Government Accounting: Recent Trends and Direction for India

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Gone are the days when the function of accounting was limited to record keeping. In today's environment, the accounting, apart from being a statutory requirement is also expected to provide the government and other users of government's financial statements with relevant, reliable and timely information that will assist them in decision-making process. This article provides an overview of the government accounting systems, examines the extent to which the present accounting system followed by our country fulfills the requirement of an ideal accounting system and highlights the experience of other countries that have reformed their accounting system in recent past.

Necessity is the mother of all inventions, so goes the old saying. Accounting as a branch of knowledge emerged as it was felt that a short pencil is better than long memory. All the transactions that were undertaken by any entity in the old days grew to such an extent that it became impossible for anyone to manage all of them by memory alone. Gradually as trade and commerce developed, accounting became a requirement and then a necessity. Not only does the law requires every organization to prepare the accounts but also decides on the format and other issues. Today, accounting has a far greater significance because of the role it plays in decision-making process.

Qualitative Characteristics of Financial Reporting

The quality of the information provided in financial reports determines the usefulness of those reports to users. The qualitative characteristics of financial information discussed in the IASC Framework are: understandability; relevance; materiality; reliability; faithful representation; substance over form; neutrality; prudence; completeness; and comparability (IFAC, 2000). In addition, the IASC notes that timeliness as important as other characteristics. However, at times a balancing or trade off between characteristics may be necessary. Different accounting systems may also score highly on one characteristic than another. Deciding the relative importance of the characteristics in different cases is a matter of judgement.

Government Accounting

Government accounting is the process of recording, analysing, classifying, summarising communicating and interpreting the financial transaction and events about government in aggregate and in detail reflecting transactions and other economic events involving the receipt, spending, transfer, usability and disposition of assets and liabilities.

In the words of Premchand (1995) Government Accounting may be defined as a system that is charged with identification, selection and analysis, measurement, estimation, processing, and communication of information on receipts, expenditure, assets, liabilities, costs, and benefits and all other aspects that legitimately form part of fiscal management and is now the recognised handmaiden of fiscal policy.

Objectives of Governmental Financial Reporting

IFAC PSC Study 1 (1991) Financial Reporting by National Governments identified the following objectives of governmental financial reporting.

Financial reporting should demonstrate the accountability of the government or unit for the financial affairs and resources entrusted to it, and provide information useful for decision making by:

- indicating whether resources were obtained and used in accordance with the legally adopted budget;
- indicating whether resources were obtained and utilised in accordance with legal and contractual requirements, including financial limits established by appropriate legislative authorities;
- providing information about the sources, alloca-

tion, and uses of financial resources;

- providing information about how the government or unit financed its activities and met its cash requirements;
- providing information that is useful in evaluating the government's or unit's ability to finance its activities and to meet its liabilities and commitments;
- providing information about the financial condition of the government or unit and changes in it; and

providing aggregate information useful in evaluating the government's or unit's performance in terms of service costs, efficiency and accomplishments.

Accounting in Government: Methods/ Systems

The Government, as we all know, is not there to make profit. Neither is it a manufacturing organisation. Considering this, a school of thought has emerged that government accounting need not be the same as commercial accounting. The advocates of this thought are of the opinion that as long as an accounting system that records each and every transaction of the government and has an inbuilt facility of comparing the budgeted figures with the actual, will do for government. On the other hand there is another school of thought that does not favor this view and is of the opinion that the accounting system should be such that in addition to the above it should be in a position to comment on the working of the government and also could reflect on the assets and liabilities of the government. To put the same in simple words the accounting system should be in position to generate relevant information for decision-making. The two schools of thought that are under reference are cash accounting and accrual accounting. In between the two other methods of preparing the accounts have also been suggested in the recent past.

The modified cash basis of accounting recognises transactions and events that have occurred by year-end and are normally expected to result in a cash receipt and/or disbursement within a specific period after year-end.

The methods or systems of preparing government accounts can be classified into four broad categories:

- Cash Accounting
- Modified Cash
- Modified accrual
- Accrual

Cash accounting: The cash basis of accounting measures the flow of cash resources. It recognises transactions and events only when cash is received or paid. Financial statements produced under the cash basis of accounting cover cash receipts, cash disbursements, and opening and closing cash balances. A cash accounting system has the advantage of being simple.

Modified cash accounting: The modified cash basis of accounting recognises transactions and events that have occurred by year-end and are normally expected to result in a cash receipt and/or disbursement within a specific period after year-end. Under this system, the accounting period includes a complementary period for payments (e.g., one or two months) after the close of the fiscal year. Receipts or payments over the complementary period that are related to the transactions of the previous fiscal year incurred during the fiscal year are reported as the revenue or expenditure of this previous fiscal year. Usually, this is achieved by holding the books open during the complementary period. This aims at ensuring a greater conformity between the annual commitments made during a fiscal year and the payments that are reported as budgetary expenditures.

