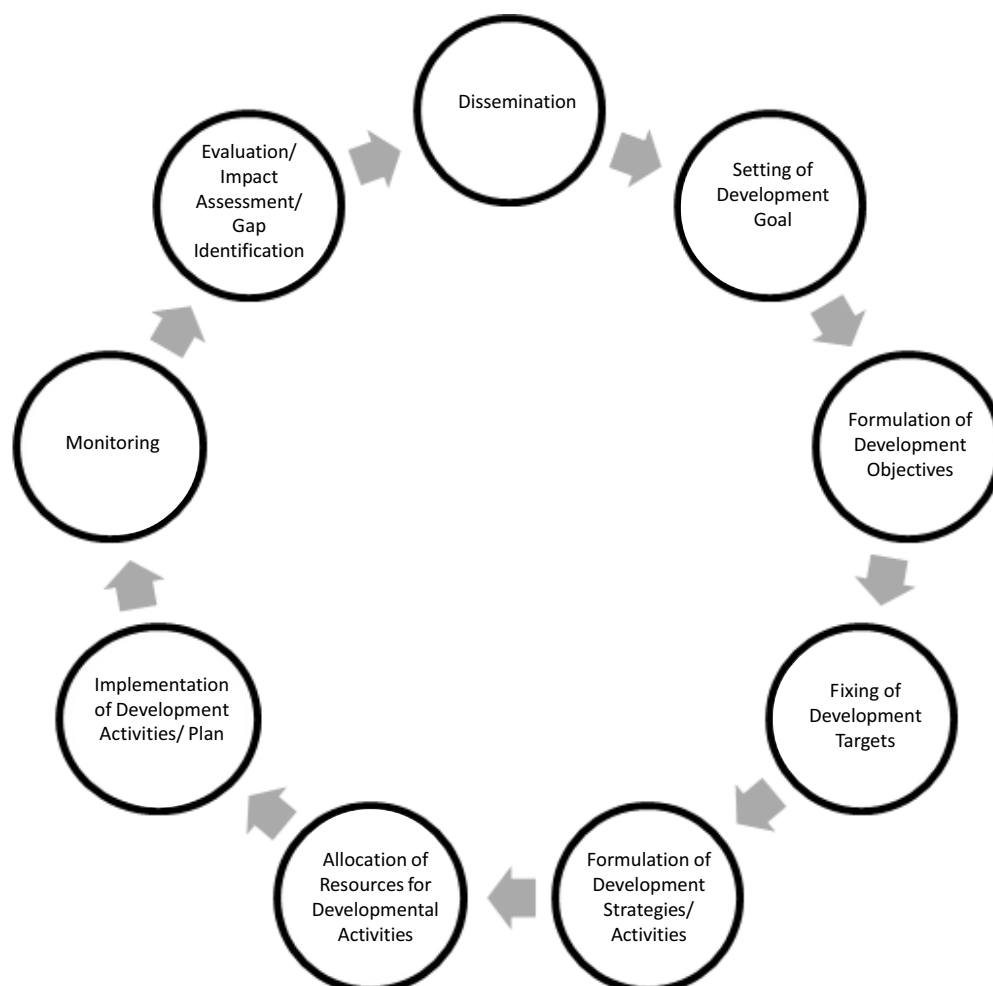
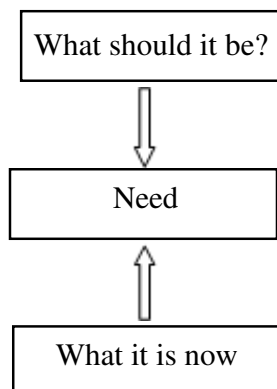


Fig. 1.4: Development Management Cycle

The nine steps of development management cycle are:

- i) Setting the development goal
- ii) Formulation of development objectives
- iii) Setting the development targets/ outcomes
- iv) Formulation of development strategies and activities
- v) Allocation of Resources
- vi) Implementation of the development plan and activities
- vii) Monitoring
- viii) Evaluation / Impact assessment/ gap identification
- ix) Dissemination of result to the policy makers and donors.

- i) **Setting the development goal:** Development goals are formulated after the identification of development needs. Development needs are the difference between what the development “should be” and “what it is”. The development gaps are identified and documented in the plan and policy documents. Based on these gaps, taken out of the plan and policy document, development goals are formulated by the national and state government, and also by the NGOs involved in the implementation of development projects and programmes at the grassroots.



- ii) **Formulation of development objectives:** Development objectives are drawn out of the developmental goals. Development objectives are the statement of a desired end product to be achieved through the development projects or programmes. These statements should clearly spell out the desired outcomes and how they will be attained and measured. The development objective as far as possible should be “SMART”, which means:

S-Simple
M-Measurable
A-Attainable
R-Realistic
T-Time-bound

Any development project or programme must intend to achieve its objective within a given time frame.

- iii) **Fixing up development targets/outcomes:** After formulation of objectives, the next action in the development management cycle is the setting of development targets and outcomes. Setting targets and outcomes comes before the development activities, because outcomes based on indicators provide clues to the development manager on how to fix the targets/outcomes. The targets and outcomes must be realistic and based on the objectives of the projects or programmes, activities and strategies. For example, the outcome of universal immunization calls for a door-to-door vaccination strategy by health workers. Otherwise, it will undermine the development projects/ programme endeavour.
- v) **Formulation of development strategies/activities:** Development objectives and expected outcomes enable the development manager to formulate suitable strategies. The activities must be in tandem with the development outcome. During the formulation of strategies the development manager

must take the help of area/ subject experts in the specified development area in which development projects and programmes are being launched.

- vi) **Allocation of resources:** Judicious allocation of resources on various activities and even between the programme personnel and programme activities is critical to development management. It is observed that a gigantic share of funds goes to the administrative side and a meagre amount is left for programme activities by the development agencies implementing various projects. This type of unbalanced allocation of resources has implications on the outcomes of developmental projects. One of the important roles of the development manager is to see that resources are allocated properly on various aspects of development. Moreover, the community contribution must be resorted to wherever necessary so that the project activities become participatory and sustainable.
- vii) **Preparation and implementation of development plans and activities:** Effective implementation of development plans and activities is a challenge before the organization implementing development projects. The activity plan with a “Gantt chart” and activity mapping are, today, widely used by development institutions during the formulation of developmental projects. It helps the donor agencies as well as implementing agencies to monitor the activities against set targets. Today, under decentralized planning, development plans are prepared at the village, block, and district levels by various partner institutions identified by the government. Development management must possess adequate skills to prepare development plans.
- viii) **Monitoring:** Monitoring is another important component of development management. Monitoring is a continuous and periodic review, and surveillance by the development management at every level of the implementation of an activity to ensure that input deliveries, work schedules, transected outputs and other required actions are proceeding according to plan. The availability of an activity plan, as discussed in the preceding point, is a pre-condition for monitoring. During monitoring, field data are collected, processed, analyzed, and presented to management.
- ix) **Evaluation/impact assessment/gap identification:** Evaluation is the process of determining, systematically and objectively, the relevance, efficiency, effectiveness, and impact of project activities in the light of the stated objectives. It provides information to the development manager about past or ongoing activities, and, in a way helps, in case there is any need for modification to project activities.
- x) **Dissemination:** The last item in the development management cycle is dissemination. The result of the project evaluation and impact assessment needs to be disseminated in the form of a report to the donor agencies. This can even be published in newspapers and journals so that other stakeholders can learn and replicate it elsewhere. While disseminating, it should be kept in mind that all the aspects including input, process, output and outcome need to be covered. Complete details will help the stakeholders as well as beneficiaries and also the development managers to interface with a larger audience.

1.7 PRE-REQUISITES FOR GOOD DEVELOPMENT MANAGEMENT

Some of the pre-requisites for good development management are given below.

- i) **Inter & Intra Sectoral Coordination:** For the effective management of development projects or programmes, the development management must have a climate of healthy intersectoral coordination. Coordination among the sectors is essential for smooth implementation of development activities. For example, the development manager, while implementing any health programme at the grassroots level, has to coordinate with health related departments such as education, public health, women and child welfare, panchayati raj, etc. Besides, intra sectoral coordination within the health sector at different levels, such as district, *taluka*, block, and village levels, is also essential for the smooth implementation of health programme.
- ii) **Good Governance:** In recent years good governance has become a buzz word in development. It is widely felt that good governance will ensure faster development. According to the United Nations, the important features of good governance are consensus oriented, participatory, accountable, transparent, responsive, equitable and inclusive. Development management needs to use good governance as a tool for effective implementation of development activities to achieve development goals. Customarily, good governance helps create an environment in which sustained economic growth becomes achievable.
- iii) **Convergence:** Convergence in recent years has been emphasized to check the duplication of effort and wastage of resources. It is seen that at the grassroots level, the activities implemented by different sectors - different agencies and different institutions - sometimes overlap, which leads to wastage of resources and man-hours. For example, in an area, if the health and education programmes with similar objectives, strategies, and activities are being implemented by the government, non-governmental organization, and by the bilateral organizations, too, then it will not only be overlapping but would create confusion in the minds of people. The convergence of the activities as well as of funds will definitely check the wastage of resources.

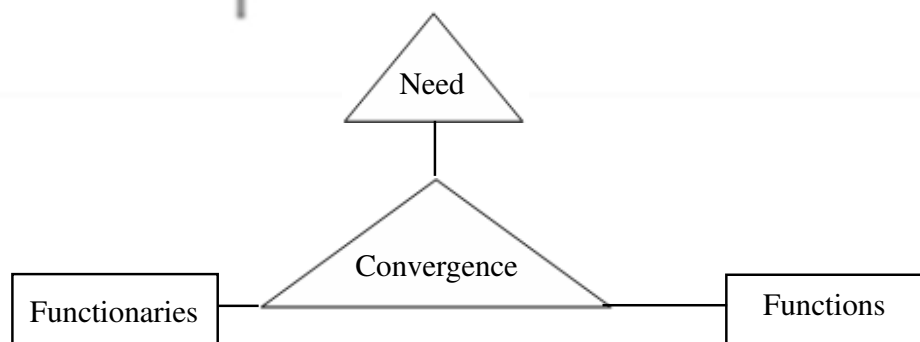


Fig. 1.5: Convergence of various Aspects

The judicious convergence of funds, functions and functionaries by the development manager will make the entire programme cost effective. In recent times, the Ministry of Rural Development and Ministry of Health

and Family Welfare of government of India are working on convergence in order to effectively implement rural development and health and family welfare programmes at the grassroots. The GOI-UN Joint convergence Programmes aims to help backward districts achieve better results in the areas of livelihoods, education, health, nutrition, water, and sanitation.

iv) **Decentralization:** One of the important pre-requisites of good development management is decentralization. Decentralization of funds, functions, and functionaries to the lower level of governments has led to effective implementation of programmes at the grassroots. To cite an example, the decentralization model of Kerala is considered as one of the factors for higher social development. Decentralization has been argued on following grounds.

- Allocative efficiency- Local authorities and grassroots functionaries are more sensitive to local priorities and needs and can allocate resources effectively.
- Information Provision- The local government can keep people better informed as they are closer to them.
- Responsiveness – The local government can be more responsive to the needs of people than state and central government.
- Local revenue maximization – As local governments are closer to the people they can better motivate and collect taxes, fees, and user charges.
- Accountability- Being closer to people, they will be more accountable to them and otherwise people by putting pressure on them will make them accountable.

v) **Leadership:** Leadership is an essential pre-requisite for good development management. Development managers must influence development workers and support them for the accomplishment of developmental tasks. Effective leadership is the key to good development management. It is said that an effective leader is one who can successfully integrate and effectively utilize scarce resources for the accomplishment of institutional goal. Five important traits of leadership are honesty, intelligence, forward looking, competency, and inspirational.

In this section, you studied the development management cycle and pre-requisites of good development management. Now, answer the questions given in Check Your Progress 3.

Check Your Progress 3

Note: a) Write your answer in about 50 words.

b) Check your answer with possible answers given at the end of the unit

1) What is the importance of the Development Management Cycle?

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- 2) Write about one of the important pre-requisites of good development management?

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1.8 LET US SUM UP

Development management has become an essential tool for facilitating better development. The scope of development in development studies is immense. The use of the development management cycle in development management would help in effective implementation of developmental projects and programmes. In this unit, you read about the meaning, aims, and scope of development management. Besides, this unit also covers the development management cycle and pre-requisites of good development.

1.9 REFERENCES AND SELECTED READINGS

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1.10 CHECK YOUR PROGRESS: POSSIBLE ANSWERS

Check Your Progress 1

- 1) What do you mean by Development Management?

Development management is one of the growing and important areas in development studies. It has been defined differently by various developmental experts. According the Solaiman "development management means evaluating change from the present situation into a better situation and it is a process of improving, building and innovating in order to ensure better quality of life for the present human being without jeopardizing those of the future".

- 2) Narrate two important role of development management.

The two important roles of development management are: (i) It aims at synergizing the three important aspects of development management such as management of development, management for development and

management in development; and (ii) Development management is more value laden and aims at promoting present development without affecting the future. In other words, development management aims at sustainable development.

Check Your Progress 2

- 1) Briefly write about the scope of development management?

The two important scope of the development management are: (i) Fasten the process of development: The development management helps to fasten the process of development. Development management intends to apply systemic approach in the management of development programmes and projects. A well formulated project with proper need assessment is not only yield good result but also helps in judicious use of resources and curtails wasteful expenditure; and (ii) Facilitate empowerment: Development management in general and participatory development management in particular lead to empowerment. The development management helps to achieve the goal of absolute, collaborative, adaptive, tacit and cosmetic empowerment. It empowers the employed and people engaged in development projects and programmes.

- 2) What are the three key elements of development management?

The three important elements of development management enhancement strategies are:

- v) Capacity building training
- vi) Technical assistance, and
- vii) Leadership and participation.

Check Your Progress 3

- 1) What is the importance of a Development Management Cycle?

Development management intends to set out a detailed and wide variety of policies to guide the decision making process for future planning. Customarily development management as an instrument is largely used in: (i) Management of development sectors such as agriculture, industry, rural development, etc. and (ii) Management of development projects and programmes. For example in India context, management of Mahatma Gandhi National Rural Employment Guarantee scheme (MGNREGS); Sarva Shiksha Abhiyan (SSA); National Rural Health Mission (NRHM), etc. are the example of management of development programmes. Development management cycle begins with the formulation of development goals and objectives and ends after the dissemination of development impact. The development management cycle helps the development manager to implement development projects and programmes in more systematic way.

- 2) Write about one of the important pre-requisites of good development management?

The three important principles of good development management are inter and intra sectoral coordination; good governance and convergence. Besides leadership and supervision also key to successful implementation of any projects and programmes.

UNIT 2 URBAN MANAGEMENT AND MANAGEMENT OF URBAN SERVICES

Structure

- 2.1 Introduction
- 2.2 Urban Management: Meaning and Scope
- 2.3 Urban Management: As a Process
- 2.4 Management of Urban Services
- 2.5 Requirements of Good Urban Management
- 2.6 Let Us Sum Up
- 2.7 References and Suggested Readings
- 2.8 Check Your Progress: Possible Answers

2.1 INTRODUCTION

Urban is one of the important and most growing sector particularly in developing countries. One of the predictions envisages that there will soon be four billion city dwellers on the planet, each of them producing consuming and travelling. These growing millions have to be fed, provided with housing, safe drinking water, sanitation and energy, and means of transportation. Management of these services is critical to raise the quality of living in city life. Many urban problems are the result of poor management, poor planning and absence of coherent urban policies rather than urbanization itself. Urban Management although a fragile yet a most important component of urban planning and development.

In this unit we will cover the meaning and scope of urban management and also management of urban services. After reading this unit, you will be able to:

- i) Define urban management and delineate its scope
- ii) Explain management and delivery of urban services
- iii) Describe the pre-requisites of good urban management

2.2 URBAN MANAGEMENT: MEANING AND SCOPE

2.2.1 Meaning of Urban Management

The concept urban management is a recent, but, widely used concept as the urbanization is growing very fast. A few definition of urban management given by various exponents are described below.

According S K Sharma the Urban Management can be described “as the set of activities which together shape and guide the social, physical and economic development of urban areas. The main concern of urban management, then, would be intervention in these areas to promote economic development and well-being and to ensure necessary provision of essential services.”

