Reforms in Government Accounting and Financial Reporting

The public finance reform in India is reflected in the regulatory framework prescribed for the government accounting and financial reporting reforms. The Financial Responsibility and Budget Management Act (FRBM) of 2003, combined with General Financial Rules (GFR) of 2005, Government Accounting Rules, 1990, Indian Government Accounting Standards (IGAS), and Outcome Budget, all demonstrate the unflinching commitment of the nation for financial reforms in the government. The rule based financial statements are being replaced by principles and standard based accounting; and cash based to accrual based system of accounting, to maintain India's predominant position as an economic power at the corridors of global economy. This article discusses reforms in Government Accounting from professional perspective.

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The Union Finance Minister inaugurated a conference on accrual based accounting and financial reporting on 21st June, 2011 at the office of the Comptroller and Auditor General of India (CAG) where finance ministers from the centre, states, and union territories as well as key stakeholders including ICAI participated.

Globally, the paradigm for public financial management has been changing quite rapidly. Australia and New Zealand initiated accounting reforms as part of an integrated financial management and accounting and budgeting reforms. Canada and United Kingdom started with accounting reforms followed by budgetary reform after a gap of three to five years. United States and Spain combined modified accrual accounting with cash budgeting as of now. Though the international experience demonstrates a flexible approach, benefits of accrual accounting and financial reporting can be fully realised only when budgetary reforms are undertaken simultaneously.

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Existing System of Government Accounting

As per Articles 266 and 267 of the Constitution of India, government accounts are maintained in three parts: Part-1: Consolidated Fund of India (CFI); Part-2: Public Account; and Part-3: Contingency Fund. CFI transactions are classified into functions and programmes largely in alignment with plan heads of development with a six tier hierarchical architecture. Articles 112 and 202 relate to the Annual Financial Statements of the Union and the State Governments respectively. These statements require that expenditure shows separately as charged upon the CFI, depicting 'charged' and 'voted' expenditure, and expenditure on 'revenue account' distinguished from 'other expenditure', thereby requiring categorisation of revenue and capital expenditure. As India has followed the policy of planned allocation of resources for economic development and that Plan and Non-Plan expenditure should also be distinctly shown.

Transactions on Public Accounts are recorded as receipts and disbursements and classified into the broad categories of Small Savings, Reserve Funds, Deposits and Advances, Suspense and Miscellaneous, Remittances, and Cash Balance. The financial reporting framework includes presentation of two audited annual accounts – the Finance Accounts and the Appropriation Accounts. These are prepared separately for the Union Government, each of the State Governments and Union Territories having Legislative Assembly. The Appropriation Accounts, being compliance reporting on legislative appropriations and grants, explanations are provided for significant variance, both excesses and saving, between the original demand and final appropriation and final appropriation and actual expenditure.

Transition to accrual based accounting for all the three tiers of government - Union, States, Urban Local Bodies (ULB) and Panchayati Raj institutions(PRI) over the years is time and resource intensive. The Thirteenth Finance Commission wanted the government to move forward with caution. The Commission advocated a 'bubble up' approach to this transition. In this approach, local bodies like large municipal bodies and PRIs would adopt accrual accounting initially. For this purpose, , the National Municipal Accounting Manual incorporating the principles of accrual accounting has already been prepared with an intention to facilitate the 'bubble up' process to percolate to all the three tiers of government. Already, 48 ULBs in 17 states have switched over to accrual based accounting.

The Finance Accounts contain the financial statements of the government concerned with statements showing functional head-wise distribution of receipts and disbursements during the year and debt and other obligations at the end of the year. Information on financial assets and guarantees issued by the government is also provided in this document. Budget documents use Fiscal Deficit to show Government's revenue-expenditure gap and measures its dependence on non government savings for funding its expenditure. The Revenue Deficit is also reflected. The emphasis in these documents is on flows into and out of Consolidated Fund, deficit and its financing from various sources. As per the provisions of the FRBM Act, additional disclosures are also being made of assets held by the Government including non-financial assets, arrears of tax and non-tax revenues and guarantees.

Reforms in Government Accounting

The government approved the Twelfth Finance Commission (TFC)'s recommendation in 2004 to introduce accrual based accounting, standardising accounting classification up to object level head for all states, adding eight more statements relating to subsidies, and separate expenditure statements on salaries, pensions, committed liabilities, maintenance expenditure, segregation of salaries and non salary portions and liabilities and repayment schedule on outstanding debts.

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states have switched over to accrual based accounting. Four states, namely Gujarat, Karnataka, Kerala and West Bengal adopted double entry accounting for PRIs. Besides, 18 states accepted the accrual based accounting in principle, 16 states accepted the Model Accounting System developed by Ministry of Panchayati Raj, which can be easily converted to accrual basis.

The Second Administrative Reforms Commission recommended appointment of a task force for conducting a cost benefits analysis and to suggest modification in the Appropriation Accounts and Finance Accounts. It observed that accrual based accounting might be tried initially in certain organisations like departmental commercial undertakings such as Railways where tangible benefits could be derived within a short period of two to three years and thereafter, on the basis of experience, the system could be extended to other departments. In order to effectively implement the transition, the accounting personnel should be trained in the concept of accrual based accounting in the government; a detailed road map to be drawn; the plan, budget, and accounts are to be aligned and a viable robust transparent financial information system is to be created.