Modified accrual accounting: The modified accrual basis of accounting (sometimes also called as expenditure basis) recognises transactions and events when they occur, irrespective of when cash is paid or received. However, there is no deferral of costs that will be consumed in future periods. Physical assets that will provide services in the future are written off (or expensed) in the period acquired. Modified accrual and full accrual accounting (discussed subsequently) have the same accounting framework. The major difference, however, lies in the time between the acquisition of goods and assets and their utilisation. Under modified accrual accounting, supplies are considered consumed and assets are written off as soon as they are acquired. Under full accrual accounting, changes in inventories are recognised and assets are progressively depreciated according to their useful life.

Full accrual accounting: Like modified accrual, the full accrual basis recognises transactions and events when they occur irrespective of when cash is paid or received. Revenues reflect the amounts that came due during the year, whether collected or not. Expenses reflect the amount of goods and services consumed during the year, whether or not they are paid for in that period. The costs of assets are deferred and charged when the assets are used to provide service. Full accrual accounting is similar to the accounting systems for private enterprises (commercial accounting).

Expenses recognised by the full accrual basis of accounting should not be confused with

actual expenditures. They are the costs of goods and services consumed as well as any increase of liabilities or decrease of assets; over the accounting period (e.g. they include depreciation and losses, which can occur in the absence of transactions). Financial statements produced under a full accrual accounting system cover revenues; expenses (including depreciation); assets (financial and physical); liabilities; and assets (Schiavo-Campo and Tommasi, 1999).

Under full accrual system of accounting the three statements that are normally prepared include, Operating Statement, Balance Sheet, and the Statement of Cash Flows. The number of the statements and the names by which these are called may differ from country to country. In terms of the ability if each bases of accounting in providing information that meets the objectives of financial reporting are summarised in Table 1.

Table 1
Alternative Bases of Accounting including Modification to those Bases – Ability to Meet Objectives

Objective	Cash		Accrual	
	Cash Basis	Modifications to the Cash Basis	Modifications to the Accrual Basis	Accrual Basis
Compliance with legally adopted budgets.	Yes	Yes	Yes	Yes
Compliance with legal and contractual requirements, including spending limits.	Relating to cash requirements and limits.	Cash and near cash requirements and limits.	Cash and financial resources requirements and limits	Cash and economic resources requirements and limits.
Sources, allocation and uses of financial resources.	Cash resources	Cash and near cash resources.	Cash and financial resources.	Cash and financial resources.
Financing and cash requirements.	Cash resources	Cash and near cash resources.	Cash and other financial requirements.	Cash and other financial requirements.
Ability to finance activities and to meet liabilities and commitments.	From cash	From cash and near cash	From financial resources	From economic resources.
Financial condition and changes therein.	Cash position	Cash and near cash position.	Financial resources.	Financial and economic resources.
Financial performance in terms of service costs.	Information not reported.	Information not reported.	Limited information reported.	Provides information necessary to assess performance.
Source: Government Financial Reporting, study 11, IFAC Public Sector Committee.				

Accounting System in Union Government of India

The Government accounts and financial reporting currently followed in our country derive their 'substance and form' largely from the accounting procedures introduced during the British rule. The system worked reasonably well in the early phase of post independence era. But over the last two to three decades, there has been a significant change in the role and responsibilities of the government. Today, our government is expected to continuously review itself in light of the changes that are taking place and should not hesitate in implementing any such change that is desired in the current scenario.

An examination of the possible areas where our Government can presently make any meaningful change is the change in the country's accounting system from cash to accrual basis. This is because an accounting system is not an end in itself but rather a means to an end. A sound accounting system should assist the Government in fulfilling its objectives in a changing scenario by providing the desired inputs for decision-making. It needs to disseminate information of high quality in terms of understandability, relevance, materiality, reliability, faithful representation, substance over form, neutrality, prudence and comparability (across periods). The present system of accounting does not fulfill the

above requirements. On the other hand accrual system of accounting has the ability to generate information that is of more use in decision-making.

If accrual accounting is considered to be a benchmark of an ideal accounting system for government, it is necessary to look into the accounting information that the present accounting system of our country fails to provide but could otherwise be available to the decision makers had the accrual system of accounting been followed by our country.