According to Amos “Urban Management is the responsibility of municipal government and urban management is concerned with all aspects of urban development, both public and private. It is no way confined to the services operated by the municipal authority. Good urban management depends on the power to coordinate the activities of a variety of agencies at national and local levels.” While Davidson writes “Urban Management is about mobilizing resources in a way that can achieve urban development objectives”.

According to Rakodi “urban management aims to ensure that the components of the system are managed so that they make possible the daily functioning of a city which will both facilitate and encourage economic activity of all kind and enable residents to meet their basic needs for shelter, access to utilities and services and income generating opportunities.”

According to Cheema “urban management is a holistic concept. It aimed at strengthening the capacity of government and non-government organizations (NGOs) to identify policy and programme alternatives and to implement them with optimal results.”

According to Ronald McGill “urban management is seemed to have a twin objective: first to plan for, provide and maintain a city’s infrastructure and services; and second to make sure that the city’s government is in a fit state, organizationally and financially, to ensure that provision and maintenance.”

William attempted to define urban management as a topic of study. He argued that “urban managerialism is not a theory nor even an agreed perspective. It is instead a framework of study”.

Churchill gave a complex definition of urban management. He maintained that “the term urban management is begging to take on a new richer meaning. It no longer refers only to the systems of control but rather, to set of behavioral relationships, the process through which the myriad activities of the inhabitants interact with each other and with the governance of the city.”

2.2.2 Scope of Urban Management

The scope of urban management is more complex and wide. The complexity of scope of urban management very well articulated by Williams “there have been considerable debate as to whether urban managerialism should simply be concerned with the role of government officials as mediators or whether it should encompass a whole range of actors in both public service and private enterprise who appear to act as controllers of resources sought by urban populations.” While Richardson gave three tests of urban management success. Firstly, the ability of metropolitan managers to implement a declared spatial strategy to be regarded as a reasonable test of managerial efficiency. Secondly, the effectiveness of metropolitan management in cities of the developing countries is the ability to deliver basic urban services and trunk infrastructure to rapidly growing urban population. Thirdly, the other key managerial problem with urban service delivery is the simple one of operation and maintenance. While Leonard touch other aspects of scope of urban management by organizing that managerialist thesis is “concern with the institutions and official empowered to allocate resources and facilities “ UNDP’s experience from different countries broadly argues scope of urban management in the following way “one of the most important lessons

learnt from the distant and recent past is the failure of outdated models and practices of physical planning as well as isolated projects and initiatives in providing an answer to the vast and pressing needs of rapidly forming urban centres in the developing world. Urban management can be answer to this challenge, provided that it develops, both in concept and in practice, as a holistic approach.”

From the above discussions, a few important scope of urban management can be drawn:

- i) Planning, implementation, monitoring of urban infrastructure and services. Effective and efficient delivery of urban services to raise the quality to living of people residing in urban areas.
- ii) Effective and efficient management of projects and programmes for achievement of urban development goals.
- iii) Promotion of intersectoral coordination in the urban sector. Coordination with the health, public health, education, women and child welfare, etc. for the holistic urban development.
- iv) Promote community participation and involve NGOs and civil society organizations in the effective provision and management of urban services.
- v) Enhance the capability of Urban Local Bodies and Urban Institution in carrying out the duties and responsibilities entrusted to them under the 74th constitution amendment (India).
- vi) Strengthen urban administration and governance to deal with various problems associated to urban development.
- vii) Effectively implement urban policies for enhancing contribution of both formal and informal sectors towards urban development.

McGill has rightly summarized the scope of urban management with the view that urban management in developing countries should seek to achieve the simple but fundamental twin objective of:

- a) Planning for, providing and maintaining a city’s infrastructure and services; and
- b) Making sure that the city’s local government is in a fit state, organizationally and financially, to ensure that provision and maintenance.

The Urban governments be it central, state or urban local bodies generally carry out the responsibility for managing six inter-related urban sector i.e. urban land, natural environment, infrastructure, urban services and development. Given in Figure 2.1

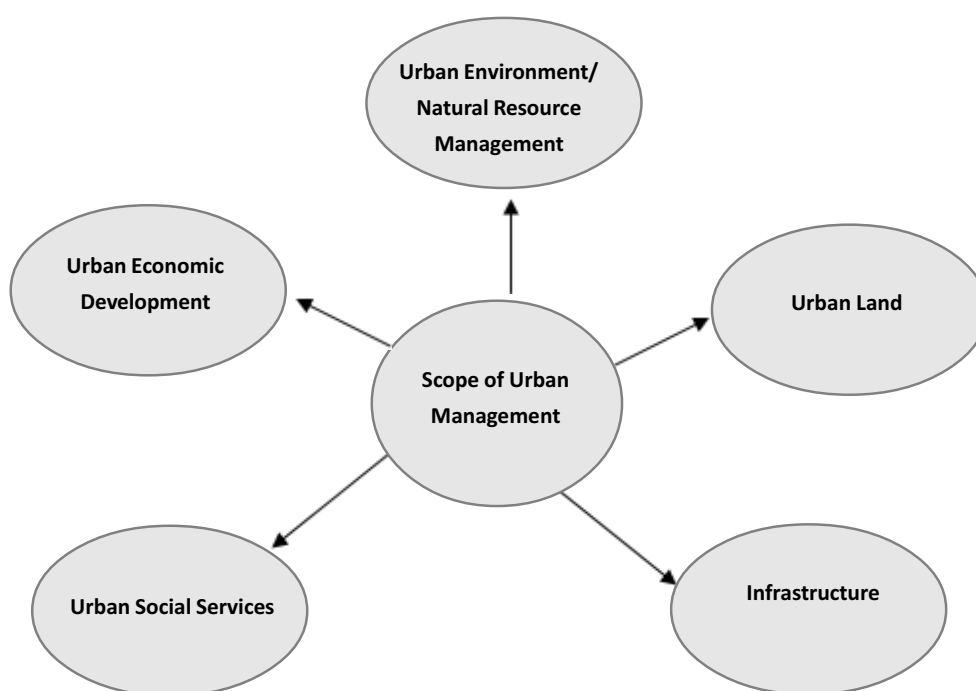


Fig.2.1: Urban Economic Development

- i) **Urban Land Use:** Management of urban land is of the prime responsibility of local governments. The equitable, efficient and effective management of urban land is essential for city development. A few important issues related to urban land management are follows:
 - a) Accurate and timely mapping, gathering and maintenance of land related data;
 - b) Fair and quick land registration procedures to facilitate effective administration of property rights;
 - c) Clear cut and fair mechanisms for assembly, transfer and disposal of land including a transparent market valuation mechanisms;
 - d) Effective policy and participatory planning of land users and
 - e) Efficient and effective procedures and systems for generating revenue from land through taxation and user fees.
- ii) **Natural Environment:** It is one of the important duties and responsibilities of local government to do proper management of natural environment of cities. The cities natural resources must be managed in a such a way that it is free from pollution and environmental degradation. If the cities, especially large towns environment are not managed properly, it would result in serious irreplaceable depletion of essential resources and affect safely to public health and the capacity of natural systems to sustain development. Therefore, there should be proper management of water resources, air quality and land resources in urban areas in tune with environmental protection and sustainable development.
- iii) **Infrastructure:** Infrastructure development is critical to urban development. The local government, therefore, need to do proper planning, provisioning, operation and maintenance of urban infrastructure such as road, water supply

and treatment system, solid waste management system, provision of electricity, urban transport, housing, communication systems ranging from telephone services to telecommunication. A proper coordination among various divisions such as planning, constructing, operation and maintenance is essential for management of urban infrastructure.

- iv) **Urban Social Services:** Local governments are often called upon to manage a diverse range of social services in their areas. These services include urban health care facilities through dispensaries and clinics; education at least pre-primary and primary education; security from crime, public safety from fire and natural disaster and during emergencies; welfare programs of physically challenged and old age; poverty alleviation programme and provision of recreation i.e. open spaces, parks and part of cultural facilities. Provision of urban social services is equally important to that of urban infrastructure. The provision of urban services also called for establishment of schools, hospitals, old age home, care house for physically challenged, recreation clubs and parks. The judicious allocation of resources between various development infrastructure and service infrastructure is sine-quanon for holistic urban development.
- v) **Urban Economic Development:** Local governments influence economic development through policies and programmes, which has relation with investment climate, distribution of goods and services and other basic amenities; and provision of services through taxation and other mechanisms. These affect various sectors of urban economy:
 - a) **Primary sector** – economic activities, for example, agriculture activities performed in peri-urban areas in Indian context Nagar Panchayats;
 - b) **Secondary Sector** – activities relating to manufacturing and construction; and
 - c) **Tertiary Sector** – functions relating to services activities such as banking, insurance, information technology. The local government needs to make necessary urban employment provision in order to provide sustainable livelihood to urban migrant labourers. Strong urban economy is essential for faster urban development.

2.3 URBAN MANAGEMENT: AS A PROCESS

The local governments and their managers face a complex task in managing various components falling under the scope of urban development i.e. environment, urban land services, infrastructure and economic development. Each scope of activity not only compete each other, but also suffer from internal contradictions. It is rightly remarked by Leman (1994) that with many competing demands from all sectors in rapidly urbanizing areas, it is often difficult to assess the impacts of actions one sector against another and to establish a rationale approach to establishing priorities for planning, directions and managing public investments. There are nine basic steps to be followed in multi sectoral urban management. The multi-sectoral urban management are follows:

- i) Identification of Problems
- ii) Formulation of objectives
- iii) Development of policies

- iv) Development of institutional arrangements
- v) Development of programmes/projects
- vi) Development of plan/strategy
- vii) Implementation of programmes/projects
- viii) Operation and maintenance
- ix) Evaluation

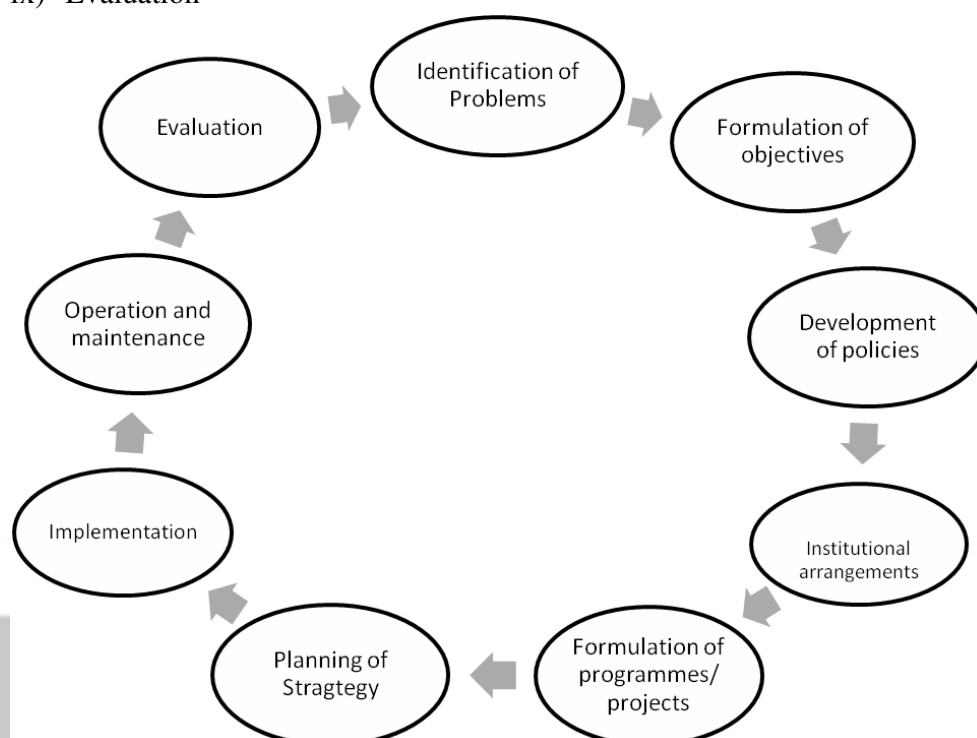


Fig.2.2: Urban Management Cycle

The nine different steps of Urban Management cycle given in Figure 2.2

- 1) **Identification of Problem:** Problem analysis is of prime importance to urban development programmes/projects, as it strongly influences the design of all possible urban development interventions. Problem identification is a deductive process. It is a state of affairs or facts or figures that cause difficulties and sufferings. The problem analysis not only investigates What is wrong? but also try to understand ‘Why’ and ‘How’ it is wrong in order to assign priority to the problem.
- 2) **Formulation of Objectives:** The objective formulation is a process, whereby, the problem are converted into objectives or good towards which activities can be directed. It is viewed that objective analysis is a tool to understand what objectives will be aimed as a result solution to the problems identified in the problem analysis. The development objectives as far as possible should be “**SMART**” that is **S**- Specific, **M**-Measurable, **A**-Attainable, **R**-Realistic and **T**-Time bound.
- 3) **Development of Policies:** In order to achieve the desired goal of urban development, the formulated objectives must be integrated into policy document. At these stage, necessary legislative, regulatory and organizational mechanism and economic, financial and technical measures required are developed.

- 4) **Development of Institutional Arrangement:** After inducting or designing policy, institutional arrangement has to be made. The institution, so created will require to implement objectives. For example, HUDCO (Housing and Urban Development Corporation) has been formulated to implement, policy of urban housing and other basic needs.
- 5) **Programme/ Project formulation:** In this phase, detail programmes and in each programme, what are the projects to be launched in order to achieve the objectives have to be formulated.
- 6) **Development of Plan/Strategies:** In this stage, programme and project specific details, technical plan and strategies has to be developed in order to achieve urban development objective.
- 7) **Implementation:** The plan formulated strategies and activities are implemented by the various institute and agencies deployed in order to achieve the developmental goals and objectives of urban development sector.
- 8) **Operation Maintenance:** Day to day monitoring of operation and maintenance of development works is required for the effectiveness of adoption of programme and project specific objectives. As major amount of money is divested in urban infrastructure development, therefore, operation and maintenance holds the key of urban development activities.
- 9) **Evaluation:** Last but not the least, stage of urban development management cycle in evaluation. The urban development department or the ULBs implementing various urban development programmes can engage third party for the impartial evaluation of their programmes and project in term of inputs, process and output. If necessary, an impact assessment can be done for the basic needs projects such as water works, sanitation and solid waste management.

These nine steps are cyclical and should be undertaken as a matter of regular routine in order to ensure relevance to changing conditions.

After reading the basic understanding and concepts of urban management, its major aspects in order to make efficient urban management process, now you can answer. Check Your Progress with following questions.

Check Your Progress 1

Note: a) Write your answer in about 50 words.

b) Check your answer with possible answers given at the end of the unit.

- 1) What is urban management?

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- 2) Write five components and scope of urban management.

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- 3) Explain urban management cycle.

