Governmental Accounting Standards—Perspective

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< EXECUTIVE SUMMARY >

◆ Before assessing the need of separate accounting standards for Public Sector Enterprises in India, as provided by the Public Sector Committee of International Federation of Accountants (IFAC), we should understand the term 'Public Sector'. Public Sector as referred to by the IFAC excludes Government Business Enterprises. It refers to national governments and local authorities. This definition of term 'Public Sector' is conceptually different from what we understand in India.

In the background of the above authors have discussed the characteristics of the standards issues by Public sector Committee of the IFAC, Author have attempted to provide the food for thoughts and prepared a platform to discuss the various issues involved in adopting separate accounting standard for governments or local authorities.

In the previous article[1], we had discussed the need for a re-examination of governmental accounting systems. In that article we had also identified two major issues of which the first one was the need to transform the system of cash based accounting to accrual based accounting – an issue that we had dealt with at length in the referred article. The second issue was whether it is necessary to follow the same accounting standards as are in existence or there is a need for a separate set of standards in line with those issued by the Public Sector Committee of IFAC.

This article, then, is specifically directed to the second issue. Before beginning a discussion on the matter it should be noted that the International Public Sector Accounting Standards apply to the published financial statements of public sector entities other than Government Business Enterprises. In this regard, the term `public sector' refers to national governments, regional governments (for example, state, provincial, territorial), local governments (for example, city and town), and related government entities (for example, agencies, boards, commissions and enterprises). Therefore, there is a clear conceptual distinction between the way that we in India understand the term 'Public Sector' and the way it is understood internationally.

Proceeding from the above, it is then pertinent at this point to mention that in the preamble to the Public Sector Accounting Standards, the Public Sector Accounting Committee of the IFAC has identified that General Purpose Financial Statements may be issued by Public Sector entities for users who are unable to demand financial information to meet their specific information needs. These users could be citizens, voters,

The authors are member of ICAI. The views expressed herein are the personal views of the authors and do not necessarily represent the views of the Institute.

1. Please refer article "Governmental accounting A Re- examination" published in November 2002 issue of the Chartered Accountant'.

their representatives and other members of the public. The objective of the Committee is to develop programs aimed at improving public sector financial management and accountability, including development of accounting standards and promoting their acceptance. In undertaking the process of developing the standards, the Committee attempts, wherever possible, to maintain the accounting treatment and original text of the IASs unless there is a significant public sector issue which warrants a departure. In its ongoing work program, the Committee also intends to develop IPSASs to deal with public sector financial reporting issues that are either not comprehensively dealt with in existing IASs or for which IASs have not been developed by the IASC. Examples of these issues include the nature of the governmental reporting entity and recognition principles for tax revenue. Thus, in developing IPSASs, the Committee considers and makes use of pronouncements issued by the IASC (now IASB) national regulatory authorities, professional accounting bodies and other organisations interested in financial reporting, accounting and auditing in the public sector. In addition to the preparation of General Purpose Financial Statements, the Government entity may also be required to prepare financial statements for others, such as Governing bodies, Trusts, the legislature or any oversight Committee of the legislature. The Public Sector Committee of the IFAC terms these as Special Purpose Financial Statements. The committee suggests that IPSASs (International Public Sector Accounting Standards) are followed in the preparation of these Special Purpose Financial Statements also.

It is an accepted fact that most Governmental entities follow the cash basis of accounting. Moving from the cash basis to the accrual basis of accounting, while being the better option, also has implicit and explicit costs in terms of both money and time. Recognizing this, the IPSAS have been formulated in such a way that transitional problems can be dealt with. In certain Standards transitional provisions have been built in, to allow the entity additional time to meet the full requirements of a specific accrual-based IPSAS. Of course, there is a limit to the time that may be taken for transition, and that is governed by the transitional provisions. At the end of that time, the entity is to report in full in accordance with the IPSAS.

These matters are mentioned here because in India we are yet to develop Governmental Accounting Standards although the first steps have been taken. Recognising the need for consistent and high standards in government accounting in India , a Government Accounting Standard Board (GASB) with the representatives from the Supreme Audit Institution of India, Government of India in the Ministry of Finance and professional accounting bodies was set up in August 2002. For us then, this is a transition state. The IPSAS provide us a certain degree of flexibility in this respect. In their application, we may find many issues that require Indianisation, so to speak. These can then be dealt with appropriately.