The present accounting system of our country can best be described as 'cash basis of accounting' that records a transaction only when either cash comes in or when cash moves out, rather than recording the transaction or event as it occurs. It also lays emphasis on transactions vis-à-vis the budget. Under the present accounting system, our Government generates the following accounting documents:

- The Appropriation Account
- The Finance Accounts

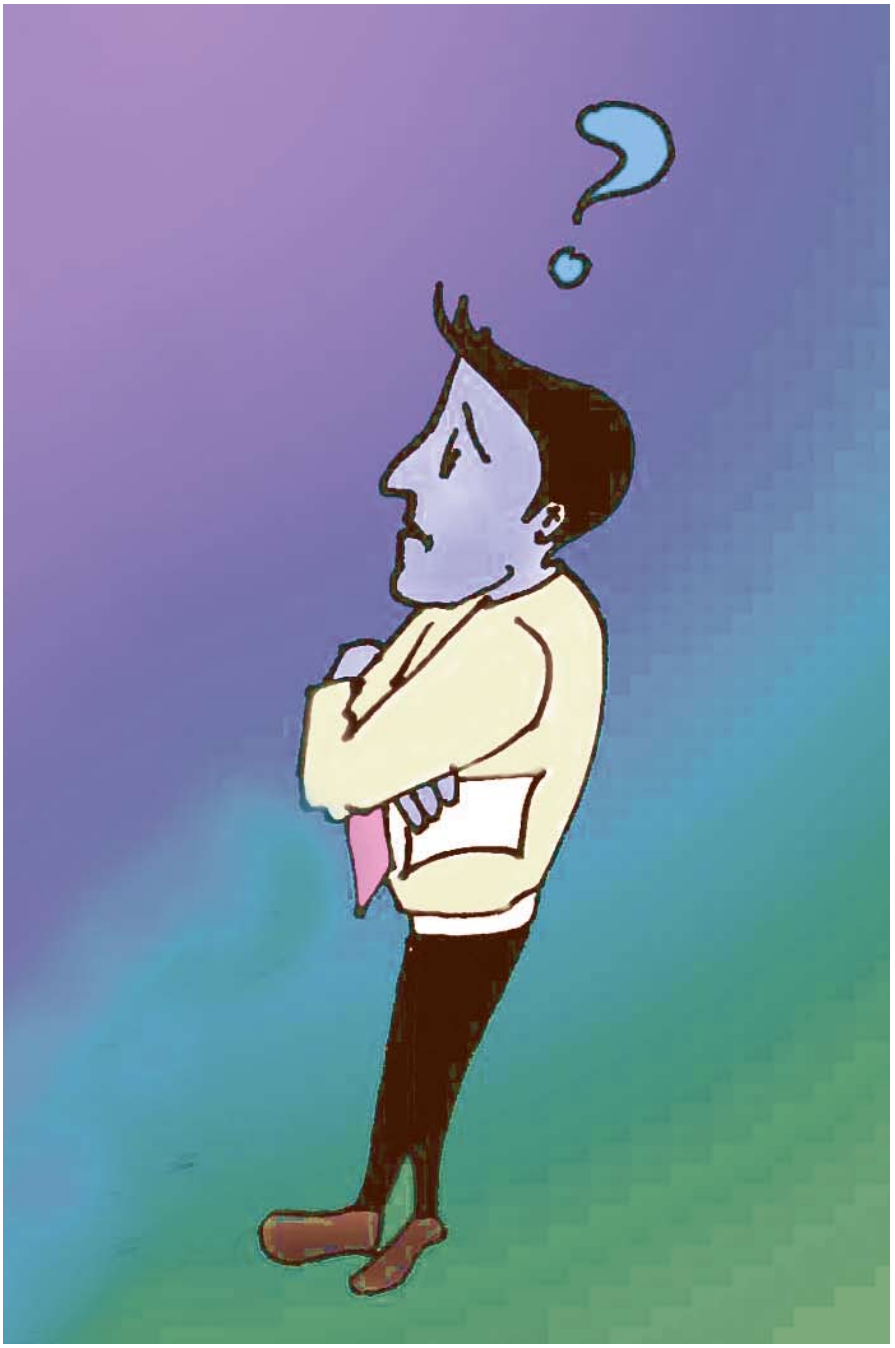
The Appropriation Accounts list the original budget estimate, supplementary grants, surrenders and re-appropriation distinctly. It also records the actual expenditure incurred against each of the above. In addition to it, this account also indicates whether the money that has been spent was legally available for the purpose or not, and also whether the expenditure incurred confirms to the authority. In the event of any variation from the budgeted figures explanations of the same are also recorded in this account.

This document appears to be less of accounting nature and more in nature of a document that can be used for control purpose. This is because the focus of this account is on whether the expenditure is incurred as per the budgeted amount or not. This account does not give an indication about the source of funds and how they are spent or how much of what is generated or spent relates to the current year. The document as such should not even be considered as a part of accounting system, as it is more in nature of knowing the extent to which expense has been made as per the allocations in the budget. In case more amounts have been spent than the budget, whether the same has been explained and sanction of the additional amount has been obtained. On the other hand if amount less than the budget has been spent, the reasons

thereof have been indicated. This is a control document rather than a part of government's financial accounting. It is for this reason a considered view has been developed that this document may not be treated as the part of Government accounts but may be considered as a report generated for control purposes.