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2.4 MANAGEMENT OF URBAN SERVICES

One of the key functions of urban management is the effective delivery of urban goods and services for the improvement of quality of life of people living in urban areas. The government of India, recently, as an urban reform agenda used “Service Level Bench-marking (SLB)” as a tool to enhance accountability for service delivery. The SLB was initiated by the Ministry of Urban Development, GOI, as part of the urban reform agenda and developed a common framework for monitoring and reporting on service level indicators. This section will cover GOI managing of urban services aspect. This can be broadly discussed in following heads:

2.4.1 Performance Parameters Indicators and Benchmarks

The four important basic urban services for which performance parameters have been identified are:

- i) Water Supply
- ii) Sewerage
- iii) Solid Waste Management; and
- iv) Storm Water Drainage

- 1) **Water Supply:** Water is one of the basic needs of urban life. Provision of safe drinking water to urban people is one of the important responsibilities of urban government. The management of water supply primarily related to reach and access to quality service and prevalence and effectiveness of the systems to manage the water supply networks. The indicators and benchmarks related to water supply parameters is given in Table 2.1

Table 2.1: Indicators/Benchmark of Water Supply Services

S.No.	Indicators	Benchmark
1.	Coverage of Water Supply Connection	100%
2.	Percapita Supply of water	135 lpcd
3.	Extent of meeting of water connection	100%
4.	Extent of non-revenue water	20%
5.	Continuity of water supply	24 hours
6.	Quality of water supplied	100%
7.	Efficiency of redressal of consumer complaints	80%
8.	Cost recovery in water supply services	100%
9.	Efficiency in collection of water supply-related charges	90%

Source: MOUD, GOI, Hand Book on Service Level benchmarking

- 2) Sewage Management (Sewerage and Sanitation):** Good sewage system is an important pre-requisite for a disease free urban life, particularly from the point of view of occurrences of recent diseases like Dengue. The performance indicators relating to sewage management broadly includes reach and access of the service, effectiveness of the network and environmental sustainability and also financial sustainability of operations. The indicators and benchmark for sewage management are given in Table 2.2

Table 2.2: Indicators/Benchmark of Sewage Management Services (Sewage & Sanitation)

S.No.	Indicators	Benchmark
1.	Coverage of toilets	100%
2.	Coverage of Sewage network services	100%
3.	Collection efficiency of sewage network	100%
4.	Adequacy of sewage treatment capacity	100%
5.	Quality of sewage treatment	100%
6.	Extent of reuse and recycling of sewage	20%
7.	Efficiency of redressal of consumer complaints	80%
8.	Extent of cost recovery in sewage management	100%
9.	Efficiency in collection of sewage charges	90%

Source: MOUD, GOI, Hand Book on Service Level benchmarking

- 3) Solid Waste Management:** Most of the urban centres are plagued by acute problems related to solid waste management. Solid waste management is one of the obligatory duties of urban government. The solid waste management performance deals with reach and access, effectiveness of network operation and financial sustainability. The indicators and benchmark for solid waste management are given in table 2.3

Table 2.3: Indicators/Benchmark of Solid Waste Management Services

S.No.	Indicators	Benchmark
1.	Household level coverage of solid waste management services	100%
2.	Efficiency of collection of municipal solid waste	100%
3.	Extent of segregation of municipal solid waste	100%
4.	Extent of municipal solid waste recovered	80%
5.	Extent of scientific disposal of municipal solid waste	100%
6.	Efficiency in redressal of customer complaints	80%
7.	Extent of cost recovery in solid waste management services	100%
8.	Efficiency in collection of solid waste management charges	90%

Source: Hand Book on Service Level Benchmarking, MOUD, GOI

- 4) **Storm Water Drainage:** The storm water drainage is vital for mega cities experiencing problems of water logging during rainy season. The performance indicators with regard to storm water drainage include extent of network and effectiveness of the network. The indicators and benchmark of storm water drainage are given in Table 2.4

Table 2.4: Indicators/Benchmark of Storm Water Drainage

S. No.	Indicators	Benchmark
1.	Coverage of storm water drainage network	100%
2.	Incidence of water logging /flooding	0%

Source: Hand Book on Service Level Benchmarking, MOUD, GOI

2.4.2 Role of Stakeholders

After discussing about the parameters and indicators of various service delines and their management, it is now pertinent to discuss about the role of various stakeholders in performing service level benchmarking. The stakeholders involved in the process of SLBs (service level benchmarking) are follows:

- i) Central Government
- ii) State Government
- iii) Urban Government
- iv) Parastatal Agencies
- v) Bi-lateral / Multi-lateral Aid Agencies
- vi) Citizen and Civil Society

Let the discuss their role one by one.

- 1) **Central Government:** The Government of India will take the lead in disseminating information about the service level parameters and building wider acceptance. SLBs will be an integral part of City Development Planning process, both for assessment of current situation and setting targets under their plans.

- 2) **State Government:** The responsibility of the state government will be to periodically evaluate the SLBs as an input for its decisions related to policy, resource allocations, providing incentives and penalties, channelizing technical and manpower support and regulatory considerations.
- 3) **Urban Local Bodies:** ULBs are the most important stakeholders for the institutionalization of SLBs. The role of ULBs is to generate performance reports on SLBs periodically by undertaking following exercises: (a) Systems for capturing data; (b) systems for collection and analysis of performance indicators; (c) Systems for assessment and evaluation of performance; (d) systems of decision making; (e) systems for operational decisions and plans; and (f) systems to take corrective action for performance improvement.
- 4) **Parastatal Agencies:** The Parastatal will play similar role to that for ULBs. They are unlike ULBs have to put systems in place for performance management. The need for periodic reporting of SLBs to ULBs and its disclosure is important in both the cases.
- 5) **Bi-lateral/ Multi-lateral Aid Agencies:** As far as role of bi-lateral / Multi-lateral aid agencies is concerned. Various urban governance and infrastructure improvement programme initiated and funded by bi-lateral and multi-lateral aid agencies can dovetail with and further strengthen this initiative.
- 6) **Citizens and Civil Society:** Citizens should be engaged with ULBs through Area Sabhas, Resident Welfare Associations (RWAs) and other such civil society organizations in examining the SLBs and suggesting remedial actions.

A performance management system developed in the Ministry of Urban Development, Government of India for service level benchmarking in the context of performance management of urban service is given in figure 2.3

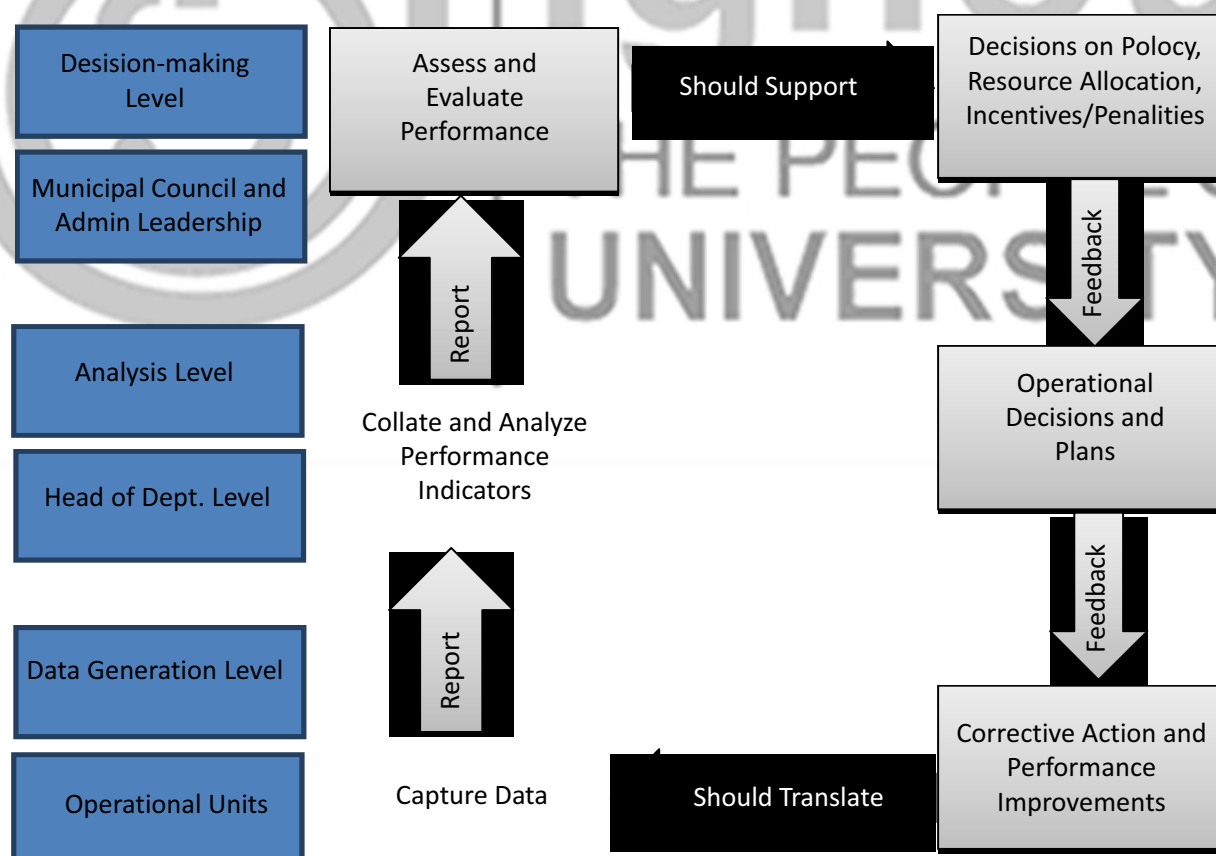


Fig 2.3: Performance Management System

The service level parameters are measured either from a utility manager's / planner's perspective or from a citizen's or customer's perspective (for detail consult Handbook on Service Level Benchmarking, Ministry of Urban Development, Government of India).

2.4.3 Prioritizing Urban Services Management Initiatives

The Government both centre and state as well as bi-lateral and multi-lateral agencies have initiated several projects and programmes on urban management for improving the quality of life of people residing in urban areas. One of such programmes is JNNURM which aims to encourage cities to initiate improvement in existing service levels in financially sustainable manner. The ultimate end users of the programme are the dwellers of urban areas.

Importance Ratings 5-High 3-Medium 1-Low What's – How Relationship 9-Strong 6-Moderate 3-Weak 0-No Relationship		How's															
		Publication	Website	Downloadable forms	User details for other department, RTO, Land record	Workflow automation	Single sign on for multiple department's online services	Interoperability	Service catalogue	Online request logging / IT enabled Service desk / Payments	City database/Hyperlinks to other database	Email facility to City managers	Concept of Ownership of Infrastructure (e.g. Know about Projects near your	Innovative Initiatives			
Measures																	
Easy access to City information	Customer Important Rating	5	9	9	6	0	0	3	6	9	6	6	6	3	6	345	Relationship Totals
Availability of forms, process details		5	9	9	9	6	3	3	3	6	3	3	6	0	0	300	
Availability of interdepartmental information for same user		5	0	3	0	9	9	9	9	3	6	6	0	0	6	300	
Reduce cyclotime of procedures		5	3	3	6	6	9	3	3	3	3	6	3	0	3	255	
Avoid human interface in process		2	6	6	9	6	9	6	6	6	9	6	6	6	6	174	
Multiple channels for payment of dues		3	0	9	9	6	9	9	9	6	9	6	0	0	0	216	
Ease of recording voice/suggestions		3	0	6	6	0	3	0	0	3	6	6	9	0	9	144	
Ease of logging & Track service requests		5	0	9	9	6	6	6	6	6	9	6	0	0	0	315	
Multiple hand offs to be avoided		1	0	0	3	6	9	9	9	3	6	0	0	0	0	45	
Clarity on initiatives of multiple department Operating in city		3	9	9	6	3	0	6	6	6	3	9	3	6	0	198	
Information on where to apply for what & what needs to be submitted		5	9	9	9	6	3	6	6	9	6	6	0	0	0	345	
Expect my request to be resolved the first time		3	0	0	0	0	3	0	0	0	9	9	0	0	0	63	
		189	294	279	210	222	216	231	240	270	267	123	45	114			
		How Important															

Fig. 2.4: Quality Function Deployment Matrix

Proful Gharpure has developed 'voice of customers (VOCs)' which would enable the service provider for better management of urban services on the one hand and provision of quality services on the other. Source of the VCOs for urban services in cities are follows:

- No clarity of the set up of civic authority (Municipal Corporation).
- Poor information availability on initiatives.
- Lack of clarity of procedures.
- Time consuming processes lead to ignorance.
- Lack of accountability of officials.
- Too many agencies and overlap of work.
- Interdependencies/document exchange.
- Non-availability of multiple payment modes.
- Refrain from lodging services requests for want of time.
- Feel left out form the decision making process.

The Quality Function Deployment (QFD) tool developed by Gharpure (2008) is given in figure 2.4 which intends to bring out the priorities list of customer requirements and potential solution. QFD essentially brings out the top ranking customer needs based on the user's priority along with the top solution ideas which the city services provider needs to incorporate while planning for the projects.

2.5 REQUIREMENTS OF GOOD URBAN MANAGEMENT

Various requirements of good urban management are as follows:

- 1) **Balancing act of Government and Market:** The urban management system must scientifically define urban government "administrative power and the operation right". Many of the activities of urban services are being regulated by the market and some of those which can not be solved by market such as the infrastructure construction, environmental protection, social justice, public welfare under taking, social security undertaking, are being provided by the government. The provision of market-led services in regulated prices and government services with time-bound manner will enhances the service delivery mechanism in urban areas. The government support is required for the impoverished urban dwellers, while the rich and upper middle class can manage the market and private sector related services such as housing and other civic amenities.
- 2) **Promoting Community Participation in Urban Management:** In simple terminology, 'community participation' refers to the involvement of the people in a community in various development projects such as education health care, drinking water, sanitation, etc. Community participation is ensured in following ways:
 - i) community leaders/whole community consulted by the development agencies;

- ii) contribution in terms of finance, material and labour;
- iii) operation and maintenance management;
- iv) project management; and
- v) promoting participation of disadvantaged such as women, Scheduled Castes and Scheduled Tribe in decision making.

The community involvement during all stages of urban development project strating from project formulation uptill impact assessment is a very good way of effective project management. The public participation in urban management presupposes that community should not be looked as the target of urban management, but need to be seen as participant of urban management.

- 3) **Empowered Urban Local Bodies:** Effective urban management call for an empowered system of urban local bodies. The urban local bodies must be endowed with three Fs: Funds, Functionaries and Functions, so that they can exercise their duties and responsibilities more effectively. The functionaries and elected representatives of ULBs must be provided with training from time to time to carry out their duties and responsibilities. The coordination between different tiers of ULBs is another areas which can promote better urban management.

- 4) **Strengthening Development Governance:** Good development governance is essential requisite for good urban management. According to World Bank, governance is the manner in which power is exercised in the management of a country's economic and social resources for development. According to UNDP, development governance aims at a corruption free political and public administration for the achievement of development goals. Therefore, for achievement of urban development goals, development governance needs to be given niggardly attention. The five governance principles, advocated by European commission i.e. openness, participation, accountability, effectiveness and coherence are also critical to urban management.

- 5) **Promotion of better Inter Sectoral Coordination:** Inter sectoral coordination is critical to the effective implementation of various urban development projects and programmes. The urban development managers must establish coordination between various sectors such as public health, health, education, environment, etc. for holistic development of urban areas. The related sectors can not work in silos rather in tandem to promote effective urban development. For example, for effective promotion of better health in urban areas, the coordination between health, public health, education, women and child development is essential. Various international agencies have emphasized on the intersectoral coordination for the effective attainment of development goals.

After going through this entire unit, it is expected that you must have understood the meaning, concept and scope of urban management, its management process, management cycle, management of various urban services, and essential requirements for good urban management. Now Check Your Progress through questions given below.

Check Your Progress 2

Note: a) Write your answer in about 50 words.

b) Check your answer with possible answers given at the end of the unit.

- 1) Discuss basic urban services required for effective urban management and its stake holders.

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- 2) Make a flow chart of urban management of your nearest area and evaluate its status.

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- 3) What are the basic requirement of good urban management.

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2.6 LET US SUM UP

Urban Management is one of the important component of urban development. Although the concept of urban management is recent one, yet is one of the most widely used concept as the urbanization is growing very fast. Urban management as a subject helps the government and agencies dealing with urban development for the efficient and effective management urban development projects, programmes and resources for the attainment of urban development goals. This unit deals in details about the concept and meaning of urban management given by a few exponents of urban development. It has also enumerated the scope and requisites of good urban management. Besides in this unit, you might have read about the performance parameters indicators and benchmark developed by the Ministry of Urban Development Government of India.

As it is predicted that more than 50 percent of population will be living in urban areas by 2025, therefore, better urban management is a challenge before the nation states of developing countries.

2.7 REFERENCES AND SUGGESTED READINGS

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- 2) Gharpure, P(2008), “Prioritizing Urban Service Management Initiatives” *International Journal of Education and Development using Information and Communication Technology (IJEDICT)* Volume 4, Issue 2, PP. 159-164
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- 6) Bhatnagar, K K and Gadeock KK (2007), *Urban Development and Administration*, Aalekh Publishers, Jaipur.
- 7) Mishra G. K. and etal. (1997) (ed), *Sustainable Urban Development*, Uppal Publishing House, New Delhi.

2.8 CHECK YOUR PROGRESS: POSSIBLE ANSWERS

Check Your Progress 1

- 1) What is urban management?

Urban Management, according S K Sharma, can be described “as the set of activities which together shape and guide the social, physical and economic development of urban areas. The main concern of urban management, then, would be intervention in these areas to promote economic development and well-being and to ensure necessary provision of essential services.”

- 2) Write five components and scope of urban management.

The important components are as follows. (1) Urban Environment/Natural Resource Management, (2) Urban Economic Development, (3) Urban Social Services, (4) Urban Land, and (5) Infrastructure.

- 3) Explain urban management cycle.

Urban management cycle comprises tasks from identification of problem till its solution, which include the scope of urban development i.e. environment, land urban services, infrastructure and economic development. There are nine basic steps to be followed in multi sectoral urban management. The multi-sectoral urban management broadly comprises- identification of Problems, formulation of objectives, development of policies, development of institutional arrangements, development of programmes/projects, development of plan/strategy, implementation of programmes/projects, operation and maintenance, and evaluation.