One other factor requires specific mention at this stage. That is the quality of financial data. Governmental entities in India operate in such manner that most often, the most important financial data are not captured within the accounting system. An example would be the determination of liabilities for construction contracts. In many States, contractual committed liabilities are determined by the engineering departments, and not counter checked by the finance department. Thus, the State's liabilities on this account are not really verified. The same is the case with assets. In most cases physical verification of assets is not even attempted. The user becomes the verifying authority. The loopholes in such systems can be easily envisaged. However, the important thing is that the data exist, but not provided to finance department. Thus, data flow systems must be redesigned before the adoption of the accrual system.

Another major factor is the adoption of practices that are not accounting-wise, defensible. There are many examples of this and we would not like to burden the reader at this juncture with such examples. The point is, confusing practices often give rise to duplication of data, and its dilution and distortion. Obviously, these are issues that need to be tackled in the process of transition but, to the extent that some of them are fundamental ones, appropriate legislative or administrative authority must accompany the initial attempts.

It should also be noted in this context that the whole process of conversion and thereafter, standardization of the presentation of financial statements is one likely to create a great deal of resistance, especially in revenue collecting entities. This is a normal reaction that should be expected and planned for.

The International Public Sector Accounting Standards has issued till date 20 IPSAS. These are as follows:

- Presentation of Financial Statements
- Cash flow Statements
- Net Surplus or Deficit for the Period, fundamental Errors and Changes in Accounting Policies
- The effects of Changes in Foreign Exchange Rates

- Borrowing Costs
- Consolidated financial Statements and Accounting for Controlled Entities
- Accounting for Investments in Associates
- Financial Reporting of Interests in Joint Ventures
- Revenue from Exchange Transactions
- Financial Reporting in Hyperinflationary Economies
- Construction Contracts
- Inventories
- Leases
- Events After the Reporting Date
- Financial Instruments: Disclosure and Presentation
- Investment Property
- Property: Plant and Equipment
- Segment Reporting.
- Provisions, Contingent liabilities and Contingent Assets
- Related Party Disclosures

There are certain differences between the International Accounting Standards and the IPSASs. In most cases though, there is no large conceptual difference. In some cases, in fact the IPSAS go beyond the IAS in providing clarifications of concepts and details.

As an example, let us look at IPSAS 1, Presentation of Financial Statements. The corresponding International Accounting Standard is IAS 1, and the corresponding Indian Accounting Standard is AS 1. Some of the majors distinguishing features of IPSAS 1 are:

- IPSAS 1 contains a transitional provision allowing the non-disclosure of items which have been excluded from the financial statements due to the application of a transitional provision in another IPSAS. The specific provision is contained in paragraph 134 of the Standard which states '***All provisions of this Standard should be applied from the date of first adoption of this Standard, except in relation to items which have not been recognized as a result of transitional provisions under another International Public Sector Accounting Standard. The disclosure provisions of this Standard would not be required to apply to such items until the transitional provision in the other International Public Sector Accounting Standard expires."***
- IPSAS 1 contains a summary of qualitative characteristics , based on IASC (International Accounting Standards Committee) framework. The qualitative characteristics are the attributes that make the information provided in financial statements useful to users. The four principal qualitative characteristics are *understandability, relevance, comparability and reliability*. The aspect of *materiality* is included under relevance. Reliability includes *faithful representation, substance over form, neutrality, prudence, and completeness*. Comparability addresses the users' need to be informed of the policies employed in the preparation of financial statements, changes to those policies, and the effects of those changes are satisfied.
- Whereas IAS 1 allows the presentation of either a statement showing all changes in net assets/equity, or a statement showing changes in net assets/equity other than those arising from capital transactions with owners and distributions to owners, in their capacity as owners, IPSAS 1 requires the presentation of a statement showing all changes in net assets/equity.

IPSAS 2 on `Cash Flow Statements' is also drawn primarily from the International Accounting Standards IAS 7 on `Cash Flow Statements'. IPSAS allows either the direct or indirect method to be used to present cash flows from operating activities. Where the direct method is used to present cash flows from operating activities, IPSAS 2 encourages disclosure of reconciliation of net surplus from ordinary activities to operating cash flows in the notes to the financial statements.

Similarly, IPSAS 3 on `Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policy' is also drawn primarily from IAS 8 on `Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policy'. IPSAS 3 contains a different definition of extraordinary item from IAS 8. The IPSAS defines extraordinary item as `Revenue or Expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the entity, are not expected to recur frequently or regularly and are outside the control or influence of the entity'. Thus, the IPSAS 3 contains a specific requirement that extraordinary items must be outside the control or influence of the entity.