In addition to it, the Government also prepares Finance Accounts that contain 16 Statements. This document mainly lists the receipts and payment of the government. It follows the cash basis of accounting, and as such, records a transaction only when either cash is paid or received. The Finance Accounts of the Union Government comprise the account of the Central Government as a whole and include the transaction of Central (Civil) Ministries, Defence Services, Posts and Telecommunications Departments and the Railways. It presents the accounts of receipts and outgoings of the Central Government for the year together with the financial results disclosed by different accounts and other data coming under examination namely Revenue and Capital Accounts, accounts of Public Debt and all other liabilities and assets as worked out from the balances recorded in the accounts. It presents classified and consolidated accounts of all transactions of Central Government under the Consolidated Fund, Contingency Fund and Public Account of India. The Finance Accounts is the general accounts of Government to the Parliament and serve the purpose of financial statements of the Union Government.

Analysis of both the documents stated above indicate that they do not provide the Government in particular and other users in general with the adequate information that is needed in day-to-day decision-making. It fails to provide full picture of the Government's financial position at any given point of time. As of today if one intends to have an idea regarding the total assets and total liabilities of the Government, the same is not possible under the present system of accounting. There are, however, a few Statements that do contain information regarding the liabilities of the country such as:



- Statement 2 that lists the Balance position;
- Statement 7 regarding External debt (charged). Loan to government service (voted); Statement 8 detailing account of capital receipt by minor head;
- Statement 13 regarding Consolidated funds, Contingency funds and the Public Account;

- Statement 14 that lists the Interest bearing obligations of government (including foreign loans in foreign currencies.);
- Statement 14a indicating the Securities issues to International Financial Institutions; and
- Statement 14a that talks about the market loan raised in India.

In addition to the above Statement No. 4 talks about the contingent liabilities of the government in somewhat a similar fashion as is required by accrual accounting but does not report all the contingent liabilities. Contingent liabilities such as the liabilities from any legal action, indemnities against different types of risk are at present not reported by the present accounting system. These Statements do not give the complete picture of total liabilities. Further the partly information that is available is also scattered here and there, reducing its usefulness in decision-making.

The analysis also reveals that the present accounting system of the country fails to record all the liabilities of the government such as the liabilities that arise out of unfunded pensions and superannuating benefits. The current liabilities that emerge because of the differences between commitments and payments are also not recorded. The present system also permits the Government to shift its liabilities outside its canvas by making its agencies autonomous. In addition to it the contingent liabilities of the government for which the government usually gives guarantee are again not reflected in finance accounts.

As regards the assets, the following Statements of Finance Accounts give some idea of the country's assets. To be specific the Statements that partly lists report about the assets are:

- Statement 3 that deals with Loans and Advances by the Union Government;
- Statement 7 that records charged and voted capital account;
- Statement 9 that lists the detailed account of capital expenditure by major heads;
- Statement 11 that reports the investment of Union Government in statuary corporations government companies other joint stock companies;
- Statement 12 that lists the capital expenditure incurred outside revenue account (also the sources form which these funds were generated are talked about.);
- Statement 13 that lists under the head Consolidated funds loans and advances; and
- Statement 15 that also provides information on balance of loans advances.

The cash base system of accounting also provides a scope for creative accounting in a way that the revenue side could also be manipulated by collecting excess revenue in a particular year and refunds could be made in subsequent year.

The above is in no way the full picture of the assets of the country. In addition to the above the present system also fails to provide full information regarding the changes that take place over time as a result of government policy. The present system is unable to track current assets as well as non-financial assets. It totally fails to list the assets held by the Government and also the cost of holding such assets. Apart from it the impact of current consumption on the value of the asset is also not reflected by the present system.

The present system also lacks in ascertaining the full cost of services provided to Government's departments or the commitments made by the Government regarding payment in future years. The system also allows deferring one year's payment to the next year and thereby reducing the expenses of that particular year.

The cash base system of accounting also provides a scope for creative accounting in a way that the revenue side could also be manipulated by collecting excess revenue in a particular year and refunds could be made in subsequent year. This act is termed as fiscal opportunism. Apart from this the cash basis of accounting also fails to make a distinction between revenue and capital items and does not even require the Government to charge depreciation on the assets it possesses.

The total revenue that relates to a particular year cannot be ascertained under the present system. This is because we follow cash basis of accounting. For example, presently the road tax that the Government receives relates to next several years but because the same are received in the current year it is recorded in the current year. This makes the exercise of comparing the financial statement of two years useless.