Check Your Progress 2

- 1) Discuss basic urban services required for effective urban management and its stake holders.

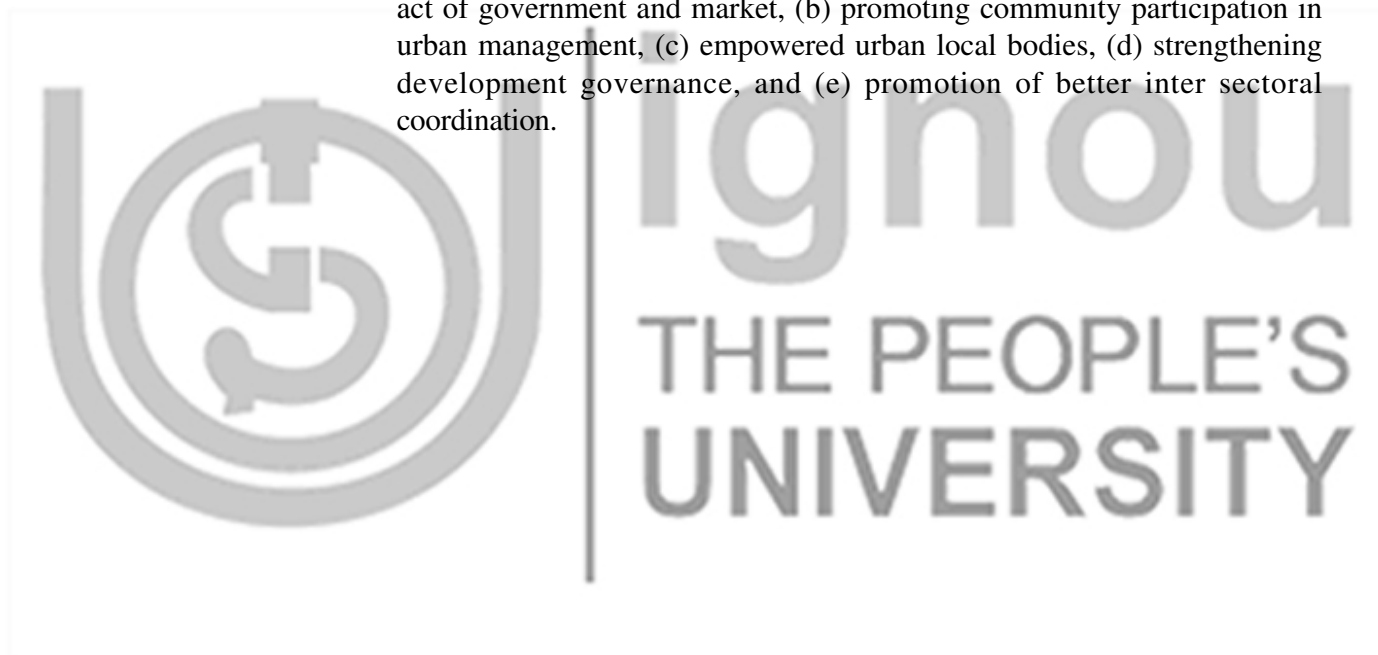
The four important basic urban services has been identified and often discussed. These are water supply, sewerage, solid waste management; and storm water drainage. There are also other important services required in urban management like education, health etc. however, above four are most significant. So far as concern of role of stake holders, the stake holders are (a) central government, (b) state government, (c) urban government, (d) parastatal agencies, (e) bi-lateral / multi-lateral aid agencies, and (f) citizen and civil society.

- 2) Make a flow chart of urban management of your nearest area and evaluate its status.

See the figure -3: performance management system of sub-section 2.5, accordingly prepare the flow chart of urban management of your nearest urban area.

- 3) What are the basic requirement of good urban management.

Various requirements of good urban management are as follows: (a) balancing act of government and market, (b) promoting community participation in urban management, (c) empowered urban local bodies, (d) strengthening development governance, and (e) promotion of better inter sectoral coordination.



UNIT 3 FINANCIAL MANAGEMENT

Structure

- 3.1 Introduction
- 3.2 Financial Management: Objectives, Functions, Significance, Approaches and Goals
- 3.3 Accounting: Concept, Objectives, Functions, Basis, Branches, Book-Keeping
- 3.4 Auditing, Meaning and Definition, Objectives and Principles
- 3.5 Budgeting: Objectives, Process, Advantages and Limitations
- 3.6 Let Us Sum Up
- 3.7 Keywords
- 3.8 References and Suggested Readings
- 3.9 Answers to Check Your Progress

3.1 INTRODUCTION

Finance is an important function in any business as money is required to support its various activities. It has given birth to “Financial Management” as a separate subject. Financial management is of recent origin and has not acquired a body of knowledge of its own. It draws heavily on “Economics” for its theoretical concepts. In the early half of the last century, the job of financial management was largely confined to the acquisition of funds. But, as business firms continued to expand, their markets and they became larger and more diversified, greater control of financial operation became highly important. Thus, now the scope of financial management is very wide and it should not be considered to be merely restricted for raising of capital. It also covers other aspects of financing such as assessing the needs of capital, raising sufficient amount of funds, cost of financing, budgeting, maintain liquidity, lending and borrowing policies, dividend policies and so on. Finance is considered as the life-blood of any business. It is defined as the provision of money at the time it is needed. All the plans of a businessman would remain mere dreams unless adequate money is available to convert them into reality. Financial management is very important to every type of organization. It refers to that part of managerial activity concerned with the procurement and utilization of funds for business purposes. Howard and Upton have defined the financial management as it involves the application of general management principles to financial operations.

Therefore, financial management is concerned with broadly four tasks. The first and foremost is estimation of the fixed and working capital requirements; secondly, formulation of capital structure; thirdly, procurement of fixed and working capital; and fourthly, management of earnings.

After studying this unit, you will be able to:

- describe financial management including its objectives, functions, significance, approaches and goals;
- define the concept, objectives, functions, basis and branches of accounting as well as make distinction between book-keeping and accounting;

- explain the objectives, principles, advantage and limitations of auditing; also classify the different types of auditor and state the qualities of an auditor; and
- discuss the concept of budgeting and explain the objectives, processes, advantages and limitations of budgeting.

3.2 FINANCIAL MANAGEMENT

Financial management is a managerial activity concerned with planning and controlling of the firm's financial resources to generate returns on its invested funds. The raising and using of capital for generating funds and paying returns to the suppliers of capital is the finance function of a firm. Thus, the funds raised by the company will be invested in the best investment opportunities, with an expectation of future benefits. Financial Management means planning, organizing, directing and controlling the financial activities such as procurement and utilization of funds of the enterprise. It means applying general management principles to financial resources of the enterprise. Scope of financial management includes:

- **Investment decisions:** includes investment in fixed assets (called as capital budgeting). Investments in current assets are also a part of investment decisions called as working capital decisions.
- **Financial decisions:** relate to the raising of finance from various resources which will depend upon decision on type of source, period of financing, cost of financing and the returns thereby.
- **Dividend decision:** The finance manager has to take decision with regards to the net profit distribution. Net profits are generally divided into two:
 - a) Dividend for shareholders- dividend and the rate of it has to be decided.
 - b) Retained profits- amount of retained profits has to be finalized which will depend upon expansion and diversification plans of the enterprise.

3.2.1 Objectives of Financial Management

The financial management is generally concerned with procurement, allocation and control of financial resources of a concern. The objectives can be:

1. To ensure regular and adequate supply of funds to the concern.
2. To ensure adequate returns to the shareholders which will depend upon the earning capacity, market price of the share, expectations of the shareholders.
3. To ensure optimum funds utilization. Once the funds are procured, they should be utilized in maximum possible way at least cost.
4. To ensure safety on investment, i.e., funds should be invested in safe ventures so that adequate rate of return can be achieved.
5. To plan a sound capital structure- there should be sound and fair composition of capital so that a balance is maintained between debt and equity capital.

3.2.2 Functions of Financial Management

- 1) **Estimation of capital requirements:** A finance manager has to make estimation with regards to capital requirements of the company. This will

depend upon expected costs and profits and future programmes and policies of a concern. Estimations have to be made in an adequate manner which increases earning capacity of enterprise.

- 2) **Determination of capital composition:** Once the estimation have been made, the capital structure have to be decided. This involves short- term and long- term debt equity analysis. This will depend upon the proportion of equity capital a company is possessing and additional funds which have to be raised from outside parties.
- 3) **Choice of sources of funds:** For additional funds to be procured, a company has many choices like-
 - a) Issue of shares and debentures
 - b) Loans to be taken from banks and financial institutions
 - c) Public deposits to be drawn like in form of bonds.

Choice of factor will depend on relative merits and demerits of each source and period of financing.

- 4) **Investment of funds:** The finance manager has to decide to allocate funds into profitable ventures so that there is safety on investment and regular returns is possible.
- 5) **Disposal of surplus:** The net profit decision has to be made by the finance manager. This can be done in two ways:
 - a) Dividend declaration - It includes identifying the rate of dividends and other benefits like bonus.
 - b) Retained profits - The volume has to be decided which will depend upon expansion, innovational, diversification plans of the company.
- 6) **Management of cash:** Finance manager has to make decisions with regards to cash management. Cash is required for many purposes like payment of wages and salaries, payment of electricity and water bills, payment to creditors, meeting current liabilities, maintenance of enough stock, purchase of raw materials, etc.
- 7) **Financial controls:** The finance manager has not only to plan, procure and utilize the funds but he also has to exercise control over finances. This can be done through many techniques like ratio analysis, financial forecasting, cost and profit control, etc.

3.2.3 Significance of Financial Management

Financial management occupies a significant place because it has an impact on all the activities of a firm. Its primary responsibility is to discharge the fiancé function successfully. No one can think of any business activity in isolation from its financial implications. The management may accept or reject a business proposition on the basis of its financial variabilities. In other words, the live executive who are directly involved in the decision-making process should give supreme importance for financial consideration. The finance function centres round the management of funds, raising of funds and the using them effectively.

But the dimensions of financial management are much broader than mere procurement of funds. Planning is one of the primary activities of the financial manager. It helps him to obtain funds and the best time in relation to their cost of the conditions under which they can be obtained. However, Financial Management should not be taken as a profit extracting device. It implies a more comprehensive concept than the simple objective of profit-making. Its broader mission should be to protect the interest of the different sections of the community undisturbed and protected through maximizing the value of the firm.

The concepts of financial management are applicable to an organization, irrespective of its size, nature of ownership and control. They can be applied to any activity of an organization which has financial implication. In the words of Raymond Chambers:

“The term Corporate Financial Management is often used to emphasize the financial management of companies or corporations. Thus, it consists of the decisions relating to: (a) investment – concerned with capital budgeting and current assets management (b) financing-concerned with determining the best financing mix, and (c) dividend-concerned with the solution to the decision of dividend policy.”

3.2.4 Approaches to Financial Management

Traditional Approach: Finance involves arrangement of funds required by the business enterprise from and through financial institutions (‘from’ signifies procurement of loan capital, and ‘through’ implies the selling of securities by financial institutions). Hence, the traditional approach of financial management focused on ‘arrangement of finance’ for meeting various financial needs of an enterprise.

Modern Approach: financial management encompasses wider applications, viz., assessment of funds required, effective procurement of those funds through most economical means, and efficient utilization of those funds through profitable investments, as well as cash and liquidity management. To put it in the words of Ezra Solomon, the key questions in financial management of a business enterprise happen to be: “(i) what is the total volume of funds, an enterprise should commit? (ii) What specific assets should an enterprise acquire? (iii) How should the funds required be financed?” These questions, if answered properly, lead to four broad decision areas of financial management, viz., funds requirement decision, financing decision, investment decision, and dividend decision.

3.2.5 Goals of Financial Management

The financial management has to take three important decisions viz. (i) Investment decision i.e., where to invest fund and in what amount, (ii) Financing decision i.e., from where to raise funds and in what amount, and (iii) Dividend i.e., how much to pay dividend and how much to retain for future expansion. In order to make these decisions the management must have a clear understanding of the objective sought to be achieved. It is generally agreed that the financial objective of the firm should be maximization of owner’s economic welfare. There are two widely discussed approaches or criterion of maximizing owners’ welfare -(i) Profit maximization, and (ii) Wealth maximization. It should be noted here that objective is used in the sense of goal or goals or decision criterion for the three decisions involved.

Profit Maximization: Maximization of profits is very often considered as the main objective of a business enterprise. The shareholders, the owners of the business invest their funds in the business with the hope of getting higher dividend on their investment. Moreover, the profitability of the business is an indicator of the sound health of the organization, because, it safeguards the economic interests of various social groups which are directly or indirectly connected with the company e.g. shareholders, creditors and employees. All these parties must get reasonable return for their contributions and it is possible only when company earns higher profits or sufficient profits to discharge the obligations to them.

Wealth Maximization: The wealth maximization (also known as value maximization or Net Present worth Maximization) is also universally accepted criterion for financial decision making. The value of an asset should be viewed in terms of benefits it can produce over the cost of capital investment. Era Solomon has defined the concept of wealth maximization as follows- “The gross present worth of a course of action is equal to the capitalized value of the flow of future expected benefits, discounted (or as capitalized) at a rate which reflects their certainty or uncertainty. Wealth or net amount of capital investment required to achieve the benefits being discussed. Any financial action which creates wealth or which has a net present worth above zero is a desirable one and should be undertaken. Any financial action which does not meet this test should be rejected. If two or more desirable courses of action are mutually exclusive (i.e., if only one can be undertaken) then the decision should be to do that which creates most wealth or shows the greatest amount of net present worth”. In short, the operational objective of financial management is to maximize wealth or net present worth. Thus, the concept of wealth maximization is based on cash flows (inflows and outflows) generated by the decision. If inflows are greater than outflows, the decision is good because it maximizes the wealth of the owners. We have discussed above the two goals of financial management. Now the question is which one is the best or which goal should be followed in decision making. Certain objections have been raised against the profit maximization goal which strengthens the case for wealth maximization as the goal of financial decisions.

Profit Maximization Vs Wealth Maximization

The financial management has come a long way by shifting its focus from traditional approach to modern approach. The modern approach focuses on wealth maximization rather than profit maximization. This gives a longer term horizon for assessment, making way for sustainable performance by businesses.

A myopic person or business is mostly concerned about short term benefits. A short term horizon can fulfill objective of earning profit but may not help in creating wealth. It is because wealth creation needs a longer term horizon. Therefore, financial management emphasizes on wealth maximization rather than profit maximization. For a business, it is not necessary that profit should be the only objective; it may concentrate on various other aspects like increasing sales, capturing more market share etc, which will take care of profitability. So, we can say that profit maximization is a subset of wealth and being a subset, it will facilitate wealth creation.

Giving priority to value creation, managers have now shifted from traditional approach to modern approach of financial management that focuses on wealth maximization. This leads to better and true evaluation of business. For e.g., under

wealth maximization, more importance is given to cash flows rather than profitability. As it is said that profit is a relative term, it can be a figure in some currency, it can be in percentage, etc. For example a profit of say Rs.10,00,000 cannot be judged as good or bad for a business, till it is compared with investment, sales, etc. Similarly, duration of earning the profit is also important i.e. whether it is earned in short term or long term.

In wealth maximization, major emphasis is on cash flows rather than profit. So, to evaluate various alternatives for decision making, cash flows are taken under consideration. For e.g. to measure the worth of a project, criteria like: “present value of its cash inflow – present value of cash outflows” (net present value) is taken. This approach considers cash flows rather than profits into consideration and also use discounting technique to find out worth of a project. Thus, maximization of wealth approach believes that money has time value.

An obvious question that arises now is that how can we measure wealth. Well, a basic principle is that ultimately wealth maximization should be discovered in increased net worth or value of business. So, to measure the same, value of business is said to be a function of two factors - earnings per share and capitalization rate. And it can be measured by adopting following relation:

$$\text{Value of business} = \text{EPS} / \text{Capitalization rate}$$

At times, wealth maximization may create conflict, known as agency problem. This describes conflict between the owners and managers of firm. As, managers are the agents appointed by owners, a strategic investor or the owner of the firm would be major concerned about the longer term performance of the business that can lead to maximization of shareholder’s wealth. Whereas, a manager might focus on taking such decisions that can bring quick result, so that, he/she can get credit for good performance. However, in course of fulfilling the same, a manager might opt for risky decisions which can put the owner’s objectives on stake.