There are distinguishing features of every IPSAS, as compared to the International Accounting Standards or the Indian Accounting Standards. The matter of showing all the differences will be dealt with in a later article.

At this point, it is important to note the *effects* of some of these distinguishing features. For instance, the importance of including the qualitative characteristics as annexures to the Standard itself becomes understandable when one realizes that these Standards would be applied to enti-

ties which have so far not dealt with many of these concepts at all. For instance, in standard government practices, materiality does not enter into consideration at all. Similarly, comparability is also not considered an important criterion, simply because governmental entities are functionally discrete, and that the presentation of financial statements has something to do with the final level of achievement of functional objectives, is not considered important. This also has to do with the fact that there are social objectives which are not quantifiable and which are intimate parts of the functional objectives of possibly most of the governmental entities.

Also the Public Sector Committee of IFAC has issued International Public Section Guidelines. These guidelines recommend practices to be followed in the public sector on financial reporting. The PSC issues these guidelines to improve public sector financial management and accountability.

The Committee has also issued International Public Sector Studies. These studies are intended to provide advice on financial reporting, accounting and auditing issues in the public sector. They are based on study of the best practices and most effective methods for dealing with the issues being addressed. Recent papers have focused on the definition and recognition of revenues and expenses.

The Institute of Chartered Accountants of India, being a premier accounting body in the country, took upon itself the leadership role by establishing Accounting Standard Board(ASB), more than 25 years ago, to fall in line with the international and national expectations. Today, accounting standards issued by the Institute have come a long way. ASB formulates accounting standards on the basis of the international accounting standards issued by the IASC. Of the 41 IAS issued so far, 34 are at present in force, the remaining have been withdrawn by the IASC. Corresponding to the IAS, so far 28 Indian accounting standards have been issued. The Institute has issued a Guidance Note on the subject corresponding to IAS 15 on `Information Reflecting the Effects of Changing Prices'. Corresponding to IAS 29 on `Financial Reporting in Hyper Inflationary Economies', no accounting standard or Guidance Note has been issued by the Institute as the International Accounting Standard is applicable only in those countries where the inflationary rate is extremely high i.e., where hyper inflationary situation exits. The Institute notes that the hyper inflationary conditions do not prevail in India. Accordingly, there is no justification to issue an accounting standard on the subject. Also, there is no accounting standard corresponding to IAS 30 on `Disclosures in Financial Statements on Banks and Similar Financial Institutions' as these subjects are covered by Banking Regulations Act, 1949 and also certain disclosure norms prescribed by the Reserve Bank of India. Thus except for three standards of IAS there exists the corresponding Indian accounting standards

In conclusion, it would therefore appear that as far as India is concerned, the aspects which need attention at this stage are :-

1. Whether it is necessary to have the whole new set of accounting standards or whether partial or substantial modification of the existing accounting standards will serve the purpose.
2. Whether given the fact that comprehensive modifications in the accounting system i.e. a change over from the cash basis to the accrual basis will require simultaneous comprehensive modification in all existing governmental accounting and auditing manuals including financial rules, etc., such an undertaking is feasible as a total project or whether a number of transitional states with their appropriate transitional accounting rules need to be formulated, and
3. Whether it is possible to create, on the basis of the modified accrual system, a type of hybrid accounting system with its own accounting standards.

Obviously, the above issues are not ones to be debated lightly. They require the application of considerable academic discipline and rigor at various levels. While it is certainly possible to apply IPSASs or their modified or even truncated versions to smaller governmental entities such as Panchayati Raj Institutions or Muncipalities/Municipal Corporations, and why it may also be possible, with some degree of effort to apply the same at the time of consolidation of accounts at the level of Department of Finance in State Governments, obtaining a comprehensive change will certainly take a lot of time. It is also important to note at this juncture that the whole situation does require the full-fledged participation of the Comptroller and Auditor General of India.

It is therefore to be hoped that given the obvious advantages of a change over of the governmental accounting system and the application of appropriate accounting standards in bringing about transparency and accountability, efforts would be made by governments and governmental organs to begin by initiatives within the smaller governmental entities. This is also important because in this process, a number of issues are likely to be highlighted that will in turn assist in the formulation of accounting standards for government that are fully indegenised. ■