The accounting information that is provided by the present accounting system is not amenable for performance evaluation. This is because the transactions are not recorded as per accrual system, i.e., the transactions are not recorded as they take place, but are recorded on cash bases. Cash basis of accounting permits that expenses that related to last year could be recorded in the current year or other way could also happen. This prevents us from ascertaining the amount of expenses that relates to current year and as such results in difficulties in controlling the cost.

The present system also lacks appropriate and well-specified accounting standards. No doubt the Government Accounting Standards

Board has very recently been set up and has come out with certain Accounting Standards, but a lot is yet to be done in this direction.

The present accounting system also fails to prepare Proforma Accounts that is the forecasted accounts for next year. Modern accounting systems, apart from reporting the past results, also attempt to forecast the financial performance and position for future years.

The geographical spread of expenses is also not ascertainable from the existing accounting system. Modern accounting systems that are developed also talk about Segment Accounting, wherein it is required that not only the total expenses or revenues may be reported but the same are shown segment-wise also. The accounting information is normally segmented on the basis of more than one attribute. On the whole, all these factors contribute to poor presentation of accounts.

Experience of Other Countries

In recent past, several countries have reformed their accounting system or are in the process of the same. The Table 2 lists the name of such countries with a brief detail.

It is evident from the Table 2 that New Zealand, Iceland, Sweden, Australia, Finland and United States of America are among the first to implement accrual accounting in government. In addition to the above, Malaysia and Tanzania have also implemented accrual accounts but at local government level (IFAC, 2000). We now intend to discuss the experience of United Kingdom and New Zealand, the nations that have implemented accrual accounting.

Experience of United Kingdom: Reforms in government accounting has attracted widespread attention as part of the public management reform agenda in UK. The architect of accounting reforms in UK Central Government, has repeatedly stressed that the

Table 2
Status of Government Accounting System of Selected Countries moving towards Reforms

Name of the Country	Accrual Accounting for Individual Agencies /Departments	Consolidated Accrual Reporting	Accrual Budgeting
Australia	Since 1995	Since 1997	Since FY 2000
Austria	No[1]	No	ESA 95. Modified accrual.
Belgium	Some	No	ESA 95. Modified accrual.
Canada	Since FY 2002	Since FY 2002	Yes
Czech Republic	No[1]	No	No, but will be introducing modified accrual budgeting in accordance with ESA 95.
Denmark	Some	Some	ESA 95. Is introducing full accrual budgeting.
Finland	Since 1998	Since 1998	ESA 95. Yes.
France	Being introduced	Some, full accrual being introduced.	ESA 95. Intends to move to modified accrual basis.
Germany	Cash Statements supplemented with accrual information.	No	ESA 95. In preparation.
Greece	Some	Yes	ESA 95. Modified accrual.
Hungary	Cash statements supplemented with accrual information.	No	No, but will be introducing modified accrual budgeting in accordance with ESA 95.
Iceland	Since 1992	Since 1992	ESA 95. since 1998.
Ireland	Cash statements supplemented with accrual information.	No	ESA 95. Modified accrual.
Italy	Yes	Yes	ESA 95. Yes

Japan	Yes	Introducing	No
Korea, Republic of	Is introducing full accrual accounting.	No	Is introducing full accrual budgeting
Luxembourg	No[1]	No	ESA 95
Mexico	No[1]	No	No
The Netherlands	Since 1994	Introducing	ESA 95. For agencies since 1997. Is introducing full accrual budgeting.
New Zealand	Since FY 1992	Since FY 1992	Since FY 1995
Norway	No[1]	No	No
Poland	Some	Some	No, but will be introducing modified accrual budgeting in accordance with ESA 95.
Portugal	Yes	No	ESA 95. Is introducing additional accrual information.
Slovak Republic	No[1]	No	No, but will be introducing modified accrual budgeting in accordance with ESA 95.
Spain	Modified accrual	Modified accrual	ESA 95. Modified cash.
Sweden	Since 1994	Since 1994	ESA 95. Is introducing full accrual budgeting.
Switzerland	Yes	No	Is introducing full accrual budgeting
Turkey	No[1]	No	No
United Kingdom	Since FY 2000	From FY 2006	RSA 95. Since FY 2002
United States	Since FY 1998	Since FY 1998	Some

[1]Most of these countries actually use modified cash accounting.
ESA-European System of Accounts, EU member countries are required to prepare government forecasts and financial statement in accordance to ESA 95.
Source: Athukorala, Sarath Lakshman, (2003) Accrual Budgeting and Accounting in Government and its Relevance for Developing Member Country, Asian Development Bank, Philippines, pp 12-14.(Modified)

Resource Accounting and Budgeting (RAB) is not just about a switch to accruals accounting but also about enhanced public accountability improved and financial management. After a long process of transition, first notice of which was given in November, 1993, Departmental Resource Accounts became the sole mechanism of Parliamentary accountability for Supply expenditure in 2001-02, and 2003-04 public expenditure plans were fully on a Resource Budgeting (RB) basis. The Resource Accounting (RA) component provides the infrastructure upon which improved decision-making and enhanced accountability can be constructed.