Hence, a manager should align his/her objective to broad objective of organization and achieve a tradeoff between risk and return while making decision; keeping in mind the ultimate goal of financial management i.e. to maximize the wealth of its current shareholders.

Check Your Progress 1

Note: a) Write your answer in about 50 words.

b) Check your answer with possible answers given at the end of the unit.

1) What is Financial Management?

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2) What are the objectives of Financial Management?

Financial Management

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3.3 ACCOUNTING

3.3.1 Concept and Definition

You know there is a limit to human memory. You cannot remember everything you do. If you are given Rs. 6000 and asked to buy a number of items you will find it difficult to remember the detail of various items you purchased. Hence, it becomes necessary for you to write them on a piece of paper or a note book. It is still more difficult in case of business which usually involves a large number of transactions. In business, you have to buy and sell more frequently. You make payments and receive payments every now and then. It becomes almost impossible to remember all these transactions. So, unless you record them properly you cannot obtain any financial information you need. For example, you cannot easily ascertain the amounts to be received from various customers to whom the goods were sold on credit. You will not know the detail of how much you owe to your suppliers. You may also find it difficult to work out the profit earned or loss incurred during a particular period. It is, therefore, necessary to maintain a proper record of all the transactions which take place from time to time. The recording of business transactions in a systematic manner is the main function served by accounting.



The Concept

The traditional meaning of accounting was provided by the American Institute of Certified Public Accountants (AICPA) in 1961 when it defined accounting as:

“the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events, which are, in part at least, of financial character and interpreting the results thereof”:

American Accounting Association (AAA) has defined the Accounting as follow:

“Accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information”.

3.3.2 Objectives of Accounting

The following are the main objectives of accounting:

- 1) **To keep systematic records:** Accounting is done to keep a systematic record of financial transactions, like purchase of goods, sale of goods, cash receipts and cash payments. In the absence of accounting there would have been terrific burden on human memory which in most cases would have been impossible to bear. Systematic record of various assets and liabilities of the business is also to be maintained.
- 2) **To ascertain the operational profit or loss.** Accounting helps in determining the net profit earned or loss suffered on account of running the business. This is done by keeping a proper record of revenues and expenses of a particular period. Profit and loss account prepared at the end of the year helps the management, suppliers, bankers and the government in knowing whether the business is earning profit or generating loss.
- 3) **To ascertain the financial position of the business:** The businessman is not only interested in knowing the operating result, but also interested in knowing the financial position of his business i.e., where it stands. In other words, he wants to know what the business owes to others and what it owns, and what happened to the capital – whether the capital has increased or decreased or remained constant. A scientific record of assets and liabilities facilitates the preparation of a “balance sheet” answers these questions.
- 4) **To facilitate rational decision making:** Apart from the owners, there are various other parties who are interested in knowing about the position of business, such as tax authorities, the management, the bank, the creditors, etc. From this viewpoint, the accounting system has to furnish the required information. In present scenario, accounting has taken up the task of analysis and reporting of information at the required point of time to the required level of authority to facilitate rational decision making.

3.3.3 Functions of Accounting

Following are the functions of accounting:

Record Keeping Function: The primary function of accounting is to keep a systematic record of financial transaction - journalisation, posting and preparation of final statements. The purpose of this function is to report regularly to the interested parties by means of financial statements.

Protect Business Property: The second function of accounting is to protect the property of business from unjustified and unwanted use. The accountant thus has to design such a system of accounting which protects its assets from an unjustified and unwanted use.

Legal Requirement Function: The third function of accounting is to devise such a system as will meet the legal requirements. Under the provision of law, a business man has to file various statements e.g., income tax returns, returns for

sales tax purpose, etc. Accounting system aims at fulfilling the requirements of law. Accounting is a base, with the help of which various returns, documents, statements etc., are prepared.

Communicating the Results: Accounting is the language of business. Various transactions are communicated through accounting. There are many parties - owners, creditors, government, and employees, etc, who are interested in knowing the results of the firm. The fourth function of accounting is to communicate the results to interested parties. The accounting shows a real and true position of the firm of the business.

3.3.4 Basis of Accounting

Cash Basis Accounting: According to this system, only actual cash receipts and payments are recorded in the books. The credit transactions are not recorded at all, till actual cash is received or paid. Thus, if purchases are made in the year 2010 on credit and payment for purchases is made in the year 2011, such purchases shall be considered to be an expense of the year 2011 and shall not be recorded in the year 2010. This system of accounting is mostly followed by non-trading organizations, professionals like lawyers, doctors, chartered accountants, etc.

Mercantile or Accrual System: According to this system, all the business transactions pertaining to the specific period, whether of cash or credit nature, are recorded in the books. This system of accounting is based on accrual concept, which states that revenue is recognized when it is earned and expense is recognized when obligation of payment arises. Actual movement of cash is irrelevant. Mercantile system of accounting is widely followed by the industrial and commercial undertakings because it takes into account the effects of all transactions already entered into.

3.3.5 Branches of Accounting

Accountants specialize in different types of accounting activities and this has resulted in the development of different branches of accounting. Some of these are:

Financial Accounting: It is the original form of accounting. It is mainly confined to the preparation of financial statements for the use of outsiders like debenture holders, creditors, suppliers, etc. The financial statements are the Income statement (or Profit and Loss Account), Statement of Retained Earnings (Profit and Loss Appropriation Account) and Balance Sheet. In this manner, the financial accounting is useful for ascertaining net profit or loss, the balance retained (undistributed profit, and the financial position).

Management Accounting: It is accounting for the management, which provides necessary information to the management for discharging its functions. It is concerned with the analysis and interpretation of accounting information to guide the management (or owners) for future planning of business activities. It makes the use of techniques such as ratio analysis and statement of cash flows.

Cost Accounting: It shows classification and analysis of costs on the basis of functions, processes, products, centers, etc. It also deals with cost computation, cost saving, cost reduction, etc. It helps in determining the selling price of products and services.

3.3.6 Book-keeping vs. Accounting

Book-keeping: It is a process of recording Company's day-to-day financial transaction into a journal. The journal entry included the date, the name of the accounts to be debited and credited, and the amounts. The bookkeeping process further requires that all transactions recorded in journal need to be classified into ledger accounts.

Accounting: It is the bigger picture. It is the system that keeps track of the data, including people, and records the transaction's history, as well as taking the information that is obtained through the bookkeeping process and using that information to analyze the results of the business. Accounting is the system that provides the reports and information needed for management to make decisions as to the direction of the business, as well as issues such as taxation, Sales Tax etc.

In this session you read about accounting, now answer the questions given in Check Your Progress 2

Check Your Progress 2

Note: a) Write your answer in about 50 words.

b) Check your answer with possible answers given at the end of the unit.

1) Define Accounting.

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2) What is the difference between Book-keeping and accounting?

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3.4 AUDITING

3.4.1 Meaning and Definition

Meaning: When the work of an accountant is finished, the duty of an auditor starts. Auditing involves verification of the entries passed by the accountant and the final accounts prepared by him. It is the scrutiny of the accounts of a business with help of vouchers, documents and the information given to him and also the explanations submitted to him. Unlike an accountant, the auditor has to satisfy himself after due verification and through scrutiny of accounts as to whether transactions entered into the books of accounts are bonafide. An auditor is required

to submit his report to the effect whether or not the Balance Sheet and Profit and Loss Account is a true and fair representation of the existing state of affairs of a business concern respectively.



Definition: “Auditing may be defined as the examination of the books, accounts and vouchers of a business with a view to ascertain whether or not the Balance Sheet is properly drawn up so as show a true and correct view of the state of affairs of the business.”

“Auditing is a systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) of an enterprise for a stated purpose. In any auditing situation, the auditor perceives and recognizes the propositions before him for examination, collects evidence, evaluates the same and on this basis formulates his judgment which is communicated through his audit report.”



3.4.2 Objectives of Auditing

For better understanding, objectives can be classified as:

Primary Objectives: To determine and judge the reliability of the financial statement and the supporting accounting records of a particular financial period is the main purpose of the audit. As per the Indian Companies Act, 1956 it is mandatory for the organizations to appoint a auditor who, after the examination

and verification of the books of account, disclose his opinion that whether the audited books of accounts, Profit and Loss Account and Balance Sheet are showing the true and fair view of the state of affairs of the company's business. To get a true and fair view of the companies' affairs and express his opinion, he has to thoroughly check all the transactions and relevant documents of the company made during the audited period. It helps the auditor to report the financial position of the organization. Audit also disclose whether the Accounting system adopted in the organization is adequate and appropriate in recording the various transactions as well as the setbacks of the system.

Secondary Objectives: In order to report the financial condition of the business, auditor has to examine the books of accounts and the relevant documents. In that process, he may come across some errors and frauds. We may classify these errors and frauds as below:

- **Detection and Prevention of Errors:** Following types of errors can be detected in the process of auditing.
 - a) **Clerical Errors:** Due to wrong posting such errors may occur. Money received from Microsoft credited to the Semens's account is an example of clerical error. Even though the account was posted wrongly, the trial balance will agree.
 - b) **Errors of Principle:** While recording a transaction, the fundamental principles of accounting is not properly observed, these types of errors could occur. Over valuation of closing stock or incorrect allocation of expenditure or receipt between capital and revenue are some of the examples of such errors. Such errors will not affect the trial balance but will affect the Profit and Loss account. It may occur due to lack of knowledge of sound principles of accounting or can be committed deliberately to falsify the accounts. To detect such errors, the auditor has to do a careful examination of the books of account.
- **Detection and Prevention of Frauds:** To get money illegally from the organization or from the proprietor frauds are committed intentionally and deliberately. If it remains undetected, it could affect the opinion of the auditor on the financial condition and the working results of the organization. Therefore, it is necessary for the auditor to exercise utmost care to detect such frauds. It can be committed by the top management or by the employees of the organization.

3.4.3 Principles of Auditing

The **Webster's New International Dictionary** defined the word 'Principle' as "a fundamental truth, primary law, a settled rule of action". Applied to auditing, principle is the fundamental truth necessary for the effective accomplishment of the objectives of auditing.

Though the principles of auditing are not as finally developed as the principles of accounting. The following fundamental principles of auditing have evolved over the years:

- 1) **Principle of Independence:** Independence is the basic veracity of auditing. Without it, objectives of auditing cannot be attained with all fairness. Since

independence is a mental situation, there must be independence to perform all the works. Only those audit report are accepted which have been made under Indian Companies Act, 1956 to give due place (importance) to independence.

- 2) **Principle of Objectivity:** Auditing must be conducted objectively. The auditor must be free from bias, emotions and whims while auditing. It demands verification of the transactions and the use of reasonable skill and diligence. According to this principle of auditing, those transactions which have been recorded in the books of accounts must be verified with true evidence.
- 3) **Principle of Full Disclosure:** According to this principle, the client should provide all possible evidence, explanations and records. The principle implies that the auditor should make full disclosure of his findings in respect of the audit work performed by him.
- 4) **Principle of Materiality:** This principle indicates that more attention must be paid to those items which are materially important and in the area where the risk of error and fraud is relatively more. The fact of materiality has to be in accordance with the situation.
- 5) **Confidentiality:** During the course of audit whatever information are supplied to the auditor, he should keep them confidentially. No information should be place before any third person without taking permission of the concerned authority. It should be provided only in case of legal duty of the auditor.
- 6) **Skills and Competence:** The work of audit should be performed by such persons who are trained, experienced and efficient. It is expected form the auditor that he is sincere to the declarations of the Indian Institute of Chartered Accountants.
- 7) **Report:** Preparation of audit report is the most important work of an auditor. Report should be provided in writing. He should provide a clean report which means that the auditor is satisfied with the books of accounts. On the other hand, if the auditor is not satisfied with the books of accounts, then he provides qualified report.

3.4.4 Advantages and Limitations of Auditing

It is compulsory for all the organizations registered under the companies act must be audited. There are advantages in auditing the accounts even when there is no legal obligation for doing so. Some of the advantages are listed below:

- 1) Audited accounts are readily accepted in Government authorities like, Income Tax Dept., Sales Tax dept., Land Revenue Departments, Banks etc.
- 2) By auditing the accounts errors and frauds can be detected and rectified in time.
- 3) Audited accounts carry greater authority than the accounts which have not been audited.
- 4) For obtaining loan from financial institutions like Banks, LIC, HUDCO, HDFC, IFCI etc., previous years audited accounts evaluated for determining the capability of returning the loan.

- 5) Regular audit of account create fear among the employees in the accounts department and exercise a great moral influence on clients staff thereby restraining them from commit frauds and errors.
- 6) Audited accounts facilitate settlement of claims on the retirement/death of a partner.

Auditing also suffers from certain **limitations** which are as follow:

- 1) **Only test check:** Since the number of transactions is very large, it is almost impossible for the auditor to check each and every transaction. Hence, only test checking is done by him. It is possible that frauds and errors may escape such test checking. In the absence of any suspicion, he is justified to do test checking only. Hence, there is no guarantee that audited accounts are free from errors and frauds as they exhibit a true and fair view of the financial position and the working results of the organization.
- 2) **Over emphasis on financial aspect:** Auditing is confined to checking, ticking, totalling, vouching etc of financial transactions recorded in the books. No attention is paid to other important aspects such as finances, efficiency and effectiveness of management and business ethics.
- 3) **Lack of independence:** In theory, the auditor is appointed by the shareholders. However, in practice, he is appointed by the management i.e. the shareholders having majority shares. As such, the auditor is hardly independent and cannot report fairly and friendly.
- 4) **Difficulty in verification and valuation of assets and liabilities:** It is almost impossible to certify and value the assets and liabilities and particularly the stock in trade. It is not possible to fix exactly the cost or market value of stock in trade. Again the stock may not even be marketable. Further, the book debts may be bad or doubtful. Hence, the balance sheet may not show a true and fair view of the financial position or its working results.
- 5) **Inefficient internal check and control:** Efficiency and effectiveness of auditing is largely dependent upon an efficient internal check and internal control systems. In case these are not efficient, the auditor cannot audit the accounts properly.

3.4.5 Types/Classification of Audit

Internal audit: An audit conducted in between two annual audits is called Interim Audit. Wherever a Company wants to declare an interim dividend, it becomes necessary to get interim audit of the accounts done up to the date at which the Company wants to declare the interim dividend. In other words, interim audit involves a complete audit of accounts for a part of the year i.e. from the date of the last Balance Sheet to the date of the interim accounting period.

External audit: External audit is that which is critical review of the representation of the published financial statements. It is compulsory for all company's which are listed in the stock exchange.

Continuous audit: An auditing process that examines accounting practices continuously throughout the year. Examination and verification of a firm's financial transactions and their supporting documents, carried out daily or on

fixed interval basis. Continuous-audit is performed usually by the firm's internal auditors to eliminate the year-end workload.

Procedural audit: It is an examination and appraisal of the procedures in maintaining the books of accounts of an organization. This can ensure the reliability for the preparation of Profit and Loss Account and Balance Sheet. It is not particular type of audit; rather it forms a part of the whole audit procedures.

Cost audit: Cost audit plays a dynamic role in the achievement of social objects of business, i.e., production of quality goods at a reduced price and the attainment of higher productivity in all factors of production. Cost audit is the audit process or verification of the cost of the manufacture or production of any article. Following is the main advantages of cost audit:

- i) It brings to notice operational inefficiencies and enables corrective action.
- ii) It suggests measure for productivity improvement.
- iii) It helps the Government in controlling prices.

Management audit: Management audit is comparatively a recent modern thinking. It deals with the evaluation of the efficiency of the performance of management in an organization. "Management audit has been defined as a comprehensive critical review of all aspects of process of management."

Balance Sheet audit: Balance Sheet Audit does not simply mean an audit of the Balance Sheet only, it is more than this. In fact, Balance Sheet Audit is a system of audit where Balance Sheet is first taken up for examination and the audit works backward to the Profit and Loss Account and the books and records.

Suitability: Balance Sheet Audit is suitable where:

- i) The size of the organization is big and transactions are numerous; and
- ii) The internal control system of the organization is effective.

Complete audit: A complete audit is an unrestricted audit for the entire financial year and for the whole organization. In complete audit, the auditor is free to check all the books and records of the organization. A statutory audit is of this type. A partial audit is only an audit of part of the transactions or records.