Cash Based Accounting Versus Accrual Based Accounting

Currently government accounts are kept on cash basis, recording actual cash received and disbursements made without indicating amount due to or from government during the accounting period. The cash-based system of accounting is based on inputs and outputs with reference to the budget and is inadequate in providing complete financial position of government at a given point for resource management. It does not reflect the changes in financial position; reporting government's accrued liabilities on interest payments due or dues on account of pensions and retirement benefits, enabling to track current as well as non-financial assets. The present system does not represent assets held by government, the cost of holding and operating these assets, and providing services by the government's departments or future commitments. Further, in a cash based system, tax revenues can be collected in excess during a period followed by high incidence of refunds, payments can easily be deferred to future periods and revenues due in the future could be compromised by providing for one-time receipts without recording or reporting in the financial statements.

While accrual based accounting records consumption of resources during a period, focuses on cost of resources consumed, and recognises income as it is earned; cash based system records only cash flows. In accrual accounting, in addition to cash flows, unpaid consumptions – payables and unrealised incomes – receivables – are also recorded. The revenue flows from an output are matched with the consumption of resources that produced the output helping in bringing out the operating performance of an entity, whereas cash accounting does not apply matching principle. Accrual accounting provides a complete measure of an entity's financial position at any given point of time by a comprehensive presentation of entity's assets and liabilities. The perceived benefits in switching over to accrual accounting in government may lead to better management of receivables and payables, assets, liabilities, contingent liabilities, assessment of full cost of service delivery, and assessment of fiscal sustainability of operations.

GASAB has prepared a roadmap for accrual accounting, specifying activities and milestones to be completed for migration to accrual accounting; a detailed operational framework and an overall architecture of the accounting model suitable to constitutional reporting requirements. The transition may take nearly five to six years in three stages: in the first stage, value addition is made by adding separate statements on salaries, subsidies, interest, pension etc; in the second stage, value addition can be made in the extant system with greater disclosures such as arrears in revenue, committed liabilities, etc., before the final stage of conversion to accrual based accounting.

Government Accounting Standard Board (GASAB)

Accounting is not meant merely for systematic recording of receipts and expenditure, or exercising budgetary and expenditure control, but should help management as a powerful instrument in planning, quality decision making and effective financial management, reflecting true and fair value of government's financial position. As per article 150 of the Constitution of India, the President, on the advice of the CAG, prescribes the form in which the accounts of the union, states and the union territories are kept. The Government of India established the Government Accounting Standards Advisory Board (GASAB) in 2002 under the aegis of the Comptroller and Auditor General (CAG) with members of

all stakeholders including premier accounting services from the government and ICAI to suggest accounting reforms indicating a road map, Operational Framework, guidelines and Indian Government Accounting Standards (IGASs) for gradual migration to accrual based accounting.

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As of now, different stakeholders, such as the Civil Ministries and Departments, Department of Posts, Ministry of Railways and Ministry of Defence at the Union level and the States and Union Territories having Legislature are at different stages in terms of their preparedness and may take different time-periods to achieve the suggested level of reforms to implement accrual accounting. Migration to accrual accounting must be within a uniform operational framework so that the final accounts of the governments, both the union and the respective states and the union territories with legislature fall within a uniform reporting framework. This also requires uniformity in the classification system. The "Operational Guidelines for Accrual Based Financial Reporting" provide the necessary guidance for the transition to accrual based accounting and financial reporting.

Challenges in Implementation

A robust IT backbone, functionally similar to Enterprise Resource Planning (ERP) systems like SAP is required to be established across the country integrating the three tiers of government encompassing the Centre, States, Union Territories and ULBs and PRIs for maintenance of accurate, authentic and reliable data, generation of accounting records and comprehensive financial statements. A few states have constituted Task Forces for preparing for the transition and providing training and guidelines. Several new statements are also added in the existing Finance Accounts of the states.

Besides, many states have already computerised the treasury systems and the Central Government has also undertaken the computerisation of treasuries in 626 districts, relevant codes are amended by the State/UTs. Provisions of appropriate accrual heads of accounts would be necessary when treasury computerisation is taken up, even though these heads may not be utilised in the very near future. Any effort in this direction would only improve the efficiency of the administration and the confidence of the stakeholders on the administration providing various analysis and MIS reports. Decision makers will be accountable for those decisions, accelerating project implementation process bringing transparency and increased efficiency in government functioning.

Besides creating necessary IT infrastructure and data base, enormous efforts are required for nationwide capacity building, skill development and training for accelerating the transition process. This involves intensive training to the accounting personnel in various government organisations. Many of these functionaries do not have professional qualifications and those who have also need to upgrade their skills and competence to make the change over smooth. ICAI can consider imparting appropriate training programmes to the accounting personnel all over the country to transform them to accounting technicians in government accounting to discharge their responsibilities efficiently, proficiently and greater accuracy and confidence to facilitate the changeover to accrual based accounting system in government smooth. ■

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