The start of 2001-02 financial year, in April 2001, heralded a new era in public sector financial management reform, for the UK Government with the full implementation of Resource Accounting and Budgeting (RAB). RAB is an accrual based approach to Government accounting and budgeting, which also reflects Parliamentary control and a move to focus on outputs, rather than inputs. The term 'resource accounting' was devised to highlight that the change proposed by the UK Government goes wider than simply the adoption of accrual accounting techniques.

Resource accounting as a technique involves the use of resource accounting information as the base for planning and controlling public expenditure. It is only UK that believes that it would be wise if both accounting and budgeting are based on accrual system otherwise most of other countries that have implemented accrual accounting do not follow accrual for budgeting purpose. In terms of the scope, RAB covers all UK central government departments, over 40 in all (with restructurings and mergers, the numbers keep changing, but for 1999-2000, there were 42 departmental resource accounts and for 2000-01, there were 45 accounts). Executive agencies are included within each department's resource accounts, and the seven of the main government pension schemes for public sector employees. In addition, a number of 'Developed Bodies' in Scotland, Northern Ireland

and Wales produce Resource Accounts.

RAB, however, does not cover the main central funds of Government, Executive Non-Departmental Public Bodies (NDPBs), Trading Funds, National Health Service (NHS) Trusts, and other public corporations, and local government. These sectors are planned to be covered subsequently. The RAB of UK Government consists of 5 Schedules and Notes to the Accounts. A brief description of these statements is presented below:

Schedule 1 – Summary of Resource Out turn: This is the Parliamentary control schedule which compares outturn with estimate for both resource expenditure and the overall cash requirement. This schedule is unique to resource accounting. The Schedule plays an important role in providing the link between resource budgeting and resource accounting. Although supply-financed agencies, which are not whole departments need not produce this schedule. There is no account or statement that could be considered to be equivalent to schedule in the private sector.

Schedule 2 – Operating Cost Statement: This Schedule shows the resources consumed during the year in support of both a department's own administrative expenditure and its programme expenditure, net of departmental income. While similar to a profit and loss account, Schedule 2 does not follow the form of the profit and loss account as prescribed in the UK Companies Act. It has been designed mainly to meet the Tressury's budgetary control requirements and those of Parliament. Profit and loss account that could be considered to be equivalent to schedule in the private sector. This statement is to be prepared by all but for agencies, which are not whole departments.

Statement of Recognised Gains and Losses: This shows gains and losses arising on asset revaluations and any other gains or losses reported through reserves. In the private sector, the Statement of Total Recognised Gains and Losses (STRGL) includes the operating costs for the year. The Statement in resource accounts omits this, on the grounds that it would be misleading to include the net operating costs as a 'loss' because it is not a loss in the commercial sense of the word. The net expenditue shown is incurred to obtain, in the main, non-financial benefits. This statement is similar to Statement of Total Recognized Gains and Losses (STRGL) that is prepared by the private sector.

Schedule 3 – Balance Sheet: This shows the assets and liabilities at the year end that are represented by taxpayers equity. As in the private sector, the Balance Sheet provides a financial snapshot of the assets and liabilities of a body at one point in time. The layout that is used follows Format 1 prescribed in the Schedule 4 of the Companies Act, striking a balance at total assets and liabilites. The main difference, however, is in the 'Taxpayers Equity' section of the statement, where the terminology replaces that of shreholders capital and reserves to reflect the central government context.

Schedule 4 – Cash Flow Statement: This statement analyses the net cash flow on both operating activities and capital expenditure and also shows how the net cash flow that has been financed. The Statement is prepared in accordance with the relevant Financial Reporting Standard-FRSI (revised). The Cash Flow Statement prepared by the private sector could be considered to be equivalent to this schedule.

Schedule 5 – Resources by Departmental Aim and Objectives: It is a restatement of Schedule 2 to show spending during the year by aim and objective. This Schedule provides the equivalent of segmental information. However, its link to programme aims and objectives makes it unique to resource accounting. The purpose of this Schedule is to reanalyse operating expenditure and income according to the aim and objectives it is intended to serve. The supply-financed agencies, which are not whole departments need not produce this schedule. The private sector does not prepare any schedule or account or statement that is

Cash Flow Statement: This statement analyses the net cash flow on both operating activities and capital expenditure and also shows how the net cash flow that has been financed.

similar to this.