Partial audit: A partial audit can be an audit covering the whole year or a part of the year. An audit to check inter-division transactions only or a cash audit or an audit of sales or purchases only is a partial audit. Thus, in partial audit, the field of audit is restricted and the nature of audit is specified to the auditor in the appointment letter. An audit which is conducted considering the particular area of accounting is known as partial audit. Under partial audit, audit of whole account is not conducted. Audit of particular area where the owner thinks essential to conduct audit will be conducted. Generally, transaction of business is related to cash, debtor, creditor, stock, etc. A business may conduct an audit of any of these transactions.

Internal audit: It involves a conduct of systematic examination of the records, procedures and operations of an organization. It is generally carried out by employees of the Company with a view to:

- i) confirming that the policies of management are being properly executed and drawing attention to those areas where policies appear to be inadequate; and
- ii) to verify that the information used by management to control the undertaking is both adequate and accurate.

Cash audit: Cash audit is an audit of cash transactions and the cash book only. It is a limited or partial audit. Only the cash receipts and payments are checked in this audit with the help of documentary evidence to ensure that they have been properly entered in the cash book.

Propriety audit: Propriety audit refers that kind of audit wherein the various actions and decisions of the management of an enterprise are examined in the light of public interest and standard of conduct. The conduct of propriety audit by an auditor requires a rare quality of prudence, wisdom and skills, since he has to examine the regularity prudence and impact of the various actions and decisions of the management. In propriety audit, the auditor has to find out the justification of the transactions, the amount of the expenditure incurred and the prudence of the sanctioning authority.

Social Audit: Social audit is performed to know the corporate social responsibility.

3.4.6 Qualities of an Auditor

An auditor must have all the qualities of head and heart as he is required to perform a variety of functions. He must be a man of character and good behaviour. He must also be a hard task master so as to do the work himself and get the work done through his assistants. In particular, he must possess the following qualities:

- 1) **Knowledge of Book-keeping, Accountancy and Auditing:** An auditor must have thorough and up-to-date knowledge of accounting and auditing principles, practices, techniques and procedures. As accounting is a changing technique, he should be fully aware of the new changes and developments in the field of accounting. He should not pass any entry or account as correct unless he becomes sure of its correctness. Hence, the knowledge of the principles of accounting becomes very much necessary for him.
- 2) **Knowledge about Working of Business:** The auditor should know the technical details about the working of the business or the industry or trade carried on by his client, only then he would be able to judge whether the profit of the business and its financial position are truly reflected in the financial statements.
- 3) **Knowledge of Economics:** He should also be familiar with the principles of economics and the economic laws. It is essential because a business has to work within some specific social and economic conditions which have definite effect on the business.
- 4) **Knowledge of Audit Case Laws:** He should have good knowledge of the audit case laws and important decisions, both past and present, which have gone a long way in defining the duties and liabilities of an auditor under varying circumstances.

- 5) **Knowledge of Industrial Management:** He should have good knowledge of industrial management, financial administration and business organization.
- 6) **Technical Knowledge:** He must have thorough knowledge of the technical and other details of the business so that he can elicit necessary information from the employees of his client. This will also help him not to ask ridiculous questions from his client during the course of audit work.
- 7) **Knowledge of Latest Audit Techniques:** He should be well versed in latest auditing techniques, practices and procedures. He will do well if he participates in Seminars, Conferences and Convocations organized from time to time by the professional bodies in India and abroad.
- 8) **Knowledge of Tax Laws:** He should have up-to-date knowledge of Income-Tax Laws particularly when he is to conduct tax audit.
- 9) **Knowledge of Cost Accountancy:** He must have thorough and up-to-date knowledge of cost accounting principles, practices, techniques and procedures in order to be a cost auditor.
- 10) **Honesty:** An auditor must be honest person. He should not certify any transactions as correct unless he is sure that it is true. He must exercise reasonable care and skill before he believes what he certifies is true as was observed by Justice Lindley in the case London and General Bank (1895).
- 11) **Tactful:** An auditor must be tactful so as to effectively deal with client to get necessary explanations for his audit work.
- 12) **Secrecy:** He must not disclose the secrets of his client otherwise he will have to make good (compensate) the loss suffered by his client. He will also lose the confidence of his client and may not get audit work in future.
- 13) **Courteous and Well-behaved:** He should be courteous and well-behaved as he is to deal with senior officers of his client. He should try to win their confidence so as to get their whole hearted co-operation to carry out his duties as auditor.
- 14) **Impartial:** He should be impartial. He must not be influenced in the discharge of his responsibilities directly or indirectly. In case he finds something suspicious, he should thoroughly examine the matter to find the truth.
- 15) **Common Sense:** He must possess good common sense to deal effectively with the employees who might be more experienced and clever than him. Well laid schemes of fraud cannot be discovered unless the auditor possesses a high level of common sense. In fact lack of common sense implies nonsense. Unfortunately, "the common sense is a thing which is uncommon to him".
- 16) **Cautious and Vigilance:** An auditor must be very cautious and vigilant. If he faces an awkward situation when his duty to his client is opposed to his own interests, he should be bold enough to discharge his duties faithfully and honestly. It will pay him in the long-run.

- 17) Eliciting Information:** An auditor should be clever to be able to extract the necessary information in full. He should be capable of preparing a proper questionnaire having intelligent questions.
- 18) Reasoning:** An auditor should always be prepared to hear arguments and must be reasonable.
- 19) Methodical:** An auditor should be methodical, hard working and accurate.
- 20) Prudence:** If the auditor is asked to give advice on matters relating to finance or to suggest improvements in the accounts, although not within his sphere, an auditor must be prudent and practical.
- 21) Ability to prepare Report:** Last but not the least, an auditor should have the ability to write his report to the shareholders clearly, correctly, concisely and forcefully.

In this session you read about auditing, now answer the questions given in Check Your Progress 3.

Check Your Progress 3

Note: a) Write your answer in about 50 words.

b) Check your answer with possible answers given at the end of the unit.

- 1) What do you mean by audit?

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- 2) What is the main objective of audit?

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3.5 BUDGETING

It is well recognized that an enterprise should be managed effectively and efficiently. Managing, in fact, implies coordination and control of the total enterprise efforts to achieve the organizational objectives. The process of managing is facilitated when management charts its course of action in advance. The function of management also includes decision-making facilitated by various managerial techniques, procedures and by utilizing the individual and group efforts in a coordinated and rational way. In our daily life, we prepare budgets for matching the expenses with income and available funds can be invested in any project giving maximum return. Similarly in business, budgets are prepared on the basis of future estimated production and sales in order to find out the

profit in a specified period. Budgeting are a management process. It is defined as the process of preparing plans for future activities of a business enterprise after considering and involving the objectives of the said organization. It is a technique to formulate a budget, implement it and to evaluate it. The work of preparing a business budget is not a simple task and it is completed through budgeting. It has following characteristics:

- 1) Budgeting is a continuous managerial process.
- 2) Budgeting is related to a definite period of future time and usually a year.
- 3) Budgeting is based on certain objectives.
- 4) Budgeting is used for future forecasting of various business activities



3.5.1 Objectives of Budgeting

The determination of budget objectives and their achievement is the object of budgeting. Generally, following are the objectives of budgeting:

- 1) One of the objectives of budgeting is to prepare a budget on the basis of past, present and future conditions for pre-determined objectives covering all the activities of the business. Thus budgeting helps in planning.
- 2) Budgeting not only helps in planning but is also helps in co-coordinating the activities of various departments.
- 3) In budgeting, objectives and targets of all the departments are fixed and monitored. Thus it helps management in its controlling function.
- 4) Budgeting communicates the objectives, policies, physical and financial targets of all the departments.
- 5) Helps in performance evaluation.
- 6) Helps in comparing two or more firms or entities.
- 7) Helps in fixing standards.
- 8) Helps in cost control and cost reduction.
- 9) Helps in removing the complexities of delegation of powers.
- 10) Helps in raising competitive strength.
- 11) Helps in increasing managerial efficiency.

3.5.2 Process of Budgeting

The budgeting process can be described as follow:

- 1) **Formulation of Business Policies:** Before preparing a budget, it is very essential that business policies must be formulated because these policies work as pillars of guidance. Therefore, such policies are determined in advance and are formulated by the top management.
- 2) **Preparation of Budget Forecasts:** After formulation of budget policies, the budget organization gives order to all the heads to prepare budget estimates for a certain period of time for their departments. The heads prepare budget keeping in view the objectives, past data, information and present conditions.
- 3) **Comparison of Alternatives, Coordination and Review:** The budget committee considers the budgets prepared by the various departments with their alternates. By analyzing and reviewing, the budget committee selects the best one among the given alternatives considering the profitability and financial position of the Company. Budget committee tries to establish the coordination among various departmental budgets. If the Budget committee requires a change in the budget, the budget officer can issue a new circular to the head with necessary guidelines and points to be considered to revise the budget.
- 4) **Formation of Master Budget, Final Approval and Budget Execution:** After comprising and reviewing the budgets, the budget committee formulates the master budget coordinating all the departmental budgets. Then it is sent to the Boar of Directors for approval. A meeting of the shareholders may be called if necessary for the final approval of master budget. After the final approval with necessary amendments, it is handed over to the top management for execution at various levels in the organization.

3.5.3 Advantages of Budgeting

- **Helpful in managerial functions** – Budgeting helps in all managerial functions such as planning, organizing, co-coordinating, motivating and controlling.
- **Profitability analysis** – Revenue and expenditure are analyzed and predicted, therefore, future profitability can be projected.
- **Cost analysis** – All types of costs are estimated and analyzed therefore cost control and reduction is possible.
- **Helpful in comparison** – In budgeting actual are compared with budgeted standards and deviations are searched.

3.5.4 Limitation of Budgeting

- 1) Budgets are simply estimates of future activities and how much success will be achieved depends upon future situations. There are good chances of personal bias in budget formulation.
- 2) Budes can be ineffective if prepared on the basis of scanty information and knowledge.

- 3) If there is no full cooperation between various departments and employees budgets are bound to fail.
- 4) Budget expenses may prove highly burden some.

In this session you read about budget, now answer the questions given in Check Your Progress 4.

Check Your Progress 4

- 1) What is meant by budgeting?

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- 2) What are the different steps in budgeting?

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3.6 LET US SUM UP

Finance is an important function in any business as money is required to support its various activities. It has given birth to “Financial Management” as a separate subject. Financial management is a managerial activity concerned with planning and controlling of the firm’s financial resources to generate returns on its invested funds. Thus now the scope of financial management is very wide and it should not be considered to be merely restricted for raising or capital. It also covers other aspects of financing such as assessing the needs of capital, raising sufficient amount of funds, cost of financing, budgeting, maintain liquidity, lending and borrowing policies, dividend policy and so on. Finance is considered as the life-blood of any business. Scope of financial management includes: Investment decisions, financing decisions and dividend decisions. The financial management is generally concerned with procurement, allocation and control of financial resources of a concern. Its main objective is to maximize the profits and value of shareholder funds. Main functions of financial management are: Estimation of capital requirements, determination of capital’s composition, investment of funds, and financial control. Approaches of financial management are: Traditional approach of financial management focuses on ‘arrangement of finance’ for meeting various financial needs of an enterprise whereas Modern approach encompasses wider applications, viz., assessment of funds required, effective

procurement of those funds through most economical means, and efficient utilization of those funds through profitable investments, as well as cash and liquidity management. Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events, which are, in part at least, of financial character and interpreting the results thereof". Accounting has three branches such as Financial accounting, Management accounting, and Cost accounting. Basis of accounting are cash basis and accrual basis. Accounting is concerned with auditing. "Auditing may be defined as the examination of the books, accounts and vouchers of a business with a view to ascertain whether or not the Balance Sheet is properly drawn up so as show a true and correct view of the state of affairs of the business." There are two main objectives of Auditing. Primary objective is to determine and judge the reliability of the financial statement and the supporting accounting records of a particular financial period is the main purpose of the audit and the secondary objective is to examine the books of accounts and the relevant documents to locate errors and frauds and to suggest the way to prevent these frauds. In our daily life, we prepare budgets for matching the expenses with income and available funds can be invested in any project giving maximum return. Similarly in business, budgets are prepared on the basis of future estimated production and sales in order to find out the profit in a specified period. Budgeting are a management process. It is defined as the process of preparing plans for future activities of a business enterprise after considering and involving the objectives of the said organization. It is a technique to formulate a budget, implement it and to evaluate it.

3.7 KEYWORDS

- Accounting** : is a means of measuring and reporting the results of economic activities.
- Management Accounting** : The process of preparing management reports and accounts that provide accurate and timely financial and statistical information required by managers to make day-to-day and short-term decisions.
- Cost Accounting** : Cost accounting is the classifying, recording and appropriate allocation of expenditure for the determination of the costs of products/services, and for the presentation of suitably arranged data for purposes of control and guidance of management.
- Financial Management** : The planning, directing, monitoring, organizing, and controlling of the monetary resources of an organization.
- Auditing** : An examination and verification of a company's financial and accounting records and supporting documents by a professional, such as a Certified Public Accountant.
- Budgeting** : is defined as the process of preparing plans for future activities of a business enterprise after

considering and involving the objectives of the said organization.

- Book-keeping** : The systematic recording of a company's financial transactions.
- Accrual basis of accounting:** The most commonly used accounting method, which reports income when earned and expenses when incurred.
- Cash basis of accounting** : It is a method which reports income when received and expenses when paid.
- Social audit** : It is performed to know the corporate social responsibility.

3.8 REFERENCES AND SUGGESTED READINGS

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3.9 POSSIBLE ANSWERS: CHECK YOUR PROGRESS

Check Your Progress 1

- 1) What is Financial Management?

Ans. Financial management is a managerial activity concerned with planning and controlling of the firm's financial resources to generate returns on its invested funds. The raising and using of capital for generating funds and paying returns to the suppliers of capital is the finance function of a firm. Thus the funds raised by the company will be invested in the best investment opportunities, with an expectation of future benefits.

- 2) What are the objectives of Financial Management?

Ans. The objectives of financial management are:

- 1) To ensure regular and adequate supply of funds to the concern.
- 2) Ensure adequate returns to the shareholders which will depend upon the earning capacity, market price of the share, expectations of the shareholders?
- 3) To ensure optimum funds utilization. Once the funds are procured, they should be utilized in maximum possible way at least cost.

Check Your Progress 2

1) Define Accounting.

Ans. Accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information.

2) What is the difference between Book-keeping and accounting?

Ans. Book-keeping: It is a process of recording Company's day-to-day financial transaction into a journal. The journal entry included the date, the name of the accounts to be debited and credited, and the amounts. The bookkeeping process further requires that all transactions recorded in journal need to be classified into ledger accounts.

Accounting: It is the bigger picture. It is the system that keeps track of the data, including people, and records the transaction's history, as well as taking the information that is obtained through the bookkeeping process and using that information to analyze the results of the business. .

Check Your Progress 3

1) What do you mean by audit?

Ans. Auditing is a systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) of an enterprise for a stated purpose. In any auditing situation, the auditor perceives and recognizes the propositions before him for examination, collects evidence, evaluates the same and on this basis formulates his judgment which is communicated through his audit report.

2) What is the main objective of audit?

Ans. Objectives of Auditing are:

Primary Objectives: As per the Indian Companies Act, 1956 it is mandatory for the organizations to appoint a auditor who, after the examination and verification of the books of account, disclose his opinion that whether the audited books of accounts, Profit and Loss Account and Balance Sheet are showing the true and fair view of the state of affairs of the company's business.

Secondary Objectives: In order to report the financial condition of the business, auditor has to examine the books of accounts and the relevant documents. In that process he may come across some errors and frauds.

Check Your Progress 4

1) What is meant by budgeting?

Ans. Budgeting are a management process. It is defined as the process of preparing plans for future activities of a business enterprise after considering and involving the objectives of the said organization. It is a technique to formulate a budget, implement it and to evaluate it. The work of preparing a business budget is not a simple task and it is completed through budgeting.

2) What are the different steps in budgeting?