Notes to the Accounts: The notes to accounts explain and amplify the information in the previous schedules. It is, however, too early to comment on the benefits which United Kingdom could get by implementing accrual accounting (referred to as resource accounting) but the perceived benefits of resource accounting (as described in the Whited Paper on resource Budgeting and Accounting in Government) are as follows:

After consultation and further work, the Government has concluded that a fully resource based system of public expenditure planning and control would achieve improved management and value for money by the taxpayer by:

- making decision-makers focus more on resources consumed and not just on cash spent;
- treating capital and current expenditure in a way which better reflects their different economic significance; and
- encouraging a greater emphasis on outputs and the achievement of aims and objectives.

Heald (2005) in his study examined the effects of implementating resource accounting in UK and concluded that the subsequent to the implementation of resource accounting and budgeting in the country the quality of accounts improved (even during the transition period) and substantial variation has been witnessed in the certification lag. Potential for shorter certification lags is identified, as are administrative deficiencies that delay the arrival of some certified Departmental Resource Accounts (DRAs) into the public domain.

Experience of New Zealand: The Government of New Zealand introduced accrual system of accounting early in the present decade. The financial statements of New Zealand Government include three core statements, namely, the Operating Statement, the Statement of Financial Position and the Statement of Cash Flows. The Operating Statement summarises revenue earned and expenses incurred by the government during the year. The difference between total revenue and total expenses is the operating balance for the period. The Statement of Financial Position (Balance Sheet) summarises the assets owned and the liabilities owed by the government. The difference between the two is termed as the Crown Balance, a measure of government's net worth. The Statement of Cash Flows analyses the net movement in cash held during the year in terms of operating, investing and financing activities.

The Operating Statement summarises revenue earned and expenses incurred by the government during the year. The difference between total revenue and total expenses is the operating balance for the period.

The three core statements —the Operating Statement, the Statement of Financial Position and Statement of Cash Flows— are interrelated closely. The operating balance (the difference between the governments' revenue and expenses) flows through directly to the balance sheet, where it is the main item affecting the change in governments' net worth. Cash inflows from borrowing, reported in the Statement of Cash Flows, will also be reflected in an increase in the level of borrowing reported in the Statement of Financial Position. Similarly, cash transactions have an impact on the Statement of Cash Flows, the balance-sheet and sometimes the Operating Statement. Some transactions can also affect all the three core statements. For example, a cash sale of goods held in stock would be recorded in the Operating Statement under 'sales of goods and services' in the Balance Sheet as a reduction in inventories and a corresponding increase in cash or bank balances, and in the Statement of Cash Flows as an operating receipt.

Some transactions affect the Operating Statement and balance sheet but are not reflected in the Statement of Cash Flows. This is because the transactions are of a non-cash nature, or because of timing differences. For example, pension liabilities accrued during the period are included as an expense in the Operating Statement and are shown as an increase in liabilities in the Balance Sheet, but are not recorded in the Statement of Cash Flows until they are paid out some years in the future. The three core statements are closely interrelated and are also supplemented by additional information as required by the Public Finance Act, 1989.

Other Financial Statements: The other statements that are required by the Public Finance Act 1989 contain additional information for interpreting the Crown's financial performance:

- The Statement of Borrowings and Appendix D to the Financial Statements provide details of the Crown's short, and long-term debt.
- The Statement of Commitments, the Statement of Contingent Liabilities and Note 23 indicate the magnitude of obligations and contingent risks that do not appear in the balance sheet.
- The Statement of Unappropriated Expenditure and Costs and the Statement of Emergency Expenditure and Costs disclose amounts not appropriated by Parliament during the financial year.
- The Statement of Trust

Money reports on the Crown's stewardship of money held on behalf of third parties. The Public Finance Act 1989 distinguishes between public money and trust money, and requires separate management of and accounting for the latter.

Notes to the Financial Statements: The Notes accompanying the Financial Statements are audited. They provide additional detail and form an integral part of the statements to which they relate. The government of New Zealand for the first time came out with the financial statements based on accrual system of accounting for the year ending June 30, 1992. This change in the reporting system was certainly the result of the economic crisis the nation faced in 1984. The crisis resulted in 20 per cent devaluation in the country's currency and all time high government deficits. Also, the public debt accumulated to an all time high. In addition to it, the currency witnessed excessive fluctuations. All this led to the defeat of the Muldoon government. The new government was forced to bring about some innovative changes. The process gave birth to three key pieces of legislation, the State Sector Act, 1988, the Public Finance Act, 1989, and the Fiscal Responsibility Act, 1994. The main objective of the State Sector Act, 1988 is to improve productivity, to ensure that the managers have greater degree of freedom and flexibility in exercising their duties and are accountable to the Government for the work done by them. The Public Finance Act, 1989, provides a legislative basis for improving the quality of financial management and also requires that government should report on a basis that is consistent with Generally Accepted Accounting Practice. The Fiscal Responsibility Act, 1994, aims to promote consistent and a good quality fiscal management. It encourages better decision-making by the government, strengthens accountability and ensures more informed public debate about fiscal policy.