Ans. The different steps in budgeting are:

- 1) Formulation of Business Policies
- 2) Preparation of Budget forecasts
- 3) Comparison of Alternatives, Coordination and Review
- 4) Formation of Master Budget, Final approval and Budget Execution



UNIT 4 URBAN ASSETS MANAGEMENT

Structure

- 4.1 Introduction
- 4.2 Definition and Categorization of Assets
- 4.3 Valuation of Assets -General Principles
- 4.4 Valuation of Assets for Opening of Balance Sheet
- 4.5 Valuation of Assets-Ongoing
- 4.6 Asset Management
- 4.7 Issues in Valuation
- 4.8 References and Selected Readings
- 4.9 Check your Progress-Possible Answers

4.1 INTRODUCTION

Urban infrastructure development and assets creation are critical to urban development. There are several important steps in fixed assets management so far as ULBs are concerned. The first step is identification and categorization; the second step is location; the third step is valuation; the fourth step is recording, the fifth, updating, the sixth, accounting, and the seventh, presentation. Municipal staff has to deal with some of the very common problems which may commonly include:

- i) the non-availability of records pertaining to the various fixed assets - including sometimes their original cost, date of acquisition or construction etc.;
- ii) the difficulty of locating a fixed asset - for instance, a road roller which had been purchased and appears on the books, but was physically scrapped a long time ago and no record of its disposal remains; and
- iii) lack of data on current condition and remaining useful life.

After studying this unit, you will be able to:

- Discuss the appropriate value, useful life and depreciation of municipal fixed assets and their reporting in the financial statements;
- Explain the effectiveness of control over municipal fixed assets; and
- Describe municipalities true financial position in facilitating budgetary planning and control over resources.

4.2 DEFINITION AND CATEGORIZATION OF ASSETS

There are several definitions of assets that are commonly used in various parts of the world, as different accounting and standards exist in different countries. Accounting Standard 10 on 'Accounting for Fixed Assets', promulgated by the Institute of Chartered Accountants of India (ICAI), defines a fixed asset as:

“An asset held with the intention of being used for the purpose of producing and providing goods or services and is not held for sale in the normal course of business”.

The context of Urban Local Bodies (ULB) is different from commercial bodies to which these accounting standards generally apply. Hence, a set of Accounting Standards for Public Sector Bodies have been developed by the International Public Sector Accounting Standards Board (IPSASB), a constituent of the International Federation of Accountants (IFAC).

The definition of Assets as per the IPSASB is:

“Assets are resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity”.

The concept of control of an asset’s economic benefit is a key issue in determining whether that asset should be reported in the financial statements of a ULB. This concept of control is what leads to non-owned assets like Hire Purchase assets, Leasehold property to be recognized as assets. This concept is important because governments are required to maintain control over public property in a fiduciary capacity and hence any loss of control is not only a financial but also a fiduciary loss. To determine whether a ULB should be reporting an asset, it is necessary to look to the indicators of control. According to AS26, ‘control’ is identified when the enterprise has the power to obtain future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits.

Where the control of the asset has been affected, say where municipal land has been encroached, the ‘Technical Guide for Accounting by ULBs’ issued by ICAI provides that a provision equal to virtually the entire carrying amount of land shall be provided. Even in such cases, the right to take possession remains with the ULB.

4.2.1 Classification of Assets

The classification of fixed assets can be done in several ways - ‘function-wise’ for example water works and sewerage and drainage or ‘nature-wise’ such as plant and machinery, etc.

The fixed assets can be divided into two main categories :

- i) Infrastructure Assets; and
- ii) Other Assets

Infrastructure assets- are long-lived capital assets associated with governmental activities that normally are stationary in nature and can be preserved for a significantly greater number of years than most capital assets the examples are roads, bridges, tunnels, drainage systems, water and sewer systems, dams, and lighting systems. Buildings are excluded from the definition of infrastructure assets unless they are an ancillary part of a network of infrastructure.

As per IPSAS, infrastructure assets displays following characteristics:

- They are part of the system or network.
- They are specialized in nature and do not have alternative uses.

- They are immovable; and
- They are subject to constraints on disposal.

Apart from this, several municipalities may have their own classification systems based on local laws (accounting rules) or practices. In some cases, the maintenance of fixed asset registers is done as per these classifications i.e. Tools Register, Plant & Equipment Register, etc.

4.2.2 Asset Classification as per National Municipal Accounting Manual (NMAM)

However, the account coding structure prescribed in NMAM, 2005, Government of India does not maintain this distinction and classifies assets into 11 major groups, all under the Broad head of 'Fixed Assets'. The choice of minor heads is left to states. The proposed classification of Fixed Asset as per NMAM code of accounts is into 11 categories as follows:

- i) Land
- ii) Buildings
- iii) Roads & bridges
- iv) Sewerage and drainage
- v) Water works
- vi) Public lighting
- vii) Plant & machinery
- viii) Vehicles
- ix) Furniture, fixtures, fittings and electrical appliances
- x) Office & other equipments
- xi) Other fixed assets

Among these, items (iii), (iv), (v) and (vi) can be classified as 'infrastructure assets'.

Besides, the NMAM has classified Assets into 'Movable' and 'Non-movable' category. This distinction is especially useful when the objective is to physically verify the assets.

- i) **Land:** Land includes parks, playgrounds, agricultural land, dhobighat, dumping ground, tonga, rickshaw, taxi (other than underground taxi stands) and cycle stand, parking places (other than those which are covered) and any vacant site on which no construction has taken place. Where assets such as buildings, roads, bridges etc. are constructed on land, all land (including cove land) should be shown as under this head.
- ii) **Buildings (including structures):** Buildings include office-buildings, school-buildings, public-conveniences, hospitals, dispensaries, maternity and child welfare centers, shopping-complex, town hall building, community centers, staff quarters, rest-house, milk dairy, workshop buildings, fire station, stores building, covered taxi stands, covered parking areas, lavatory blocks, urinals, dhalaos and dustbins and garbage vats, etc. structures include public

fountains and others which cannot be classified as buildings but are nevertheless of a permanent nature. Land under buildings should be separated and shown distinctly under 'land'.

- iii) **Roads & bridges:** This includes several types of assets including roads, pavements, footpaths, bridges, subways over bridges, flyovers, culverts, and causeways.
- iv) **Sewerage and drainage:** This includes items like roadside drains, underground drains, sewerage network, etc. Plant and machinery for stations including pumps etc. would be classified under this head.
- v) **Water works:** This includes all items related to water works such as bore wells, treatment plants, reservoir, overhead tanks, pipelines, plant and machinery for water works, etc.
- vi) **Public lighting:** This covers all assets related to lighting and includes electrical installations like transformers, cables etc, lamps and fittings and poles. Any electrical installations other than for public lighting would be covered under subsequent head of 'furniture, fixture, fittings & electrical appliances'.
- vii) **Plant and machinery:** Plant and machinery include all engineering equipments like road rollers, bull dozers, etc.; medical equipments used in hospitals, dispensaries and maternity centers, scientific equipments, generators, clock tower, etc. This will not include plant and machinery used specifically in waterworks, pumping stations, sewerage treatment plant, etc. which are already classified under those heads. However, plant and machinery used for other purposes should be included under this head.
- viii) **Vehicles:** Vehicles include all types of trucks, water tankers, buses, jeeps, cars, two-wheelers, three-wheelers and loaders, etc. Mobile machinery such as road rollers and bulldozers would not be classified as vehicles as their primary purpose is not transportation.
- ix) **Office & Other equipments:** All items of office use such as computers, peripherals, photocopy machines, type-writers, communication and telecom equipments would be recorded under this head. Other equipment should also be recorded under this head.
- x) **Furniture, fixture, fittings & electrical appliances:** They include metal as well as wooden chairs, tables, racks, cupboards, water coolers, fans, air conditioners, refrigerators, TV, etc. Items which can be classified as office and other equipment should be first classified under that head. Else, should be included here.

It would also include all types of installation cables, lampposts, mercury vapor lamps, sodium vapor lamps, light fittings, power points, etc., used in the buildings and other premises used by the ULB (other than those used for street-lighting as they are included under the heading 'Public lighting').

- xi) **Other fixed assets:** This will include all other assets not specifically covered in any of the earlier heads. It will include for instance, intangible assets such as software, etc. Specific assets with different valuation or re-use norms (such as heritage assets, works of art etc.) may also be classified as separate sub-groups under this head.

4.2.3 Capital Work in Progress

In addition to the above categories, one more category is important 'Capital Works in Progress'. This includes costs of constructing fixed assets before construction is substantially complete. The identification of an item of construction as 'Capital Work in Progress' means that the item is intended to be capitalized once it is complete / put into use. Capital Work in Progress (CWIP) is included in the 'Fixed Assets' group of assets but is only an interim account, until the asset is put into use. In particular following:

- a) CWIP is not recorded in any of the 'asset' registers. Instead, a separate CWIP Register is maintained to record progressive bills for construction;
- b) Any amount paid for purchase / construction of an asset which has not been completed / put to use should be shown as CWIP and recorded in CWIP Register;
- c) No depreciation is charged on CWIP since the asset has not been put to use;
- d) The asset should be transferred from CWIP to Fixed Asset Register when it is put into use. Hence, CWIP register should be reviewed regularly for such items.

In this section you studied definition and categorization of assets. Now, you should be able to answer some questions relating to this section given in Check Your Progress-1.

Check Your Progress 1

Note: a) Write your answer in about 50 words

b) Check your answer with possible answers given at the end of the unit.

- 1) Define fixed assets?

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- 2) What are the characteristics of "infrastructure assets"?

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4.3 VALUATION OF ASSETS - GENERAL PRINCIPLES

4.3.1 Models of Valuation of Fixed Asset

There are two models for valuation of fixed assets:

- i) Cost Model; and
- ii) Revaluation Model

i) The cost model

The cost model requires that:

After recognition as an asset, an item of property, plant and equipment shall be carried at cost less any accumulated depreciation and any accumulated impairment losses. This is the traditional 'historical cost' model based on which assets are generally valued for financial reporting purposes in India.

ii) Revaluation Model

Under the revaluation model, the valuation of assets is continually reviewed to reflect the fair market value as much as possible. The model is described below:

After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

The fair value of items of assets is usually determined from market-based evidence by appraisal. However, many ULBs have assets for which it may be difficult to establish market value because absence of market for these assets. In such cases, the fair value of the item may be established by reference to other items with similar characteristics, in similar circumstances and location.

The recommended valuation model for fixed assets is that:

- a) Assets should be valued at initial (historical) cost paid to acquire them;
- b) Depreciation should be charged periodically to reflect the written down value of the asset;
- c) Revaluation would be permitted, with some restrictions.

4.3.2 Principles of Assessment of Fixed Assets Costs

Following principles are generally taken into consideration while valuating the fixed assets costs:

i) Recognition of Fixed Assets

The principle for determining capitalization is given below:

The cost of an item shall be recognized as a fixed asset if:

- i) the asset is held for producing or providing goods or services and is not held for the normal course of business;
- ii) the future economic benefits or service potential associated are expected to fit the entity;

- iii) the estimated useful life of the asset is beyond one year; and
- iv) is beyond the minimum threshold limit for recognition as fixed asset.

ii) Historical Cost

This is the bedrock of the valuation principle and is stated as follows:

Fixed assets are to be reported at Historical Cost. The cost of a fixed asset includes not only its purchase price or construction cost but also related charges necessary to place the assets in its intended location and condition for use. Since the historical cost of donated / gifted assets is NIL, they are to be valued at a nominal cost of Rs.1/

The fixed assets includes:

- a) purchase price, less trade discounts and rebates, if any;
- b) import duties;
- c) other taxes or levies which are non-refundable in nature;
- d) transportation cost, if charged separately from the purchase price;
- e) cost of inspection, if paid separately;
- f) handling costs;
- g) cost of site preparation;
- h) installation cost, including cost of such permanent or temporary structures that are considered necessary for installation;
- i) professional fees for engineers or architects or inspectors, etc.; and
- j) any other cost incurred to put the asset at its location and use.

iii) Self Constructed Assets

In cases where a ULB constructs the asset itself (school building, primary health clinic, etc.), the cost of construction of that building and other costs which are directly attributable should be taken into consideration in arriving at the value of the building. This means that all the material costs of construction, payments made to the various contractors, etc., should be included. For example, if the ULB appoints an Assistant Engineer whose only work is to look after the construction of the building, then the salary of the Assistant Engineer for the construction period should also be added.

iv) Assets acquired under exchange

Sometimes, a ULB may acquire some fixed assets in exchange for some other fixed assets. This can happen for instance, when old office machinery is exchanged for a newer model. Where assets exchanged are similar, the net book value of the asset (the office machinery) which is exchanged should be taken, and to it the extra amount that is paid, if any, is added. If instead an extra payment, a refund is involved, the necessary adjustment will have to be made. In case of dissimilar assets, the assets acquired should be recognized at its fair value.

v) Process of Valuation

The process of valuation of assets is required:

- a) When the first (opening balance sheet) is being prepared; and
- b) At the time of preparing annual financial statements

In this section you studied valuation of assets-general principles assets. Now, you should be able to answer some questions relating to this section given in Check Your Progress-2.

Check Your Progress 2

Note: a) Write your answer in about 50 words

b) Check your answer with possible answers given at the end of the unit.

1) What is a revaluation model for valuation of assets?

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2) What are the principles for determining capitalization of fixed assets?

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4.4 VALUATION OF ASSETS FOR OPENING OF BALANCE SHEET

i) Process for Preparation of Opening of Balance Sheet

The following steps need to be followed for preparation of Opening Balance Sheet:

- a) **Identification of assets** - using various sources of data.
- b) **Verification of assets** - This is prescribed to be carried out as current identification initiatives may either miss out existing assets or take in assets which do not belong to the ULB. Hence, some test checks or verification, with records and physical inspection are recommended;
- c) **Identification of assets that require valuation** - This shortlists the assets which need to be valued in accordance with the following procedures and have not outlived their useful life in which case a summary valuation of Re.1/- can be made;
- d) **Valuation of assets** - This is the subject matter of this manual. Although accounting norms / policies for these are provided, ULBs lack guidance in practical matters of asset valuation.
- e) **Passing of opening entries** - This is the process for preparation of First (Opening) Balance Sheet. Taking cognizance of the assets value in the accounting records brings it within the purview of the new accrual based double entry accounting system.

- f) **Maintenance and updating of fixed asset records** - The details of assets are also recorded in appropriate Fixed Asset Registers and a system has to be developed through which these registers are continually updated with any addition, modification or disposal of these assets.

ii) **Basic Premises**

The basic premises proposed in the NMAM for the valuation methodology are:

- a) Considering the current practices in asset record maintenance, most ULBs do not have readily available records about existing assets;
- b) The purpose of valuation is not to determine the 'correct value' of an asset. It is to get a reasonable estimate of the book value for the purpose of including in a statement which reflects the 'true and fair' financial position of the ULB; and
- c) Unlike other entities where valuation of assets affects share prices and / or prospective takeovers based on valuation of the company, this concern is not relevant to ULBs.

iii) **Asset received as a gift**

If evidence exists, or it is known that an asset was received by the ULB as a gift i.e. without any consideration being paid, it should be recognized at Re.1/-. This is in line with the basic policy of historical cost reporting i.e. to report an asset at the consideration paid for it.

However, these assets may be of considerable value in the market and hence, their nominal valuation should not take away the importance to maintain and monitor them appropriately. It is not necessary that there should be a document establishing the gift - mere knowledge should suffice.

iv) **Historical cost based**

Where the details of purchase are available (this will usually happen in case of recent years assets), the amount of purchase cost and date of purchase would be available. In such a case valuation should be done as follows:

- a) Step 1: Determine historical cost as on the date of purchase
- b) Step 2: Determine depreciation till valuation date
- c) Step 3: Deduct depreciation (a) from historical cost and (b) to arrive at the book value on the date of valuation.

This is the closest we can get to the historical cost of the asset. All other methods are improvisations to overcome deficient information about the existing assets.

Although policies for capitalizing assets require inclusion of ancillary expenses such as borrowing cost, these require significant analysis and are elaborate. Unless the amount of such expense is likely to be significant, they can be ignored for valuation of existing assets in the opening Balance Sheet.

4.5 VALUATION OF ASSETS – ONGOING

Once the asset have been valued and included in the Balance Sheet, their carrying value leads to be periodically recomputed to provide for depreciation and other transactions.

Aspects such as revaluation of assets, depreciation of assets, etc. which arise on a regular basis in the ULB are discussed as follows.

- i) **Depreciation of Assets:** Depreciation has a significant effect on the determination and presentation of the financial position of a ULB. Depreciation is charged in each accounting period by reference to the extent of the depreciable amount.

ULBs need to report depreciation accurately in their financial statements for two main reasons:

- a) to match expenses with the incomes generated because of or with, those expenses; and
- b) to ensure that the asset values in the balance sheet are not overstated. An asset acquired in Year 1 is unlikely to be worth the same amount in Year 5.