Moving with the reform process, the New Zealand Government went in for free play of market forces, stripping away the complex and comprehensive web of regulations and subsidies and improving the accounting and reporting system of the government to provide information essential for a robust system of government budgeting. The policy changes brought about by the Labour Government (1984-90) were so extensive that they were collectively more popularly called `Rogernomics' after the name of the than Finance Minister Sir Roger Douglas.

This exercise did improve the financial indicators of New Zealand. In 1994, the fiscal deficit of the country was eliminated after 10 years of difficult political decision-making and managing the reforms. The position of external public debt improved from NZ$ 17,256 million (44.1% of total public debt) in 1988 to NZ$ 5,262 million (14.1 % of total public debt) in 1997. As on June 2003 this further improved to NZ$ 4,523 million (11.8% of total debt). The interest burden of external public debt also exhibited a significant decline from NZ$ 1,477.8 million in 1988 to NZ$ 559.1 million in 1997 and further dropped to NZ$ 216.6 million in 2003. Interest charges on external public debt as percentage of total exports also moved favorably from 9.0% in 1988 to 2.1% in 1997. This further dropped to 0.5% in 2003. The reforms also improved the position of total public debt in the country. From 1992 to 1997 the total public debt as a percentage of GDP dropped from 63.8 per cent to 37.8 per cent and this further dropped to 29.8% in 2003. During the same period (1992-1997) the operating balance also witnessed a significant improvement from 1.1% of GDP to 3.7% of GDP. This rose to 4.5% for the year ended on June 2003. Total operating expenses as a percentage of GDP also improved from 41.2% in 1992 to 35.4% in 1997 and was 39.3 % in 1997, indicating more scope for improvement. The most exciting result of the reform undertaken by government happens to be the appreciation of NZ$ against US$ from 0.5382 in 1993 to .6788 in 1997. Since then, the rate is clustering around this appreciated rate. In addition to it the government also achieved its objective of zero net foreign-currency debt during 1996. Another significant achievement of the Government of New Zealand has been that from September 1997 onwards, monthly Financial Statements are now published. This is done on cumulative basis that is for the month of July one-month accounts are presented. In subsequent months cumulative performance is reported, for example for the month of August it will be two months and for September it will be three months. If we evaluate the cost and the benefits associated with the adoption of accrual accounting by the government it can be safely concluded that the benefits far outweighed the costs involved in the transition to accruals accounting. It also needs to be stated that it is not only the change in accounting system that has improved the financial indicators of the

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economy but the commitment from the government itself to improve is also must. Good accounting system is a means for bringing about the desired improvements and not an end in it self.

Steps Taken and Directions Suggested for India

India at present is following cash basis of accounting. The following steps taken by India, however, indicate that it is on its way to an accrual system accounting.

- Very recently all the Local Bodies, Autonomous Institutions and Universities have been instructed to prepare their accounts on format basis that is just equivalent to meeting the requirements of accrual accounting.
- The Twelfth Finance Commission in its report has suggested for a change in the nations accounting system that has been accepted, indicating a move from cash basis to accrual basis.
- A committee has also been set up by the Comptroller and Auditor General of India to develop a framework and examine the technical feasibility of reforming the Government accounting system.
- The Government has also set up Government Accounting Standards Board for the developing Government accounting standards for the country.
- The activity of accounting reforms has already been initiated at 'Ministry of Surface Transport' on pilot basis. The accounts there are initially planned to be prepared on accrual basis parallel with cash basis.

Considering all this and the merits associated with the accrual system of accounting and also understanding its strategic need for a nation in terms of providing information which is more useful for decision making, India certainly needs to quickly switch over to the accrual system of accounting. However, it is also important to mention that the exercise of moving from cash system of accounting to accrual system of accounting should be done in a phased manner and some pilot studies may be conducted. Before the government wishes to move from cash accounting system to accrual accounting system it must ensure that:

a) the top level officers are fully involved in the process and are committed to implementing it;
b) sufficient knowledge has been imparted to the officers involved at different levels;
c) the change should not be spontaneous but gradually over a span of three to four years and all possible preparation should be done before embarking on full implementation;
d) there must be sufficient resources with it to implement the change;
e) it has examined the implications of presenting financial statements in accrual manner; and
f) the employees are trained not only to prepare the statements based upon accrual system of accounting but also to understand as to how to analyse them. ❐