- ii) **Accounting Principles:** The basic principles with regard to depreciation are:

- a) Depreciation shall be provided at the rates prescribed by the state. Depreciation on all fixed assets is to be provided consistently on either Written Down Value or Straight Line Method. Whatever method is used, it should be applied consistently.
- b) Depreciation shall be provided at full rates for assets, which are purchased / constructed before October 1 of an Accounting Year. Depreciation shall be provided at half the rates for assets, which are purchased / constructed on or after October 1 of an Accounting Year.
- c) Depreciation shall be provided at full rates for assets, which are disposed on or after October 1 of an Accounting Year.

- iii) **Straight-line Method (SLM):** Straight-line depreciation is the simplest and most often used technique, in which the ULB estimates the “salvage value” of the asset after the length of time over, which it will be used to generate revenues or provide service (useful life), and will recognize a portion of that original cost in equal increments over that amount of time.

- iv) **Written Down Value Method (WDV):** The WDV method is a type of accelerated depreciation because it recognizes a higher depreciation cost earlier in the asset’s lifetime. Under this method, each year’s depreciation is applied to the opening net book value of the asset rather than original cost of the asset. This process continues until we reach the residual/salvage value or the end of the asset’s useful life.

Residual or Salvage value is the amount which an enterprise expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal.

- v) **Amortization:** In the case of an intangible asset, the term ‘amortization’ is generally used instead of depreciation. Both terms have the same meaning.

The period of amortization will depend on the asset. In case of items like software, where technological advances will result in a quicker obsolescence, a time frame of 5 years is recommended.

Intangible assets below Rs.25,000 can be expensed and need not be capitalized. The higher limit (compared to tangible assets) is prescribed to avoid detailed recording and amortization of minor items like software which generally cost below Rs.25,000.

- vi) **Impairment of Assets:** ‘Impairment’ is a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the asset’s future economic benefits or service potential through depreciation.

In other words, if the carrying amount of an asset is more than the amount that is to be recovered through use or sale of the asset, then the asset is said to be ‘impaired’. It basically means that although there may be useful life left of an asset, the-productivity of the asset has gone down sharply. For example, if by policy of the government, certain items are decided not to be produced by the ULB, the future cash flows would be affected that the existing recoverable value of assets used in the production could go below its carrying amount.

- vii) **Disposal of Assets:** When an asset is retired from service, it should be treated in accordance with the following procedures :

- a) No depreciation should be charged after disposal/retirement of the asset;
- b) In case the disposal happens before October 1, 50% of the depreciation should be charged. If it is on or after October 1, full depreciation should be charged;
- c) The assets which are out of service should be recorded in a separate register;
- d) Once an asset is disposed, its movement should be updated in the Fixed Asset Register.

4.6 ASSET MANAGEMENT

The following strategies are used during asset management.

i) Asset Life-cycle

An asset proceeds through a number of sequential phases during its life cycle acquisition, operation and maintenance, refurbishment or enhancement, and, finally, disposal. The life cycle of an asset begins with a planning process that identifies the need for that asset and determines how and when it is to be procured. The asset is then acquired - either an existing asset is purchased or a new one is created. The asset then enters its operational phase.

As the asset ages, it may deteriorate or become obsolete, at which stage a decision is made to either refurbish, enhance or dispose it of. If the need still exists for the service provided by the asset, the cycle recommences.

There are essentially three broad stages in the life cycle of an asset:

- a) Acquisition;
- b) Operation and Maintenance; and
- c) Disposal.

ii) Asset life-cycle management strategy: Asset Life Cycle Management (ALCM) is a strategic, integrated approach to maintenance that considers all the elements that affect the productive life of an asset - from design to disposal. It is a proactive process that complements existing policies by providing strategic focus and perspective.

Asset-intensive organizations including ULBs which successfully adopt asset life cycle management will reduce maintenance costs and improve productivity through superior planning. From design to disposal, an asset's life cycle includes the following stages:

- a) Clarify the need or requirement to be satisfied by the asset;
- b) Identify the type of asset suitable for the requirement and fulfill the need;
- c) Determine the maintenance strategy, cycle and plan for the life of the asset
- d) Purchase the asset;
- e) Commission, operate and maintain the asset; and
- f) Dispose of the asset at the end of its economical life.

These planned maintenance strategies improve reliability, overall productivity, the length of an asset's life, and ultimately total cost of asset ownership.

ii) Asset Management Unit (AMU): It would be clear from the foregoing discussions that ALCM would greatly enhance productivity and performance of ULBs. However, currently there is no unified department in ULBs which looks at all aspects of asset management. In most ULBs, the acquisition assets is the responsibility of the Stores and Purchase Department. Similarly, the account department normally records only the financial transaction and is not concerned with maintenance and management of the asset.

For these reasons, it may be useful for the ULBs to set up an Asset Management Unit (AMU) so that various aspects of asset life cycle are properly managed. This AMU may be centrally located and under the charge of the head of Finance or the Commissioner. The justification for the cell to report directly to the Commissioner arises from the fact that the use of many of the fixed assets such as land and building has policy overtones, and the alternatives in these respects may have to be examined from a larger perspective.

In this connection it is also to be noted that planning for assets (capital budgeting) is a specialized and time consuming exercise by itself, and most departments of finance and accounts in ULBs do not have the wherewithal in terms of either time or human resources to spare for it. Hence, the AMU can have specialized and dedicated staff for exclusively focusing on these issues.

b) Structure of AMU

The AMU could consist of the following staff and officers:

- a) Head, AMU - preferably a person with Asset Management experience, including MIS and computer systems;
- b) Procurement plan Officer- responsible for purchase planning, scheduling and design;
- c) Recording Officer - for review / maintenance of Fixed Asset registers. Also to keep track of disposed assets, sales and preparation of various reports including depreciation schedules;
- d) Maintenance plan Officer - To oversee all scheduled, planned maintenance, to co-ordinate with relevant departments to ensure all assets are in working condition and serviced in time; and
- e) Other staff as may be needed

The AMU staff and officers must all be computer literate and reasonably proficient in working with electronic spreadsheets. If capacity building measures are necessary in these regards, the ULB must speedily plan for the same and implement necessary programs.

Attention is to be paid to the qualifications and experience of the officers deputed to the AMU. At the minimum, officers should have formal accounting qualifications, with in-service training or external diplomas or other qualifications in information technology. Staff should be appropriately chosen with regard to experience in accounting, procurement, and MIS.

c) Functions of AMU

The functions of the AMU shall be, without any loss of generality, as follow:

i) Procurement Planning

- a) To prepare short and medium term asset acquisition plans in consultation with the proposer/user departments and to present the same with due financial impact exercises and alternatives for consideration of Competent Authority.
- b) To prepare general Procurement Plan for fixed assets before the beginning of the fiscal year in terms of the approved asset acquisition plans and to layout necessary timelines, parameters and benchmarks.

ii) Asset Acquisition

- a) To assist and facilitate the purchase department in the process of acquisition of assets as per Asset Procurement Plan.
- b) To assist and facilitate the other execution departments to carry out the Procurement Plan.

iii) Recording and Reporting

- a) To develop, update and maintain an asset tracking database with respect to the location, condition, and other parameters per fixed assets;
- b) To develop, update and maintain a Capital Works in Progress database and to generate necessary MIS there from;
- c) To develop, update and maintain the Fixed Assets Register and to record all fixed asset related transactions which add to or subtract from the book-value of the asset.
- d) To separately maintain the register of impaired assets and assets scheduled for disposal with due attention to computation of value in use and recovery/salvage values. To also assure that due process is followed in determination of fair values and market prices.
- e) to prepare evaluative and analytical reports for the management from time to time.
- f) to prepare depreciation schedules.

iv) Maintenance

- a) To prepare, in consultation with other departments, planned maintenance schedules and to oversee their implementation.
- b) To prepare, in consultation with concerned departments, schedules for conditional assessment and plans for major renovations, repairs, and modifications.

v) Disposal of Assets

- a) To prepare and follow through on the annual disposal plan for fixed assets.
- b) To prepare Asset renewal plan which will feed into the capital procurement plan.

In this section you studied valuation of assets for opening of balance sheet, valuation of assets- ongoing and asset management. Now, you should be able to answer some questions relating to this section given in Check Your Progress-3.

Check Your Progress 3

Note: a) Write your answer in about 50 words

- b) Check your answer with possible answers given at the end of the unit.

1) What is an Asset Life Cycle?

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2) Explain an Asset Life Cycle Management Strategy?

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4.7 ISSUES IN VALUATION

The valuation of urban assets many times confronted with issues. A few important issues associated with valuation of urban assets are narrated below:

- i) **Freehold Land:** All land ownership of which vests with the ULB should be included in the opening balance sheet. The categories are:

Land acquired through purchase

The land will be recorded at the purchase price paid/payable and other incidental costs such as registration charges incurred to bring the asset to its present location and condition.

Lands acquired through compulsory acquisition

The land will be recorded at the total compensation paid/ payable for the acquisition of land.

Compensation paid: It shall be valued at compensation actually paid.

No Compensation Paid: If the asset was acquired without paying any compensation then shall be valued at Re.1/-. However, any developmental work done should be capitalized cost.

Compensation in dispute: The amount paid will be recorded as the asset value. Any extra amount that may be payable, if determinable, should be shown as contingent liabilities. When any further amount is paid to the previous owner, it will be added to the asset in 1 year of payment.

- ii) **Vested Government Lands:** Vested government lands are those lands which are not owned by the ULBs nor does any economic benefit accrue to the ULB. The ownership of these lands vest with the State/Central government and the ULB merely acts as a trustee for these lands. As per Technical Guide issued by ICAI for ULBs, vested government land shall not be recorded as asset as neither ownership nor economic benefits is with ULBs. The description of such lands shall form a part of the number to the balance sheet.

Land improvement

Original cost of any improvement to land such as land development and land filling should be capitalized as an improvement to the land.

Land acquired through government grants

If the ULB has purchased land from government grants, then the cost of the land will be shown at gross value i.e. cost paid/ payable or as determined. The grant received should be shown as Capital Reserve in the Balance Sheet.

- iii) **Buildings:** The valuation of buildings shall be carried out as follows:

Buildings purchased

Purchase cost of the building shall include the purchase price cost and incidental costs such as registration charges and other costs incurred to bring the asset to its present location and condition.

Building constructed

If the building has been constructed, then the cost of construction will be taken as the cost.

Heritage Buildings

Heritage buildings are generally to be valued in the same manner as other buildings. However, they are to be disclosed separately under the Head 'Heritage Assets' under Other Assets. The purpose is to distinguish the assets for their historical, cultural and / or religious significance and to recognize the restrictions on their use or sale.

Art and Historical items

ULBs should capitalize works of art, historical treasures, and similar assets at their historical cost. These items can be classified under 'Heritage Assets' under 'Other Assets'.

Governments should disclose information about their works of art and historical collections. Capitalized collections or individual items that are exhaustible, such as exhibits whose useful lives are diminished by display or educational or research applications, should be depreciated over their estimated useful lives. Depreciation is not required for collections or individual items that are inexhaustible.

- iv) **Value of land under Roads:** Roads are generally built on property that is owned by the ULB. Hence, apart from the road, the land under the road also needs to be valued and accounted.

Such land is to be kept under 'Land' and not included in 'Roads & Bridges'. The value of such land should be taken at the historical cost i.e. if any amount is paid to acquire it then at the compensation paid, etc. If the amount cannot be ascertained, a nominal value of Re. 1/- should be considered for the land under each road.

- v) **Pipe networks:** Networks will normally have trunks, mains, and sub-mains. This is equally valid for water supply as well as sewerage network. Those parts of network which are relatively stand alone should be considered separate assets on their own. The criterion to be also used is that failure of the smaller network is not critical to the continued operation of the larger one.

While computing historical costs, original costs of digging an earth work should be included.

Any major cost for improvement of network functioning (for instance, removal of sediments and coating from mains or trunks) should be added to the book value.

- vi) **Intangible Assets:** Intangible assets in ULBs will generally be in the nature of expenditure on software. The ULB will assess the expenditure made in development or purchase of the intangible asset in the last 2 years and capitalize it as fixed asset. In case the intangible asset has been provided free of cost on a sharing basis, it should not be shown in the balance sheet.

The process of valuation of intangible asset would be as follows:

- a) **If Purchased:** The cost of an intangible asset comprises its purchase price, including any import duties and other taxes (excluding recoverable amount from the taxing authorities), and any directly attributable expenditure like professional fees for legal services, etc. on making the asset ready for its intended use. Any trade discounts and rebates are deducted in arriving at the cost.
- b) **If Internally Generated:** The cost of internally generated assets such as software should be determined in line with Accounting Standard 26 'Intangible Assets'. Where the asset meets the criteria for recognition, its cost will comprise all expenditure that can be directly attributed or allocated on a reasonable and consistent basis to create the asset / software for its intended use. Costs include: (i) expenditure on materials and services used in developing the asset, (ii) salaries, wages and other employment related costs of personnel directly engaged in developing the asset, (iii) any expenditure that is directly attributable to generating the asset. However, it excludes: (i) selling, administrative and other general overhead expenditure unless this expenditure can be directly attributed to making the asset ready for use; (ii) clearly identified inefficiencies and initial operating losses and (iii) expenditure on training the staff to operate the asset.
- c) **If Gifted/Donated:** If the asset was acquired without paying any price and gifted to ULB (or if it is donated): then it shall be valued at Re .1/-.
- d) **If Acquired through exchange:** An intangible asset may be acquired in exchange or part exchange for old intangible asset. Where the assets exchanged are similar, the net book value of the asset which is exchanged should be taken, and to it the extra amount that is paid, if any, is added. If instead of an extra payment, a refund is involved, the necessary adjustment will have to be made. In case of dissimilar assets, the assets acquired should be recognized at its fair value. The residual value of an intangible asset in ULBs should be assumed to be zero. Hence, the full cost should be 'amortized' over the estimated useful life of the asset. Subsequent expenditure on intangible assets should be generally recognized as an expense unless it increases the capacity or the life of asset.

4.8 REFERENCES AND SELECTED READINGS

- 1) Andhra Pradesh Municipal Asset Management Manual, Department of Municipal Administration and Urban Development, Government of Andhra Pradesh, 2008
- 2) Model National Municipal Asset Valuation Methodology Manual, Ministry of Urban Development, Government of India, 2009

4.9 CHECK YOUR PROGRESS- POSSIBLE ANSWERS

Check Your Progress 1

- 1) Define fixed assets?

An asset held with the intention of being used for the purpose of producing and providing goods or services and is not held for sale in the normal course of business.

- 2) What are the characteristics of “infrastructure assets”?

As per IPSAS, infrastructure assets display the following characteristics:

- they are part of the system or network.
- They are specialized in nature and do not have alternative uses.
- They are immovable; and
- They are subject to constraints on disposal.

Check Your Progress 2

- 1) What is a revaluation model for valuation of assets?

Under the revaluation model, the valuation of assets is continually reviewed to reflect the fair market value as much as possible. After recognition as an asset, an item of property (plant and equipment whose fair value can be measured reliably) shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

- 2) What are the principles for determining capitalisation of fixed assets?

The principle for determining capitalisation of fixed asset is that the :

- a) the asset is held for producing or providing goods or services and is not held for the normal course of business;
- b) the future economic benefits or service potential associated are expected to fit the entity;
- c) The estimated useful life of the asset is beyond one year; and
- d) Is beyond the minimum threshold limit for recognition as fixed asset.

Check Your Progress 3

1) What is an Asset Life Cycle?

An asset proceeds through a number of sequential phases during its life cycle acquisition, operation and maintenance, refurbishment or enhancement, and, finally, disposal. The life cycle of an asset begins with a planning process that identifies the need for that asset and determines how and when it is to be procured. The asset is then acquired and enters its operational phase. As the asset ages, it may deteriorate or become obsolete, at which stage a decision is made to either refurbish, enhance or dispose of it.

2) Explain an Asset Life Cycle Management Strategy?

From design to disposal, an asset's life cycle includes the following stages

- a) Clarify the need or requirement to be satisfied by the asset;
- b) Identify the type of asset suitable for the requirement and fulfill the need;
- c) Determine the maintenance strategy, cycle and plan for the life of the asset
- d) Purchase the asset;
- e) Commission, operate and maintain the asset; and
- f) Dispose of the asset at the end of its economical life.

